



**FINANCIAL  
SERVICES  
BOARD**

**Retail  
Distribution  
Review  
2014**





This paper outlines the results of the Retail Distribution Review (RDR) carried out by the Financial Services Board (FSB) and proposes far-reaching reforms to the regulatory framework for distributing retail financial products to customers in South Africa.

The review was undertaken in response to the fact that, despite the significant progress achieved through the Financial Advisory and Intermediary Services (FAIS) Act in raising intermediary professionalism, improving disclosure to clients and mitigating certain conflicts of interest, significant concerns about poor customer outcomes and mis-selling of financial products remain.

This paper outlines a number of key risks inherent in the current distribution landscape, including distribution relationships and intermediary remuneration models that contribute to poor outcomes and mis-selling, and puts forward a number of proposals aimed at addressing these risks. The review outlines a more proactive and interventionist regulatory approach; it proposes a shift away from a purely rules-based compliance approach to one that also sees the introduction of a set of structural interventions designed to change incentives, relationships and business models in the market in a way that supports the consistent delivery of fair outcomes to customers.

Key structural changes include placing greater responsibility on product suppliers for ensuring the delivery of fair customer outcomes through their chosen distribution channel; limitations on the types of remuneration that intermediaries can earn and from whom, designed to address conflicts of interest; and enabling customers to understand and compare the nature, value and cost of advice and other services that intermediaries provide. These changes should also support the development of more competitive markets and the development of more transparent and fair products.

The RDR proposals seek to give retail customers confidence in the retail financial services market and trust that product suppliers and advisers will treat them fairly. This in turn will support a more sustainable market for financial advice and financial services over the longer term.

## Background and objectives

The review has been undertaken against the background of a new approach to regulating market conduct in the financial sector. Under a "Twin Peaks" approach, that will separate prudential and market conduct regulation of the sector, market conduct regulation and supervision is informed by the *Treating Customers Fairly* (TCF) framework.

The TCF approach focuses on the extent to which regulated financial institutions deliver fair outcomes for financial customers and entails a more proactive and interventionist approach by regulators and policymakers to dealing with market failures. The RDR is a prominent example of this new approach.

The paper advocates a consistent cross-sectoral approach to regulating the distribution of financial products. The primary aim of the RDR is to ensure that financial products are distributed in ways that support the delivery of TCF outcomes.

Desired outcomes of the RDR are distribution models that:

- Support the delivery of suitable products and provide fair access to suitable advice for financial customers
- Enable customers to understand and compare the nature, value and cost of advice and other services intermediaries provide
- Enhance standards of professionalism in financial advice and intermediary services to build consumer confidence and trust
- Enable customers and distributors to benefit from fair competition for quality advice and intermediary services, at a price more closely aligned with the nature and quality of the service, and
- Support sustainable business models for financial advice that enable adviser businesses to viably deliver fair customer outcomes over the long term.

The findings and proposals in the paper build on a series of South African financial sector regulatory and policy developments. The proposals take cognisance of international developments, but are tailored to local circumstances – in particular, the proposals:

- Build on the strong foundation already provided by the FAIS Act in terms of intermediary professionalism, disclosure to clients and mitigating certain conflicts of interest.
- Give special attention to achieving fair outcomes for low-income customers, through enabling distribution models that support financial inclusion combined with other measures to ensure that products marketed and sold are suitable and offer adequate value, including targeted product standards.

## Structure of this paper

Chapter 1 outlines the context, scope and objectives of the RDR.

Chapter 2 describes the current financial services distribution landscape in South Africa, which is characterised by a wide and complex range of distribution models. The paper describes the current distribution landscape from three perspectives: Types of service provided by intermediaries; types of relationships between intermediaries and product suppliers; and types of remuneration earned for the services concerned.

Chapter 3 outlines risks and benefits of the current distribution landscape. It highlights that aspects of the current distribution landscape pose risks not only to fair customer outcomes, but also to intermediary sustainability and supervisory effectiveness.

Chapter 4 sets out a range of specific regulatory policy proposals to meet the desired RDR outcomes. A total of 55 specific proposals is put forward for discussion and comment. The proposals aim to rationalise

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the complex distribution landscape outlined in the paper, to address the various risks the paper highlights. The proposals are grouped around:

- The types of services provided by intermediaries to customers and product suppliers respectively, proposing an activity-based approach to categorising these services.
- Rationalisation of the range of relationships between product suppliers and intermediaries. Proposals under this heading also address the responsibility of product suppliers for advice and intermediary/outsourced services provided.
- The types of intermediary remuneration models that should apply to the revised sets of services and relationships proposed, including measures to deal with conflicts of interest in the provision of financial advice.

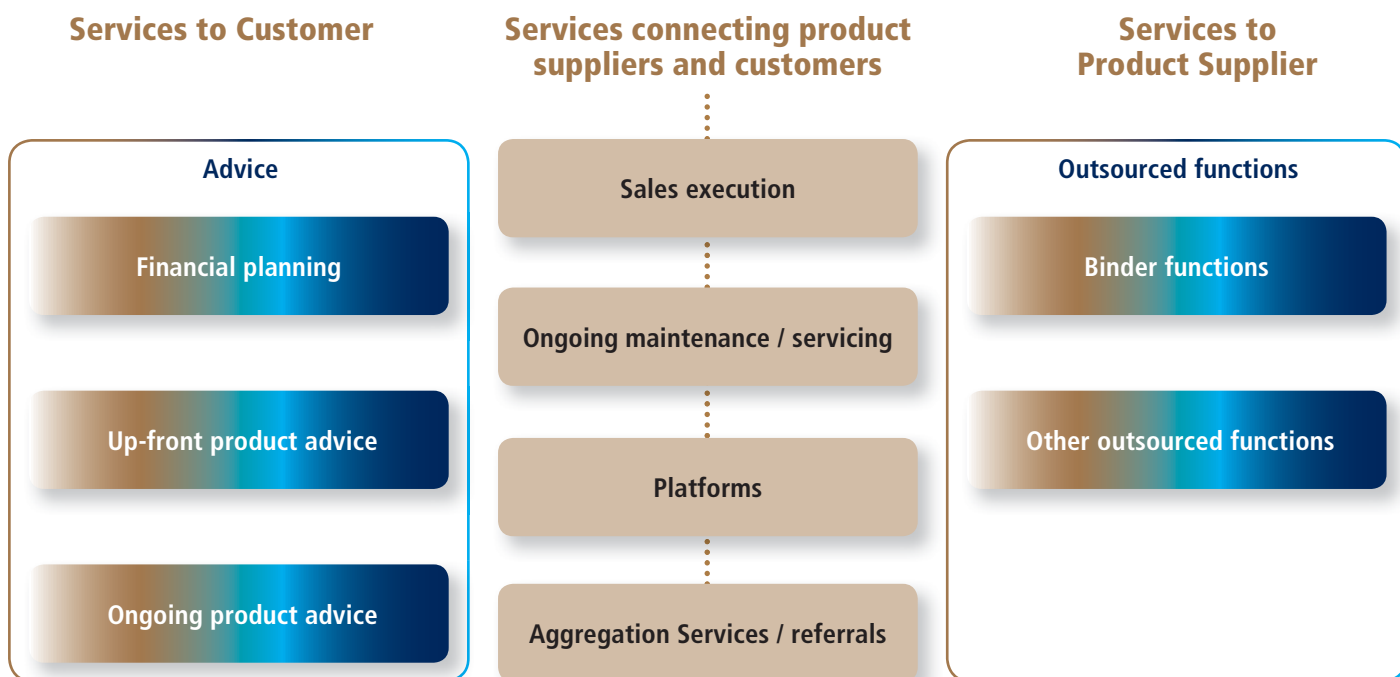
Chapter 5 outlines the implications for the regulatory framework in order to give effect to these proposals. The changes will be implemented in a phased manner; some changes will be carried out within the current regulatory framework, while other changes will be implemented as the Twin Peaks legislative framework evolves.

Lastly, Chapter 6 provides some concluding comments and maps out the way forward, including some comments on transitional measures.

### ***Proposals relating to types of services provided by intermediaries:***

These proposals aim to clarify which services are provided to which party and what capacity an adviser or intermediary acts in when performing these activities. A clear understanding of what constitutes financial advice and intermediary services respectively, through a consistent set of definitions in the regulatory framework, will facilitate compliance and support a level-playing field for competing service and product offerings. Customers will also be in a better position to assess and select the types of services available to them, and the cost and value of those services.

An activity-based approach to defining advice (a service to the customer), intermediary services (services connecting product suppliers and customers) and other services provided by advisers and intermediaries (services to product suppliers) is proposed. The following diagram illustrates this activity-based approach:



- Three forms of advice will be defined: Financial planning, up-front product advice, and ongoing product advice
- Standards will be set for distribution models that do not include advice (described as "non-advice sales execution") or where advice is limited ("low advice"). These will include placing limits on the types of products or product features that may be distributed using non-advice sales execution or low advice models. These models should be restricted to simple products that comply with explicit product standards. Specific fit and proper standards will also be set for entities or individuals providing factual information in these models.

- Standards will be set for ongoing product servicing. Where certain ongoing services present particular conduct risks, limitations will be placed on which intermediaries can perform these functions – in particular, insurance premium collection will be limited to qualifying intermediaries only.
- Standards will be set for product aggregation and comparison services, informed by international standards in this regard, including putting customers in a position to make meaningful comparisons between products on a number of criteria, not just price. Standards will also be set for referrals and lead generation.



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- Outsourced services carried out on behalf of product suppliers will be more clearly identified and regulated, in a manner consistent with the outsourcing directive (Directive 159) currently applicable to insurers.

### ***Proposals relating to relationships between product suppliers and intermediaries:***

The financial services customer should be in a position to clearly understand what services are being provided by the intermediary with whom they are dealing, and in what capacity the intermediary is acting (ie the nature of the relationship between the intermediary and one or more product suppliers). This understanding is particularly important in the case of financial advice, to enable customers to evaluate the type and extent of advice they are receiving, including any limitations or restrictions on that advice, before deciding whether or not to act on it.

This set of proposals therefore focuses specifically on the criteria used to determine different types of relationships between financial product suppliers and financial advisers, the terminology used to describe these relationships, and how elements of these relationships should be disclosed to customers. Although FAIS requires these relationships to be disclosed to customers in a comprehensible manner, the proliferation of possible relationships makes this challenging and it is doubtful whether customers are indeed in a position to understand the implications of the different relationships.

- Three types of adviser will be defined: Independent financial advisers (IFAs), multi-tied advisers and tied advisers. Any person providing financial advice to financial customers will only be permitted to do so in one of those capacities – and subject to further criteria. Advisers will also only be permitted to use one of the three terms to describe their status as an adviser. An adviser that also qualifies as a financial planner may also use the additional designation of financial planner. Slightly modified terminology is proposed to describe advisers operating only in the short-term insurance or health benefits sectors
- To meet the standards to qualify as an IFA, an adviser will be required to meet two sets of independence criteria – one set of criteria relating to the choice of product and product supplier, and a second set of criteria relating to being free from product supplier influence. Further input is requested on the criteria for an IFA to offer sufficient product and product supplier choice
- A financial adviser is a multi-tied adviser if the adviser is not a tied adviser and also does not satisfy the criteria to be described as an IFA. This would be the case where the adviser for any reason (including the adviser's own choice) does not meet the requisite criteria in relation to product choice and/or freedom from product supplier influence required to be described as an IFA. Additional conduct standards will be set to ensure that any actual or potential conflicts of interest arising from the relationship between a multi-tied adviser and any one or more product suppliers are managed
- A financial adviser is a tied adviser if the adviser has an employment or other relationship with or mandate from a product supplier which restricts the adviser to providing advice in relation to the products of that product supplier only – or, subject to clear controls, another product supplier in the same group. A financial adviser that does not meet the definition of "tied financial adviser" is a multi-tied financial adviser (or an IFA, if the appropriate criteria are satisfied)
- Insurer tied advisers will no longer be permitted to provide advice or services in relation to another insurer's products – with some exceptions for another insurer in the same group
- "Juristic representatives" will be disallowed from providing financial advice. The juristic representative model undermines the customer's ability to appreciate the capacity in which advice is provided and any

potential conflicts of interest, and also undermines effective oversight of fair customer outcomes by both the regulated entities concerned and the regulator. The effect will be that any individual natural person providing advice must either be a tied adviser of a product supplier, an independent adviser or a multi-tied adviser in its own right, or a representative of a juristic intermediary that is authorised to provide advice in its own right. In other words, the concept of providing advice in the capacity of a "representative of a representative" will disappear

- Standards will be set for juristic intermediaries (adviser firms), and the relationship between the status of the adviser firm and the individual financial advisers who act on its behalf. In effect, an adviser firm may not describe itself as being either independent or multi-tied unless the firm itself meets the standards set for an IFA or multi-tied adviser, as the case may be
- Advisers will not be permitted to act as representatives of more than one juristic intermediary (adviser firm)
- As a general standard, and to address potential conflicts of interest, the outsourcing of product supplier functions or activities (as opposed to true intermediation activities connecting product suppliers and customers) to financial advisers will be prohibited, other than in the case of specific identified and regulated functions. Permitted activities in the insurance space include binder activities (subject to the binder regulations) and issuing of policy documents on behalf of insurers. This general standard does not impact on outsourcing to third parties who are acting solely as agents of the product supplier in respect of non-customer facing activities, and who are not intermediaries or associates of intermediaries
- Standards will be set regarding a product supplier's responsibility in relation to the conduct of tied advisers, multi-tied advisers and IFAs respectively. A product supplier will be fully responsible for the advice provided by its tied advisers. In view of the relationship between multi-tied advisers and product suppliers – which by definition is not entirely at arms' length – product suppliers and multi-tied advisers will be expected to share responsibility for the quality of advice provided to their shared customers, as opposed to the current framework which places this responsibility almost entirely on the adviser. To achieve this, product suppliers will be expected to pay greater attention to the general customer treatment culture and supporting controls that an adviser has in place. Conduct standards will also require product suppliers to take responsibility for a number of specific aspects of the conduct of multi-tied advisers with whom they contract. Where IFAs are concerned, product suppliers will be required to take responsibility for certain specific aspects (somewhat more limited than in the case of multi-tied advisers) of the conduct of IFAs who provide advice on their products
- Standards will also be set regarding a product supplier's responsibility for non-advice sales execution, including ensuring that the products concerned meet the requisite product standards and that any individual providing factual information as part of the non-advice sales process meets the requisite fit and proper standards
- Ownership and similar arrangements or relationships between product suppliers and intermediaries will be reviewed to assess conflicts of interest.

### ***Proposals relating to intermediary remuneration:***

Greater clarity on the activities that make up advice, intermediation and outsourced services respectively, as well as on whose behalf the services are rendered, creates the foundation for a clearer set of principles and rules for intermediary remuneration.

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To achieve the desired RDR outcomes, it is proposed that the future regulatory framework for intermediary remuneration should meet the following criteria:

- Intermediary remuneration should not contribute to conflicts of interest that may undermine suitable product advice and fair outcomes for customers. As part of this aim, intermediary remuneration should not undermine reasonable customer benefit expectations or inhibit customers' access to their savings (such as through early termination charges designed to recover commission costs)
- The regulatory framework should recognise the range of services available, the related remuneration for these, and whom may pay or receive it
- All remuneration must be reasonable and commensurate with the actual services rendered
- Remuneration structures should strike a balance between supporting ongoing service and adequately compensating intermediaries for up-front advice and intermediary services
- Ongoing fees and/or commission may only be paid if ongoing advice and services are indeed rendered
- An intermediary may not be remunerated for the same or a similar service twice
- All fees paid by customers must be motivated, disclosed and explicitly agreed to by the customer
- The different types of services and fees should be readily comparable by customers; and
- Remuneration structures should promote a level playing field between different types of intermediaries providing similar services.

The following proposals apply to these principles in practice:

- Standards will be set for financial planning fees, and for up-front and ongoing product advice fees, respectively. Standards will relate to customer consent, regulatory reporting, disclosure, and product supplier obligations to monitor fees (with different levels of product supplier responsibility for different types of adviser). The regulator may also publish benchmark guidelines in relation to different types of fees, together with requirements to monitor and / or report on adherence or deviations from such guidelines and to enable comparability of such fees
- Additional standards will be set for ongoing advice fees, to ensure that the customer has adequate control over the charging of such fees and that ongoing fees are only payable for ongoing service
- Product suppliers will be obliged to facilitate the collection of advice fees on the customer's instruction, from product investment values or through separate deductions from contributions, as the case may be
- Product suppliers will be prohibited from paying any form of remuneration to intermediaries in respect of investment products and intermediaries will correspondingly be prohibited from earning any form of remuneration in respect of investment products, other than advice fees agreed with the customer. Exceptions will apply to investment products marketed in the low-income market
- Remuneration for selling and servicing life risk policies will comprise a mix of up-front commission and as-and-when service fees. Subject to a differentiated approach for the low-income sector, 50% of the remuneration payable by long-term insurers in respect of life risk policies may be paid up-front as a sales commission, with the remaining 50% be payable on an as-and-when basis to provide for on-going servicing and maintenance of the risk policy. Both the level and structure of these commission and service fee payments will continue to be subject to regulated caps and other regulatory requirements. Further technical work and consultation will be

undertaken to determine what the new maximum commission and service fee levels should be

- Product supplier commission will be prohibited on replacement life risk policies, to address conflicts of interest and mis-selling risks
- Standards will be set to clarify and strengthen the principle of "equivalence of reward" as the basis on which long-term insurers may remunerate their tied advisers. These standards will confirm that the principle of equivalence applies at the level of each individual tied adviser
- Additional consultation and technical work will be undertaken to determine an appropriate remuneration dispensation for product suppliers and intermediaries serving low-income customers, in respect of life insurance risk products and investment products
- The as-and-when remuneration model for short-term insurance will be retained, to provide for sales commission for the selling of a policy and service fees for on going servicing and maintenance of the policy. The level of these commission and service fee payments will continue to be subject to regulated caps and other regulatory requirements, with further technical work and consultation to be undertaken to determine what the new maximum commission and service fee levels should be. The current provision allowing for additional fees over and above commission (through section 8(5) of the Short-term Insurance Act), will be removed. Short-term insurance advisers will be able to earn advice fees from customers, separately from commission, subject to the requirements applicable to such fees
- New conditions will be imposed for short-term insurance cover cancellations by intermediaries and insurers, to improve policyholder protection
- Investment platform administration services (LISPs) will only be permitted to be remunerated by means of a platform administration fee disclosed, agreed to, and paid for by the customer. Payments from product suppliers to LISPs, including any rebates, will be prohibited
- Maximum insurance binder fees payable to multi-tied intermediaries, per binder activity, will be prescribed. Although further consultation will take place on the appropriate caps, comment is invited on initial indicative fee caps for different types of binder activities, ranging between 1% and 3% of premiums
- The current commission cap of 22.5% for credit life insurance schemes with "administrative work" will be removed, with the effect that – pending further review of the regulatory regime for group schemes policies – the cap for all credit life group schemes will be at the lower level of 7.5%
- Where an intermediary is not a binder holder, an outsourcing fee – at a proposed flat rate of R100 per policy – may be paid over and above commission or a service fee for issuing policy documents on behalf of an insurer
- For avoidance of doubt, a general standard will be set to confirm that no financial interests of any kind may be provided by product suppliers to intermediaries unless specifically provided for in the regulatory framework.

### Implications for the regulatory framework

The proposals outlined in the paper will entail structural changes to intermediary relationships and remuneration and will require extensive amendments to the regulatory framework. These changes will form part of a broader review of the legislative architecture necessary to give effect to a Twin Peaks regulatory model. The changes will be implemented in a phased manner. Some changes will be carried out within the current regulatory framework, while other changes will be implemented as the Twin Peaks legislative framework evolves.

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A target date for implementation of the structural changes to intermediary relationships and remuneration will be confirmed following further consultation and depending on the final legislative architecture of the Twin Peaks framework. Based on current expectations of the legislative and regulatory timetable outlined above, it is not expected that the implementation date will be before mid-2016.

It is acknowledged that many of these structural changes will require extensive changes to business models and systems, and accordingly an implementation period of approximately 12 months will be provided for from the date of the finalisation of more detailed proposals.

The new standards with respect to intermediary / product supplier relationships, disclosure of intermediary status, and intermediary remuneration will apply as from the implementation date. Product suppliers and intermediaries will be expected to put plans in place to modify business relationships, business models and charging structures to be in a position to implement the changes with effect from the implementation date.

Transition measures will need to be put in place around the implementation of certain of the proposals, including changes to the structure and level of commission for long-term insurance risk products, and payment of "trail" commission on legacy products.

### Way forward

These RDR proposals seek to give consumers confidence in the retail financial services market and trust that product suppliers and advisers will treat them fairly. The inherent information asymmetry risks in the sector will be mitigated by placing financial customers in a position to understand more clearly what kind of advice or services they are getting, how much it will cost and how it will be paid for and to provide them with confidence that their adviser is sufficiently qualified to provide suitable advice and is acting in their best interests.

We also expect that these proposals will help to reduce the negative perceptions associated with the advice process and encourage people to seek financial advice. Over time, more financial customers will develop the confidence to seek financial advice as attitudes about perceived conflicts within the industry change. The reforms will improve the quality of financial advice, particularly with respect to product recommendations, and provide strong safeguards for investors against biased advice. They also present significant opportunities for intermediary firms and individual advisers in the retail financial services market to build sustainable and trusted businesses by modernising practices, raising standards and freeing themselves of conflicts of interests.

In addition to increased consumer trust and improved customer outcomes, the measures aim to:

- Clarify the types of advice available and empower customers to choose the model best suited to their needs
- Clarify the circumstances in which no-advice or 'low advice' distribution models are appropriate and the consumer protection measures required in such models
- Better align the interests of advisers with their customers by reducing a number of key remuneration based conflicts of interest that can lead to sub-optimal financial advice – including by limiting the extent to which advisers may be remunerated for extraneous services to product suppliers

- Ensure that product aggregation and comparison services and investment platform providers provide unbiased objective support to financial decision-making and transacting
- Enable consumers to better understand the status of advice services, including the level of independence of the advice provided from product supplier influence, including through reducing the scope for conflicts of interest in complex distribution models which disguise the true status of advice
- Strike a fairer balance between the responsibilities of product suppliers and advisers in relation to the delivery of fair customer outcomes
- Provide transparency for consumers in relation to adviser charging. Adviser charging will be clear, product neutral, and directly related to the services provided
- Facilitate customers paying for advice using flexible payment arrangements, such as the deduction of adviser charges from a customer's investments over time – subject to clear disclosure of the impact of such charges on benefit expectations
- Reduce the impact of adviser remuneration on reasonable benefit expectations, particularly through eliminating the justification for penal early termination charges and inappropriate product replacements
- Remove inappropriate incentives toward tied advice models
- Support the efforts of those in the industry who have already adopted business models consistent with the RDR objectives, including by reducing the risk of 'early adopter' disadvantages
- Support affordability and access to financial advice, particularly for low income consumers
- Build on the professionalism of the industry already achieved through FAIS, by including enhanced competency and conduct standards
- Provide an opportunity for industry to develop more efficient advice delivery models.

Comment on the RDR paper and its proposals, using the comment template provided, must be submitted to the Financial Services Board by no later than 2 March 2015. Comments should be submitted:

- By e-mail to [FSB.RDRfeedback@fsb.co.za](mailto:FSB.RDRfeedback@fsb.co.za); or
- In writing to Ms Leanne Jackson, Head: Market Conduct Strategy, Financial Services Board, P.O. Box 35655, Menlo Park, 0102.

The FSB also intends to set up stakeholder feedback workshops on the RDR before the comment period closes. Dates and venues for these workshops will be communicated in due course.

Once the comment period has closed, key stakeholders will be invited to participate in specific consultation structures that will be put in place to develop final legislative and regulatory changes.

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**1.1. Introduction – a new context for market conduct regulation**

This paper outlines the results of the Retail Distribution Review (RDR) carried out by the Financial Services Board (FSB) and proposes far-reaching reforms to the regulatory framework for distributing retail financial products to customers in South Africa. The review has been undertaken against the background of a new approach to regulating market conduct in the financial sector, informed by the *Treating Customers Fairly* (TCF) framework.

In 2011, in the wake of the global financial crisis, the National Treasury published *A safer financial sector to serve South Africa better*.<sup>1</sup> This policy document proposed a comprehensive overhaul of financial sector regulation in South Africa – including a “Twin Peaks” approach that will separate prudential and market conduct regulation of the sector. *Implementing a twin peaks model of financial sector regulation in South Africa*, National Treasury’s 2013 paper, laid out eight overarching principles that should be applied in designing the future regulatory and supervisory approach:

- **Transparent:** Appropriate information regarding the regulator’s decisions, actions and approaches will be made available, within the necessary bounds of confidentiality;
- **Comprehensive and consistent:** The framework will limit opportunity for regulatory arbitrage by ensuring consistent principles and rules for comparable activities. It will also ensure comprehensive coverage and consistent supervisory intensity based on identified risks;
- **Appropriate, intensive and intrusive:** The framework must be appropriate to the sub-sector concerned (i.e., not “one-size-fits-all”). Sufficient intensity and intrusiveness will ensure the rigour of regulation and supervision;
- **Outcomes-based:** Customer protection regulation will require financial institutions to comply with both principles- and rules-based regulations, both of which will be legally binding and enforceable;
- **Risk-based and proportional:** Regulatory requirements will be proportional to the risks to regulatory objectives. Firms that consistently comply with market conduct obligations and deliver TCF outcomes will attract less regulatory scrutiny than those which show less regard for fair customer treatment;
- **Pre-emptive and proactive:** The market conduct regulator will pre-emptively intervene to prevent or limit material damage that might result in negative customer outcomes;
- **A credible deterrent to misconduct:** Both customers and regulated entities should be confident that the regulator will detect and take meaningful action against misconduct and unfair customer treatment;
- **Aligned with applicable international standards:** The framework must adhere to applicable international standards. South Africa will continue to play an active role in shaping such international standards.

In particular, the design of the market conduct “peak” of the regulatory framework is informed by the *Treating Customers Fairly* (TCF) initiative led by the FSB. The TCF approach focuses on the extent to which regulated financial institutions deliver fair outcomes for financial customers and entails a more proactive and interventionist approach by regulators and policymakers to dealing with market failures. Over and above placing clear obligations on regulated financial institutions to

treat their customers fairly, this outcomes based approach means that, where existing regulatory frameworks do not consistently support the delivery of desired outcomes, structural interventions are necessary to change incentives, relationships and business models in the market.

The RDR is a prominent example of this new approach.

Despite the significant progress achieved through the Financial Advisory and Intermediary Services Act 37 of 2002 (FAIS) in raising intermediary professionalism, improving disclosure to clients and mitigating certain conflicts of interest, significant concerns about poor customer outcomes and mis-selling remain. This paper outlines a number of key risks inherent in the current regulatory framework for the distribution of retail financial products, including the frameworks regulating distribution relationships and intermediary remuneration, and puts forward a number of proposals aimed at mitigating these risks.

The proposals are designed to support the consistent delivery of fair outcomes to customers. This involves ensuring a vibrant and sustainable market for financial advice and distribution, while also ensuring that advice and distribution models are fair and appropriate to the needs of the customers to whom they are targeted. To achieve this balance, reforms are required to explicitly address any potential conflicts of interest that may undermine the duty of product suppliers, financial advisers or other intermediaries<sup>2</sup> to act in the best interests of their shared customers.

The paper recognises that not all the proposals put forward will be appropriate to all business models. In market segments where access to financial advice may be limited or difficult to sustain, certain of the interventions proposed may exacerbate these challenges. In these cases, a balance will need to be struck between strengthened regulation of distribution and advice practices, and alternative consumer protection mechanisms (such as targeted product standards) to ensure that the products that are distributed add value to customers and meet their reasonable expectations.

**1.2. Scope of the RDR****1.2.1. A retail focus**

The review focuses primarily on achieving improved outcomes for retail financial customers,<sup>3</sup> who are most vulnerable to the risks of unfair and conflicted advice and sales practices, due to the inherent information asymmetry and financial capability risks they face. Accordingly, the interventions proposed relate most directly to regulatory reforms for the distribution of financial products and services in the retail market.<sup>4</sup>

The paper therefore does not propose reforms in relation to activities carried out by financial markets infrastructures and their users and participants, as regulated by the Financial Markets Act 19 of 2012. It also does not propose reforms in relation to the activities of occupational pension funds or investment managers.<sup>5</sup> This is not to say however that these sectors are not under regulatory scrutiny. The regulatory framework for financial markets and infrastructures is under review in preparation for the strengthened financial market efficiency and integrity objective of the Twin Peaks model, while a comprehensive review of retirement fund regulation (including investment management practices in relation to retirement fund assets, as well as the costs of retirement

<sup>1</sup> References to this paper and other policy material referred to in this RDR are set out in Annexure 1.

<sup>2</sup> In this paper, the term “intermediary” is used as a general term to include both financial advisers and other individuals or entities providing the various intermediation activities. The term “adviser” is used to refer specifically to those intermediaries that provide financial advice.

<sup>3</sup> Although the paper does not propose a definition of “retail customer”, our focus has been on the interests of individual customers, households and smaller businesses. Low income and under-served customer segments have been specifically considered.

<sup>4</sup> Note however that a number of the proposals – for example prohibitions on earning commissions on investment products from product suppliers, or the distinction between tied, multi-tied and independent advice – will apply to intermediaries regardless of whether their customers are retail or wholesale customers.

<sup>5</sup> The proposals relating to investment platform fees and rebates may however have indirect impacts on these providers.

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provision) forms part of National Treasury's broader retirement reform process.

As the Twin Peaks legislative framework evolves, greater cross-sectoral alignment of market conduct regulation, including alignment between frameworks for retail and wholesale conduct where appropriate, should also be expected.<sup>6</sup>

### 1.2.2. A cross-cutting approach

The paper advocates a consistent cross-sectoral approach to regulating the distribution of products that are designed or marketed to meet similar customer needs. In particular, a consistent approach to distribution of investment products in the insurance sector and other retail investment products (including but not limited to collective investment schemes) is proposed. The distribution of individual retirement savings products is also included.

The RDR is however not confined to investment offerings, but also proposes interventions in relation to the distribution of insurance risk products – both in the long-term and short-term insurance sectors.<sup>7</sup>

### 1.2.3. Particular focus on "advice"

The current FAIS framework regulates two main sets of activities in relation to the distribution of financial products: The provision of "advice" and the rendering of a widely defined set of "intermediary services". This RDR also looks at a broad range of distribution activities and proposes a structured, activity based approach to regulating these activities – as set out in detail in Chapter 4.

Particular emphasis has however been placed on reforming the regulatory framework for the provision of financial advice. It is in this area that the regulatory framework itself entrenches inherent conflicts of interest and inhibits the ability of customers to assess the value of the advice they receive. The current framework also hampers the ability of financial advisers to be fairly rewarded for good quality advice. This is particularly so in relation to the current regulated commission model in the insurance sector. Accordingly, although the RDR is not confined to the regulation of advice and remuneration for advice, it is in these areas that the most far-reaching regulatory reforms are put forward.

### 1.2.4. Scope limitations

In the future Twin Peaks legislative framework, it is envisaged that the market conduct authority will be granted jurisdiction to regulate the conduct of banks in relation to their transactional banking products. The FAIS Act already regulates advice and intermediation in relation to bank deposits, and the proposals in this paper will therefore extend to these FAIS regulated activities. However, to the extent that the paper proposes obligations for product suppliers (outside their role as FAIS regulated providers or representatives), implementation of some of the proposals in relation to banking products are dependent on the promulgation of the Twin Peaks legislation.

Activities regulated by the National Credit Act 34 of 2005 are outside the scope of this paper.<sup>8</sup> Broader engagements are however underway between the National Treasury, the Department of Trade and Industry, the National Credit Regulator and the FSB to develop a co-ordinated

approach to reducing household over-indebtedness, as mandated by the Cabinet.

Where distribution of medical schemes is concerned, certain aspects of the distribution model are regulated by FAIS, while the Medical Schemes Act 131 of 1998 also imposes supplementary requirements – particularly in relation to intermediary remuneration. Co-ordination with the Council for Medical Schemes will be necessary to consider how best to ensure that the objectives of this RDR are achieved in relation to health benefit brokers and medical scheme distribution.

## 1.3. Objectives of the review

The primary aim of the RDR is to ensure that financial products are distributed in ways that support the delivery of TCF outcomes – in particular, to promote appropriate, affordable and fair advice and distribution of financial products in the retail market, through sustainable business models.

The FSB's concerns with the current framework are discussed in more detail in Chapter 3. In summary, our primary concerns relate to significant conflicts of interest in the way financial products are distributed and the way financial advice is provided. Related to this is a concern that the current framework makes it difficult for customers to understand the extent, value and cost of advice and other services they can expect from intermediaries. The FSB is also mindful of the need to keep raising standards of professionalism in the advice market in particular.

Specific desired outcomes of the RDR are therefore distribution models that:

- Support the delivery of suitable products and provide fair access to suitable advice for financial customers
- Enable customers to understand and compare the nature, value and cost of advice and other services intermediaries provide
- Enhance standards of professionalism in financial advice and intermediary services to build consumer confidence and trust
- Enable customers and distributors to benefit from fair competition for quality advice and intermediary services, at a price more closely aligned with the nature and quality of the service, and
- Support sustainable business models for financial advice that enable adviser businesses to viably deliver fair customer outcomes over the long term.

The regulatory and supervisory framework for financial advice and intermediation needs to robustly support the delivery of these desired RDR outcomes, in line with the overarching principles outlined above. The RDR proposals will therefore also be underpinned by broader changes in the approach to market conduct regulation and supervision that are currently being introduced:

- A consistent approach to regulating and supervising market conduct will include a consistent approach to distribution and advice standards for comparable products and activities across sectors.
- A pre-emptive and proactive approach to measuring and managing risks to fair customer outcomes will apply equally to risks arising from distribution models. This shift from a 'tick the box', process driven approach to compliance, to an outcomes-focused approach in which

<sup>6</sup> For example, work is already underway to better align the codes of conduct for authorised users of exchanges under the Financial Markets Act, with those for FAIS licensed intermediaries.

<sup>7</sup> In this regard, the South African RDR is broader than distribution regulation reviews undertaken in some other countries. The RDR implemented by the Financial Conduct Authority in the United Kingdom, for example, addressed only retail savings products. See further details in Annexure 2.

<sup>8</sup> An exception is the distribution of consumer credit insurance products, which falls squarely within the scope of the FSB's market conduct regulation mandate and this RDR, with the National Credit Regulator (NCR) also having certain regulatory and supervisory powers in this regard. The FSB is working together with the NCR to co-ordinate regulatory developments in this regard.

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financial institutions must measure and demonstrate delivery of the right outcomes, will require senior leadership of financial institutions to be the 'first line of defence' in avoiding poor outcomes for customers arising from the institution's chosen distribution or advice model. This will also entail more even sharing of accountability for fair customer outcomes between financial product suppliers on the one hand, and the entities that distribute and / or provide advice on their products on the other.

- A supervisory approach that is proportionate to the risks in the business concerned and to the risks to regulatory objectives being achieved. Regulation of distribution can be less interventionist where other considerations reduce the risks arising from the distribution model concerned – for example where product standards are in place to ensure that the products being distributed present a low risk of poor customer outcomes.

This broader change in approach recognises that achieving fair customer outcomes requires a combination of regulatory and supervisory tools. No single regulatory intervention can, in isolation, achieve all the desired RDR outcomes, which need to be achieved through a combination of means. For example, enhanced point-of-sale product disclosure should be balanced with enhanced supervisory scrutiny of the way product suppliers develop products to ensure they are appropriately targeted to meet identified needs and designed to deliver value in line with expectations created. Similarly, obligations on financial advisers to provide appropriate advice should be balanced by obligations on product suppliers to ensure the distribution models they use are appropriate for the customers targeted and the products concerned. These mechanisms are often mutually reinforcing: Product disclosures are likely to be more meaningful to customers if the products concerned are appropriately targeted, whereas disclosure requirements demanding clear information are likely to highlight unreasonably complex product features. Changes to intermediary remuneration structures will support the development of more transparent and fair products.

## 1.4. Developments to date

### 1.4.1. The FAIS framework (2002, with subsequent enhancements)

The RDR builds on an already strong and comprehensive regulatory framework for advice and intermediary services in the form of the FAIS Act and its supporting Codes of Conduct and fit and proper criteria. FAIS has clearly raised the standards of professionalism and the management of conflicts of interest in the financial advice and intermediary services sector. In particular, FAIS already provides for:

- A statutory fiduciary duty for intermediaries, requiring them to act in the best interests of their clients and to place the interests of their clients ahead of their own when providing advice or services
- Transparent disclosure of remuneration arrangements and aspects of relationships with product suppliers
- Specific prohibitions, disclosures and policies with respect to actual and potential conflicts of interest
- Increased levels of intermediary professionalism, fitness and propriety through a combination of competence, integrity, operational, and compliance requirements – including specific regulatory examinations.

Despite this detailed compliance framework, remaining concerns about the potential for mis-selling and poor outcomes for customers have continued to fuel debate as to whether more fundamental structural interventions in the regulatory framework are necessary.

### 1.4.2. The National Treasury discussion paper on Contractual Savings (2006)

Questions regarding the structural effectiveness of the regulation of distribution were first raised in 2006 in a National Treasury discussion paper entitled *Contractual Savings in the Life Insurance Industry*. The paper was released in the wake of a Statement of Intent signed between the Minister of Finance and the life insurance industry in December 2005 to deal with some of the worst inequities arising from contractual savings products – in particular, extreme early termination penalties on savings policies. The paper concluded that several aspects of the traditional intermediated business model followed by life insurers in providing savings products were inappropriate and led to sub-optimal outcomes for consumers.

The discussion paper led to a change in commission structures for contractual savings products (limiting the extent of up-front commission to 50 per cent) and the introduction of capped early termination charges.

The discussion paper also raised a number of concerns about the need to clarify the legal capacity in which an intermediary acts – in particular, the question of when an intermediary can be said to be providing independent advice. The discussion paper concluded that: *"The triangular association – whereby the intermediary provides advice to the policyholder but is incentivised by the insurer, who then recoups such costs from the policyholder – is fundamentally flawed. A commission-receiving intermediary cannot, by definition, be thought to be truly independent."* In addition, the discussion paper highlighted the need to introduce a level playing field across different investment product sectors in the structure of intermediary remuneration and suggested that a review of remuneration structures should be extended to insurance risk business.

Although this RDR builds on a number of the issues raised in the 2006 National Treasury discussion paper, it has also been informed by broader South African reforms to market conduct regulation and supervision since then, as well as international developments.

### 1.4.3. Treating Customers Fairly Roadmap (2011)

In April 2010, the FSB published a discussion document and consulted on its intention to adopt a strengthened framework for financial consumer protection, entitled Treating Customers Fairly (TCF). The TCF Roadmap was published in March 2011, confirming that the TCF framework would be implemented and providing details of its structure, intent and planned implementation process. The National Treasury simultaneously confirmed, in its February 2011 policy paper *A safer financial sector to serve South Africa better*, that the TCF approach would be a key component of a dedicated market conduct regulatory mandate under the Twin Peaks model.



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The TCF framework requires regulated financial institutions to demonstrably deliver a set of six fair treatment outcomes, at all levels of their organisations and at all phases of the financial product lifecycle. Importantly, it requires institutions to be able to demonstrate that a commitment to delivering these outcomes is embedded in their organisational culture and strategies, and is supported by their governance frameworks. Appropriate management information systems and operational controls are expected to be in place to support TCF delivery.

The six TCF fairness outcomes are:

- *Outcome 1:* Customers can be confident they are dealing with firms where TCF is central to the corporate culture
- *Outcome 2:* Products and services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly
- *Outcome 3:* Customers are provided with clear information and kept appropriately informed before, during and after point of sale
- *Outcome 4:* Where advice is given, it is suitable and takes account of customer circumstances
- *Outcome 5:* Products perform as firms have led customers to expect, and service is of an acceptable standard and as they have been led to expect
- *Outcome 6:* Customers do not face unreasonable post-sale barriers imposed by firms to change product, switch providers, submit a claim or make a complaint.

TCF Outcome 4, regarding suitable advice, is most directly relevant to the RDR. As explained above however, although financial advice is a particular focus area, the RDR seeks to address risks to fair outcomes more broadly. Aspects of some current distribution practices also compromise the achievement of a number of the remaining TCF outcomes, including those requiring appropriate product design, clear information, product performance in line with reasonable expectations and the prevention of barriers to accessing product benefits. Conflicts of interest inherent in some models are also not consistent with a commitment to a culture of fair treatment.

Where financial advisers themselves are concerned, meaningful compliance with FAIS requirements already go a long way to ensuring their delivery of TCF Outcome 4. Current regulation does not however adequately address the role of product suppliers and other entities in the financial services value chain (including wholesale entities) in delivering fair outcomes for end customers. It is fair to say that, through FAIS, financial advisers and intermediaries have been the primary focus of market conduct regulation over the last decade or so and that there has been, arguably, insufficient regulatory scrutiny of the customer treatment practices of product suppliers. Consistent application of TCF principles across the value chain will mean a more even spread of accountability between the different participants. In particular, responsibility to deliver TCF Outcome 4 will no longer be the exclusive responsibility of FAIS regulated financial advisers, but will also require product suppliers using intermediated distribution models to share accountability for the quality of advice provided to their customers.

