



Guidance on the meaning of remuneration within the Conduct of Business (Long Term Business) Code 2017

This guidance is issued in consideration of the requirements of the Conduct of Business (Long Term Business) Code 2017 (“the Code”) and sets out the Financial Services Authority’s (“the Authority”) expectations in respect of the treatment of different types of remuneration paid to intermediaries under the Code.

The Authority issues guidance for various purposes, including to illustrate best practice, to assist regulated entities to comply with legislation and to provide examples or illustrations. This guidance is, by its nature, not law, however it is persuasive. Where a person follows guidance this would tend to indicate compliance with the legislative provisions, and vice versa.

The Authority’s intention in issuing the Code was to establish principles (in paragraphs 8 and 11 of the Code) surrounding disclosure of remuneration as a way of mitigating the risk of conflicts of interest arising in the sales process and distorting the advice that customers receive.

The Authority is aware that there will be wide variation in models of remuneration and charging structures, although the most common method by which brokers are remunerated is by the payment of a commission. The introduction of the requirement to disclose commission to policyholders has the potential to drive changes in these models of remuneration.

It is the Authority’s view that any remuneration used to incentivise intermediaries (whether monetary or not) potentially creates a conflict of interest for the intermediary between its duties to provide appropriate advice to potential policyholders and its relationship with the insurer, that is providing the remuneration. Therefore, insurers need to consider how the payment of any remuneration is consistent with the obligation to treat policyholders fairly (in accordance with the Corporate Governance Code of Practice for Regulated Entities (“CGC”) and paragraphs 5 and 6 of the Code), and how any resultant conflicts of interest should be managed accordingly. An insurer should document, and be able to explain to the Authority, how their product charging and remuneration structures have been developed to pay due regard to the interests of policyholders and to treat them fairly.

Disclosure of commission

In relation to the scope of the disclosure requirements under the Code, the Authority’s expectation is that remuneration paid that is attributable to the initial and ongoing advice and sale of the specific policy (and is therefore likely to be reflected in policy charges) must be disclosed to the policyholder to enable them to make an informed decision. Generally, this would capture initial and ongoing commission paid by the insurer to the intermediary.



When considering whether or not the remuneration should be captured within the disclosure to policyholders, the regulated entity should take into account the degree to which the costs of the remuneration are met by the charges reflected in the charging structure of the product and so impact directly on the cost of the product to the policyholders.

Form of commission disclosure required in a Key Information Document (“KID”)

Paragraph 8 of the Code prescribes the mandatory content of a KID, including mandatory text for disclosing commission. This paragraph allows insurers to disclose commission either as a monetary amount (in policy currency), or as a percentage of premiums being paid. Where adopting a percentage of premium disclosure insurers should note the following guidance:

Initial Commission - Single premium policies

The disclosure for commission paid at the commencement of single premium policies should be calculated as:

$$Comm \% = \frac{Total\ Commission\ Paid}{Contractual\ Single\ Premium} \times 100$$

where—

Comm % denotes the disclosure of commission as a percentage in the KID;

Total Commission Paid denotes the actual amount of initial commission paid to a broker, including any override; and

Contractual Single premium denotes the amount of single premium paid by the policyholder and therefore excludes any additional or reduced premium allocation.

Initial Commission - Regular premium policies

The disclosure for commission paid at the commencement of regular premium policies should be calculated as one of the following:

$$Comm \% = \frac{Total\ Commission\ Paid}{Annual\ Premium} \times 100$$

where—

Comm % denotes the disclosure of commission in the KID;

Total Commission Paid denotes the actual amount of initial commission paid to a broker, including any override and indemnity payment; and



Annual Premium denotes the amount of premiums contractually due per annum.

OR

$$Comm \% = \frac{Total\ Commission\ Paid}{Total\ Contractual\ Premiums} \times 100$$

where—

Comm % denotes the disclosure of commission in the KID;

Total Commission Paid denotes the actual amount of initial commission paid to a broker, including any override and indemnity payment; and

Total Contractual Premiums denotes the sum of premiums contractually due over the policy premium payment term. For whole of life policies with no contractual premium payment term, payment term shall be assumed to be to period between policy commencement and the last insured attaining 80 years of age.

The disclosure of commission paid on an ongoing, renewal basis is set out in paragraph 8(g)(iii) and 8(g)(v) of the Code.

Managing the payment of other inducements

The Authority is cognisant of the risk that the payment of commission may be substituted by other financial inducements, or benefits, that are intended to achieve the same outcome, i.e. to secure distribution of a regulated entity's products. These other financial inducements (such as marketing allowances, sales competitions and volume related payments) may not generally directly affect the charges on a product and therefore would not need to be disclosed to a policyholder under the Code, but these other inducements must still be considered by a regulated entity in terms of how the payment meets the entity's obligations under its fair treatment of customers and product development policies and procedures. And in particular the requirement to identify and manage any conflicts of interest in the product design and distribution.

Criteria that may be taken into account when considering whether a conflict of interest may arise from the provision of benefits other than commission, include a consideration of whether the benefits:

- are reasonable and proportionate, commensurate with the benefit obtained by the insurer or its customers;
- enhance the quality of service to customers;



- are not relied on by the intermediary firm in the future in order to continue to service its customers (so that should the benefit cease to be provided, the impact on the advisory firm or its customers would not be significant); and
- could reasonably not be expected to result in the channelling of business from the intermediary to the provider.

"Soft commission" from fund / asset managers

For unit linked business there are instances of observed market practice where an intermediary receives remuneration directly from the fund manager for placing business under a unit linked contract with an insurer (e.g. soft commissions), in addition to receiving a commission from the insurer. Such arrangements present a high risk of customer detriment.

Although the insurer would not ordinarily be directly party to these payments, the Authority is of the view that insurers are well placed to identify and mitigate the risk of conflicts of interest arising from such practice. Insurers offering products that link the value of benefits payable under the policy to assets provided by parties external to the insurer, should include in product development and asset vetting procedures, specific consideration and mitigation of the risk of customer detriment arising from the payment of soft commission that may lead to unreasonable levels of remuneration to brokers.

For example, at asset vetting stage insurers should consider including, as part of the review of asset/fund literature, a review of the level of charges associated with the asset; often the availability of intermediary commission is directly disclosed in fund literature or reflected in higher end front end charges or exit fees.

Alternatively, insurers may seek direct disclosure from the fund / asset manager of its approach to commission payments.