



Treating Customers Fairly

General Status Update: Retail Distribution Review

A general update on the status of 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. This document provides a high level status update on the FSB's approach to implementing the RDR proposals, including process and planned next steps. It also summarises key stakeholder feedback received on the initial RDR proposals.

This update should be read together with the FSB's discussion document "Status Update: Retail Distribution Review Phase 1" which was published in November 2015.

December 2015

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:

- *Phase 1:* Changes 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. These Phase 1 proposals are expected to largely be implemented from July 2016 onwards¹.
- *Phase 2:* Changes to be incorporated into the FSR Act itself, through conduct standards made under the FSR Act or through amendments to other items of primary legislation (including existing sectoral laws which will remain in place during Phase 2). The implementation window for such changes is broadly between the effective date of relevant provisions of the FSR Act and the effective date of a future overarching market conduct Act (expected to be named the Conduct of Financial Institutions Act – or CoFI Act).
- *Phase 3:* Longer term structural changes to be implemented once the CoFI Act is in effect. This is currently expected to happen in early 2018. Typically, these will be changes which would be most pragmatic to implement once the harmonisation of existing sector-specific legislation under the CoFI Act, and the revised market conduct licensing framework for financial institutions, are in place.

¹ For further details of implementation dates and relevant regulatory instruments please refer to the RDR Phase 1 Status Update discussed later in this section.

It is however important to note that, in the event of the implementation of the FSR Act and / or the CoFI Act being materially later than expected, the FSB (or future Financial Sector Conduct Authority (FSCA)) may revise the implementation process. Particularly where we deem implementation of particular proposals necessary to address practices that pose a high risk of poor customer outcomes, we will seek to do so using the regulatory instruments available to us at the time.

The FSB published a discussion document titled *“Status Update: Retail Distribution Review Phase 1”* in November 2015 (“RDR Phase 1 Status Update”). This discussion document provided an update on the 14 RDR proposals which were identified for implementation in Phase 1 above, and also provided feedback on the FSB’s current thinking regarding an effective adviser categorisation model. This more general status update, covering the remaining RDR proposals, should therefore be considered together with the RDR Phase 1 Status Update.

A total of 88 commentators provided feedback on the RDR paper through the formal consultation process, with additional comments and perspectives provided by industry participants and from multiple other sources. During the 6-month period from April to September 2015, the FSB undertook a comprehensive review of all stakeholder feedback received. This work was 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.

This document provides a high level status update on the FSB’s approach to implementing the RDR proposals, including process and planned next steps. It also summarises key stakeholder feedback received on the initial RDR proposals. In all cases the proposed next steps will be subject to further specific consultation, as specific regulatory instruments are drafted to give effect to each proposal. In addition, wherever necessary, consultation processes will include consideration of reasonable transition measures to allow existing businesses and processes to adapt to the new requirements.

2. Status update on RDR proposals

The section of the document discusses the status of the FSB's work on the RDR proposals by grouping them into six themes, aligned to the six workstreams of the RDR project team:

- *Theme 1: Adviser categorisation.* This theme focusses on the adviser categorisation model and related proposals.
- *Theme 2: Investments.* This theme focusses on those RDR proposals impacting on the distribution of investment and savings products, including those offered through long-term insurance policies.
- *Theme 3: Long-term insurance risk.* This theme considers the impact of the RDR proposals on the distribution of long-term insurance policies that provide risk benefits.
- *Theme 4: Short-term insurance.* This theme focusses on those RDR proposals impacting on the distribution of short-term insurance policies.
- *Theme 5: Sales execution and other intermediary services.* This theme deals with those proposals relating to non-advice based distribution models, but including so-called "low advice" models.
- *Theme 6: Low income market.* The focus here is mainly on RDR Proposal TT relating to the development of a special dispensation for product distribution in the low income market. This FSB workstream is however also mandated to consider financial inclusion imperatives more broadly.

Some of the 55 RDR proposals are relevant to more than one of the above themes. Accordingly, in some cases more than one workstream deals with the same proposal, from the workstream's particular perspective. For example, RDR proposals relating to outsourcing to advisers will be relevant to a number of the above themes. In addition, a few of the RDR proposals are cross-cutting and do not fall squarely within any of the above themes but cut across all of them. These are discussed separately.

Note that the 14 proposals identified as RDR "Phase 1" proposals are not dealt with in this document. For details on the status of those proposals please refer to the RDR Phase 1 Status Update.

2.1. Theme 1: Adviser categorisation

This theme focusses on the adviser categorisation model initially set out in RDR Proposal K, together with a number of related proposals² regarding adviser categorisation. Although these proposals are **not** Phase 1 proposals, the FSB recognises that they require priority focus because any material changes to the adviser categorisation model will trigger consequential changes to a number of the other RDR proposals. For this reason we shared our updated thinking on adviser categorisation in the RDR Phase 1 Status Update.

In summary, the update confirmed that:

- The FSB has agreed to change or review some aspects of the initial categorisation proposal. In particular, we recognise that terminology used to describe adviser categories is vague and confusing – particularly the term “multi-tied”. We also agree that Proposal M, which would have required independent financial advisers to offer a minimum range of products and product suppliers, would have unintended consequences and will not be pursued in its current form. Instead, the extent of product supplier influence – tested mainly against the criteria listed in Proposal N – should be the main determinant of the status of advice.
- The FSB remains of the view that “tied” advice should be restricted to the products of a single product supplier or product supplier group, but possibly with some exceptions where the primary product supplier / group is not licensed to provide certain classes of business.
- The FSB is still considering whether the adviser categorisation model should comprise three tiers of advice (as per the initial proposed model), or be simplified to two tiers. We requested comment on a possible two-tier model that will distinguish between (a) tied advisers operating on the licence of a product supplier, and (b) advisers that operate on their own licence as sole proprietors or on the licence of an adviser firm that is not also a product supplier. The former could potentially be referred to as “registered product supplier agents” and the latter as “registered financial advisers”.
- In such a two-tier model, there would be no separate licence category for “independent” financial advisers, although an adviser or adviser firm would be permitted to use the term “independent” if additional limitations on product supplier influence were met. In

² Including but not limited to Proposals L to S and Proposals BB to DD.

addition, either category of adviser would be permitted to designate themselves as a “financial planner” if specific standards in this regard were met³.

- Regardless of whether a two-tier or three-tier categorisation is adopted, additional controls are required to address potential conflicts of interest where an adviser could be subject to different levels of influence from different product suppliers. Specific proposals to address these types of conflict are set out in the RDR Phase 1 Status Update.

2.1.1. Key stakeholder feedback and initial responses for Theme 1

Please refer to the RDR Phase 1 Status Update, which summarises the key issues raised by stakeholders in respect of the adviser categorisation model, and the FSB’s revised thinking in light of those inputs.

Three proposals falling under this theme that were not dealt with in the RDR Phase 1 Status Update are Proposal C: *Standards for “wholesale” product advice*; Proposal W: *Juristic representatives to be disallowed from providing financial advice* and Proposal X: *Standards for adviser firms*.

