Banking & Payments Federation Ireland

Response to the CBI Discussion Paper on the Payment of Commission to Intermediaries

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Banking & Payments Federation Ireland

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Contents

1. Introduction

Banking & Payments Federation Ireland (BPFI) represents over seventy domestic and international institutions. We welcome the opportunity to respond to the Central Bank of Ireland (CBI) discussion paper on the payment of commission to intermediaries.

Overall we support the current approach to the treatment of commissions as set out in the existing regulations. As a sector, we believe that the role of advice has an important part to play in ensuring that consumers make informed decisions regarding their finances. We also believe that the CBI has an important role in overseeing the provision of advice and the transparency of any costs associated with such a service.

Intermediaries offer consumers choice and most importantly Independent financial advice. We believe there are benefits to retaining a commission based model for Intermediaries and we have outlined these in our response to Question 7.

There are a number of areas where we also see benefits to the financial market as a whole from a commission based framework. These include:

- **Competition**

  A key role of the intermediary sector within financial markets is to provide a means by which new entrants /existing providers can look to extend the offering currently available and also to reach new consumers. This is critical to ensure a competitive market place for all consumers. The recent entry of Pepper to the mortgage market is an example of the use of intermediaries to reach consumers by a new provider. A more restrictive policy on the payment of commissions to intermediaries may be perceived as a barrier to entry to the Irish market and therefore introduce a limit on new providers of financial services.

- **Consumers and the Value of advice**

  We believe that consumers should be in a position to choose to have access to independent financial advice. We also believe that any potential consumer detriment can be mitigated by a strong oversight framework, with perhaps scope for further improvement, along with clear and transparent communication regarding the cost of advice being provided. We are aware that some consumers would prefer to deal with a single independent source of financial information rather than a variety of providers. This can be either through a financial intermediary or a Bank who provides a 'one stop shop' option across the range of financial products which saves a consumer researching products separately if they choose not to do so. In addition, another benefit of financial intermediaries is that Consumers can avail of free advice where they ultimately decide not to purchase which encourages shopping around.

- **Advice Gap**

  The UK Financial Conduct Authority has recently published the Financial Advice Market Review (the Review) which identifies some key issues that have emerged following the introduction of changes to the rules on advice three years ago. The UK regulations require financial advisers to charge customers for their services instead of being paid commission for selling products. The rules were introduced to make advice more transparent and to address potential conflicts of interests where advisors received commission payments. The Review was launched in 2015 due to concerns that the advice market was not working for consumers following implementation of the new rules. Among the findings of the Review the following issues were identified:

  - *The move from paying for advice via commission to paying adviser fees has contributed to many people not being able to get the advice they want and need at a price they are willing to pay*
  - *Due to the high costs associated with face-to-face advice, it is unprofitable to serve customers who have assets below a certain level, and so firms will focus on customers with assets above that level*
  - The introduction of 'basic' and 'simplified' advice models - *neither has been successful in creating a way for consumers to get advice on simpler needs without paying for full advice, which looks at all aspects of an individual's needs and financial affairs.*
  - Demand – *Those with greater wealth are more likely to take advice. There are many people who would be willing to pay something for advice but who are put off by higher prices.*

The Review provides some interesting analysis of the research undertaken among consumers and firms in relation to advice and the purchase of financial products. One critical finding is the identification of advice gaps with the vast majority of respondents 'believing that a gap exists for people on lower incomes or with lower levels of assets'. We have included this feedback as we believe that it is important to understand the impact of changes to the regulatory framework in other markets and to avoid any potential negative impact for consumers where issues have been identified.

2. Conclusion

We believe that consumers should have a choice in how they access financial advice. We also believe that the current regulatory framework enables consumers to benefit from access to financial products directly or through intermediaries who are authorised and regulated. We have outlined the benefits in our introduction and we provide further detail in our responses to the questions raised in the discussion paper.

When the risks identified in the discussion paper are reviewed, a key risk would be a failure to provide to consumer with the most suitable product for their needs due to a conflict of interest based on the commission payment structure on offer. We believe that this risk is fully mitigated by existing Regulation and specifically the following requirements:

- The requirements for an intermediary to go through a robust authorisation process.
- The requirements for the Intermediary to be “Fit and Proper” to undertake their role.
- The requirements to disclose information, including commissions, to the consumer during the sales process.
- The duty under the Consumer Protection Code (CPC) to ensure that the sale is suitable.
- The CPC obligations on the Intermediary to have a written Conflicts of Interest policy in place and to ensure that, where conflicts do arise, it does not result in damages to the interests of the consumer.
- The CPC Conflict of Interest obligations on the product producer when distributing products through an Intermediary.

