

# 192

Financial Services Authority

## Further consultation on fees for mortgage firms and insurance intermediaries

July 2003





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**Annex 1:** Summary of questions asked in this consultation paper

**Annex 2:** ‘Near final’ rules and guidance from CP180

**Annex 3:** Draft rules for consultation

The Financial Services Authority invites comments on this Consultation Paper (CP). Comments on our proposals should reach us by 27 October 2003.

Comments on this CP may be sent electronically using the form on our website at: [http://www.fsa.gov.uk/pubs/cp192\\_responses.html](http://www.fsa.gov.uk/pubs/cp192_responses.html)

Alternatively, please send comments in writing to:

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**It is our policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.**

# 1 Executive summary

- 1.1 In April 2003 we published CP180 ('Fees for mortgage firms and insurance intermediaries'). In that paper we consulted on:
  - our proposed policy framework for charging fees to firms undertaking the mortgage and general insurance activities that are soon to be regulated;
  - draft rules to give effect to our application fees framework; and
  - proposed application fee rates for the firms concerned.
- 1.2 This paper consults on certain further aspects of our fees regime for firms involved in carrying out the newly regulated activities. The proposals in this paper are only relevant to:
  - insurers who also act as intermediaries;
  - mortgage lenders and administrators who also act as intermediaries; and
  - mortgage and insurance intermediaries who receive payments from lenders and insurers other than on a straightforward commission/fees basis.
- 1.3 A key element of our proposals is to introduce a method for calculating a notional income figure in respect of business which does not generate commission income in the 'normal' way. We also propose to alter the fee-block arrangement set out in CP180 for insurers carrying out intermediary activities.
- 1.4 We have **not** made any rules that we consulted on in CP180, or our final application fees for firms wishing to continue to undertake mortgage and general insurance activities after regulation begins. We plan to give feedback on CP180 and make the necessary fee rules arising from that consultation in September 2003.

- 1.5 Because the consultation material in this paper proposes extending the framework of rules consulted on in CP180, we have included in Annex 2 a 'near final' version of the application fees framework from CP180 (not including the fee rates themselves). This will help respondents see how the proposals in this paper fit into the framework.
- 1.6 We welcome responses to the proposals in Chapters 4 and 5, which should be sent using the contact details on page 2 by 27 October 2003.

## **CONSUMERS**

This CP contains no material of direct relevance to retail consumers or consumer groups.

# 2 Introduction

## **Background: mortgage and insurance regulation – N(M&GI)**

- 2.1 The government has announced that it proposes to extend the scope of our responsibilities to include the regulation of:
- mortgage lending, administration, arranging and advising; and
  - the selling and administration of general insurance and pure protection contracts (e.g. critical illness, income protection and term assurance).
- 2.2 Mortgage regulation and the regulation of long-term care insurance is due to start on 31 October 2004. The regulation of general insurance and other pure protection contracts is due to start on 14 January 2005. For more details and links to other related consultation papers, please see our website at [www.fsa.gov.uk/mort\\_gen\\_ins/](http://www.fsa.gov.uk/mort_gen_ins/).
- 2.3 For the sake of brevity, we will refer in this paper to these two dates as ‘N(M&GI)’. We use the term ‘non-investment insurance’ to refer to general insurance and pure protection contracts. Where we refer in this CP to ‘intermediary activities’ or ‘selling’ or ‘advising and arranging’, we are referring to all the activities that fall under the full definitions of mortgage mediation activity or insurance mediation activity.

## **Purpose of this paper**

- 2.4 This paper consults on further aspects of the fees regime for the newly regulated activities, which were not included in CP180 – that is, policy proposals and draft rules for application fees, and policy proposals for the periodic fees, of:
- insurers who also act as intermediaries;
  - mortgage lenders and administrators who also act as intermediaries; and

- intermediaries whose income from advising and arranging is not adequately captured by the income definition in CP180 (broadly, that from commission and fees).
- 2.5 The framework for application fees we proposed in CP180 covered the vast majority of intermediaries. The proposals in this paper do not directly affect these firms.
- 2.6 The proposals in this CP need to be considered against the background of our existing general policy framework for raising fees. We will shortly be publishing an updated version of our *Consolidated Policy Statement on our general policy framework for raising fees* (CPS) which summarises the policy underpinning our fee raising arrangements. You may wish to refer to the CPS after reading this CP. It is available on our website at <http://www.fsa.gov.uk/pubs/policy/>. Consultees may also find it helpful to read this paper with CP180, available on our website at <http://www.fsa.gov.uk/pubs/cp/180/>.

### **Structure of this consultation paper**

- 2.7 The proposals we are consulting on in this paper add to the application fees rule framework in CP180. Although we have not made the rules from CP180, and so are not giving feedback in this paper, we include at Annex 2 a ‘near final’ version of those rules – excluding application bands and fees. This allows respondents to see how the rules being consulted on in this paper (contained in Annex 3) will fit into the final rule structure. So, we are not seeking further comments on the rules in Annex 2.
- 2.8 The remainder of this paper is set out as follows:
- Chapter 3 – explains the need for these consultation proposals and gives brief background material.
- Chapter 4 – includes details of our further fee consultation proposals for mortgage activities.
- Chapter 5 – includes details of our further fee consultation proposals for insurance activities.
- Chapter 6 – sets out why we believe the proposals we are now consulting on are compatible with our general duties, as set out in section 2 of the Financial Services and Markets Act.
- Annex 1 – summarises the questions that we are consulting on in this paper.
- Annex 2 – contains a ‘near final’ version of the application fees rules framework consulted on in CP180, and an explanation of where and why they differ from that included in CP180.