(a) “Wholesale” advice:

Stakeholder feedback regarding “wholesale” advice included general comment that the RDR, by its nature, focused mainly on “retail” distribution models and that further information was required on the extent to which the various proposals would apply to non-retail business models and customers. The FSB accepts that more discussion is required regarding the implications of the RDR proposals for non-retail models. This needs to be considered as part of the broader discussion on the extent to which the future Twin Peaks market conduct regulatory framework will distinguish between retail and non-retail customer segments and how these segments will be defined.

At this stage, we would like to clarify that the primary focus of the current RDR proposal is to ensure that the end customer’s interests are adequately taken into account in models where advice is not provided directly to the end customer but rather to an intermediate entity (such as an employer or retirement fund) purchasing a financial product to provide

³ See RDR Proposals T, U and II.

benefits for the end customer (such as the employee or fund member). It is in this relatively narrow sense that the term “wholesale” is used in the RDR. Standards in relation to wholesale market conduct issues affecting the efficiency and integrity of financial markets more broadly, will be considered in the development of the overall market conduct regulatory framework, but are not specifically addressed in the RDR. Some aspects of this RDR proposal also link to the broader discussions underway on retirement fund reform.

(b) Juristic representatives:

Commentators on the proposal to disallow juristic representatives from providing financial advice focused mainly on submitting scenarios where the juristic representative model was operationally justified and should be permitted. These included group structures where a single juristic entity houses the financial adviser operations in relation to multiple product suppliers within a financial conglomerate. As has been explained in the RDR Phase 1 Status Update, the FSB is considering permitting juristic entities to operate as tied advisers (product supplier agents) within a group, subject to branding and other controls. The FSB remains concerned that the complexity of other juristic representative models, outside the tied adviser model, is unwarranted but will consider further specific motivations in this regard.

(c) Other proposals related to adviser categorisation:

As indicated in the RDR Phase 1 Status Update, the FSB is considering a revised two-tier adviser categorisation model – in other words a reframing of Proposal K (“Types of adviser defined”). Our thinking will be informed by any feedback we receive on this proposed model, which is due by 1 February 2016. Once this feedback has been reviewed, further consultation with the industry reference group⁴ on this workstream will be set up to debate views on the model.

The following RDR proposals are closely related to the adviser categorisation model, so work on these proposals will be combined with the work on Proposal K⁵:

⁴ Industry reference groups for each of the six RDR theme workstreams have been set up as sub-structures under the Market Conduct Regulatory Framework Steering Committee (MCRF), which is a multi-stakeholder consultation forum established by the FSB. The reference groups comprise representatives of various financial sector industry and professional bodies who provided input on the initial RDR discussion document.

⁵ Note that, as indicated in the RDR Phase 1 Status Update, Proposal M will fall away. Proposal L (*An IFA may advise on certain products on a multi-tied basis*) was related to Proposal M, and will no longer be required.

- *Proposal N*: Criteria for an IFA to be free of product supplier influence (dealt with in the RDR Phase 1 Status Update).
- *Proposals P, R and T*: Criteria for different types of financial advisers.
- *Proposals O, Q, S and U*: Status disclosures to be made by different types of advisers.
- *Proposal V*: Insurer tied advisers may no longer provide advice or services in relation to another insurer's products (dealt with in the RDR Phase 1 Status Update).
- *Proposal X*: Standards for adviser firms.
- *Proposal Y*: Advisers may not act as representatives of more than one adviser firm (dealt with in the RDR Phase 1 Status Update).
- *Proposals BB, CC and DD*: Proposals dealing with product supplier responsibility for different types of advisers (dealt with in the RDR Phase 1 Status Update).
- *Proposal FF*: General product supplier responsibilities in relation to receiving or providing customer related data (dealt with in the RDR Phase 1 Status Update).

The final adviser categorisation model will also be informed by the review of the FAIS competency framework that is currently underway. Industry consultation on this framework is in progress, and the FSB will issue a proposal for public consultation by the end of the first quarter of 2016. The objective of this review is to build on the existing FAIS "fit and proper" competency requirements by establishing an effective and proportionate regulatory framework to ensure advisers and other intermediaries have the right levels of product related knowledge, meet appropriate standards of professionalism and undergo continuous professional development where necessary. The development of appropriate standards for different levels of advice⁶ – including standards for financial planners and standards for advisers in so-called "low advice" models⁷ – will also be dealt with through this work.

2.1.2. Implementation phases for Theme 1

(a) Phase 1

As discussed in the RDR Phase 1 Status Update, the following proposals fall within Phase 1 and next steps for these proposals are set out in that document:

- *Proposal V*: Insurer tied advisers may no longer provide advice or services in relation to another insurer's products.
- *Proposal Y*: Advisers may not act as representatives of more than one adviser firm.

⁶ See RDR proposal A

⁷ See RDR proposals T, U and II and proposal B, and the discussion on Theme 5 below.

- *Proposal FF*: General product supplier responsibilities in relation to receiving or providing customer related data.

(b) Phase 2

As previously communicated, the FSB shares the view of a number of commentators that the extent of product supplier responsibility for customer outcomes should be aligned to the extent of product supplier influence over advice. It follows that proposals BB, CC and DD dealing with product supplier responsibility for different types of advice need to take the final adviser categorisation model into account. The FSB is however concerned that, even in the current regulatory framework, product suppliers do not take sufficient responsibility for customer outcomes arising from their choice of distribution channel. This point has been made in various forums in the context of our Treating Customers Fairly (TCF) expectations, and various product suppliers have asked us to provide greater clarity on what we expect of them in this regard. We therefore intend to introduce elements of these product supplier responsibility proposals in Phase 2, prior to full implementation of the new adviser categorisation model. In particular, product supplier responsibilities in relation to ensuring that any adviser who provides advice on their products has adequate product specific knowledge, will be introduced together with the enhanced FAIS competency framework (see above).

It is also expected that implementation of the enhanced FAIS competency framework will start during the Phase 2 period. This means that aspects of the proposals relating to levels of advice (financial planning, product advice, “low advice”, etc.) will be introduced during this phase.

The proposal to disallow juristic representatives from providing financial advice (Proposal W) is also not a change that the FSB believes needs to be, or should be, deferred until Phase 3. As pointed out in the initial RDR discussion document, the FSB believes that these juristic representative models pose significant risk of customer confusion and conflicted advice. We therefore propose to implement this change in Phase 2, subject to possible motivated exceptions discussed above. As part of the development of the FAIS competency framework, we will also consider whether the use of juristic representatives is justified in certain types of “low advice” distribution models and / or in relation to certain types of products.

Lastly, standards to improve the protection of end customers in “wholesale” financial advice models, as contemplated in Proposal C, will also be progressed in this phase.