We also note that efforts to improve standardisation and transparency in the area of commissions’ disclosure will further mitigate this risk.

In addition to the regulatory requirements, the ‘claw back’ of intermediary commissions represents a barrier to churn business and can help to ensure that the intermediary provides the consumer with the most suitable product.

Finally, we also believe that any changes to the current regulatory framework should be aligned with initiatives due for implementation in the near future to ensure consistency and avoid potential confusion for consumers.

Question 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?

Our view is that the existing regime is "fit for purpose" and is overall working well from both a regulatory and a process perspective in delivering responsible business conduct. In particular, we would highlight that the commission based structure encourages the consumer to undertake a holistic review of their financial needs, which is not subject to an upfront payment. This is important in ensuring that consumers have access to free quality financial advice, and that they are only recommended suitable products. Suitability, as set out in CPC, encourages regulated entities to act in the consumers best interests and to ensure that they avail of products relative to their needs.

The existing regulatory regime, in particular the requirements of CPC 2012 and the Minimum Competency Code (MCC), encourages the provision of high quality advice, the avoidance and management of conflicts of interests and the disclosure of relevant information to customers. The CBI Guidelines on Variable Remuneration ensure that the staff of financial institutions are appropriately incentivised, with at least an equal weighting on qualitative measures. This ensures that any risk of Product Bias, is significantly reduced. The existing commission based structure which includes ‘claw back’ arrangements, promotes choice and encourages diversity and increased competition in the market place, enabling customers to "shop around". This is a positive outcome in our view and worth maintaining.

We believe that intermediaries have a role to play in a functioning consumer financial market. We also believe that intermediaries should continue to have high standards of oversight and be compliant with the requirements of all appropriate regulations/legislation. This is necessary to ensure a robust and sustainable sector for the benefit of consumers. When an intermediary is appointed by a financial firm there are quality controls in place to protect consumers as well as reviews linked to ‘claw back’ arrangement which are used to manage any risks. These controls also ensure that products are sold appropriately i.e. intermediaries are encouraged to ensure products are best suited to consumer needs due to ‘claw back’ arrangements.

We believe that the Industry standard commission structure - paid on completion of the mortgage is appropriate and ensures customers are fully serviced by their Intermediary through the full mortgage journey.

Question 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?

As stated in our introduction, we believe that the current framework in relation to the payment of commission is working well and provides choice and access for consumers in a fair and reasonable way. There may be a small number of adjustments that would further improve the current framework in order to maximise the transparency of the process for consumers.

Intermediaries and product producers under the existing regulatory framework, at both Irish and European level, have undertaken considerable change to ensure that the payment of commission is transparent, responsible and in the best interest of consumers. Examples of this include the requirements in the revised Consumer Protection Code 2012 relating to Conflict of Interest management, and in particular the CBI Variable Remuneration Guidelines issued in 2014. The recently transposed Insurance Distribution Directive (IDD) contains enhanced requirements to ensure that insurance distributors are not remunerated or do not remunerate or access performance of their employees in a way that conflicts with its duty to act in the best interests of its customers. Additionally, the focus on Conduct Risk within regulated entities is ensuring that the interests of the consumer are to the forefront of all consumer engagements and product development.

In respect of Mortgages lending, there may be scope to improve the transparency of intermediary arrangements by disclosure of the existing requirements, in a standardised format.

Question 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?

We believe that the current system which operates in Ireland in relation to the remuneration of intermediaries on the basis of a commission based structure, is in the best interests of consumers and should be retained. From a regulatory view point as outlined in our response to Question 2 above, the appropriate oversight is already in place to support this structure, and to ensure that the consumer is protected and informed in an open and transparent manner. Fundamentally the move to a fee based system, poses a large number of risks principally surrounding the impacts on the provision or lack of provision of financial advice which a move to this structure would entail.

The commission based model is important in ensuring that financial advice is available for all, as it is typically provided free of charge to consumers. It encourages consumer engagement and financial inclusion, as customers are less likely to seek out financial advice which incurs a fee. It is important in encouraging customers to seek a holistic view of what their broader financial needs are. A fee based system could potentially exclude consumers who cannot afford to pay for financial advice from engaging with regulated entities and lead to consumers self-determining what products or services they need. This in turn can have long term knock on effects for consumers who may choose products which are inappropriate, short term in nature and also to prioritise their shorter term financial needs.

The commission based model is not just important in the context of individual consumer needs, but is also important in a wider context. Ireland has a severe personal pension deficit at present. It is estimated that less than 50% of the population have private pension coverage[1]. A move to a fee based model we believe could lead to a further deterioration in these figures and to increased pressure on government and society more broadly to fund an increasing pension gap.