#### 1.4.4. The FSB call for contributions on intermediary services and remuneration (2011)

In November 2011, the FSB issued a letter to industry associations<sup>9</sup> in which it called for contributions on the subject of intermediary services and related remuneration in the insurance sector. The purpose of this

letter was to solicit contributions from these associations on possible refinements to the definition of intermediary services in the insurance laws<sup>10</sup> and reforms to related remuneration structures.

While the letter focused on distribution issues in the insurance sector, it recognised that many of the issues identified were common across other financial sectors, and emphasised that proposed reforms should apply on a cross-sectoral basis to promote a level playing field for competing products and services. The letter invited comments on some initial thinking around what reforms should be applied in the South African context.

Commentators were overwhelmingly in favour of the FSB's stated objective of trying to attain an appropriate balance between client interests and those of product suppliers and intermediaries – it is readily accepted that fair outcomes for customers are in the interest of a sustainable financial services sector. However, there was a range of views on how best to achieve this balance. On some issues there was broad consensus among commentators, but views differed widely on many issues. A summary of comments provided in response to the call for contributions is included in Annexure 3.

Comments that were common across a number of inputs included the following:

- The review of remuneration models should be seen as only part of a solution toward fair customer outcomes – particular attention should also be given to the role of product suppliers in developing suitable products that add customer value, as well as the role of improved financial consumer education.
- The reforms should recognise South Africa's specific needs and circumstances rather than merely copying international developments.
- Care should be taken to avoid unintended consequences, such as reducing customer access to advice by reducing the number of financial advisers, or inappropriately skewing the mix between independent and tied distribution channels.
- Any reforms should provide for sustainable business models for financial advice, given the key role of appropriate advice in delivering fair customer outcomes. In particular, the reforms should recognise the role independent advisers can play in encouraging product suppliers to improve their product offerings, and support the sustainability of independent advice businesses.
- A phased approach to the reforms should be followed, dealing on a priority basis with specific current inappropriate practices that are exacerbating the inherent risks of conflicted advice. Dealing with deeper structural reforms will need to make allowance for the time it takes to adapt business models and change systems and processes.

These general comments have been taken on board in terms of the proposals contained in this paper with respect to both the content and timing of regulatory reforms. In particular, the proposals take into account South African specific circumstances, including:

- The nature of the South African financial services distribution landscape
- The imperative that the regulatory framework supports increased financial inclusion, and
- The recognition that the RDR proposals form just one element of broader reforms to the framework for market conduct regulation and supervision, informed by the TCF initiative and given effect to through the Twin Peaks model of financial regulation.

<sup>9</sup> Association of Savings & Investments SA (ASISA), South African Insurance Association (SAIA), Financial Intermediaries Association of Southern Africa (FIA), Financial Planning Institute (FPI) and South African Underwriting Managers Association (SAUMA).

<sup>10</sup> The Long-term Insurance Act, 1998 and the Short-term Insurance Act, 1998, respectively.

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**1.4.5. International developments**

Concerns regarding market conduct risks arising from distribution and advice models in the financial services sector are not unique to South Africa. Regulators and policymakers in a number of jurisdictions are grappling with similar issues and have introduced or are in the process of introducing various regulatory interventions to improve customer outcomes. In carrying out this review, a number of these approaches have been studied to consider how experiences and practices in other jurisdictions can be learnt from to shape a framework that will be relevant to South African circumstances, needs and objectives.

The jurisdictions that were most closely reviewed are the United Kingdom and Australia, particularly in view of the fact that these jurisdictions operate under a Twin Peaks regulatory model. Developments in Singapore and the European Union were also monitored.

In Australia, the recently introduced Future of Financial Advice (FoFA) reforms, which became mandatory on 1 July 2013, include a ban on conflicted remuneration structures (including commissions and volume based payments) in relation to the distribution of and advice about retail investment products (but not including, for example, general insurance products and basic banking product advice); a duty for financial advisers to act in the best interests of their customers subject to a 'reasonable steps' qualification; an obligation to provide fee disclosure statements; an opt-in obligation that requires advice providers to renew their customers' agreement to ongoing fees every two years; and enhanced powers for the market conduct regulator (ASIC). These reforms are, however, subject to ongoing review by the newly elected Government.

The UK has a long history of regulating financial advisers. The most recent set of reforms were implemented through the UK's Retail Distribution Review. This review focused only on retail investment products and did not address the distribution of general insurance or protection products (the equivalent of short-term insurance or life risk insurance products in South Africa). As a result, on December 31, 2012, new rules entered into force providing for comprehensive regulation of financial advisory services in the areas of: (i) labelling of advisory service; (ii) remuneration; and (iii) professionalism. The new regulation is activity-oriented, that is, the main distinction is made between providing 'independent advice' and 'restricted advice'. Independent advice must be: (i) based on a comprehensive and fair analysis of the relevant market; and (ii) unbiased and unrestricted. If an adviser provides restricted advice, its disclosure must explain the nature of the restriction – either by reference to a limited scope of analysis or ties to a specific product supplier. Neither the independent adviser nor the restricted adviser is allowed to accept commissions from product suppliers in relation to investment products. Instead, they must charge clients directly.

In Singapore, reforms have been introduced following the recommendations of the 2012 Financial Advisory Industry Review (FAIR) Panel. The FAIR review involved a fundamental review of practices in the financial advisory industry, which was aimed at raising the standards and professionalism of financial advisers to safeguard the interests of retail customers. The main FAIR recommendations which are in the process of being implemented by the Singaporean authorities cover the

following topics: (i) a balanced scorecard remuneration framework to reward provision of good quality advice; (ii) a requirement that payout commissions be spread over a minimum of six years or the premium payment period (whichever shorter); (iii) a 55% cap on first year commissions; (iv) a requirement that financial advisers meet higher academic requirements; (v) a cap on revenue for non-financial advising related activities; (vi) additional safeguards to ensure transparency of products (e.g. bundled insurance products, trailer fees for collective investment schemes etc.); (vii) a requirement for insurers to participate in a web aggregator to enhance comparability among life insurance products; and (viii) a requirement for life insurance companies catering to the retail market to make available a set of "basic insurance" products through a direct channel at a nominal administration charge.

Lastly, in the European Union there are two main EU directives relevant to distribution of retail financial products: The Directive on Markets in Financial Instruments (MiFID I) for investment products and EU Directive on Insurance Intermediation (IMD I) for insurance mediation. Both – MiFID and IMD – include rules regarding distribution of the covered retail products with a specific focus on: (i) suitability or appropriateness test, (ii) disclosure requirements, and (iii) regulation of remuneration and inducements. Both of these instruments are undergoing review.

Annexure 2 summarises the international approaches to distribution reform considered.

Some of the reforms underway in other jurisdictions have already been implemented in South Africa (for instance, measures to improve professionalisation of the financial adviser sector through higher qualification requirements), while others have been considered as input into the reforms proposed in this paper, adjusted to reflect South African circumstances.

**1.5. Structure of this paper**

- *Chapter 2* outlines the financial services distribution landscape in South Africa, which is characterised by a wide range of distribution models.
- *Chapter 3* argues that certain aspects of current distribution models pose risks not only to fair customer outcomes, but also to intermediary sustainability and supervisory effectiveness. At the same time, there are certain benefits of current distribution models that should be preserved through the reform process, insofar as this is may be achieved together with mitigating identified risks.
- *Chapter 4* sets out a range of specific regulatory policy proposals to meet the desired RDR outcomes outlined in Chapter 1. The proposals envisage a rationalisation of the complex distribution landscape outlined in Chapter 2 through measures that addresses the various risks highlighted in Chapter 3.
- *Chapter 5* sets out, at a high level, the envisaged changes to regulatory provisions to give effect to the regulatory policy proposals outlined in Chapter 4 and clarifies that they will be implemented in a phased manner. Some changes will be carried out within the current regulatory framework, while other changes will be implemented as the Twin Peaks legislative framework evolves.
- Lastly, *Chapter 6* outlines the way forward in terms of consultation and the finalisation of regulatory policy proposals.

This Chapter outlines the structure of the financial services distribution landscape in South Africa, which is characterised by a wide range of distribution models.

## 2.1. Components of the current distribution landscape

In the current landscape, distribution models are made up of different combinations of:

- *Types of service provided by intermediaries.* The extent of intermediation ranges from discretionary mandates where clients mandate intermediaries to make financial decisions and effect financial transactions on their behalf, at the one extreme, to outsourced services carried out solely on behalf of product suppliers at the other.
- *Relationships between product suppliers and intermediaries.* These relationships range from wholly independent financial advisers with no contractual commitments or allegiances to particular product suppliers, to fully tied advisers recommending products of a single product supplier.
- *Intermediary remuneration models.* These range from a minority of intermediaries that are remunerated by fees paid directly by clients, with no product supplier intervention, to intermediaries remunerated solely by one or more product suppliers through commission or in some cases regular salary payments.

Combinations of services, product relationships and remuneration models differ depending on the particular financial products being distributed and the different customer groupings to which they are distributed, with some distribution models being more prevalent in some product and customer markets than others. Although there are exceptions, there is a broad correlation between the levels of sophistication of the customer base concerned, the complexity and riskiness of the product, and the extent and level of independence of the advice provided.

Paragraphs 2.2 to 2.4 summarise the current distribution landscape from each of the three perspectives mentioned above: Type of service provided; type of relationship with product supplier; and type of remuneration. The different categories discussed under each of these headings are not discrete or necessarily mutually exclusive, but frequently occur in combination with one another.

## 2.2. Types of services provided

The types of services provided through different distribution models entail differing degrees of intermediation and differing levels of advice. Common service types include:<sup>11</sup>

### 2.2.1. Discretionary investment mandate

In terms of FAIS, intermediaries holding a discretionary investment mandate are required to be licensed as Category II or IIA financial services providers (investment managers).<sup>12</sup> Typically, investment managers are juristic entities, although there are a number of individuals holding such licences in their personal capacities.<sup>13</sup> As investment management is a specifically regulated activity,<sup>14</sup> this discussion document will not focus directly on discretionary investment management services as a type of intermediation, other than to note that individual investment managers who hold discretionary mandates

may also carry out one or more other types of intermediation, such as providing financial planning services or financial product advice.

### 2.2.2. Financial planning

The Financial Planning Institute (FPI) defines financial planning as “the process of structuring and arranging your financial resources to meet your life goals. These can be as short term as saving for a car, to long term planning for retirement. Financial Planning aims to provide financial certainty and clarity on your current and future financial wellbeing”.<sup>15</sup> This typically involves a financial needs analysis (gathering relevant financial information, setting financial goals and examining the customer’s current financial status) and coming up with a strategy or plan to meet the customer’s goals given the customer’s current situation and future plans. This may include aspects such as budget planning,<sup>16</sup> cash flow planning, debt management, estate planning, tax planning, health care planning, retirement planning, and savings planning. In the short-term insurance space, this can be described as risk planning, including risk finance consulting, loss control advice and surveys and risk management advice. Depending on the extent of services agreed between the customer and the financial planner, financial planning may include ongoing review of the initial financial plan.

There is however no legislative definition of “financial planning” and the use of the term is not prescribed or limited by law. In practice, it can and does occur that intermediaries whose services do not meet the FPI description may refer to themselves as financial planners. It should also be borne in mind that financial planning may be carried out by intermediaries who have various types of relationships with product suppliers, including those with limited product ranges at their disposal.<sup>17</sup> Provision of financial planning services may or may not entail a recommendation to purchase one or more financial products or enter into specific transactions in relation to a financial product. The current FAIS regulatory framework does not recognise financial planning as an activity distinct from the provision of advice or rendering of intermediary services in relation to a financial product. Financial planning typically includes the development of a financial plan for a client, together with periodic reviews and possible adjustments of that plan to ensure it remains suitable to the client’s financial needs and circumstances. As such, financial planning activities are conceptually independent of the product life cycle.<sup>18</sup>

### 2.2.3. Financial product advice

This is the most common form of advice provided by financial intermediaries, and is consistent with the FAIS definition of “advice”.<sup>19</sup> The nature and extent of product advice models vary however, including:

- Advice in relation to a single product type, offered by a single product supplier or product supplier group.
- Advice in relation to a single product type, offered by multiple product suppliers.
- Advice in relation to multiple product types, offered by a single product supplier or product supplier group.
- Advice in relation to multiple product types, offered by multiple product suppliers.

Within the above models, there are further permutations in regard to how wide or narrow the range of product suppliers and / or product types may be. The FAIS definition of “advice” does not draw any distinctions between these permutations.

<sup>11</sup> This paper does not attempt to describe every possible distribution model in the current landscape, but rather highlights more prevalent models. Comment is specifically invited in respect of distribution models that may require specific additional analysis.

<sup>12</sup> Section 8 of the FAIS Act read with Board Notice 106 of 2008 on the Determination of fit and proper requirements for authorised financial service providers and representatives.

<sup>13</sup> There were 630 Category II licences (including Category IIA licences) and 110 Category IIA licences in force as at October 2014.

<sup>14</sup> Currently regulated through the FAIS framework, in terms of requirements set out in the Code of Conduct for Administrative and Discretionary FSPs published under Board Notice 79 of 2003. In the future Twin Peaks regulatory architecture, it is likely that investment management will become a distinct class of authorised activity.

<sup>15</sup> Financial Planning Institute website (<http://www.fpi.co.za>)

<sup>16</sup> Some of these additional planning services, such as debt management and tax planning, are also subject to separate regulatory regimes (under the National Credit Act, No. 34 of 2005 and the Tax Administration Act, No. 28 of 2011 respectively). Further consideration will be given as to how or whether to take account of these additional standards in the financial services regulatory framework.

<sup>17</sup> By way of illustration, the FPI currently has roughly 6000 members, of which roughly half can be considered ‘tied’ agents and many of the remainder ‘multi-tied’.

<sup>18</sup> Under the current framework, independence from the product lifecycle is true in theory but not necessarily in practice. Practically all of the FPI members, with very few exceptions, provide a recommendation to purchase one or more financial products or enter into specific transactions in relation to a financial product (i.e. financial product advice as described in 2.2.3) in addition to the financial planning process.

<sup>19</sup> See Annexure 1 for relevant extracts from current legislation.

### 2.2.4. "Wholesale" financial product advice

This is a form of financial product advice where advice is not provided directly to the end user of the financial product concerned, but to an intermediate entity purchasing the product to provide benefits for end users. The most common examples are advice provided to an employer purchasing various forms of insurance cover for its employees in terms of their employment contracts (for example through "group life cover" schemes), the board of trustees of a retirement fund purchasing insurance or other investment products to provide retirement or risk benefits for its members and their dependants, or the trustees of a medical scheme benefits to provide to their members.<sup>20</sup> In these models, the adviser needs to consider not only the interests of the immediate customer (such as the employer or fund), but also the suitability of the advice from the perspective of the end users (employees, fund members or medical scheme members). This type of advice may also entail elements of financial planning (see 2.2.2 above), for example where the intermediary provides a more comprehensive planning service to support an employer's goals to meet its employment needs.

### 2.2.5. Factual information in response to customer queries

This service is distinguished from advice in that it does not entail any form of recommendation. This is typically the type of service provided by so-called "execution only" direct marketing distribution models, where factual information is provided to a potential customer, who then makes his or her own (non-advised) decision in regard to a product, after considering the factual information provided. The provision of purely factual information is however not only relevant in the direct marketing context, but could also apply to post-sale interactions, such as an on-line or call centre based customer enquiries facility. This service falls outside the FAIS definition of "advice" and, unless an "intermediary service" as defined in FAIS is also provided, the service currently falls entirely outside of the ambit of FAIS. In practice however there is a fine line between advice and purely factual information, particularly in the case of face-to-face or telephonic interactions.<sup>21</sup> In the case of direct marketing models, the factual information provided will typically relate to one product supplier and one product only, although it is possible that information can be provided in relation to a number of products offered by the product supplier concerned.

### 2.2.6. Sales execution ("selling")

This service refers to facilitation of the actual purchase or entering into of a financial product, other than the provision of product advice – loosely described as "selling" the product. Sales execution can occur in different models:

- Direct non-advice sales execution: This model entails a product supplier concluding transactions directly with its customers, without an intermediary acting as "go-between". This may be achieved through written exchanges (so-called "mailshot" marketing), through internet, cell phone or other electronic transactions, or through a telephonic call centre. In most cases these models operate on an "execution only" or non-advice model (see also paragraph 2.2.5). The contact may either be initiated by the customer (so called "inbound" or "unsolicited" direct models), or by the product supplier – for

example through unsolicited "cold calling" of individuals on a database of potential customers.<sup>22</sup> Although these models are often referred to as "direct marketing" models, this can be confusing as the term "direct marketing" is also currently more broadly used to describe advised sales, where advice is provided telephonically by the product supplier's call centre operatives.

- Non-advice sales execution carried out by an intermediary: This is a model where the "selling" service concerned is not carried out directly by the product supplier, or by an outsource service provider acting in the name of the product supplier, but rather on behalf of an intermediary entity that acts as "go-between" between the customer and the product supplier – for example so-called "intermediary call centres".
- Sales execution carried out by a financial adviser: This refers to the "selling" component of the service provided by a financial adviser, in the event that the financial product advice provided results in a product being entered into and the adviser facilitates that transaction. This "selling" activity can conceptually be thought of as separate from the provision of advice to a customer.

### 2.2.7. Investment platform administration

This activity relates to aggregating (called 'bulking' in FAIS), safeguarding and administering investments offered to clients by more than one product supplier on a single platform. It enables intermediation between large numbers of clients on the one side and product suppliers (usually collective investment schemes (CISs), but also suppliers of other products such as linked investment insurance policies) on the other. This service falls within the FAIS definition of an "intermediary service" and is regulated under the current FAIS framework through the Administrative Financial Service Provider (Category III FSP) licence category.<sup>23</sup> Investment platform administrators are also commonly referred to as "linked investment service providers" or LISPs.

In terms of FAIS, customers' assets (whether cash or participatory units in a CIS portfolio or other assets) are held in the name of the LISP's independently operated FSB approved nominee company. LISPs are then able on a daily basis to aggregate client buy and sell orders to place bulk orders per CIS portfolio or other product supplier. This enables clients to "switch" between different portfolios on the LISP platform, usually without charge.

In some cases, LISPs provide, as part of their value proposition, a system-based tool that generates investment fund options for the customer's consideration. The fund options presented by such tools typically include only a very limited number of funds – often only the funds of the CIS management company that is "in-house" to that brand.

### 2.2.8. Product aggregation and comparison services

Typically, these providers provide a similar service to that described in 2.2.5, viz. factual information in response to customer queries, although by definition the information provided relates to multiple products and product suppliers. The information may relate to one or more types of products. As the information is typically provided in a standardised

<sup>20</sup> The retirement fund or medical scheme in turn may be established and sponsored by an employer for its employees. In these cases, advice is provided to both the employer and thereafter to the fund / scheme concerned – by the same or different advisers.

<sup>21</sup> See also paragraph 2.2.6.

<sup>22</sup> Protections provided for in the Consumer Protection Act, No. 68 of 2008 and the Protection of Personal Information Act, No. 4 of 2013 place some limitations on this model.

<sup>23</sup> See the FAIS Code of Conduct for Administrative and Discretionary FSPs.



format through a web-based facility, and not through face-to-face or telephonic services, the divide between advice and factual information is easier to maintain. However, the possibility that such a service constitutes product advice does arise where the range of products or product suppliers considered is not representative of the available universe (unless the limited scope of the comparison is made clear to potential customers), or where the information filtering processes used create a bias in favour of particular products or suppliers. Also, web-based aggregation services may be offered in combination with other types of intermediation, such as a follow-up call to the customer by a direct marketing operation, or a referral to a financial product adviser or financial planner.

### 2.2.9. Referrals and “leads”

These activities entail a person or entity (lead provider) providing an intermediary or a product supplier with names and / or contact details of potential customers whom the intermediary or product supplier may then approach with an offer to provide advice or other services. Alternatively, the lead provider could provide a potential customer with the name and / or contact details of an intermediary or product supplier, whom the customer may then approach to obtain advice or other services. The lead provider is typically remunerated in some form by the product supplier or intermediary concerned (or by the intermediary's principal, where relevant). Referrals can also be reciprocal, with product suppliers or intermediaries entering into agreements to refer customers to each other, based on their respective product ranges or areas of expertise. The current FAIS regulatory framework does not regulate the provision of referrals and leads or their remuneration,<sup>24</sup> unless the relationship between the intermediary and the lead provider is such that the remuneration would fall within the scope of the “Conflict of Interest” provisions of FAIS. Depending on the circumstances of a particular case, it is possible that this type of remuneration could fall within the scope of the commission regulations under the insurance laws if the lead or referral is related to the entering into of an insurance policy. Lead providers may be structured as so-called “product aggregators” (see 2.2.8).

### 2.2.10. Binder services

These services entail the carrying out of specific insurer functions under a prescribed form of outsourcing agreement, referred to as a “binder agreement”. Binder services are outsourced underwriting functions related to entering into, varying or renewing an insurance policy; determining the wording, premiums or policy benefits of an insurance policy; or settling claims under an insurance policy. Binder functions are specifically defined and regulated by the Binder regulations<sup>25</sup> under the insurance laws. They are a specialised form of the outsourced services discussed in 2.2.11. Although they constitute “intermediary services” for purposes of FAIS, they are not regarded as intermediary services in terms of the insurance laws and hence fall outside of the scope of commission regulations.

### 2.2.11. Other outsourced services

These are services carried out for and on behalf of a product supplier, which the product supplier would otherwise be required to carry out themselves. Sometimes these functions may be sub-outsourced, for example from one intermediary to an administrator or another intermediary. Where the services result in the conclusion of a financial transaction between a customer and a product supplier, or in other defined cases, they would currently constitute “intermediary services” for FAIS purposes. In the insurance context, these services (other than binder services) could either fall within the definition of “rendering services as intermediary” in the insurance laws (which means that they are subject to commission regulations), or would be subject to the provisions of the insurance outsourcing directive (referred to in the rest of this paper as Directive 159)<sup>26</sup> which sets largely principles-based requirements to ensure that outsourcing arrangements do not prejudice the sound governance of an insurer or the interests of its policyholders.

## 2.3. Relationships between product suppliers and intermediaries

The various types of services discussed in section 2.2, are carried out in terms of a number of different types of legal and contractual relationships between the product suppliers and intermediaries concerned. As with the types of services, some of these models apply in combination. The situation also arises that a particular intermediary may stand in different legal relationships to different product suppliers – either for different types of services, different types of products, or both. Although FAIS requires these relationships to be disclosed to customers in a comprehensible manner, the proliferation of possible relationships makes this challenging and it is doubtful whether customers are indeed in a position to understand the implications of the different relationships.

### 2.3.1. Independent financial adviser

The term “independent” is not defined in current financial services legislation. In the insurance laws, the term “independent intermediary” is defined to refer, in effect, to any intermediary other than a single insurer's tied agent and the definition is used in the specific context of commission regulation. In most instances, these so-called independent intermediaries are in fact advisers contracted to multiple product suppliers to distribute their products (in other words, multi-tied advisers as discussed in 2.3.2). As such, it is questionable whether the term “independent intermediary” as currently defined in the insurance laws, is consistent with the ordinary meaning of “independent”, namely being free of influence or control of another, self-reliant, or without allegiance or affiliation.

In those cases where advisers choose to be remunerated solely by fees paid to them by customers, as opposed to product supplier funded fees or commission, the term “independent financial adviser” is arguably more accurate. In practice, very few financial advisers currently operate on such a “customer fee only” basis.

<sup>24</sup> Where these activities fall outside the ambit of FSB legislation, it is possible that they may be subject to the Consumer Protection Act, No. 68 of 2008.

<sup>25</sup> Part 6 of the Regulations issued under the Short-term Insurance Act and Long-term Insurance Act.

<sup>26</sup> Directive 159.A.i (LT + ST); Compliance with section 9(3)(b)(i) read with section 12(1)(c) of the Long-term Insurance Act and Short-term Insurance Act, respectively: outsourcing (12 April 2012). Similar general controls regarding outsourcing are not currently prescribed by other financial services legislation.

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It should also be noted that the insurance laws definition of “independent intermediary” does not take into account the number of product suppliers (insurers in this case) with whom the intermediary contracts. In law, an intermediary who chooses to enter into a commission agreement with a single insurer, but not on terms which bind the intermediary to market the products of that insurer only, would still be classified as an “independent intermediary”. In practice, most such intermediaries do have contracts with multiple product suppliers, but in some instances only with a small number of suppliers.

### 2.3.2. Adviser contracted to multiple product suppliers (multi-tied adviser)

As discussed under 2.3.1, in the insurance context an adviser contracted to multiple product suppliers to distribute their products (usually through commission paying contracts) is defined in our current legislation as an “independent intermediary”. In certain other jurisdictions this type of intermediary is referred to as “multi-tied”, a concept not currently used in our legislation, but sometimes used in practice. These intermediaries are also commonly referred to as “brokers” or “brokerages” (terms not defined in legislation), depending on whether they are natural or juristic persons. In terms of our common law, they are regarded (at least in certain respects) as the agent of the customer to whom they provide advice in spite of the fact that they are remunerated by the product supplier. In practice some of the services they provide in addition to intermediary services could be seen as administrative services that are, in effect, outsourced to them by product suppliers and provided for and on behalf of the product supplier.

### 2.3.3. Adviser contracted to one product supplier (tied adviser)

In the insurance context, an adviser contracted with an insurer on terms requiring the adviser to market the products of that insurer only is defined as a “representative” of that insurer. Such an adviser is also commonly referred to as an “insurer agent” or “tied agent”, although these terms are not used or defined in legislation. At common law, this type of intermediary is regarded as the agent of the product supplier concerned.

The Long-term Insurance Act<sup>27</sup> also provides for a situation where, although the representative is contracted to one insurer only, that insurer may enter into agreements with other insurers, allowing its representative to also market the other insurers’ products.<sup>28</sup> This arrangement is sometimes loosely referred to as a “multi-tied” arrangement, but the term is used incorrectly as the agent is not contracted (“tied”) to the other insurers – the arrangement is between the two insurers only.

Rather confusingly, the term “representative” is also defined in the FAIS Act, but in that Act refers to an individual acting for a licensed financial services provider (who could be a product supplier or an intermediary that is not a product supplier) on terms where the individual is mandated to act on behalf the licensed financial services provider, who takes responsibility for their actions.

The table below provides statistics on the size and composition of the authorised intermediary population, using FAIS data as at May 2014:

Total number of FSPs	10 270
Total number of Representatives	113 532
Total number of Key Individuals	10 865
Insurer FSPs <sup>29</sup>	98
Insurer Representatives (Persons)	38 318
Insurer Juristic Representatives	924
Insurer Key Individuals	298
Bank FSPs <sup>30</sup>	40
Bank Representatives (Persons)	19 961
Bank Juristic Representatives	4
Bank Key Individuals	78
Total number of Insurer Representatives (incl. juristic)	39 242
Percentage of total Representatives that are Insurer Representatives	34.6%
Total number of Bank Representatives	19 961
Percentage of total Representatives that are Bank Representatives	17.6%
Total number of Bank & Insurer Representatives	59 281
Percentage of total Representatives that are Insurer & Bank Representatives:	52.2%

In most instances, insurer representatives are contracted to provide advice or intermediary services in relation to that insurer’s products only. Accordingly, it is reasonable to assume that the majority of insurer representatives are “tied”. (There may be some duplication where insurers agree that their representatives may also sell another insurer’s products (see 2.3.3 above)). Where bank representatives are concerned, they may or may not be restricted to providing services in relation to products of the bank only. Even where bank representatives are not so restricted, business models are often in place that encourage bank representatives to focus their attention on marketing products of financial institutions within the banking group – for example the products of an associated insurer. The table above therefore also combines statistics of insurer and bank representatives to reflect the percentage of total representatives that are either tied or, even where not fully tied, would typically have an allegiance to the products of a particular group.<sup>31</sup> The data in the table therefore suggests that more than a third of all registered representatives are tied agents of insurers, and that just over half of all representatives represent a banking and / or insurance group. The balance of representatives – those representing an FSP that is neither a bank nor an insurer – are in most cases multi-tied representatives as described in paragraph 2.3.2 above.

<sup>27</sup> See sub-paragraph (iii) of the definition of “representative” in Part 3 of the Regulations issued under the Long-term Insurance Act, 1998.

<sup>28</sup> The contract between the insurer and the representative usually places limits on the amount of business that may be placed with the other insurer/s concerned, such as setting out a maximum percentage of total business to be placed with another insurer or insurers, or the circumstances in which another insurer’s products may be offered.

<sup>29</sup> FSPs that are also licensed as insurers under the insurance laws or are a division or other part of an insurer’s business.

<sup>30</sup> FSPs that are also licensed as banks under the Banks Act, 94 of 1990, or are a division or other part of a bank’s business.

<sup>31</sup> Note however that these statistics are only indicative. There may be an element of “double counting” on the lists of registered representatives. Currently there is no separate designation for fully “tied” representatives, and it is possible for the same individual to be registered as a representative of more than one FSP.

### 2.3.4. Binder holder

As discussed in 2.2.10, a binder holder carries out specific types of insurer functions on an outsourced basis on behalf of the insurer. Binder functions are therefore carried out as agent of the insurer, with the insurer retaining responsibility for the binder holder's actions. An insurer may enter into a binder agreement with either an "underwriting manager" or a "non-mandated intermediary".<sup>32</sup>

An underwriting manager acts solely as an agent of the insurer – the underwriting manager may never act as an agent of or on behalf of an insurance customer. The underwriting manager usually acts on behalf of one insurer only but there are cases where the underwriting manager can act on behalf of more than one insurer, where both insurers agree.

Where a non-mandated intermediary (as defined in the binder regulations) is the binder holder, the legal relationships are less clear as the intermediary acts as the agent of the insurer in relation to the binder services, but is also regarded as the agent of the customer (not the insurer) in relation to the advice and any other intermediary services. In other words, a non-mandated intermediary provides both binder services, and financial product advice. For this reason, current regulations prescribe that a binder agreement with a non-mandated intermediary must contain certain conditions and restrictions, designed to minimise the inherent conflicts of interest.

### 2.3.5. Outsource service provider to product supplier

Where this type of service (described in 2.2.11 above) is concerned, the service is rendered solely as agent of the product supplier concerned. Examples would be outsourced administration or claims assessment services which do not entail a customer sales or advice interaction. In practice however, confusion regarding legal roles can arise in relation to some of the services provided where they are outsourced to an intermediary, since the intermediary becomes the agent of the product supplier for these outsourced services, creating an inherent conflict of interest. In this case, some of the services provided (for example advice) are provided as agent of the customer, others (for example collection of premiums) are actual "intermediation" activities between customer and product supplier, while still others (such as printing of insurance policy documents) could be seen to be performed as agent of the product supplier.

### 2.3.6. Additional, more complex relationships

In addition to the above common types of arrangements, more complex distribution models exist which contain some of the above features, but overlaid with additional "layers" of relationships between the parties involved. In some cases, the distribution model is a "hybrid" of some of the relationships described above. Each of these in turn entails varied remuneration arrangements. These relationships run the risk of being opaque to customers and introducing conflicts of interest and layers of costs into the distribution of the products concerned.

Some examples include:

- "White label" or third party branding relationships, where a product supplier enters into an arrangement with a third party – typically a financial adviser – in terms of which the product supplier allows the third party to distribute its products under the third party's brand, or on a co-branded basis.
- Arrangements where a product supplier owns shares or a similar ownership interest in an intermediary entity or an associate of the intermediary entity.
- Arrangements where an intermediary owns shares or has a similar ownership interest in a product supplier or an associate of a product supplier.
- So-called "third party cell captive" models or similar arrangements.
- Joint venture / affinity arrangements between financial product suppliers and third party non-financial retail product suppliers, in terms of which the third party distributes the financial products concerned to its particular client or membership base, usually on a customised or specifically branded basis.
- Bundled product offerings where combinations of different types of financial products offered by different product suppliers (who may or may not form part of the same group) are marketed as a combined offering. Examples include "bancassurance" products and consumer credit insurance.
- So-called "netco" or intermediary "franchise" models, where product suppliers establish or contract with separate entities to provide various support services, on behalf of the product supplier, to so-called "independent intermediaries" contracted to market the product supplier's products. In some models these separate entities are structured as "juristic representatives" of the product supplier, but render services under their own name and brand rather than that of the product supplier.
- Relationships between product suppliers and product aggregation or comparison services.
- Combinations of the above.

## 2.4. Types of intermediary remuneration

The various types of services discussed in section 2.2 above are remunerated in a number of different ways, often dependent on the types of contractual relationships discussed in 2.3. Examples of remuneration models featuring in the current distribution landscape include:

### 2.4.1. Fees paid directly by customer

This model is relatively scarce, with a relatively small number of well-established intermediaries charging such fees – usually those specialising in providing financial planning and financial product advice in relation to investment products to high net worth customers. Customer fee based models also arise in the short-term insurance space, where short-term insurance intermediaries dealing with large corporate clients do not earn commission from the insurer but rebate the commission back to the customer, instead earning fees paid directly by the customer.

<sup>32</sup> Part 6 of the Regulations made under the Long-term Insurance Act and Short-term Insurance Act.

Few if any of these intermediaries however rely on these fees paid directly by customers as their sole source of remuneration. Instead, they usually earn a combination of direct fees and fees paid by the customer but facilitated by the product supplier through deductions from investment product values (see 2.4.2 below). In addition, a number of advisers further supplement their remuneration through commissions paid by product suppliers on certain products – for example where they also market insurance risk products. Typically, these intermediaries will charge direct fees only in respect of a portion of their customer base, for example those (usually high net worth) customers who are willing to pay a direct fee for the provision of a comprehensive financial plan. Even these customers will usually pay a direct fee for certain services, but remunerate the adviser through fees deducted from product values for other (usually ongoing) services. Where direct fees are charged, the agreed calculation basis for fees could comprise: a fixed up-front or *ad hoc* lump sum; periodic fixed payments; a percentage of a lump sum investment; a percentage of a series of ongoing investment contributions; an ongoing percentage of the product's investment value from time to time; a specific fee for specific services; a time based fee (for e.g. an hourly rate); or a combination of these. Neither the amount nor calculation basis of such direct customer fees is currently regulated.<sup>33</sup>

#### **2.4.2. Fees paid by customer, facilitated by product supplier (deducted from investment product values)**

This model is most common in relation to investment or savings products of product suppliers other than insurers – for example, collective investment scheme based products. In this model, the customer agrees a fee basis with the adviser, and authorises the product supplier to deduct the relevant fee from a lump sum amount invested, where applicable (commonly termed an “initial advice fee”) and / or periodically from the value of the investment from time to time (commonly termed an “ongoing advice fee”) and pay the fee across to his or her appointed adviser. Ongoing fees may be a specific authorised amount, but are more commonly expressed as a percentage of the investment value of the product (sometimes called a “trail” fee). The customer usually has the right to instruct the product supplier to cease deducting ongoing fees at any time. Other than in the case of insurance products, neither the amount nor the calculation basis of these fees is currently regulated.

Although some insurers have designed remuneration models that are similar to the above-mentioned initial and ongoing customer-authorised advice fee models for their investment and savings products, these remuneration models are complicated by having to comply with the constraints of the insurance commission regulations. For most insurance savings or investment products, insurers simply pay commission in accordance with the maximum regulated commission amounts.

#### **2.4.3. Commission paid by product supplier – up-front:**

This model applies to long-term insurance individual risk products, where commission (subject to a prescribed cap expressed as a percentage of future contractual premiums) is payable in the first and second year of the product. In the case of recurring premium savings policies offered by long-term insurers, up to half of the total commission may be paid up-front in this manner, with the balance payable over the term of the investment as premiums are received (referred to as “as-and-when” commission). Although commission is generally not paid by financial product suppliers other than insurers (and medical schemes) where various aspects of commission are regulated, there is no prohibition on

other types of product suppliers paying commissions to intermediaries, provided the intermediaries adhere to the conflict of interest limitations under the FAIS framework.<sup>34</sup>

#### **2.4.4. Commission paid by product supplier – ongoing (as-and-when commission)**

In the case of short-term insurance products and certain group scheme long-term insurance products, insurance legislation prescribes the payment of commission payable over the life of the product as premiums are received, subject to a cap expressed as a percentage of the premium concerned. This is commonly referred to as “as-and-when” commission. Medical scheme legislation also prescribes a maximum as-and-when commission cap for intermediaries distributing medical scheme products.<sup>35</sup> In the case of long-term insurance assistance business (typically small funeral insurance products) commission is payable on an as-and-when basis, but no maximum commission cap is imposed. The balance of commission payable on individual long-term insurance recurring premium savings products, after a maximum of 50% of the commission is paid up front, is also subject to an as-and-when basis.

#### **2.4.5. Salary or similar remuneration paid by product supplier**

This model applies mainly in the case of tied intermediaries who are employed or contracted by a particular product supplier (most commonly an insurer – see paragraph 2.3.3) to provide advice or other intermediary services only in respect of the product supplier or its group's own products. Salary-based models are most common in the case of advisers operating in lower income / low value product markets, where it may not be possible for pure commission-based remuneration to provide a sustainable income and where customer fee-based models may not be feasible. Salary models are also commonly used in the case of direct sales models (whether advised or non-advised) – for example to remunerate telesales agents in call centres. In many cases, salary-based remuneration will be supplemented by other employee “fringe” benefits and / or other forms of remuneration and incentives, such as commission or other production-based bonuses, allowances or non-cash incentives. Such additional remuneration would need to be provided within the limitations imposed by the FAIS conflict of interest controls. Salary based models are also sometimes used as an initial remuneration model for new intermediaries, before they build up a sufficient customer base to shift to a non-guaranteed commission-based income.

#### **2.4.6. Salary or similar remuneration paid by an intermediary's principal (other than a product supplier)**

This model applies in relation to representatives of a FAIS-licensed intermediary that is not a product supplier – for example a “brokerage” that appoints a number of “brokers” / representatives to provide services to customers on its behalf. This model is relatively common in the short-term insurance market. In other markets, as in the case with salaries provided by product suppliers themselves (discussed in 2.4.5), this type of salary-based model is most common in the case of lower income / low value product market segments, new intermediaries and direct sales operations. An example of the latter would be remuneration for front line staff who sell financial products as a bundled “add-on” to other retail products (such as sales staff in a furniture store who arrange sale of goods on credit, coupled with credit insurance). As for the preceding model, salaried remuneration would often be supplemented by other employee “fringe” benefits and / or other production-based remuneration or incentives such as bonuses, allowances or non-cash

<sup>33</sup> However, see the Supreme Court of Appeal decision in *Maree v C Booysen t/a NVM Beleggings & Versekeringsadviseurs* (307/09) [2010] ZASCA 44 (31 March 2010). This case has highlighted that the existing definition of what constitutes “rendering services as intermediary” in the Long-term Insurance Act and its commission Regulations is ambiguous and subject to varying interpretations. See also paragraph 3.3.3 below.

<sup>34</sup> Section 3(i)(c) and 3A of the General Code of Conduct for Authorised Financial Services Providers, 2003.

<sup>35</sup> Regulation 28 of the Regulations made under section 67 of the Medical Schemes Act, No. 131 of 1998.



incentives. Again, such additional remuneration would need to be provided within the limitations imposed by the FAIS conflict of interest controls.

#### **2.4.7. Rebates or platform fees paid by product supplier:**

LISPs are remunerated for their platform administration service by means of administration fees which are either payable directly by the customer (see the “vanilla” fee structure described below) or by the underlying product supplier (most commonly a CIS management company) as a “platform fee”, or both. The platform fee is defined in the FAIS General Code as a payment by a product supplier to a LISP for the administration and / or distribution and / or marketing cost savings represented by the distribution opportunity presented by the administrative platform and may be structured as a stipulated monetary amount or a volume based percentage of assets held on the platform.

LISP administration fees can be paid in various ways:

- “Vanilla” LISP fee structure: When a LISP purchases CIS units on behalf of the customer, the application form (the client mandate to the LISP) sets out the administration fees to be charged to the customer for the LISP administration services, as well as the advice fee that will be paid by the customer (facilitated by the LISP) to the financial adviser. These fees are usually generated by selling off units on a monthly basis. These unit sales are reflected in the periodic statements that are issued to customers. (The CIS management fees are reflected in the CIS fund fact sheet, and are taken off income distributions before the distributions are declared by the CIS management company and credited to the LISP for allocation to the customer’s account).
- “All-in” fee structure: In this model the CIS management company inflates its management fee to cover all applicable fees and charges. The CIS management company deducts its share of the management fee (and shares an agreed portion with the relevant FSP / financial adviser in the case of third part / white-labelled portfolios). The balance of the management fee is paid across to the LISP. The LISP deducts its platform fee and pays the customer-agreed advice fee over to the adviser. In some cases, the adviser and / or the LISP will have agreed to reduce their fees and the customer may benefit from this by way of a credit – either in the form of the purchase of additional units or the crediting of cash to the client’s “cash account” where that LISP offers cash accounts on its platform. In some cases, the reduction in the LISP platform fee goes hand in hand with an increased fee for the adviser. Under this model, the customer statements will not reflect the sale of units to pay for the various fees (instead, the fees have been settled through the CIS management fee, with the CIS distribution reduced accordingly), but the allocation of the CIS management fee to the three different parties (CIS management company, LISP and adviser) is in general disclosed.
- Hybrid models: In some cases, a hybrid of the two above structures is used. The all-in fee arrangement may not be sufficient to cover a particular adviser fee or LISP platform fee, in which case units are also sold off to boost the fees.
- Lately, some LISPs have moved to a “clean pricing” model, proactively responding to regulatory reforms and the trend towards increased transparency in other jurisdictions, such as the UK. Under this model, the investment management charge for different funds listed on the LISP strips out any adviser or platform fees. The adviser fee and administration fee are then separately paid for by the client, in most

cases facilitated by the LISP through the sale of units. There is transparent disclosure of the respective investment management fee, adviser fee and platform fee.