In summary, the following RDR proposals will be implemented during Phase 2:

- *Proposal A*: Forms of advice defined, with related conduct standards (insofar as this will be addressed through the enhanced FAIS competency framework).
- *Proposal C*: Standards for “wholesale” product advice.
- *Proposals T and U*: Criteria for financial planners and related status disclosures (to be addressed through the FAIS competency model review process).
- *Proposal W*: Juristic representatives to be disallowed from providing financial advice.
- *Proposals BB, CC and DD*: Proposals dealing with product supplier responsibility for different types of advisers (subject to further refinement in Phase 3).

(c) Phase 3

The final adviser categorisation model entails material changes to the current FAIS licensing framework. It therefore makes sense to implement this change in Phase 3, together with the introduction of a new market conduct licensing framework for financial institutions more broadly under the CoFI Act. The intention however is to finalise the framework proposals well in advance of the commencement of the CoFI Act, to allow sufficient time for any necessary changes to business models.

Standards for adviser firms, governing the relationships between adviser firms and their individual advisers, and related remuneration arrangements (Proposals X and SS) will be developed together with the final adviser categorisation model and final adviser remuneration related proposals.

Proposals that will be addressed in Phase 3 are therefore⁸:

- *Proposal A*: Forms of advice defined, with related conduct standards (to the extent not covered in Phase 2 through the enhanced FAIS competency model).
- *Proposal K*: Types of adviser defined.
- *Proposal N, P and R*: Criteria for IFAs to be free of product supplier influence and criteria for tied and multi-tied advisers.
- *Proposals O, Q and S*: Status disclosures to be made by different types of advisers.
- *Proposal X*: Standards for adviser firms.

⁸ Note that the language used in many of these Proposals is linked to the original three-tier adviser categorisation (tied, multi-tied and IFA) and will need to be updated if this is changed.

- *Proposals BB, CC and DD:* Proposals dealing with product supplier responsibility for different types advisers (any necessary refinement of requirements implemented in Phase 2).

2.2. Theme 2: Investments

This theme focusses on those RDR proposals impacting on the distribution of investment and savings products, including those offered through long-term insurance policies – whether structured as lump sum investments, recurring contribution products, or income generating annuity products⁹. This includes proposals relating to adviser remuneration in relation to these products, proposals relating to investment platform administration and remuneration, and proposals relating to outsourcing of investment management to advisers. The theme also covers proposals relating to improving customer outcomes on certain “legacy” insurance investment products and related remuneration practices.

2.2.1. Key stakeholder feedback and initial responses for Theme 2

(a) Investment platforms:

Where investment platform administration is concerned, commentators suggested that the scope of the activity concerned be more clearly defined. Suggestions were made that frameworks for different types of administration activities over and above the activities of administrative FSPs (LISPs) as defined in FAIS – for example certain pension fund administration and insurance administration models – should be better aligned. The FSB agrees that it would be helpful to ensure consistency of general standards for administration services, but points out that the “bulking” activities of administrative FSPs require specific focus.

It was also highlighted that clarity is needed regarding the distinction between system-based tools that generate possible investment options for customers, and the actual provision of advice. The FSB agrees and will consider this as part of our work on developing standards for non-advice execution only sales and so-called “low advice” distribution models (see the discussion of Theme 5 later in this document).

There was general support for the proposal that investment platform administration services should be remunerated only through a platform administration fee that is

⁹ The FSB has noted that some stakeholders see the term “investments” as referring only to lump sum / single contribution products, while “savings” refers to recurring or regular contribution products. We confirm that the term “investment” as used in the RDR and (unless clear from the context or specifically stated otherwise) in this update document includes both types of product.

disclosed, agreed to and paid for by the customer, with rebates and other payments from product suppliers or investment managers to LISPs being prohibited – in other words, a shift to a “clean pricing” model (Proposal YY). One commentator however felt that platform fees should be carried by the “seller” of the investment offerings (i.e. the funds whose offerings are placed on the platform) as opposed to the “buyer” (customer). Some views were expressed that, provided rebates are passed on to customers (as currently required by FAIS), they are in fact beneficial to customers. Although the FSB agrees that such rebate structures may not have a direct detrimental financial impact on customers, we remain of the opinion that a “clean pricing” approach will improve customer understanding and that greater transparency and comparability of charges in a “clean pricing” model will promote more competitive pricing.

Some concerns were raised that it is not feasible for a LISP to offer all available funds on its platform. The FSB takes this opportunity to point out that we did not suggest this in the original RDR discussion document. Instead, the RDR proposed that featuring specific funds more prominently than others on the platform menu should be prohibited – in other words, those funds that are offered on the platform should enjoy equal prominence¹⁰.

(b) Outsourcing investment management to financial advisers:

The proposed prohibition¹¹ on a collective investment scheme manager outsourcing investment management to “authorised agents” (as defined in the Collective Investment Schemes Control Act) or intermediaries that are also financial advisers, attracted extensive comment. A number of commentators argued that this effective abolition of so-called “white label” funds would have negative consequences for both advisers and customers. Arguments in favour of retaining “white labeling” included the fact that this model facilitates market entry for potential new investment managers (as a form of “incubator”) and also that this is a mechanism for offering customers “model portfolios” through which they are able to access risk-profiled, customised investment options that pose a less bewildering choice than selecting from the full range of funds available on the market.

The FSB confirms that it is not the intention to disallow outsourced investment management for purposes of operating so-called “incubator” funds, as currently permitted. We do however remain very concerned that there is an inherent conflict of interest in

¹⁰ See RDR page 60.

¹¹ Included in Proposal Z.

allowing a financial adviser to recommend funds to a customer (and earn related advice fees) while also being remunerated by the investment manager concerned for outsourced investment management on those same funds. We are also concerned that, in a number of cases, the advisers in these models are not necessarily competent to carry out actual investment management services and are therefore potentially being rewarded for services without adding meaningful value to customer outcomes.

Some commentators pointed out however that an outright prohibition on advisers performing outsourced investment management was not consistent with the approach proposed in RDR for other outsourced administration services. For example, in the case of outsourced insurance administration, RDR recognises that such services may be carried out by financial advisers subject to specific controls. Others argued that there should be no objection to permitting such services to be outsourced to advisers on the understanding that this could mean classifying the adviser concerned as a “tied” adviser. The FSB agrees that these arguments warrant consideration.

Decisions on the final approach for Proposal Z, insofar as it relates to outsourcing of investment management to financial advisers, also needs to take into account the final adviser categorisation model. For example, the question whether a financial adviser should be permitted to provide such services on a “tied” basis and, if so, whether additional conflict of interest controls are required, needs debate. The question arises whether, in such outsourcing scenarios, the investment managers concerned should be regarded as equivalent to product suppliers for these purposes.