Annex 3 – contains the draft rule amendments to give effect to the application fees proposals in Chapters 4 and 5.

### **What happens next?**

2.9 We are currently

- analysing responses to CP180;
- working on improving our population estimates of the number of firms carrying out the newly regulated activities; and
- improving our estimates of the costs involved in preparing for their authorisation and regulation.

We will invite our **September 2003** Board to make the rules and application fees that arise, using the best information available to us at that time.

2.10 This means the vast majority of firms seeking authorisation will be able to calculate what their application fees will be in September. The proposals in this paper are only relevant to lenders or insurers carrying out intermediary activity, and intermediaries who receive payment for their activities other than on a straightforward commission or fees basis.

2.11 The consultation period for this paper, which contains additions to the CP180 framework relevant to the types of firms in paragraph 2.4 above, closes in **October 2003**. After this we will provide feedback, and amend our fees rules as necessary. So, our application fees rules for all firms will have been published before applications for authorisation are accepted in early 2004.

2.12 We invite comments on the proposals in Chapters 4 and 5. Please send them, using the contact details on page 2, to reach us by **27 October 2003**.

# 3 Insurers and mortgage lenders with direct sales forces, and related firms

## Need for consultation

- 3.1 CP180 proposed that application and periodic fees for firms advising on or arranging mortgages and general insurance products be calculated by reference to the volume of this business that each firm undertakes. We said that we would measure the scale of business undertaken by the annual commission, brokerage and fee income earned from these activities.
- 3.2 However, a number of firms sell mortgages or general insurance products but their size of business cannot be measured accurately just using commission or brokerage income.
- 3.3 Broadly speaking, these firms are:
  - mortgage lenders that advise on or arrange their own, or another lender's, mortgage products;
  - mortgage advisers that advise on or arrange mortgage products provided by a lender that is a related company;
  - insurers that advise on or arrange their own, or another insurer's, non-investment insurance products; and
  - insurance intermediaries that advise on or arrange non-investment insurance products provided by an insurer that is a related company.

Firms of this kind would not earn their income from these activities as 'commission' – so, the amount of business undertaken may not be accurately captured by the income measure in CP180.

- 3.4 Our proposals for dealing with this issue are described in the next two chapters. In developing these proposals, we have had to ensure fair and consistent treatment of product providers (mortgage lenders and insurers) who mediate their own products, and 'pure' intermediaries (who were the focus of the proposals in CP180).

- 3.5 This issue is particularly relevant to insurers who also act as intermediaries, and in Chapter 5 of this paper we explain why we have decided to modify our original proposals for the treatment of these firms, set out in CP180.
- 3.6 As well as the issue of fairness, in developing our proposals we have taken into account the need for:
- consistency of treatment for different firms that are conducting the same type of business; and
  - clarity in our rules about how firms' fees are calculated.

### **Summary of CP180 proposals**

- 3.7 Our fees framework in CP180 proposed three new activity groups (also known as 'fee-blocks'), to cover the activities to be regulated after N(M&GI):
- block A.2 – for mortgage lenders and administrators;
  - block A.18 – for mortgage advising and arranging; and
  - block A.19 – for general insurance intermediaries.
- 3.8 In Chapter 6 of CP180 we explained how our application fees process works, and proposed that for firms applying to carry out the newly regulated activities after N(M&GI):
- a system of variable application fees would operate where the level of the fee was determined by the amount of business currently conducted by the firm; and
  - bands would be used to allocate a fee based on the amount of business done by the firm.
- 3.9 The draft rules in CP180 set out the manner by which firms should calculate the amount of business done, allowing them to see which band they fell into and so what their application fee would be. The proposals in Chapters 4 and 5 of this paper allow us to extend this framework to the types of firms described in paragraph 3.3.

# 4 Consultation on application and periodic fees for mortgage firms

- 4.1 In this chapter we set out the detail of our fee proposals relevant to:
- mortgage lenders and administrators who also act as intermediaries; and
  - intermediaries whose income from mortgage business is not adequately captured by the income definition in CP180.

## **Application fees**

### *Mortgage lenders who also act as intermediaries*

- 4.2 A number of firms combine the business of mortgage lending with intermediary activities, through a sales force that they employ (ie in a single authorised entity). These firms will fall into both the A.2 (for their lending and administering activities) and the A.18 (for their advising and arranging activities) fee-blocks.
- 4.3 Our proposed income measure from CP180 for the A.18 fee-block - broadly, annual net commission from arranging and advising on mortgage sales – will not adequately capture the income from the intermediary activities carried out in-house by the lender. This is because the firm will not earn ‘commission’ by selling its own mortgages.
- 4.4 We believe that lenders should pay a variable rate application fee for their intermediary activities on the same basis as independent mortgage intermediaries will in our A.18 fee-block. So, to achieve this we propose using an adjusted annual income figure for mortgage lenders who also act as intermediaries. This will allow broad comparison with the commission income an independent mortgage intermediary would earn from the same volume of business.
- 4.5 We propose to calculate the adjusted annual income by applying a weighting factor to the value of mortgage advances made by the lender as a result of its own sales activities. The factor we propose to use is 0.5% – that is, a

£100,000 mortgage advance would be taken to generate £500 of commission income. We appreciate that the commission earned can vary considerably over different types of mortgage lending. However, we think this weighting achieves a balance between providing an adequate figure for setting fees and ensuring our fees rules are not unreasonably complex.

