Treating Customers Fairly

Status Update:

Retail Distribution Review Phase 1

An update on the "Phase1" Proposals identified in the Retail Distribution Review

The Financial Services Board (FSB) published its Retail Distribution Review (RDR) discussion document in November 2014. Against the background of the Treating Customers Fairly approach to regulating conduct of business in financial services, the document proposed far-reaching reforms to the regulatory framework for distributing financial products to financial customers.

The RDR put forward a total of 55 specific regulatory proposals, to be implemented in phases. A subset of 14 RDR proposals was identified for implementation in "Phase 1." This document provides an update on next steps for implementation of those proposals, including proposed changes to some of them. It also shares the FSB's current thinking regarding the adviser categorisation model proposed in the RDR discussion document.

The FSB takes this opportunity to thank all stakeholders who commented on the RDR discussion document for their constructive contributions to the development of these proposals.

1. Introduction

The Financial Services Board (FSB) published its Retail Distribution Review (RDR) discussion document in November 2014. Against the background of the Treating Customers Fairly approach to regulating market conduct in financial services, the document proposed far-reaching reforms to the regulatory framework for distributing financial products to financial customers.

The RDR put forward 55 specific regulatory proposals aimed at meeting the objectives set out in the paper. The paper confirmed that these proposals would be effected in three broad phases, aligned to the broader reform of financial regulation in terms of the Twin Peaks regulatory model. As part of this phased approach, a subset of 14 RDR proposals was identified for implementation in “Phase 1.” These were envisaged as RDR proposals to be effected within the existing regulatory framework, using existing subordinate legislative and administrative powers. The implementation window for these Phase 1 proposals was intended to be between the close of the period for comment on the RDR (March 2015) and the effective date of the Financial Sector Regulation (FSR) Act. At the time the RDR was published, the effective date of the FSR Act was anticipated to be in the second half of 2015. This timing has shifted, and a revised version of the FSR Bill was tabled in Parliament on 27 October 2015, with promulgation expected in late 2016.

A total of 88 commentators provided feedback on the RDR paper through the formal consultation process, with additional comment and perspectives provided by industry participants and from multiple other sources. During the 6-month period from April to September 2015, the FSB has undertaken a comprehensive review of all stakeholder feedback received, including feedback on the Phase 1 proposals. This work has been undertaken by a dedicated, cross-departmental FSB RDR project team. Additional workshops on various subsets of the RDR proposals have also taken place with industry reference groups.

2. Purpose of this status update document

The current focus of the RDR project team is on next steps in relation to the RDR proposals, in light of feedback received and in light of the evolving FSR Bill timeframes.

The team has also taken note of requests made by many commentators to consider the interconnectedness of the various RDR proposals and the importance of sequencing the implementation of the proposals to minimise market disruption and uncertainty as far as possible. In particular, commentators correctly pointed out that clarity on the final adviser categorisation model – in other words the proposed three-tier model of categorising advisers as tied, multi-tied or independent – is important. This is because any material changes to this proposal will have knock-on impacts on a number, although not all, of the other RDR proposals.

This document therefore has two main purposes:

- To provide an update on the FSB's current thinking regarding the adviser categorisation model – see section 3; and
- To provide an update on the next steps for implementation of the RDR Phase 1 proposals, including proposed changes to those proposals – see detail in section 4 and a summary in section 5.

A high-level timeline and process update for the implementation of the balance of the RDR proposals is planned for publication before the end of 2015.

3. Adviser categorisation

RDR Proposal K, together with a number of related proposals[1] regarding adviser categorisation, requires priority focus. This is because, although this proposal is not flagged for "Phase 1" implementation, any changes to this proposal will trigger consequential changes to a number of the other RDR proposals.

3.1. Aspects of initial RDR proposals on adviser categorisation that the FSB has agreed to change / review

Having reviewed stakeholder comments, the FSB agrees that the following aspects of the initial RDR proposals are potentially problematic and should be changed:

(a) Terminology used to describe adviser categories is vague and confusing – particularly the term "multi-tied".

The FSB accepts the concern raised by many commentators that the terminology proposed to describe and differentiate the three categories of adviser – particularly the concept of a "multi-tied" adviser - is potentially confusing and may not be helpful in assisting customers to understand the status of the advice offered. In addition, the term is arguably technically incorrect as the advisers concerned would be licensed in their own right as opposed to being "tied" to multiple product suppliers as the "multi-tied" label suggests.

There is also concern that the term "tied" may not be easily understood. The current FSB view is that the term "agent" is clearer as well as being legally correct, and that this term should be considered instead of the "tied" label.

Particularly if a three-tier model is retained (see paragraph 3.2 below), different terminology must be considered that will more meaningfully clarify the nature and status of the advice provided – particular in the "middle" category (currently labelled "multi-tied").

(b) Minimum product and product supplier choice to qualify as independent will lead to unintended consequences (Proposal M) – test for independence should be degree of product supplier influence.

1 Including but not limited to Proposals L to S and Proposals BB to DD.

The FSB agrees with stakeholder concerns that Proposal M, requiring an appropriate range of product supplier and product choice to be offered in order to qualify as an Independent Financial Adviser (IFA), would give rise to unintended consequences and could lead to inappropriate advice merely to "make up the numbers". We also agree with comments that: Such standards would be difficult to design as different industry sectors have different degrees of product choice in the market; it is unclear how specialist advisers operating in niche markets would be accommodated; and advisers may have legitimate TCF aligned reasons (not based on any form of product supplier influence) for favouring certain products or suppliers over others.

The FSB therefore agrees that freedom from product supplier influence is a more meaningful determinant of independence than the range of product or product supplier choice offered. We will therefore not pursue Proposal M in its current form. Instead, the range of product suppliers and products offered should be monitored by the supervisor, with the possibility of requiring re-classification as a tied adviser (product supplier agent) or another adviser category if applicable, where significant product supplier influence is identified and the situation is not rectified. It may be necessary to provide, at the very least,

that an adviser who provides advice only on the products of a single product supplier / product supplier group, must be categorised as a product supplier agent, other than possibly in very narrow specialist markets.

(c) Scope of tied advice (Proposal R) should be strictly defined – but could allow for "gap filling" across different lines of business.

The FSB considered various arguments that tied advisers (product supplier agents) should also be able to advise on products of other product suppliers ("external" suppliers), subject to the principal supplier's approval and oversight, for so-called "gap fill"[2] reasons. We remain concerned however that allowing tied advisers to also advise on "external" products will perpetuate current hybrid models, where tied advisers are able to create the incorrect impression for customers that their advice is "independent". There is some doubt as to whether enhanced disclosure will be enough to mitigate the risk of confusion in these cases. There are also question marks as to whether the need to allow tied advisers to offer "external" products is indeed based on customer needs, or whether it is more aimed at

2 The argument for "gap filling" is that, in order to provide complete and holistic advice to customers, tied advisers should be able to provide advice on products of other product suppliers in cases where their primary supplier's product range does not adequately meet an identified customer need.

adviser retention, to counter complaints by tied advisers that they are having difficulty competing against external offerings. The FSB therefore believes that – subject to the discussion immediately below – Proposal R should be retained.

The FSB has also considered a refined tied adviser model – in line with an approach used in India – where a tied adviser (product supplier agent) should be able to act as the agent of one product supplier per line of business. This would mean, for example, that an adviser may be tied to one product supplier for long-term risk products, one for short-term insurance products, one for medical schemes, one for savings and investment products, etc. The adviser would be licensed as a product supplier agent of each such product supplier. However, further consideration would need to be given as to whether, where the adviser is tied to a supplier / group that offers multiple lines of business, it should only be permitted to act as an agent of another supplier where the "home" supplier / group does not offer the line of business concerned.

Advantages of this model are that it addresses the "gap fill" concerns to a substantial degree, while avoiding the legal complexity and potential conflicts of interest in allowing a tied adviser to also offer products of competing principals. This type of conflict is avoided as the products concerned will meet different needs and the products and product suppliers do not compete with one another.

The FSB therefore believes that this model warrants further investigation. This will include further work on how best to delineate what constitutes a "line of business" for purposes of this proposal.

The FSB agrees with stakeholder suggestions that, in determining what constitutes the products of a particular supplier / group, "external" investment products offered through an investment platform ("LISP") operated by the primary supplier / group will qualify.

To the extent that "gap fill" concerns remain, the option of developing appropriate standards for tied advisers and their product suppliers to use lead and referral mechanisms will be further explored (as per Proposals I and XX).

3.2. A two-tier or three-tier adviser categorisation?

The majority of commentators on Proposal K indicated a preference for a two-tier categorisation, sometimes also proposing different terminology to describe the tiers from that used in the RDR. The proponents of a two-tier model fell into two broad groups:

- Those that proposed strict criteria for tied advisers, with all other advisers classified as "non-tied" or "independent"; and
- Those that proposed strict criteria for independent advisers, with all other advisers classified as "tied" or "non-independent".

One association[3] proposed a variant on the RDR three-tier model (the "ASISA model"). This model proposes that the three-tier "Proposal K" model be retained, but that the multi-tied category should apply where more than one product supplier exercises any form of influence over the adviser, in which case all such product suppliers should be jointly and severally liable for the advice provided on any products (whether the products are products of those suppliers or not). In addition, where only one product supplier exercises any form of influence, the adviser would be classified as a tied adviser of that supplier, who is liable for all advice provided on any products (whether the products are those of that product supplier or not). The ASISA model also proposes that such tied advisers need not be limited to products of the primary product supplier or group but can also offer certain external products with the approval of the primary product supplier.

In light of feedback received, the FSB agrees that Proposal K should be reconsidered. However, having carefully considered the alternative models proposed by stakeholders, we are of the view that they do not satisfactorily address concerns with the current frameworks nor do they adequately support the RDR objectives.