Related to this, the FSB has noted that a review of the role of “Category II” FAIS licensed intermediaries is required. Currently, the scope of this category is wide, including both fully fledged investment management firms, but also intermediaries whose main function is to provide FAIS “Category I” product advice but who also hold different forms of (sometimes very limited) discretionary mandates from customers. In many cases, fully fledged Category II investment management firms also hold Category I licences “in case” their activities could be construed as constituting advice. This gives rise to distribution models comprising potentially confusing “layers” of multiple Category I and Category II intermediaries, with increased risks of conflicts of interest and unwarranted layers of costs.

(c) Prohibition of product supplier remuneration on investment products:

Another key proposal under Theme 2 that attracted substantial comment was Proposal MM – the prohibition of product supplier remuneration for selling and servicing investment products, and the proposal that intermediary remuneration for such services be restricted solely to advice fees payable by the customer (but able to be facilitated by product suppliers). A number of commentators voiced strong support for this proposal – in particular insofar as it relates to lump sum investment products. Views regarding recurring contribution investment products (described by some as “savings” products) were mixed, with some arguing that recurring contribution products should be excluded from the proposal and remain eligible for product supplier commissions. Negative responses to the proposal centred mainly around two concerns: (i) That it would have a negative impact on adviser sustainability due to reduced cash flows and create a barrier to entry for new advisers; and (ii) That it would lead to an “advice gap” for lower and middle income consumers who were either unwilling to pay advice fees or where it would not be profitable for advisers to serve them in view of the relatively small investment amounts concerned. Commentators also correctly pointed out that the full impact of the proposal can only be assessed once there is greater clarity regarding Proposal TT – the proposed special remuneration dispensation for the low income market (see further the discussion of Theme 6 later in this document).

The FSB remains of the opinion that Proposal MM should apply to both lump sum and recurring contribution investments, subject to the low income market dispensation, in order to ensure a level remuneration playing field between products sold through long-term insurance policies – where commission has been the traditional form of remuneration – and other investment products. We do however propose that these changes be effected in a phased manner (see below).

Consultation with industry reference groups on the proposals under this theme will continue during the first half of 2016, with a focus on the feedback areas summarised above. The FSB recognises that full implementation of Proposal MM (the prohibition of product supplier commissions for advice on investment products) needs to coincide with implementation of Proposals TT (the low income market dispensation) and Proposals JJ, KK and LL (related to standards for advice fees).

2.2.2. Implementation phases for Theme 2

(a) Phase 1

The RDR Phase 1 Status Update provides details regarding implementation of Proposals PP and QQ, which address certain “legacy” practices in relation to investment products. These include resolving commission regulation anomalies in relation to variable premium increases on investment policies sold by long-term insurers, and conflicted remuneration on retirement annuity transfers.

Engagement with the long-term insurance industry in relation to broader measures to reduce termination charges on legacy policies will continue in Phase 1. Implementation of such measures will be phased in to appropriately align with the stepped decline in maximum termination charges that will apply to new investment policies (see below), with due regard to both the interests of existing customers and the potential financial impact on insurers.

(b) Phase 2

Implementation of proposals in relation to investment platform administration and related platform remuneration, will be addressed in this phase (Proposals G and YY).

Phase 2 will also include the prohibition of outsourcing of investment management functions to financial advisers, with possible exceptions where warranted and where potential conflicts can be acceptably mitigated.

Consideration will also be given to introducing a prohibition of product supplier commissions for lump sum investment products, including annuity products¹², during Phase 2. The FSB considers that the possible negative impacts of disallowing commissions – such as the cash flow impacts for advisers and the potential for an “advice gap” for certain customers – are less likely to materialise for these products than for recurring contribution savings products. We note in this regard that a considerable number of lump sum investments are being placed in collective investment scheme based products outside long-term insurance wrappers, and that advisers in these cases are therefore already typically remunerated through advice fees rather than commissions. Also, the dependency on implementation of Proposal TT (low income market dispensation) is lower in respect of lump sum investments as lump sum long-term insurance investment policies are not

¹² The FSB has however noted that prohibiting commission on conventional life annuities (if they are classified as investment products) may have unintended consequences. Ongoing advice fees will be difficult to justify, discouraging recommendation of these products. On the other hand, we need to avoid the risk of undue bias in favour of these products if they remain eligible for product supplier commissions. The position will be reconsidered to seek a level playing field between these alternatives.

common in this market segment¹³. Also, both new and existing advisers operating in the low income market are relatively less dependent on commissions for lump sum insurance investment sales as a source of cash flow.

Prohibiting commissions on lump sum investments will mean that standards in relation to advice fees and the requirement for product suppliers to facilitate advice fees (Proposals JJ, KK and LL) will also need to be implemented in Phase 2, in relation to lump sum investment products – recognising that lead times will be required for product suppliers to effect any necessary system changes¹⁴.

In addition, consideration will be given to reducing the maximum causal event charges for new recurring contribution policies sold during this phase, pending further reduction once commissions on such policies are fully prohibited in Phase 3. This is to ensure that the decision to defer the prohibition of recurring contribution policy commissions to Phase 3 does not unduly perpetuate the sales of new policies at current causal event charge levels.

(c) Phase 3

Extension of the prohibition of product supplier remuneration to recurring contribution investment products, will take place in Phase 3. Implementation will be aligned with implementation of the proposed special remuneration dispensation for the low income market. Further reduction in causal event charges will also need to coincide with the finalisation of the remuneration model for recurring contribution products.

¹³ Further consideration will however be given as to whether the low income market dispensation discussed in Theme 6 below should specifically accommodate small lump sum investments. The commission dispensation for lump sum tax free savings products will also require discussion.

¹⁴ We are however of the view that systems changes required to facilitate advice fees on lump sum investment products are likely to be less complex than for recurring contribution products.

2.3. Theme 3: Long-term insurance risk

This theme considers the impact of the RDR proposals on the distribution of long-term insurance policies that provide risk benefits such as benefits payable on death, disability or health events. The theme covers proposals relating to adviser remuneration in relation to these products generally, as well as specific proposals relating to policy replacements, certain credit life policies and the equivalence of reward between tied insurance advisers and other advisers. It also deals with proposals on outsourcing arrangements between advisers and long-term insurers.

2.3.1. Key stakeholder feedback and initial responses for Theme 3

(a) Ongoing product servicing:

In response to Proposal E, relating to standards for ongoing product servicing, the majority of commentators felt it would be important to identify the particular types of post-sale servicing activities envisaged. There was a general concern that, given the nature of long-term risk policies, post-sale servicing transactions are usually infrequent and unpredictable and that it would therefore be difficult to set clear standards in this regard. The point was also made that the extent of ongoing servicing required may differ per product type and for different distribution models. For example, in the case of products sold on a non-advice “single need” basis – such as credit life, travel or cell phone insurance – commentators argued that there is little need for ongoing post-sale service.

(b) Mix of up-front commission and ongoing service fees:

Views on the proposal that remuneration for selling and servicing risk life products would be a mix of up-front commission and as-and-when service fees (Proposal NN), were mixed. Although a number of commentators accepted the concept in principle, the concerns raised in relation to Proposal E were relevant here too. Concerns were raised that it was unclear what particular ongoing services advisers would be required to provide to be eligible for the as-and-when service fees. Insurers in turn raised concerns that it was unclear what was expected from them in relation to monitoring such ongoing service.