- 4.6 A lender's direct sales force may also earn commission income in the traditional sense by selling mortgages from other lenders. So our income measure also needs to capture these payments.
- 4.7 Finally, payments may also be received from other lenders for selling their mortgages, but on a basis other than traditional commission. This income can be captured by applying the 0.5% factor to any advances made by that lender as a result of the intermediary activity of the firm that has sold the mortgage.
- 4.8 The sum of these three figures:
- a commission equivalent from intermediary activities on the lender's own advances;
  - any traditional commission earned; and
  - a commission equivalent from any advances made by other lenders as a result of intermediary activities for which the firm has been paid by a method other than traditional commission;

can then be used to establish the appropriate fee against our application fee scales.

*Mortgage advisers who sell mortgage products provided by a lender that is a related company*

- 4.9 An intermediary firm may sell mortgages provided by a related company – effectively operating as a direct sales force, but in a separately legal entity. This type of firm will fall in the A.18 fee-block. However, its income from intermediary activities may not be adequately captured by the 'simple' measure of commission we proposed in CP180. This is because payments may be made between the lender and the advising firm on a different basis – for example, as a contribution towards operating costs irrespective of the volume of mortgages sold.
- 4.10 To generate an annual income measure for this type of intermediary, we propose to use the same framework as set out above. That is, to create a commission equivalent by taking into account the value of advances achieved by the lender as a result of the intermediary's activity. The intermediary may also earn traditional commission from selling mortgages, so this needs to be captured in the income measure as well.

*How we will calculate the income measure for application fees*

4.11 Table 1 below summarises how we propose to calculate annual income for the advising and arranging activities of mortgage firms. In the table:

- ‘A’ will capture the amount of traditional commission paid to the firm for selling mortgage products;
- ‘B’ is relevant to lenders only, and is the figure generated for the commission equivalent of the value of the firm’s **own** mortgage advances made as a result of its **own** advising and arranging; and
- ‘C’ in the table captures the commission equivalent figure for any advances made by **other** lenders as a result of the firm’s intermediary activity, for which payment has been made to the firm on any basis other than that included in ‘A’.

<b>Table 1 – Application fees – calculating the income for mortgage mediation activity</b>				
Annual commission or fee income <i>(as currently defined for the A.18 fee-block)</i>			=	A
<i>(where the firm is a lender)</i>				
Annual value of mortgage loan advances made by the firm in relation to its mortgage mediation activity	X	0.5%	=	B
<i>(where the firm receives any payments from a lender for mortgage mediation activity other than on the basis captured in ‘A’:)</i>				
Annual value of mortgage loan advances resulting from that activity	X	0.5%	=	C
Annual income			=	(A + B + C)

Note: ‘B’ will always be zero for a firm that is not itself a lender.

The sum of these figures is the annual income for application fees purposes.

4.12 Our application fees rules state that firms applying for permissions that would place them in more than one fee-block only pay the highest of the application fees that would be payable for each of those blocks. In the case of a lender who also acts as an intermediary (and so needs to apply for A.2 and A.18 permissions), normally the A.2 fee will actually be the highest.

Q1: Do you have any comments on the proposed factor of 0.5% for converting advances into an income measure for fees purposes?

## **Periodic fees**

- 4.13 A firm pays periodic fees for each fee-block that it falls into. This means that a lender who also acts as an intermediary will pay periodic fees in the A.2 fee-block (for its lending activities) and the A.18 fee-block (for its advising and arranging activities). However, separately authorised intermediaries will only fall into the A.18 fee-block. We set out in CP180 our proposal for A.2 periodic fees.
- 4.14 The proposals in paragraphs 4.2 to 4.11 above explain why we need to adjust the ‘simple’ annual income calculation consulted on in CP180. This will make the income reported for application fees purposes in the A.18 fee-block properly comparable as between:
- pure intermediaries;
  - mortgage lenders who also act as intermediaries; and
  - intermediaries where our CP180 definition does not adequately capture their income from advising and arranging.
- 4.15 Exactly the same arguments apply to the tariff-base that we propose using to set the A.18 fee-block periodic fees for these firms. So we propose to extend the CP180 proposal in the same way as we have for application fees. That is, the tariff-base for A.18 periodic fees will be as set out in Table 1.

## **Draft fee rules for consultation**

- 4.16 We have drafted the amendments we need to make to our application fee rules to give effect to the application fee proposals made in this chapter. The draft amendments proposed are detailed in Annex 3. We will produce draft rules for consultation to put in place these periodic fee proposals in due course.
- 4.17 Although our proposals will amend the framework of application fees rules in CP180 (see Annex 2 for an updated version of these proposals), the extra factors in the proposals (‘B’ and ‘C’ in Table 1) will be zero for pure intermediaries. So the method they will use to calculate their annual income for application fees purposes will not change.

Q2: Do you have any comments on the draft rules in Annex 3 as they apply to mortgage firms?

# 5 Consultation on application and periodic fees for insurance firms

- 5.1 In this chapter we set out the detail of our fee proposals relevant to:
- insurers who also act as intermediaries; and
  - intermediaries whose income from insurance business is not adequately captured by the income definition in CP180.
- 5.2 We also set out in more detail below, for both application and periodic fees, our decision to allocate insurers who also act as intermediaries to the A.19 fee-block.

