Response of the Pensions Council to the Discussion Paper published by the Central Bank on the Payment of Commission to Intermediaries

October 2016

Our comments relate to pension products, our area of competence, but may have wider application.

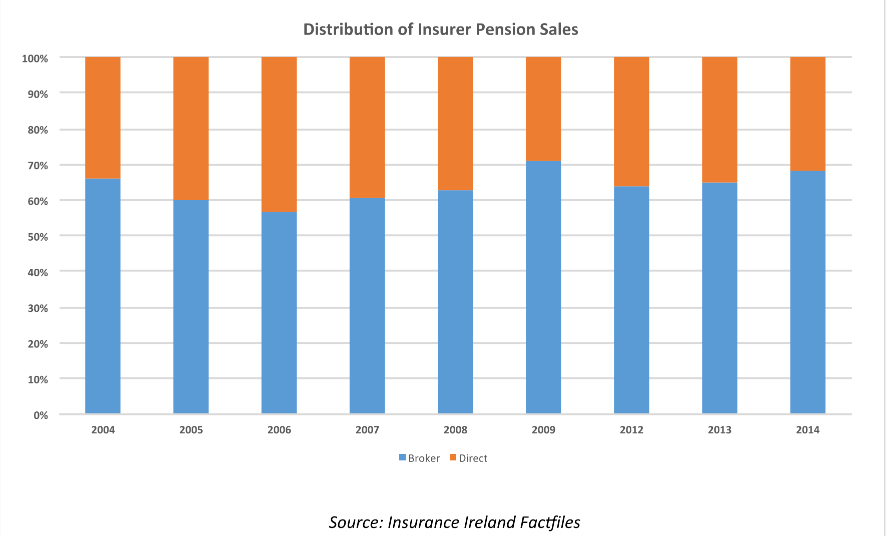
1. The Discussion Paper covers a broad range of the risks and benefits of payments to intermediaries. Here we give particular attention to issues of competition, market dynamics and transparency in relation to payment of commissions for pension products, at accumulation and de-cumulation phases.

2. However commission is paid, it is of course the consumer who pays it, and the final yield on a pension product is reduced pro tanto.

3. In general, with some very limited exceptions, for example for smaller contracts, consumers would be better off and will have a higher yield on their investment if they pay up front for independent advice, instead of paying commission[1]. This may be particularly the case for higher amounts where the commission is a percentage of the sums involved. Consumers should be encouraged to choose the "up-front" option but in practical terms the role of the intermediary needs to be carefully supervised. From the consumer perspective, the value of an intermediary depends on the quality of advice given (and understood) but the commission system may provide little or no incentive to give the best advice. Indeed, the level of commission would appear to be independent of the quality of advice or the level of service.

4. Intermediaries are significant actors in the market for pension products. Insurers sell most of their pensions through intermediaries:

Table 1

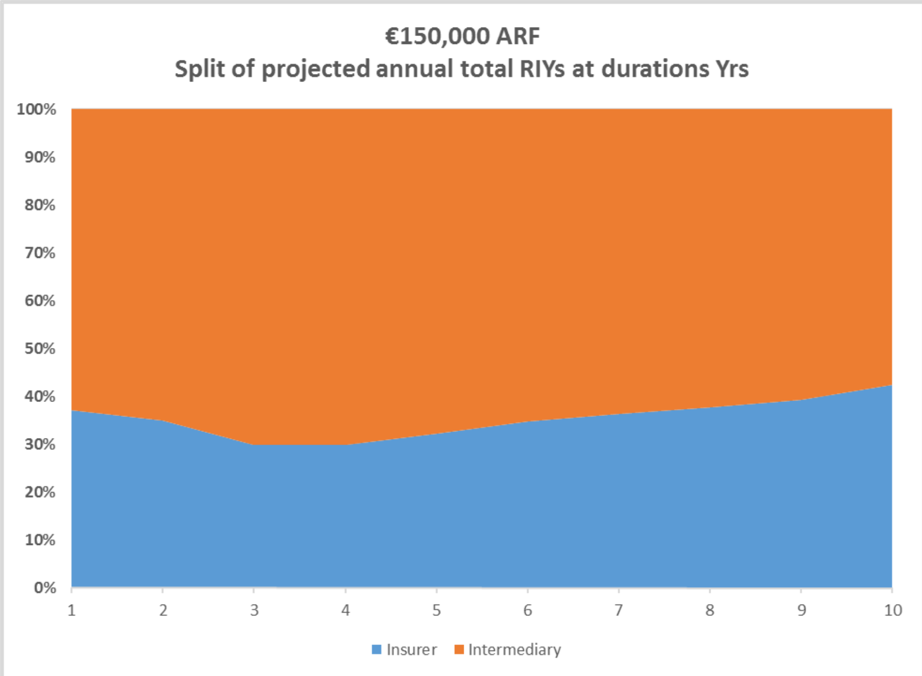


Source: Insurance Ireland Factfiles

[1] *Assuming, which may not be the case, that a "commission-free" product is bought. In practice, providers tend to include an element of "commission" in their price even when there is no intermediary to be paid. This is questionable.*

5. In the case of Approved Retirement Funds (ARFs), intermediary commission is likely to have the heavier impact – ranging from 52 to 70% of the total charges borne by the consumer[2].