As noted in the RDR document itself, the FSB recognises that further consultation will be required on this point. This will include a discussion on whether it is correct to characterise

the as-and-when remuneration component as a payment for ongoing service, or whether it should instead be regarded as a deferred payment of the commission (in other words deferred remuneration for selling the policy, as opposed to for ongoing service). The FSB recognises that it would be simpler to regard the as-and-when component as deferred commission, and that it will be difficult to prescribe particular types of ongoing service, but we are concerned that this approach would mean that advisers who provide no ongoing service at all would be entitled to the same as-and-when remuneration as those who do provide such service. This result would not be consistent with the activity-based remuneration framework envisaged by the RDR. We would therefore like to continue exploring an appropriate link between the entitlement to as-and-when remuneration and at least some degree of ongoing service.

We also noted some confusion in the comments between the proposals relating to remuneration for ongoing servicing (payable by the insurer and built into the premium charged to the customer), as opposed to remuneration for ongoing advice (payable by the customer, although it could be facilitated by the insurer) and recognise that clarification is needed.

The main objections to the proposed shift from fully to only partially up-front remuneration for life risk products centred around negative impacts on adviser cash flow, linked to barriers to entry for new advisers. Most commentators requested that, if such an approach is adopted, it should be phased in over time to minimise these impacts, and that exceptions should be considered for new entrants. Various phasing-in permutations were put forward. There was however strong support for the fact that at least some up-front commission is proposed to be retained, although there were minority views that all commission on life risk policies should be payable on an as-and-when basis. A smaller minority argued that commission on these products should be prohibited, in line with the proposal for investment products.

The FSB intends to proceed with the implementation of a partially up-front remuneration model for these products, but in a phased manner (see paragraph 2.3.2 below).

A number of concerns were also raised that customers would not be willing to pay advice fees in respect of risk products and that, if the overall level of sales commission on these products was reduced as proposed, advisers would be substantially worse off as they would not be able to make up the difference in earnings from advice fees. Commentators

recognised however that the potential impact could only be assessed once more detail on the proposed new commission caps becomes available.

A number of practical, technical concerns were raised in response to the proposal that the up-front commission component must be payable at the start of the policy, not split between the first and second year.

Consultation in the course of 2016 for this theme will focus largely on technical testing of the impacts of different commission cap levels on different levels and types of adviser sales activity and different product combinations, including potential phasing in of new caps. A number of insurers have already undertaken initial impact testing in relation to their adviser channels, based on preliminary assumptions. The Actuarial Society of South Africa has also offered support in this regard. The FSB will work with these insurers and associations to take this testing further.

(c) Premium collection:

Specific comments regarding proposed standards in relation to premium collection (Proposal F) are discussed under Theme 4 below on short-term insurance, as this was the focus of most feedback on this proposal. Some of the feedback was however also relevant to the life insurance risk space.

2.3.2. Implementation phases for Theme 3

(a) Phase 1

As discussed in the RDR Phase 1 Status Update, the following proposals fall within Phase 1 and next steps for these proposals are set out in that document:

- *Proposals J¹⁵, Z and AA:* Proposals relating to standards for outsourced services and restricted outsourcing to financial advisers.
- *Proposal OO:* Product supplier commission prohibited on replacement life risk policies (see also Phase 2 below).
- *Proposal RR:* Equivalence of reward to be reviewed (see also Phase 3 below).
- *Proposal ZZ:* Binder fees payable for multi-tied intermediaries to be capped¹⁶.

¹⁵ Although not explicitly identified as a Phase 1 proposal, Proposal J is closely linked with Proposals Z and AA.

¹⁶ See detail under Theme 4 below on short-term insurance.

- *Proposal AAA*: Commission cap for credit life insurance schemes with “administrative work” to be removed.

(b) Phase 2

As noted in the RDR Phase 1 Status Update, the FSB recognises that the prohibition of commission on replacement policies cannot be implemented until such time as standards relating to advice fees are in place. Interim controls to mitigate the risks of inappropriate incentive driven replacements will therefore be introduced in Phase 1. We will however consider the introduction of remuneration based interventions during Phase 2, coupled with provision for advice fees in relation to replacement advice.

The FSB also intends to implement Proposal F, restricting premium collection to qualifying intermediaries, in Phase 2¹⁷.

(c) Phase 3

Implementation of the future commission levels for life risk policies – including a combination of up-front and on-going remuneration – will commence in this Phase. It is likely to be phased in over a period of two to three years thereafter, subject to the outcome of technical impact testing. For example, the maximum proportion of up-front remuneration in the first year of implementation may be higher than 50% of the total, reducing to 50% over a two to three year phasing-in period. The final commission model will also reflect the outcome of consultations regarding how best, if at all, to distinguish between remuneration for selling the policy and remuneration for on-going servicing.

Full implementation of equivalence of reward standards, including confirmation of the extent to which the principle of equivalence of reward is to be applied at individual adviser level, will also occur in Phase 3. Consultation will inform possible exceptions to accommodate new advisers and / or advisers operating in the low income market, where the imposition of strict equivalence standards at individual level may not be sustainable or could pose barriers to adviser entry and inhibit customers’ access to advice.

¹⁷ See further discussion on Proposal F under Theme 4 relating to short-term insurance. Also note that the FSB intends to address current inconsistencies between premium collection requirements in the Long-term Insurance and Short-term Insurance Acts.

2.4. Theme 4: Short-term insurance

This theme focusses on those RDR proposals impacting on the distribution of short-term insurance policies. The theme covers proposals relating to adviser remuneration in relation to these products. It also deals with proposals on outsourcing arrangements between advisers and short-term insurers, including specific proposals relating to insurance premium collection, issuing of policy documents and binder agreements. Note that although the proposals on binder agreements are dealt with under this theme because they are most common in the short-term insurance environment, these proposals are also relevant in the long-term insurance space. The theme also covers proposals in respect of short-term insurance cover cancellations.

2.4.1. Key stakeholder feedback and initial responses for Theme 4

(a) Ongoing product servicing:

In response to Proposal E, relating to standards for ongoing product servicing, similar concerns were raised by short-term insurance stakeholders to those summarised above in Theme 3 relating to long-term insurance. As was the case for the long-term insurance sector, commentators highlighted that it would be important to identify the particular types of post-sale servicing activities envisaged. Although it was generally recognised that post-sale servicing interactions are more frequent for short-term policies than for long-term policies, clarity was still requested on the regulator's expectations as to which types of post-sale services would entitle an adviser to ongoing service fees.