## **Application fees**

### *Insurers who also act as intermediaries*

- 5.3 A number of currently authorised general insurers (who pay fees in our A.3 fee-block) both provide insurance products and – as part of the operations of a single authorised firm – conduct business selling those products, or the products of another insurer.
- 5.4 CP180 did not include any proposals for the payment of application fees for the intermediary activities of these firms. This is because fee arrangements for the A.3 fee-block were - at the time CP180 was published – the subject of a separate consultation, which is now completed. So we are now setting out proposals on fee issues for these firms.
- 5.5 Our draft fee-block definitions in CP180 envisaged that insurers selling products would not be placed in the A.19 fee-block. They would still have to apply for a variation of their current permission (known as a ‘VOP’) to carry on the newly regulated activities. We also proposed work on the tariff base of the A.3 fee-block (which has already changed several times since N2) to reflect the fact that it would need in future to capture the advising and arranging activities of insurers.

- 5.6 In developing our current proposals, and for the reasons in paragraphs 3.4 and 3.6, we have re-visited this decision. We now propose that just as mortgage lenders who also act as intermediaries will fall into the A.2 and A.18 fee-blocks, insurers who carry out intermediary activities will be allocated to the A.3 and A.19 fee-blocks. This will apply both to the calculation of application and periodic fees. Our proposals on periodic fees are in paragraphs 5.15 to 5.22 below.
- 5.7 Consistent with our approach in CP180, we propose that insurers who advise and arrange should pay a variable application fee for their VOP based on the scale of the intermediary activities they currently undertake. This measure would then be compared against the application fee scale for insurance intermediaries in the A.19 fee-block.
- 5.8 The CP180 measure of annual income ('commission earned' or 'brokerage') will not adequately capture the income from intermediary activities being carried out by insurers. So, we propose to adjust the calculation of annual income, using a similar approach to that described in Chapter 4 for mortgage lenders who also advise and arrange.
- 5.9 This means that for an insurer who also acts as an intermediary, annual income for the purposes of the A.18 fee-block will consist of:
- any ordinary commission earned for the insurer by its sales force from selling products; plus
  - the volume of its own sales (measured by premiums) achieved by the insurer as a result of its own intermediary activity, multiplied by a factor; plus
  - where any payment other than ordinary commission is received for selling another insurer's products, the premiums receivable by the other insurer as a result of the intermediary activity, multiplied by the factor;
- to create a notional income for the insurer broadly equivalent to that a pure intermediary would earn by conducting the same amount of business.
- 5.10 The weighting factor we propose to use to generate the commission equivalent is 10%. We appreciate that the commission earned can vary considerably over different types of insurance. However, we think this weighting achieves a balance between providing an adequate figure for setting fees and ensuring our fees rules are not unreasonably complex.

*Insurance intermediaries who sell non-investment insurance products provided by a related company*

- 5.11 An intermediary firm may sell insurance products provided by a related company – effectively operating as a direct sales force, but in a separately authorised entity. As a separate entity, this type of firm will fall into the A.19

fee-block. The income of these firms may not be adequately measured by the commission basis outlined in CP180. This is because payments may be made to the firm for their intermediation activity, but on a basis not directly connected to their volume of sales. So, we are proposing to establish the size of business by using a similar framework to that set out above.

- 5.12 The annual income for this type of intermediary will be measured by calculating a notional commission equivalent. This will use the value of premiums receivable by the insurer as a result of the intermediary's activity, weighted by a factor (again we propose 10%). The intermediary may also earn traditional commission through selling insurance products.

*How we will calculate the income measure for application fees*

- 5.13 Table 2 below sets out how we propose to calculate annual income for the advising and arranging activities of insurance firms. In the table:

- ‘X’ captures any traditional commission payments to the firm from advising and arranging on insurance products;
- ‘Y’ is relevant to insurers only, and is the figure generated for the commission equivalent of the value of the firm’s **own** premiums receivable made as a result of its **own** intermediary activity; and
- ‘Z’ is the commission equivalent figure for any premiums receivable by **other** insurers as a result of the firm’s intermediary activity, for which payment has been made to the firm on any basis other than that included in ‘X’.

<b>Table 2 – Application fees – calculating the income for insurance mediation activity</b>				
Annual commission or fee income <i>(as currently defined for the A.19 fee-block)</i>			=	X
<i>(where the firm is an insurer)</i>				
Annual value of gross premiums receivable by the firm in relation to its insurance mediation activity	X	10%	=	Y
<i>(where the firm receives any payments from an insurer for insurance mediation activity other than on the basis captured in ‘X’)</i>				
Annual value of gross premiums receivable by the insurer resulting from that activity	X	10%	=	Z
Annual income			=	(X + Y + Z)

Note: ‘Y’ will always be zero for a firm that is not itself an insurer.

The sum of these figures is the annual income for application fees purposes.

5.14 The notional annual income amount produced can then be used with the A.19 application fee bands, to set the application fee. Insurers who are seeking a VOP pay 50% of the appropriate application fee.

Q3: Do you have any comments on the proposed factor of 10% for converting premiums into an income measure for fees purposes?

### **Periodic fees**

5.15 As set out in CP180, general insurance intermediaries will pay periodic fees for their mediation activity in the A.19 fee-block, based on the scale of that activity (as represented by commission or fee income).

5.16 We now propose that an insurer who also acts as an intermediary will also be placed in the A.19 fee-block, so they will pay periodic fees in the A.3 and A.19 blocks.

5.17 We believe this is a more desirable approach than the alternative, which would involve modifying the tariff-base in the A.3 fee-block. Currently the tariff-base is designed to capture the costs of prudential regulation of insurers, and it has changed a number of times already since N2.

