COBS 6 Annex 5 G

Calculation of a maximum rate of commission

1. The net present value of each *commission* (or *equivalent*) rate may be calculated by adopting the method set out in the worked example below, used in conjunction with tables of sample net present value factors issued by the *FSA*. These factors will be calculated using the assumptions set out in paragraphs 8 to 12 of *COBS* 6 Annex 4G.

Worked Example of Commission Disclosure in a *menu*

2. For the purposes of the following worked example four variations of *commission* (or *equivalent*) are shown for an investment bond. The market averages and NPV factors are purely illustrative.

A *firm* has commission arrangements for the sale of investment bonds with five *product providers* involving all four variations. The *firm* retains all commissions from each provider. The arrangements are:

	Provider Commission		
Provider	Initial	% of fund value	Fund based start month
1	5.25%	-	-
2	4.5%	-	-
3	-	0.75%	13
4	3.0%	0.5%	1
5	3.5%	0.25%	1

Stage 1 - Comparison of net present value

The *firm* has to decide which provider pays "our maximum". The test is to calculate the net present value of the different commissions using the assumptions prescribed by the *FSA*.
To do this, the method in form 1b below is used. The *firm* needs to look up the table of NPV factors which shall be made available by the *FSA*. Looking these up, and completing the form as follows gives:

Product group	**Investment Bonds**						
	Initial Commission			**Fund Based Renewal / Trail Commission**			**Total NPV**
	Commission Rate	**NPV Factor**	**Value = Rate x Factor**	**Commission Rate (& Start Month)**	**NPV Factor**	**Value= Rate x Factor**	
	A	B	C = A x B	J	K	L = J x K	M = C + L
1	5.25%	1.00	5.25%	-	-	-	5.25%
2	4.5%	1.00	4.5%	-	-	-	4.5%
3	-	1.00	-	0.75% from month 13	3.997	2.98%	2.98%
4	3.0%	1.00	3.0%	0.5% from month 1	4.943	2.47%	5.47%

5	3.5%	1.00	3.5%	0.25% from month 1	4.943	1.24%	4.74%

So commission shape 4 has the highest net present value and is thus "our maximum".

Stage 2 – Worked example
An example is calculated by applying "our maximum" rates to the prescribed lump sum or monthly amounts. £10000 in this case gives "£300 immediately plus £50 each year from year 1".

Stage 3 – Market Average
"The market average" is the market average rate published by the *FSA* expressed in the shape that most corresponds to the shape of "our maximum". To do this, the method used in form 2 below is used. The *firm* needs to look up the table of NPV factors and the table of market average NPVs prescribed by the *FSA*. Looking these up, and completing the form as follows gives:

Form 1 (Worked Example)

Product group		Investment Bond						
Market Average NPV		5.0%						
		Fund Based Renewal / Trail Commission		**Premium Based Renewal Commission**		**Spread initial / Non-Indemnified Commission**		**Initial / Indemnified Commission**
		Commission rate	**Start month**	**Commission rate**	**Start month**	**Commission rate**	**Spread period**	**Commission rate**
Commission Shape of your maximum	**A**	0.5%	Month 1	-	-	-	-	3.0%
NPV Factor	**B**	4.943		-		-		1.000
Value of Commission Shape	**C = A x B**	2.47%		-		-		3.0%
Value of market average - Fund Based Commission	**D1 – see notes**	2.47%						
Value of market average – Premium Based Commission	**D2 – see notes**			-				
Value of market average - Spread Initial Commission	**D3 – see notes**					-		
Value of market average - Initial Commission	**D4 – see notes**							5.0% - 2.47% = 2.53%
Market Average Commission Shape	**E = D ÷ B**	2.47% / 4.943 = 0.5% from month 1		-		-		2.53% / 1.000 = 2.5%

Therefore the market average, expressed in the shape that most closely resembles "our maximum" is 2.5% of the lump sum plus 0.5% of the fund from month 1

Stage 4
Enter the appropriate figures in the *menu* as shown below.

Lump sum products	Example term or age	Comparison of costs		Example based on £10,000 lump sum
		Our maximum	*Market average*	*This shows the maximum costs of our sales and advice for a lump sum investment of £10,000 ignoring any changes to fund value*
Savings and investments				
Investment bond	Any	**3.0%** of the amount you invest plus **0.5%** of your fund value each year from year 1	**2.5%** of the amount you invest plus **0.5%** of your fund value each year from year 1	**£300** in year 1 plus **£50** each year from year 1 (The actual amount will vary in line with your fund

Form 1a – Calculation of Maximum Commission Amounts (Monthly Premium Products)

This form should be used to help decide which of the commission options received for a product group in the "monthly products" table should appear as "our maximum" on the *menu*.