(b) Short-term insurance remuneration model:

Next steps for Proposal UU, namely the proposed remuneration model for selling and servicing short-term insurance policies, were largely discussed in the RDR Phase 1 Status Update, focusing on the repeal and replacement of the current "section 8(5) fee" permitted by the Short-term Insurance Act. In addition, further technical work will take place in the course of 2016 to test the impacts of different commission cap levels for different levels and types of adviser sales activity and different product combinations.

As pointed out in the RDR Phase 1 Status Update, this consultation will include discussion on whether the remuneration payable by short-term insurers in respect of post-sale

servicing, and the remuneration payable by them for the actual product sale (both payable as-and-when premiums are received) should be subject to separate standards and caps, or whether they should both be addressed through a single cap on commission. We have mentioned in the RDR Phase 1 Status Update however that, despite the simplicity and ease of implementing a single commission cap, this approach does not enable appropriate reward for advisers who provide ongoing services as opposed to those who do not. As for the long-term insurance remuneration model, we would therefore like to pursue an appropriate link between the entitlement to as-and-when remuneration and at least some degree of ongoing service.

(c) Premium collection:

Short-term insurance commentators expressed mixed views on the proposal that the outsourcing of premium collection should be limited to qualifying intermediaries (Proposal F). Some commentators proposed that premium collection by financial advisers should be prohibited completely, while others felt that this was a useful service and that sufficient safeguards were in place to mitigate risks of misconduct. A number of commentators proposed that premium collection should be carved out of the scope of “intermediary services” (as currently defined in the FAIS Act) and instead be regarded as an outsourced service on behalf of the insurer for RDR purposes. The FSB is considering the implications of this approach as part of the broader review of the RDR proposals relating to outsourcing, which we discussed in the RDR Phase 1 Status Update. It was also pointed out that premium collection may be necessary in the case of non-traditional bundled products such as travel insurance or credit insurance, where the premium is collected together with payment for the primary transaction.

The FSB intends to proceed with Proposal F regarding standards for premium collection, and consultation with the industry reference groups for both long-term risk and short-term insurance will take place regarding who should be a “qualifying intermediary” and the standards for such intermediaries. Consultation will include discussion on the circumstances in which intermediaries in so-called non-traditional insurance markets could be permitted to collect insurance premiums.

(d) RDR application to commercial lines business:

A general concern raised was that the RDR discussion document is not clear on the extent to which the various proposals will apply to commercial lines business. This point is well

made and the FSB will engage with the short-term insurance industry reference group to consider the extent to which the various RDR proposals are relevant to, and impact on, the distribution of commercial lines policies. In particular, note that we indicated in the RDR Phase 1 Status Update that we are considering the extent to which commercial lines advisers should be permitted to enter into binder arrangements.

2.4.2. Implementation phases for Theme 4

(a) Phase 1

As discussed in the RDR Phase 1 Status Update, the following proposals relevant to this theme fall within Phase 1 and next steps for these proposals are set out in that document:

- *Proposals J¹⁸, Z and AA*: Proposals relating to standards for outsourced services and restricted outsourcing to financial advisers.
- *Proposal UU*: Remuneration for selling and servicing short-term insurance policies (to the extent dealt with in the RDR Phase 1 Status Update in relation to the removal of the “section 8(5) fee”).
- *Proposal VV*: Conditions for short-term insurance cover cancellations.
- *Proposal ZZ*: Binder fees payable for multi-tied intermediaries to be capped.
- *Proposal BBB*: Outsourcing fees for issuing insurance policy documents (the RDR Phase 1 Status Update advised that the FSB does not intend to proceed with this proposal).

(b) Phase 2

Implementation of the future commission levels for short-term insurance policies will take place in this Phase. Consideration will be given to phasing the expected reduction of commission caps in over a period of two to three years, subject to the outcome of technical impact testing. The final commission model will also reflect the outcome of consultations regarding how best, if at all, to distinguish between remuneration for selling the policy and remuneration for on-going servicing.

It follows that standards in relation to advice fees and the requirement for short-term insurers to facilitate advice fees (Proposals JJ, KK and LL) will also need to be

¹⁸Although not explicitly identified as a Phase 1 proposal, Proposal J is closely linked with Proposals Z and AA.

implemented in Phase 2, with due allowance for lead times for product suppliers to effect any necessary system changes.¹⁹

The FSB also intends to implement Proposal F, restricting premium collection to qualifying intermediaries, in Phase 2.

(c) Phase 3

Any refinement of the short-term remuneration model that may be required to align with the final adviser categorisation model would be implemented during this phase.

¹⁹ It is however the FSB's understandings that most short-term insurers already have systems in place for the payment of section 8(5) fees, which systems should be reasonably capable of being adapted for the facilitation of advice fees.

2.5. Theme 5: Sales execution and other intermediary services

This theme deals with those proposals relating to non-advice based distribution models, but also includes so-called “low advice” models. It also considers proposals relating to services such as product aggregation and comparison services and other forms of referrals and lead generation, including related remuneration.

2.5.1. Key stakeholder feedback and initial responses for Theme 5

(a) Non-advice sales execution (no advice) and “low advice”:

Commentators generally supported the need for clear standards for non-advised sales execution as a specific form of distribution, although a number cautioned against undermining the cost effectiveness of direct marketing models by imposing overly rigorous compliance requirements. Concerns were raised particularly regarding the practical feasibility of testing a customer’s “financial capability” and clarity was requested as to whether this related purely to affordability, or to general financial literacy. The FSB confirms that our intention is not to limit the term only to affordability, but that an appropriate level of affordability testing may be a necessary measure in these models. We recognise that further work will be required to develop pragmatic standards in this regard.

There was considerable support for the introduction of a so-called “low advice” model, to provide a level of customer support and guidance between non-advised sales execution models and models offering a fully fledged financial needs analysis. Views differed however on exactly what a “low advice” model should address. Some suggested that it should focus on so-called “single need” product advice. Others argued that it should not be limited to a particular range of needs and / or products, but instead be a form of “scaled down” advice with a simplified prescribed advice process. Views also differed on the distinction between “non-advice” and “low advice” – ranging from arguments on the one hand that current direct marketing channels should not be seen as providing non-advice services but rather that they actually all provide a form of “low advice”; to arguments on the other hand that there “is no such thing as low advice” and that all forms of advice should meet the same standards.

The FSB agrees with concerns expressed that the phrase “low advice” has negative connotations, and could be incorrectly interpreted as implying a lower quality of advice and/or as applying only to the low income market. In particular, care should be taken to avoid a perception that lower standards of advice will apply to low income customers. The FSB will consider a more accurate description of what we previously termed “low advice” as the final model develops.

Views on the extent to which non-advice or “low advice” models lead to fair outcomes in lower income or mass market segments were mixed. Some argued that face-to-face advice was fairer to unsophisticated customers and should always apply in these markets, while others argued that the costs of face-to-face advice were prohibitive in these markets and that correctly designed non-advice or low advice models were the most effective way to provide access to affordable products for low income and or mass market customers.