5.18 The costs involved in ongoing supervision and regulation of intermediary activities are similar, whether they are being conducted by a pure intermediary or by an insurer itself. So, by paying fees in the A.19 fee-block, insurers who make direct sales and intermediaries will be charged fees on the same basis for their advising and arranging activities.

5.19 It is important to note that insurers should not pay higher fees simply as a result of being placed in two fee-blocks rather than one. On the basis of our original proposal, we would have had to allocate extra costs to the A.3 fee-block, to cover our work in regulating the advising and arranging activities of these insurers. We would then have adjusted the A.3 tariff-base so firms paid an appropriate share of those costs.

5.20 Instead these costs will now be accounted for in the A.19 fee-block, and insurers who advise and arrange will pay fees in that fee-block on a consistent basis with pure intermediaries. Leaving the A.3 tariff-base unchanged also means that insurers who do not carry out intermediary activities will not be affected by our proposals.

5.21 The proposals in paragraphs 5.3 to 5.13 explain why we need to adjust the 'simple' annual income calculation consulted on in CP180. This will make the income reported for application fees purposes in the A.19 fee-block properly comparable as between:

- pure intermediaries;

- insurers who act as intermediaries in a single entity; and
- intermediaries where our CP180 definition does not adequately capture their income from mediation.

5.22 Exactly the same arguments apply to the tariff-base that we propose using to set the A.19 fee-block periodic fees for these firms. So we propose to extend the CP180 proposal in the same way as we have for application fees. That is, the tariff-base for A.19 periodic fees will be as set out in Table 2 above.

### **Draft fee rules for consultation**

5.23 We have drafted the amendments we need to make to our application fee rules to give effect to the application fee proposals made in this chapter. The draft amendments proposed are detailed in Annex 3. We will produce draft rules for consultation to put in place our periodic fee proposals in due course.

5.24 Although our proposals will amend the framework of application fees rules in CP180 (see Annex 2 for an updated version of these proposals), the extra factors in these proposals ('Y' and 'Z' in Table 2) will be zero for pure intermediaries. So the method they will use to calculate their annual income for application fees purposes will not change.

Q4: Do you have any comments on the draft rules in Annex 3 as they apply to insurance firms?

# 6 Compatibility statement

6.1 When we issue proposals for consultation, we are required by s.155(2)(c) of the Financial Services and Markets Act 2000 (the ‘Act’) to explain why we believe our proposals are compatible with the general duties imposed on us by s.2 of the Act. This chapter of the CP fulfils this requirement.

## Cost-benefit analysis

6.2 In s.155(9) of the Act, rules on fees are exempted from the requirement to carry out cost-benefit analysis. These proposals refine the application fees regime for firms carrying out the activities to be regulated after N(M&GI) and relate to the expected expenditure on:

- preparing for and undertaking the authorisation process; and
- preparing – before N(M&GI) – to regulate firms after N(M&GI).

6.3 We set out details of this expected expenditure in Chapter 5 of CP180. The table below summarises the costs allocated to each of the three new fee-blocks:

**Table 3 – Allocation of our estimated costs to proposed fee-blocks (taken from CP180, Chapter 5.5.)**

	Fee-block			
Cost	A.2 (£m)	A.18 (£m)	A.19 (£m)	Total (£m)
Total	5	3	25	33

The application fees that we will make (which will be detailed in the feedback statement to CP180) will reflect the need to recover these costs.

6.4 We are continuing our work on refining firm population data and budget details, and will provide further information in September, when we feedback on CP180 and make the application fees themselves.

- 6.5 That feedback statement will also contain a revised compatibility statement, if necessary, to address changes from the CP180 proposals to the final rules made. Annex 2 of this paper includes near-final text with an explanation of the changes we expect to make.

### **Compatibility with our statutory objectives**

- 6.6 The draft rules on which we are consulting in this CP build on our earlier consultations on the general policy framework for our funding arrangements, and in particular the proposals in CP180, which set out the rules framework for application fees. So we believe that the current proposals are compatible with our general duties in section 2(3) of the Act.
- 6.7 In discharging our general duties, we are required to act in a way that is compatible with our four statutory objectives. As we have stated in previous consultations on fees, our fee-raising arrangements support each of our statutory objectives because they provide the resources that allow us to meet them. However, apart from funding our activities, we do not intend any of our funding arrangements in themselves to act as a means to achieve our statutory objectives.

### **Compatibility with the principles of good regulation**

- 6.8 In Annex 1 of CP180 we explained how our proposals for funding the mortgage and general insurance regime were influenced by the ‘have regard’ factors (also known as the ‘principles of good regulation’) in s.2(3) of the Act. Below we consider how our proposals in this CP take account of the principles of good regulation:

*The need to use our resources in the most efficient and economic way.*

The rules framework in CP180 included proposals on fee discounts to encourage firms to apply for authorisation early and by electronic means. Both of these methods will help us to use our resources for the authorisation process most effectively and so be more economic for fee payers. Our further proposals on application fees in Chapters 4 and 5 of this paper will also be subject to these discounts.

*The responsibilities of those who manage the affairs of authorised persons.*

Our proposals have no significant effect on this principle.

*The principle that a burden to be imposed should be proportionate to the benefits.*

To investigate whether the burden of a proposal is proportionate to the benefits that are expected to arise from its imposition, we normally use cost-

benefit analysis. However, rules made on fees are excluded from this requirement by s.155(9) of the Act.

In CP180 we considered the market impacts of the framework for application and periodic fees we were proposing, which is based on our general policy that:

- firms conducting similar types of authorised business are grouped into fee-blocks;
- costs that are attributable to regulating those firms are allocated to the respective fee-block; and
- appropriate volume of business measures are used to apply those costs to the firms in each block.