Product group													
	Initial / Indemnified Commission			**Spread Initial Commission**			**Premium Based Renewal Commission**			**Fund Based Renewal / Trail Commission**			**Total NPV**
	Commission Rate	**NPV Factor**	**Value = Rate x Factor**	**Commission Rate (& Spread Period)**	**NPV Factor**	**Value= Rate x Factor**	**Commission Rate (& Start Month)**	**NPV Factor**	**Value= Rate x Factor**	**Commission Rate (& Start Month)**	**NPV Factor**	**Value= Rate x Factor**	
	A	B	C = A x B	D	E	F = D x E	G	H	I = G x H	J	K	L = J x K	M = C + F + I + L
1		*1.00*											
2		*1.00*											
3		*1.00*											
4		*1.00*											
5		*1.00*											
6		*1.00*											
7		*1.00*											
8		*1.00*											

The maximum rate of commission for this product group is the shape with the highest Total NPV (column M).
This maximum rate of commission should be included in the menu for this product group

Notes for completion of Form 1a

1. A separate form should be completed for all monthly product groupings appearing on the *menu*.

2. Complete a separate row for each potential maximum commission shape that you receive in the chosen product group.

3. Commission shapes that are clearly lower in value than others of the same shape should be omitted – for example, 15% initial + 0.5% fund based paid from month 12 is clearly lower than 20% initial + 0.5% fund based paid from month 12, and so only the latter needs to be included in the calculations.

4. Commission rates used should be the highest rates of the total commission payable that you may retain;

5. Commission rates should be entered for each commission type as follows:

    - Column A (Initial/Indemnified) - a percentage of the first 12 months' premiums;
    - Column D (Spread Initial/Non-Indemnified Initial) – a percentage of each premium paid in the initial commission period;
    - Column I (Premium based renewal) – a percentage of each premium paid in the renewal period;
    - Column L (Fund Based renewal/trail) – a percentage of the fund value each year.

6. Level commissions, payable as a percentage of all monthly premiums, should be treated as premium-based renewal commissions.

7. The relevant NPV Factors in columns B, E, H & K should be inserted for the relevant Product Group, Commission Type, Spread Period and Start Month. They can be obtained from the document "Published NPV Factors".

8. Columns C, F, I, L & M should be calculated based on the figures inserted in the previous columns.

9. The commission shape which has the highest total NPV in column M should be used in the "Our Maximum" section of the *menu*.

Form 1b – Calculation of Maximum Commission Amounts (Lump Sum Products)

This form should be used to help decide which of the commission options received for a product group in the "lump sum products" table should appear as "our maximum" on the *menu*.

Product group							
	Initial Commission			**Fund Based Renewal / Trail Commission**			**Total NPV**
	Commission Rate	**NPV Factor**	**Value = Rate x Factor**	**Commission Rate (& Start Month)**	**NPV Factor**	**Value= Rate x Factor**	
	A	B	C = A x B	J	K	L = J x K	M = C + L
		1.00					
2		*1.00*					
3		*1.00*					
4		*1.00*					
5		*1.00*					
6		*1.00*					
7		*1.00*					
8		*1.00*					

The maximum rate of commission for this product group is the shape with the highest Total NPV (column M).
This maximum rate of commission should be included in the menu for this product group

Notes for completion of Form 1b

1. A separate form should be completed for all lump sum products appearing on the *menu*.

2. Complete a separate row for each potential maximum commission shape that you receive in the chosen product group.

3. Commission shapes that are clearly lower in value than others of the same shape should be omitted – for example, 15% initial + 0.5% fund based paid from month 12 is clearly lower than 20% initial + 0.5% fund based paid from month 12, and so only the latter needs to be included in the calculations.

4. Commission rates used should be the highest rates of the total commission payable that you may retain.

5. Commission rates should be entered for each commission type as follows:

   - Column A (Initial) - a percentage of the lump sum payment;
   - Column J (Fund Based renewal/trail) – a percentage of the fund value each year.

6. The relevant NPV Factors in columns B & K should be inserted for the relevant Product Group, Commission Type and Start Month. They can be viewed in the document "Published NPV Factors".