Some commentators queried the proposal to limit non-advice and “low advice” models to the distribution of simple products only, arguing that relatively sophisticated investors should not be “forced” to use (and pay for) the services of an adviser if they do not wish to. The FSB accepts this argument, and confirms that our intention is not to disallow individual customers from making an informed decision to act without advice, but rather to address information asymmetry risks where relatively complex products are provided to the mass market without customers having the benefit of appropriate advice. Caution was also urged against overly rigorous product standards which could stifle innovation and competition in products offered through these channels. The FSB agrees that this would be a negative outcome, although we also point out that for customers to fully benefit from competitive product offerings they need to be in a position to understand and compare offerings and make informed choices.

Commentators representing product suppliers also requested clarity regarding the extent of product supplier responsibility in relation to non-advice or low advice distribution models. This will be addressed through further consultation, but the FSB takes this opportunity to reiterate the general principle that, in cases where a product supplier elects to use a distribution channel that offers non-advice or limited advice, we expect the product supplier to take particular care regarding the suitability of the product for its intended target market and the quality and suitability of information provided during the sales process. In particular, product supplier responsibility to ensure that telemarketers or other product “sellers” in these models have adequate product specific knowledge will be a focus area.

The need to consider system based or so-called “robo-advice” tools, that guide a customer to a particular product or product type selection, in developing standards for non-advice or low advice channels was also highlighted. The FSB agrees that this is an important focus area. Such tools are potentially important in mitigating the risk of an “advice gap” for customers who – for various reasons – may not use traditional advice channels.

Appropriate standards for such tools need to be considered and will require debate regarding when such tools should be regarded as providing “advice” and, if so, what safeguards will be reasonable to balance customer protection against the benefits of innovation and convenience.

The FSB agrees that the various stakeholder inputs summarised in the preceding paragraphs all require further debate. Further consultation on how best to define and set standards for these non-advice and “low advice” models – including whether to link them to particular product types, particular advice / sales processes, or a combination of both – is taking place through the FSB’s current engagements on the enhanced FAIS adviser competency model (see discussion under Theme 1 above).

(b) Product aggregation and comparison services and leads and referrals:

Other proposals included in this RDR theme are those relating to setting standards for product aggregation and comparison services, and for referrals and lead generation. There was general support for the development of standards for aggregation and comparison services, particularly regarding the importance of not over-emphasising price in relation to benefits and other product features. The need for clarity regarding the identity and range of product suppliers offered by the comparison or aggregation service was also highlighted. Some stakeholders requested clarity on the scope of activities that would be included in the proposal. The FSB agrees that these points need to be considered in the development of the proposed standards.

The proposal to set standards for referrals and lead generation also enjoyed general support, although the FSB was cautioned against using wide definitions that would bring lay people into the regulatory net. We confirm that the intention is to focus on referral activities that are carried out for remuneration or as part of a business. Various concerns were also raised regarding the importance of information protection measures in such models, and not duplicating requirements of the Protection of Personal Information Act. The FSB confirms that it is not our intention to duplicate other regulatory frameworks. We also agree

with comments made that standards will need to deal appropriately with referrals and leads within groups of companies and with external third parties respectively.

2.5.2. Implementation phases for Theme 5

(a) Phase 1

This theme does not include any Phase 1 proposals.

(b) Phase 2

As mentioned under Theme 1, it is expected that implementation of the enhanced FAIS competency framework will start during the Phase 2 period. This means that those aspects of Proposals B and D relating to non-advice sales execution only models and “low advice” (to be renamed) models that will be addressed through the competency model work, will be implemented in this phase. Other aspects of these models may be deferred until Phase 3, to align with full implementation of the final adviser categorisation model. Implementation of Proposals EE and WW, dealing with product supplier responsibility for non-advice sales execution and remuneration for non-advice sales execution will be aligned with the implementation of Proposal D.

Other proposals to be implemented during Phase 2 include:

- *Proposal H*: Standards for product aggregation and comparison services.
- *Proposals I and XX*: Standards for referrals and lead generation and related remuneration standards.

(c) Phase 3

Those elements of Proposals B and D (the non-advice and “low advice” standards) that are not addressed through the FAIS competency model review and require alignment with the final adviser categorisation model will be progressed in Phase 3.

2.6. Theme 6: Low income market

The focus here is mainly on RDR Proposal TT relating to the development of a special dispensation for product distribution in the low income market. This FSB workstream is however also mandated to consider financial inclusion imperatives more broadly. Proposal TT therefore forms part of a holistic approach to transformation and inclusion for the financial sector in line with the National Development Plan 2030.

Meaningful inclusion will require a multi-prong approach focusing on innovative solutions for distribution and delivery, proportionate regulatory frameworks that do not create barriers to entry, as well as consumer education. Customers in the low income sector need access to advice, which means that any regulatory proposal should not create unnecessary barriers to entry to providers who wish to service this segment. In this regard proposal TT considers not only access to advice but also sustainability of advice businesses in this sector. There is a need to find a balance between remunerating advisers sufficiently so that they are encouraged to service the low income sector whilst ensuring access to fair and affordable advice and products that deliver fair outcomes for customers.

Proposal TT, as set out in the initial RDR discussion document, suggested that additional consultation and technical work should be undertaken to determine an appropriate remuneration dispensation for product suppliers and intermediaries serving low income customers, in respect of life insurance risk products and investment products. Elements to be considered in carrying out this work included:

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

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

2.6.1. Key stakeholder feedback and initial responses for Theme 6

All commentators on proposal TT were in support of a different dispensation for the low income sector in order to avoid any “advice gap” that could potentially result from the introduction of an advice fee based remuneration structure or changes to commission structures. The majority of commentators were of the opinion that the low income sector should not be defined based on customer demographic segments (such as “LSM” levels) or income levels but favoured a product definition approach. A product approach also ties in with the approach to developing the enhanced FAIS competency model as discussed earlier in this paper. The development of product standards and criteria that define the products that will be eligible for the special dispensation for this market is therefore critical. Also regarded as critical by stakeholders were market appropriate remuneration models, disclosures and competency requirements for advisers.

Stakeholders also highlighted the necessity of aligning Proposal TT with many of the other proposals under RDR and in this regard agreed that the timing of a special dispensation for the low income sector needs to take place in parallel with other proposed changes to remuneration for advice and intermediary services.

Some specific feedback areas included:

(a) Remuneration models:

Commentators were opposed to a fee based model in the low income sector and there was general support for consideration of as-and-when commission structures, salaried advisers and / or building remuneration into the premium. Any change to the approach on equivalence of reward will need to accommodate remuneration models agreed to for the low income sector.

(b) Product standards:

The criteria for product standards are critical. Some raised a concern that defining product by limits on underwriting could result in underwriting at claims stage or higher premiums,

while others felt that defining products by maximum premium size could drive mis-selling of multiple products. Product suppliers argued that the cost of designing, building and marketing products is significant and is the same whether the market is low income or affluent. It is therefore crucial that remuneration models support the continued research, development and investment into such products.