This framework ensures that proportionality is taken into account in our fee-raising policy, including the proposals in Chapters 4 and 5.

Those proposals are based on the application of weighting factors to the amount of business done, to generate a commission equivalent. The factors are set at a high level of aggregation so it is possible that they may impose disproportionate fee burdens on some firms (e.g. those that sell high proportions of low commission products). However, we are of the opinion that this will not be an issue of substance in practice, although we would welcome the views of respondents.

*The desirability of facilitating innovation in connection with regulated activities.*

Our proposals have no significant effect on this principle.

*The international character of financial services and the desirability of maintaining the competitive position of the UK.*

Our proposals have no significant effect on this principle.

*The need to minimise the adverse effects on competition that may arise from our proposals.*

Application fees that bear disproportionately heavily on sub-sets of firms can have adverse effects on competition. Our proposals in Chapters 4 and 5 address the issues peculiar to certain types of firms – for example, insurers and lenders who also mediate – so that their fees will reflect more appropriately the costs to us of authorising and regulating them, avoiding discrimination.

*The desirability of facilitating competition between those subject to our regulation.*

We seek to facilitate competition wherever possible. However, these proposals do not facilitate competition to a significant extent.

**'Most appropriate' method**

6.9 We believe that the fee arrangements for mortgage and general insurance firms proposed in this CP are the most appropriate means of raising the funding required to maintain our statutory objectives (as required by section 2(1)(b) of the Act) because they:

- are consistent with – and build upon – our current fee raising arrangements;
- are strongly influenced by the risk-based approach to achieving our statutory objectives that we have adopted; and
- are compatible with the legal framework provided by both the Act and our Handbook.

# Summary of questions asked in this consultation paper

Q1 (Chapter 4): Do you have any comments on the proposed factor of 0.5% for converting advances into an income measure for fees purposes?

Q2 (Chapter 4): Do you have any comments on the draft rules in Annex 3 as they apply to mortgage firms?

Q3 (Chapter 5): Do you have any comments on the proposed factor of 10% for converting premiums into an income measure for fees purposes?

Q4 (Chapter 5): Do you have any comments on the draft rules in Annex 3 as they apply to insurance firms?



# 'Near final' rules and guidance from CP180

The text that follows does not include made rules, or application fees or fee bands for firms undertaking the activities to be regulated from N(M&GI). It is an updated version of the framework of rules in CP180 for application fees.

It is included here to allow respondents to see how the proposals being consulted on in this paper (draft rules can be found in Annex 3) will fit into the revised framework that we plan to take forward.

We are not seeking further comments on this material and will issue full feedback – including any necessary revised compatibility statement – and made rules in September.

The 'near final' rules that follow differ from those in CP180 in several ways:

- a) As outlined in Chapter 5 of this paper, we believe it is appropriate that insurers who mediate should be allocated to the A.19 fee-block for their mediation activity. So the description of the A.19 activities has been amended to remove the exclusion of insurers.
- b) CP180 inserted the new application fee rules into the existing Annex 1 of Chapter 4 of the Authorisation manual. Annex 1 contains application fees for other regulated activities and is re-made in time for 1 April each year.

We have decided now to place the application fee rules for the newly regulated activities into a separate new Annex to AUTH 4, Annex 2. This will assist firms applying for permissions as:

- they will be able to identify more easily the provisions applicable to them; and
- Annex 2 will run from the period from when the application process opens, to when regulation of the new activities starts; so it will not have to be re-made for April 2004.

A number of consequential rule changes have had to be added to give effect to the new Annex.

- c) We have made clear that, in assessing income for application fees purposes, a firm must include income earned by any entity which will become its appointed representative after authorisation.
- d) We have updated the Glossary definitions and the activity group descriptions to include the latest definitions of 'insurance mediation activity' and 'mortgage mediation activity'.
- e) We have clarified the definition of 'electronic application'.
- f) We have clarified the language used in the notes to the application fees table.

Amend *AUTH* 4 as follows (underlining indicates new text and striking through deleted text):

4.1.5AG *AUTH* 4 Annex 2R contains details of the application fees payable by firms seeking to obtain *permission* to carry out any of the activities included in the A.2 (mortgage lenders and administrators), A.18 (mortgage advisers and arrangers) and A.19 (general insurance intermediaries) activity groups, for the period before these activities begin to be subject to regulation.

4.1.7G Except as set out in *AUTH* 4.1.7AG, Applications (and exercises of *Treaty rights*) are categorised by the *FSA* for the purpose of fee raising as complex, moderately complex and straightforward as identified in *AUTH* 4 Ann1R. This differentiation is based on the *permitted activities* sought and does not reflect the *FSA*'s risk assessment of the applicant (or *Treaty firm*).

4.1.7AG For the period before the activities are subject to regulation, applications for the A.2 (mortgage lenders and administrators), A.18 (mortgage advisers and arrangers) and A.19 (general insurance intermediaries) activity groups are categorised by the *FSA* for the purpose of fee raising using a measure of the amount of business being undertaken by the *person*, as detailed in *AUTH* 4 Ann 2R.

