

Chapter 6

Information about the firm, its
services and remuneration

Calculating commission equivalent

This table forms part of ■ COBS 6.4.6 E.

Calculating commission equivalent

This table sets out the basis on which the *firm* should determine the value of cash payments, benefits and services to be disclosed as *commission equivalent*. Benefits and services, as set out in parts B and C below, need be included only if their value is such that they could not be provided to a *firm* as a non-monetary benefit listed in the table in COBS 2.3.15 G. The result of the calculation should be that the amounts disclosed as *commission equivalent* are, as far as possible, the same as the amounts and value of *commission* which would be paid in a corresponding sale.

Part A: Cash payments

1. These cover all payments by a *firm* to a *representative*, *appointed representative* or, where applicable, a *tied agent*, or a *firm* in the same *immediate group* in relation to a transaction in a *packaged product*. This includes bonus payments, manager's overrides, extra earnings from other transactions and other payments conditional on amounts of new business.
2. In determining the amounts to be included in the calculation, a *firm* should have regard to the following:
 - (a) when the precise rate of *commission equivalent* is not known in advance (for example, if retrospective volume overrides apply), the *firm* should estimate the rate likely to apply to the *representative* in question. When an identical *commission equivalent* scale applies to all *representatives* (although they might earn differing percentages of it), the same average amount of *commission equivalent* (and the value of other benefits and services) in respect of identical transactions may be disclosed, regardless of the percentage of the scale paid to each individual *representative*. Averaging should not be used for *appointed representatives*, or, where applicable, *tied agents*.
 - (b) all credits to an account from which periodic withdrawals may be made should be included.
 - (c) when a payment is made before the *firm* receives the *premium* or the investment monies to which it relates (for example, indemnity *commission equivalent*), it should be included as being received at the time of payment. *Firms* that wish to explain this arrangement to the *clients* are free to do so, provided this does not detract from the required disclosure.
 - (d) when the *firm* arranges for a third party to make a payment to a *representative* in exchange for the income stream to which the *representative* is entitled, or to make a loan to the *representative* on the security or expectation of future payments from the *firm*, this should be treated as if it were a payment from the *firm* at the time of the transaction.
 - (e) when a *firm* provides, or arranges for a third party to provide, a loan to a *representative*, on the security of, or in the expectation of, future payments from the *firm*, the amounts to be included are the payments to the *representative* on which the provision of the loan is based, as if they were received at the time the transaction was effected, irrespective of their actual timing.

Calculating commission equivalent

- (f) when an agent is employed and remunerated by the *firm's appointed representative*, or, where applicable, *tied agent*, the payments to be included should be those made by the *firm* to the *appointed representative* or *tied agent*, not those made by the *appointed representative* or *tied agent* to its own agent.

Part B: Benefits

3. Benefits include the cost to the *firm* of all non-monetary benefits provided by it to a *representative*. A benefit should be included whether or not the *representative* is liable to income tax on it and whether it is chargeable to tax. Examples of benefits include the use of a car, attendance at conferences, subsidised loans, contributions to *pension schemes*, national insurance contributions, and the value of *share option* (taking into account any discount on issue and assuming that the *shares* in question grow at a reasonable rate in line with other *investments*).

Part C: Services

4. Services include benefits which are not indirect benefits within the table in COBS 2.3.15 G.
5. The following services should be included:
- (a) office accommodation and equipment, including telephone, photocopying and fax;
 - (b) loans where a commercial rate of interest is not charged, including *commission equivalent* advances overdue for repayment;
 - (c) general stationery and mailing or distribution costs;
 - (d) computer hardware and software (except software which specifically relates to the *firm's packaged product*, such as software used for producing illustrations, *projection* and product information);
 - (e) clerical and administrative support;
 - (f) business insurance cover, including professional indemnity and fidelity guarantee;
 - (g) recruitment;
 - (h) compliance monitoring;
 - (i) *client services*;
 - (j) business planning services;
 - (k) line management.
6. To put a value on these services, the following costs should be included:
- (a) all overheads attributable to a particular cost item (for example, the cost of a compliance official);
 - (b) salary costs pro rata if individuals are only engaged part-time on relevant business;
 - (c) rent and associated premises costs at an appropriately reduced rate if the premises are also used for other business activities;
 - (d) only that proportion of the cost of lead generation promotions attributable to the generation of relevant business (but including the placing of any *financial promotion*, and its mailing or provision of access to third party *clients*);
 - (e) only the marginal additional compliance costs of ensuring that *representatives* and their support and training material comply with relevant *rules*;
 - (f) the commercial value of a service which is the use of an asset owned by the *firm* (for example in the case of a property, its full market rent);