Although a two-tier model is potentially simpler and less confusing to customers than the three-tier model proposed in the RDR, the two-tier alternatives as put forward by commentators do not adequately clarify the nature of different product supplier / adviser relationships. Instead, they perpetuate various poor outcomes of the status quo. If a two-tier model were to be adopted, it would need to address these shortcomings.

3 The Association of Savings and Investments South Africa (ASISA)

The three-tier "ASISA model", despite addressing some of the shortcomings of these two-tier proposals, is also problematic for various reasons and would in the FSB's view also ultimately perpetuate current shortcomings. Our concerns relate mainly, but not only, to the concept of more than one "influencing" product supplier accepting joint and several responsibility for the advice provided by a multi-tied adviser - regardless of which of these suppliers' products the advice relates to, or even where it relates to a product offered by a completely separate "non-influencing" supplier. The concept deviates significantly from common law principles of agency and vicarious liability and creates a situation of a single entity acting as the agent of competing principals in relation to similar activities, which is problematic. In light of these concerns it is, in our view, unlikely that product suppliers will expose themselves to these uncertain levels of advice and mis-selling risk, particularly in respect of a competitor's products. The result therefore is expected to be a very low take-up of this form of multi-tied model. In practice, the result is likely to be a two-tier model with product suppliers choosing between tied models (albeit with the ability for advisers to offer "external" products) or opting to exert no influence whatsoever and deal with fully independent advisers. Given the strict criteria to qualify as independent, together with the flexibility ASISA proposes for the tied model, it is likely that the net effect of the ASISA model would be a significant move to tied models, including the problematic current "hybrid" tied models.

In debating the relative merits of a two-tier or three-tier model, the FSB considered the following factors:

- As mentioned above, it is agreed that range of product and product supplier choice should not be a determinant of an adviser's degree of independence. The extent of product supplier influence (tested against the criteria listed in Proposal N) should be the main determinant. This somewhat limits the current confusion as to what constitutes "multi-tied" advice if a three-tier model were to be retained, but would not resolve it completely.

- In addition to considering product supplier influence, the categorisation model should also clearly distinguish between (i) advisers acting as an agent of a product supplier (using current language, advisers who are representatives of an FSP that is also a product supplier), and (ii) advisers that are or act for entities that hold their own licence to provide financial advice and are not also product suppliers (in current language, this would include sole proprietor FSPs or representatives of FSPs that are not product suppliers). This distinction is important to enable customers to understand which legal entity is primarily responsible for the quality of advice provided, and who they should look to when seeking redress. Accordingly, if a two-tier model is adopted, this “licence status” distinction should be the main differentiator between the two tiers. It would also assume that the first tier (product supplier agent) was subject to a strictly defined scope of tied advice, as contemplated above – i.e. no “hybrid” models.

- Although it is clear from comments received that some advisers attach importance to the ability to describe themselves as “independent”, it is less clear that this attribute is highly valued by customers. Instead, some insights suggest that customers place more value on the level of competence (including qualifications) and expertise of advisers, and their ability to assist the customer in making difficult financial decisions, than their status as “tied”, “independent”, “restricted”[4] or similar labels.

- A two-tier model would be significantly less complex – from both a customer understanding and a regulatory and supervisory perspective – than a three-tier model. However, without additional limitations on conflicts of interests, such a two-tier model does not resolve how to deal with the fact that, within the “own licence” tier, varying degrees of product supplier influence, and thus varying degrees of independence, could exist. The FSB believes that it remains essential for the regulatory framework to mitigate current conflict risks arising from these types of potentially conflicted relationships. Accordingly, regardless of whether a two-tier or three-tier model is adopted, additional measures are required to mitigate risks of conflicts arising from product supplier influence.

3.3. Additional conflict of interest controls where product supplier influence exists

The FSB has considered what additional controls are required to mitigate the risk of conflicts of interest arising from different types of product supplier influence – including different degrees of influence exerted over the same adviser by different product suppliers. To attempt an answer to this question, the FSB considered each of the following types of influence as listed under Proposal N *(Criteria for IFAs to be free of product supplier influence)*:

4 “Restricted” is the term used in the United Kingdom to describe advisers (in the investment and savings space) that do not offer advice on a broad “whole of market” product selection.

(a) Any form of employment; agency; representative; outsource service provider; or other mandated relationship with a product supplier.

Where the adviser has an employment, agency or similar mandated relationship with a product supplier, the adviser will typically be a tied adviser of that product supplier (product supplier agent). Such a relationship would therefore preclude the adviser from providing advice in any other capacity and the question of differing degrees of influence from different product suppliers does not arise.

Where advisers enter into outsourcing arrangements (including binder arrangements) with insurers, such arrangements will be subject to existing regulatory requirements plus the additional requirements discussed later in this paper (see discussion on Proposals Z, AA and ZZ). These additional controls are designed to further mitigate the conflict of interest risks arising from these additional income streams.

(b) The adviser is directly or indirectly subject to production or sales targets in relation to products of the product supplier.

The FSB proposes that the setting of any direct or indirect production or sales targets by product suppliers be prohibited for all advisers other than the supplier's tied advisers[5]. The FSB shares the concern, raised by a number of commentators, that the practice of some product suppliers of terminating intermediary contracts with advisers who do not meet certain production levels, amounts to an implicit production target and may give rise to conflicts of interest. On the other hand, we recognise that it may not be commercially viable for product suppliers to maintain contracts, with the resulting need for administrative and technical support, with advisers that market very low volumes of their product. The FSB also does not believe it is appropriate to be unduly prescriptive to either product suppliers or advisers as to who they should be contracting with, or the circumstances in which they should maintain contracts.

The FSB will therefore consult on measures to enable advisers whose contracts with a particular supplier are terminated or inactive for production related reasons[6], to be able to provide a reasonable degree of ongoing service to existing customers and be able to

5 Bear in mind that, in the case of tied advisers (representatives of the relevant product supplier as FSP, for FAIS purposes), incentives based solely on production volumes are already disallowed by the FAIS General Code conflict of interest provisions. See s.3A(1)(b) of the Code.

6 Note that this dispensation does not apply where the contract is terminated for other legitimate reasons.

continue earning any ongoing commissions to which they would have been contractually entitled if not for the reduced production. Any other current or future requirements relating to the basis on which ongoing remuneration may be paid, or in relation to adequate ongoing product knowledge, will also apply.

(c) There is a direct or indirect ownership or other financial interest in the adviser by the product supplier ; and
(d) The adviser has a direct or indirect ownership or other financial interest, other than as an ordinary financial customer, in the product supplier

Sharply conflicting views were expressed by commentators on the extent to which any form of ownership interest or similar financial interest between product suppliers on the one hand and advisers or adviser firms on the other, constitutes a fundamental conflict of interest. Some argued that it is unavoidable that such an interest will result in influence over the advice concerned, thus creating bias and compromising independence. Others argued that it is possible for ownership interests to exist without any such influence being exerted, by ensuring effective safeguards are in place. The FSB's current thinking is that the mere existence of an ownership interest does not automatically result in influence, but there is a strong presumption that such influence arises. To rebut this presumption and ensure that potential conflicts arising from ownership interests are adequately mitigated, strict standards - coupled with close supervisory scrutiny[7] - would have to be applied to demonstrate that there is no bias in favour of the product supplier concerned. Indications of such bias would require appropriate corrective action, including potential re-classification as a tied adviser / product supplier agent.

(e) The relationship in any way imposes restrictions on the adviser's ability to provide or earn remuneration in respect of any other product supplier's product, in respect of which the adviser would otherwise be able to provide advice.

The FSB proposes that product suppliers should in principle be prohibited from imposing any such restrictions on advisers (other than in respect of their own tied advisers).

(f) 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.

7 Including for example regular, motivated reporting on the split of product suppliers whose products are recommended

Such general conflicts of interest are already, and will continue to be, governed by the general conflict of interest controls in the FAIS General Code of Conduct, which may be further strengthened.

(g) The adviser chooses, for any reason, to limit the range of products or product suppliers in relation to which it offers advice to the extent that the adviser will not meet the product choice criteria to qualify as an IFA.

As a result of the decision not to pursue Proposal M, this criterion falls away.

3.4. A possible revised categorisation model

Against this background, the FSB's current thinking – to be developed after further consultation - is to adopt a two-tier model, with the following features:

(a) The main distinction between the two tiers will be whether the adviser is (i) the agent of a product supplier; or (ii) a licensed adviser in their own right (sole proprietor) or a representative of a licensed adviser firm that is not also a product supplier. As currently proposed in RDR, an adviser or adviser firm will only be permitted to provide advice in one capacity – the same adviser or firm will not be permitted to act in both of these capacities. This also removes the complexity of having to provide for different categorisations at adviser firm and individual adviser level, which is necessary in a three-tier model.

(b) Appropriate designations for the two types of advisers will be required. The FSB's current thinking is to refer to the first tier as a "registered product supplier agent" and the second tier as a "registered financial adviser" [8]. Note however that these designations are for licensing purposes and will not necessarily be used in full in customer facing communications. Customer facing designations, as well as

8 Note that references to being "licensed", "authorised", "registered" etc. will need to be finalised as the future licensing model under the Twin Peaks framework develops. It is likely that the term "authorised financial services provider" as used in the current FAIS framework will not be applied in the same way.

appropriately standardised additional descriptors, will need to be developed to ensure customer understanding of the status of the advice provided[9].

(c) Product supplier agents (previously tied advisers) will be permitted to provide advice on the products of one product supplier or product supplier group only. In the case of investment or savings products, this will include allowing the agent to also advise on products of “external” suppliers that are offered through an investment platform (LISP) administered by the primary supplier / group.