Some LISPs have fee arrangements on offer that seek to simulate those applicable to linked investment life policy arrangements – the idea being that there should be no difference in fee structure whether the customer enters into a policy or invests directly into CIS investments. These fee structures only apply to recurring contribution products. The LISP essentially subsidises the financial adviser’s up-front fee by following a “100% or 100% plus allocation” to the investment account. The advanced amount for the up-front adviser fee (and any other excess over capital invested by the customer) is collected from the customer’s investment on a monthly basis. The monthly platform fee or administration fee is thus higher than it would otherwise have been because the up-front payment by the LISP to the intermediary has to be recouped.

A practice which is quite common internationally, and is also a feature of the LISP environment in South Africa, is for a CIS management company to rebate part of its management fee to the LISP based on the volume of business placed with the CIS management company. In some ways this represents a bulk discount being passed back to the LISP, since the platform’s aggregation service on behalf of customers increases volumes and turns ‘retail’ business into ‘wholesale’ business by reducing the administrative load for the investment manager / product supplier.

In practice, a number of CIS management companies and LISPs have adopted the view that such rebates, where applicable, belong to the customer and must be disclosed and passed on to the individual investor. Accordingly, in these cases rebates are passed through to the customer, whether by reduced fees (offset against the adviser fee or the platform fee), the purchase of additional investment units or direct payment.

In some cases, CIS managers or LISPs enter into arrangements with intermediaries (usually financial advisers) to pass on rebates or discounts to the adviser. The FAIS General Code prohibits intermediaries from earning such fees or discounts unless the customer has agreed to them and is able to stop their payment. Intermediaries that fail to disclose the receipt and nature of such remuneration to their customers are therefore in breach of the FAIS General Code.

#### **2.4.8. Binder fees**

The Binder regulations allow an insurer to pay a binder holder a fee for the services rendered under a binder agreement. This fee must be reasonably commensurate with the actual costs incurred by the binder holder for rendering the binder services, with allowance for a reasonable rate of return for the binder holder. The binder regulations allow an underwriting manager (or a LISP / administrative FSP, in respect of long-term insurance) that is a binder holder to share in the profits of the insurer attributable to the type or kind of policies referred to in the binder agreement. The binder regulations prohibit certain types of fees being paid to a non-mandated intermediary that may settle claims or determine the value of policy benefits, to minimise the scope for conflicts of interest. The fee payable to a non-mandated intermediary that is a binder holder must be disclosed to a policyholder.

The binder regulations further prohibit a non-mandated intermediary that is a binder holder from (directly or indirectly) receiving or being

offered any share in the profits of the insurer in respect of, specifically, the binder services and the type or kind of policies referred to in the binder agreement. This prohibition is therefore not a general prohibition on profit sharing, but merely prohibits a non-mandated intermediary from being entitled to a percentage of the profits that the intermediary generates because of its performance of the binder functions provided for in the binder agreement. (Also see 2.2.10 and 2.3.4 above for further details on binder arrangements.)

#### **2.4.9. Outsource service fees**

As these services are carried out for and on behalf of a product supplier, they are generally remunerated by means of a fee negotiated with the product supplier. In most cases, the level of these fees is not subject to regulation, although where the service constitutes an “intermediary services” for FAIS purposes it is subject to certain requirements.

Remuneration paid in respect of the outsourcing of insurance activities is subject to Directive 159 it must –

- be reasonable and commensurate with the actual function or activity outsourced
- not result in any function or activity in respect of which commission or a binder fee is payable being remunerated again
- not be structured in a manner that may increase the risk of unfair treatment of policyholders, and
- not be linked to the monetary value of insurance claims repudiated, paid, not paid or partially paid.

The above principles also apply to any sub-outsourcing.

#### **2.4.10. Other insurance sector specific forms of remuneration**

- Section 8(5) fees

In terms of section 8(5) of the Short-term Insurance Act, a fee may be charged to the policyholder over and above commission and / or binder and outsource fees paid by product suppliers, provided that the amount of the fee is disclosed expressly and separately to the policyholder. These section 8(5) fees have many descriptions but are commonly referred to as “broker fees” or “policyholder fees”. The fees are charged either as a fixed Rand amount per policy or as a percentage of the premium.

- Cell captive dividends

Cell captive models are arrangements where an entity (the cell owner) holds an equity participation in a specific separately administered class or type of shares of an insurer. The cell owner performs certain functions on behalf of the insurer in respect of specific insurance products, which are underwritten by the insurer in a ring fenced manner and cover risks other than those of the cell owner. The cell owner is entitled to dividends as a result of the equity participation, which dividends are linked to profits generated by the specific insurance business concerned and are usually calculated as a percentage of the profits generated by that business.

- Joint venture / affinity profit share or similar remuneration

This remuneration flows from an arrangement similar to the cell captive arrangements described above, but where the equity participation is in respect of a specific class or type of shares in a direct or indirect holding company of an insurer, with dividends linked to the profitability of the holding company, rather than in shares of the insurer itself.

#### **2.4.11. Referral / lead generation fee**

These are fees paid to lead providers, as discussed in 2.2.9 above. The remuneration may be an agreed amount payable regardless of whether the “lead” results in business for the recipient of the lead, or may be conditional on business being done – usually the sale of a financial product. In the latter case, the remuneration often takes the form of an agreed percentage or “split” of commission or other remuneration earned from a product supplier for sale of its product. Such “splits” may or may not be facilitated by the product supplier concerned, and may or may not be disclosed to the customer concerned.

#### **2.4.12. Other types of fees paid from product suppliers to intermediaries**

Intermediaries may also – subject to the provisions of the FAIS General Code of Conduct governing conflicts of interest – receive various other types of fees from product suppliers, often linked to more intangible services like branding or sharing of intellectual property. Examples include fees or other forms of remuneration (such as profit share arrangements) for branding or “white label” arrangements in the CIS and insurance sectors.

The analysis in Chapter 2 points to a number of concerns regarding the current financial services distribution landscape. In particular, certain aspects of current distribution models pose risks to:

- Fair customer outcomes
- Intermediary sustainability, and
- Supervisory effectiveness.

At the same time, there are certain benefits of current distribution models that should be preserved through the reform process, insofar as this may be achieved together with mitigating identified risks.

### 3.1. Risks to fair customer outcomes

#### 3.1.1. Information asymmetry and customer sophistication

The inherent asymmetry of information and bargaining power between ordinary financial customers on the one hand, and product suppliers and intermediaries on the other, exposes financial customers to particular risks of exploitation and mis-selling. Although customers with low levels of financial literacy are most vulnerable to such exploitation, information asymmetry remains a risk to fair outcomes even in more sophisticated customer segments.

- *Mass market / low income customers:* Demand-side features of the low-income market, including poor financial literacy and the inability to pay for the full cost of advice, combined with supply-side constraints such as the cost of sustaining a full advice model in this market, means that low-income customers are particularly vulnerable to mis-selling. An appropriate regulatory framework for this market requires careful balancing of consumer protection and financial inclusion objectives. To mitigate the risks of unfair sales practices and / or inaccessible advice in this market, distribution related regulation needs to be supported by appropriate safeguards in the form of more interventionist product regulation.
- *Mid-market customers:* Although relatively less vulnerable to mis-selling risks than the mass market segment, mid-market customers remain significantly less knowledgeable than product suppliers and intermediaries in relation to financial products and services. Such customers are also unwilling or unable to pay up-front direct fees for advice, exposing them to the risks of commission led product and adviser bias. Advisers operating in this market are also of widely varying quality.
- *High net worth customers:* Even wealthy customers are not always aware of the ability to negotiate the cost of advice. These customers also typically invest in products and use distribution channels (such as platforms, “white label” products, products with complex underlying instruments) that may be subject to opaque fee structures. Again, the quality of advice in this market varies. Despite the qualification standards introduced by the FAIS framework, which require higher qualifications in relation to more complex types of products, the complexity of some specific products create the risk that advisers may not have the specific product knowledge to provide appropriate advice.

#### 3.1.2. Inherent conflicts of interest in the insurance sector’s commission model

A number of the features of the current commission-based remuneration model in the insurance sector entail inherent conflicts – both actual and perceived – between the interests of intermediaries, customers and product suppliers.

- *Tripartite legal relationship creates conflicts:* The intermediary is subject to a clear legal obligation<sup>36</sup> to act in the best interests of the customer and ensure that advice provided is suitable to the customer’s needs. In the case of a so-called independent intermediary,<sup>37</sup> advice is provided as an agent of the customer.

However, the intermediary is dependent on the product supplier (insurer) for its remuneration for this advice. This creates an inherent conflict of interest – in particular, the temptation to provide biased product advice, or potentially even biased financial planning, if the intermediary is offered better remuneration by one product supplier or in respect of one product type rather than another. Even the perception of commission led bias undermines confidence in the quality of the advice offered.

To avoid potential conflicted advice, the remuneration that an intermediary receives for providing advice should not be influenced by the product supplier, but should be agreed between the adviser and his or her client. This should lead to advisers who are product supplier and product type neutral – consumers should receive the right product for their needs and circumstances, irrespective of product supplier relationships.

- *Commission system is opaque and potentially misleading:* Given the “built-in” nature of commission charges, customers may believe that they are not paying for advice. In reality, the costs of advice (whether a customer actually receives advice or not) is almost always blended into the cost of the insurance product. Even where customers do appreciate that part of the product cost is allocated to the intermediary they may not pay adequate attention to how much they are in fact being charged for advice and other intermediary services. The “built-in” commission cost model also makes it difficult to compare advice costs across offerings.

The hidden impact of intermediation and advice costs on product prices or values can be high. If customers believe that they are not paying for advice, there is less potential for supply and demand of intermediary and advisory services to result in efficient pricing. The opaque nature of the costs can lead to cost escalation – or at least not a proper assessment of value. The blurring of product and advice costs may also result in intermediary remuneration not being commensurate with the actual cost of the services provided – including the possibility of the customer paying twice for the same services (such as paying a “policyholder fee” over and above commission – see below).

The low visibility of the impact of commission also undermines accountability for the quality of advice, and customer rights to recourse are not always clear. As customers may not always be aware whether or how much they are paying for advice, or that they are paying for it at all, there is a weaker accountability mechanism when it comes to the quality of advice.

Often, the cost of ongoing commissions (for example commission on annual premium escalations) remains “built in” to the product cost even once the intermediary who initially sold the product no longer has a relationship with the insurer concerned and no ongoing commissions are in fact being paid to the intermediary.

- *Entitlement to commission is not dependent on providing advice:* Although the FAIS framework imposes strict quality controls on the advice process where advice is indeed provided, the regulatory framework imposes no obligations on insurance intermediaries to provide advice before being entitled to commission. As the commission agreement exists solely between the insurer and the intermediary, the intermediary is typically entitled to regulated commission solely on the basis of selling a policy, regardless of whether advice or any other service is provided to the customer. Accordingly, the customer has no right of recourse against either the insurer or the intermediary for reversal or recovery of commission costs in the event of dissatisfaction with the intermediary’s advice or

<sup>36</sup> Sections 2 and 8 of General Code of Conduct for Authorised Financial Services Providers, 2003.

<sup>37</sup> See 2.3.1 above.

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services. The insurer is only obliged to “claw back” commission in the event of premium cessation or refunds, and then only within certain limits.

- **Commission paid as a percentage of premium creates inherent problems:** Commission as a percentage of premiums can lead to mis-selling, as there is an incentive for intermediaries to sell the highest premium / contribution possible, including the possibility of unrealistic contractual escalations in premium / contribution. There is also an incentive to sell an insurance product when, in fact, another type of product – or no product at all – would have been more appropriate.

Commission paid as a percentage of premium may not be commensurate with the cost of the actual services provided. In particular, the intermediary’s cost of providing advice or other intermediary services may be very similar for a small premium product as it is for a large premium product, but the commission paid will be substantially different. Customers paying higher premiums therefore typically cross-subsidise the cost of services to customers taking out lower premium products. Customers who receive advice (whether financial planning or product advice), but who do not subsequently buy a product, do not usually pay for that advice. They are cross-subsidised by those customers who are paying for advice or services through commission.

- **Up-front commission creates inappropriate incentives:** The up front or partially up front nature of most long-term insurance commission structures creates a potential incentive – or at least no disincentive – to ‘churn’ products to generate additional income, not necessarily in the best interests of the customer. This is particularly the case where the cost of advice, or the need to demonstrate value for the cost of advice, is not explicit. In the long-term insurance sector, levels of churn are high, with corresponding risks in terms of mis-selling. The direct costs to customers of churn can be substantial in the case of contractual savings products in the form of early termination charges, but even in life risk business the direct costs may be severe if an individual policyholder is switched to risk products that are not appropriate to their individual circumstances or needs. In addition, the costs to the long-term insurance sector of high levels of churn are substantial, which ultimately results in higher premiums for consumers than would otherwise be possible.

Up-front commission also creates no incentive for intermediaries to provide ongoing advice and services to customers. It also creates no incentive, and in fact creates a disincentive, for intermediaries to provide advice or services to ‘orphan’<sup>38</sup> customers who have existing policies, unless they can persuade the customer to buy a new policy – which may not be in the customer’s interests.

Importantly, the up-front commission model is also the main driver of early termination charges<sup>39</sup> being deducted from values of long-term insurance investment products. Where a customer stops or reduces contributions to such a product, often due to circumstances outside their control, the insurer recovers outstanding up-front commission costs from the product value, often significantly compromising the TCF requirement that products should deliver on reasonable benefit expectations, and that customers should not face unreasonable barriers to accessing benefits. Despite a series of regulatory amendments since 2005 aimed at reducing the impacts of these charges, they remain a concern.

- **Fees over and above commission:** In the absence of regulatory clarity, intermediaries are charging policyholders various fees over and above

commission, although it is not clear that this is in return for the provision of services over and above services as intermediary (which are intended to be subject to commission limits). In the short-term insurance industry in particular, this is prevalent through the payment of so-called section 8(5) ‘policyholder fees’.<sup>40</sup> There is no requirement that the policyholder explicitly agree to the policyholder fee, nor is there clarity on the policyholder’s right to cancel the payment of the fee if no adequate service is being rendered. As such, some intermediaries tended to treat this as an additional commission. There is also no consistency between the Short-term Insurance Act and the Long-term Insurance Act regarding the circumstances under which a policyholder fee may be charged and the services for which it may be charged.

- **An unlevel playing field exists for investment product remuneration:** Different remuneration structures apply across industries providing similar investment products that could be recommended to meet similar customer needs, for example single CIS products, CIS products through a LISP structure, and long-term insurance endowment policies (which may in turn “wrap” underlying CIS or LISP structures). This creates an unlevel playing field, creating the potential for biased product advice and mis-selling.
- **A potential bias towards tied advice models exists:** The “equivalence of reward” provisions in the long-term insurance commission regulations are vague and have been interpreted in an inconsistent manner, resulting in some insurer tied representatives earning remuneration significantly in excess of the maximum regulated commissions available to other distribution channels. This introduces a potential inappropriate bias towards tied advice models. Aspects of the FAIS framework also contribute to this potential bias. The FAIS prohibitions on conflicts of interest are less rigorous in respect of incentives payable to representatives of an FSP with limited product supplier choices than in respect of incentives payable to the FSP itself.<sup>41</sup> As a result, where the FSP is also a product supplier, it can offer more flexible incentives to its tied representatives than those it can offer to other intermediaries.

The potential for such bias is exacerbated by the increasing prevalence of so-called “hybrid” distribution models. These are legally structured as tied models, where the intermediary is a representative of an insurer for commission regulation purposes and so is entitled to remuneration on the “equivalence of reward” basis, but in reality allow the intermediary to offer a range of products and services closer to those typically offered by independent intermediaries. Such models run the risk of creating significant confusion in the mind of the customer as to the level of independence of the advice provided.

### 3.1.3. Conflict of interest risks arise from other forms of fees paid to intermediaries by product suppliers

Other forms of fees and remuneration, paid by product suppliers to intermediaries, also have the potential to create conflicts of interest or otherwise compromise fair customer outcomes:

- **Binder fees and outsourcing fees paid by insurers:** Directive 159 under the insurance laws contains principles governing outsourcing,<sup>42</sup> including remuneration for outsourced activities. These principles include an obligation on the insurer to avoid, and where this is not possible mitigate, any conflicts of interest between the insurance business of the insurer, the interests of policyholders or the business of the other person that performs the outsourcing. Linked to this, remuneration paid in respect of outsourcing must be reasonable and commensurate with the actual function or activity outsourced; must not result in any function or activity in respect of which commission or a binder fee is payable being remunerated again; must not be

<sup>38</sup> The term “orphan customer” is commonly used in the insurance industry to describe the situation where the insurer does not have a record of a particular intermediary who is providing services to the customer concerned – usually because the intermediary who initially sold the product to the customer no longer has a relationship with the insurer and the customer has not appointed a new servicing intermediary.

<sup>39</sup> Defined in regulations to the Long-term Insurance Act as “causal event” charges.

<sup>40</sup> See 2.4.10 above.

<sup>41</sup> The FAIS General Code only requires an FSP to ensure that incentive to its representatives do not give preference to: The quantity of business secured for the FSP to the exclusion of the quality of the service rendered; a specific product supplier where a representative may recommend more than one product supplier; or a specific product of a product supplier where a representative may recommend more than one product of that product supplier.

<sup>42</sup> These principles are equally applicable to insurance binder services, which are a particular form of outsourcing.



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structured in a manner that may increase the risk of unfair treatment of policyholders; and must not be linked to the monetary value of insurance claims repudiated, paid, not paid or partially paid.

The FSB however has a number of concerns as to the degree to which these principles are being applied in practice. The FSB has observed a marked variation in the degree of effective oversight exercised by insurers with respect to the performance and conduct of third parties performing outsourced functions (including binder functions). In some cases, this has been shown to materially undermine the quality of the governance framework of the insurer, including the insurer's ability to manage its risks and meet its legal and regulatory obligations. This also impairs the ability of the regulator to monitor the insurer's compliance with its regulatory obligations, as the insurer is not able to adequately report on the financial and conduct risks arising from the outsourcing relationship. This lack of effective oversight is in most cases linked to inadequate access to customer information and data, in some cases (particularly in the short-term insurance sector) exacerbated by the fact that intermediaries collect premiums on behalf of insurers, without proper data controls.

The principle that an outsource fee should be reasonable and commensurate with the cost of providing the activity or function is difficult to test in practice. A real risk exists that outsource fees paid to intermediaries create a conflict of interest if the outsourcing fee is not reasonable and commensurate with the cost of providing the outsourced service, as the intermediary may be incentivised to direct business towards product suppliers that pay the most attractive outsource fees while product suppliers seek to boost product sales by competing on the quantum of incentives that are offered. In the binder function context in particular, the FSB has received numerous complaints since the introduction of the binder regulations indicating undesirable business practices whereby intermediaries have directed business to insurers based not on customer interests but on the insurer with whom they have been able to negotiate the highest binder fee.

An additional complexity is the fact that the current long-term insurance commission regulations for credit life group scheme structures provide for an increased commission cap of up to 22.5% of premiums<sup>43</sup> in cases where administration services are provided by an intermediary in relation to such a group scheme. It is questionable whether this additional commission cap is necessary in light of the promulgation of the binder regulations and Directive 159. Cases have been observed of intermediaries earning both this additional commission cap and a separate outsource fee from the insurer concerned in relation to the administration services provided in these models. This is inconsistent with the principle outlined above that intermediaries should not be remunerated twice for the same service.

- **Other forms of outsourcing fees:** Although the provisions of Directive 159 are currently specific to the insurance sector, similar concerns arise regarding outsourcing practices in other sectors. For example, the model where a financial adviser enters into an arrangement with a CIS manager or LISP (whether through a third party arrangement or otherwise) to earn a volume based share of the CIS management fee has the potential to introduce bias into product advice.
- **Other forms of remuneration:** Other forms of remuneration paid to financial advisers for less tangible or quantifiable services, such as branding, market intelligence research or intellectual property related fees, pose similar risks to the provision of unbiased advice when they

are paid to financial advisers. Conflicts of interest arising from these arrangements – including but not limited to “soft commissions” (such as corporate hospitality and gifts) have already been dealt with through the FAIS General Code.

### 3.1.4. Conflict of interest risks and complexity of charging structures arising from platform fees and rebates paid by product suppliers

Platform fees and rebates are generally negotiated between a LISP and a product supplier. The level of platform fees and rebates is not regulated. The FAIS General Code provides that where regulated commission and fees are not paid, the FSP may only receive fees that have been specifically agreed to by customers in writing. Although signed LISP mandates reflect disclosure and agreement with the rebated platform and adviser fees, the transparency and level of understanding by customers of what they have agreed to may be questionable.<sup>44</sup> There is therefore no regulatory limitation on the amount or type of any rebate, or any requirement that any rebate be fully paid into the membership accounts of customers. Rebates and / or all-in fees from CIS management companies have generally been introduced to assist with operational efficiency (it means that the CIS manager does not have to launch multiple fund classes for different account sizes of customers) and to collect charges in a tax efficient way. However, current practices raise a number of significant concerns:

- **Effectiveness of disclosure:** In practice, the effectiveness of platform fee and rebate disclosures is unclear. Disclosure is often not prominent, and investors may be unaware of the meaning of the disclosure even where it is prominent. The complexity created by rebate payments can make this difficult in some cases. Some providers do not appear to disclose the entire rebate or platform fee received to their customers, or may arrange their affairs so that the rebate is paid back indirectly rather than explicitly.
- **Conflicts of interest:** The fact that platform fees and rebates are negotiated with different product suppliers creates a clear potential for conflict of interest, in that a LISP may bias the selection of products to be listed on its platform towards those suppliers willing to provide the highest fee or rebate, or away from investment products with lower charges toward more expensive options that can afford to pay greater fees or rebates. Rebates could therefore create a conflict between the platform and its ultimate customers, raising the ultimate costs paid by consumers for financial services.
- **Competition between service providers providing advice, administration, and investment management:** Paying rebates reduces the amount of influence that customers have over charges for different services, including administration and investment management. This decreases competition in the market for platforms, investment management and possibly even advice, resulting in a less efficient market for consumers. For example, financial product suppliers may try to cap their rebate levels at the administration costs of different platforms to prevent more efficient administration platforms from undercutting other distribution channels – a form of resale price maintenance which is enabled by the payment of rebates.
- **Complexity of charging structures:** Despite the promise of greater simplicity, in practice, paying rebates probably increases rather than reduces the complexity of charging structures. Rebates make it difficult, if not impossible, for most customers to identify how much they are paying to which entity in the value chain and for what. As a result, some customers may end up paying more than once for the same services. For example, customers may invest in an all-in fund on a platform which does not pay rebates back to customers, or may pay an adviser who already receives a rebate, an additional amount for financial advice. Customers may also think that various aspects of the

<sup>43</sup> See the “Table” as set out in Annexure 1 to Part 3 of the regulations under the Long-term Insurance Act, 1998.

<sup>44</sup> Specifically, the FAIS Code of Conduct for Administrative and Discretionary Financial Service Providers requires a LISP to fully disclose to its customers the total fees and benefits to be received by itself and the underlying product suppliers in respect of a customer's investment, in the signed mandate it must receive from customers before it may conduct any business with them.

## CHAPTER 3: RISKS AND BENEFITS OF THE CURRENT LANDSCAPE

services provided (especially administration and advice) are free or cheaper than they actually are. This lack of transparency may impede competition and efficient pricing.

The system-based investment fund options generated for customers by some LSPs also raise potential risks. The tools tend to generate only a very limited number of recommended funds – often only the funds of the CIS management company that are “in-house” to that brand. The fact that the funds presented are usually multi-manager funds is generally put forward by the LSP and subscribing advisers as evidence of the fact that advice is being given across a broad enough spectrum of providers. However, although in theory there is nothing stopping the customer from holding other CISs outside of those that are generated at the end of the process, they will not be included in the whole system-generated, comprehensive picture of the customer’s exposure across the various market segments, which is what the model is designed to capture. The customer holding CIS funds / portfolios outside of those that are included in the model would effectively negate the usefulness of the whole model, which is a considerable risk to the provision of unbiased advice.

### 3.1.5. “Wholesale” distribution models

In these models advice or other services are not provided directly to the end user of the financial product concerned, but to an intermediate entity purchasing the product to provide benefits for end users – most commonly an employer or a retirement fund. As discussed in 2.2.4 above, the intermediary concerned should therefore consider not only the interests of the immediate customer (such as the employer or fund), but also those of the end users (employees, fund members or medical scheme members). There is concern however regarding the extent to which end user interests are indeed taken into account, and potential conflicts between the interests of end users, the intermediate customer and the intermediary.

Concerns in this regard include the following:

- The advice given to an employer (including where an employer is a sponsor of or participating employer in an occupational retirement fund or ‘restricted membership’ medical scheme) often includes advice in regard to the types of product features which the employees / members concerned should be entitled to select – such as retirement fund investment portfolios, medical scheme options, insurance coverage options, etc. Advice on these benefit options is usually provided to employers / funds without regard for the specific circumstances of individual employees / members, with the adviser assuming that the employer / fund will take such individual needs into account. However, the cost of this advice is often borne by the employees / members themselves in various ways – such as by way of deductions from contributions, deductions from investment values, and / or as part of their ‘total cost of employment’ remuneration package. As a result, the employer to whom the advice on the choice of benefits is provided may not be particularly concerned about the cost of this advice and / or these benefits as it will be borne by its employees by the adjustment in the amounts of their take home pay. This poses the risk of members / employees bearing the cost of “advice” that they have not received directly, and which may or may not pay adequate regard to their needs.<sup>45</sup>
- Similar problems may be evident in relation to risk benefit cover provided by retirement funds and medical schemes to their members in terms of their rules (that is, ‘approved’ risk benefit cover) although this may be mitigated by the fact that retirement funds and medical schemes are ‘not for profit’ entities and their boards have a fiduciary

duty to ensure that assets are used in an appropriate manner to fulfil their objects.

- A problem specific to retirement funds is that the adviser to the employer / fund may also, in some cases, be remunerated for placing employees’ / members’ retirement savings in specific investment portfolios even if those investments were not made on the request of the employees / members themselves and on the advice given by the adviser to those employees taking into account their individual circumstances. Such remuneration may be provided to the intermediary via arrangements with the investment manager or investment platform concerned – but still ultimately at the cost of the end employee / member.
- If the individual employee / member is entitled to choose his or her own investment and / or benefit options and wishes to obtain their own personal advice in relation to these choices, this will generally either be at their own additional cost or, where the employer / fund may make access to “free” advice available, the choice of adviser may be limited and the cost may still be borne indirectly by the employee / member concerned.

### 3.1.6. Conflicts of interest arising from ownership or similar arrangements and relationships between intermediaries and product suppliers

Conflicts of interest may also arise from ownership relationships between adviser firms and product suppliers, or between different adviser firms – for example where there is cross-ownership between an adviser firm and a product supplier that may influence advice, due to indirect benefits or profit-share arrangements between the entities concerned. Similar concerns arise in cases where, although there may not be a cross-ownership between entities, the entities share the same significant shareholder, or a related significant shareholder.

One area that has been reviewed in the insurance sector is third-party cell captive arrangements<sup>46</sup> – in particular, instances where an intermediary owns a cell (i.e. owns shares in an insurer that entitle the intermediary to a share of the profits and losses arising from the business placed with that insurer). Due to the inherent conflict of interest that arises, the Registrar of Insurance has indicated an intention to vary the licence conditions of third-party cell captive insurers to prohibit cells being owned by intermediaries except under narrowly defined circumstances.

Another area that will require attention is ‘bancassurance’ or other conglomerate arrangements, where there may be an adviser business (described as an “independent intermediary” business in the current regulatory framework) in the same group as an insurer or other product supplier, and an inherent conflict arises because of the various indirect incentives that may be in place to direct business towards the product supplier/s in the group.

### 3.1.7. Disclosure standards may not be adequate

Although the FAIS framework does currently require intermediaries to disclose various details regarding their remuneration, the nature of their contractual relationships with product suppliers and conflicts of interest to which they may be subject, the range and complexity of some current distribution models, as discussed in Chapter 2, casts doubt on the extent to which these disclosures are helpful to ordinary financial customers. Concerns regarding the adequacy of disclosure arise, in particular, in relation to remuneration and intermediary status.

<sup>45</sup> For example, if in terms of its employment contracts with its employees an employer will be liable to pay to an employee or his or her nominated beneficiaries a determinable amount on the employee’s disablement or death before retirement, the employer’s contingent liability to the employees is then underwritten by an insurer in terms of a policy issued by the insurer to the employer. A share of the cost to the employer of the premiums payable by it to the insurer (which will include the cost of commission payable by the employer to the employer’s adviser) is deductible from the employees’ remuneration in terms of their employment contracts. The deductible amounts are not fixed or determinable in terms of the employment contracts alone. In these cases, the employer may not be particularly concerned about whether the cover is provided on a ‘value for money’ basis because the cost of it is borne by its employees and the needs of individual employees or the employees as a group may not be given sufficient weight in the formulation of the adviser’s advice.

<sup>46</sup> Review of third-party cell captive insurance and similar arrangements, Discussion Paper (11 June 2013).

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- **Remuneration disclosure:** As for any other professional service, it should be clear to customers what services they can expect to receive from a financial intermediary and how they can expect to pay for them. Current FAIS disclosure obligations in relation to intermediary remuneration, while extensive, do not necessarily enable customers to make informed decisions regarding the range of advice or intermediary services available, what exactly is being paid for, the impact of these costs on product prices or returns, or available payment methods. Inconsistencies in the types of charges and fees paid for intermediation or advice and, where applicable, the way these charges and fees relate to other product costs, mean that the customer may not be in a position to know when a charge of fee is appropriate.
- **Intermediary status disclosure:** Despite relevant FAIS disclosure provisions, the proliferation of distribution models and inconsistent use of terminology means that customers may nevertheless not be clear on the legal and contractual status of the intermediary they are dealing with – particularly as to whether or to what extent the advice they are receiving is likely to be influenced by the intermediary's relationship with one or more product suppliers. Currently, no consistent definition of or criteria for "independent" advice exists. As discussed in Chapter 2, the current definition of an "independent intermediary" in insurance legislation includes intermediaries that, in reality, the average customer would most likely not regard as offering independent advice if they fully understood the limitations on such advice. Customers may believe they are getting comprehensive and objective advice, when in fact it could be restricted to products from a single provider or a very small number of providers; a restricted range of product types; influenced by contractual obligations to the product supplier through binder or outsource agreements; or otherwise not free of the influence of remuneration paid by product suppliers.

**3.2. Risks to intermediary sustainability****3.2.1. Intermediaries not adequately remunerated for advice**

In a commission based model, the intermediary receives no remuneration for professional time spent on financial planning or product advice if these efforts do not result in a product sale. The risk also exists that a customer will obtain advice from a professional adviser, but then act on that advice by contracting on a direct "execution only" basis with the relevant product supplier, thus avoiding commission costs.

**3.2.2. Value of financial advisers' services not properly recognised**

In a model where commission cost is "built in" to other product costs, the risk arises that advice is not valued as it should be by consumers. Where customers believe that they are not paying for advice, they will not properly value the advice and rather "take it for granted."

The commission system by and large results in an intermediary who provides a comprehensive service, including financial planning and comprehensive product advice, potentially being paid the same as an intermediary who provides little more than a "post box" service or even in some cases performs non-advice selling (such as call centre agents).

The commission system therefore limits the ability of more experienced and proven professionals to charge more for their services than more junior advisers or advisers that provide a far more basic service. This creates a barrier to the professionalisation of the financial advice industry.

**3.2.3. Up-front commission system does not support a sustainable business model**

An up-front commission structure forces intermediary businesses to follow a 'cash-flow' model, rather than building an annuity income stream that can be sold as a going-concern, creating value in the business and enhancing business continuity and succession planning.

An up-front commission structure also does not fully promote the development of the long term customer relationships that are necessary to build a sustainable business, as it does not incentivise ongoing contact with and services to customers.

**3.2.4. Inappropriate incentive structures expose intermediaries to regulatory risk**

Inherently conflicted incentive structures increase the risk of intermediaries being tempted to provide inappropriate advice, giving rise to customer complaints. Resultant adverse Ombud rulings or regulatory action, even if triggered by an isolated instance, could have disastrous consequences for the intermediary's reputation and the survival of his or her business. Where distribution and advice models fail to consistently deliver on fair outcomes for customers, this also undermines trust in financial services and financial advisers, weakening the sustainability of the intermediated business model.

**3.3. Risks to supervisory effectiveness****3.3.1. Imbalances in responsibility of product suppliers and intermediaries for customer outcomes**

The current regulatory framework, primarily through the FAIS Act, places rigorous obligations on intermediaries, aimed at ensuring that the advice and other services they provide will achieve fair customer outcomes. There is significantly less responsibility imposed on product suppliers to be accountable for customer outcomes achieved through their chosen distribution channel. This imbalance means that product suppliers may try to abdicate all responsibility for mitigating risks of unfair customer treatment by intermediaries with whom they contract. Instead, product suppliers may see such risk mitigation as being the sole responsibility of the regulator – for example through the FAIS licensing, compliance and dispute resolution frameworks.

This "washing of hands" attitude, where it exists, complicates supervision and undermines the regulator's effectiveness in achieving fair customer outcomes. The regulator should not be the 'first line of defence' in ensuring fair outcomes in relation to advice and distribution models. Product suppliers, who are naturally closer to the intermediary force and have a clear interest in effective and appropriate distribution of their products to their customers, are in a better position than the regulator to monitor advice and distribution outcomes and put reasonable controls in place to promote fair treatment and mitigate mis-selling risks.

The current remuneration model – particularly in the case of commissions, which are by definition a volume-based form of remuneration – exacerbates this imbalance by enabling product suppliers to incentivise intermediaries for volume-based product sales, with insufficient concomitant accountability in relation to the quality or outcomes of the sales process from a customer perspective. Although the FAIS framework disallows an FSP from remunerating its own representatives for quantity of business at the expense of quality, the mere fact that commission may be paid by the product supplier to the FSP (or to its own representatives where the product supplier is an FSP), creates an inherent bias toward rewarding quantity of business.

**3.3.2. Fit and proper standards for intermediaries not always supportive of financial inclusion**

It is a key principle of financial regulation that the regulatory and supervisory framework must be proportional to the nature, scale and complexity of the business being regulated and the risks to which the business and its customers are exposed. The regulatory framework for financial services in relation to mass market or low income consumers requires careful balancing of consumer protection and financial inclusion objectives.

There is a risk that elements of the current regulatory framework for distribution, particularly in relation to fit and proper standards for intermediaries, are not sufficiently flexible to strike this balance appropriately. The regulator has had to make use of complex regulatory exemptions to ensure that the framework does not pose unreasonable barriers to entry that hamper financial inclusion and access to advice. This process of “regulating through exemptions” is undesirable, resulting in regulatory uncertainty. The proportionality principle recognises that simpler regulatory standards can apply to distribution where other safeguards against mis-selling are in place – such as product standards ensuring simple, low risk products.

**3.3.3. Inconsistencies between FAIS and sector-specific provisions**

In the current framework, various inconsistencies and / or overlaps between the FAIS Act and provisions in sector-specific items of legislation have created a degree of confusion and regulatory arbitrage. These include inconsistencies between descriptions of intermediary services in the FAIS Act and insurance laws, as well as overlapping provisions in the FAIS Act, Collective Investment Schemes Control Act and Financial Markets Act.

The existing definitions of intermediary services in the respective insurance laws are not the same, nor are they completely consistent with the definition contained in the FAIS Act. The following is evident from a closer examination of the respective definitions:<sup>47</sup>

- In terms of the FAIS Act, advice is defined separately from other intermediary services
- In terms of the insurance laws, advice is not separately mentioned, but can be seen as forming part and parcel of “any act directed towards entering into” a policy (in the case of upfront advice) or “maintaining or servicing” a policy (in the case of ongoing advice), both of which are key elements of the definition of services as an intermediary
- In terms of the insurance laws, the definition of services as an intermediary covers not only the initial act directed at entering into a policy, but also covers subsequent maintenance and servicing activities in relation to a policy; and
- In terms of the Long-term Insurance Act, the definition of services as intermediary also extends to “providing administrative services in relation to a policy”, whereas in terms of the Short-term Insurance Act, the definition of services as intermediary extends in a similar way to “receiving, submitting or processing claims under a short-term policy”.

The definitions of services as intermediary in the insurance laws are broad and encompass all services rendered by an intermediary during the life cycle of a policy (advice, intermediation and administration). The remuneration payable in respect of these services is limited to regulated

commission. There is no distinction between the remuneration payable when advice is provided or not (although the FAIS Act contains certain requirements with respect to advice). There is also no separation between the remuneration payable for the initial sale versus payment for ongoing service. As a result, in a completely up-front commission environment (such as that currently applicable to many long-term insurance risk products) there is a reduced incentive for the intermediary to provide such ongoing service.

Precisely because the remuneration payable in respect of services as intermediary is limited to regulated commission, there has been much interest and debate over a number of years as to what precisely falls within the scope of this definition – mainly driven by the desire to argue for additional remuneration for undertaking services that fall outside of this definition. There has been an added imperative to seek regulatory clarity, arising from the Supreme Court of Appeal decision in *Maree v C Booysen t / a NVM Beleggings & Versekeringsadviseurs (307 / 09) [2010] ZASCA 44 (31 March 2010)*. This decision implies that section 49 of the Long-term Insurance Act (and the Regulations) prohibit an independent intermediary from accepting any remuneration from the insured, insurer or any third party in relation to intermediary services rendered, otherwise than in the form of commission provided for in the Regulations. This interpretation prohibits the payment of independent advice fees even where no commission is paid and runs counter to Directive 132.A.ii issued by the Registrar of Long-term Insurance on 30 January 2004.

**3.3.4. Complex and “hybrid” distribution models create scope for regulatory arbitrage**

Some of the more complex distribution models – including the so-called “hybrid” models discussed in 2.3.6 above – enable entities to operate in multiple capacities, creating the risk of significant consumer confusion regarding the extent and status of services provided. Some of these models also undermine supervisory effectiveness, by enabling product suppliers and / or intermediaries to structure relationships in such a way that they escape particular regulatory requirements, despite offering similar services to those of more straightforward business models. For example the “juristic representative” model is often used to enable the same legal entity to provide advice or other services in different capacities – for example the same entity can currently operate as a FAIS licensed financial services provider in its own right, as a juristic representative of another financial services provider, and / or as a product supplier. Juristic representatives also typically have their own corporate branding, making it difficult (despite current FAIS disclosure requirements) for customers to understand who the adviser they deal with is in fact acting for and which entity takes responsibility for the advice provided.

**3.3.5. Gaps in current regulatory framework**

Various limitations of the current framework allow some products and related advice to fall outside the regulatory net. FAIS defines advice as being related to one or more of an itemised list of product types. Accordingly, advice in relation to transactions that do not relate to one of these listed products escapes regulatory oversight, even where the intermediary markets the product or service concerned as providing benefits comparable to those of financial products. It follows that the remuneration or incentives available to intermediaries in respect of these products or services also fall outside the regulatory net.

<sup>47</sup> See Annexure 1 for the wording of the relevant definitions.



A further gap in the current framework is the fact that direct non-advised sales of financial products (as discussed in 2.2.6 above) fall outside the FAIS framework. This is because the factual information provided to customers in these models does not constitute advice and product suppliers are able to structure their sales models so that the individuals providing this information are not representatives for FAIS purposes. As discussed above, there is however a fine line between the provision of advice and purely factual information in these models. Particularly where remuneration or incentives are based on sales volumes, the risk of crossing the line between pure “execution” and a “recommendation” is high. Even where this line is maintained, there is additional risk to fair customer outcomes in the fact that the individuals providing the factual information are not subject to any FAIS fit and proper or competency standards.

The current framework also does not adequately address potential risks arising from product comparison and aggregation services. As explained in 2.2.8, this service involves the provision of factual information in response to client queries, in respect of multiple products and product suppliers, but could in certain cases constitute up-front product advice. The service is most commonly provided through a web-based portal that requests high level information from the customer and generates quotes for comparison purposes, sometimes based on a basic level of “underwriting”. Currently, the service is most prevalent in relation to insurance products, particularly short-term insurance products.

The FSB through supervisory reviews has identified a number of concerns with these models:

- Information about the website itself is inadequate
- The range of product suppliers and products that are being compared on the website are not made clear from the outset or are misrepresented
- The main criterion (and in some cases the only criterion) used for comparison is price, with little or no disclosure regarding other important product features and risks that are necessary for a customer to make an informed product choice. This over-focus on price at the expense of understanding the quality of the product undermines the TCF objective of ensuring that customers are sold products that perform as they were led to expect
- There are considerable potential conflicts of interest with websites presenting a limited range of products of product suppliers with whom they are associated or by whom they are incentivised, which is not disclosed to customers
- Payment of unregulated referral fees to the comparison service providers by product suppliers may introduce bias in the listing of products on the websites and in some cases are used to circumvent insurance commission regulations.

Similar concerns are highlighted by other regulatory authorities – for example in the results of a thematic review into comparison websites in the general insurance (short-term insurance) sector published by the Financial Conduct Authority (FCA) in the UK in July 2014.<sup>48</sup> The FCA review in turn encouraged comparison service providers to consider a report on Good Practices on Comparison Websites published by the European Insurance and Occupational Authority in January 2014 (The EIOPA report)<sup>49</sup>.