7. Columns C, L & M should be calculated based on the figures inserted in the previous columns.

8. The commission shape which has the highest total NPV in column M should be used in the "Our Maximum" section of the *menu*.

Form 2 – Re-expression of market average commission

This form should be used to re-express the market average NPV into the relevant shape, for use in the *menu*.

Product group								
Market Average NPV								
		Fund Based Renewal / Trail Commission		**Premium Based Renewal Commission**		**Spread initial / Non-Indemnified Commission**		**Initial / Indemnified Commission**
		Commission rate	**Start month**	**Commission rate**	**Start month**	**Commission rate**	**Spread period**	**Commission rate**
Commission Shape of your maximum	**A**							
NPV Factor	**B**							
Value of Commission Shape	**C = A x B**							
Value of market average - Fund Based Commission	**D1 – see notes**							
Value of market average – Premium Based Commission	**D2 – see notes**							
Value of market average - Spread Initial Commission	**D3 – see notes**							
Value of market average - Initial Commission	**D4 – see notes**							
Market Average Commission Shape	**E = D ÷ B**							

Notes for completion of Form 2

1. A separate form should be completed for each product group appearing on your *menu*;

2. The Market Average NPV should be obtained from the FSA's most recent published list of market averages, choosing the appropriate rate for the relevant product group.

3. In row A, enter the details of the commission shape that the market average is to be expressed in. This should be the commission shape shown as "your maximum" for the relevant product group in your *menu*.

4. Commission rates should be entered for each commission type as follows:

   - Fund Based renewal/trail – a percentage of the fund value each year;
   - Premium based renewal – a percentage of each premium paid in the renewal period;
   - Spread Initial/Non-Indemnified Initial – a percentage of each premium paid in the initial commission period;
   - Initial/Indemnified - a percentage of the first 12 months' premiums, or a percentage of the lump sum, as appropriate.

5. Level commissions, payable as a percentage of all monthly premiums, should be treated as premium-based renewal commissions.

6. Where "your maximum" commission does not contain a commission type (e.g. your maximum has no spread initial commission), the column relating to that commission type should be left blank.

7. The relevant NPV Factors in row B should be inserted for the relevant Product Group, Commission Type, Spread Period and Start Month. They can be obtained from the document "Published NPV Factors".

8. Row C should be calculated as the product of the relevant commission rate in row A and the NPV factor in row B.

9. Row D1 should be calculated as the lower of:

   - the Market Average NPV, and
   - Row C - The Value of Commission Shape for the **fund based commission** type (but see the note below)

Note: If the commission shape in row A contains no premium-based, spread initial or initial/indemnified commission (i.e. if fund based commission is the final commission type being considered) then the calculation in row C should be ignored when calculating D1. In this instance, the value in D1 should be equal to:

- the Market Average NPV

10. Row D2 should be calculated as the lower of:

- The Market Average NPV minus the value calculated for row D1; and
- Row C – The Value of Commission Shape for the **premium based commission** type (but see note below).

If this calculation gives a negative value, D2 should be set to zero.

Note: If the commission shape in row A contains no spread initial or initial/indemnified commission (i.e. if premium-based commission is the final commission type being considered) then the calculation in row C should be ignored when calculating D2. In this instance, the value in D2 should be equal to:

- The Market Average NPV minus the value calculated for row D1.

11. Row D3 should be calculated as the lower of:

- The Market Average NPV minus the value calculated for row D1,
  minus the value calculated for row D2, and
- Row C – The Value of Commission Shape for the **spread initial / non-indemnified commission** type (but see note below).

If this calculation gives a negative value, D2 should be set to zero.

Note: If the commission shape in row A contains no initial/indemnified commission (i.e. if premium-based commission is the final commission type being considered) then the calculation in row C should be ignored when calculating D3. In this instance, the value in D3 should be equal to:

- The Market Average NPV minus the value calculated for row D1,
  minus the value calculated for row D2.

12. Row D4 should be calculated as:

    - The Market Average NPV <u>minus</u> the value calculated for row D1,
      <u>minus</u> the value calculated for row D2,
      <u>minus</u> the value calculated for row D3.

    If this calculation gives a negative value, D4 should be set to zero.

13. Row E should be calculated as the value in the relevant row D (for that commission type, e.g. row D2 for premium based renewal commission) <u>divided by</u> the relevant NPV factor in row B. For presentation in the *menu*, this result should be rounded to the nearest 0.1% (or the nearest 0.25%, if fund-based commission is paid as an exact multiple of this).