(d) Despite (c), consideration will be given to permitting an adviser to act as the product supplier agent for one additional product supplier / group per line of business. In such a case, each product supplier would be fully responsible for the advice provided by the agent, to the extent the advice relates to the products of the supplier concerned[10]. An appropriate “line of business” delineation will need to be developed, informed by the future conduct licensing framework, future product segmentation under the proposed Insurance Act, and the work being done on revising the adviser competency model (currently under FAIS)[11]. If this approach is to be pursued, the following factors – among others - would also need to be considered:

- Does one of the product suppliers act as “lead” supplier for licensing and regulatory purposes, or is the adviser simply registered as a product supplier agent in the same way for all product suppliers concerned?
- Is there any requirement for the respective product suppliers to be notified of and / or approve the adviser’s appointment by the other product suppliers?
- What disclosure standards will need to apply in relation to the adviser’s status?

(e) Consideration may be given to allowing product supplier agents to be structured as juristic entities, but only on condition that they clearly adopt the principle supplier’s branding and corporate identity. In addition, if such juristic entities are permitted, they will be required to have their own financial soundness and operational ability

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9 For example, authorised product supplier agents could be required to include a phrase such as *“…providing advice on the products of [supplier /group name]”* in their business documentation. Note too that the use of incorrect designations would be a contravention of the relevant standards and subject to regulatory action.

10 The risk of overlapping accountability is reduced by the fact that the products will be in different lines of business, and will therefore not be addressing similar needs.

11 Our current thinking is that the product categories used in the FAIS “fit and proper” competency requirements would be too granular for this purpose, and that the “line of business” categorisation needs to be at a higher level – for example distinguishing between long-term insurance; short-term insurance; medical schemes; savings & investments; etc.

requirements. All other criteria for product supplier agents – including product scope limitations – would apply equally to juristic product supplier agents[12].

(f) Product supplier agents (whether individuals or, if permitted, juristic entities) will not be licensed advisers in their own right but will operate under the product supplier's licence. Their remuneration will also, in the case of long-term insurance risk products, be subject to the principle of equivalence of reward.

(g) All advisers that are not product supplier agents as contemplated above, will fall into the second tier - i.e. they will be categorised as "registered financial advisers". These will be advisers that are either licensed to provide advice in their own right, as sole proprietors, or are registered representatives of a firm that is licensed to provide advice (where the firm is not also a product supplier).

(h) The controls outlined in paragraph 3.3 above to mitigate conflicts of interest arising from product supplier influence will apply to all registered financial advisers.

(i) Notwithstanding (h), a registered financial adviser, or the adviser firm concerned, may only describe itself or its advice as "independent" if:

- it has not entered into any binder agreement with any insurer
- it does not earn any remuneration, directly or indirectly, from any product supplier for outsourced services provided on behalf of that product supplier
- it does not hold any ownership or similar interest in any product supplier
- no product supplier holds any ownership or similar interest in it, and
- the remaining criteria in paragraph 3.3 (b), (e) and (f) are met.

Where these criteria are met, the registered financial adviser or firm may use the term "independent" in its designation, or to describe itself or its advice, in addition to any required designation and descriptors as contemplated in (b) above. The designation "independent" will not however be a separate licence category.

(j) Both registered product supplier agents and registered financial advisers may, in addition to any other required designations or descriptions, describe themselves as a "financial planner" - provided they meet the standards for financial planning to be developed in respect of RDR proposal T.

12 This would only apply to juristic entities acting as product supplier agents. The FSB's current thinking remains that other juristic entities should not be permitted to provide advice as "juristic representatives", although this will be consulted on further.

(k) The principle that the extent of product supplier responsibility for customer outcomes should be aligned to the extent of product supplier influence over advice, will be retained. Accordingly, if the two-tier adviser categorisation model described in this section is adopted, RDR Proposals BB, CC and DD will be reworked to align them with this categorisation. The responsibilities of any product supplier who has a binder, outsourcing or ownership relationship with a registered financial adviser in relation to any advice provided on its (or its group's) products will be more rigorous than the responsibility imposed on product suppliers where these relationships do not exist.

4. Phase 1 proposals

The proposed next steps on each of the 14 RDR Phase 1 proposals – using the proposal numbering in the RDR discussion document – are as follows:

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

<u>*Original Proposal V:*</u> *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.*

(a) Updated FSB view

Proposal V deals with a provision specifically applicable to representatives of long-term insurers. However, stakeholder comments on the proposal were aligned with comments on the broader Proposal R (*Criteria for tied advisers*). Some commentators suggested that Proposal V should be deferred until the overall adviser categorisation has been finalised.

Comments opposed to both Proposals V and R were based mainly on the need for "gap filling" by tied advisers[13]. Arguments were also raised that the current provision does not pose risk to customers, as the primary product supplier (insurer) is fully accountable for the advice provided, whether on its own products or those of the other insurer/s which the representative may provide advice on.

The FSB remains concerned that the provision underlies a number of confusing and potentially conflicted "hybrid" distribution models in the current long-term insurance environment. We do not agree that this risk is sufficiently mitigated by the fact that the

13 See footnote 2.

primary insurer is accountable for the advice. The FSB also does not agree that it is necessary for the broader adviser categorisation model to be finalised before proceeding with Proposal V.

As discussed in section 3 of this paper, the FSB agrees that there is merit in the argument that tied advisers should be able to "gap fill" in cases where the primary product supplier or its group is not licensed to provide certain types of financial products, and will consider accommodating this need in the final adviser categorisation model. We are however not persuaded that "gap filling" is warranted where the primary insurer is in fact licensed (as an insurer) to provide the type of long-term insurance product concerned, but the adviser feels that the particular product features offered by its primary insurer are deficient in some respect and would therefore prefer to recommend an external insurer's product. In the FSB's view, it is a necessary consequence of choosing to be a tied adviser that the advice is restricted to the principal's offerings. If the adviser feels that the primary insurer's product is incapable of meeting the customer's identified needs, the adviser should refrain from recommending it and advise the customer that they are unable to recommend a suitable product[14]. Arguably, if this were a common occurrence, the insurer would find itself at a competitive disadvantage and review its offerings accordingly. Insurers and advisers could also consider developing mechanisms to refer customers to alternative advisers or product suppliers in appropriate cases, as contemplated in RDR Proposal XX.

Pending finalisation of the overall categorisation model, it is therefore proposed that Proposal V be implemented as proposed, but modified to accommodate "gap filling" in cases where the insurer is not licensed (in terms of the insurance laws) to provide the particular long-term insurance policy types concerned. For example, if an insurer ("primary" insurer) is licensed by the Registrar of Long-term Insurance to provide assistance policies only, the primary insurer's tied adviser[15] would be permitted to provide advice on non-assistance long-term policies offered by another insurer (the "external" insurer) with whom the primary insurer has entered into the necessary arrangement.

In practice, this situation is expected to be uncommon. This is because, over and above any limitations arising from the relevant insurance licence, the FAIS authorisation framework also needs to be considered. Currently, in order for a long-term insurer's tied

14 The FSB recognises that there is a risk of product suppliers and their agents being tempted to recommend their existing products even where these may not be suitable. We are considering enhanced standards to mitigate this risk.

15 The insurer's "representative" as currently defined in the Long-term Insurance Act commission regulations.

adviser to be able to offer products of an external insurer, the primary insurer (as the authorised FAIS FSP concerned) will need to be authorised to provide advice for the products concerned, and ensure that the adviser complies with the necessary FAIS fit and proper requirements to provide advice on the external insurer's product. In the above example, this would mean that, even where the primary insurer's insurance licence only caters for assistance policies, the primary insurer and the adviser would need to meet the requisite FAIS authorisation requirements in respect of any external insurer non-assistance policies on which the adviser intends to provide advice. The FSB does not expect that many primary insurers will wish to take on the relevant FAIS compliance obligations to cater for these situations, but we have no objection to permitting the scenario where insurers may wish to implement it.

Importantly, this model also implies that the adviser concerned is not only the representative of the primary insurer concerned for purposes of the Long-term Insurance Act, but also a representative of the insurer (as FSP) for FAIS purposes. In other words, the primary insurer retains full accountability for the advice provided by its representative on the external insurer's products[16].

It should also be noted that this would be a transitional arrangement, pending the requirements for tied advisers in the final adviser categorisation model.

(b) Next steps for Proposal V

The FSB will consult on an appropriate amendment to the current definition of "representative" in Part 3 of the Regulations to the Long-term Insurance Act (the commission regulations). The proposed amendment will be drafted to provide that an insurer's representative will only be permitted to render services as intermediary (as currently defined in the regulations) in relation to:

(i) the insurer's own policies;

(ii) the policies of another long-term insurer which is a subsidiary or holding company of the first insurer; and

(iii) the policies of any other long-term insurer (external insurer) which has entered into a written agreement with the first insurer, in terms of which persons employed or engaged by the first insurer may render services as intermediary in relation to the external insurer's policies, provided that the licence conditions of neither of the insurers referred

16 This is in line with the current position.

to in (i) or (ii) above, allow it to provide insurance policies in relation to the class of insurance policies concerned.

The proposed amendment will apply in relation to new policies entered into after the amendment comes into effect. It will recognise that insurer tied advisers who have rendered services on an external insurer's policies prior to this amendment, in accordance with the current paragraph (iii) of the definition of "representative", will be permitted to continue providing ongoing advice or services in relation to such policies, and will be able to continue to receive any currently permissible ongoing commissions or fees in relation to such policies, to which they may be contractually entitled[17].

It should also be borne in mind that all FAIS requirements applicable to the insurer (as the authorised FSP) and the tied adviser (as FAIS representative of that FSP) must also be satisfied.