### 3.4. Benefits of the current landscape

#### 3.4.1. Customers may be more willing to seek and obtain advice if they think it is for free

Despite the risks arising from the opacity of the “built in” commission model discussed under 3.1.2, an advantage of the model is that it avoids the natural resistance of consumers to “reach into their pockets” to pay for a service which they currently (albeit short-sightedly) perceive as free. Any new system should therefore flexibly cater for various ways that customers can pay for advice, including in instalments facilitated by the product supplier, to avoid direct payment for advice becoming a barrier to investing or taking out insurance.

#### 3.4.2. Commission cross-subsidisation generally works in favour of low income customers

Currently high-contribution business will generally, to some extent, cross-subsidise the cost of advice given to low-income customers, where these costs are borne by the product supplier across a broad book of business. In any new system, it may not be feasible for the full cost of advice to be borne directly by the customer receiving it, especially in the case of low income customers.

#### 3.4.3. Ease of administration

The current commission system is easy to administer, as it is rolled into the contribution paid for the product itself. In any new system, there will need to be mechanisms that allow for the easy collection of advice fees, similar to the way in which commission is collected today.

<sup>48</sup> Thematic Review TR 14/11, Price comparison websites in the general insurance sector (July 2014) <http://www.fca.org-uk/static/documents/thematic-reviews/tr14-11.pdf>

<sup>49</sup> Report on Good Practices on Comparison websites, EIOPA-CCPFI-13/100 (30 January 2014) <https://eicpa.europa.eu>.

## CHAPTER 4: REGULATORY POLICY PROPOSALS

This chapter sets out the specific regulatory policy proposals on how to meet the desired RDR outcomes outlined in Chapter 1. The proposals envisage a rationalisation of the complex distribution landscape outlined in Chapter 2 through measures that address the various risks highlighted in Chapter 3.

The proposals follow the same sequence as used in Chapter 2:

- Section 4.1 considers the types of services provided by intermediaries to customers and product suppliers respectively, and proposes an activity-based approach to categorising these services.
- Section 4.2 presents proposals for rationalising the range of relationships between product suppliers and intermediaries. This section also discusses the responsibility of product suppliers for advice and intermediary / outsourced services provided.
- Section 4.3 then presents proposals for intermediary remuneration models in relation to the revised sets of services and relationships outlined in the preceding sections, including measures to deal with conflicts of interest in the provision of financial advice.

The proposals consider both intermediated and direct distribution models. Intermediated distribution models present particular challenges – the intermediary is generally placed in a position where they can be thought of as providing services to both the product supplier and the customer, acting in the capacity as an agent of the product supplier in respect of some activities, and an agent of the customer for others. In these circumstances, the potential for conflicts of interest is particularly acute and there is a need for heightened controls to ensure that fair customer outcomes are not undermined.

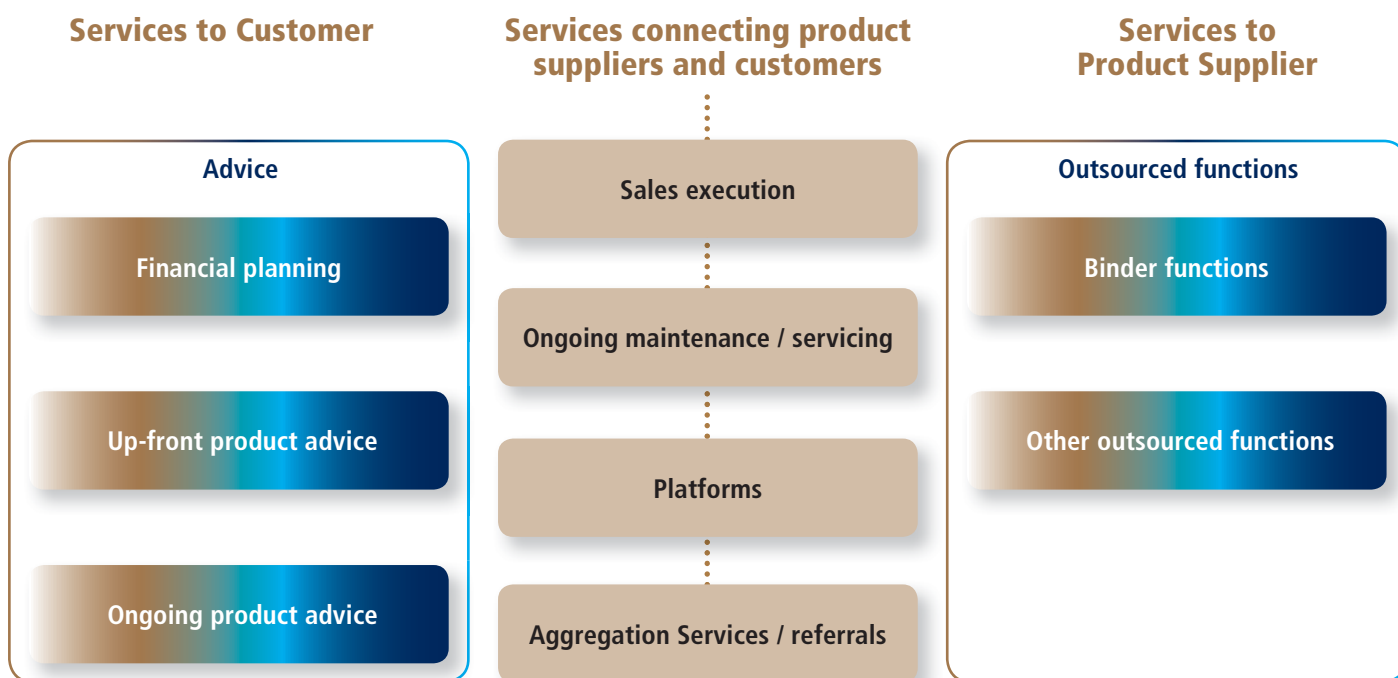
At the same time, direct distribution models can present their own challenges. In models where advice is provided (for example through a telesales adviser), the extent of that advice is usually limited, and does not comprise a full suitability analysis. In non-advice sales models, the assumption is made that customers have the necessary capability and information they need to make informed decisions and therefore do not require advice. In these circumstances there is a particular imperative to ensure that fair outcomes are achieved notwithstanding the lack of advice. Other protections, such as setting appropriate product standards for products offered without advice, need to be considered.

The proposals take cognisance of international developments, but are tailored to local circumstances – in particular:

- Building on the strong foundation already provided by the FAIS Act, but putting in place structural interventions to close current regulatory gaps and ensure that distribution models are aligned with TCF outcomes, and
- Giving special attention to achieving fair outcomes for low-income customers, through enabling distribution models that support financial inclusion combined with other measures to ensure that products marketed and sold are suitable and offer adequate value.

References in the proposals to “standards” or “conduct standards” are to subordinate regulatory provisions that are proposed to be introduced into the regulatory framework - either through current regulatory powers and instruments or in terms of the future Twin Peaks regulatory framework. Chapter 5 provides more detail on the types of measures contemplated.

### Diagram: Activity-based approach to defining advice and intermediary services



## CHAPTER 4: REGULATORY POLICY PROPOSALS

**4.1. Services provided – an activity-based approach to defining advice and intermediary services**

A clear understanding of what constitutes financial advice and intermediary services respectively, through a consistent set of definitions in the regulatory framework, will facilitate compliance and support a level-playing field for competing service and product offerings. Customers will also be in a better position to assess and select the types of services available to them, and the cost and value of those services.

To clarify which services are provided to which party and what capacity an adviser or intermediary acts in when performing these activities, it is proposed that an activity-based approach be followed in defining advice, intermediary services and other services provided by advisers and intermediaries. There was strong support for this approach among commentators on the November 2011 call for contributions.

**4.1.1 Services to customer:**

Certain services are viewed as being provided by the intermediary to the customer – chief among these is advice. In performing this function, the intermediary clearly acts as an agent of the customer and has a duty to ensure that the advice provided is in the best interests of the customer and suitable to the customer's needs and circumstances.

In response to the call for contributions, the various comments pointed to some inconsistency in the use of the term "advice" – some commentators appeared to use it in reference to "financial planning", others to "product advice". This reinforces the importance of improved clarity on the components of advice and intermediary services.

It was also highlighted that the FAIS Act currently links advice to the sale of a product, regardless of whether advice is provided in the course of financial planning, which is problematic as financial planning advice does not necessarily constitute a product recommendation or lead to a product sale.

The proposal is to define sub-components of advice, namely:

**• Financial planning:**

As discussed in 2.2.2, financial planning involves advice on structuring and arranging a customer's financial resources to meet his / her life goals. In the short-term insurance space, this can be described as risk planning, including risk finance consulting, loss control advice and surveys and risk management advice. Depending on the extent of services agreed between the customer and the financial planner, financial planning may include ongoing review of the initial financial plan.

**• Up-front product advice:**

Up-front product advice involves provision of a recommendation, guidance or proposal to a customer on the suitability of a product to the identified needs of the customer, including on the replacement of a product. In addition to identifying a suitable type of product, up-front product advice would also entail selection of a specific product and / or product supplier, depending on the range of offerings the adviser has access to.

In some up-front advice models, particularly those where products are sold through telephone call centres,<sup>50</sup> product advice may be provided but is of a limited extent as the model does not lend itself to a proper suitability analysis. The outcomes-based approach envisaged under TCF recognises that fair outcomes can be achieved in different ways. For instance, if there are limitations on the extent of advice that can sustainably be provided, then this increases the emphasis that must be placed on other mechanisms – particularly appropriate product standards – to ensure fair outcomes for the targeted customer group. So-called "low advice" models may require appropriate product or other conduct standards to mitigate the risk of the advice limitations.

**• Ongoing product advice:**

Ongoing product advice involves provision of a recommendation on changes to product solutions during the life of a product, including investment allocation where applicable, in response to changing market conditions or changed customer needs and circumstances. This would include recommendations in relation to the variation of any term or condition applying to a financial product, or the termination of any product. A recommendation to maintain an existing product without change is also ongoing product advice.

While the call for contributions asked the question whether there are other possible services to customers that do not fall within the definition of advice or intermediary services, no specific examples were provided (tax planning and estate planning, for instance, can be seen as part of financial planning). In particular, the normal business functions of an intermediary (such as marketing its own services) do not constitute a separate service to the customer.

<sup>50</sup> This model must be distinguished from the non-advice sales execution model discussed in 2.2.6.

## CHAPTER 4: REGULATORY POLICY PROPOSALS

**Proposal A: Forms of advice (financial planning, up-front product advice, ongoing product advice) defined, with related conduct standards**

Definitions of "financial planning", "up-front product advice" and "ongoing product advice" will be included in the regulatory framework. The definitions will be used to set conduct standards regarding the provision of each of these forms of advice, including in relation to the circumstances in which these terms may be used to describe services provided, and the way in which these services must be disclosed and explained to customers. Specific fit and proper standards will also be set for entities or individuals providing each of these forms of advice.

**Proposal B: Standards for "low advice" distribution models**

In distribution models where the extent of advice provided is limited, such as those where it is not feasible to conduct a full suitability analysis, conduct standards will be set to ensure the risk of this more limited advice is appropriately mitigated – including possibly in relation to the types of products or product features that may be distributed using such models. The aim of these standards will be based on the understanding that the more basic the advice provided, the more responsibility there will be on product suppliers and intermediaries to ensure that the distribution model and level of advice provided is appropriate to the riskiness / complexity of the product. Note that any product limitations set in this regard will be relatively less restrictive than those imposed for non-advice models (see Proposal D) below.

Chapter 3 highlighted particular concerns regarding so-called "wholesale" advice models, where advice is not provided directly to the end user of a financial product, but to an intermediate entity such as an employer, retirement fund or medical scheme. Some of the answers to these concerns may lie in the realm of employment law to ensure fair treatment of employees in relation to employment benefits provided, and other solutions may need to form part of the current broad reforms in the retirement and health care sectors<sup>51</sup> – all of which fall outside the scope of this RDR. However, the risks to end users in these models may also be mitigated by more focused regulation and supervision of intermediaries providing advice on employee / member benefits to employers and employee benefit schemes.

**Proposal C: Standards for "wholesale" financial advice**

Explicit conduct standards will be developed in relation to financial product advice provided to employers, retirement funds or medical schemes. Such standards will seek to mitigate particular conflicts of interest inherent in these models, including through a requirement that advisers be able to demonstrate that, when providing advice, they took into account the circumstances of the affected employees / members who are the end customers and those who ultimately bear the cost of the advice given.

**4.1.2 Services connecting product suppliers and customers:**

These are services relating to distribution of products to customers directly by product suppliers or where an intermediary truly 'intermediates' between the product supplier and the customer.

**• Sales execution:**

As explained in 2.2.6, this activity relates to the "selling" of the product (through various mediums), and may be carried out either through a product supplier concluding transactions directly with its customers or through an intermediary, and may occur with or without also providing advice. It would include soliciting business for the product supplier and then providing factual information on the product and facilitating the transaction process, once customer contact is established. This service is distinguished from advice in that it does not entail any form of recommendation, guidance or proposal.

The argument is sometimes raised that in cases where sales execution is carried out directly by the product supplier, it is not in fact an "intermediary" service, as it is carried out by the product supplier itself, or in the product supplier's own name.<sup>52</sup> As discussed in 3.3.5, this interpretation exploits a gap in the current FAIS framework and poses risk to fair customer outcomes. It is therefore proposed that sales execution be recognised and regulated as a specific form of financial intermediation, whether carried out directly by the product supplier, using its own staff and / or systems, or in the name of the product supplier through an outsourcing arrangement, or by an intermediary entity.

As explained under the discussion of "low advice" models in 4.1.1, the TCF approach recognises that fair outcomes can be achieved in different ways. Where the distribution model does not include advice at all, it becomes particularly important to ensure that customers are protected in other ways from entering into unsuitable products or transactions. The regulatory framework should therefore set specific conduct standards for distribution using a non-advice sales execution model.

<sup>51</sup> In particular, regulation should require greater and better disclosures of costs and the bases on which retirement funds and medical schemes have selected underlying products and product suppliers.

<sup>52</sup> For example, a product supplier will outsource sales activities to a call centre company, where call centre operators "cold call" potential customers, introducing themselves as calling on behalf of the product supplier concerned.



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### **Proposal D: Standards for sales execution, particularly in non-advice distribution models**

A definition of "sales execution" will be included in the regulatory framework and will be used to set conduct standards regarding the provision of this service. These will include steps to be taken to reasonably establish the customer's financial capability in relation to the product or type of product concerned in non-advice models.

In addition, limits will be placed on the types of products or product features that may be distributed using different types of non-advice sales execution. These models should be restricted to simple products that comply with explicit products standards. Specific fit and proper standards will also be set for entities or individuals providing factual information in the course of non-advice sales execution.

### **Ongoing product maintenance / servicing:**

This activity relates to the after-sales maintenance and service provided by an intermediary to the customer in relation to a financial product, which involve the intermediary acting as 'go-between' between the product supplier and the customer, to facilitate post-sale transactions or other interactions between them. It would include services such as:

- Providing regular product related communications to the customer
- Dealing with routine administrative customer queries in relation to the product
- Execution of product changes (e.g. changing investment allocations, adding or deleting insurance policy beneficiary appointments, exercising benefit options, etc.)
- Collection of insurance premiums
- Claims and disbursement management (e.g. receiving and submitting claims under an insurance policy or medical scheme, or assisting a customer in accessing funds from an investment or retirement fund product)

These services do not include any ongoing product advice that may have led to, or be provided together with, the administrative service concerned.

### **Proposal E: Standards for ongoing product servicing**

The regulatory framework will enable the setting of conduct standards in relation to post-sale services generally, or in relation to specific types of product servicing. These may include standards in relation to services carried out by an intermediary to connect product suppliers and customers, including conditions subject to which these services may be carried out. Standards may also apply to post-sales servicing undertaken by the product supplier itself.

In the insurance sector, the service of collecting insurance premiums presents particular conduct risks. It is part of current practice in the short-term insurance sector in particular for the consumer to pay insurance premiums to the insurance intermediary, who in turn will tend to pay a bulked amount of premiums collected over to the insurer. In terms of the insurance laws, as soon as the customer pays the premium to the insurance intermediary, it is deemed to have been paid to the insurer. There have however been cases where an insurance intermediary has misappropriated the premium amounts – either because an insurer has cancelled cover for the book of business or in the event of a rogue individual. This exposes the insurer to financial risks (although currently protected against through a regulatory requirement for the intermediary to contribute to a guarantee facility) and expose consumers to the risk of unknowingly being uninsured and claims not being paid as and when they arise. Premium collection by intermediaries also tends to exacerbate challenges regarding insurer access to policyholder information and management of conduct risks.

### **Proposal F: Insurance premium collection to be limited to qualifying intermediaries**

Collection of insurance premiums will not be permitted to be carried out by intermediaries in the case of any long-term insurance business or in the case of personal lines short-term insurance business, unless the intermediary complies with prescribed conduct standards for this service. Details of these standards will be consulted on but they will include operational capability requirements and standards relating to remuneration for the service and mitigation of conflicts of interest.

A transition period will be granted for intermediaries to become compliant with such standards or for insurers to either take over this function themselves or outsource it to third parties who are not intermediaries or associates of intermediaries.

### **• Investment platform administration**

As outlined in 2.2.7, this activity relates to aggregating, safeguarding and administering investments offered to clients by more than one product supplier or investment manager on a single platform. While to some extent this activity can be considered an outsourced administration and distribution function of the product supplier or investment manager, this is also a service where the intermediary truly 'intermediates' between the

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product supplier and the customer. Similar to other intermediary services, the intermediary should be subject to a primary duty to act in the best interests of the customer.

Where LSPs also provide a system-based tool that generates investment fund options, this service should be subject to the definitions, limitations and conduct standards applicable to advice activities.

#### **Proposal G: Revised standards for investment platform administration**

This activity will continue to be recognised as a specific, licensed regulatory activity in the future regulatory framework, although the specific terminology and licensing process used to describe the activity will change from that in the current FAIS framework. Specific conduct standards will apply to investment platform administration, including regular disclosure to the customer. Also see Proposal YY below for proposed changes to the remuneration model in relation to investment platform administrators and intermediaries engaged in this model.

#### ● **Product aggregation and comparison services:**

As explained in Chapter 3, gaps in the current regulatory framework mean that risks identified in relation to these services, by both the FSB and international authorities, are not adequately addressed. Guidelines published in the EIOPA report<sup>53</sup> are equally applicable to the South African market and should be incorporated into the regulatory framework, to ensure that comparison and aggregation services are conducted in a way that delivers fair customer outcomes.

#### **Proposal H: Standards for product aggregation and comparison services**

Specific conduct standards (informed by the EIOPA report) will be introduced into the regulatory framework to regulate this service, including standards relating to:

- Information about the service itself (for e.g. the website).
- The range of products or product suppliers on which information is provided and the information filtering processes to be used, to ensure that the process does not constitute product advice by creating a bias in favour of particular products or suppliers. In the event of the aggregation or comparison service not meeting these standards, it will be deemed to amount to up-front product advice, subject to the same regulatory requirements as for that service.
- Disclosure of: The number of products that are being compared or are available; the number of product providers' products that are being compared or are available; the criteria used to select the products and product providers concerned; and the basis on which quotes or other product features provided are ranked or otherwise filtered.
- Provision of minimum product information, including but not limited to price information, to ensure that customers are placed in a position to compare the overall suitability of the products to the customer's needs on a number of criteria (not just price).
- Information presentation formats, accuracy and updating.
- Disclosure of and other limitations on the nature and source of remuneration or other financial interest derived by the aggregation or comparison service provider.
- Management and disclosure of any potential conflict of interest between the provider of the product or service and the product suppliers whose product information is provided, including details of the nature of the relationships between the provider and the product suppliers.

In addition, Proposal D in respect of sales execution, which provides that non-advice sales execution models should be restricted to simple products meeting explicit product standards, will be extended to products sold through comparison or aggregation service providers.

#### ● **Referrals and lead generation:**

As discussed in 2.2.9 above, these activities currently fall outside the regulatory framework other than in limited circumstances. Although it is accepted that not all forms of referrals or lead generation warrant market conduct regulatory intervention,<sup>54</sup> certain business models do constitute a form of financial intermediation with potential to expose customers to conflicted or inappropriate marketing tactics. This will depend largely on the nature of the relationship between the lead providers and the product suppliers and / or potential customers concerned.

Particularly where the referral occurs between intermediaries, between product suppliers, or between intermediaries and product suppliers, the referral could be regarded as part of a broader process of connecting customers and product suppliers and be regulated appropriately. This would include reciprocal arrangements where product suppliers or intermediaries enter into agreements to refer customers to each other, based on their respective product ranges or areas of expertise.

Where a referral involves the mere passing on of contact details of a prospective customer to an intermediary or product supplier by another person (who is not a regulated financial institution or intermediary) then this may not be treated as an intermediary service, except in those cases where the

<sup>53</sup> See discussion in 3.3.5

<sup>54</sup> Note however that these activities will be subject to relevant general consumer legislation, such as the Protection of Personal Information Act, 4 of 2013 and, in some circumstances where they fall outside the ambit of financial sector legislation, the Consumer Protection Act, 68 of 2008.

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referral involves an interface / dialogue between the prospective customer and the lead provider. In these cases, the line between referrals and non-advice sales execution can become blurred, and to avoid regulatory arbitrage such a process should be regarded as a form of financial intermediation subject to appropriate conduct standards.

Where the lead provider performs the service of providing a potential customer with the name and / or contact details of an intermediary or product supplier, whom the customer may then approach to obtain advice or other services, this may also be regarded as a form of financial intermediation, subject to appropriate standards.

### **Proposal I: Standards for referrals and lead generation**

Certain specifically identified forms of referrals and leads will be included in the regulatory framework as a form of financial intermediation, and will be subject to specific conduct standards. Conduct standards in this regard may relate to:

- Disclosure of and limitations on the nature and source of remuneration or other financial interest derived by referral or lead provider.
- Management and disclosure of any potential conflict of interest between the provider of the referral and the customers or other parties concerned.
- Measures to ensure customer consent and protection of customer information in appropriate circumstances.
- The responsibility of product suppliers or intermediaries in relation to their use of referral or lead generation services.

In cases where the referral or lead provision does not meet the relevant criteria to be regarded as financial intermediation, depending on the structure of the arrangement, it may nevertheless be subject to relevant standards for marketing and advertising activities, or for the outsourcing of activities by a product supplier or intermediary as the case may be.

### **4.1.3 Services to product supplier:**

Some of the services (other than advice) currently performed by intermediaries are more appropriately regarded as functions performed on behalf of the product supplier (i.e. outsourced functions), than true intermediary services – despite the fact that some of these activities currently fall within the broad FAIS definition of “intermediary services.” These are services that the product supplier would otherwise have to perform itself, and which do not involve ‘intermediating’ between the product supplier and the customer.

A particular outsourced function in the insurance sector is the outsourcing of “binder services,” subject to the so called “binder regulations” under the insurance laws as described in 2.2.10.

Other outsourced functions would include “back office” administration functions that do not involve interacting with customers such as data management or processing, record keeping, asset valuations or custodial services, or the outsourcing of investment management by a CIS to an authorised investment manager (who does not also provide advice to customers).

### **Proposal J: Outsourced services on behalf of product suppliers to be more clearly identified and regulated**

The regulatory framework will delineate more clearly between intermediation activities (as discussed in paragraph 4.1.2 above) and outsourced services on behalf of product suppliers, and set appropriate conduct standards for each of these – including, where appropriate, specific conduct standards in relation to specific forms of outsourced services and associated remuneration (see Proposals Z and AA below). General standards in relation to outsourcing will build on the approach applied in the current Directive 159, whereby outsourcing will only be permitted where the following principles are adhered to by both the product supplier outsourcing the activity and the entity to whom it is outsourced, as applicable:

- The product supplier outsourcing the activity remains responsible for the activity concerned
- An activity may not be outsourced if outsourcing would materially impair the quality of the product supplier’s governance framework, risk management or ability to meet legal or regulatory obligations; impair the regulator’s ability to monitor its regulatory compliance; or compromise fair treatment or quality of service to customers.
- Conflicts of interest between the product supplier’s core business, the interests of customers and the interests of the outsource service provider must be avoided or, where avoidance is not possible, mitigated
- Additional principles relating to remuneration for outsourced services (see Proposals ZZ, AAA and BBB)

In line with the activity-based approach to intermediary activities proposed in this review, the current wide definition of “intermediary services” in FAIS will be reviewed to develop more tailored conduct standards in relation to different types of outsourced services and who will be permitted to provide them.

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### 4.2. Relationships between product suppliers and intermediaries

The financial services customer should be in a position to clearly understand what services are being provided by the intermediary with whom they are dealing, and in what capacity the intermediary is acting (ie the nature of the relationship between the intermediary and one or more product suppliers). This understanding is particularly important in the case of financial advice, to enable customers to evaluate the type and extent of advice they are receiving, including any limitations or restrictions on that advice, before deciding whether or not to act on it.

The proposals in this section of the RDR (Proposals K to U) therefore focus specifically on the criteria used to determine different types of relationships between financial product suppliers and financial advisers, the terminology used to describe these relationships, and how elements of these relationships should be disclosed to customers.

The combined effect of these proposals, insofar as they relate to the provision of financial advice, will be that every individual providing financial planning or financial product advice will be one (and only one) of the following:

- An IFA, licensed in his or her own right to provide independent advice (and may also provide multi-tied advice in relation to certain non-investment products)
- A multi-tied adviser, licensed in his or her own right to provide multi-tied advice
- An IFA authorised to provide independent advice, as a representative of a licensed financial institution (other than a product supplier or part of a product supplier group), where the institution is authorised to provide independent financial advice. (This individual may also provide multi-tied advice in relation to certain non-investment products)
- A multi-tied adviser authorised to provide multi-tied advice, as a representative of a licensed financial institution (other than a product supplier or part of a product supplier group), where the institution is authorised to provide independent financial advice
- A multi-tied adviser authorised to provide multi-tied advice, as a representative of a licensed financial institution (other than a product supplier), where the institution is authorised to provide multi-tied advice
- A tied adviser authorised to provide tied advice as a representative of a product supplier, in relation only to the products of that product supplier or (subject to controls) the products of another product supplier in the same financial services group.

If any of the above individuals also provides financial planning services, they will need to meet the appropriate standards to do so.

#### **Proposal K: Types of adviser defined: Independent (IFA), multi-tied or tied**

Subject to Proposal L below, any person providing financial advice to financial customers, may only do so in one of the following three capacities – and subject to the further criteria in Proposals L to S below – and may only use one of the following three terms to describe their status as an adviser:

- Independent financial adviser ("IFA")
- Multi-tied financial adviser, or
- Tied financial adviser

In the case of an adviser who provides advice in relation to short-term insurance products only, the above terms may be replaced with:

- Independent insurance broker
- Multi-tied insurance broker, or
- Tied insurance agent

In the case of an adviser who provides advice in relation to health services benefits only, the above terms may be replaced with:

- Independent health benefit broker
- Multi-tied health benefit broker, or
- Tied health benefit agent.

These requirements will be supported by conduct standards requiring advisers to ensure that the above terminology is clearly and consistently used on all business documentation such as business cards, letterheads, e-mail correspondence, websites, and any other documentation disclosing the adviser's status or promoting the adviser's services.

In addition to one of the above three terms, an adviser may also use the term "financial planner" (or "insurance risk planner" in relation to short-term insurance) to describe their activities, subject to Proposal U below.

Where the regulator determines that a particular adviser or entity does not comply or no longer complies with the standards applicable to being an IFA, multi-tied adviser, tied adviser or financial planner, as the case may be, the regulator may determine that the adviser or entity concerned may no longer be so described or purport to provide advice in such a capacity. The regulator may in such cases also determine that the adviser or entity concerned is in fact providing advice in another capacity and may continue to provide advice only in compliance with the standards applicable to the other capacity. For example, where an IFA ceases to meet the standards applicable to be described as an IFA (see later proposals), but does meet the standards to be described as a multi-tied adviser, the regulator may reclassify the adviser as a multi-tied adviser and require them to comply with all conduct standards applicable to multi-tied advisers.



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It is accepted that, where an adviser meets the criteria for being an IFA in relation to investment products, meeting these criteria could be more challenging in relation to short-term insurance products, long-term insurance risk products or health benefits. Accordingly, it will be acceptable for such an adviser to describe themselves as an IFA, despite providing advice on these types of risk products on a multi-tied basis as contemplated in 2.3.2, subject to the provisions of Proposal L below.

### **Proposal L: An IFA may advise on certain products on a multi-tied basis**

An adviser that complies with the requirements of Proposal K for being an IFA in relation to investment products, may describe themselves as an IFA notwithstanding the fact that, where the adviser also provides advice on short-term insurance products, long-term insurance risk products and / or health benefits, the adviser does not meet the same standards in relation to one or more of these product types, provided that:

- The adviser complies with the requirements of Proposal P for being a multi-tied adviser in relation to the short-term insurance products, long-term insurance risk products or health services benefits concerned,
- The adviser complies with relevant disclosure standards that will be set to ensure that the customer is not placed under the impression that advice in relation to such products is provided on an independent basis, and
- The adviser and complies with relevant standards that will be set to ensure that the advisers independence in relation to advice on investment products is not compromised, including a prohibition on receiving any direct or indirect incentive from any of the long-term insurance, short-term insurance or health benefit product suppliers concerned to promote any investment products offered by that product supplier or an associate.

For purposes of this Proposal, "investment products" includes all forms of long-term insurance products that are structured as investments or savings products, including products which offer a combination of investment and risk benefits (such as "universal" products).

### **4.2.1 Independent financial adviser (IFA)<sup>55</sup>**

To qualify as an IFA a financial adviser should be able to demonstrate an adequate degree of independence in relation to the following two main criteria:

#### **• IFA independence criterion 1: Product and product supplier choice**

Independent financial advisers must be able to offer advice on multiple products, offered by a number of product suppliers. To meet this standard, the adviser must offer advice that goes beyond making recommendations on a restricted set of products or product suppliers. On the other hand, it is accepted that the "whole of market" concept may not be appropriate. In particular, standards in this regard will have to be balanced against relevant FAIS and TCF expectations. TCF will require product suppliers to take reasonable steps to satisfy themselves that any advisers (not only tied advisers) who provide advice on their products have adequate product specific knowledge to provide appropriate advice regarding that product. A "whole of the market" standard for independence might not be feasible if IFAs are also expected to be able to demonstrate high standards of product specific knowledge across all products available to them.

In addition to the product and product supplier choice available to the adviser, the adviser should be able to demonstrate that they have in fact provided advice across an appropriate range of products and product suppliers, in order to continue using the designation "IFA".

Further consultation and analysis is required on how to set standards for this criterion.

<sup>55</sup> Or "independent insurance broker" or "independent health benefit broker" where advice is provided only in relation to short-term insurance products or health benefits, as the case may be.

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### **Proposal M: Further input required on criteria for IFA's to offer sufficient product and product supplier choice**

In order to determine the degree of product and / or product supplier choice which would satisfy the criteria for an adviser to be described as an independent financial adviser (IFA), independent insurance broker or independent health benefit broker, as the case may be, specific input is invited on:

- The number of product types or categories on which the adviser should be able to provide advice.
- The number of specific products within a product type or category on which the adviser should be able to provide advice.
- The number of product suppliers, per type or category of product, on whose products the adviser should be able to provide advice.
- In particular, where investment product advice is offered, whether the designation "IFA" should require an adviser to offer advice across a minimum range of investment product types, classes and / or needs and what this minimum range should be?
- Where investment product advice is offered, the standards that should be set in relation to recommendations involving the use of investment platforms. For example, what standards if any should be set in relation to the number of platforms offered, the range of investment portfolios or portfolio types available on such platforms, or the relationships between the adviser and the platforms or underlying investment managers concerned?
- Whether an IFA should be able to select a "panel" of products and / or product suppliers and, if so, the criteria for selecting the panel, the circumstances in which the IFA should be required to offer advice beyond the panel and the manner and frequency of revising the make-up of the panel.
- Whether an adviser that provides advice in relation to long-term insurance risk products only, but not in relation to investment products, should be able to be described as an IFA. If so, what is the number of product types and / or the number of product suppliers on which the adviser should be able to provide advice in order to be described as such?
- Where an adviser provides advice in relation to short-term insurance products only, what is the number of short-term insurance product types and / or the number of short-term insurance product suppliers on which the adviser should be able to provide advice, in order to be described as an "independent insurance broker"?
- Where an adviser provides advice in relation to health benefits only, what is the number of health benefit product types and / or the number of health benefit suppliers on which the adviser should be able to provide advice in order to be described as an "independent health benefit broker"?
- What role, if any, should the nature of the remuneration earned by the adviser play in determining whether or not the adviser may be described as an IFA, independent insurance broker or independent health benefit broker, as the case may be?
- Once the adviser has met the requisite standards to describe themselves as an IFA, independent insurance broker or independent health benefit broker, what standards should be set in relation to the range of products and products suppliers actually recommended, in order for the adviser to remain entitled to use this designation?

### **● IFA independence criterion 2: Relationship with product supplier**

In order to be able to be described as an IFA, the adviser concerned must be in a position, and be seen to be in a position, to make recommendations that are free of product supplier influence. Certain types of relationships with product suppliers therefore preclude an adviser from being an IFA.

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### Proposal N: Criteria for IFA's to be free of product supplier influence

Over and above the standards to be set in respect of Proposal M, an adviser may not be described as an IFA, independent insurance broker or independent health benefit broker if any of the following situations (to be described in greater detail in conduct standards), or any combination of these situations, applies to the relationship between the adviser and any product supplier (which for purposes of these standards includes any associate, agent or representative of such a product supplier), in relation to whose products the adviser is able to provide advice:

- The adviser has any form of employment; agency; representative; outsource service provider; or other mandated relationship with the product supplier.
- The adviser is directly or indirectly subject to production or sales targets in relation to products of the product supplier.
- There is a direct or indirect ownership or other financial interest in the adviser by the product supplier.
- The adviser has a direct or indirect ownership or other financial interest, other than as an ordinary financial customer, in the product supplier.
- The relationship in any way enables the adviser to directly or indirectly earn more remuneration or other financial interest from that product supplier, or in relation to any of that product supplier's products, than from any other product supplier.
- The relationship in any way imposes restrictions on the adviser's ability to provide advice or earn remuneration in respect of any other product supplier or any other product supplier's product, in respect of which the adviser would otherwise be able to provide advice.
- The relationship is such that the adviser is in any other way directly or indirectly influenced by the product supplier – or could be seen to be influenced – to recommend the products of the product supplier concerned.
- The adviser chooses, for any reason, to limit the range of products or product suppliers in relation to which it offers advice to an extent that the adviser will not meet the product choice criteria to qualify as an IFA.

Notwithstanding the requisite criteria in relation to product choice and product supplier relationships, there may still be limitations on an IFA's advice that customers should be made aware of.

### Proposal O: Status disclosures to be made by IFAs

Conduct standards will be set requiring an IFA to disclose the following matters to customers at appropriate times:

- That the adviser is an independent financial adviser and an explanation (which may be standardised) of what this means.
- The range of product types and product suppliers in relation to which the IFA is able to provide advice, including any limitations on such ranges.
- Appropriate details of the range of product types, product suppliers and specific products that the adviser has in fact recommended over a period (for example the previous twelve months), with an appropriate explanation for preferring a particular product type, product supplier, or specific product, where applicable.

### 4.2.2 Multi-tied financial adviser:

As discussed in 2.3.1 the insurance laws currently use the term "independent intermediary" to refer, in effect, to any intermediary other than a single insurer's representative. In most instances, these so-called independent intermediaries are in fact advisers contracted to multiple product suppliers – sometimes a very small number of them – to distribute their products. They are usually remunerated in the form of commission paid by the insurers concerned.

It is proposed that the term "multi-tied" more accurately describes this type of relationship between intermediaries and product suppliers. The term "multi-tied" is not currently used in South African legislation, and its introduction will require changes to the existing FAIS, insurance and certain other legislative frameworks.

Breaking down the term "multi-tied", the "multi" component means that the adviser provides advice on the products of more than one product supplier, while the "tied" component means that – unlike an IFA – the nature of the contractual, ownership or other relationship between the intermediary and any one or more of the product suppliers concerned is such that the intermediary has the potential to be directly or indirectly influenced – or could be seen to be influenced – to recommend the products of those product supplier / s. For these purposes, "product supplier" includes an associate, agent or representative of such product supplier. A financial adviser that does not meet the requisite criteria in relation to product and product supplier choice to be classified as an IFA, but is also not a tied adviser, will also be classified as a multi-tied adviser, regardless of whether or not the adviser's relationship with any product supplier / s entails the type of influence described above.

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### Proposal P: Criteria for multi-tied advisers

A financial adviser is a multi-tied adviser if the adviser is not a tied adviser and also does not satisfy the criteria to be described as an IFA. This would be the case where the adviser for any reason (including the adviser's own choice) does not meet the requisite criteria in relation to product choice and / or freedom from product supplier influence required to be described as an IFA, as described in proposals M and N. Without limiting the generality of this requirement, an adviser will not satisfy the criteria to be described as an IFA where any of the situations listed in Proposal N apply.

Where any of the situations listed in Proposal N apply, additional conduct standards will be set to ensure that any actual or potential conflicts of interest arising from such situation are managed. These will include:

- Specific standards to limit the extent to which any of the above situations may apply unequally across the different product suppliers on whose products the adviser may provide advice or otherwise limit conflicts in this regard
- a requirement for the multi-tied adviser to keep specific records, in a manner to be prescribed by the regulator, of the proportion of business placed with the product supplier / s concerned and to document a motivation for any proportion of business that suggests a preference of such product supplier / s' products over those available from other product suppliers whose products the adviser is able to recommend. Such records and motivation must be provided to the regulator on request.

Note that for purposes of this proposal, references to product suppliers and products apply equally to investment managers and their investment portfolios in relation to which advice may be provided.

Also note the provision in proposal K empowering the regulator to determine, inter alia, that a particular adviser does not comply or no longer complies with the standards applicable to being a multi-tied adviser and that the adviser or entity concerned may no longer be so described or purport to provide advice in such a capacity. Using this power, in cases where the regulator determines that an adviser's relationship with one or more particular product supplier is such that there is an inappropriate bias in favour of such product supplier or its products, the regulator may direct the adviser to take necessary steps to ensure fair customer treatment and prevent customers from being misled as to the status of advice provided. (For example, the regulator could direct that the adviser either change its relationship with the product supplier/s concerned, or henceforth only purport to offer products from a more limited range of suppliers or operate as a tied adviser.)

Where financial customers receive advice from a multi-tied adviser, it is important for them to understand the scope and limitations of any such advice.

### Proposal Q: Status disclosures to be made by multi-tied advisers

Conduct standards will be set requiring a multi-tied adviser to disclose the following matters to customers at appropriate times:

- That the adviser is a multi-tied adviser and an explanation (which may be standardised) of what this means
- The identity of the product suppliers with whom the adviser has a tied relationship and appropriate details of the nature of the relationships concerned
- Appropriate details of the range of product types offered by the product suppliers concerned in relation to which the multi-tied adviser is able to provide advice, including any limitations on such ranges
- Appropriate details of the proportion of products in fact recommended over a period (for example the past twelve months) in respect of and, where applicable, remuneration earned from, each of the respective product suppliers with whom the adviser has a tied relationship, with an appropriate explanation for preferring one or more of these product suppliers, where applicable
- Appropriate details of the range of product types and specific products offered by the product suppliers concerned, that the adviser has in fact recommended over a period (for example the previous twelve months), with an appropriate explanation for preferring a particular product type or specific product, where applicable.

A multi-tied adviser will also be prohibited from using the term "independent" in relation to the advice it provides or otherwise creating the impression that the adviser or advice is independent or free of product supplier influence.



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**4.2.3 Tied financial adviser:**

A tied financial adviser is an adviser whose contractual, ownership or other relationship with a product supplier restricts the adviser to providing advice in relation to the products of that product supplier only. For these purposes, "product supplier" includes an associate, agent or representative of such product supplier.

As explained in 2.3.3, an intermediary contracted with an insurer on terms requiring the intermediary to market the products of that insurer only<sup>56</sup> is defined as a "representative" of that insurer. Although such representatives are sometimes referred to as "tied agents", this term is not currently used or defined in legislation. The term "representative" is however differently defined in the FAIS Act, where it refers to the relationship between the intermediary and its principal, rather than the relationship between the intermediary and a product supplier. It follows therefore that the term "representative" is not helpful in enabling customers to understand the status of an intermediary and that more meaningful and consistent terminology is required. The term "tied" is therefore proposed to describe the situation where an adviser is contracted to provide advice in relation to a single product supplier only. Note that the term "tied" will only apply to the relationship between adviser and product supplier and not, for example, to the relationship between an adviser and an advisory firm (that is not a product supplier) that the adviser represents.

**Proposal R: Criteria for tied advisers**

A financial adviser is a tied adviser if the adviser has an employment or other relationship with or mandate from a product supplier which has the effect that the adviser is restricted to providing advice in relation to the products of that product supplier only. (The definition of "tied financial adviser" will to be expanded on in conduct standards.) A financial adviser that does not meet the definition of "tied financial adviser" is a multi-tied financial adviser (or an IFA, if the appropriate criteria are satisfied), and must describe itself as such and meet all applicable standards for that status.

It is recognised that it may be unreasonably restrictive, in some business models, to require a tied adviser to recommend only the products of a single entity in a financial services group – for example in cases where the group is structured so that different product types are provided by different product supplier entities in the same group. The requirement that a tied adviser recommend only one product supplier's products will therefore be based on a definition of "product supplier" that appropriately includes associates or group entities. On the other hand, care must be taken to avoid this dispensation resulting in customers being under the mistaken impression that a tied adviser is in fact multi-tied or even independent, or that an adviser is tied when in fact it is not. Standards (not necessarily limited to disclosure standards) will be set in this regard.