**4.2.1R** ***A person to whom this chapter applies must pay to the *FSA* an authorisation fee for each application made (or exercise of a *Treaty right*), as set out in *AUTH* 4 Annex 1R and *AUTH* 4 Annex 2R.***

**4.2.2R** ***In respect of a particular application (or exercise) the authorisation fee referred to in *AUTH* 4.2.1R is the highest of the tariffs set out in part 1 of *AUTH* 4 Annex 1R and part 2 of *AUTH* 4 Annex 2R which apply to that application (or exercise).***

After *AUTH* 4 Annex 1R, insert new Annex 2R:

**Authorisation fees payable in relation to the A.2 and A.18 activity groups up to and including 30 October 2004 and the A.19 activity group up to and including 13 January 2005**

Note: This annex specifies the application fees for *firms* seeking to apply for *Part IV permission*, or to vary their existing *Part IV permission*, in order to undertake any of the activities specified in the A.2, A.18 and A.19 activity groups (see Part 7 of *SUP* 20 Ann 1R for details of the activities).

For the *permitted activities* included in the A.2 and A.18 activity groups, regulation commences on 31 October 2004. Regulation commences on 14 January 2005 for the *permitted activities* included in the A.19 activity group.

The fee *rules* set out in this annex will apply from the beginning of the application period until regulation of these *permitted activities* commences. At that time, these *rules* will cease to have effect and application fees for these types of *permitted activities* will be dealt with alongside the other *authorisation* fees as part of *AUTH* 4 Annex 1R.

**1 Table Part 1 - Application periods R**

- 1 For the A.2 and A.18 activity groups, these rates apply up to and including 30 October 2004.**
- 2 For the A.19 activity group, these rates apply up to and including 13 January 2005.**

**2 Table Part 2 - Authorisation fees payable R**

Activity group	Amount payable				
	Fee bands	Fee - early applications	Fee - other applications	Discount - electronic applications	Discount - non-electronic applications paying by direct debit
A.2 Mortgage lenders and administrators	<b><u>Gross advances (£m)</u></b>	Fee (£)	Fee (£)	Fee (£)	Fee (£)
	[to be inserted later]	[to be inserted later]	[to be inserted later]	[to be inserted later]	[to be inserted later]
A.18 Mortgage advisers and arrangers; and A.19 General insurance intermediaries	<b><u>Annual income (£m)</u></b>	Fee (£)	Fee (£)	Fee (£)	Fee (£)
	[to be inserted later]	[to be inserted later]	[to be inserted later]	[to be inserted later]	[to be inserted later]

**Notes**

- (1) An early application is an application lodged:**
  - (a) for A.2 or A.18 applications, before 1 April 2004; and**
  - (b) for A.19 applications, before 1 June 2004.**
  
- (2) For the purposes of this table:**
  - (a) An electronic application is one submitted via the electronic facility provided by the FSA for these purposes.**
  - (b) Gross advances means the value of all new mortgage advances made (not the total mortgage balances outstanding) including loans for house purchase, remortgages, further advances and top-up loans, in the 12 months to 31 December 2003; PLUS the value of all new mortgages administered (not the total mortgage balances outstanding) including loans for house purchase, remortgages, further advances and top-up loans, in the 12 months to 31 December 2003, multiplied by 0.5.**

**Note:** For this purpose, a mortgage is a contract for a loan secured by a first charge over residential property in the *United Kingdom*.

- (c) Annual income means the net amount retained by the *firm* of all brokerages, fees, commissions and other related income (e.g. administration charges, overrides, profit shares) due to the *firm* in respect of or in relation to:

(i) activities which would be *mortgage mediation activity* if they had been carried out after 30 October 2004; PLUS

(ii) activities which would be *insurance mediation activity* if they had been carried out after 13 January 2005;

earned in its latest financial year ending on or before 31 December 2003.

The *firm* must include in its income calculation, on the same basis as above, earnings from those who will become its *appointed representatives* after *authorisation*.

### 3 Table Part 3 - Activity Groupings R

3 The activity group definitions are set out in *SUP 20 Annex 1R*.

Amend *SUP 6.3.22R* as follows (underlining indicates new text and striking through deleted text):

6.3.22R If a *firm* applies for a variation of its *Part IV permission*, it must pay the fee specified in Part 3 of *AUTH 4 Annex 1R* in either of the following cases:

(1) if the variation is granted, the business of the *firm* will fall within one or more fee blocksactivity groups specified in ~~Part 5 of *AUTH 4 Annex 1R*~~Part 7 of *SUP 20 Annex 1R* not applicable before the grant of the variation; or

(2) any other circumstances specified in Part 3 of *AUTH 4 Annex 1R* apply.

Amend *SUP 20 Annex 1R* as follows (underlining indicates new text):

### 5 Table

Activity group (defined in Part 7)	Valuation date for tariff bases (defined in Part 7)	Fee payable (tariff bases defined in Part 7)
A.1 Deposit acceptors	...	...
<u>A.2 Mortgage lenders and administrators</u>	<u>[Not applicable for the 2003/04 period]</u>	<u>[Not applicable for the 2003/04 period]</u>
...		
<u>A.18 Mortgage advisers and</u>	<u>[Not applicable for the</u>	<u>[Not applicable for the</u>

<u>arrangers</u>	<u>2003/04 period]</u>	<u>2003/04 period]</u>
<u>A.19 General insurance intermediaries</u>	<u>[Not applicable for the 2003/04 period]</u>	<u>[Not applicable for the 2003/04 period]</u>
<b>B Firms</b> that have been prescribed as an operator of a prescribed market under the Financial Services and Markets Act 2000 (Prescribed Markets and Qualifying Investments) Order 2001, SI 2001/996.	...	...