A move away from a commission to a fee based structure, as evidenced by the UK and Dutch models, could lead to a reduction in intermediaries operating in the market place, which would have the effect of undermining and reducing competition. This would ultimately

[1] (Source: CSO, April 2013)

lead to less choice and innovation available to consumers. A commission based structure encourages "shopping around". Consumers have more choice; they are not under any obligation to purchase products and are not faced with an "upfront fee". A move away from this model, could lead to reluctance on behalf of consumers to review their product choices, as the cost of seeking new advice may be too great. In a fee based model, customers would potentially be faced with paying individual fees for example for life assurance, house insurance etc. rather than as part of a collective sales review.

It is also important to note that a commission based structure does not, as is often quoted, increase the base-line cost to the consumer. Whilst commission payments incorporate the cost of distribution of the product, there is no evidence to suggest that a consumer pays a higher interest rate on a mortgage product. ‘Product Bias’ which can also be a concern in a commission based model has been effectively regulated by the Central Bank Variable Remuneration Guidelines, and therefore we believe that this risk in the market place is being effectively managed.

We would be supportive of proposals to improve the transparency and the standardisation of customer documentation in order to support fee / commission transparency. Standardisation of the format used for disclosure will be beneficial to consumers and aid the operation of an efficient marketplace.

Question 4

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

Not at this time

Question 5

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

Not at this time

Question 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?

Not at this time

Question 7

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

We believe there are benefits to retaining a commission based model for Intermediaries which include:

- Intermediaries are intensely regulated by the CBI and there has been little or no evidence to suggest that Intermediaries are not giving the correct advice to customers.
- The Intermediary authorisation process with the CBI is very rigorous. This has resulted in suitably qualified and professional individuals obtaining and retaining authorisation and giving financial advice to consumers.
- Intermediaries must obey strict rules and regulations in relation to reasons why, best advice and terms of business. Consumers are made aware of the amount of commission that the Intermediaries receive.
- Under the current framework, consumers have the ability to obtain free Independent Financial Advice as there is no obligation to purchase a product following engagement with an intermediary. Were this to change, we believe that many consumers will not pay upfront for this type of service. We are also aware that many consumers are 'time poor' and there is a key role for Intermediaries as an independent advisor to research the market place for the most suitable product to satisfy individual consumer's needs.
- From a consumer perspective competition is a crucial component of any marketplace. Removing the mechanism of paying Intermediary commission will potentially threaten the viability of some product producers that have a reliance on the Intermediary channel to distribute their products in the Irish Market. It may also reduce the potential for new entrants. Removing such competition would not be healthy for the market and ultimately the consumer would lose out.
- The intermediary market is growing, customers want choice and independent advice, and banks are operating 'Omni channel' approaches and various distribution channels, voice, digital, retail and intermediary.
- Commission payments and structures are very transparent and the whole process is available for the consumer to see and understand what costs relate directly to the product sold and what other costs were distribution factors.

- In the absence of a commission based system, consumers have been found in other jurisdictions to gravitate towards the cheapest provider rather than choosing the best advice. This can result in poor customer outcomes.

Question 8

Are there weaknesses or gaps in the current consumer protection framework in the context of commissions specifically?

While the current consumer protection framework outlines the responsibilities of the parties involved this should be expanded on so there is no ambiguity. Roles and responsibilities in these business relationships must be clearly defined and evidenced. The development of feedback loops between intermediaries and the product producer is a key component in ensuring consumers' needs /issues are handled effectively.

Question 9

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

- We note that the domestic framework is undergoing significant changes specifically with regard to new/recent regulatory changes covering mortgages (MCD), investments (MiFID II), insurance (IDD & PRIIPs) and retail banking products (CPC changes) each setting out obligations in relation to commissions/remuneration. These developments augment requirements with regard to disclosure and the fair treatment of consumers.
- There would be merit in the regulator issuing guidance/implementation notes to accompany the introduction of regulatory changes, in order to enable the implementation of solutions to an acceptable standard, across industry participants. This should be accompanied by consultation to ensure no unintended 'second order' consequences across the industry.

Question 10

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

The existing regulatory framework also accommodates fee based options and we believe that this choice should continue to be available to consumers in any revisions to the Code.

Question 11

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

None

Question 12

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

No

Question 13

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

No

Question 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?

As mentioned above, standardisation and transparency of disclosures to consumers in the mortgage market is desirable. Guidance notes on the interpretation of the relevant regulations will assist market participants in meeting these objectives.

Question 15

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

As previously mentioned, the transparent disclosure of commission arrangements is the key to enabling consumers to make informed decisions on their choice of product / service from the range of providers.

Question 16

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

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Question 17

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

Not at this time

Question 18

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

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Question 19

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

Question 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?

Not at this time