Where financial customers receive advice from a tied adviser, it is important for them to understand the scope and limitations of any such advice. The fact that the advice is limited to the products of a single product supplier may not be the only restriction on this advice – additional restrictions as to product type or specific products may also apply.

**Proposal S: Status disclosures to be made by tied advisers**

Conduct standards will be set requiring a tied adviser to disclose the following matters to customers at appropriate times:

- That the adviser is a tied adviser and an explanation (which may be standardised) of what this means
- The identity of the product supplier with whom the adviser has a tied relationship and appropriate details of the nature of the relationship concerned
- The identity of any associates or group entities of the product supplier concerned, that are product suppliers on whose products the adviser may provide advice, with appropriate details of the nature of the relationship between the adviser and such entities
- Appropriate details of the range of product types offered by the product supplier concerned in relation to which the adviser is able to provide advice, including any limitations on such ranges
- A tied adviser will also be prohibited from using the term "independent" or "multi-tied" in relation to the advice it provides or otherwise creating the impression that the adviser or advice is not tied.

<sup>56</sup> Subject to the exception described in paragraph 2.3.3, whereby a representative of an insurer may currently also market products of another insurer if permitted in terms of an arrangement between the two insurers concerned.

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### 4.2.4 *Financial planner:*

It is accepted that an intermediary may provide objective financial planning services as contemplated in 2.2.2, despite being restricted in the choice of product or product supplier in respect of which they can offer product advice. Accordingly, IFAs, multi-tied advisers and tied advisers will be able offer financial planning services, subject to relevant competence and other conduct standards for such services. In the case of tied or multi-tied agents in particular, it will be important that conflicts of interest are managed.

#### **Proposal T: Criteria for financial planners**

The regulatory framework will set conduct standards for the provision of financial planning services, including:

- Fit and proper standards for the provision of financial planning services. These will include competency standards in relation to the financial planning process, as well as in relation to the types of financial planning solutions recommended through the planning process. Such standards may be set with reference to membership of or qualifications provided by appropriate professional associations, or may vary depending on such membership or qualification, which may be recognised for these purposes.
- Standards on the level and extent of financial product knowledge required to provide financial planning services. Although financial planning does not necessarily entail the provision of advice relating to any particular financial product, adequate knowledge of the classes or types of financial product that are likely to underpin a proposed solution would nevertheless be important.
- Standards for financial planners that are also multi-tied or tied advisers – particularly with a view to ensuring that the restrictions in relation to product advice they may provide do not conflict with or compromise the quality of the financial planning service.

Where a financial customer receives a financial planning service, it is important for them to understand the scope and purpose of the financial plan and any limitations on the plan the adviser is able to propose.

#### **Proposal U: Status disclosures to be made by financial planners**

Conduct standards will be set requiring a financial planner to disclose the following matters to customers at appropriate times:

- That the adviser is a financial planner and an explanation (which may be standardised) of what this means, as well as details of whether or not the financial planner is a member of or holds a qualification issued by a relevant professional organisation.
- Appropriate details of the scope and purpose of the financial plan, including any limitations in this regard.

The above standards may be determined with reference to corresponding standards set by appropriate professional associations. Where the adviser is also an IFA, multi-tied or tied adviser, the above disclosure obligations will apply in addition to the status disclosure obligations in Proposals O, Q or S above, as the case may be.

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**4.2.5 “Hybrid” advice models:**

As highlighted in earlier chapters, the current complex and often conflicted range of distribution and advice models poses risks to customers, intermediaries and supervisory effectiveness. In particular, the complexity of the current landscape, coupled with information asymmetry, means that disclosure alone is not an adequate tool to mitigate these risks. The activity-based approach to intermediary services proposed in this Chapter seeks to mitigate these risks by reducing the complexity of the current landscape. However, for this to succeed, it is important that there are clear structural lines between the new models – particularly between tied, multi-tied and independent advice models.

As a result, it is proposed that various aspects of the current regulatory framework, that have allowed “hybrid” models to develop where the same intermediary can operate in different capacities – at different times or sometimes even at the same time – in relation to different products or product suppliers, are eliminated. Proposals V to Y provide further details. In all cases, the proposals relate to distribution models that undermine the customer’s ability to appreciate the capacity in which advice is provided and any potential conflicts of interest, and also undermine effective oversight of fair customer outcomes by both the regulated entities concerned and the regulator.

**Proposal V: Insurer tied advisers may no longer provide advice or services in relation to another insurer’s products**

The definition of “representative” in Part 3 of the Regulations to the Long-term Insurance Act (the commission regulations) will be amended by removing sub-paragraph (iii) of the definition, which provides that a representative may render services in relation to policies of “another insurer which has entered into a written agreement with that insurer in terms of which persons employed or engaged by that insurer may render services as intermediary in relation to the other insurer’s policies”. The effect will be that tied advisers of an insurer will be able to provide advice (or any other services) in relation to that insurer’s products only. The current part (ii) of the definition of “representative”, which allows the representative to also provide services in relation to another insurer which is a subsidiary or holding company of the first insurer, will be retained at this stage.

**Proposal W: “Juristic representatives” to be disallowed from providing financial advice**

The FAIS framework currently allows a “representative” as defined in that Act to be either a natural person or a juristic person. In these cases, both the juristic entity and all of the natural persons who provide advice or intermediary services on its behalf are regarded as “representatives” of the FAIS licensed financial services provider concerned. Both the licensed financial services provider and the juristic representative are required to have key individuals who take responsibility for the conduct of the juristic entity and the ultimate representatives.

The juristic representative model is also often used to enable the same legal entity to provide advice or other services in different capacities – for example the same entity can currently operate as a FAIS licensed financial services provider in its own right, as a juristic representative of another financial services provider, and / or as a product supplier. Juristic representatives also typically have their own corporate branding, making it difficult (despite current FAIS disclosure requirements) for customers to understand who the adviser they deal with is in fact acting for and which entity takes responsibility for the advice provided.

It is proposed that appropriate amendments will be made to the FAIS framework – and carried through to the future legislative framework – to disallow this confusing “layering” of roles and responsibilities, by disallowing the “juristic representative” structure to be used in providing financial advice.

The effect will be that any individual natural person providing advice must either be a tied adviser of a product supplier, an IFA or a multi-tied adviser in its own right, or a representative of a juristic intermediary (see 4.2.6 below). The juristic intermediary will be required to be authorised to provide advice in its own right and will not in turn be permitted to provide advice as a representative of any other entity. In other words, the concept of providing advice in the capacity of a “representative of a representative” will disappear.

A further effect of this change will be that a product supplier, being a juristic entity, will be disallowed from providing advice other than on its own products (including products of group entities, subject to appropriate controls).

A further review will be undertaken on the use of the juristic representative model to render non-advice sales execution or other intermediation activities, to assess conflicts of interest in such models and whether additional controls or prohibitions on the use of the juristic representative model are required in regard to those types of services. Specific comment is invited in this regard.

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### 4.2.6 Juristic intermediaries (adviser firms):

In most cases, financial advisers are not self-employed individuals, but are employed or mandated to act as representatives of a juristic entity. Consideration needs to be given to the allowable relationships between such adviser firms, product suppliers, and the types of advice provided – including the inter-relationship between the status of the advisory firm itself and that of its individual advisers. Clarity regarding these relationships is important to ensure that the key aims of the activity-based approach – namely mitigation of conflicts of interest and reducing customer confusion regarding the status of advice – are not undermined by complex and conflicted business structures. In particular, ownership relationships between adviser firms and product suppliers should not be structured in a way that creates conflicts of interest or disguises the true status of advice.

The distinction between IFA's, multi-tied advisers and tied advisers in Proposal K above therefore applies to both the status of the individual financial advisers concerned, and the status of the adviser firms that they represent. It follows that the various criteria to qualify as an IFA or multi-tied adviser as set out in Proposals M, N and P will apply equally to juristic intermediaries (adviser firms). Note that in light of Proposal W it will no longer be possible for a juristic entity to be a tied adviser.

However, additional standards are required to govern the inter-relationship between the status of the adviser firm itself and that of its individual advisers. As set out in Proposal SS, consideration also needs to be given to the remuneration arrangements that exist between an adviser firm and its individual advisers on the one hand, as opposed to the remuneration rules applicable as between the adviser firm (including its individual advisers) and a product supplier, on the other hand.

#### **Proposal X: Standards for juristic intermediaries (adviser firms)**

An adviser firm may not be described as being independent or offering independent advice unless the firm itself meets the standards set out in Proposals M and N.

Individual advisers acting as representatives of such an independent adviser firm may similarly not be described as independent or providing independent advice unless they, as individuals, also meet these standards (to the extent applicable to an individual). However, it is accepted that not all individual representatives of an advisory firm will necessarily be in a position to offer the requisite range of products or product suppliers to qualify as an IFA. Accordingly, it will be possible for an individual representative of an independent advisory firm to act as a multi-tied adviser if for any reason that individual is restricted to a more limited range of products or product suppliers than that for an IFA. Appropriate disclosure standards will be set to ensure that this scenario does not cause consumer confusion and that the restrictions on the advice available from the individual adviser are clear.

An adviser firm to which any of the situations set out in Proposal P applies, will be a multi-tied firm. Individual advisers acting as representatives of such a multi-tied firm will similarly be multi-tied advisers, and will not be able to operate as IFA's. However, it is accepted that not all individual representatives of an advisory firm will necessarily be in a position to offer advice in respect of the same range of products or product suppliers available to the firm itself. For example, where the firm itself has a multi-tied relationship with say ten product suppliers, it will be acceptable that some of its advisers may be able to offer products of only three or four of those product suppliers, or only be able to offer advice in respect of a more limited range of product types. Again, appropriate disclosure standards will be set to ensure that this scenario does not cause consumer confusion and that the restrictions on the advice available from the individual adviser are clear.

It is proposed that an individual adviser acting as a representative of either an independent or a multi-tied advice firm, may not be limited to the products of one product supplier or product supplier group only (i.e. they will not be able to operate as a tied adviser). The effect of this, read together with Proposal W (juristic representatives to be disallowed from providing advice) will be that tied advice will only be able to be provided by an individual employed or mandated directly by the product supplier concerned, and not by a representative of an advisory firm that is not a product supplier. Conversely, no product supplier will be able to operate as an independent or multi-tied adviser firm.

A further source of customer confusion in the current regulatory framework is that the same individual adviser can act as a representative of more than one adviser firm – sometimes providing different levels of advice for different firms. It is proposed that this situation be disallowed.

#### **Proposal Y: Advisers may not act as representatives of more than one juristic intermediary (adviser firm)**

No individual IFA or multi-tied adviser may provide advice in the capacity of a representative of more than one adviser firm.



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### 4.2.7 Outsourced service providers, including binder holders:

The outsourcing of product supplier functions or activities to intermediaries gives rise to inherent conflicts of interest because, as discussed in paragraph 2.3.5 and 3.1.3, the intermediary acts as agent for (and is remunerated by) the product supplier when performing an outsourced function while at the same time having a duty to act in the best interests of the customer when providing advice or intermediary services. Proposals Z and AA below therefore aim to limit the potential for this conflict.

#### Proposal Z: Restricted outsourcing to financial advisers

As a general standard, the outsourcing of product supplier functions or investment management functions or activities (as opposed to true intermediation activities connecting product suppliers and customers, as discussed in paragraph 4.1.2) to financial advisers will be prohibited, other than in the case of specific identified and regulated functions.

Note that this proposal includes a prohibition on a CIS manager outsourcing investment management to an "authorised agent" (as defined in the Collective Investment Schemes Control Act) or to any intermediary through a third-party arrangement where that authorised agent or intermediary is also a financial adviser.

See also Proposal J above. General standards in relation to outsourcing will build on the approach applied in the current Directive 159. In addition, as discussed in Proposals ZZ to CCC below, outsourcing (including binder activities) will be subject to remuneration standards.

The general rule in Proposal Z does not impact on outsourcing to third parties who are acting solely as agents of the product supplier in respect of non-customer facing activities, such as back-office administrators or binder holders who act as underwriting managers and who are not financial advisers or associates of financial advisers.

#### Proposal AA: Certain functions permitted to be outsourced to financial advisers

Despite the general rule in Proposal Z, product suppliers will be able to outsource certain functions and activities to financial advisers, subject to appropriate standards to ensure fair customer treatment and limit conflicts of interest. Permitted functions include:

- Binder functions, subject to the Binder regulations.
- Administration functions carried out by authorised administrators on behalf of retirement funds or medical schemes, where the administrator also operates an adviser function.
- Issuing of policy documents on behalf of insurers (the printing of policy wordings, policy schedules and the mailing thereof or the electronic dispatching of the policy wording and / or policy schedule to policyholders), subject to remuneration rules set out in Proposal BBB.
- Where an intermediary is a binder holder, the issuing of policies by the intermediary is seen as incidental to the activity of concluding new contracts with policyholders or concluding policy renewals or endorsements, and hence is not deemed to be separate from the binder function, nor may it be separately remunerated when performed under a binder agreement.

Comment is invited on whether there are other product supplier functions or activities that should be permitted to be outsourced to financial advisers (subject to appropriate standards), particularly recognising that some activities that fall within the current definitions of "intermediary services," "rendering services as intermediary" or "services as intermediary" as defined in the FAIS Act and the insurance laws respectively, may be better described as outsourced services.

In addition to the proposals above, readers are reminded that the FSB has already taken action to address unfair customer outcomes and conflicts in certain outsourcing models. These actions include:

- The general outsourcing standards set out in the abovementioned Directive 159.
- Action taken to prohibit insurers from outsourcing "broker consulting services" to an intermediary or a related party of an intermediary.<sup>57</sup>
- Action taken to prohibit long-term insurers entering into so-called "80 / 20" / "Co-administration" arrangements with administrators or intermediaries, that allows them to retain the underwriting profits from a particular book of insurance business because of the inherent conflicts of interest this presents.<sup>58</sup>

In considering future standards regarding permissible or disallowed outsourcing practices, these existing measures will also be taken into account.

<sup>57</sup> Various regulatory actions in terms of breaches of the principles contained in Directive 159.

<sup>58</sup> Information Letter 2/2014(LT): Conducting of insurance business in respect of assistance and life policies through co-administration agreements (also referred to as profit sharing or 80/20 agreements (29 August 2014).

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### 4.2.8 Responsibility of product suppliers for advice and intermediary or outsourced services provided

As discussed in Chapter 3, the current regulatory framework gives rise to imbalances in the responsibility of product suppliers and intermediaries for fair customer outcomes, by placing rigorous obligations on intermediaries (particularly in relation to advice), but significantly less responsibility on product suppliers to be accountable for customer outcomes achieved through their chosen distribution channel – despite the fact that product suppliers have a clear interest in effective and appropriate distribution of their products to their customers.

Going forward, the regulatory framework will aim to rebalance these responsibilities, by requiring product suppliers to monitor advice and distribution outcomes and put reasonable controls in place to promote fair treatment and mitigate mis-selling risks, regardless of the distribution channel they adopt.

#### • Tied advisers

##### **Proposal BB: Product supplier responsibility for tied advisers**

A product supplier will be fully responsible for the advice provided by advisers with whom it has a tied relationship as contemplated in Proposal R, as well for ensuring the tied adviser's compliance with all relevant regulatory provisions. The regulatory framework will impose similar obligations on a product supplier in this regard to those currently imposed through the FAIS Act on an authorised FSP in respect of its representatives. New conduct standards will be set to confirm the product supplier's responsibilities in this regard, including more explicit responsibilities in relation to ensuring that the tied adviser has the requisite generic and specific product knowledge, and in relation to monitoring the adviser's delivery of TCF outcomes. The product supplier's responsibilities in relation to its tied advisers will include, but not be limited to, the product supplier responsibilities in respect of multi-tied advisers set out in Proposal CC below.

Note that, for purposes of this proposal, references to product suppliers and products apply equally to investment managers and their investment portfolios in relation to which advice may be provided.

#### • Multi-tied advisers

A multi-tied adviser will not be regarded as the agent or representative of any one product supplier with whom it has a relationship as contemplated in Proposal P. A multi-tied adviser will instead be required to either be licensed in its own right as a financial institution authorised to provide multi-tied advice, or act as a representative of a juristic entity holding such an authorisation (a multi-tied advice firm).

However, in view of the relationship between multi-tied advisers and product suppliers – which by definition entails that the relationship between the product supplier and the adviser is not entirely at arms' length – it is reasonable to expect product suppliers and multi-tied advisers to share responsibility for the quality of advice provided to their shared customers, as opposed to the current framework which places this responsibility almost entirely on the adviser. To achieve this, product suppliers would also be expected to pay greater attention to the general customer treatment culture and supporting controls that a multi-tied adviser has in place.

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### **Proposal CC: Product supplier responsibility for multi-tied advisers**

Conduct standards will require product suppliers to take responsibility for aspects of the conduct of multi-tied advisers with whom they contract, including in relation to the following:

- Ensuring that the advisers are adequately equipped to provide appropriate information and advice on the product supplier's products. Specifically, product suppliers will be responsible for ensuring that the adviser meets specific levels of generic and product specific product training, failing which the product supplier may not enter into any form of arrangement with the adviser in relation to its products (including paying commission, paying any form of outsource or binder fee, or facilitating payment of advice fees). Such product specific training may either be provided by the product supplier itself, or through an appropriate service provider, subject to strict standards. Product suppliers should not impose unreasonable barriers or conditions (for example minimum production levels) related to the provision of training. This will result in fit and proper requirements being rationalised, particularly the removal of RE2 exam requirements and their replacement with a new model requiring both generic training in relation to product types and classes, and specific training on a product supplier's specific product structures. Further consultation will take place regarding details of this proposed new product knowledge framework.
- Taking reasonable steps before entering into any such arrangement, and in the course of the arrangement, to satisfy itself that the adviser will be in a position to deliver fair customer outcomes and provide advice suitable to the needs of the type of customer base and product types concerned. This includes the product supplier taking reasonable steps to establish that the adviser is fit and proper, has adequate governance and control measures in place to deliver TCF outcomes and that there is no cause for concern regarding the adviser's commitment to a culture of fair customer treatment.
- Reasonably monitoring appropriate fair treatment indicators, at adviser level, in relation to the adviser's book of business, including (where applicable) the type and volume of: Product sales, after sale product changes, product terminations, transfers, replacements, claims, and customer complaints; and taking appropriate action to address or mitigate identified poor customer outcomes.
- Identifying specific types of activities that pose a high risk of poor customer outcomes and putting reasonable risk mitigation measures in place. Possible examples would be monitoring sales of products with unusually large recurring contributions, or sales of long term products to elderly customers, or sales outside of the relevant product's target market, to identify potential mis-selling risks.
- Having processes in place to monitor and resolve customer complaints relating to the multi-tied adviser's services, and take appropriate action to mitigate unfair customer outcomes identified.
- Monitoring adherence by advisers to the fee guidelines for advice.

The market conduct regulator will monitor that product suppliers are effectively exercising these oversight responsibilities.

Further consultation will take place on appropriate measures for product suppliers to proactively manage the quality of advice provided by multi-tied advisers (for example, sample based review of advice provided in particular cases).

Note that, for purposes of this proposal, references to product suppliers and products apply equally to investment managers and their investment portfolios in relation to which advice may be provided.

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### • Independent financial adviser (IFA):

Although the principle that product suppliers and intermediaries should accept shared responsibility for customer outcomes is also relevant in relation to IFA's, it is accepted that the relationship between a product supplier and an IFA is at arms' length and that product suppliers cannot reasonably be expected to exercise the same degree of control in relation to customer outcomes in this regard. It is also accepted that the only relationship that will exist between a product supplier and an IFA in relation to the product supplier's products is the product supplier's facilitation of payment of advice fees from product values or contributions, or the payment of commissions in respect of certain products, where applicable.

#### **Proposal DD: Product supplier responsibility for IFAs**

Conduct standards will require product suppliers to take responsibility for aspects of the conduct of IFA's who provide advice on their products, in relation to the following:

- Where the product supplier pays any form of commission or facilitates the payment of any advice fee to an IFA, the product supplier will be required to ensure that the adviser meets the same levels of generic and product specific product training as applicable in respect of a multi-tied adviser, failing which the product supplier may not enter into such commission or advice fee facilitation arrangement.
- Identifying specific types of activities that pose a high risk of poor customer outcomes and putting reasonable risk mitigation measures in place. Possible examples would be monitoring sales of products with unusually large recurring contributions, or sales of long term products to elderly customers, or sales outside of the relevant product's target market, to identify potential mis-selling risks.
- Where an advice fee facilitation arrangement is entered into with the IFA, monitoring adherence by the IFA to the fee guidelines for advice (see proposal II).
- Taking reasonable steps to monitor and assist in the resolution of customer complaints relating to the IFA's services, and take appropriate action to mitigate unfair customer outcomes identified.

The market conduct regulator will monitor that product suppliers are effectively exercising these oversight responsibilities.

Note that, for purposes of this proposal, references to product suppliers and products apply equally to investment managers and their investment portfolios in relation to which advice may be provided.

### • Non-advice sales execution:

As proposed in Proposal D, a definition of "sales execution" will be included in the regulatory framework and will be used to set conduct standards regarding the provision of this service and also placing limits on the types of products or product features that may be distributed using non-advice sales execution. Product suppliers will be responsible for ensuring these standards are met.

#### **Proposal EE: Product supplier responsibility for non-advice sales execution (Also see proposal D)**

Product suppliers that distribute their products through a non-advice sales execution model will be responsible for ensuring that:

- The products concerned meet the requisite product standards for the distribution model.
- Any individual providing factual information as part of the non-advice sales process meets the requisite fit and proper standards.
- Any other conduct standards, including disclosure standards, relating to non-advice sales execution are met.

Over and above the responsibility product suppliers will be expected to take in relation to specific forms of distribution, as set out in proposals BB to EE above, the regulatory framework will ensure that product suppliers are generally not in a position to abdicate or avoid responsibility for fair customer outcomes by shifting this responsibility inappropriately to other parts of the product value chain. A particular risk in this regard relates to the level of access to customer data by the product supplier, and the quality of the product supplier's monitoring of customer outcomes. As a general principle therefore, product suppliers will be expected to build reasonable controls into their contractual arrangements and their day-to-day relationships with any type of intermediary or outsource service provider, in relation to customer related data. The argument is sometimes raised that the product supplier's access to customer related data held by intermediaries is restricted because the intermediary "owns the customer relationship." This argument is not considered valid. Although clearly customer confidentiality must be respected, product suppliers should be in a position to access information reasonably required by them to assess the delivery of TCF outcomes by their chosen distribution channels and outsource service providers.

Conversely, product suppliers should also be required – subject to relevant confidentiality safeguards – to provide customer related information to financial advisers, where this information is necessary to enable the adviser to provide financial planning or product advice to a customer. It is accepted however that product suppliers are entitled to, and indeed should, take care to ensure that such information is not provided to advisers where there is reasonable doubt as to whether the adviser is in a position to provide appropriate advice on the product supplier's products.



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### **Proposal FF: General product supplier responsibilities in relation to receiving and providing customer related data**

Conduct standards will be set to clarify product supplier responsibilities in relation to ensuring ongoing access to and monitoring of customer related data held by intermediaries and outsourced service providers, to ensure that the product supplier's ability to monitor delivery of TCF outcomes to customers is not undermined. Such standards will build on the approach already included in the insurance sector binder regulations and outsourcing directive, adapted where necessary to the particular distribution or outsourcing model concerned.

Standards will also be set relating to appropriate levels of customer information that product suppliers will be required to provide to IFAs or multi-tied advisers, when authorised to do so by the customer. Standards may differ for IFAs and multi-tied advisers respectively. Standards may also take into account whether the product supplier is satisfied that the adviser concerned has the requisite product specific knowledge in relation to its products held by the customer. At a minimum, where product suppliers have a valid reason (as recognised in the standard concerned) not to provide the requested customer information to the adviser, the product supplier will be required to provide the information to the customer directly, with a fair and objective explanation to the customer as to why the information is not being provided to the relevant adviser.

Any standards relating to obtaining or providing customer information will include appropriate confidentiality safeguards.

Note that, for purposes of this proposal, references to product suppliers and products apply equally to investment managers and their investment portfolios in relation to which advice may be provided.

### **4.2.9 Ownership and similar relationships between intermediaries and product suppliers**

Although the various proposals in this part of the paper relating to the relationships between product suppliers and intermediaries are aimed at reducing conflicts in these relationships, as discussed in 3.1.6 conflicts of interest may also arise from ownership or similar relationships between adviser firms / other intermediary entities and product suppliers, or between different adviser firms / intermediary entities.

### **Proposal GG: Ownership structures to be reviewed to assess conflicts of interest**

Although the various proposals in this RDR relating to the relationships between product suppliers and intermediaries are aimed at reducing conflicts in these relationships, certain ownership structures may nonetheless perpetuate conflicts. The FSB will fast-track engagement on these issues to understand how ownership structures may compromise customers' ability to assess the status of advice and whether any additional prohibitions or controls are required to further mitigate any potential advice bias.

## **4.3. Intermediary remuneration**

Greater clarity on the activities that make up advice, intermediation and outsourced services respectively, as well as on whose behalf the services are rendered, creates the foundation for a clearer set of principles and rules for intermediary remuneration.

To achieve the desired RDR outcomes, it is proposed that the future regulatory framework for intermediary remuneration should meet the following criteria:

- Intermediary remuneration should not contribute to conflicts of interest that may undermine suitable product advice and fair outcomes for customers. As part of this aim, intermediary remuneration should not undermine reasonable customer benefit expectations or inhibit customers' access to their savings (such as through early termination charges designed to recover commission costs).
- The regulatory framework should recognise the range of services available, the related remuneration for these, and whom may pay or receive it.
- All remuneration must be reasonable and commensurate with the actual services rendered.
- Remuneration structures should strike a balance between supporting ongoing service and adequately compensating intermediaries for up-front advice and intermediary services.
- Ongoing fees and / or commission may only be paid if ongoing advice and services are indeed rendered.
- An intermediary may not be remunerated for the same or a similar service twice.
- All fees paid by customers must be motivated, disclosed and explicitly agreed to by the customer.

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- The different types of services and fees should be readily comparable by customers; and
- Remuneration structures should promote a level playing field between different types of intermediaries providing similar services.

The paragraphs that follow apply set out proposals to apply these principles in practice. Remuneration related proposals are set out in accordance with the activity-based model discussed and illustrated in paragraph 4.1, with specific remuneration standards proposed for each of the following:

- Services to the customer, split into –
  - Financial planning / non-life insurance risk planning
  - Up-front and ongoing product advice
- Services connecting customers and product suppliers, split into
  - Sales execution (“selling”) and ongoing product maintenance and servicing by intermediaries
  - Non-advice sales execution; aggregation and comparison services; and investment platforms
- Services to product suppliers
  - Binder services
  - Other outsourced services.

In all instances, disclosure standards will apply in relation to any fees or other remuneration payable to intermediaries.

### **Proposal HH: General disclosure standards in relation to fees or other remuneration**

Over and above specific standards applicable to specific types of fees or charges, the regulatory framework will set general standards relating to:

- Standardised terminology to be used to describe particular types of services and related fees or charges
- Standardised terminology and / or methodologies to be used to disclose the impact of any fees or other charges on product values or benefits (for example an “effective annual charge” disclosure model), including the respective impacts of asset-based fees and fees deducted from contributions
- The production, maintenance and accessibility of “schedules” or “menus” of fees that an intermediary charges
- The content and timing of fee related disclosures, both in respect of up-front and ongoing fees
- Record keeping obligations in relation to fees and fee disclosures
- Obligations for product suppliers to ensure that the above disclosure obligations are adhered to by their tied advisers.
- Disclosure relative to any fee guidelines or benchmarks to be set by the regulator

The remainder of this chapter provides further details of remuneration proposals for each of these activities.

### **4.3.1. Fees for financial planning / non-life insurance risk planning (service to customer)**

This is a service rendered to the customer and should accordingly be remunerated by means of a planning fee (a specific type of advice fee), negotiated with the customer. The fee should be pre-agreed directly with the customer on the basis of a clearly disclosed charging structure, with a clear indication of the nature and extent of planning services to be provided. Regulations will not prescribe the quantum or charging basis of the planning fee, although the regulator or, where appropriate, a professional association, may publish benchmark guidelines. Advisers who provide more comprehensive planning services should be able to charge more than those whose planning services are more limited. For example, although it is accepted that a tied adviser may in certain circumstances be able to provide financial planning services, it is likely that the financial plan will be more limited than that available from an IFA. Financial planning fees should also take the level of expertise of the planner into account.

Monitoring of adherence to the financial / risk planning fee guidelines published by the regulator will be the responsibility of the product supplier in the case of tied agents,<sup>59</sup> and the regulator in the case of multi-tied advisers or IFA's.

<sup>59</sup> The regulator will in turn monitor the quality of the product supplier's oversight.

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**Proposal II: Standards for financial planning / risk planning fees**

Conduct standards will be set in relation to:

- The requirement to obtain explicit customer consent to a planning fee before any financial or risk planning is carried out, where consent must relate to the quantum of the fee, the fee calculation basis, the manner of payment and the scope of planning service to be rendered, including in relation to any ongoing financial planning services.
- Regulatory reporting obligations in relation to fees earned.
- Related disclosure obligations.
- Product supplier obligations to monitor planning fees charged by tied advisers and the scope and quality of the planning services provided by tied advisers.

In addition, the regulator may publish benchmark guidelines in relation to planning fees, together with requirements to monitor and / or report on adherence or deviations from such guidelines and enable comparability of such fees.

**4.3.2. Up-front and ongoing product advice fees (service to customer)**

Product advice – whether up-front or ongoing – is a service rendered to the customer and should accordingly be remunerated by means of an advice fee, negotiated with and paid by the customer. This principle should apply regardless of product type – in other words it should apply consistently to all investment products (whether in the form of an insurance policy or not) as well as to life insurance and short-term insurance risk products.<sup>60</sup> An exception would be for qualifying products sold into the low-income market (see Proposal TT below).

The product supplier should not dictate the advice fee that the adviser may charge,<sup>61</sup> or negotiate the advice fee with the adviser, but may facilitate the payment of the advice fee, as an alternative to the customer paying the fee directly to the adviser. For investment products, this can be facilitated by means of a once-off or ongoing deduction from the investment value of the product concerned, or from investment contributions made by the customer. For risk products or other products where deduction from the product value is not applicable, the advice fee may be collected in instalments as an additional amount, over and above the contribution or premium payable for the product concerned (for example a separate debit order amount). The advice fee will have to be differentiated from the product contribution amount as well as from any underlying product charges, and separately disclosed. It should be clear to customers that advice fees – whether facilitated by the product supplier or not – are separate from and in addition to product charges.

Neither the quantum nor the fee basis for up-front or ongoing product advice will be prescribed, although strict disclosure standards will apply. Various charging structures may be negotiated – for example a flat fee, an asset-based “trail” fee, a percentage of contribution, an hourly rate, etc. However, a number of conduct standards will be necessary to mitigate the risk of abuse or unfair outcomes arising from this flexible framework. Regulatory guidance on appropriate advice fees should also form part of consumer education initiatives.

**Proposal JJ: Standards for up-front and ongoing product advice fees**

Conduct standards will be set in relation to:

- The requirement to obtain explicit customer consent to an advice fee before any such fee may be charged and (in the case of up-front product advice) before any product transaction is entered into – where consent must relate to the quantum of the fee, the fee calculation basis, the manner of payment, and the type of advice to which the fee relates.
- Regulatory reporting obligations by advisers in relation to advice fees earned.
- Related disclosure obligations.
- Product supplier obligations to monitor and report to the regulator on advice fees charged by tied advisers and the scope and quality of the planning services provided by tied advisers.
- Product supplier obligations to monitor advice fees charged by multi-tied advisers and IFA's, where the product supplier facilitates the fee collection.
- Limitations on the extent to which advice fees charged may vary between product types.
- The principle that advice charges should be reasonable and commensurate to the service being provided, and not allow for cross-subsidisation by product charges.

In addition, the regulator may publish benchmark guidelines in relation to advice fees – in the form of a “safe harbour” benchmark or tariff guideline – together with requirements to monitor and / or report on adherence or deviations from such guidelines and enable comparability of such fees.

<sup>60</sup> This means that, in those cases where product supplier commission will still be payable (see paragraph 4.3.3 below), the adviser may charge an advice fee over and above any commission they may earn, subject to all applicable requirements. This will not apply in respect of health service benefits, which are subject to remuneration limits set in the Medical Schemes Act, 1998.

<sup>61</sup> Provided that, in the case of its tied advisers, a product supplier will be required to monitor the advice fees charged against regulatory guidelines, and may therefore wish to set parameters in this regard.

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**Proposal KK: Additional standards for ongoing advice fees**

The standards referred to in proposal JJ above will apply to both up-front and ongoing advice fees. The following additional standards will however be set in relation to ongoing advice fees:

- Ongoing advice fees may not be charged unless the customer has agreed in advance to receive ongoing advice and to the fee concerned, and such ongoing advice is in fact provided.
- Where there is a periodic fee paid for ongoing advice, the customer should be able to "opt out" if no ongoing advice is provided.
- Where a customer agrees to pay a periodic fee for ongoing advice, and such advice is provided, the adviser may stop providing the ongoing advice if the customer does not pay or stops paying the agreed fee.

For investment products, product suppliers will be required to provide a facility for deducting advice fees. This will enable customer-agreed deductions from a customer's investment<sup>62</sup> to pay for financial advice and flexibility in payment options, obviating the need for the customer to have to pay advice fees directly, up-front, or in full. While these deductions from a customer's investment would need to be facilitated by a product supplier, this is not the same thing as commission, as the remuneration is not set by the product supplier and the product supplier plays no part in the negotiation of the fee amount or fee structure.

**Proposal LL: Product suppliers to facilitate advice fees**

For investment products, product suppliers will be obliged to offer a facility for customers to instruct the product supplier to deduct up-front advice fees (in a single payment or in instalments) or periodic ongoing advice fees, and pay these across to their appointed adviser. Standards will be set providing for:

- The requirement to provide, at the customer's election, for deductions from either the amount of any investment contribution paid by the customer, or from the value of the investment product from time to time, or both.
- The type of customer instruction that the product supplier must receive before making any fee deduction.
- The product supplier's obligations to cease or amend any such deductions at the customer's request.
- A requirement that the product supplier offer the same advice fee facilitation services for all types of adviser – IFAs, multi-tied or tied.
- The product supplier's obligation to disclose to customers any advice fees that it facilitates, in a manner that clearly distinguishes them from any product charges.

For risk products or other products where deduction from the product value is not applicable, the product supplier will also be required to offer a facility to deduct advice fees as additional amounts over and above the contribution or premium payable for the product concerned (for example a separate debit order amount). Product suppliers will be obliged to offer the same facility for all types of adviser – IFAs, multi-tied or tied.

Comment is specifically invited on the range of fee deduction options which product suppliers should be required to facilitate.

The above approach to advice fees will apply equally to IFAs, multi-tied advisers and tied advisers, to avoid arbitrage and inappropriate migration of IFAs to multi-tied or tied advice models. However, the quantum of product advice fees would be expected to take account of the scope of advice available – IFAs would for example be expected to be able to charge higher fees than those charged by multi-tied or tied advisers, as the case may be. The level of expertise of the adviser concerned would also be relevant.

**4.3.3. Remuneration for services connecting product suppliers and customers – sales execution ("selling") and ongoing product maintenance and servicing by intermediaries**

The reference to "sales execution" in the heading of this paragraph refers to the role an intermediary plays in facilitating the actual purchase or entering into of a financial product, other than the provision of product advice – loosely described as "selling" the product. It should not be confused with direct non-advice sales execution, which is a model where the product supplier concludes transactions directly with its customers, without an intermediary acting as "go-between".<sup>63</sup>

As indicated in the diagram in paragraph 4.1 illustrating the activity-based model, this selling activity and the activity of facilitating post-sale product maintenance and servicing, are services that connect customers and product suppliers – a product could not be entered into, and post-sale product changes or transactions could not take place, without both the customer and the product supplier taking part in the transaction. However, in practice, these particular services could equally be carried out by the product supplier itself interacting directly with its customer, if they were not undertaken by the intermediary.

<sup>62</sup> It is noted that amendment of certain provisions of the Long-term Insurance Act may be required in order to permit the deduction of such fees from long-term insurance investment policy values.

<sup>63</sup> For example through an on-line or electronic distribution model, or through telesales call centres providing factual information on behalf of the product supplier.

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Accordingly, the activity-based approach would suggest that these services be remunerated by the product supplier. In the case of sales execution ("selling") such remuneration would typically take the form of sales commission, while remuneration for ongoing product maintenance or servicing would take the form of a service fee – both paid by the product supplier to the intermediary.

The proposals below therefore recognise that "selling", as a service rendered primarily to the product supplier, is separate from (and may be remunerated separately from) the provision of advice to the customer. Importantly however, the proposal is that – for reasons set out below – this distinction should not be applied where the product being sold is an investment product.

This separation of "advice" from sales execution and ongoing product maintenance / servicing (with a separate advice fee chargeable to the customer) will necessitate an adjustment to current regulated insurance commission rates. As discussed in Chapter 3, the current regulatory framework imposes no obligations on insurance intermediaries to provide advice before being entitled to commission. On the other hand, the regulated maximum commission levels presuppose that the commission will cover the costs of advice together with that of other intermediary services. It follows therefore that if current maximum commission levels were to be maintained, over and above the availability of a separate advice fee, the adviser would be paid twice for performing the same function.

It also follows that, if commissions cease to be payable or, where commission continues to be payable but commission levels are reduced, this should result in correspondingly lower product charges, as product suppliers will no longer need to recover such commission costs through product charges.

Further technical work is required to determine what the new maximum commission levels should be for "selling" products or for performing ongoing policy servicing or maintenance.

Specific remuneration proposals for "selling" and servicing of investment products, life insurance risk products, and short-term insurance products respectively are set out in more detail below. Specific proposals in relation to insurance product replacements and "equivalence of reward" in insurance distribution are included, as well as a differentiated approach for the distribution of qualifying investment and risk products sold into the low-income sector.

#### • Investment products

The potential consumer impact of unfair or inappropriate charging structures is particularly important in the investment product space, where product, distribution and advice related costs all have a direct impact on the ability of products to meet reasonable customer benefit expectations. This impact is particularly acute where recovery of up-front commission costs triggers early termination charges. Risks in this regard are exacerbated by the fact that there is scope for arbitrage between the different intermediary remuneration models available in the current regulatory framework, which creates scope for advice bias between products that offer largely similar types of customer benefits.

This elevates the priority of ensuring a level playing field across investment sub-sectors, through a consistent remuneration and incentive structure. Ensuring that remuneration for advice and sales is determined consistently, irrespective of the products recommended, was seen by many commentators on the FSB's 2011 call for contributions on intermediary services and remuneration, as having the most significant impact on the quality and independence of product advice.

For this reason, the policy view is that product suppliers will be prohibited from remunerating intermediaries (in the form of commission or fees) for the sale or servicing of investment products, and that intermediaries may only be remunerated by means of an advice fee paid for by the customer<sup>64</sup> in respect of investment products, in accordance with the requirements set out in Proposals JJ to LL above. Correspondingly, intermediaries will be prohibited from accepting any form of remuneration in relation to these products other than such advice fees. In effect, the costs of an intermediary's services in relation to selling and ongoing servicing of investment products may therefore not be borne by the product supplier but must be met out of the advice fee agreed between the intermediary and the customer. A further outcome of this approach will be that the costs of advice and other intermediary services provided by intermediaries will no longer need to be recovered by product suppliers in the event of early termination of a product or early cessation of ongoing investment contributions.

The same approach will apply to all types of advisers, whether IFAs, multi-tied advisers or tied advisers, so as to avoid arbitrage and the potential inappropriate migration of IFAs to tied or multi-tied models. A differentiated approach will apply to distribution in the low-income market (see below).

Note that this proposal relates only to intermediated distribution models that entail the provision of advice on investment products. Where an investment product is distributed through a non-advice sales execution model, no advice fees are applicable and all relevant requirements for that distribution model will apply – bearing in mind that product standards will be introduced to limit the types of investment products that may be sold through such models (see Proposal D).

<sup>64</sup> However, see Proposal SS below regarding remuneration arrangements between an adviser firm and its individual advisers.



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**Proposal MM: Remuneration for selling and servicing investment products**

Product suppliers will be prohibited from paying any form of remuneration to intermediaries in respect of investment products, and from including any costs associated with intermediary remuneration in product charging structures, whether in the form of ongoing charges or early termination charges. Intermediaries will correspondingly be prohibited from earning any form of remuneration in respect of investment products other than advice fees agreed with the customer, in accordance with the applicable requirements for such fees. (Subject to Proposal SS below regarding remuneration arrangements between adviser firms and their individual advisers).

Where existing investment products are priced to include the cost of commission in product charging structures, product suppliers will be required to demonstrate how they have reduced product charges on products sold after the applicable effective date, in light of the prohibition on commissions.

Exceptions will apply to investment products marketed in the low-income market.

- **Life insurance risk business**

Long-term insurers may remunerate intermediaries directly for selling life risk policies<sup>65</sup> (i.e. “sales commission” in the strict sense) and for certain types of ongoing servicing or maintenance of such policies.

Feedback from consultations on the initial proposals (in the FSB’s 2011 call for contributions) to move towards an as-and-when basis for commission for life risk policies – where commission is payable only as and when each recurring premium is paid – pointed to strong resistance to this approach. Commentators argued that the move to a full as-and-when commission basis would threaten the sustainability of many intermediaries’ business models, with the consequent risk that many customer and potential customers would not have access to the advice they need in order to protect themselves and their families from insurable crisis events.