Calculating commission equivalent

- (g) in respect of *appointed representative*, or, where applicable *tied agent*, the costs of any promotion in a newspaper or elsewhere and the provision of *representative-specific* literature in connection with a *financial promotion*;
 - (h) in respect of a *firm* in the same *immediate group* and connected *appointed representatives* or, where applicable, *tied agents*, where the name of the company is included in the *financial promotion*, the costs of any promotion in a newspaper or elsewhere and the provision of literature specific to the *representative* in connection with a *financial promotion*.
7. The following costs should be excluded:
- (a) the cost of corporate awareness advertising;
 - (b) training costs;
 - (c) costs of developing and maintaining computer systems for the provision of *projections* of benefits, *client-specific key features documents* or other product information; or other product information;
 - (d) costs of compensating *clients*;
 - (e) the costs of head office and branch level management and support, other than payments to *managers* falling under Part 1, for *representatives*, if these services could also be provided to a *firm* not in the same *immediate group*, for example, broker consultants and 'inspectors'.
- Part D: Calculation methodology
8. Estimating commission equivalent
- The cost of benefits and services should normally be based on the most recent relevant experience of the *firm*, except if the *firm* has grounds to believe that the *commission equivalent* for the period concerned will be higher or lower than that implied by the experience or no such experience is available. In such a case, the estimate should be based on and evidenced by business plans which the *firm* is satisfied are achievable.
9. *Firms* that receive or expect to receive:
- (a) *commission* in respect of *packaged products* which are not its own products or the products of a *product provider* who is in the same *immediate group*; and
 - (b) *commission equivalent* in respect of its own products;
- must ensure that the costs and benefits attributed to these products do not exceed the amounts that can be financed from that *commission*.
- Construction of commission equivalent scales
10. The total costs of cash payments, benefits and services should be assessed and the normal approach is to split them into new business costs and after sale servicing costs. The costs of each of these functions should be assessed directly in relation to the work carried out by the *representatives*.
11. (a) The total *commission equivalent* costs identified in 10 should be spread across the business using a new business *commission equivalent* scale and a servicing *commission equivalent* scale respectively.
- (b) The *commission equivalent* scales should distinguish between products for which the *commission equivalent* of *representatives* is likely to be different.
12. If the *representative's commission equivalent* includes a cash payment related to volume and/or value of the transactions sold (which payment must be in accordance with the *client's best interest rule*), the following method would be appropriate:

Calculating commission equivalent

- (a) The payment scales should be grossed up by new business uplift factors or servicing uplift factors as appropriate to reflect the cost of benefits and services. The grossed up scales represent the new business and servicing *commission equivalent* scales, and are applied to each contract to derive the *commission equivalent* to be disclosed.
 - (b) If servicing costs are expected to be incurred in any year in which no servicing payments are to be made on a contract, disclosure should still be made, for example by using a technique similar to that described in 14.
13.
 - (a) When a *representative* receives a salary, or other payment unrelated to volume or sales:
 - (i) this should be amalgamated with the cost of benefits and services; and
 - (ii) the total costs should be apportioned over individual transactions in a way that reflects the value of a contract to a *firm* or the *firm's immediate group*.
 - (b) If a *firm* is a distributor for a *product provider* within the same *immediate group*, the *firm* must apportion total costs over individual transactions in a way that reflects the value of the contract to the *firm's immediate group*.
14. If a *representative* agrees to forgo part of his or her normal payment to improve the terms of the contract, the disclosure may be reduced in such a way that fairly reflects the overall effect of the amount foregone.
15. The *firm* should review the *commission equivalent* scales if at any time it becomes aware that the *commission equivalent* figures have become misleading. A review should take place at least annually.

Payments to associates
16. If a *firm* pays *commission equivalent* to another *firm* in the same *immediate group*, or an *appointed representative* or, where applicable *tied agent*, which is an *associate* of the *firm*, it should ensure that the calculation of the sum to be disclosed is the higher of:
 - (a) all payments, benefits and services provided to the *firm* or *appointed representative* or *tied agent*, from whatever source, plus an additional allowance for profit of 15% - unless the *firm* can demonstrate that another figure (higher or lower) is more appropriate; and
 - (b) the cash payments actually paid by the *firm*, plus the value of services provided.