This change requires amendments to the Regulations made by the Minister[18] under the Long-term Insurance Act. The intention is, as far as possible, to combine consultation processes in respect of a number of proposed changes to these Regulations set out in this document, together with other changes necessitated by other pending regulatory reforms[19].

Consultation on this set of changes is planned for March 2016, with implementation targeted for July 2016.

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

<u>*Original Proposal Y:*</u> *No individual IFA or multi-tied adviser may provide advice in the capacity of a representative of more than one adviser firm.*

(a) Updated FSB view

17 This will be subject to any future phasing in provisions that may be introduced in respect of broader RDR proposals relating to ongoing remuneration.

18 Timelines in respect of these changes and other changes to Regulations proposed in this document are therefore dependent on the timing of the necessary Ministerial decisions.

19 For example, changes to the insurance Regulations that will be required for alignment with the prudential framework and microinsurance frameworks to be introduced by the Insurance Bill.

The FSB remains of the view that the situation where an adviser provides advice as a representative on the FAIS licence of more than one authorised FSP is problematic, for the reasons provided in the RDR. We therefore propose to proceed with implementation of Proposal Y.

Commentators did however provide various inputs on specific scenarios where the ability to act as a representative providing advice on more than one FSP's licence is justified and, in some cases, necessary. The FSB agrees that the following scenarios justify exceptions to Proposal Y:

(i) Where the FSP concerned wishes to expand the range of products on which it provides advice, but is unable to apply for the necessary FAIS licence profile change because it does not currently have an individual on its staff who meets the requisite experience standards for the product type/s concerned. In such a case, one or more representatives may need to be appointed as representatives of another FSP, in order to obtain the necessary experience under supervision.

(ii) Where a financial services group is structured to comprise multiple FSPs authorised to provide advice on different product categories. In such cases, in order for a particular adviser to offer advice across the range of products or services offered by the group, the adviser may need to be appointed as a representative of more than one of the FSPs concerned.

The FSB proposes to accommodate these scenarios by disallowing an adviser from being appointed as a representative on more than one FSP licence where the FSPs concerned are licensed for the same product categories. In other words, a representative of FSP A will only be permitted to also act as a representative of FSP B in respect of product categories[20] for which FSP A is not licensed.

Despite the FSB's acceptance of these exception scenarios at this stage, we intend to undertake further analysis of the number of representatives currently operating on multiple FSP licences, the types of services that they are most commonly rendering, and the distribution models and practices concerned. This work will help us determine the extent to which the above exceptions will be necessary in the final regulatory framework, or whether these scenarios can be accommodated in other ways. Also note that the final decisions regarding Proposal W *(Juristic representatives to be disallowed from providing financial*

20 The intention is to apply current FAIS product categories for this purpose, although some further refinement may be necessary in cases where the FAIS categories are wide. For example, the current FAIS "commercial lines" category for short-term insurance does not further distinguish between specific types of commercial lines specialisations.

advice) may in due course further impact the extent to which these exceptions to Proposal Y - particularly the exception relating to group structures - are required.

In addition, the scope of exception (ii) above will be further curtailed by ensuring that, in the case of future FSP licence applications, a single legal entity will be permitted to hold only one FSP licence. Undue regulatory complexity, supervisory workload and potential customer confusion is currently caused by cases where a single legal entity chooses to hold multiple FAIS licences. The FSB will engage with entities that currently hold more than one FSP licence with a view to consolidating their licences.

Arguments for additional exceptions to Proposal Y, including for purposes of business continuity actions, were also considered. However, the scenarios described are too varied to be effectively provided for in clear standards. Accordingly, where such actions cannot be addressed through the exceptions allowed for above[21], the intention is not to provide explicitly for any additional exceptions unless and until the additional analysis work described above evidences a need to do so. Instead, motivated exemptions may be applied for and will be considered in the normal course.

A number of commentators highlighted the fact that Proposal Y focuses only on advisers, but is silent on key individuals. Questions were raised as to whether key individuals will continue to be able to act as such in relation to more than one authorised FSP. As the FSB has highlighted on various platforms, in addition to supervisory concerns regarding so-called “rent a licence” distribution models, we are equally concerned with “rent a key individual” practices. These are cases where an individual is appointed as a key individual merely because he or she can “tick the blocks” in respect of minimum FAIS qualification and experience standards, but does not in fact carry out any true oversight over services provided by the FSP and representatives concerned. The FSB intends to address this risk through appropriate provisions in the revised FAIS Fit and Proper requirements, which will be published for consultation shortly (see paragraph (b) below). We will also increase our supervisory scrutiny of the actual level of oversight being exercised by key individuals, including through enhanced reporting requirements.

(b) Next steps for Proposal Y

The FSB will consult on:

21 We believe that these exceptions will in fact accommodate a number of the scenarios that have been put to us.

(i) Amendments to the conflict of interest provisions in the FAIS General Code of Conduct, confirming that a representative may not be appointed as a representative of more than one FSP in respect of the same product categories, as discussed above. This will include appropriate disclosure and branding requirements, aimed at ensuring that the relationships between the respective FSPs, the status of the adviser, and which entities are accountable for the advice, is clear to customers. Note that the consultation will be combined with consultation in respect of various other proposed changes to the General Code of Conduct set out in this document, as well as certain other changes necessitated by other pending regulatory reforms.[22] Consultation on this set of changes is planned for early in the second quarter of 2016, with implementation targeted for July 2016.

(ii) Revised Fit and Proper requirements for key individuals (KIs), requiring an FSP to be able to demonstrate that the KI has the necessary operational ability to carry out their responsibilities, including in cases where the KI acts as such for multiple FSPs. These provisions will form part of the overall revision of the FAIS Fit and Proper requirements, with consultation planned for late 2015 into early 2016, and implementation targeted for July 2016.

In addition, the following supervisory actions will be taken by the FAIS department of the FSB during the first quarter of 2016.

(iii) Data analysis to determine the extent to which representatives currently operate on more than one FSP licence, and in relation to which types of products and services.

(iv) An information request requiring identified FSPs to provide further detail regarding the rationale for representatives operating on multiple FSP licenses.

4.3. Proposal Z: Restricted outsourcing to financial advisers <u>and</u> Proposal AA: Certain functions permitted to be outsourced to financial advisers

These interconnected proposals will be discussed together.

<u>*Original Proposal Z:*</u>

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

22 For example planned changes to complaints management requirements to align with the TCF Framework.

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.

<u>*Original Proposal AA:*</u>

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 and 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.

(a) Updated FSB view

The FSB remains of the view that allowing product suppliers to outsource aspects of the business they are licensed for to advisers, and remunerate them for such outsourced activities, creates an inherent conflict between the duties the adviser owes to the product supplier as its agent under the outsourcing arrangement, and the duties it owes to customers when advising them on the supplier's financial products. Accordingly, we intend to retain the general standard in Proposal Z, subject to specific exceptions as contemplated in Proposal AA.

The FSB has however refined our views on the types of activities that may be outsourced by insurers to advisers, and associated standards. Standards to address conflicted outsourcing arrangements by product suppliers that are not insurers, including the outsourcing of investment management by a CIS manager 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 – will not be addressed in Phase 1 of the RDR implementation but will be addressed in subsequent phases.

As contemplated in Proposal AA, administration functions carried out by authorised administrators on behalf of retirement funds or medical schemes, where the administrator also operates an adviser function, will continue to be permissible.

Our updated views in relation to outsourcing by insurers to financial advisers are:

(i) As contemplated in Proposal AA, we propose to continue permitting financial advisers to carry out binder functions subject to the binder regulations. (However, see the discussion of Proposal ZZ below for updated views and proposed stricter standards in relation to binder agreements).

(ii) An adviser (i.e. a non-mandated intermediary for purposes of the binder regulations) who carries out the binder activity of "entering into, varying or renewing" policies may not also earn any outsourcing fee from an insurer in relation to policy administration. This is because the policy administration function is regarded as incidental to this binder function.

(iii) An adviser who is not a binder holder, or an adviser who carries out only the "claims settlement" binder activity, may also earn outsourcing fees from an insurer in relation to policy administration, but **only if** the insurer and the adviser can demonstrate that the outsourcing enhances administrative efficiency and eliminates duplication of effort and cost – for e.g. inefficiencies due to double capturing of information. To demonstrate such efficiency, the parties will need to ensure the operational capability for the adviser to effect "real time" updates of policy records through direct capturing onto the insurer's IT platform. This specific efficiency requirement will not, in Phase 1, apply where policy administration of assistance policies is outsourced to a funeral administrator authorised under FAIS Category IV or to an adviser authorised under FAIS Category 1A. Revised standards for funeral administration will be addressed as part of the broader low-income market dispensation being developed for purposes of RDR Proposal TT.

(iv) In all cases where outsourcing to an adviser is permitted, strengthened conduct standards will also apply, aimed at minimising remaining conflict of interest risks, ensuring strengthened oversight by the insurer and requiring the parties to be able to demonstrate that the outsourcing arrangement is in the interest of policyholders.

(v) Where outsourcing of policy administration meets the above standards and, as a consequence, results in efficiencies due to elimination of duplicated effort and cost (such as double capturing) – while also ensuring proper oversight – the insurer may remunerate the adviser for the outsourced administration. It is the view of the FSB that these outsourcing fees should be subject to prescribed caps, and we propose a maximum fee of 2% of gross written premium for this purpose. Further technical work is however required to determine the appropriateness of this suggested cap.