Key arguments against a full as-and-when commission basis included:

- A view that there is no clear evidence that up-front commission drives mis-selling and churn
- The majority of advice and intermediation occurs up-front for these product, with relatively lower requirements for post-sale advice and service
- Annuity income from as-and-when commission can create capital value in the adviser’s business, but the model may also create barriers to entry for new financial advisers; and
- Any shift to as-and-when commission cannot happen suddenly, but would have to be phased in to allow for adaptation to a different cash flow.

At the same time, there are a number of arguments against a fully up-front commission basis:

- Much of the up-front activity that was pointed to in the consultations relates to up-front financial planning and product advice, for which a separate advice fee negotiated with the customer can be charged going forward
- A fully up-front commission model does not incentivise ongoing service to the client
- While evidence that up-front commission for life risk policies contributes to mis-selling and churn was challenged by commentators, this is difficult to reconcile with voluminous anecdotal evidence that this is indeed the case and the general view that some level of intervention regarding replacements is warranted.

Considering both the arguments for and against the as-and-when model, it is proposed that a balance between the as-and-when and up-front models be introduced.

<sup>65</sup> To be defined to include policies providing death, disability or illness benefits, but excluding policies that include any form of investment benefit.

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**Proposal NN: Remuneration for selling and servicing life risk policies – mix of up-front commission and as-and-when service fees**

Subject to a differentiated approach for the low-income sector (see below), it is proposed that 50% of the remuneration payable by long-term insurers in respect of life risk policies may be paid up-front as a sales commission, and that the remaining 50% be payable on an as-and-when basis to provide for ongoing servicing and maintenance of the risk policy. The following additional requirements – to be expanded in more detailed conduct standards – will support this model:

- Both the level and structure of commission and service fee payments by life insurers will continue to be subject to regulated caps and other regulatory requirements. Further technical work and consultation will be undertaken to determine what the new maximum commission and service fee levels should be.
- The up-front commission component will be payable at the start of the policy, not split between the first and second year.
- Commission “clawback” provisions in relation to the up-front commission component will be retained
- To avoid the current complications that arise from the creation of “mini policies” for contractual premium escalations, sales commission will be calculated in a way that takes these premium escalations into account up-front – with a regulated cap on the percentage of contractual premium escalations (for example, the higher of 5% or CPI) that may be included in the commission calculation so as to avoid the risk of mis-selling policies with unreasonable premium escalation clauses.
- Where an intermediary performs ongoing product maintenance / servicing on behalf of the insurer, the life insurer may pay a fee to the intermediary for providing such services, subject to the following conditions:
  - Further work will need to be undertaken to determine the range of services that fall within the category of product maintenance / servicing, to distinguish these from other “outsourced services” rendered solely on behalf of the insurer (which will be subject to the provisions discussed in 4.3.5)
  - Insurers must include the cost of these fees in the premium or other product charges they charge for the policy itself, subject to explicit disclosure to the customer regarding the quantum and purpose of the fee
  - Servicing fees will be regulated and capped (similarly to commission) to avoid provider bias, including a requirement that similar fees be payable to for similar services, regardless of which type of intermediary renders the services concerned
  - The insurer must monitor whether the ongoing service concerned is in fact being provided by the intermediary and stop charging the service fee against the policy if no ongoing service is in fact provided, including but not limited to cases where the intermediary concerned ceases to have a tied or multi-tied arrangement with the insurer or cases where the customer can show that no ongoing service is being provided
  - Product suppliers will be required to demonstrate how they have adjusted product charges on products sold after the applicable effective date, in light of the changes in level and structure of commissions. A transition period will be provided for to smooth the impact on intermediary revenues of the move away from a fully up-front commission model for life risk policies.

**• Replacement of life insurance risk policies**

Analysis of the current distribution landscape has pointed to concerns about up-front commission on replacement policies contributing to incentive-driven churn of life insurance risk policies. The risk of inappropriate churn is sometimes exacerbated by substantial recruitment incentives offered by long-term insurers for independent intermediaries (using current terminology) to become tied advisers, or for tied advisers to move between insurers – leading to so-called “adviser churn”. This practice is also inconsistent with the principle of “equivalence of reward” between tied or non-tied advisers (see below).

Some commentators have pointed out that “churn” (used here to refer to inappropriate or unnecessary replacement of policies driven by intermediary incentives) should be distinguished from responsible replacement of policies, driven by what is in the policyholder’s best interests. However, it was also acknowledged that it is very difficult in practice to design a framework that will enable this distinction to be consistently achieved. Some suggested placing more emphasis on the replacement process, and enforcement of standards in this regard. Others believed that the only meaningful disincentive for commission-driven churn is to either prohibit commission on replacement policies, or to limit such commission to a fully as-and-when basis.

As pointed out above, the view that there is insufficient evidence that up-front commission for life risk policies contributes to mis-selling and churn, is difficult to reconcile with voluminous anecdotal evidence that this is indeed the case and the general view that some level of intervention regarding replacements is warranted.

Having considered the various views expressed, the policy view is that a focus on the replacement process is on its own unlikely to be sufficient to fully mitigate the conflicts of interest created by the opportunity to earn new up-front commission by recommending a policy replacement. Accordingly, the proposal is to prohibit commission on replaced life risk policies. Appropriate replacement of policies may be remunerated by means of an advice fee.

In addition, the exacerbation of policy churn through “adviser churn” is in the process of being addressed by an amendment to the FAIS General Code of Conduct prohibiting “sign-on bonuses”.<sup>66</sup>

<sup>66</sup> Invitation to comment on proposed amendment to the General Code of Conduct for Authorised Financial Services Providers and Representatives, 2003 published 1 September 2014.

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### **Proposal OO: Product supplier commission prohibited on replacement life risk policies**

Long-term insurers will be prohibited from paying any form of commission or fee to an intermediary in respect of the replacement of life risk policies. Intermediaries will be prohibited from accepting any remuneration other than an advice fee, subject to all applicable requirements for such advice fees, in respect of such replacements. An appropriate definition confirming what type of transaction constitutes a “replacement” for these purposes will be developed, together with specific advice and disclosure standards in relation to replacements.

### **• Replacement of other long-term insurance products**

Certain historic or so-called “legacy” long-term insurance business models also exacerbate the risk of inappropriate product replacements. The following areas of concern have been identified:

- Variable premium increases (i.e. voluntary *ad hoc* increases to recurring premiums) on legacy contractual savings products entered into before March 2009, when new commission regulations came into effect, still attract full up-front commission in line with the regulations that applied at the time the policy was entered into. This introduces a potential conflict of interest, as an intermediary may be biased towards advising a client to increase premiums on a legacy product rather than investing in a newer type of product, without fully considering the advantages and disadvantages of the legacy product – including the fact that such legacy products typically incur higher early termination penalties than newer generation products. The relevant commission regulations will be amended to address this anomaly. Accordingly, commission regulations will be changed to consistently apply the same commission basis to variable premium increases on legacy products as is applied to new generation contractual savings policies.

### **Proposal PP: Commission regulation anomalies on “legacy” insurance policies to be addressed**

The commission regulations under the Long-term Insurance Act will be amended to consistently apply the same commission basis to variable premium increases on “legacy” investment products as is currently applied to new investment policies.

This will be used in combination with other measures to help ensure that early termination values on legacy contractual savings products are reduced to reasonable levels within the next few years and that such products deliver fair outcomes for both new and existing customers.

- “Section 14 transfers”<sup>67</sup> between retirement annuity (RA) funds – i.e. the transfer of a member’s accumulated savings from one RA fund to another – may in some cases be motivated by differences in intermediary remuneration for different types of RA funds rather than the best interests of the customer. Specifically, investments in ‘underwritten’ RA funds (where the underlying investment is a long-term insurance investment policy) attract commission for the intermediary, while investments in ‘non-underwritten’ RA funds (where the underlying investment is usually a collective investment scheme) will generally result in the payment of a ‘trail fee’ (i.e. a percentage of assets under management) to the intermediary. Regulations under the Pension Funds Act have attempted to discourage incentive-driven churn of investments between underwritten RA funds by specifying that no new commission may be earned by an intermediary for a transfer from one underwritten RA fund to another, meaning that any advice in this regard must be remunerated by means of an advice fee only.<sup>68</sup> However, a risk remains that there may be incentive-driven churn between underwritten RA’s and non-underwritten RA’s, where intermediaries who have already earned up-front commission on the initial sale of the underwritten RA may be driven to earn additional asset trail fees by advising the client to shift to a non-underwritten RA, even if this may not be in the client’s best interest, particularly taking account the early termination penalties that may be payable when withdrawing from the underwritten RA fund.

### **Proposal QQ: Conflicted remuneration on retirement annuity transfers to be addressed**

Specific conduct standards will be set to mitigate the risk of poor customer outcomes where an adviser recommends the transfer of accumulated benefits from one retirement annuity fund to another. Standards will include strengthened disclosure requirements to ensure that the cumulative impact of any early termination charges deductible from the transferred value, together with that of advice fees and product charges on the investment value post transfer, are clearly communicated. Consideration will also be given to placing specific obligations on both the transferring and the receiving funds and / or product suppliers concerned, to take steps to satisfy themselves that the transfer is in the fund member’s interests – particularly in instances of transfers from underwritten RAs (where up-front commission costs will already have been incurred).

As referred to in Proposal PP, early termination values on legacy contractual savings products will also be reduced to reasonable levels within the next few years so as to address excessive penalties on the transfer of retirement annuity savings.

<sup>67</sup> So named because they are carried out in terms of s14 of the Pension Funds Act, 1956.

<sup>68</sup> Section 14(7) of the Pension Funds Act, 1956 determines that such fees must be negotiated and agreed to in writing by the transferring member or non-member spouse annually.

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● **“Equivalence of reward” to be reviewed**

The current Regulations to the Long-term Insurance Act provide that the Registrar may determine how the principle of equivalence of reward must be achieved. The Registrar of Insurance has however not to date issued any determination, and the principle of “equivalence” is largely ignored by long-term insurers in practice, with insurer representatives often earning remuneration significantly in excess of the corresponding quantum of commission that would have been payable to an “independent intermediary” for similar volumes of business.<sup>69</sup> Where the concept of equivalence is considered, this has typically been interpreted as applying to the aggregate remuneration paid across an insurer’s their full complement of representatives, rather than at the level of individual representatives.

There were stark differences in feedback from stakeholders on the need to strengthen equivalence of reward provisions. Some of the arguments put forward by commentators ignore the fact that differences in the structure and level of remuneration may lead to an unintended migration from the independent intermediary model to tied advice models.

While an argument was made that it will be important to allow flexibility to support remuneration of new tied adviser recruits where their initial commission earnings may not be sufficient to afford them a living, other commentators felt strongly that reforms where necessary to strengthen equivalence of reward provisions to achieve a more level playing field between tied agents and independent advisers.

Guided by this objective of promoting a more level playing field, the proposal is that equivalence of reward provisions will be strengthened by applying equivalence at an individual intermediary level, but within bounds to provide for support for new recruits. The strengthened equivalence provisions will include prohibitions on recruitment and incentive practices that create opportunities for arbitrage in favour of tied advice models.

In addition, although the principle of equivalence of reward is currently not included in the Short-term Insurance Act or its regulations, consideration will be given as to whether this concept should be introduced into the short-term insurance environment to mitigate potential risks of arbitrage between tied and non-tied advice models in the future framework.

**Proposal RR: Equivalence of reward to be reviewed**

Specific standards will be set to clarify and strengthen the principle of “equivalence of reward” as the basis on which long-term insurers may remunerate their tied advisers. These standards will include provisions:

- Confirming that the principle of equivalence applies at the level of each individual tied adviser.
- Detailing the nature of remuneration and benefits to be taken into account in assessing equivalence. This will be based on a “total cost to company” approach, whereby all benefits payable to the adviser are taken into account in applying the principle – including commissions, fees, salary-based payments, allowances, medical and pension benefits, non-cash incentives, participation in conferences and events, share options, etc. So-called “sign-on bonuses” and all forms of production or other performance incentives or rewards, whether or not they are conditional or deferred, will also be included.
- Providing for how to apply the principle of equivalence at appropriate time periods or across appropriate tranches of business, bearing in mind that the equivalent value of commission that would have been payable to a non-tied adviser can only be calculated with hindsight.
- To clarify that the equivalence model relates to remuneration relating to life insurance risk benefits only (being the products in respect of which product supplier commission and fees remain payable), with remuneration relating to investment products being determined with reference only to the quantum of customer agreed advice fees paid. Any portion of a tied adviser’s “total cost to company” remuneration that is attributable to advice on or sale of investment products, may not in aggregate exceed the value of customer advice fees in fact paid by customers in respect of such products over an appropriate period.

The regulator will specifically monitor insurers’ application of equivalence of reward standards.

Specific input is invited on

- The types of benefits to be taken into account in applying the principle of equivalence and on whether any margin over the corresponding maximum commission levels payable to multi-tied advisers or IFAs, should be permitted. The argument has historically been made that equivalence of reward should permit such a margin, in recognition of the fact that the restricted range of products and product suppliers available to a tied adviser, inevitably limits the adviser’s earning potential, as compared to that of a non-tied adviser of equal competence.
- The extent to which and manner in which the principle of equivalence of reward should be applied to mitigate the creation of barriers to entry for new tied advisers.
- Whether it may be necessary to introduce the concept of equivalence of reward into the short-term insurance environment to mitigate potential risks of arbitrage between tied and non-tied advice models in the future framework.

<sup>69</sup> Examples have been observed of insurer representatives earning remuneration levels in excess of 150% of so-called “broker maximum” commissions.

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### • **Remuneration arrangements between juristic intermediaries (adviser firms) and their individual advisers**

The prohibition on commission payments for investment products applies as between the product supplier (or any entity acting directly or indirectly on its behalf) and the intermediary concerned. Where the individual who provided the product advice and / or facilitated the selling of the product is an individual representing an adviser firm, the prohibition applies as between the product supplier on the one hand, and both the adviser firm and the individual on the other.

However, this is not to say that an adviser firm is restricted from paying remuneration in another form to its individual advisers. For example, the employment or other remuneration arrangement between the firm and its adviser may provide for a regular salary, or some other payment structure that is not identical to the cash flow generated by the actual advice fees the individual negotiates with customers. The commission prohibition is not intended to interfere in such remuneration arrangements. However, such remuneration arrangements should also not be structured to allow advisers in these cases to earn remuneration on investment products that is in excess of the value of fees actually payable by customers. If such structures were available, this would place larger adviser practices – who are better placed to afford such subsidisation – at an unfair advantage over smaller purely fee-earning advisers, and the costs of such subsidisation would also likely ultimately be passed on to customers indirectly.

### **Proposal SS: Standards for remuneration arrangements between adviser firms and their individual advisers**

In the case where an individual IFA or multi-tied adviser provides product advice and / or facilitates the selling of an investment product as a representative of an adviser firm, any portion of the individual adviser's remuneration that is attributable to advice on or sale of investment products, may not in aggregate exceed the value of customer advice fees in fact paid by customers in respect of such products over an appropriate period.

### • **Specific remuneration dispensation for selling and servicing investment and life risk products in the low-income sector**

It is recognised that a different approach is necessary for investment products and life risk products sold in the low income sector, to balance the need to promote financial inclusion and access to advice, against the particular information asymmetry and customer vulnerability risks in this sector. Importantly, the regulatory framework must not permit product suppliers to compromise the quality or value for money of products sold to low income customers, in the name of providing "access".

For investment products in this market, an exception will therefore be made to the rule that intermediaries may earn only advice fees in respect of investment products. Product suppliers will be permitted to supplement intermediary remuneration for distribution of or advice on these products by means of commission.

The structure and level of permitted commission for both investment and risk products will require further technical work and consultation.

To avoid the difficulties of defining "low-income sector" products, and to ensure appropriate value for customers in relation to these products, the special remuneration dispensation will be linked to specific product standards, such as those that will apply to micro-insurers and / or to the proposed tax-free investment accounts. These product standards will be designed to ensure appropriate, affordable, low-risk products, designed to achieve consumer protection objectives – including the absence of penal early termination charges. To the extent that the standards include caps on premium or investment amounts to qualify for this dispensation, product suppliers will be responsible for monitoring product sales to identify potential abuse of the caps – for example by selling multiple "below the cap" products to the same customer in order to earn commission instead of being restricted to advice fees. The regulator will also monitor intermediary conduct in this regard.

Where short-term insurance distribution is concerned, consideration will also be given to whether there is a need for a specific remuneration dispensation for selling and servicing personal lines policies in the low income sector.



## CHAPTER 4: REGULATORY POLICY PROPOSALS

### **Proposal TT: Special remuneration dispensation for the low income market**

Additional consultation and technical work will be undertaken to determine an appropriate remuneration dispensation for product suppliers and intermediaries serving low income customers, in respect of life insurance risk products and investment products. Elements to be considered include:

- Product standards to allow products to qualify for this dispensation, including in relation to: Benefit types, premium / contribution limits, product terms and charges. In particular, such product standards will either prohibit or significantly reduce the extent to which product suppliers may recover any up-front commissions payable from product values in the form of early termination charges.
- Inter-relationship between this dispensation and policy proposals in respect of microinsurance and tax free savings products.
- The types of intermediary and advice services qualifying for this dispensation.
- Permissible commission limits.
- Permissible product supplier / intermediary relationships.

In addition, comment is invited on the extent to which a special remuneration dispensation is required for the low income market in respect of personal lines short-term insurance products.

### **● Short-term insurance**

In the short-term insurance sector, the nature of intermediary services is seen as ongoing, given the relatively continuous nature of the customer servicing and policy maintenance that is typically performed by the short-term insurance broker or agent. Accordingly, there is support for a continued as-and-when commission basis of remuneration for the selling and ongoing servicing of short-term insurance business.

As discussed in 2.4.10, currently section 8(5) of the Short-term Insurance Act provides that the broker may charge the policyholder an additional fee – often referred to as a “policyholder fee” or a “broker fee”. Concerns regarding this current practice are discussed in 3.1.2.

It is proposed that these concerns be addressed through the consistent application of the activity-based model of remuneration described above. The short-term insurance broker or agent should be able to negotiate an advice fee with the customer, over and above commission payable by the product supplier (insurer), and this advice fee should replace the existing section 8(5) fee.<sup>70</sup> This will have the benefit that the fee will be clearly negotiated and agreed with the customer at the outset, with clarity on what services the fee is being charged for. As previously discussed, this advice fee may be charged for “risk planning” advice or for up-front or ongoing product advice, as applicable to the type of advice provided.

<sup>70</sup> See 2.4.10

## CHAPTER 4: REGULATORY POLICY PROPOSALS

### **Proposal UU: Remuneration for selling and servicing short-term insurance policies**

It is proposed that the as-and-when model for short-term insurance be retained, to provide for sales commission for the selling of a policy and service fees for ongoing servicing and maintenance of the policy to be paid by short-term insurers. The following additional requirements – to be expanded in more detailed conduct standards – will support this model:

- The level of commission and service fee payments by short-term insurers will continue to be subject to regulated caps and other regulatory requirements. Further technical work and consultation will be undertaken to determine what the new maximum commission and service fee levels should be. The current provision allowing for additional fees over and above commission (through section 8(5) of the Short-term Insurance Act), will be removed. Short-term insurance advisers will be able to earn advice fees from customers, separately from commission, subject to the requirements applicable to such fees.
- The service fee component of the intermediary's remuneration will be subject to the following conditions:
  - Further work will need to be undertaken to determine the range of services that fall within the category of ongoing product maintenance / servicing, to distinguish these from other "outsourced services" rendered solely on behalf of the insurer. In those cases where an intermediary is permitted to collect premiums (subject to proposal F), premium collection will be included in this range of services and an appropriate service fee determined.
  - Insurers must include the cost of these fees in the premium or other product charges they charge for the policy itself, subject to explicit disclosure to the customer regarding the quantum and purpose of the fee.
  - Servicing fees will be regulated and capped (similarly to commission) to avoid provider bias, including a requirement that similar fees be payable to for similar services, regardless of which type of intermediary renders the services concerned.
  - The insurer must monitor whether the ongoing service concerned is in fact being provided by the intermediary and stop charging the service fee against the policy if no ongoing service is in fact provided, including but not limited to in cases where the intermediary concerned ceases to have a tied or multi-tied arrangement with the insurer or cases where the customer can show that no ongoing service is being provided.
  - Product suppliers will be required to demonstrate how they have adjusted product charges on products sold after the applicable effective date, in light of the changes in level and structure of commissions.

### • **Replacement of short-term insurance products**

The as-and-when short-term insurance commission model does not expose customers to the same degree of risk of inappropriate replacement advice as the up-front commission for life risk insurance does. However, there are elements of the current short-term model that are cause for concern.

Inappropriate replacement of short-term insurance policies may be driven by conflicted remuneration in cases where an intermediary directs business to an insurer who is willing to pay a higher binder fee or outsourcing fee. This is exacerbated by the fact that in practice, despite relevant FAIS obligations, it appears that customers are often not asked to consent to the change in insurer and the new policy contract prior to the replacement taking place. In other cases, a policy may be cancelled by an insurer, but the intermediary is not able to find alternative cover for the customer. In these cases, particularly where the intermediary is collecting the premium, there is a risk that the intermediary may be tempted to "self-insure" the risk concerned by conducting unregistered insurance business.

Specific interventions – in addition to the various proposals made elsewhere in this paper to strengthen standards relating to binders and outsourcing – are proposed to mitigate this risk.

### **Proposal VV: Conditions for short-term insurance cover cancellations**

In the event of cancellation of a short-term insurance policy by an intermediary, additional conduct standards will apply to ensure that the customer has consented to a new replacement policy prior to the cancellation becoming effective and that the replacement of the customer's existing policy is in the best interest of the customer.

In the event of cancellation of a short-term insurance policy by an insurer, the original insurer should stay on risk until it has received confirmation that the customer is aware of the cancellation of the policy and has either consented to a new replacement policy or has been afforded a reasonable period to secure alternative cover. It is proposed that this reasonable period be set at 60 days.

## CHAPTER 4: REGULATORY POLICY PROPOSALS

### **4.3.4. Remuneration for services connecting product suppliers and customers – direct non-advice sales execution; aggregation and comparison services; and investment platforms**

- **Direct non-advice sales execution**

As explained elsewhere in this paper, this activity relates to the “selling” of a product (through any medium), through a product supplier concluding transactions directly with its customers, without providing advice. This may be carried out directly by the product supplier, using its own staff and / or systems, or in the name of the product supplier through an outsourcing arrangement. By definition, this activity excludes the provision of advice.

Clearly no advice fees of any kind will be payable by the customer in these models.

#### **Proposal WW: Remuneration for direct non-advice sales execution**

Standards will be set in relation to remuneration for this service, seeking to ensure that remuneration models are commensurate with the fact that no advice or ongoing product maintenance / servicing is provided. In the case of insurance products, the remuneration levels should not exceed a level equivalent to that which will be payable for the sales commission component of an intermediary’s remuneration.

- **Remuneration for referrals and leads, including aggregation and comparison services**

In line with the aims of this RDR, services that refer customers, product suppliers and / or intermediaries to one another should be transparent, avoid conflicts of interest, and deliver fair customer outcomes. This is particularly important where referrals take place through commercially operated product comparison and aggregation service providers, given the increasing accessibility of these services (usually via the internet) and the growing volumes of product sales resulting from them.

#### **Proposal XX: Remuneration for referrals, leads and product aggregation and comparison services**

The current regulatory provisions in the FAIS General Code of Conduct in relation to conflicts of interest will be reviewed to ensure that the regulatory framework sets adequate conduct standards to mitigate conflicts in relation to the provision of different forms of leads and referrals. In particular, conduct standards may address potential conflicts of interest arising from so-called “commission sharing” or “commission splitting” arrangements between intermediaries and / or product suppliers.

In addition, a specific review of the remuneration models used by commercial product comparison and aggregation providers will be undertaken, to ensure that remuneration is reasonable and commensurate to the actual services rendered, transparent to customers and not conflicted.

- **Investment platform administration**

As outlined in 3.1.4, the current practice of investment platform administration services being remunerated by means of a platform fee and rebates negotiated with, and paid by, the product supplier presents various risks with respect to conflicts of interest, complexity of charging structures and ultimately a reduction in effective competition, to the detriment of consumers.

## CHAPTER 4: REGULATORY POLICY PROPOSALS

Various options have been considered in the debates internationally on how to deal with these challenges. These options – and their possible effects with respect to each of the problem areas identified above – are described in the table below:

	<b>Conflicts of interest between intermediaries and their customers</b>	<b>High complexity of charging structure for consumers</b>	<b>Lower price competition at different levels of value chain</b>
Allow all rebates but require cash rebates to be paid to customers in full, toughen enforcement of disclosure	Conflicts potentially removed; hard to enforce	No effect	Little effect?
Limit cash rebates but not unit-based rebates	Conflicts ameliorated, but not entirely removed; hard to enforce	Complexity possibly increased	No effect?
Forbid cash rebates but allow unlimited rebates to be paid in units	Conflicts potentially removed; easier to enforce	No effect?	No effect
Forbid cash rebates and limit rebates to be paid in units	Conflicts potentially removed; easier to enforce	Complexity reduced	Potentially improved price competition
Allow neither unit-based nor cash-based rebates	Conflicts potentially removed; easy to enforce	Complexity significantly reduced	Improved price competition

In line with the general objective of addressing conflicted remuneration and creating a simple and transparent system that supports fair customer outcomes, it is proposed that the payment of rebates will be prohibited. Likewise, the payment of rebates outside these channels (thus avoiding LISPs) directly to financial advisers is also prohibited in terms of proposals contained elsewhere in this paper. Product suppliers will be required to provide “clean pricing” – i.e. stripping out any rebates or third-party fees.

Instead, platform administration fees must be separately disclosed, agreed to and paid for by the customer. This platform administration fee may be paid for through selling off units on a monthly basis. The platform administration fee should be the same, regardless of the fund that the customer chooses to invest in.

The prohibition on LISPs receiving rebates extends to other payments from product suppliers, consistent with the standards applied to IFAs. Specifically, LISPs will not be permitted to receive payment from product suppliers for advertising specific funds or for providing management information on customers who are invested in their products, as these services are considered to form a standard part of the service of administering an investment platform, for which LISPs are remunerated by means of a platform administration fee paid by the customer. Featuring specific funds more prominently than others on the platform menu will also be prohibited.

These reforms will promote effective competition in the market by removing product supplier influence over the distribution of products and adviser remuneration and improving the clarity of services offered by firms to consumers. Platforms will have to become more transparent about the services they provide to justify their charging structures to consumers. Fund prices will also become more transparent through clean pricing, enhancing more effective competition (including between active and passive funds with lower investment management fees who may previously have struggled to pay the same level of rebates or platform fees), ultimately reducing investment products costs for consumers.

#### **Proposal YY: Remuneration for investment platform administration**

Investment platform administration services should be remunerated by means of a platform administration fee disclosed, agreed to, and paid for by the customer. Payments from product suppliers or investment managers to LISPs, including rebates, will be prohibited.

#### **4.3.5. Remuneration for outsourced services (service to product supplier)**

The inconsistent interpretation and application of the general principle that outsourcing fees (including binder fees) must be reasonable and commensurate to the activity or function performed, has given rise to particular risks of conflicts of interest where functions and activities are outsourced to financial advisers. To avoid this conflict, the following additional reforms are proposed in addition to those set out in Proposals J, Z and AA.

- **Binder fees**

Binder fees paid to intermediaries will be capped to ensure consistency of application, avoidance of conflict of interest and promotion of fair customer outcomes.

The range of activities performed under a binder agreement by a non-mandated intermediary varies, and it is proposed that maximum binder fees be differentiated to reflect this:

- In some cases a non-mandated intermediary is mandated to enter into or vary policies on behalf of the insurer, but without any discretion with respect to the risk factors, underwriting criteria or ratings methodology to be applied (for example, where the policy wording is prescribed and the policy premium and benefits are pre-determined according to a “black box” system).
- In other cases, the non-mandated intermediary may be granted an additional mandate to vary the policy wording, premium or benefits and have their own underwriting and actuarial capabilities to perform this function appropriately. In these cases, an additional binder fee may be paid.
- In respect of claims settlement, the normal fast-track claims settlement mandate granted to a non-mandated intermediary would attract a specific maximum fee, while in cases where the non-mandated intermediary has a full claims settlement capability, including more complex activities such as motor and non-motor salvage management and third party recoveries, this fee may increase up to a higher maximum.

The proposed binder fee for entering into, varying or renewing a policy is informed by the fact that the acceptance or variation of the policyholder liability by the non-mandated intermediary does not, in the vast majority of cases, involve substantial additional work on the part of the non-mandated intermediary. Most of the administrative work involved is already performed by the non-mandated intermediary as part of “any act directed towards entering into, maintaining or servicing a policy” (i.e. intermediary services as currently defined) for which commission is already payable.

#### **Proposal ZZ: Binder fees payable to multi-tied intermediaries to be capped**

Maximum binder fees payable to multi-tied non-mandated intermediaries, per binder activity, will be prescribed. Although further consultation will take place on the appropriate caps and the activities to which they will be applied will take place, the table below sets out an initial indicative fee capping model, on which comment is invited.

<b>Binder activity</b>	<b>Max. binder fee (% of premium)</b>
a) Enter into, vary or renew a policy	2%
b) Determine the wording of a policy	2%
c) Determine premiums under a policy	
d) Determine the value of policy benefits under a policy	
e) Settle claims under a policy	1% to 3%

Standards regarding binder fees will apply in addition to standards regarding enhanced oversight and governance of binder functions by insurers.

The above proposal does not apply to binder fees paid to underwriting managers in terms of the Binder regulations. Underwriting managers act solely as agents of the insurer; may not sell directly to the customer; and may not do business with a related intermediary. Accordingly, the concerns that arise regarding potential conflicts of interest when an intermediary provides binder services do not arise in the case of an underwriting manager. For underwriting managers, no regulatory caps on binder fees will apply, but the fees should comply with the general principle that they must be reasonable and commensurate with the cost of performing the function. Underwriting managers may also continue to participate in the underwriting profits of the insurer.

#### • **Other outsourcing fees**

Outsourcing fees should be differentiated from service fees payable by the product supplier in respect of ongoing product servicing / maintenance. The latter service fee, discussed in paragraph 4.3.3 above, relates to product servicing or maintenance services carried out by an intermediary to connect customers and product suppliers. Outsourcing fees on the other hand relate to a function or activity performed solely on behalf of the product supplier (other than insurer binder services, which are subject to their own specific rules).

As a general principle, outsource fees must be reasonable and commensurate with the cost of the actual function or activity outsourced. Proposal Z provides for the restriction of outsourcing of functions or activities to financial advisers, with some exceptions. In those cases where outsourcing to financial advisers is permitted, the outsourcing fee payable will be subject to regulated caps to ensure consistency of application, avoidance of conflict of interest and promotion of fair customer outcomes. As pointed out elsewhere in this paper, further work will need to be undertaken to determine the range of services that fall within the category of product maintenance / servicing, to distinguish these from other “outsourced services” rendered solely on behalf of the product supplier.



In the insurance sector, given the current definitions of binder functions (which includes activities that are incidental to the adequate performance of the binder function) and intermediary services, there may be limited circumstances under which the payment of any separate outsource fee is justified. Accordingly, the FSB will undertake a targeted supervisory review of the payment of outsourcing fees, including administration fees, in the insurance sector, to verify that such fees are justified and do not undermine fair outcomes for customers.

As noted in paragraph 3.1.3 above, a particular current anomaly exists in relation to the maximum commission cap for credit life insurance schemes involving "administrative work". To remove the risk of such additional commission being payable over and above a binder or outsourcing fee, in conflict with the principle that an intermediary should not be remunerated twice for the same activity, it is proposed that this additional maximum cap be removed. Note that this is an interim measure pending further reviews of the regulatory framework – including but not limited to the remuneration framework – in respect of so-called "group scheme" life insurance risk policies.

**Proposal AAA: Commission cap for credit life insurance schemes with "administrative work" to be removed**

The provision in Part 3 of the regulations to the Long-term Insurance Act for an additional maximum commission level of 22.5% of premiums for credit life insurance schemes with "administrative work" will be removed. The effect of this will be that, pending further review of the regulatory framework for "group scheme" insurance policies, the maximum commission level for all credit life schemes will be the same (currently 7.5%), regardless of whether or not "administrative work" is carried out. The extent of additional remuneration available for any administrative work carried out by the intermediary will then be informed by the proposals elsewhere in this paper relating to binders, outsourcing or ongoing product servicing / maintenance, as the case may be.

As noted in Proposal AA, it is proposed that in the insurance sector an activity that will continue to be permitted to be outsourced to an intermediary is the issuing of policies, subject to specific remuneration rules.

**Proposal BBB: Outsourcing fees for issuing insurance policy documents**

Where an intermediary is a binder holder, no separate remuneration over and above the binder fee may be paid for issuing policy documents, nor may this activity be separately remunerated when performed under a binder agreement. The issuing of policy documents in these cases is incidental to the binder function of entering into policies.

Where an intermediary is not a binder holder, an outsourcing fee may be paid over and above commission or a service fee, as this activity is not viewed as an intermediary service. However, the costs involved in performing this activity are likely to be insignificant (limited to cost of printing and time spent) and the fee will be capped at a commensurate level – initially proposed to be an up-front (not recurring) absolute Rand amount of R100 per policy.

Note that the activity of capturing information on an insurer's system in order to be able to issue the policy document is currently deemed to be part of "any act directed towards entering into, maintaining or servicing a policy", and is accordingly an intermediary service remunerated by means of commission – and in future possibly through a service fee. Once the policy has been entered into by the insurer, the subsequent transmission of the policy to the policyholder is deemed to be an insurer function that may be outsourced to an intermediary.

To conclude the various policy proposals set out in this Chapter, it should be noted – for the avoidance of doubt – that any form of financial interest by a product supplier will be prohibited unless it is specifically provided for in the regulatory framework.

**Proposal CCC: General standard: No financial interests may be provided by product suppliers to intermediaries unless specifically provided for in the regulatory framework.**

The payment by a product supplier, and the receipt by an intermediary, of any form of remuneration, incentive or other financial interest – whether direct or indirect – is prohibited unless it is specifically permitted in terms of legislation.

Further consultation will be undertaken to determine whether this prohibition should extend to financial interests for recommending, distributing or servicing non-financial "add-on" products or services offered together with the core financial product, or the setting of specific standards to ensure fair customer outcomes in regard to the distribution of such "add-ons".

If in doubt as to whether or not any financial interest is permitted, financial institutions are strongly advised to consult with the regulator before entering into the arrangement concerned.

## CHAPTER 5: IMPLICATIONS FOR THE REGULATORY FRAMEWORK

**5.1. RDR and the broader Twin Peaks framework**

The proposals outlined in Chapter 4 entail structural changes to intermediary relationships and remuneration and will require extensive amendments to the regulatory framework. These changes will form part of a broader review of the legislative architecture necessary to give effect to a Twin Peaks regulatory model. In particular, the legislative architecture applicable to the new market conduct regulator will be designed to entrench and give effect to the TCF approach. At a high level, this will involve:

- Embedding the obligation to deliver TCF outcomes into legislation, so as to hold financial institutions accountable not only for compliance with specific conduct standards, but also for conducting their business in a manner that does not pose risk to the delivery of these outcomes;
- Ensuring that a consistent and comprehensive set of principles and standards applies to the conduct of business of all financial institutions supervised by the market conduct regulator, regardless of sector – possibly given effect to through a consolidated and overarching Act<sup>71</sup> covering all regulatory requirements for conduct of all regulated financial services business; and
- Clearly identifying the responsibility and accountability for delivery of fair customer outcomes of different parties under different circumstances.

This shift will entail repeal and / or substantial revision of a number of existing items of legislation, including the FAIS Act and various sector-specific Acts such as the Long-term and Short-term Insurance Acts, the Collective Investment Schemes Control Act, the Pension Funds Act, the Financial Markets Act and the Banks Act. It will also require a comprehensive review of existing subordinate regulatory instruments, to transition existing conduct standards appropriately into the new framework and enhance them as necessary. These changes will require a considerable lead time to implement, and are likely to be introduced in a phased manner over the next two to three years.<sup>72</sup>

**5.2. A phased approach to implementing RDR proposals**

In the interim however, as explained in the TCF Implementation Update and Baseline Study Feedback Report (December 2013), TCF principles are being incrementally introduced into the existing regulatory framework, pending the full roll-out of the Twin Peaks legislative architecture. A similar approach will be adopted to the implementation of the various proposals outlined in this RDR paper, after consideration of feedback received on this paper.

The intention therefore is to effect the RDR proposals in three broad phases:

- Phase 1: Changes to be effected within the existing regulatory framework, using existing subordinate legislative and administrative powers. These changes will be introduced either by amending existing subordinate regulatory instruments or issuing new instruments. The implementation window for such changes will be broadly between March 2015 and the effective date of the Financial Sector Regulation Act ("FSR Act"), currently anticipated to be in the second half of 2015.
- Phase 2: Changes to be incorporated into the FSR Act itself, through conduct standards made under the FSR Act or through amendments to other items of primary legislation. The implementation window for such changes will be broadly between the effective date of the FSR Act and the effective date of the future overarching market conduct Act.
- Phase 3: Longer term structural changes to be implemented once the overarching market conduct Act is in effect.

Details of how the changes proposed in Phases 2 and 3 will be implemented are therefore dependent on the final legislative architecture of the Twin Peaks framework. As such, further consultation will take place in due course on the sequencing of these changes and the exact items of legislation or regulation that will be used to implement them, once further detail on the Twin Peaks architecture is available. Changes made in Phases 1 and 2 will in turn be carried through to the final regulatory framework in Phase 3, as the framework evolves.

As pointed out in Chapter 1, the phased approach to implementation of these proposals seeks to deal on a priority basis with specific current inappropriate practices that are exacerbating inherent risks of conflicted advice. The Table below therefore sets out those of the proposals outlined in Chapter 4 which are proposed to be implemented in Phase 1 – in other words, during the first half of 2015. The Table also provides an indication of the legislative or regulatory instrument likely to be used to implement each of these Phase 1 changes. It is important to note however that this list of Phase 1 items is indicative at this stage, and should not be interpreted as a closed list of regulatory interventions that the regulator is considering or may implement during this period. The feedback received on this paper may also influence the sequencing of implementation actions. In all cases, any specific legislative or regulatory change will be subject to public consultation in the normal course.

<sup>71</sup> The final name of this statute is still to be determined

<sup>72</sup> Further details of the sequence of legislative changes required to give effect to the final Twin Peaks regulatory model are expected to be communicated by the National Treasury with the publication of a revised Financial Sector Regulation Bill in late 2014.

## CHAPTER 5: IMPLICATIONS FOR THE REGULATORY FRAMEWORK

**Table: Implementation of Phase 1 RDR proposals**

No.	Proposal	Regulatory instrument
V	Insurer tied advisers may no longer provide advice or services in relation to another insurer's products	Amendments to the Regulations issued under the Long-term Insurance Act, 1998 and Short-term Insurance Act, 1998 ("the insurance laws Regulations")
Y	Advisers may not act as representatives of more than one juristic intermediary (adviser firm)	Amendments to the FAIS General Code
Z	Restricted outsourcing to financial advisers	INSURANCE: Amendments to Directive 159.A.i: Compliance with sections 9(3)(b)(i) read with sections 12(1)(c) of the Long-term Insurance Act and Short-term Insurance Act, respectively: Outsourcing (12 April 2012) ("Directive 159") and / or amendments to Board Notice 114 of 2014: Proposed Governance and Risk Management Framework For Insurers (26 September 2014)
AA	Certain functions permitted to be outsourced to financial advisers	INSURANCE: Amendments to Directive 159 and / or amendments to Board Notice 114 of 2014: Proposed Governance and Risk Management Framework For Insurers (26 September 2014)
FF	General product supplier responsibilities in relation to receiving and providing customer related data	INSURANCE: Amendments to Directive 159 and / or amendments to Board Notice 114 of 2014: Proposed Governance and Risk Management Framework For Insurers (26 September 2014)  Amendments to the FAIS General Code in respect of information from FSP to product supplier and provider supplier to FSP where the product supplier is also an FSP
OO	Product supplier commission prohibited on replacement life risk policies	Amendments to the insurance laws Regulations
PP	Commission regulation anomalies and early termination values on "legacy" insurance policies to be addressed	Amendments to the insurance laws Regulations
QQ	Conflicted remuneration on retirement annuity transfers to be addressed	Amendments to the FAIS General Code and possible inclusion in proposed revised governance requirements for boards of management of retirement funds under the Pension Funds Act, 1956
RR	Equivalence of reward to be reviewed	Amendments to the insurance laws Regulations and determination by the Registrar
UU	Remuneration for selling and servicing short-term insurance policies	Amendments to the insurance laws Regulations (under the Short-term Insurance Act, 1998)
VV	Conditions for short-term insurance cover cancellations	Amendments to the Policyholder Protection Rules issued under the Short-term Insurance Act, 1998
ZZ	Binder fees payable to multi-tied intermediaries to be capped	Amendments to the insurance laws Regulations and determination by the Registrar
AAA	Commission cap for credit life insurance schemes with "administrative work" to be removed	Amendments to the insurance laws Regulations (under the Long-term Insurance Act, 1998)
BBB	Outsourcing fees for issuing insurance policy documents	Amendments to Directive 159 and / or amendments to Board Notice 114 of 2014: Proposed Governance and Risk Management Framework For Insurers (26 September 2014)

## CHAPTER 5: IMPLICATIONS FOR THE REGULATORY FRAMEWORK

### 5.3. Transitional arrangements

A target date for implementation of the structural changes to intermediary relationships and remuneration will be confirmed following further consultation and depending on the final legislative architecture of the Twin Peaks framework. Based on current expectations of the legislative and regulatory timetable outlined above, it is not expected that the implementation date will be before mid-2016.