Table 2



6. The following points are taken from our study of ARF charges:

   (a) Insurers' ARF charges vary widely and consumers could save up to 7-8% of their initial investment by choosing (if they know about it) the fund with the cheapest charges. Comparing the lowest as against the highest charge, consumers might save as much as 5,440 euro over ten years on an investment of 75,000, and some 11,720 euro on an initial sum of 150,000. Consumers will have little or no knowledge of this possibility unless the intermediary tells them; there are no obvious incentives (and there may be disincentives) for intermediaries to offer the consumer the choice of the cheapest product. Disincentives may arise if or when the intermediary's commission is dependent on the choice of the product.

   (b) Similar considerations arise from the fact that individual insurers may have two or more charges for the same product; the higher rather than the lower charge may typically reduce the yield for the consumer by up to nearly 3% of the initial sum invested. In such cases, consumers may never know that there was a cheaper version of the exact same product. (Codes on the application form can allow intermediaries to choose the charging version without the knowledge of the consumer.) Here too, a closer investigation is needed of the balance of incentives and disincentives for the intermediary.

   (c) As already indicated (Table 1) intermediary commission can reduce the yield for the consumer by as much and more than the insurers' charges. In such cases, which

[2] *Based on initial commission of 3% and trail commission of 0.5% per annum.*

seem to be typical, the intermediary makes more from the product than the insurer. Any general effort to reduce charges for pension products must therefore include a close scrutiny of the role of the intermediary.

(d) It is clear from the Report that re-brokering (changing to a different scheme) may bring substantial benefits to the intermediary, particularly when a new initial charge is levied on the new product. Concealed commission can act as an incentive for the intermediary to try to alter the initial contract or arrangement.

While not covered in our study the Department's Report on Pension Charges in Ireland 2012 noted that *“A key finding is that scheme re‐brokering is significant in the case of occupational pension schemes and is also relatively common in individual pension arrangements. …The high level of re-brokering in the marketplace raises some concerns.”* pp. *211-212.* Re-brokering can be in the consumer’s interest but experience elsewhere suggests that this is often not the case.

7. Price variations can of course be found in competitive markets but the wide differences found here in insurers’ charges, including different charges for the exact same product, do not seem to be consistent with a fully competitive and transparent market oriented in the consumers’ interest. Why do these wide differences exist? It may be that many intermediaries are simply not aware of these wide differences in insurer charges (as distinct from commissions). Secondly, the incentives may not be there or may not be sufficient for intermediaries to chase the lowest charges for the consumer. Thirdly, the dealings between insurer and intermediary may be based more on a relationship that suits both sides, than on the strict principles of economics and competition.

8. The reaction among intermediaries and their representatives to the ARF Report was relatively muted, giving rise to the suspicion that the information in the Report was not seen as immediately relevant to their day-to-day work. A closer examination is needed of the conditions for competition in this market, the range of relationships between intermediaries and insurers, together with policies on commission, and at the relationship if any between insurer charges and commission.

9. Given the structure of the market, the variety of charges, commissions, and incentives and the inherent complexity of products, there is ample reason to suspect that insurers see the intermediary as the client, and not the consumer. Commission rates are effectively decided between the insurer and intermediary, with little or no possibility of input from the consumer. Products seem designed to appeal to intermediaries, and to provide a wide menu of commission options for the intermediary, without alerting the consumer to this fact. The use of codes on the application form and the placing of information on charges and commission options on the ‘broker only’ part of the insurer’s website, not accessible to the consumer, does not facilitate transparency or consumer choice. Insofar as competition does exist in the market it is not necessarily for the benefit of the ultimate consumer.

10. The case for more, or more correctly better, transparency in the market is overwhelming. Consumers (and intermediaries) must have better and more useable information about product charges and commission, in absolute and comparative terms. The kind of comparative pricing information in our Report is not normally available to consumers or intermediaries and it would be useful if it were publicly available and updated regularly.

11. Even if more data on product charges and commission were publicly available, as is desirable, consumers may still tend to rely on the intermediary for the bulk or all of the information they need to make rational choices. Despite the numbers involved it may be possible to publish and keep updated some general information about the range of such commissions.

12. Closer attention must be paid to the “intermediary/consumer interface” – to how exactly, when and in what form individual intermediaries disclose their own charges to prospective clients. Even if information on commissions is given in some form, that information may be overshadowed in the overall complexity of the product, in other things that are said to the consumer and by practices that tend to minimise or disguise the true impact of charges. To take just one example, practices such as “103% allocation” to a fund are likely to, and may be intended to, disguise the true charges of provider and intermediary.

13. In practical terms it is very difficult for consumers to shop around between intermediaries, mainly because of the lack of any standard and understandable basis for comparison between different offers. They may also be inhibited from shopping around if they know or have some social links with the first intermediary they meet. The principle of “Caveat Emptor” is not nearly enough here and there is a convincing case for a strongly interventionist approach on the part of the regulator(s) here.