The RDR paper also asked for input on other outsourced activities that advisers should be permitted to perform and be remunerated for through outsourcing fees. A number of examples were provided, including research on products, marketing and customers; vehicle inspections and other short-term insurance value added services such as vehicle micro-dotting; and various functions governed by other legislation such as the Financial Intelligence Centre Act. The FSB is not persuaded that any of these examples warrant specific exceptions to the general standard in Proposal Z. We are however open to further consultation on the matter. It will also remain open to any regulated entity to apply for and motivate specific exemptions from the standard concerned, but it must be noted that strong evidence would be required that the arrangement concerned does not pose risk to fair customer outcomes – particularly where the arrangement is entered into with an entity that is not a product supplier agent. For example, further inputs will be considered on the appropriate regulatory treatment, including appropriate remuneration standards, for various distribution arrangements between product suppliers and so-called “non-traditional” distribution partners[23].

(b) Next steps for Proposals Z and AA

(i) The FSB will, before the end of 2015, publish the findings of the binder thematic review that the Insurance department carried out in 2014, which findings were considered in parallel with the RDR consultation process. The review findings will

23 Examples pointed out to us include branding and customer or “shop space” access arrangements with various retail entities.

provide an indication of the FSB's enhanced supervisory expectations of steps to be taken by insurers to mitigate conduct risks identified during the review and in the course of our ongoing general supervision of binder and outsourced arrangements. The Insurance division is also planning a follow-up information request regarding aspects of binder arrangements. These review findings and the information request will in turn inform strengthened conduct standards for both binders and other insurance outsourcing arrangements.

(ii) As part of the implementation of the future Insurance Act, the current insurance Outsourcing directive 159.A.i (LT & ST) ("the Outsourcing directive") will fall away and its provisions (subject to necessary amendments) will be largely incorporated into prudential standards to be issued under the enabling provisions of the Insurance Act. As the Insurance Act is primarily focused on prudential matters consideration is being given to possibly also amending the Regulations or the PPRs under the Long-term and Short-term Insurance Acts to introduce the strengthened conduct standards for outsourcing arrangements, as discussed above. Consultation on these measures will take place during March and April 2016, with implementation expected in July 2016. This consultation will form part of broader consultation on other regulatory changes required for implementation of the Insurance Act.

(iii) Consultation and technical work on outsourcing of non-insurance activities to advisers – including in relation to investment management outsourcing by CIS managers – will continue, with a view to implementing relevant standards in future phases of the RDR roll-out.

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

<u>*Original Proposal FF:*</u> *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.

(a) Updated FSB view

The FSB intends to proceed with this Proposal, which relatively speaking did not attract extensive comment, as it stands.

The proposal has three components:

(i) Conduct standards to ensure product suppliers will have adequate access to customer data held by intermediaries, to enable them to monitor TCF outcomes for customers. Some commentators raised concerns that this would lead to inappropriate interference by product suppliers in their relationships with customers. This concern is noted, but in order to achieve the shared responsibility for fair customer outcomes required by the TCF framework, an appropriate level of information sharing and co-operation between advisers and product suppliers will be essential. This proposal will be further developed together with Proposals BB, CC and DD, relating to product supplier responsibilities. The conduct standards under Proposal FF will be set to ensure that product suppliers are reasonably enabled to meet their specific obligations under these three Proposals – which will in turn be finalised together with the final adviser categorisation model[24].

(ii) Conduct standards to ensure product suppliers will have adequate access to customer data held by binder holders or other outsourced service providers. These will be addressed as part of the enhanced binder and outsourcing standards discussed under Proposals Z and ZZ.

24 This is because there is general agreement that the extent of product supplier responsibility in relation to different categories of advisers should be broadly aligned to the extent of product supplier influence over such advisers.

(iii) Conduct standards 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 customers. Having considered valid concerns raised by both product suppliers and advisers, the FSB believes a fair balance needs to be struck between enabling advisers to access sufficient information to enable effective customer advice and service on the one hand, and on the other hand recognising that product suppliers need to reasonably satisfy themselves that advisers interacting with their existing customers have the requisite product knowledge and are otherwise acting in the customer's best interests. The FSB therefore proposes a requirement that, where a product supplier receives a request for customer information from an adviser with whom the supplier does not have an intermediary agreement, and the release of such information is duly authorised by the customer, the product supplier may elect to either:

- Comply with the request; or
- Decline to provide the requested information to the adviser concerned, provided that the product supplier must in this case provide the requested information directly to the customer, together with a fair and objective explanation of why the information has not been provided directly to the adviser.

(b) Next steps for Proposal FF

The FSB will consult on appropriate amendments to the PPRs to incorporate the proposal in paragraph (a)(iii) above, in respect of long-term and short-term insurers. The intention is to combine this consultation with consultation on other changes to the PPRs set out in this document, as well as other PPR changes necessitated by other pending regulatory reforms.[25] Consultation on this set of changes is planned for April 2016, with implementation targeted for July 2016.

The remaining aspects of this proposal will be addressed in subsequent phases of the RDR implementation.

25 For example, PPR changes to address complaints management requirements and changes in the regulatory treatment of assistance business group schemes.

4.5. Proposal OO: Product supplier commission prohibited on replacement life risk policies

<u>*Original Proposal OO:*</u>

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 which type of transaction constitutes a "replacement" for these purposes will be developed, together with specific advice and disclosure standards in relation to replacements.

(a) Updated FSB view

Proposal OO attracted extensive and widely divergent comments, ranging from strong support for the proposal to outright rejection. Most commentators supported the need to mitigate the risk of inappropriate incentive driven policy "churn", but many argued that the Proposal does not distinguish between such mis-selling cases and "good" policy replacements that are in the interests of policyholders. They were concerned that the Proposal would have the unintended consequence of dis-incentivising appropriate replacements. Alternatives proposed included extending the commission "clawback" period for replacement policies, or moving to a full "as-and-when" commission model for replacement policies.

Some commentators raised a concern that there was insufficient statistical data on the extent of policy replacements, and therefore queried the basis on which the FSB concluded that inappropriate replacements posed significant risk. On the other hand, many commentators acknowledged that the quality of replacement advice records – as required by the FAIS General Code of Conduct – were generally inadequate and poorly monitored by FSPs, making it difficult to distinguish between appropriate and inappropriate replacements. Some adviser representatives also made the point that product suppliers who accept new replacement business should also shoulder some responsibility for managing the risks of inappropriate replacements.

Regardless of the wide-ranging opinions expressed, a consistent concern was raised that it is not feasible to implement Proposal OO as part of Phase 1 of RDR, because the regulatory framework for advice fees – which are put forward as the means to ensure advisers are fairly remunerated for "good" replacements – is planned for a later implementation phase.

The FSB accepts that it will not be feasible to prohibit commission on replacement policies in the absence of further refinement to the advice fee framework. However, we remain seriously concerned that current FAIS based disclosure requirements are on their own insufficient to mitigate the risks of inappropriate replacement advice, incentivised by the opportunity to earn up-front commissions.

We therefore propose, as an interim Phase 1 measure – pending the finalisation of a remuneration based intervention - to impose replacement monitoring obligations on the insurers concerned. These monitoring obligations will be a precondition for releasing commission on replacement policies, over and above the disclosure obligations imposed on the advisers themselves. This is consistent with the TCF aim of shared product supplier and adviser responsibility for advice outcomes, and will mean that insurers who benefit from inward policy replacements will not be in a position to "turn a blind eye" to poorly motivated replacements. It should therefore improve the quality of replacement advice records and pose a deterrent to inappropriate replacements.

These replacement monitoring obligations will apply to long-term insurance risk policies that entitle the adviser to up-front commission. Although recurring premium savings policies also currently attract a portion of up-front commission, they will not be included in the scope of this requirement in view of the proposed prohibition of commission in respect of such policies (per RDR Proposal MM), which would significantly reduce the risk of replacement driven churn in this market.[26]

In addition, new conduct of business regulatory reporting requirements for both insurers and advisers will include reporting requirements in respect of insurance replacements.

(b) Next steps for Proposal OO

The FSB will consult on amendments to the FAIS General Code and Regulations under the Long-term Insurance Act, collectively providing for:

(i) A definition of "policy replacement" that will clarify which transactions constitute the replacement of a long-term insurance risk policy, for purposes of the proposed new

26 An intervention may however become necessary for savings policies in the low-income market, if the special dispensation to be allowed in this market will permit up-front commission.

replacement obligations. The definition will encompass the effecting of any new long-term insurance risk cover on the same life insured as previously secured risk cover, where the previous cover is terminated.[27] The definition will be crafted to ensure that it includes transactions which have a similar effect, such as reducing cover on one policy (as opposed to full replacement) or increasing cover on another policy (as opposed to effecting a brand new policy), as well as transactions where the existing cover is terminated only after the new cover is effected.

(ii) Similar to current FAIS requirements, an obligation on any adviser who recommends such a replacement to notify the new insurer at application stage that the application relates to a replacement policy.

(iii) Specific standardised requirements for the content and format of a "replacement policy advice record" in respect of such replacements[28].

(iv) A requirement that an appropriate person (role to be identified[29]) within the new insurer must, within a stipulated period, review the replacement policy advice record and record in writing that they are satisfied that it complies with the applicable disclosure standards. The new insurer may issue the policy concerned in accordance with its normal new business processes, but will not be permitted to pay any commission, fee or other remuneration to the adviser concerned unless and until this confirmation has taken place. Note that this requirement applies regardless of whether or not the adviser is a representative of the insurer.

(v) A requirement that the new insurer must provide the insurer of the replaced policy (the original insurer) with a copy of the replacement policy advice record within a stipulated period after satisfying itself that the advice record complies with the applicable standards. This requirement will replace the current FAIS requirement that the adviser concerned must notify the original insurer of the replacement.

(vi) A provision that the 30 day "cooling off" period on the replacement policy does not begin to run until the advice record has been sent to the original insurer.