Part 7 - Activity groups and tariff bases

15 Table

Activity group	Fee-payer falls in the activity group if	Tariff-base
<b>A.1 Deposit acceptors</b>	...	...
<u>A.2 Mortgage lenders and administrators</u>	<u>its permission includes one or more of the following:</u> <ul style="list-style-type: none"> <li>• <u>entering into a regulated mortgage contract;</u> <u>or</u></li> <li>• <u>administering a regulated mortgage contract;</u> <u>or</u></li> <li>• <u>agreeing to carry on a regulated activity which is within either of the above.</u></li> </ul>	<u>[Not applicable for the 2003/04 period]</u>
...		
<u>A.18 Mortgage advisers and arrangers</u>	<u>its permission includes one or more of the following:</u> <ul style="list-style-type: none"> <li>• <u>arranging (bringing about) regulated mortgage contracts;</u> <u>or</u></li> <li>• <u>making arrangements with a view to regulated mortgage contracts;</u> <u>or</u></li> <li>• <u>advising on regulated mortgage contracts;</u> <u>or</u></li> <li>• <u>agreeing to carry on a regulated activity which is within either of the above.</u></li> </ul>	<u>[Not applicable for the 2003/04 period]</u>
<u>A.19 General insurance intermediaries</u>	<u>its permission includes one or more of the following in relation to a general insurance contract or a pure protection contract:</u> <ul style="list-style-type: none"> <li>• <u>dealing in investments as agent;</u> <u>or</u></li> <li>• <u>arranging (bringing about) deals in investments;</u> <u>or</u></li> <li>• <u>making arrangements with a view to transactions in investments;</u> <u>or</u></li> <li>• <u>assisting in the administration and performance of a contract of insurance;</u> <u>or</u></li> </ul>	<u>[Not applicable for the 2003/04 period]</u>

	<ul style="list-style-type: none"> <li>• <u>advising on investments; or</u></li> <li>• <u>agreeing to carry on a regulated activity which is within any of the above.</u></li> </ul>	
<b>B</b>	...	...

Amend the Glossary by inserting the following two new definitions at the appropriate place:

<b>Defined expression</b>	<b>Definition</b>
<i>insurance mediation activity</i>	<p>any of the following <i>regulated activities</i>, which is carried on in relation to a <i>contract of insurance</i>:</p> <ul style="list-style-type: none"> <li>(a) <i>dealing in investments as agent</i> (article 21);</li> <li>(b) <i>arranging (bringing about) deals in investments</i> (article 25(1));</li> <li>(c) <i>making arrangements with a view to transactions in investments</i> (article 25(2));</li> <li>(d) <i>assisting in the administration and performance of a contract of insurance</i> (article 39A);</li> <li>(e) <i>advising on investments</i> (article 53);</li> <li>(f) <i>agreeing to carry on a regulated activity</i> in (a) to (e) (article 64).</li> </ul>
<i>mortgage mediation activity</i>	<p>any of the following <i>regulated activities</i>:</p> <ul style="list-style-type: none"> <li>(a) <i>arranging (bringing about) regulated mortgage contracts</i> (article 25A(1));</li> <li>(b) <i>making arrangements with a view to regulated mortgage contracts</i> (article 25A(2));</li> <li>(c) <i>advising on regulated mortgage contracts</i> (article 53A);</li> <li>(d) <i>agreeing to carry on a regulated activity</i> in (a) to (c) (article 64).</li> </ul>



# Draft rules for consultation

We would make these rules by exercising the following powers and related provisions in the Financial Services and Markets Act 2000:

- (1) section 156 (General supplementary powers);
- (2) section 157(1) (Guidance); and
- (3) paragraph 17(1) of Schedule 1 (Fees).

In this Annex, underlining indicates new text and striking through indicates deleted text.

In Part 2 (Authorisation fees payable) of *AUTH* 4 Ann 2R, amend Note 2 as follows:

**(2) For the purposes of this table**

...

**(c) Annual income means:**

**(i) the net amount retained by the *firm* of all brokerages, fees, commissions and other related income (e.g. administration charges, overrides, profit shares) due to the *firm* in respect of or in relation to:**

**(i)(aa) activities which would be *mortgage mediation activity* if they had been carried out after 30 October 2004; PLUS**

**(i)(ab) activities which would be *insurance mediation activity* if they had been carried out after 13 January 2005;**

**earned infor its latest financial year ending on or before 31 December 2003-;**

**PLUS**

**(ii) in relation to the activities set out in (i)(aa):**

**(aa) if the *firm* is a mortgage lender, the value of all new mortgage advances made by the *firm* multiplied by 0.005; PLUS**

**(ab) for any *mortgage mediation activity* carried out by the *firm* for which it receives payment from the lender on a basis other than that in (i), the value of mortgage loan advances resulting from that *mortgage mediation activity* multiplied by 0.005;**

**Note: For this purpose, a mortgage is a contract for a loan secured by a first charge over residential property in the *United Kingdom*;**

**for its latest financial year ending on or before 31 December 2003;**

**PLUS**

**(iii) in relation to the activities set out in (i)(ab):**

**(aa) if the *firm* is an *insurer*, the gross premiums receivable by the *firm* multiplied by 0.10; PLUS**

**(ab) for any *insurance mediation activity* carried out by the *firm* for which it receives payment from the *insurer* on a basis other than that in (i), the value of the gross premiums receivable on the *contracts of insurance* resulting from that *insurance mediation activity* multiplied by 0.10;**

**for its latest financial year ending on or before 31 December 2003.**

The *firm* must include in its income calculation, on the same basis as above, earnings from those who will become its *appointed representatives* after *authorisation*.



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