It is acknowledged that many of these structural changes will require extensive changes to business models and systems, and accordingly an implementation period of approximately 12 months will be provided for from the date of the finalisation of more detailed proposals.

The new standards with respect to intermediary / product supplier relationships, disclosure of intermediary status, and intermediary remuneration will apply as from the implementation date. Product suppliers and intermediaries will be expected to put plans in place to modify business relationships, business models and charging structures to be in a position to implement the changes with effect from the implementation date.

Transition measures will need to be put in place around the implementation of certain of the proposals, including:

*Changes to the structure and level of commission for long-term insurance risk products:* The shift from a fully up-front to 50% up-front commission model will be phased in over time. Technical analysis and consultation will take place to inform the period over which such a change will be phased in, taking into account other proposed changes to intermediary remuneration, so as to support the sustainability of intermediary business.

*Payment of "trail" commission on legacy products:* The payment of "trail" commission (including commission on contractual insurance premium increases or as-and-when commission on life insurance investment products) on pre-RDR assets can continue. However, any new advice on a pre-RDR product will have to be paid for by means of an advice fee paid for by the client. Allowing new commission for post-RDR advice would lead to commission bias persisting in the market.

This prohibition on "new" commission will also extend to voluntary top-ups or increases in regular payments. Additional commission will not be able to be paid on top-ups into a retail investment product, or on non-contractual increases to regular payments into a product, as this has the potential to introduce advice bias in favour of legacy products at the expense of new generation products.

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## CHAPTER 6: WAY FORWARD

### 6.1. Concluding remarks

The RDR proposals seek to give consumers confidence in the retail financial services market and trust that product suppliers and advisers will treat them fairly. The inherent information asymmetry risks in the sector will be mitigated by placing financial customers in a position to understand more clearly what kind of advice or services they are getting, how much it will cost and how it will be paid for and to provide them with confidence that their adviser is sufficiently qualified to provide suitable advice and is acting in their best interests.

We also expect that these proposals will help to reduce the negative perceptions associated with the advice process and encourage people to seek financial advice. Over time, more financial customers will develop the confidence to seek financial advice as attitudes about perceived conflicts within the industry change. The reforms will improve the quality of financial advice, particularly with respect to product recommendations, and provide strong safeguards for investors against biased advice. They also present significant opportunities for intermediary firms and individual advisers in the retail financial services market to build sustainable and trusted businesses by modernising practices, raising standards and freeing themselves of conflicts of interests.

In addition to increased consumer trust and improved customer outcomes, the measures aim to:

- Clarify the types of advice available and empower customers to choose the model best suited to their needs
- Clarify the circumstances in which no-advice or 'low advice' distribution models are appropriate and the consumer protection measures required in such models
- Better align the interests of advisers with their customers by reducing a number of key remuneration based conflicts of interest that can lead to sub-optimal financial advice – including by limiting the extent to which advisers may be remunerated for extraneous services to product suppliers
- Ensure that product aggregation and comparison services and investment platform providers provide unbiased objective support to financial decision-making and transacting
- Enable consumers to better understand the status of advice services, including the level of independence of the advice provided from product supplier influence, including through reducing the scope for conflicts of interest in complex distribution models which disguise the true status of advice
- Strike a fairer balance between the responsibilities of product suppliers and advisers in relation to the delivery of fair customer outcomes
- Provide transparency for consumers in relation to adviser charging. Adviser charging will be clear, product neutral, and directly related to the services provided
- Facilitate customers paying for advice using flexible payment arrangements, such as the deduction of adviser charges from a customer's investments over time – subject to clear disclosure of the impact of such charges on benefit expectations
- Reduce the impact of adviser remuneration on reasonable benefit expectations, particularly through eliminating the justification for penal early termination charges and inappropriate product replacements
- Remove inappropriate incentives toward tied advice models
- Support the efforts of those in the industry who have already adopted business models consistent with the RDR objectives, including by reducing the risk of 'early adopter' disadvantages
- Support affordability and access to financial advice, particularly for low income consumers
- Build on the professionalism of the industry already achieved through FAIS, by including enhanced competency and conduct standards
- Provide an opportunity for industry to develop more efficient advice delivery models.

### 6.2. Providing feedback on the RDR

Comment on this RDR paper and its proposals, using the comment template provided, must be submitted to the Financial Services Board by no later than 2 March 2015. Comments should be submitted:

- By e-mail to [FSB.RDRfeedback@fsb.co.za](mailto:FSB.RDRfeedback@fsb.co.za); or
- In writing to Ms Leanne Jackson, Head: Market Conduct Strategy, Financial Services Board, PO Box 35655, Menlo Park, 0102;

The FSB also intends to set up stakeholder feedback workshops on the RDR before the comment period closes. Dates and venues for these workshops will be communicated in due course.

Once the comment period has closed, the FSB intends to establish a number of focused working groups, to do further work on developing final legislative and regulatory changes – taking into account feedback received on this paper. Key stakeholders will be invited to participate in these working groups.



ANNEXURE 1: EXTRACTS FROM CURRENT LEGISLATION AND OTHER  
REFERENCE MATERIAL**FAIS ACT:**

**"advice"** means, subject to subsection (3)(a), any recommendation, guidance or proposal of a financial nature furnished, by any means or medium, to any client or group of clients:

- (a) in respect of the purchase of any financial product; or
- (b) on the conclusion of any other transaction, including a loan or cession, aimed at the incurring of any liability or the acquisition of any right or benefit in respect of any financial product; or
- (d) on the variation of any term or condition applying to a financial product, on the replacement of any such product, or on the termination of any purchase of or investment in any such product, and irrespective of whether or not such advice:
  - (i) is furnished in the course of or incidental to financial planning in connection with the affairs of the client; or
  - (ii) results in any such purchase, investment, transaction, variation, replacement or termination, as the case may be, being effected;

**"intermediary service"** means, subject to subsection (3)(b), any act other than the furnishing of advice, performed by a person for or on behalf of a client or product supplier:

- (a) the result of which is that a client may enter into, offers to enter into or enters into any transaction in respect of a financial product with a product supplier; or
- (b) with a view to:
  - (i) buying, selling or otherwise dealing in (whether on a discretionary or non-discretionary basis), managing, administering, keeping in safe custody, maintaining or servicing a financial product purchased by a client from a product supplier or in which the client has invested;
  - (ii) collecting or accounting for premiums or other moneys payable by the client to a product supplier in respect of a financial product; or
  - (iii) receiving, submitting or processing the claims of a client against a product supplier;

**LONG-TERM INSURANCE ACT NO. 52 OF 1998:****Regulation 3.1 of the Regulations issued under section 72 of the Long-term Insurance Act**

**"representative"** means as a person:

- (a) employed or engaged by a long-term insurer for the purpose of rendering services as intermediary only in relation to policies entered into or to be entered into by:
  - (i) that insurer;
  - (ii) another insurer which is a subsidiary or holding company of that insurer; or
  - (iii) another insurer which has entered into a written agreement with that insurer in terms of which persons employed or engaged by that insurer may render services as intermediary in relation to the other insurer's policies;

- (c) on conditions of employment or engagement complying with the principle of "Equivalence of Reward", in terms whereof the remuneration paid by an insurer, whether in cash or in kind, shall substantially be in accordance with this Part, as determined by the Registrar, but excludes such a person in respect of whom the Registrar has made a determination under regulation 3.2 (5).

**"rendering services as intermediary"** means the performance by a person other than a long-term insurer or a policyholder, on behalf of a long-term insurer or a policyholder, of any act directed towards entering into, maintaining or servicing a policy or collecting, accounting for or paying premiums or providing administrative services in relation to a policy, and includes the performance of such an act in relation to a fund, a member of a fund and the agreement between the member and the fund;

**SHORT-TERM INSURANCE ACT NO. 52 OF 1998:****SECTION 1**

**"representative"** means a natural person employed:

- (a) by or working for a short-term insurer and receiving or entitled to receive remuneration; and
- (b) for the purpose of rendering services as intermediary in relation to short-term policies entered into or to be entered into by the short-term insurer only.

**"services as intermediary"** means any act performed by a person:

- (a) the result of which is that another person will or does or offers to enter into, vary or renew a short-term policy; or
- (b) with a view to:
  - (i) maintaining, servicing or otherwise dealing with;
  - (ii) collecting or accounting for premiums payable under; or
  - (iii) receiving, submitting or processing claims under, a short-term policy.

**OTHER REFERENCE MATERIAL****Legislation**

Banks Act 94 No. 1990

Collective Investment Schemes Control Act No. 45 of 2002

Consumer Protection Act No. 68 of 2008

Financial Advisory and Intermediary Services Act No. 37 of 2002

Financial Markets Act No. 19 of 2012

Final Sector Regulation Bill, 2013

## ANNEXURE 1: EXTRACTS FROM CURRENT LEGISLATION AND OTHER REFERENCE MATERIAL

Long-term Insurance Act No. 52 of 1998

Medical Schemes Act No. 131 of 1998

National Credit Act No. 34 of 2005

Pension Funds Act No. 24 of 1956

Protection of Personal Information Act No. 4 of 2013

Short-term Insurance Act No. 53 of 1998

Tax Administration Act No. 28 of 2011

Regulations under the Long-term Insurance Act, 1998 published under Government Notice R1492 in *Government Gazette* 19495 of 27 November 1998

Regulations under the Medical Schemes Act No. 131 of 1998

Regulations under the Short-term Insurance Act, 1998 published under Government Notice R1495 in *Government Gazette* 19495 of 27 November 1998

Codes of Conduct for Administrative and Discretionary FSPs published under Board Notice 79 in *Government Gazette* 25299 of 8 August 2003

General Code of Conduct for Authorised Financial Services Providers and Representatives published under Board Notice 80 in *Government Gazette* 25299 of 8 August 2003

Determination of Fit and Proper Requirements for Financial Services Providers, 2008 published under Board Notice 106 in *Government Gazette* 31514 of 15 October 2008

Directive 159.A.i (LT&ST): Compliance with sections 9(3)(b)(i) read with sections 12(1)(c) of the Long-term Insurance Act and Short-term Insurance Act, respectively: Outsourcing (12 April 2012)

### **Other**

Financial Planning Institute website (<http://www.fpi.co.za>)

Information Letter 2/2014 (LT): Conducting of insurance business in respect of assistance and life policies through co-administration agreements (also referred to as profit sharing or 80/20 agreements (29 August 2014)

*Maree v C Booysen t/a NVM Beleggings Versekeringsadviseurs* (307/09) [2010] ZASCA 44 (31 March 2010)

National Treasury Policy Document, A safer financial sector to serve South Africa Better (23 February 2011)

Implementing a twin peaks model of financial regulation (February 2013)

Report on Good Practices on Comparison Websites, EIOPA-CCPFI-13/100 (30 January 2014) <https://eiopa.europa.eu>

Review of third-party cell captive insurance and similar arrangements, Discussion Paper (11 June 2013)

Treating Customer Fairly implementation update and baseline study feedback report (December 2013)

Treating Customer Fairly, The Roadmap (31 March 2011)

Thematic Review TR 14/11, Price comparison websites in the general insurance sector (July 2014) <http://www.fca.org.uk>

## ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO DISTRIBUTION REFORM

### RETAIL DISTRIBUTION MODELS: INTERNATIONAL COMPARISON OF AUSTRALIA, SINGAPORE, THE UNITED KINGDOM AND THE EUROPEAN UNION

#### I. INTRODUCTION

This Annexure is a high level summary of some key features of the regulatory regime and recent policy developments for retail financial product distribution, in a selection of international jurisdictions. The jurisdictions discussed are those where the FSB has followed recent developments closely and taken these developments into account in considering options for reform of the South African framework.\*

The jurisdictions concerned are Australia, Singapore, and the United Kingdom as well as the relevant regulation in the European Union. More detail is provided in the comparison tables that follow.

#### II. AUSTRALIA

In Australia, regulation of the retail distribution of financial products is primarily to be found in two legislative regimes, both of which fall under the Australian Securities and Investment Commission's jurisdiction (ASIC):

- Chapter 7 of the Corporations Act 2001 which contains the legislative regime relating to *financial products*. A *financial product* is broadly defined to include (in summary) a facility through which a person makes a financial investment (such as interests in a managed investment scheme), manages a financial risk (such as insurance), or makes non-cash payments.
- The National Consumer Credit Protection Act, which relates to consumer credit products that are specifically excluded from the above mentioned definition of a *financial product*.

The Corporations Act provisions include the recently introduced Future of Financial Advice (FoFA) reforms, which became mandatory on 1 July 2013. These reforms include a ban on conflicted remuneration structures (including commissions and volume based payments) in relation to the distribution of and advice about retail investment products (but not including, for example, general insurance products and basic banking product advice); a duty for financial advisers to act in the best interests of their clients, subject to a 'reasonable steps' qualification; an obligation to provide fee disclosure statements; an opt-in obligation that requires advice providers to renew their clients' agreement to ongoing fees every two-years; and enhanced powers for ASIC. These reforms are, however, subject to ongoing review by the newly elected Government.

Australia is also currently reviewing its financial system under the wide-ranging Financial System Inquiry (FSI), which is due to report by November 2014.

#### III. SINGAPORE

Similarly to Australia, in Singapore regulation of retail distribution of financial products is split between two legislative regimes:

- The Financial Advisers Act (FAA) regulates the following activities: providing advice on investment products including securities (which includes unit trusts), futures contracts, foreign exchange and leveraged foreign exchange contracts, and life insurance policies (which include investment-linked life insurance products) and structured products. For completeness it is noted that the FAA does not cover bank deposits, loans or mortgages.
- The Insurance Act (IA) regulates general insurance products and now incorporates the Insurance Intermediaries Act. Please note that general insurance products are consumption-based and are therefore not considered investment products, in Singapore.

The Monetary Authority of Singapore (MAS) is the relevant market conduct supervisor for both regimes. Credit intermediaries such as mortgage originators and brokers are not covered in this brief as there is not specific legislation relating to their advisory activities.

The analysis covers reforms proposed by the 2012 Financial Advisory Industry Review (FAIR) Panel where the recommendations have been accepted by MAS. Where relevant, references are made to FAIR Panel recommendations and the MAS response. The FAIR Panel involved a fundamental review of practices in the Financial Advisory industry, which was aimed at raising the standards and professionalism of financial advisers to safeguard the interests of retail clients; therefore it focused on the FAA.

The main FAIR recommendations which have been accepted by MAS and are gradually being made the subject of MAS Guidelines cover the following topics (in summary): (i) a balanced scorecard remuneration framework to reward provision of good quality advice; (ii) a requirement that payout commissions be spread over a minimum of six years or the premium payment period (whichever shorter); (iii) a 55% cap on first year commissions; (iv) a requirement that financial advisers meet higher academic requirements; (v) a cap on revenue for non-financial advising related activities; (vi) additional safeguards to ensure transparency of products (e.g. bundled insurance products, trailer fees for collective investment schemes etc.); (vii) a requirement for insurers to participate in a web aggregator to enhance comparability among life insurance products; and (viii) a requirement for life insurance companies catering to the retail market to make available a set of "basic insurance" products through a direct channel at a nominal administration charge.

\* This summary was prepared with the assistance of external specialists sourced by the National Treasury in terms of its broader financial sector policy research programme.

## ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO DISTRIBUTION REFORM

### IV. UNITED KINGDOM

The UK has a long history of regulating financial advisers beginning in the 1980s with a statutory distinction between an Independent Financial Adviser (IFA) and a tied agent, which is commonly known under the term 'bipolarisation'. In 2004, following the overhaul of regulatory and supervisory regime regarding financial markets (introduced by the Financial Service Markets Act of 2000), the system of bipolarisation was abandoned and financial advisers were given three options: (i) offer advice from the whole of the market; (ii) from a limited number of providers; or (iii) from a single provider. In the aftermath of the financial crisis of 2008, the most recent reform was adopted under the name Retail Distribution Review (RDR). As a result, on December 31, 2012, new rules entered into force providing for comprehensive regulation of financial advisory services in the areas of: (i) labelling of advisory service; (ii) remuneration; and (iii) professionalism.

The new regulation is activity-oriented, that is, the main distinction is made between providing 'independent advice' and 'restricted advice'. Thus, from the consumer's perspective we can distinguish between independent advisers and restricted advisers (tied agents). Independent advice must be: (i) based on a comprehensive and fair analysis of the relevant market; and (ii) unbiased and unrestricted. If an adviser provides restricted advice, its disclosure must explain the nature of the restriction – either by reference to a limited scope of analysis or ties to a specific provider. Neither the independent adviser nor the restricted adviser is allowed to accept commissions from product providers. Instead, they must charge clients directly.

Subject to detailed application provisions, the RDR rules are mandatory for various types of firms (banks, investment firms, insurance advisers) as far as retail investment products and services are concerned. Retail investment products and services are defined in FSA Handbook Glossary as follows: (i) a life policy; (ii) a unit; (iii) a stakeholder pension scheme; (iv) a personal pension scheme; (v) an interest in an investment trust savings scheme; (vi) a security in an investment trust; (vii) any other designated investment which offers exposure to underlying financial assets, in a packaged form which modifies that exposure when compared with a direct holding in a financial asset; and (viii) a structured capital-at-risk product. Further, the RDR rules do not apply to the sale of cash savings products, general insurance, protection products (term life insurance, critical illness cover, income protection insurance etc.) or mortgages, unless they are sold at the same time as a regulated investment product. Finally, some firms may switch to offering an 'information only' (non-advised) service instead.

The Financial Conduct Authority is responsible for supervision and enforcement of the RDR rules, with relevant provisions to be found in the FCA Handbook and the COBS sourcebook (as described in the comparison tables). The RDR, however, does not cover all types of financial advice being provided in the UK. As well as the RDR rules, the FCA Handbook covers other types of advisory services and distribution of financial retail products, namely: (i) advising on general and non-investment life insurance (ICOBS 5); and (ii) advising on mortgage contracts and home purchase plans.

### V. EUROPEAN UNION

On the EU level, there are two main areas regarding distribution of retail financial products that are covered by EU legislation: (i) retail investment products and services; and (ii) insurance intermediation and distribution. Currently these areas are primarily covered by EU directives, specifically the Directive on Markets in Financial Instruments (MiFID I) for investment products and EU Directive on Insurance Intermediation (IMD I) for insurance mediation.

Neither MiFID nor IMD includes a definition of 'financial advice' or 'financial adviser'. However, MiFID defines 'investment advice' as "the provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments." Financial instruments are defined in Section C of Annex I of MiFID and include various types of investment instruments such as transferable securities, money-market instruments, units in collective investment undertakings, options, futures, swaps, forwards, derivative instruments for the transfer of credit risk, and financial contracts for differences.

IMD focuses narrowly on mediation of insurance products, where 'insurance mediation' is defined to mean "the activities of introducing, proposing or carrying out other work preparatory to the conclusion of contracts of insurance, or of concluding such contracts, or of assisting in the administration and performance of such contracts, in particular in the event of a claim." Pursuant to Article 2(3) of IMD, the activities described in the previous sentence performed by insurers or their employees are not considered as insurance mediation. That is, the rules set for intermediaries do not apply to insurers and their employees, which is not the case of MiFID which requires all providers of investments advice to meet minimum requirements (including employees).

Both – MiFID and IMD – include rules regarding distribution of the covered retail products with a specific focus on: (i) suitability or appropriateness test, (ii) disclosure requirements, and (iii) regulation of remuneration and inducements. In the table in Annex 1, a list of provisions covering different topics related to retail distribution is provided. References to provisions in new MiFID II and IMD II have been included to demonstrate near-term changes in the regulatory framework for retail distribution – in the table, the new directives are called 'Prospective Directives'. Part of the regulatory reform is also a proposal of Packaged Retail Investment Products regulation known under the acronym PRIIPs.

Besides the above mentioned directives, there are also other areas where the EU legislation touches upon the issue of distribution of retail financial products. Most importantly, the EU Directive on consumer credit (CCD), which defines the term of 'credit intermediary' and sets minimum disclosure requirements and the creditworthiness test (affordability) binding on both creditors and credit intermediaries.

ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO  
DISTRIBUTION REFORM

## COMPARISON TABLES

## AUSTRALIA

## ACRONYMS:

ASIC	= Australian Securities and Investments Commission
ASIC RG	= ASIC Regulatory Guide: <a href="http://www.asic.gov.au/rg">www.asic.gov.au/rg</a>
CA	= Corporations Act 2001: <a href="http://www.comlaw.gov.au">www.comlaw.gov.au</a>
NCCC	= National Consumer Credit Code: <a href="http://www.comlaw.gov.au">www.comlaw.gov.au</a>
NCCPA	= National Consumer Credit Protection Act 2009: <a href="http://www.comlaw.gov.au">www.comlaw.gov.au</a>

AUSTRALIA		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>1. Regulatory scope and framework for financial advice business models</b>		
<b>1.1 Definition of financial advice (activity / product based) and major exemptions</b>	Financial product advice is defined (in summary) as a recommendation or a statement of opinion that is intended to influence a person in making a decision about a particular <i>financial product</i> or class of products, or an interest in either.	CA: See especially section 761A definitions of <i>financial product advice</i> and <i>financial product</i> .  ASIC RG 36: <i>Licensing: Financial product advice and dealing</i> .
<b>1.2 Activities covered by rules concerning financial advice (e.g. personal financial advice, general advice)</b>	See 3.1. Note too that AFS licensing obligations apply to any person who carries on a <i>financial services business</i> i.e. who provides <i>financial product advice</i> (both personal and general advice), deals in a financial product, makes a market for financial products, operates a registered scheme or provides a custodial or depository service.	CA: See especially section 761A definitions of <i>financial product advice</i> , <i>financial product</i> , <i>financial service</i> and <i>financial services business</i> .  ASIC RG 36: <i>Licensing: Financial product advice and dealing</i> .
<b>1.3 Products covered by rules concerning financial advice (e.g. long-term insurance)</b>	See 1.1 re definition of <i>financial product</i> .	
<b>1.4 Persons / entities to whom / which financial advice rules apply (e.g. employees, tied agents, brokers).</b>	The rules apply to any person who carries on a <i>financial services business</i> (see 1.2).	
<b>2. Product suitability</b>		
<b>2.1 Requirements for assessment of product suitability</b>	A provider (including representatives) must act in the best interests of a <i>retail client</i> when providing <i>personal advice</i> in relation to a <i>financial product</i> . This includes, amongst other things, considering their objectives, financial situation and needs. A <i>Statement of Advice</i> must also be provided (but not for, e.g. basic deposit products, most general insurance products and certain small investments).	CA: See section 761A for definitions of italicised terms; Part 7.7A Division 2 <i>Best Interests Obligations</i> ; and Part 7.7 Division 3 <i>Additional Requirements for Personal Advice provided to a Retail Client</i> .  ASIC RG 175: <i>Licensing: Financial Product Advisers: Conduct and Disclosure</i> (see Section D).



## ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO DISTRIBUTION REFORM

AUSTRALIA		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>2.2 Product disclosure rules</b>	<p>Product Disclosure Statement (PDS) requirements apply to <i>financial products</i> provided to retail clients when personal advice is provided and there is a recommendation to acquire a financial product. The PDS must include specified information (e.g. re benefits, features, costs, risks, commissions, dispute resolution) as well as information a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product. Exceptions apply e.g. for basic deposit products.</p> <p>A <i>financial product</i> is broadly defined to include (in summary) a facility through which a person makes a financial investment (such as interests in a managed investment scheme), manages a financial risk (such as insurance), or makes non-cash payments. Numerous exemptions apply (such as for credit, which is separately regulated).</p>	<p>CA: Part 7.9, Division 2 <i>Product Disclosure Statements</i>.</p> <p>ASIC RG 168: <i>Disclosure: Product Disclosure Statements (and other disclosure obligations)</i>.</p>
	Pre-contractual, contractual and ongoing disclosure requirements apply to consumer credit contracts.	NCCC: See especially, Part 2, Division 1 <i>Negotiating and Making a Credit Contract</i> and Division 5 <i>Credit Provider's Obligation to Account</i> .
<b>2.3 Affordability assessment rules</b>	Responsible lending standards apply to consumer credit products (including those distributed by intermediaries).	<p>NCCPA: Chapter 3 <i>Responsible Lending Conduct</i>.</p> <p>CA: Part 7.8, Division 4A, Subdivision A – <i>Responsible lending conduct for margin lending facilities</i>.</p> <p>ASIC RG 205: <i>Credit Licensing: Responsible Lending Conduct</i></p>
<b>3. Disclosures re nature of intermediary services</b>		
<b>3.1 Disclosure re capacity in which intermediary is acting, who they are acting for and on nature of intermediary services</b>	<i>Financial Services Guide</i> (FSG) requirements apply to a financial product provider and their authorised representatives. The required information must include e.g. name and contact details (including of authorising licensee), the nature of the services to be provided, remuneration / commission details and information about associated relationships.	<p>CA: Part 7.7, Division 2 <i>Person provided with financial service as retail client to be given a Financial Services Guide</i>.</p> <p>ASIC RG 175: <i>Licensing: Financial Product Advisers: Conduct and Disclosure</i> (see Section C).</p>
	The obligation to provide a similar <i>credit guide</i> applies in the consumer credit context.	<p>NCCPA: Chapter 3 Division 2 <i>Credit guide of credit assistance providers</i>.</p> <p>ASIC RG 205: <i>Credit Licensing: Responsible Lending Conduct</i>.</p>

ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO  
DISTRIBUTION REFORM

AUSTRALIA		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>3.2 Restrictions on use of certain expressions such as independent</b>	Restrictions exist on the use of <i>independent, impartial or unbiased</i> unless, for example, they do not receive commissions of any type and operate free of any conflicts of interest.	CA: Part 7.6 Division 10 <i>Restrictions on use of terminology</i> .
	Similar restrictions apply in the consumer credit context.	NCCPA: Part 3-6A – <i>Miscellaneous rules Division 2: Representations</i> .
<b>3.3 Liability rules (e.g. liability of product provider for advice given by intermediary) and (if required) disclosure of liability rules</b>	An AFS licensee will generally be subject to potential civil and criminal liability for breaches of financial services laws by its authorised representative. This is in addition to any action that may be taken directly against the authorised representatives.  AFS licensees also have obligations to monitor and supervise their representatives as part of their licensing conditions and to ensure compensation arrangements cover representatives as well.	CA: Part 7.6 Division 6 <i>Liability of financial services licensees for representatives</i> and see also ss. 912A and 912B.  ASIC RG 175: <i>Licensing: Financial Product Advisers: Conduct and Disclosure</i> (see Section E).
	A similar liability regime applies in the consumer credit context.	
4. Professionalism in regards to advice / intermediary services		
<b>4.1 Licensing and registration requirements</b>	Persons who carry on a <i>financial services</i> business must have an <i>Australian Financial Services</i> (AFS) licence. Exemptions apply including for a <i>representative</i> of an AFS holder (includes employees and authorised representatives).	CA: See especially definitions of <i>financial product, retail client, general advice</i> and <i>personal advice</i> in s. 761A; Part 7.6 <i>Licensing of Providers of Financial Services</i> (especially Divisions 1, 2, 3 and 5).  ASIC: <i>Do You Need a Licence?</i>  ASIC RG 104: <i>Licensing: Meeting the general obligations</i> .
	It is also possible to obtain a limited AFS licence to provide advice about certain superannuation, simple managed investment schemes, securities, general and life products and basic deposit products.	ASIC Information Sheet (IS) 179: <i>Applying for a limited ASF Licence</i> .
	A person who engages in <i>credit activities</i> must be licensed. Exemptions apply e.g. for employees and <i>credit representatives</i> .	NCCPA: Part 1.2 for definitions of italicised terms and Chapter 2 <i>Licensing of persons who engage in credit activities</i> .  ASIC RG 203: <i>Do I need a credit licence?</i>
<b>4.2 Professional training / competence requirements</b>	AFS and credit licensees must ensure that their representatives are adequately trained, and are competent, to provide relevant services.	CA: s. 912A (1).  ASIC RG 146: <i>Licensing: Training of financial product advisers</i> .
	Similar obligations to credit licensees.	NCCPA: Section 47(1).  ASIC RG 206: <i>Credit licensing: Competence and training</i>

ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO  
DISTRIBUTION REFORM

AUSTRALIA		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>4.3 Conflict of interest rules</b>	AFS licensees must have in place adequate arrangements for the management of conflicts of interest for themselves and their representatives.	CA: Section 912A (1).  ASIC RG 181: <i>Licensing – Managing Conflicts of Interest</i> .
	Similar obligations to credit licensees.	NCCPA: Section 47(1).  ASIC RG 205: <i>General conduct obligations</i> .
<b>4.4 Requirements to treat customers fairly / act in their best interests</b>	An AFS and credit licensees are required to do all things necessary to ensure that the relevant services covered are provided "efficiently, honestly and fairly".	CA: Section 912A.  NCCPA: s. 41(1).  See also 1.1 above.
	Similar requirements apply to a credit licensee.	NCCPA: Section 47(1).  ASIC RG 205: <i>General conduct obligations</i> .
<b>5. Remuneration arrangements</b>		
<b>5.1 Disclosure of remuneration and commissions</b>	Remuneration and commissions must be disclosed in a PDS and an FSG (see 1.2 and 2.1 above).	See 1.2 and 2.1 above.
	A credit licensee is required to provide a credit disclosure document to a prospective customer which must, amongst other things, contain details of fees, charges and commissions. The credit contract itself must also disclose such details.	NCCPA: Chapter 3 Division 5 <i>Fees, commissions etc. relating to credit contracts</i>  NCCC: Sections 16 and 17.
<b>5.2 Bans / limits on remuneration and commissions</b>	There are broad bans on giving and accepting <i>conflicted remuneration</i> when <i>financial product advice</i> is given to <i>retail clients</i> (in summary, any benefit that could reasonably be expected to influence a choice of financial product or financial advice).	CA: Part 7.7A Division 4 <i>Conflicted Remuneration</i> (see s. 963A definition of <i>conflicted remuneration</i> ).  ASIC RG 246: <i>Conflicted Remuneration</i> .
	There is also a cap on the commission payable for consumer credit insurance products equivalent to 20% of the premium.	NCCC: Section 145.
<b>5.3 Specific limits on multiple remuneration for similar services (e.g. an intermediary may not be remunerated for the same or similar service twice)</b>	See 5.2 above.	See 5.2 above.
	There are various restrictions applying to fees in relation to a credit contract, including a prohibition on loading third party fees.	NCCPA: s. 122.

## ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO DISTRIBUTION REFORM

<b>AUSTRALIA</b>		
<b>Issue</b>	<b>Summary of legislative approach</b>	<b>Resource links (laws / regulations / regulatory guidance etc.)</b>
<b>6. Sustainable Business Models</b>		
<b>6.1 Restraints on product provider outsourcing of functions to an intermediary</b>	An AFS licensee can authorise in writing any person (such as a body corporate or an individual) to provide on their behalf any services covered by their licence (employees do not need to be authorised).	CA: Part 7.6, Division 5 <i>Authorised Representatives</i> .  ASIC: <i>Appointing and ceasing an authorised representative</i> .
	There are also limits on the outsourcing of material functions by institutions regulated by the Australian Prudential Regulation Authority (such as banks and life and general insurers). These standards cover appropriate due diligence, approval and ongoing monitoring.	APRA: Prudential Standard 231 <i>Outsourcing</i> .
<b>7. Other Issues</b>		
<b>7.1 Fees for financial advisers re investment platforms</b>	See 5 above.	See 5 above.
<b>7.2 Fees for product providers re investment platforms</b>	See 5 above.	See 5 above.
<b>7.3 Aggregators / comparison websites for insurance products</b>	ASIC has reminded operators that websites that allow consumers to obtain and / or compare insurance quotes will generally be providing regulated financial services.	ASIC RG 234: <i>Advertising financial products and services (including credit): Good practice guidance</i> .  ASIC: <i>ASIC warns comparison websites</i> .
<b>7.4 Special rules for low income / low financial literacy consumers</b>	There is some relief from the above mentioned AFS and credit licensing requirements in relation to, for example, advice on <i>basic deposit</i> accounts and services provided by financial counsellors and agency banking services.	ASIC: Class Order 11 / 927 – <i>Licensing Class Order 03 / 1063 – Licensing relief for NGOs providing advice on basic deposit products</i> .  ASIC: Class Order 03 / 1063 – <i>Licensing relief for financial counselling agencies</i> .  ASIC: <i>Relief for agency banking services</i> .

ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO  
DISTRIBUTION REFORM

## SINGAPORE

## ACRONYMS:

IA	= Insurance Act: statutes.agc.gov.sg
IIA	= Insurance Intermediaries Act: statutes.agc.gov.sg
GIA	= General Insurance Association of Singapore
FAA	= Financial Advisers Act: statutes.agc.gov.sg
FFR	= Financial Advisers Regulations: statutes.agc.gov.sg
FA	= Financial Advisers
MAS	= Monetary Authority of Singapore

SINGAPORE		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>1. Regulatory framework for financial advice</b>		
<b>1.1 Definition of financial advice (activity / product based) and major exemptions</b>	The definition includes (i) advising on investments products and life insurance products other than a contract of reinsurance; (ii) advising through publications or writings or by issuing or promulgating research analyses or research reports concerning any investments products; and (iii) marketing of any collective investment scheme.	FAA: Section 2.
	The definition includes advising on general insurance products and advising on behalf of an insurer or insured.	IA: Section 1.
<b>1.2 Activities covered by rules concerning financial advice (e.g. personal financial advice, general advice)</b>	See 1.1	
<b>1.3 Products covered by rules concerning financial advice (e.g. long-term insurance)</b>	The FAA covers investment products including securities (which includes unit trusts), futures contracts, foreign exchange and leveraged foreign exchange contracts, and life insurance policies (which include investment-linked life insurance products) and structured products.	FAA: Section 2.
	The IA covers general insurance products.	IA: Section 1.
<b>1.4 Persons / entities to whom / which financial advice rules apply (e.g. employees, tied agents, brokers)</b>	The FAA rules apply to any person or entity who / which conducts a financial advisory service (See 1.1).	FAA: Section 2.
	The IA rules apply to any person or entity which advises on or arranges contracts of general insurance.	IA: Section 1.



## ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO DISTRIBUTION REFORM

SINGAPORE		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>2. Product suitability</b>		
<b>2.1 Requirements for assessment of product suitability</b>	There is no specific "suitability" requirement but more a test of "appropriateness". Recommendations need to be appropriate having regard to the investment objectives, particular needs of the customer and financial situation.	<p>FAA: Section 27(1)(2).</p> <p>MAS: <i>Guidelines on Fair Dealing-Board and Senior Management Responsibilities for Delivering Fair Dealing Outcomes to Customers</i>.</p> <p>MAS: <i>Guidelines on Standards of Conduct for Financial Advisers and Representatives</i>.</p>
	Insurance brokers and intermediaries are required to offer products which meet the customers' needs.	<p>IA: Section 35TA.</p> <p>MAS: <i>Guidelines on Market Conduct and Service Standards for Insurance Brokers</i>.</p> <p>GIA: <i>The Singapore General Insurance Code of Practice</i>.</p>
<b>2.2 Product disclosure rules</b>	FAs need to disclose all material information relating to any designated investment product recommended. No licensed financial adviser shall make a false or misleading statement. There is also an obligation to provide clear, accurate and not misleading information.	<p>FAA: Sections 25 and 26 and 58.</p> <p>MAS: <i>Notice on Information to Clients and Product Information Disclosure</i>.</p> <p>MAS: <i>Guidelines on Fair Dealing-Board and Senior Management Responsibilities for Delivering Fair Dealing Outcomes to Customers</i>.</p>
	Insurance intermediaries are subject to similar obligations.	<p>IIA: Section 6.</p> <p>IA: Section 35R.</p>
<b>2.3 Affordability assessment rules</b>	A licensed financial adviser, when making recommendations concerning a product must consider the financial situation of the client (See 2.1).	
	There is no specific requirement of affordability assessment but a need to consider customers' needs (See 2.1).	

ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO  
DISTRIBUTION REFORM

SINGAPORE		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>3. Disclosures re nature of intermediary services</b>		
<b>3.1 Disclosure re capacity in which intermediary is acting, who they are acting for and on nature of intermediary services</b>	FAs need to disclose: name and business; the types of financial advisory service that it is authorised to provide under the Act; the or types of investment products in respect of which it is authorised to provide financial advisory service; the product providers whose products the financial adviser procures on behalf of its client, recommends or markets to its clients, or markets to its client on behalf of the product providers. FA representatives need to disclose all the above plus the financial advisers for which they act.	FAA: Section 58.  MAS: <i>Notice on Information to Clients and Product Information Disclosure</i> .
	Insurance intermediaries need to disclose: the name of the registered insurer, their relationship with the registered insurer and the premium charged by the registered insurer.	IIA: Section 5(1).  IA: Section 35P.
<b>3.2 Restrictions on use of certain expressions such as "independent"</b>	No FA can use the word "independent" or any of its derivatives that is alike. There is an exception for FAs with no links to product providers.	FAR: Regulation 21.  MAS: <i>Guidelines on the Use of the Term Independent by Financial Advisers</i> .
<b>3.3 Liability rules (e.g. liability of product provider for advice given by intermediary) and (if required) disclosure of liability rules</b>	An FA is liable for their representatives.	FAA: Sections 23B – 23E.
<b>4. Professionalism in regards to advice / intermediary services</b>		
<b>4.1 Licensing and registration requirements</b>	Corporations are required to hold a FA's licence from MAS, unless exempt. An FA's licence will only be granted to a corporation with an established physical presence in Singapore. There are major exemptions for licensed institutions under other relevant Acts.	FAA: Sections 6, 9, 23.  FAR: Regulations 15, 16, 17.  MAS: <i>Guidelines on Criteria for the Grant of a Financial Adviser's Licence</i> .
	A licence issued by MAS is needed to carry insurance business (exemptions for foreign insurance schemes). There are other requirements (e.g. being a company or cooperative and financial requirements).	IA: Sections 3 and 8.
<b>4.2 Professional training / competence requirements</b>	Financial advisers need to have a GCE "A-Level" or equal level of education (some exceptions, such as grandfathering apply). The Capital Markets and Financial Advisory Services Examination must be taken for advisory services (See 1.1, 1.2, 1.3).	FAA: Sections 9 and 58.  MAS: <i>Guidelines on Criteria for the Grant of a Financial Adviser's Licence</i> .  MAS: <i>Response to Feedback Received – Public Consultation on Recommendations of The Financial Advisory Industry Review (FAIR)</i> .

ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO  
DISTRIBUTION REFORM

SINGAPORE		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>4.3 Conflict of interest rules</b>	FA s must act in the best interest of the client and should disclose in writing any conflict of interest that may arise. FA must ensure that there is proper segregation of duties to minimise any possible conflict of interests.	FAA: Sections 9 and 64.  MAS: <i>Guidelines on Standards of Conduct for Financial Advisers and Representatives</i> .
	Insurance brokers are required to avoid situation where a conflict may arise. If unavoidable it should be disclosed.	IA: Section 35TA.  MAS: <i>Guidelines on Market Conduct and Service Standards for Insurance Brokers</i> .  GIA: <i>The Singapore General Insurance Code of Practice</i> .
<b>4.4 Requirements to treat customers fairly / act in their best interests</b>	AN FA licence can be revoked or denied if there is reason to believe it may not perform its function honestly, fairly and efficiently.	FAA: Sections 9 and 19.
	An insurers' licence can be revoked if it fails to meet obligations under the Act (e.g. product suitability and disclosure). Insurers are expected to act fairly when dealing with clients.	IA: Section 12.  MAS: <i>Guidelines on Market Conduct and Service Standards for Insurance Brokers</i> .  GIA: <i>The Singapore General Insurance Code of Practice</i> .
<b>5. Remuneration arrangements</b>		
<b>5.1 Disclosure of remuneration and commissions</b>	FAs must disclose, in writing, all remuneration, including any commission, fee and other benefit for making any recommendation. If not quantifiable, FA should give its client a description of how it will be remunerated. For life policies they are only required to disclose the distribution costs.	FAA: Section 64.  MAS: <i>Guidelines on Standards of Conduct for Financial Advisers and Representatives</i> , Paragraph 6.7-6.13.  MAS: <i>Practice Note on the Disclosure of Remuneration by Financial Advisers</i> .  MAS: <i>Notice on Information to Clients and Product Information Disclosure</i> .
<b>5.2 Bans / limits on remuneration and commissions</b>	There is a cap of 55% commission on any regular premium life insurance policy and commissions need to spread out a 6 year period (or duration of the policy if less). For other products a Balanced Scorecard remuneration framework applies (See FAIR).	FAA: Section 64.  MAS: <i>Report on the Recommendations of the Financial Advisory Industry Review Panel</i> . FAA: Section 64.  MAS: <i>Response to Feedback Received – Public Consultation on Recommendations of The Financial Advisory Industry Review (FAIR)</i> .
<b>5.3 Specific limits on multiple remuneration for similar services</b>	See 5.2	

## ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO DISTRIBUTION REFORM

SINGAPORE		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>6. Sustainable Business Models</b>		
<b>6.1 Restraints on product provider outsourcing of functions to an intermediary</b>	Material outsourcing must be notified to MAS in writing. There must be a structure for the management and control of outsourcing. The more significant the functions outsourced the more rigorous risk management approach should be adopted. All outsourcing arrangements must be agreed in writing and contain minimum specified terms.	MAS: <i>Guidelines on Outsourcing</i> .
<b>7. Other Issues</b>		
<b>7.1 Fees for financial advisers re investment platforms</b>	No specific rules.	No specific rules.
<b>7.2 Fees for product providers re investment platforms</b>	No specific rules.	No specific rules.
<b>7.3 Aggregators / comparison websites for insurance products</b>	As part of the FAIR reforms, a requirement for insurers to participate in a web aggregator will be introduced to enhance comparability among term policies, whole life and endowment policies. A warning on the importance of seeking advice will be included.	MAS: <i>Response to Feedback Received – Public Consultation on Recommendations of The Financial Advisory Industry Review (FAIR)</i> .
<b>7.4 Special rules for low income / low financial literacy consumers</b>	No specific rules.	No specific rules.

ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO  
DISTRIBUTION REFORM

## UNITED KINGDOM

## ACRONYMS AND DEFINITIONS

BCOBS	= Banking: Conduct of Business Sourcebook <a href="http://fshandbook.info/FS/html/handbook/BCOBS">http://fshandbook.info/FS/html/handbook/BCOBS</a> The BCOBS sourcebook applies to banking activities of accepting deposits from banking customers.
COBS	= Conduct of Business Sourcebook <a href="http://fshandbook.info/FS/html/handbook/COBS">http://fshandbook.info/FS/html/handbook/COBS</a> The COBS sourcebook regulates two types of activities: (i) the activities of designated investment business defined in the PRA Handbook Glossary as a broad range of activities ranging from dealing in investments as principal, to managing investments, operating a multilateral trading facility, to establishing, operating or winding up a collective investment scheme; and (ii) the activities of long-term insurance business in relation to life policies.
ICOBS	= Insurance: Conduct of Business Sourcebook <a href="http://fshandbook.info/FS/html/handbook/ICOBS">http://fshandbook.info/FS/html/handbook/ICOBS</a> The ICOBS sourcebook applies to the following activities carried on in relation to a non-investment insurance contract: (i) an insurance mediation activity; (ii) effecting and carrying out contracts of insurance; (iii) managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's; and (iv) communicating or approving a financial promotion.
MCOB	= Mortgages and Home Finance: Conduct of Business Sourcebook <a href="http://fshandbook.info/FS/html/handbook/MCOB">http://fshandbook.info/FS/html/handbook/MCOB</a> The MCOB sourcebook applies to every firm that (i) carries on a home finance activity (subject to the business loan and loans to high net worth mortgage customers application provisions); or (ii) communicates or approves a financial promotion of qualifying credit, of a home purchase plan, of a home reversion plan or of a regulated sale and rent back agreement.
PRIN	= Principle for Business <a href="http://fshandbook.info/FS/html/handbook/PRIN">http://fshandbook.info/FS/html/handbook/PRIN</a> High-level principles of market conduct

## UNITED KINGDOM

Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>1. Regulatory scope and framework for financial advice business models</b>		
<b>1.1 Definition of financial advice (activity / product based) and major exemptions</b>	<p>A <i>personal recommendation</i> is defined as <i>advice on investments or advice on a home finance transaction</i>.</p> <p>FCA and industry refer to <i>independent advice</i> and <i>restricted advice</i> (<i>basic advice</i> and <i>simplified advice</i> being a type of restricted advice) but there is no express definition of these terms in the FCA Handbook Glossary.</p> <p>Advising on investments further defined and regulated in both the PRA Handbook and the FCA Handbook.</p> <p>The RDR rules do neither cover everyone getting financial advice in the United Kingdom, nor all financial products. Only UK-based firms are subject to the RDR.</p>	FCA Handbook Glossary COBS. 6.2A.
<b>1.2 Activities covered by rules concerning financial advice (e.g. personal financial advice, general advice)</b>	Financial (investment) advice.	COBS 9, FCA Handbook.
	Insurance advice.	ICOBS 5.
	Mortgage contracts and home finance plans-related advice.	MCOB 4,8.



ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO  
DISTRIBUTION REFORM

UNITED KINGDOM		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>1.3 Products covered by rules concerning financial advice (e.g. long-term insurance)</b>	<p>Retail investment products are defined as follows:</p> <ul style="list-style-type: none"> <li>• a life policy;</li> <li>• a unit;</li> <li>• a stakeholder pension scheme;</li> <li>• a personal pension scheme;</li> <li>• an interest in an investment trust savings scheme;</li> <li>• a security in an investment trust;</li> <li>• any other designated investment which offers exposure to underlying financial assets, in a packaged form which modifies that exposure when compared with a direct holding in a financial asset; and</li> <li>• a structured capital-at-risk product.</li> </ul> <p>All retail investment products, such as those listed above, are within the scope of the RDR. But RDR does not cover individual stocks and bonds, structured deposits, mortgages, and pure protection insurance products. The RDR rules also do not cover execution-only services, so inducements are still payable for products sold without advice.</p>	FCA Handbook Glossary.
<b>1.4 Persons / entities to whom / which financial advice rules apply (e.g. employees, tied agents, brokers)</b>	<ul style="list-style-type: none"> <li>• Independent Financial Advisers (including employees).</li> <li>• Restricted Financial Advisers (including employees).</li> </ul>	COBS.
<b>2. Product suitability</b>		
<b>2.1 Requirements for assessment of product suitability</b>	A personal recommendation, including <i>general advice</i> , must meet suitability test requirements (as opposed to appropriateness test) taking into account product / service features and client's characteristics / expectations.	COBS 9.
	Advice must be based on reasonable care to ensure its suitability.	ICOB 5.3.
	Advice on mortgage contracts, home purchase plans, are subject to suitability assessment.	MCOB 4.7A, MCOB 4.10.
<b>2.2 Product disclosure rules</b>	Key features document and key features illustration must be disclosed to consumers.	COBS 13, COBS 14.
	General, pre-contractual and post-contractual disclosure requirements set.	ICOB 6.
	Pre-application disclosure, disclosure at the offer stage and disclosure at start of contract and after sale requirements set.	MCOB 5, MCOB 6, MCOB 7.

ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO  
DISTRIBUTION REFORM

UNITED KINGDOM		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>2.3 Affordability assessment rules</b>	Loans and mortgages must be taken in account for the purpose of the suitability test.	COBS 9.3.4.
	For regulated mortgage contracts the appropriateness test requirement.	
	Responsible lending and financing of home purchase plans requirements include the affordability test.	MCOB 4.7A.6, MCOB 11.6.
<b>3. Disclosures re nature of intermediary services</b>		
<b>3.1 Disclosure re capacity in which intermediary is acting, who they are acting for and on nature of intermediary services</b>	Disclosure regarding identity, capacity and remunerations, particularly distinguishing between <i>independent advice</i> and <i>restricted advice</i> (COBS 6.2A).	COBS 6.
	Identity, capacity and nature of advice of an insurance intermediary must be disclosed.	COBS 7.2.
	Disclosure of a range of products and other limitations.	MCOB 4.4A.
<b>3.2 Restrictions on use of certain expressions such as "independent"</b>	Financial advisers may claim to be ' <i>independent</i> ' (or rather to provide independent advice) only under specific circumstances (a comprehensive and fair analysis, unbiased, unrestricted).	COBS 6.2A.3.
<b>3.3 Liability rules (e.g. liability of product provider for advice given by intermediary) and (if required) disclosure of liability rules</b>	If a client buys a financial product on the advice of an IFA which turns out to be unsuitable, they have the right to complain and, if the complaint is upheld, may receive compensation.	COBS 2.1.2, ICOBS 2.5, MCOB 2.6.
	Restrictions on exclusion of liability set.	
<b>3.4 Specific rules regarding product provider outsourcing functions to an intermediary</b>	General outsourcing requirements set for all sorts of financial services.	SYSC 8.
	Reliance on other firms and outsourcing of information.	COBS 2.4.
	Outsourcing in general and restrictions on exclusion of liability.	ICOBS 2.5.
	Reliance on other firms and outsourcing of information.	MCOB 1.2, MCOB 2.5.

## ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO DISTRIBUTION REFORM

UNITED KINGDOM		
Issue	Summary of legislative approach	Resource links (laws / regulations / regulatory guidance etc.)
<b>4. Professionalism in regards to advice / intermediary services</b>		
<b>4.1 Licensing and registration requirements</b>	Financial advisers must be authorised (licensed).	Schedule 2 of the Financial Services and Markets Act 2000.
<b>4.2 Professional training / competence requirements</b>	<p>Financial advisers must: (i) hold a qualification level 4; (ii) adhere to ethical standards; (iii) participate in continuous professional development activities; (iv) annually obtain and hold a Statement of Professional Standing from a FCA accredited body.</p> <p>Individuals who have not been assessed as competent must be supervised until they are assessed as competent.</p> <p>Investment advisers are required to obtain and hold an annual Statement of Professional Standing (SPS), provided by an accredited body.</p>	<p>Retail Distribution Review (Training and Competence Instrument 2011).</p> <p>FCA Feedback.</p>
<b>4.3 Conflict of interest rules</b>	Conflict of interests and inducements rules restricting remuneration schemes that may affect incentives to provide advice (or other service) in the best interest of a client or that may create a conflict of interests.	<p>COBS 2.3.</p> <p>ICOBs 2.3.</p> <p>MCOB 2.3.</p>
<b>4.4 Requirements to treat customers fairly / act in their best interests</b>	Advisers must act honestly, fairly and professionally in accordance with the best interests of their clients.	<p>PRIN 2.1(6).</p> <p>COBS 2.1.1.</p> <p>MCOB 2.5A.</p>
<b>5. Remuneration arrangements</b>		
<b>5.1 Disclosure of remuneration and commissions</b>	Pre-contractual disclosure of <i>charging structure</i> .	COBS 6.1A.16.
	Fee disclosure.	ICOBs 4.3, ICOBs 4.4, ICOBs 4.6.
	Commission disclosure for commercial customers.	
	Commission disclosure for pure protection contracts sold with retail investment products.	
<b>5.2 Bans / limits on remuneration and commissions</b>	Commissions generally prohibited – payment to / through advisers only subject to an agreement with a client.	COBS 6.1A.
<b>5.3 Specific limits on multiple remuneration for similar services (e.g. an intermediary may not be remunerated for the same or similar service twice)</b>	Commissions generally prohibited – payment to / through advisers only subject to an agreement with a client.	COBS 6.1A.

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<b>UNITED KINGDOM</b>		
<b>Issue</b>	<b>Summary of legislative approach</b>	<b>Resource links (laws / regulations / regulatory guidance etc.)</b>
<b>6. Sustainable Business Models</b>		
<b>6.1 Restraints on product provider outsourcing of functions to an intermediary</b>	See 3.4.	COBS 6.1E.9.
<b>7. Other Issues</b>		
<b>7.1 Fees for financial advisers re investment platforms</b>	Regulation of investment platforms and their remuneration – platforms should be paid through platform charges that need to be disclosed to retail clients (payments from product providers banned)  Advisers must not use a platform for a personal recommendation unless satisfied that the platform complies with rules.	COBS 6.1E, COBS 6.1F.
<b>7.2 Fees for product providers re investment platforms</b>	See 7.1.	No specific rules.
<b>7.3 Aggregators / comparison websites for insurance products</b>	No specific rules.	No specific rules.
<b>7.4 Special rules for low income / low financial literacy consumers</b>	No specific rules.	No specific rules.

ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO  
DISTRIBUTION REFORM

## EUROPEAN UNION

## ACRONYMS AND DEFINITIONS

MiFID I	= EU Directive on markets in financial instruments <a href="http://eur-lex.europa.eu/legal">eur-lex.europa.eu/legal</a>
MiFID II	= EU Directive on markets in financial instruments <a href="http://eur-lex.europa.eu/legal">eur-lex.europa.eu/legal</a>
IMD I	= EU Directive on insurance intermediation <a href="http://eur-lex.europa.eu/legal-content">eur-lex.europa.eu/legal-content</a>
IMD II	= EU Directive on insurance distribution <a href="http://register.consilium.europa.eu/doc">register.consilium.europa.eu/doc</a>

EUROPEAN UNION		
Issue	Directives in force	Prospective directives
<b>1. Product suitability</b>		
<b>1.1 Requirements for assessment of product suitability</b>	Article 19(4) MiFID I Article 19(5) MiFID I	Article 24(7)(a) and 25 MiFID II
	Article 12(2) IMD I	Article 25 IMD II
<b>1.2 Product disclosure rules</b>	Article 19(3) MiFID I	Article 24(4)(b) MiFID
	Articles 12 and 13 IMD I	Articles 15a and 15b IMD II
<b>1.3 Affordability assessment rules</b>	Article 8 CCD	
<b>2. Disclosures re nature of intermediary services</b>		
<b>2.1 Disclosure re capacity in which intermediary is acting, who they are acting for and on nature of intermediary services</b>	Article 23(2) MiFID I	24(4)(a)(i)(ii) MiFID II
	Article 12 IMD I	Articles 15a and 15b IMD II
	Article 21(a) CCD	
<b>2.2 Restrictions on use of certain expressions such as independent</b>	No specific rules	24(4)(a)(i) and 24(7) MiFID II
<b>2.3 Liability rules (e.g. liability of product provider for advice given by intermediary) and (if required) disclosure of liability rules</b>	Regulated on a national level	
<b>2.4 Specific rules regarding product provider outsourcing functions to an intermediary</b>	Article 23 MiFID I	Article 29 MiFID II
<b>3. Regulatory scope and framework for financial advice business models</b>		
<b>3.1 Definition of financial advice (activity / product based) and major exemptions</b>	Article 4(1)(4) MiFID I (investment advice)	Article 4(1)(4) MiFID II (investment advice)
	Article 12(2) IMD I (analysis-based recommendation)	Article 2(9) IMD II
<b>3.2 Activities covered by rules concerning financial advice (e.g. personal financial advice, general advice)</b>	Article 4(1)(4) MiFID I	Article 4(1)(4) MiFID II
	Article 1 IMD I	Article 1 IMD II

ANNEXURE II: SUMMARY OF INTERNATIONAL APPROACHES TO  
DISTRIBUTION REFORM

EUROPEAN UNION		
Issue	Directives in force	Prospective directives
3.3 Products covered by rules concerning financial advice (e.g. long-term insurance)	Articles 1 to 4 MiFID I	Article 1 to 3 MiFID II
	Article 1 IMD I	Articles 1 and 2 IMD II
3.4 Persons / entities to whom / which financial advice rules apply (e.g. employees, tied agents, brokers)	Articles 1, 13(2), 18, 23 MiFID I	Articles 1 to 3, 16, 29 MiFID II
	Article 1 IMD I	Articles 1 and 2 IMD II
4. Professionalism in regards to advice / intermediary services		
4.1 Licensing and registration requirements	Article 5 MiFID I	Article 5 MiFID II
	Article 3 IMD I	Article 3 IMD II
4.2 Professional training / competence requirements	Article 9(1) MiFID I Article 23(3) MiFID I	Article 9) MiFID II Article 29(3) MiFID II
	Article 4 IMD I	Chapter V IMD II
4.3 Conflict of interest rules	Article 18 MiFID I	Article 23 MiFID II
	Article 12(1) IMD	Articles 16a and 16b IMD II
4.4 Requirements to treat customers fairly / act in their best interests	Article 19(1) MiFID I	Article 24(1) MiFID
		Article 15(1) IMD II
5. Remuneration arrangements		
5.1 Disclosure of remuneration and commissions	Article 19(3) MiFID I	Article 24(4) MiFID II
	Article 21(b)(c) CCD	Article 15a(2)(d)(e) Article 15c(3)
5.2 Bans / limits on remuneration and commissions	No specific rules	Article 24(10) MiFID II Article 27(2) MiFID II
		Article 15a(2)(d) and (e) IMD II
		Article 15(4) IMD II
5.3 Specific limits on multiple remuneration for similar services (e.g. an intermediary may not be remunerated for the same or similar service twice)	No specific rules	No specific rules
6. Sustainable Business Models		
6.1 Restraints on product provider outsourcing of functions to an intermediary	Article 13 and 23 MiFID I	Article 16 MiFID II
7. Other issues	No specific rules	No specific rules



## ANNEXURE III: SUMMARY OF COMMENTS RECEIVED ON FSB'S "CALL FOR CONTRIBUTIONS ON INTERMEDIARY SERVICES AND REMUNERATION (2011)"

### SUMMARY OF COMMENTS RECEIVED ON THE NOVEMBER 2011 CALL FOR CONTRIBUTIONS: INTERMEDIARY SERVICES AND RELATED REMUNERATION IN THE INSURANCE SECTOR

Extensive comments were received in response to the call for contributions. In addition to the main industry associations, comments were also received from individual insurers and intermediaries.

Commentators were overwhelmingly in favour of the FSB's objective of seeking an appropriate balance between customer interests and those of product suppliers and intermediaries, as fair treatment of customers is seen as ultimately being in the interest of a sustainable financial services sector.

However, there was a wide range of views on how best to achieve this balance. While there was some consensus in the responses to some of the questions posed, there were differing views on most issues. The degree of consensus is indicated under each topic below.

#### General comments

##### *Relatively common general comments included:*

- The review of remuneration models should be seen as only part of a solution to fair customer outcomes – particular attention should also be given to the role of product suppliers in developing suitable products that add customer value, as well as the role of enhanced financial consumer education.
- The reforms should recognise South African specific circumstances rather than blindly copying international developments.
- The reforms should be mindful of the need to avoid unintended consequences in terms of reducing the number of financial advisers or skewing the mix between independent and tied distribution channels. In particular, the reforms should provide for a sustainable independent financial adviser model, taking into account that appropriate product advice can be key to customer value and fair outcomes, as well as the role that independent financial advisers can play in ensuring that product providers strive to continuously improve their product offering.
- A phased approach to the reforms should be followed, dealing on a priority basis with inappropriate practices that are leading to conflicted advice. Dealing with structural reforms will need to make allowance for the time it takes to make system and business model changes.

#### Definition of intermediary services

The call for contributions posed the question of how to further clarify the definition of "services as intermediary", noting that any discussion of intermediary remuneration must be informed by a clear understanding of what constitutes financial advice and intermediary services.

There was universally strong support for a consistent set of definitions in the regulatory framework, although views differed on how this should be given effect to.

There was agreement that the term "intermediary services" is not always helpful, as it does not appropriately capture the different capacities in which an intermediary may be acting.

In general, there was strong support for the proposed "activity-based" definition of advice, intermediary services and other services provided by advisers and intermediaries.

The comments also pointed to some inconsistency in the use of the term "advice" – some commentators appeared to use it in reference to "financial planning", others to "product advice". This reinforces the importance of improved clarity on the components of advice and intermediary services.

Specific questions included:

***Should the definition of services as intermediary in the insurance laws continue to include all activities supplemental to the sale of an insurance policy?***

***If there is a view that the definition should be separated into component parts, how could the separate activities be categorised? In particular, should 'advice' form an explicit component of the definition of 'intermediary services'? Or should 'advice' be defined and dealt with separately from the definition of 'intermediary services'?***

There was overwhelming support from commentators for separating out an advice component from the definition of intermediary services.

It was recommended that the insurance laws definition of "services as intermediary" should follow the FAIS Act, which creates a clear distinction between intermediary services and advice. However, it was further recommended that the definition of advice be expanded from the current definition in the FAIS Act to one that explicitly includes the concept of financial planning. The FAIS Act currently links advice to the sale of a product, which is problematic as advice does not necessarily lead to a sale.

More broadly, there was strong support for the "activity-based" approach to distinguishing advice from intermediary services and other services rendered to the product provider. Accordingly, the general view was that the definition of services as intermediary should not continue to include all activities supplemental to the sale of an insurance policy, such as services rendered to either product suppliers by way of outsourcing arrangements or to policyholders for non-intermediary services.

Commentators were of the view that this would provide greater certainty regarding the delineation of activities that an intermediary may perform in the course of carrying out his/her duties to the respective policyholders and product suppliers. This in turn would create greater certainty from a remuneration perspective for all role players concerned.

***Should there be a distinction between the up-front activities directed at entering into a policy and the ongoing activities aimed at servicing a policy?***

There was general support for further refining the definitions of "advice" and "intermediary services" to distinguish between the up-front and ongoing activities.

***What types of services provided to a policyholder might fall outside of the definition of services as intermediary?***

Long-term insurance:

- Financial planning (including financial needs analysis)
- Product advice
- Outsourced administration on behalf of the insurer, similar to binder functions

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Short-term insurance:

- Risk finance consulting
- Loss control advice and surveys
- Risk management advice
- Outsourced functions (e.g. premium collection)

### ***Should the definitions of 'advice' and / or 'intermediary services' in the FAIS Act and the insurance laws be aligned, and if so, what suggestions are there in this regard?***

Commentators saw value in standardising definitions of "advice" and "intermediary services" across the financial sector, to help ensure consistency and the ease with which advisers and intermediaries can meet regulatory requirements.

To ensure level playing fields, the remuneration receivable by FSP's from any financial product supplier, as defined in FAIS, for the activities listed in the definition of 'rendering services as an intermediary' should be regulated in FAIS.

One commentator submitted a suggested definition of "intermediary services":

"any act other than advice that results in:

- Another person offering to enter into, varying or renewing a policy, or
- With a view to –
  - Maintaining, servicing or otherwise dealing with; or
  - Receiving and submitting claims under a policy,"

Another commentator suggested the following components of intermediary services:

- Submission of applications
- Regular reviews
- Product changes (adding or deleting benefits)
- Claims management
- Administrative functions

### ***How, if at all, should referrals, introductions or 'lead' generation be dealt with for purposes of these definitions?***

Commentators were split on this question.

Among ASISA members, the majority view was that these activities should not be incorporated into the definitions of advice or intermediary services. A minority view was that in order to avoid any remuneration for these activities resulting in higher costs to the consumer, they should be provided for in the FAIS legislation.

A specific suggestion was that referrals between FSPs should be included in the definition of intermediary services, but referrals by non-FSPs should not be included in these definitions. A person who regularly refers clients to an intermediary should be required to declare the financial interest he or she has in the referral. The term regularly could be replaced by a requirement to declare if such a person has a written or verbal referral agreement in place with an intermediary.

SAIA suggested that the activity of leads generation should remain excluded from the definition of intermediary services, as they regard it as a commercial activity governed by contractual law. Aggregators are regarded as comparative quote systems and are a specific type of leads generation, and accordingly should similarly be governed by contract law.

The FIA suggested that the mere passing on of contact details of a prospect to an FSP should be treated as a separate commercial transaction, but that where the referral involves an interface / dialogue with the prospect / potential policyholder by the lead generator, it should form part of the definition of intermediary services.

### ***Independent advice***

#### ***What is an appropriate definition of "independent advice" in the South African context? What criteria should be taken into account in determining whether advice is "independent"?***

There were different views expressed on this question, which appeared to correspond to how the term "advice" was interpreted.

Some commentators responded to the question on the basis that "advice" referred to the financial planning stage of advice. On this basis, it was argued that independence of advice should not be seen as synonymous with independence from product supplier – i.e. that tied advisers can give objective financial planning advice even though they are restricted in the choice of product they can offer.

With respect to independent product advice, the various comments were relatively consistent in pointing to two main elements of a potential definition:

#### ***• Product choice:***

Advisers must be able to offer advice on multiple products / solutions from a number of product suppliers.

There were very few specific comments on how this criterion should be tested. One commentator suggested a minimum range of three product suppliers, while another commentator argued against prescribing a minimum number of products or broking contracts on the grounds that this could lead to behaviours where advisers would seek to 'write the quota' in order to meet a contrived definition of independence.

#### ***• Relationship with product supplier:***

Advisers must be free of influence from product suppliers, including a relationship of employment or any other compelling mandate to a product supplier or a group of companies which includes product suppliers.

This would imply that the adviser should be free of minimum production targets and that any contractual relationship with a product supplier cannot be based on a minimum level of sales.

A commentator suggested that it may be simpler to categorise the adviser as independent or not, rather than trying to define 'independent advice'.

One commentator suggested that the current FAIS requirements regarding disclosure and management of conflicts of interests and the disclosures regarding percentage earnings from product suppliers are adequate, but that enforcement should be intensified to encourage comprehensive compliance. Other commentators suggested that the FAIS requirements would have to be enhanced to make the distinction between independent advisers, multi-tied agents and tied-agents clearer.

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One commentator provided specific examples of when the adviser should not be regarded as providing independent advice:

- When advisers are influenced by product suppliers with whom they do business or they are influenced by potential earnings rather than considering the customer's needs.
- Where advisers have production or sales targets imposed on them. Forced sales targets impact the independence of the advice. Targets and incentives jeopardise independence.
- Where advisers are "encouraged" or incentivised to write for a particular supplier (especially suppliers who are part of the "home company").
- Where more remuneration (direct or indirect) can be earned selling the product of one company / brand vs. another.
- Operating under instructions, e.g. where employed advisers have their behaviour directed by employers. If advisers are to remain independent then they should not have any company material that represents them. Similarly, companies should not push for production figures, but should rather do what is best for the customer.
- Where there is undisclosed remuneration payable to an adviser, it could create a conflict of interest between the interests of the adviser and the interests of the customer (e.g. a payment made by an investment manager or platform to encourage placement of funds without being disclosed to the customer; or an employed person offering home company products when others can be offered and not disclosing such).

For the reasons set out above, the commentator was of the opinion that tied agents, franchise agents, corporate brokers and bank brokers should not be regarded as independent.

On a specific point, the FIA felt that independence would not be sacrificed when a financial adviser utilises only one LISP platform for his / her customers, but rather that it would lead to improved service levels and turnaround times which ultimately should benefit the customer. Others agreed that independence of product advice is not sacrificed by using only one LISP platform for customers, but pointed out that the adviser must compare such a LISP platform with the others on offer when recommendations are made.

A commentator also argued that the fact that an intermediary may develop and sell its own products (e.g. a white-labelled CIS) should not impact on his / her independence, provided there are no production targets and a proper comparison of the product to other products is undertaken.

**Question: Should intermediaries be required to select whether they offer independent financial advice or restricted advice in respect of all clients – or should an intermediary be able to offer a combination of the two varying depending on the type of product being sold?**

Views differed on this question. Some commentators felt that an adviser cannot, under any definition, sometimes position themselves as 'restricted' and sometimes as 'independent'. Others believed that representatives should be able to switch between providing 'independent advice' and 'restricted advice' depending on the client and / or the product, provided that the nature of advice is clearly disclosed.

### Investment products

Do stakeholders agree that a customer contracted fee-based approach to intermediary remuneration for investment products will support appropriate advice and a level playing field across sectors?

There was majority support among commentators for the view that intermediaries should be remunerated solely by means of a customer contracted fee for advice and intermediary services related to investment products, in the interests of appropriate advice and a level playing field across different types of investment product providers.

Applying the same rules to different product types within the same advice category, and placing control of the fee to be paid with the customer, were viewed as important elements of levelling the playing field across product types and removing the potential product supplier bias which can lead to inappropriate advice.

A fee-based model was seen as sustainable, provided that the fee can be deducted from the investment value and paid to the intermediary by the product supplier.

There was general agreement that fees should be based on the level of support and services that the intermediary provides.

It was emphasised that a reasonable transition period will be required for such a change.

An alternate view was that intermediaries and clients should be permitted to negotiate a fee arrangement in respect of advice, payable by the customer, but that for intermediary services in the insurance sector there should be a choice between:

- Intermediaries and customers negotiating a fee arrangement in respect of intermediary services (in which case no commission may be paid by the product supplier to that intermediary in respect of the services in question); or
- Intermediaries continuing to be allowed to be remunerated by means of commission payable from the insurer only.

This view also argued that a customer-contracted fee-based approach for advice on single-premium insurance investment business was workable, but less so for recurring premium insurance investment business. Additionally, the argument was made that a commission based approach could still result in fair outcomes for customers if it shifts towards an as-and-when approach and is combined with zero early-termination penalties on insurance investment products.

A number of commentators were of the view that a customer-contracted fee model would not be sustainable for low and middle income markets which are virtually exclusively serviced by tied agents. It was argued that most customers in this sector would be unwilling or unable to pay for advice and that, as a result, access to advice and financial education will be compromised.

**Question: Should the fee basis be prescribed or flexible – for instance, should a fixed fee, an hourly rate or percentage of funds invested, all be considered viable options?**

The majority view was that intermediaries should be afforded the opportunity to charge customer-agreed fees for advice without the basis of the fees being prescribed, but rather left to negotiation and agreement. This would allow an adviser to personalise a charging structure based on the circumstances and needs of the customer.

However, concerns were voiced that if customer-contracted fees are not regulated and placed under the same scrutiny as legislated commission caps, they may lead to poor customer outcomes. Thus it was suggested

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that regulatory guidelines are necessary to prevent abuses. It was also argued that a standardised schedule of tariffs, as in other professions, would assist with the practical feasibility of recouping certain advice-related fees from customers.

Commentators also cautioned that advisers should gain some protection against situations where they deliver up-front advice for a fee, which they agree may be payable over time in instalments, and the customer takes the advice but opts out before fully paying for it.

**Question: Is it agreed that the structure of an intermediary's fees should not vary according to the type of product or product supplier that is recommended?**

There was a strong consensus view that the fee payable for the advice should not depend on the type of investment product ultimately recommended, as this supports a consistent approach to remuneration across product types.

**Question: If an adviser is to provide an ongoing service, should the adviser be required to send a periodic renewal notice to the customer (and if the customer does not want to renew the services, then the adviser cannot continue to charge the customer)?**

While some commentators were in favour of an annual renewal of the ongoing advice service (i.e. an annual "opt-in"), most commentators suggested that annual fee disclosure is adequate, including a reminder of the customer's right to terminate the ongoing fee (i.e. an "opt-out").

It was suggested that the FAIS framework should be strengthened and effectively enforced by placing an obligation, as part of the FAIS audit review, to evidence a review with customers.

**Question: Should product suppliers be obliged to offer customers the option of having adviser charges deducted from their investments? If not, how might the risk of bias toward suppliers who offer this facility be mitigated?**

Views were split on this question.

Product suppliers were mostly of the view that they should be permitted, not obliged, to administer these deductions, and that competitive forces will suffice (it was pointed out that it is the norm for product suppliers to deduct advice fees in the investment product space, with the exception of life insurance products where certain regulatory constraints were highlighted).

Among intermediaries, the biggest concern expressed about the advice-fee model was the administrative burden that may be placed on them to collect fees from customers, and particularly the responsibility to pursue bad debts. The proposal to allow the deduction of fees to be facilitated through ongoing deductions from investment amounts was welcomed. It was felt that this facility should be offered by all product suppliers and investment platform (LISPs) so as to "level the playing field" and to ensure that an adviser is not incentivised to use one product supplier over another based on the availability of this facility. 77% of FPI members surveyed felt that the option of having adviser charges deducted from customer investments should be standard across all product suppliers – i.e. all product suppliers and LISPs should be obliged to offer the option.

**Question: How might remuneration of advisers by other product suppliers (such as CISs) and other channels (LISPs) need to be adapted to be consistent with these principles?**

A strong majority view was that the same principles should apply in respect of long-term insurance investment products, CISs and LISPs. Concerns were raised regarding potentially unfair outcomes due to LISPs that offer all-in-fee CIS funds on their platforms. A minority alternative option to deal with this issue was to ban all-in fee portfolios in both CIS and long-term insurance products.

**Question: How might the remuneration received by LISPs from product suppliers need to be adapted to avoid any potential conflicts of interest?**

There was no consensus on this issue, although the majority were of the view that current practices need to be adapted.

A number of commentators felt that all 'rebates' received by LISPs from CIS management companies in respect of CIS assets placed with the LISP should be explicitly disclosed and transparently offset against customer fees, not retained by the LISP.

Some commentators felt that platform fees received by LISPs from product suppliers are acceptable, provided they are disclosed at investor level. It was argued that any fee earned by a LISP from a product supplier relates to services rendered, such as administration and bulking of trades, thereby reducing administration and hence administration costs for the product supplier. In addition, the point was made that the LISP provides significant distribution and support for the product supplier's products. Many of these suppliers would need to incur considerable expense in order to otherwise realise such broad distribution opportunities. These are actual services rendered for which a fee can be justified, and do not present a conflict of interests.

At the other end of the spectrum, some commentators felt that as the market has moved away from product suppliers providing rebates to LISPs, this may be an opportunity to ban the practice altogether.

### Life risk products

Question: Do stakeholders agree that a shift towards an as-and-when commission basis for life insurance risk products is necessary to reduce mis-selling and support industry sustainability?

Commentators were almost unanimous in rejecting the move to a full as-and-when commission basis for life risk products.

Commentators pointed out that this would threaten the sustainability of financial adviser and intermediary business models, with consequences for the sustainability of the insurance industry.

Key comments included:

- A key rationale for the move to as-and-when commission on savings business was to support improved surrender values. This is not a concern with risk business.
- There is no clear evidence that up-front commission for life risk policies drives incentive-driven churn of policies.
- Most of the work in selling life risk policies is performed upfront.
- It will be very difficult to recruit new intermediaries into the industry, as new entrants will require a large capital outlay to sustain themselves while they build up a practice. This would also "wipe out" the broker or independent intermediary market and lead to a loss of jobs.



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As a result, commentators pointed out that there is a risk that many customers will not get the necessary advice in order to protect themselves and their families from a crisis like death or disability.

It was also pointed out that any change from up-front to as-and-when commission would have to involve a gradual transition.

### ***To what extent do certain up-front advice and intermediary services performed for life insurance risk products argue for an up-front element to remuneration?***

Commentators pointed out that in most cases there is a far greater investment in time and effort by the intermediary before the sale compared to what is required post the sale, and that this justifies the payment of an up-front element of commission for life risk business.

Commentators suggested that these up-front services include:

- Up-front advice services, such as:
  - Discussion of current needs with the customer;
  - Evaluation of existing cover, including drawing policy information and values, analysing the existing portfolio and consolidating into a single view;
  - Explaining all products and options available to meet identified needs. This also generally involves significant requirements from the product supplier where a new solution is implemented;
  - Consideration of tax implications of the advice and implementation; and
  - Documenting the needs analysis and records of advice.
- Drawing quotes for new policies and checking them;
- Arranging medicals;
- Completing and checking application forms;
- Submission of all documentation to the life office;
- Liaison between life office and customer;
- Processing any supplementary information that is needed; and
- Meeting regulatory requirements – FAIS, FICA etc.

It is noted that many of the up-front services that were mentioned by commentators fall into the category of up-front advice, for which an advice fee may be negotiated with the customer.

### ***On what basis should an intermediary be permitted to receive a fee from a policyholder over and above commission? In return for what types of services?***

Some commentators indicated that, in their view, fees over and above commission should be permissible with the proviso that there is full disclosure and explicit agreement with the customer, without being too specific about what types of services these fees would be in return for.

Some other commentators made specific suggestions that the fee could be for services that are not part of the selling of a product, such as financial planning advice, or other services such as the preparation of an estate plan.

The FPI recommended that the FSB should provide "recommended" tariffs for certain services, which could serve as guidelines, to avoid consumer abuse.

### ***Do other elements of the commission structure, like claw back rules or the treatment of contribution increases, need to be revisited to support the desired outcomes for consumers?***

There were different views on this issue.

The majority of commentators indicated that they do not think a change is necessary. Of these, some indicated that a longer claw back period may be considered for life risk business, but that it should be kept in mind that claw back of commission presents a number of challenges that would be exacerbated by an increase in the claw back period.

A minority view was that the only cost effective way to address churning would be to lengthen the claw back period to 5 years, which was seen as a better alternative to as-and-when commission.

Commentators also suggested that no change in commission claw backs should be considered for the low-income market.

Some commentators pointed out problems with the current practice whereby the commission arising from an increase in premium continues to be paid to the original selling adviser. It was argued that if the commission was paid to the current servicing adviser, then this would result in less churn.

### **REPLACEMENT POLICIES**

#### ***Consistent with the principle that all remuneration must be reasonable and commensurate with the actual services rendered, how should remuneration for replacement policies differ from that for new policies, if at all, particularly given the aim of limiting the risks of inappropriate commission driven churn?***

Commentators pointed out that "churn" (inappropriate replacement of policies driven by intermediary incentives) should be distinguished from responsible replacement of policies (driven by what is in the policyholder's best interests).

A particular commentator argued that while it can never be argued that commission-driven churn does not occur, their view is that replacements may have accelerated for reasons other than commission incentives, such as:

- Product innovation – for example, there has been a significant shift to risk-only business due to new generation risk-only policies with lower premiums (although these premiums are not strictly comparable with premiums on earlier generation universal life policies);
- Lower early termination charges on legacy contractual savings products have reduced barriers to portability; and
- There is now a reasonable expectation that the diligent intermediary will present the client with new quotations on a regular basis to verify that the client's current policy is offering the best premium. It is argued that in a competitive industry the intermediary is often able to offer a better rate even though full commission is paid again.

At the same time, commentators also recognised that the "battle for distribution" in terms of the "poaching" of independent advisers to join tied adviser forces, or persuading tied advisers to move from one product supplier to another, through offering large "sign-on bonuses" is a considerable contributor to churn, as the sign-on bonus is often implicitly linked to incentives to move existing customer business to the new product supplier.

The views were expressed that ideally, regulation should try to stamp out churn while still allowing for "good" replacement. Some commentators made suggestions on how to this could be achieved, relying mostly on more rigorous oversight by insurers and the FSB. Some of the suggestions included enhanced audits / checks by the FSB and requiring product suppliers to submit statutory returns on replacement business.

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Other commentators believed that it is very difficult to distinguish "good" from "bad" replacements in practice, and accordingly that to minimise the risk of unnecessary replacements intermediaries should receive either no commission or only as-and-when commission when a policy is replaced. (Reference was made to the old Life Offices Association (LOA) rule that prevented advisers from getting commission on any business after old business was cancelled and the fact that replacement business was almost non-existent under these rules.)

The FPI surveyed a large number of its members on this question, and the results pointed to an almost even split on the proposal to have a different commission regime for replacement policies.

### EQUIVALENCE OF REWARD

#### ***How can the equivalence of reward provisions be strengthened to avoid arbitrage between independent advice and in-house agent models?***

This was an area of particularly divergent views.

Some commentators voiced objections to the whole concept of equivalence of reward, on the basis that as long as products are not priced differently for customers depending on which channel they access the product through (i.e. the product costs the same for the customer no matter whether they access it through an independent intermediary of an in-house agent or representative), there is no need to legislate employer / employee or agency / principal contractual relationships.

However, others pointed out that arguments against equivalence of reward provisions ignored the fact that differences in the structure and level of remuneration may lead to an unintended migration from the independent intermediary model to tied agency forces.

It was also mentioned that it will be important to allow flexibility to support remuneration of new recruits where their commission earnings aren't sufficient to afford them a living. Accordingly it was argued that a model for salaried advisers needs to be permissible, particularly as the tied distribution channel has traditionally been the feeder for the independent financial adviser sector.

Other commentators felt strongly that reforms designed to strengthen equivalence of reward provisions would help to create level playing fields.

Equivalence of reward would include a prohibition on sign-on bonuses and overrides paid to independent intermediaries to incentivise them to become tied agents, particularly where they are linked to production targets and other conditions that result in conflicted advice.

Some commentators also suggested that cognisance should be given to the additional value that independence brings. It was further suggested that there are more costs associated with practising as an independent adviser.

Lastly, it was pointed out by some that the option of shares, bonuses and other forms of conflicted remuneration should not be offered to commission earners.

#### ***Are specific provisions needed to address equivalence of reward and the risk of miss-selling by representatives appointed for a limited period, such as call centres appointed to deal with specific campaigns – for instance a requirement to hold back a reserve or portion of the up-front commission that is only paid back after the claw back period expires and the extent of persistency can be accurately ascertained?***

There was limited comment on this question. The main view expressed was that no specific interventions are required, as the risk belongs to the product supplier and current consumer remedies cover the policyholders who may be affected.

### LOW-INCOME PRODUCTS

#### ***How may the fee-based approach need to be adapted – if at all – to accommodate sales of investment products to the low-income sector?***

The majority view expressed was that a fee-based approach should not be implemented for the simple savings products offered in the low income market, on the basis that low and middle market customers cannot afford to pay a fee for financial advice. As a result, it is argued, a fee-based regime will not result in a sustainable business model for intermediaries in this market and low and middle income earners would be deprived the benefit of receiving financial advice. Some commentators made the point that these considerations should not apply only in the low income market, but apply equally in what they described as the middle income market.

A minority view was that the risks of the move to a fee-based model are overstated, and that financial services firms will be innovative and develop new and different distribution models to reach potential customers.

Commentators suggested that an appropriate remuneration model for this sector is commission-based with regulated parameters and disclosures, combined with a revision of the FAIS framework to facilitate access. Some commentators also pointed out that product suppliers need to revisit their product models so as to provide easily accessible, affordable and non-penal product structures which can be accessed through a variety of distribution models; and that simple products should reflect appropriate and generally lower distribution costs in order to protect the interests of lower income customers, with remuneration structures that therefore should not penalise the customer.

#### ***How must a shift towards an as-and-when commission basis for life insurance risk products be adapted – if at all – to accommodate sales of risk products to the low-income sector?***

The majority of commentators did not support an as-and-when commission basis for risk products in the low-income sector. "Broker house" structures within the low-income market have a remuneration practice which requires that the bulk of the annualised commission is paid to the sub-agents / representatives who market and distribute the product. It is argued that a severe change to the level and structure of commissions would potentially render these distribution businesses unsustainable.

Commentators suggested a model that continues to allow a combination of a commission and salary-basis for remuneration, possibly with the level of commission revisited.







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