(vii) If it is established that the adviser concerned has failed to submit a replacement policy advice record to the new insurer where this is required, an obligation on the new insurer to reverse any commission or remuneration that may have been paid in respect of the new policy. The contravention must be reported to the regulator, and

27 Further consideration will be given as to whether a time limit should be posed within the transaction should take place in order to qualify as a replacement for these purposes and, if so, what that time limit should be.

28 The FSB will assess existing ASISA measures in this regard, to inform the design of these standards as appropriate.

29 This will not be a member of the new insurer's compliance function, as the compliance function should act as a "second line of defence" to monitor compliance with these monitoring obligations, but a sufficiently qualified and senior member of the insurer's management. Where the adviser is a representative of the new insurer, this sign-off will be done by the relevant Key Individual overseeing that representative.

will be subject to regulatory action. The policyholder must be notified that they have a new 30 day cooling off period within which to review the suitability of the policy[30].

(viii) Reporting requirements to be submitted by the new insurer to the regulator in respect of aspects of the findings of the monitoring process.

(ix) Additional standards to address aspects of Proposals QQ and VV, relating to retirement annuity transfers and short-term insurance cover cancellations respectively. (See separate discussions on these Proposals later in this document).

Note that, although the above new requirements apply specifically to long-term insurance risk policies, the existing FAIS disclosure obligations relating to all forms of product replacement recommendation will also remain in force, and may be clarified.

Consultation on the above FAIS General Code and Regulations will take place in March to April 2016. The consultation will include consultation on an appropriate implementation date for these particular obligations, recognising that they will entail business process changes for insurers but also recognising the FSB's serious concerns regarding the inadequacy of current replacement controls.

In addition, consultation will also take place on:

(x) Conduct of Business statutory returns for insurers. Among a broad range of other conduct related indicators, these will include specific reporting on both new business arising from replacements (i.e. reported by the new insurer) as well as policies terminated as a result of replacement (i.e. reporting by the original insurer). Consultation on these returns first commenced in late 2013, resulting in substantial revision of the structure of the returns to ensure reasonable alignment with future insurance product segmentation and prudential reporting frameworks. Consultation on the revised Conduct of Business return will take place in late 2015 into early 2016.

(xi) Conduct of business returns for FAIS licensed FSPs, intended to replace and enhance the current FAIS compliance reports, which will in future have a different format and purpose. These returns will include reporting on replacement advice details and volumes. Consultation on these returns is planned for the first quarter of 2016. The consultation will include consultation as to implementation timelines.

30 A time limit may need to be provided for after which this additional cooling off period will no longer be offered. For example, where it only comes to light some years after the new policy has been issued that the replacement was not reported as required, it may not be reasonable to provide the customer with a new cooling off period.

4.6. Proposal PP: Commission regulation anomalies and early termination values on “legacy” insurance policies to be addressed

<u>Original Proposal PP:</u>

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 conjunction 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.

(a) Updated FSB view

The FSB intends to proceed with this proposal as stated. The proposed commission regulation change in regard to variable premium increases will therefore remain part of RDR Phase 1.

Engagement with the long-term insurance industry in relation to broader measures to reduce termination charges on legacy policies continues to take place. Technical work to inform these discussions is in progress, including a review of causal event charging practices. In particular, a detailed investigation will be undertaken to ascertain steps taken by insurers to ensure timeous compliance with parts 5A and 5B of the Regulations under the Long-term Insurance Act and Directive 153.A.ii (LT).

(b) Next steps for Proposal PP

The planned broader consultation on revising various aspects of the Regulations under the Long-term and Short-term Insurance Acts (as referred to earlier in this document), will include consultation on changes to the Parts 3 and 5 of the Regulations under the Long-term Insurance Act. These amendments will seek to ensure that the commission basis and resultant causal event charge basis for variable premium increases on legacy investment products is aligned to the current bases for new investment policies. As mentioned above, this consultation will take place during March 2016, with implementation expected in July 2016.

4.7. Proposal QQ: Conflicted remuneration on retirement annuity transfers to be addressed

<u>*Original Proposal QQ:*</u>

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.

(a) Updated FSB view

In the longer term, the FSB's concerns underlying this Proposal - namely the combined impact of early termination charges on the existing product and commissions and charges on the new product - will be largely addressed by the further reduction of early termination charges on legacy products, as well as the removal of commissions on investment products. However, in the interim, these risks remain. The FSB therefore intends to proceed with this Proposal as stated, in conjunction with other measures discussed in this document.

(b) Next steps for Proposal QQ

The consultation on proposed stricter product replacement standards to be included in the FAIS General Code of Conduct, as discussed for Proposal OO, will also include consultation on measures to address Proposal QQ. The measures proposed will include specific disclosure obligations applicable to advisers when recommending transfer from one retirement annuity fund or preservation fund to another, as well as transfers between living annuities, aimed at ensuring customers fully appreciate the impact of termination charges on the replaced product, where applicable, and commission or other charges on the replacing product. This will include consultation on appropriate measures to ensure that, where applicable, retirement fund trustees and / or product suppliers monitor the adequacy of disclosures in this regard.

4.8. Proposal RR: Equivalence of reward to be reviewed

<u>Original Proposal RR:</u>

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 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 the 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 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 the potential risks of arbitrage between the tied and non-tied advice models in the future framework.*

(a) Updated FSB view

The FSB recognises, as pointed out by a number of commentators, that implementation of Proposal RR will need to address a broad range of current insurance tied adviser remuneration models, which will require further technical work. We also recognise that this technical work will need to be carried out in parallel with planned work on setting the future long-term insurance commission caps, the framework for advice fees, as well as the special dispensation for the low income market (Proposals JJ, NN and TT). The FSB will therefore not proceed with full implementation of Proposal RR in Phase 1 of the RDR implementation.

The FSB is however concerned that a number of current practices in relation to tied adviser remuneration give rise to inappropriate distortions in the advice market. The concept of equivalence of reward is intended to ensure a reasonably level playing field between the sustainability of independent and tied advice models. However, the current non-observance of the equivalence principle poses risk of unintended levels of migration from independent to tied models.

The FSB shares concerns expressed by non-tied advisers that tied advisers currently enjoy an unfair advantage by earning remuneration and incentives significantly in excess of those available to non-tied advisers, while current "hybrid" distribution models also allow them to offer similar product and supplier choice to that offered by non-tied advisers. In addition, the FSB has recently noted the implementation of benefit structures for tied advisers that appear to be aimed at circumventing the recently introduced sign-on bonus prohibition and constitute increasingly aggressive deviations from the principle of equivalence of reward.

Accordingly, as an interim measure pending full implementation of Proposal RR, the FSB intends to clarify certain practices that the Registrar regards as inconsistent with the principle of equivalence of reward, using mechanisms provided for in Part 3 of the Regulations to the Long-term Insurance Act (see paragraph (b) below).

(b) Next steps for Proposal RR

Part 3 of the Regulations to the Long-term Insurance Act (the commission regulations) contains the following provisions in relation to equivalence of reward:

- Paragraph (b) of the definition of "representative" provides that a representative is employed or engaged by a long-term insurer "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) (our emphasis); and
- Regulation 3.2(5) provides that "the Registrar may by notice determine that a person or long-term insurer is not complying with the principle of "Equivalence of Reward"".

During the first quarter of 2016, the FSB will consult on a determination by the Registrar, as contemplated in the above definition of "representative", indicating certain practices that the Registrar regards as not being substantially in accordance with the commission regulations, and thus not consistent with the principle of equivalence.

Practices that are likely to be scrutinised include substantial non-cash incentives; lump sum payments structured as retention bonuses, restraints of trade or similar arrangements where we have concerns that these may be disguised incentives to influence production; and benefits that are provided to select individuals rather than advisers or groups of advisers more generally. The intention will be to finalise this determination during the first quarter of 2016, with immediate implementation (subject to appropriate provision for existing contractual commitments).

As indicated above, further technical work will be required before full implementation of Proposal RR. This technical work will include a review of current remuneration models for insurer representatives (tied advisers). If, in the course of this review, the Registrar identifies any practices that are not consistent with the principle of Equivalence of Reward , the Registrar will issue a notice as contemplated in Regulation 3.2(5) in respect of the adviser and / or the insurer concerned, and take appropriate regulatory action. **Particular attention** will be paid to arrangements entered into after the publication of the RDR discussion document in November 2014 as the FSB is conscious of the risk that some insurers and advisers may have sought to (or, regrettably, will after publication of this document seek to) deliberately pre-empt the introduction of more explicit Equivalence of Reward standards by entering into remuneration arrangements that materially deviate from the equivalence principle. This approach will enable the FSB to mitigate the most material current risks of non-observance of the equivalence principle, pending full implementation of Proposal RR.

4.9. Proposal UU: Remuneration for selling and servicing short-term insurance policies

Original Proposal UU:

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 detail in 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 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) Updated FSB view

The FSB accepts the view of a number of commentators that it will not be feasible to fully implement Proposal UU in Phase 1 of the RDR implementation. We recognise that further technical work first needs to be undertaken to determine the future commission model for short-term insurance, as well as details of the advice fee model (Proposal NN).

In reviewing stakeholder feedback on this Proposal, it became apparent that there was considerable confusion caused by those aspects of the proposal relating to fees for ongoing service and maintenance of short-term policies to be paid by insurers. Some commentators interpreted Proposal NN to mean that we were suggesting a move away from as-and-when remuneration for short-term insurance.

The FSB takes this opportunity to clarify the position: All remuneration payable by short-term insurers to advisers, regardless of whether the purpose of the remuneration is for selling the policy, or for providing ongoing service or maintenance, will be payable on an as-and-when basis. Further consultation will be undertaken, in subsequent phases of the RDR implementation, to decide whether these two elements of as-and-when insurer-funded remuneration require separate standards and caps, or whether they will both be addressed through a single cap on commission. Although the FSB recognises that a single cap is simpler to implement, we are concerned that it does not enable appropriate reward for advisers who provide ongoing services as opposed to those who do not.

The maximum cap for such remuneration - to be determined after further technical work – is expected to be lower than current commission caps. This is because the remuneration paid by the insurer will no longer include provision for providing advice. Advice will in future be paid for by the customer (but facilitated by the insurer if the customer so authorises) as a separate advice fee.

In the interim, the FSB's main concern regarding short-term insurance adviser remuneration relates to fees currently payable in terms of section 8(5) of the Short-term Insurance Act. As the FSB has indicated on various occasions, we are concerned that so-called "section 8(5) fees" are inconsistent with RDR objectives as their purpose is unclear and customer consent to the fee is not a requirement. Section 8(5) has accordingly been repealed by the Financial Services Laws General Amendment Act, 2013 although the repeal has not yet come into effect. The FSB view is that, although in the final RDR framework this fee will no longer be required due to the future availability of advice fees, risks related to current practices in respect of such fees need to be addressed in the interim.

(b) Next steps for Proposal UU

The intention is to give effect to the repeal of section 8(5) in the course of implementing the revised Regulations to the Short-term Insurance Act, as discussed elsewhere in this document. Further consultation will take place regarding the effective date of the section 8(5) repeal, together with consultation for an appropriate fee mechanism to replace the section 8(5) fee. Such a mechanism will be designed to ensure that any fees are agreed to by the customer, and that it is clear to the customer what services the adviser is providing to earn the fee. Strengthened disclosure standards will therefore also apply. This will be an interim mechanism, pending full implementation of the RDR proposals regarding advice fees and revised short-term insurance commissions (Proposals JJ, KK, LL and UU).

4.10. Proposal VV: Conditions for short-term insurance cover cancellations

<u>*Original Proposal VV:*</u>

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.*

(a) Updated FSB view

Some commentators have highlighted practical difficulties in obtaining consent from all policyholders in cases where an entire "book" of policies is cancelled by an adviser and replacement policies entered into with another insurer – a practice that is most prevalent in the short-term insurance sector. The FSB feels strongly however that the customer's right to make an informed decision regarding such changes must outweigh any practical inconvenience. We also point out that customer consent to the replacement of cover is already required by the FAIS General Code, regardless of whether or not the replacement relates to an entire "book" of policies. Advisers who undertake such replacements without the required customer consent are therefore already exposing themselves to regulatory action.

Accordingly, the FSB intends to proceed with Proposal VV as part of Phase 1 of RDR, subject to the following modifications of the Proposal:

(i) In the case of cover cancellations by an intermediary, it will be clarified - for avoidance of doubt - that each customer's <u>explicit</u> consent (as opposed to tacit, assumed or "negative" consent) to any cover replacement must be obtained. For personal lines business, appropriate amendments to the FAIS Act will be considered to ensure that, where the adviser holds a discretionary mandate in relation to the policy/ies concerned, any cover cancellations are indeed consistent with the mandate and customers are aware of transactions.

(ii) In the case of cover cancellations by the insurer, the proposal will be modified to provide that the original insurer must remain on risk for the shorter of (i) a period of 30 days after the date on which the original insurer receives proof that the customer is aware of the cancellation of the cover or (ii) the period until the original insurer receives proof that the customer has secured new cover.

(b) Next steps for Proposal VV

The FSB will consult on amendments to the following instruments to address Proposal VV and incorporate the modifications proposed in paragraph (a) above:

(i) Requirements in respect of cover cancellations and replacements by the intermediary will be included in the FAIS General Code of Conduct. The amendments will be added to other amendments relating to insurance policy replacements, as contemplated for Proposal OO.

(ii) Requirements in respect of cover cancellation by the insurer will be included in the revision of the PPRs for short-term insurance.

The consultation and implementation timetable will form part of the respective broader consultation processes for the FAIS General Code and the PPRs, discussed elsewhere in this document.

4.11. Proposal ZZ: Binder fees to multi-tied intermediaries to be capped

<u>*Original Proposal ZZ:*</u>

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.

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

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

(a) Updated FSB view

Proposal ZZ elicited extensive and divergent stakeholder comment, particularly from players in the short-term insurance sector. Views were divided as to whether or not caps should be applied. Most arguments against capping were based on concerns that a “one size fits all” cap is inflexible and will not cater for wide variations in the actual costs of binder services in different cases. Concerns were also raised that caps would result in all or nearly all binder arrangements defaulting to the maximum permissible fee.

However, both commentators for and against fee capping raised concerns that the cap percentages proposed in the RDR document were not adequately motivated – with some arguing that the proposed caps were unreasonably low and others arguing that they were too high.

Having considered all these arguments, the FSB remains of the view that the current principle based approach to setting binder fees – merely requiring fees to be “reasonably commensurate” with actual costs plus a return margin – has proven inadequate to address the significant conflicts of interest that arise when an adviser (non-mandated intermediary) also performs binder functions. The findings of our recent thematic review of binder arrangements, which will be published shortly, strongly reinforce this view.

The FSB has therefore concluded that the alternatives are either to disallow advisers from entering into binder agreements altogether, or to make these arrangements subject to prescribed fee caps. Although the former approach would be consistent with the overall RDR aim of eliminating conflicts of interest as far as possible, we accept that appropriately structured arrangements may offer efficiency benefits or access to specialisation - provided that the inherent conflicts of interest can be mitigated.

We therefore intend to proceed with the implementation of binder fee caps for financial advisers (i.e. non-mandated intermediaries, per the current binder regulations). It is however accepted that further technical work should be undertaken to assess the appropriateness of the caps proposed in the RDR document, and revise them if necessary. It should be noted however that at this stage the FSB remains of the view that the 2% cap proposed for the “enter into, vary or renew” binder function remains appropriate.

Consideration will also be given to allowing deviations from the prescribed fee cap on a case by case basis in special circumstances – for example for particular complex products or low premium business – but only in respect of product supplier agents, where the risk of conflict of interest is lower.

We have also refined our views on binder arrangements in the following respects:

(i) Based on our general supervisory experience and the findings of the recent thematic review of binder arrangements, we believe that conduct standards for binder arrangements require significant strengthening. We are particularly concerned about the inadequate level of ongoing oversight exercised by insurers over binder holders as well as the poor quality of data currently being accessed by insurers from binder holders. It is also evident from current market practices that fee generation remains the primary motivation for the provision of binder mandates to advisers, often at the expense of operational efficiencies, resulting in higher costs to customers.

(ii) The FSB is questioning the value of allowing insurers to enter into binder agreements with advisers (as opposed to underwriting managers) for purposes other than the “enter into, vary or renew” and “claims settlement” functions.

(iii) The FSB is also questioning the appropriateness of short-term insurers entering into binder agreements with advisers (as opposed to underwriting managers) for commercial lines business generally. The arguments for efficiency and the ease and speed of service that apply in the personal lines space, are typically not applicable to commercial lines business. We are also concerned that in view of the specialist skills required for most commercial covers, outsourcing core underwriting and / or benefit design to potentially conflicted financial advisers, introduces unnecessary underwriting and reinsurance risk. Given the varied scope of commercial lines offerings, it is also difficult to determine appropriate binder fee caps to mitigate the inherent conflict of interest risks that arise. We are therefore considering a proposal to disallow binder agreements with advisers for commercial lines business, in the absence of compelling reasons why such binder agreements would be in the best interest of policyholders. Before finalising this proposal, we will however carry out further analysis of the type and number of commercial lines binder agreements in place with advisers (non-mandated intermediaries) and consult further on the potential impact of such a prohibition.

(b) Next steps for Proposal ZZ

(i) The FSB will, before the end of 2015, publish the findings of the binder thematic review that the Insurance department carried out in 2014. The review will provide an indication of the FSB’s enhanced supervisory expectations of steps to be taken by insurers to mitigate conduct risks identified during the review and during ongoing supervision in respect of binder arrangements. These findings will in turn inform strengthened conduct standards for binders (and also for other outsourcing arrangements – see discussion of Proposals Z and AA above).

(ii) Together with the findings of the binder thematic review, the FSB will issue a follow up information request on binder fees to assist with the further technical work on assessing appropriate binder fee caps as contemplated in the proposal.

(iii) As part of the broader consultation on the Regulations under the Long-term and Short-term Insurance Acts discussed above, the FSB will include consultation on changes to the binder Regulations, intended to introduce the strengthened conduct standards mentioned above. Consultation on these measures will take place during the first half of 2016. Although implementation of the revised set of Regulations is expected to take place in June 2016 , implementation of some aspects of the binder regulations – such as enhanced system requirements - may be deferred to a later date in order to allow a reasonable period to restructure current arrangements.

(iv) In parallel with the consultation process described under (ii), consultation and technical work on the appropriate binder fee caps will continue, with a view to implementing these in terms of the revised binder regulations.

(v) Also in parallel with the above consultation process, specific consultation will take place regarding the prohibition of insurers entering into commercial lines binder agreements with advisers.

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

<u>*Original Proposal AAA:*</u>

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.

(a) Updated FSB view

The FSB intends to proceed with Proposal AAA, as an RDR Phase 1 measure. In the longer term, the revised product segmentation under the Insurance Act will clarify the types of group structures that may be used in the credit life market. Implementation of this Proposal in the interim will however ensure that the remuneration model for existing credit life agreements is better aligned to the activity based RDR remuneration approach, by ensuring that remuneration for selling a product (commission) is clearly distinguished from remuneration for outsourced administration (outsourcing fees).

The effect will be that commission for all existing credit life group schemes will be capped at 7.5% of each premium, regardless of whether administrative work is carried out or not. In line with the updated views on Proposals Z and AA outlined above, it follows that an adviser will only be able to earn remuneration in relation to credit life insurance policy administration if this forms part of a binder arrangement (subject to the applicable binder fee cap) or through an outsourcing arrangement (subject to the applicable outsourcing fee cap) if the adviser has the capability to effect "real time" updates on the insurer's system as required[31].

(b) Next steps for Proposal AAA

The FSB will, as part of the broader consultation on revised insurance laws Regulations referred to elsewhere in this document, consult on removing the specific 22.5% commission fee cap for credit life schemes "with administrative work". As mentioned above, consultation on these Regulations is planned for March 2016, and implementation expected in July 2016.

Insurers and advisers who currently have these 22.5% commission arrangements in place are urged to review their business models in preparation for this change and approach the FSB in regard to any concerns relating to the impact.

4.13. Proposal BBB: Outsourcing fees for issuing insurance policy documents

<u>Original Proposal BBB:</u>
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 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

31 See discussion of Proposals Z and AA.

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 is 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.

(a) Updated FSB view

The FSB has reconsidered the need for Proposal BBB, in line with our updated views on Proposals Z, AA and ZZ, covering outsourcing and binder arrangements more generally. We have concluded that there is no compelling reason why, except in the cases described below, a financial adviser is better positioned to issue policy documents than the insurer itself. On the contrary, it will typically be more efficient and less costly for the insurer to provide the policy document directly to the policyholder, rather than placing this administrative responsibility (and cost) on the adviser. The insurer is of course free to provide the adviser with a copy of the policy document and / or relevant policy summaries or schedules, for the adviser's own records.

Exceptions to the above, where it will be appropriate for the adviser to issue the policy document, are where:

- the adviser holds a binder to "enter into, vary or renew" policies; and
- where the insurer has outsourced policy administration to the adviser in the manner described under Proposals Z and AA above – i.e. where the adviser's and the insurer's IT systems are integrated so that the adviser effects "real time" changes on the insurer's system.

However, in both of the above scenarios, the issuing of the policy document is incidental to the binder or outsourcing activity concerned and should therefore not attract any fee over and above the (appropriately capped) binder or outsourcing fee concerned.

The FSB will therefore not proceed with Proposal BBB.

(b) Next steps for Proposal BBB

No next steps. The Proposal is being withdrawn.

5. Phase 1 proposals: Summary of actions and timelines

The tables in sections 5.1 and 5.2 summarise the main regulatory instruments and related consultation processes planned to implement the RDR Phase 1 proposals discussed in section 4, as well as some of the key related supervisory activities.

Key to the tables:

Q	= Calendar quarter (e.g. Q3 16 = July to September 2016)
🖂	= Estimated consultation period
✓	= Estimated implementation date
🖰	= Estimated period for supervisory activity
TBC	= Implementation date to be confirmed after consultation

5.1. Regulatory implementation of Phase 1 proposals

Regulatory Instrument	Purpose of the amendment	RDR Proposals	Q4 15	Q1 16	Q2 16	Q3[32] 16	Q4 16	Q1 17	Comments
FAIS General Code of Conduct	Amendments to the conflict of interest provisions to confirm representatives may not be appointed to more than one FSP for the same product category.	Y		⌧		✓			
	Strengthened requirements for product replacements, in particular RA transfers, S-T insurance cover cancellations and specific requirements and definitions for long-term risk policy replacements.	OO, QQ, VV		⌧	⌧				Implementation TBC
FAIS Fit and Proper requirements	Revised requirements for key individuals (KIs), in order to demonstrate that the KI has the necessary operational ability to carry out their responsibilities.	Y	⌧			✓			
Prudential Standards under the new Insurance Act	Outsourcing Directive withdrawn and its provisions incorporated into prudential standards issued under the appropriate Regulatory framework.	Z, AA		⌧				✓[33]	
Regulations and / or the PPRs under the Long-term Act (LTIA) and Short-term Insurance Act (STIA) Acts	Amendment to the LTIA definition of “representative” with regards to the services a representative may render as an intermediary in respect of another insurer’s products	V		⌧		✓			
	Strengthened conduct standards and systems requirements for outsourcing arrangements	Z, AA		⌧	⌧	✓	✓	✓	Implementation July 2016 onwards, depending on specific

32 Although the intention is to target July 2016 for implementation of most of the main regulatory instruments concerned, actual effective dates of specific provisions may be staggered between July and November 2016 where necessary to align with broader changes or where an implementation date later than July 2016 is reasonably required to make necessary changes. Where an implementation date is indicated as “TBC”, specific consultation on the implementation timeframe will take place. Also note that, although not fully detailed on this table, transition measures will be consulted on where necessary.

33 Note that, although the prudential standards to be introduced under the Insurance Act are only expected to take effect in January 2017, this does not preclude earlier changes to instruments within the current regulatory framework, such as changes to the Regulations under the Long-term and Short-term Insurance Acts,

Regulatory Instrument	Purpose of the amendment	RDR Proposals	Q4 15	Q1 16	Q2 16	Q3[32] 16	Q4 16	Q1 17	Comments
									transition provisions
	Requirements for handling of requests for customer information from an adviser with whom the insurer does not have an intermediary agreement.	F			⌧	✓			
	Requirements for insurers to monitor and take prescribed steps in respect of long-term risk policy replacements, including definition of “replacement” for these purposes	OO			⌧				Implementation TBC
	Amendments to ensure that commission basis and causal event charges for variable increases on legacy investment policies are aligned with those for new policies.	PP		⌧		✓			
	Requirements in respect of cover cancellation by S-T insurers, confirming how long insurer stays on risk.	VV			⌧	✓			
	Amendments to binder regulations to clarify types of binders advisers may enter into, strengthened conduct standards and binder caps.	ZZ		⌧		✓	✓	✓	Implementation July 2016 onwards, depending on specific transition provisions
	Removal of 22.5% commission cap for credit life group schemes with “administrative work.”	AAA		⌧		✓			
Repeal of s8(5) of the Short-term Insurance Act	Give effect to the repeal of section 8(5) as well as consultation on an appropriate fee mechanism to replace the s8(5) fee which mechanism will ensure customer consent as well strengthened disclosure standard.	UU		⌧					Implementation TBC
Equivalence of Reward directive / determination	Determination by the Registrar, indicating certain practices that the Registrar regards as not being substantially in accordance with the commission regulations, and thus not consistent with the principle of equivalence of reward.	RR		⌧ ✓					Immediate implementation, with appropriate transition provisions

5.2. Related supervisory activities

Supervisory activity	Purpose of the activity	RDR Proposals	Q4 15	Q1 16	Q2 16	Q3[34] 16	Q4 16	Q1 17	Comments
Conduct of Business statutory returns for Insurers	These returns, designed to provide a wide range of statistical conduct indicators, include reporting on both new business arising from replacements (i.e. reported by the new insurer) as well as policies terminated as a result of replacement (i.e. reporting by the original insurer).	OO	⌧	⌧					Implementation TBC
FAIS Conduct of Business statutory returns	These returns, designed to replace and enhance current FAIS Compliance Reports, will include (amongst a wide range of other information) replacement advice details and volumes.	OO		⌧	⌧				Implementation TBC
Insurance supervisory actions	Publication of binder thematic review, confirming supervisor's conduct expectations.		🖰						
	Information request on aspects of binder arrangements, including binder fees and binders entered into by L-T advisers and S-T personal lines and commercial lines advisers.			🖰					
	Technical work and consultation to inform caps on binder fees and outsourced policy administration fees			🖰	🖰				
	Review of tied adviser remuneration practices to inform final Equivalence of Reward standards, with notices to be issued by Registrar to entities not complying with Equivalence of Reward directive.			🖰 ✓	🖰 ✓	✓	✓	✓	The issuing of notices in cases of non-compliance will be an ongoing activity.

34 Although the intention is to target July 2016 for implementation of most of the main regulatory instruments concerned, actual effective dates of specific provisions may be staggered between July and November 2016 where necessary to align with broader changes or where an implementation date later than July 2016 is reasonably required to make necessary changes. Where an implementation date is indicated as "TBC", specific consultation on the implementation timeframe will take place. Also note that, although not fully detailed on this table, transition measures will be consulted on where necessary.

Supervisory activity	Purpose of the activity	RDR Proposals	Q4 15	Q1 16	Q2 16	Q3[34] 16	Q4 16	Q1 17	Comments
FAIS supervisory actions	Data analysis to determine the extent to which representatives and KIs currently operate on more than one FSP licence.			🖰					
	Information request requiring identified FSPs to provide further detail regarding the rationale for representatives and KIs operating on multiple FSP licenses.				🖰				
	Engagement with legal entities who hold more than one FSP licence with a view to licence consolidation.				🖰	🖰			

6. Comments welcome on this document

As explained in section 2, the purpose of this document is to provide an update of the FSB's current view and our planned next steps regarding the adviser categorisation model and the implementation of the so-called "Phase 1" RDR proposals. It is not intended to provide final FSB proposals on either of these matters.

In both cases, final proposals will be subject to the normal prescribed consultation processes for the applicable regulatory and legislative instruments that will be used to implement them. The FSB will also continue to engage with stakeholders through other appropriate processes as we continue our technical work and research to finalise a number of the proposals. This is therefore by no means the only or final opportunity to comment on these elements of the RDR framework.

However, the FSB welcomes comments on the preliminary information provided in this document from any interested persons. It would be appreciated if any comments or questions for clarification could be submitted by e-mail to FSB.RDRfeedback@fsb.co.za or by post to Ms Leanne Jackson, Head: Market Conduct Strategy, Financial Services Board, PO Box 35655, Menlo Park, 0102 by no later than **1 February 2016.**