(c) Advice:

Commentators all agreed that there is a need for sufficiently comprehensive financial needs analysis in the low income sector and that while low income market customers typically have limited financial insights and resources, they have a range of needs that should be assessed and prioritised. Advisers in the low income segment of the market play an important role by providing financial education and assisting with prioritising customer needs according to financial means. Remuneration models and competency requirements must therefore not create barriers to entry into the advice market and should ensure that access to such services is sustainable. There were also requests to consider a more proportionate model for the regulation of advice to reduce costs of compliance.

The FSB agrees that all of the above comments require careful consideration.

2.6.2. Implementation phases for Theme 6

The FSB recognises that full implementation of Proposal TT needs to coincide with implementation of a number of other RDR proposals including MM (the prohibition of product supplier commissions for advice on investment products), Proposals JJ, KK and LL (related to standards for advice fees) and equivalence of Rreward (Proposal RR). The proposal on a special dispensation for remuneration in the low income sector also needs to align as previously indicated with the enhanced adviser competency model being designed under FAIS.

(a) Phase 1

Consultation with industry reference groups on the proposals under this theme will continue during the first half of 2016.

In line with the stakeholder feedback that this market should not be defined based on income or customer demographics but rather be segmented based on product, consultation on product criteria that would define which products would qualify for a different

remuneration dispensation will commence in this phase. This will include consultation on the types of intermediary and advice services qualifying for this dispensation.

Research and consultation as to whether or to what extent short-term insurance policies should be subject to a special dispensation in the low income market will also be completed in this phase.

This work will also align with the FAIS competency model discussions on how best to align competency requirements with different product categories, which will also occur in this phase.

(b) Phase 2

Consultation on product definitions will continue in this phase and will be extended to determine the appropriate remuneration models for this segment, linking remuneration models to product features and charges.

Depending on the outcome of Phase 1 discussions, Phase 2 will see the introduction of permissible commission limits or alternative remuneration structures in line with other RDR proposals for short-term insurance products and lump sum investment products.

Phase 2 will also see work commence on permissible commission limits or alternative remuneration structures for recurring contribution investment products. In particular, there will be a focus on ensuring that applicable product standards and remuneration structures will either prohibit or significantly reduce the extent to which product suppliers may recover any up-front commissions payable from product values in the form of early termination charges.

It is also expected that implementation of the enhanced FAIS competency framework will start during the Phase 2 period. This means that certain aspects of the proposals relating to levels of advice will be introduced during this phase.

Proposals that will be addressed in phase 2 on which Proposal TT has a direct dependency – some of which will be addressed through the FAIS competency framework during this phase – are:

- *Proposal A*: Forms of advice defined, with related conduct standards.
- *Proposals B and D*: Standards for “low advice” and non-advice sales execution.

- *Proposal MM*: Remuneration for selling and servicing investment products (to the extent that a low income market dispensation may be required for lump sum investments).
- *Proposal UU*: Remuneration for selling and servicing short-term insurance policies (to the extent that a low income market dispensation may be required for short-term insurance).
- *Proposals BB, CC, DD and EE*: Product supplier responsibility for different types of advice / distribution (Particularly in relation to product specific training).

(c) Phase 3

Implementation of the dispensation designed in phases 1 and 2 commences in this phase, taking account of the need for alignment with other Phase 3 implementation timelines.

2.7. Overarching RDR proposals

This section discusses RDR proposals that are cross-cutting and do not fall squarely within any of the above themes but cut across a number of them. Proposals in this category are:

- *Proposal GG*: Ownership standards to be reviewed to assess conflicts of interest.
- *Proposal HH*: General disclosure standards in relation to fees or other remuneration.
- *Proposal JJ*: Standards for up-front and ongoing product advice fees.
- *Proposal KK*: Additional standards for ongoing advice fees.
- *Proposal SS*: Standards for remuneration arrangements between adviser firms and their individual advisers.
- *Proposal LL*: Product suppliers to facilitate advice fees.
- *Proposal CCC*: General standard – no financial interests may be provided by product suppliers to intermediaries unless specifically provided for in the regulatory framework.

2.7.1. Key stakeholder feedback and initial responses on these overarching proposals

(a) Ownership relationships:

Comments on the proposal to review ownership relationships mainly focused on concerns that such relationships should not be unduly interfered with. Although the need to manage conflicts of interest was generally recognised, some commentators argued that such conflicts are not inherent in all ownership relationships. Counter arguments were however raised that ownership arrangements between product suppliers and advisers, in particular, inevitably result in biased advice in favour of the product supplier concerned. A number of stakeholders urged the FSB to make use of the future regulatory and supervisory framework for conglomerate and group structures and significant ownership, as provided for in the Financial Sector Regulation Bill and the Insurance Bill, to gain further insight into group relationships before proposing any specific interventions. It was also argued by some that any potential conflicts arising from ownership relationships could be adequately managed through clear disclosure. Clarity was requested on the future regulatory framework for cell captive insurance models in particular.

The FSB has indicated in the RDR Phase 1 Status Update that our current thinking regarding ownership arrangements between product suppliers and advisers is that the mere existence of such arrangements does not automatically result in influence over the advice concerned, but that there is a strong presumption that such influence arises. Accordingly, we pointed out that strict standards and supervisory scrutiny would be required to demonstrate absence of such bias.

Despite this position, the FSB remains of the view that further work is required to determine whether any particular types of ownership or similar arrangements constitute material inherent conflicts of interest requiring further risk mitigation measures. Information gathered through the supervisory and regulatory tools for conglomerate / group supervision discussed above, will provide input into this review. Information gathered through future enhanced FAIS conduct of business reporting – which will include reporting on relationships with product suppliers and the mix of products and suppliers offered by advisers – will also be taken into account. We are not persuaded that, should such material conflicts be identified, disclosure alone is an adequate control.

(b) Proposals relating to advice fees:

Feedback largely supported the principle that advisers should be explicitly remunerated for the provision of advice, and shared the FSB's concern that current remuneration regulations do not recognise the extent or quality of advice provided or enable customers to appreciate the value of advice. Concerns with the proposals related largely to the combined impact of introducing advice fees and reducing or prohibiting product supplier commissions. As discussed under some of the RDR themes earlier in this document, concerns highlighted included the view that many customers would be unable or unwilling to pay advice fees, and that this would therefore have a knock-on negative impact on the sustainability of adviser businesses. Related concerns, also discussed earlier in this document, were barriers to entry for new advisers and the creation of an "advice gap" for certain groups of customers.

It was pointed out that the risk of such impacts cannot however be fully assessed until the FSB provides greater clarity on the future commission caps (for life risk insurance and short-term insurance); on the future equivalence of reward dispensation for insurer agents; and on the special remuneration dispensation for the low income market. Strong arguments were also put forward that the impact of the shift to advice fees should be mitigated by implementing the shift in phases, not on a "big bang" basis.

The FSB recognises the interconnectedness of these proposals and our technical work on finalising them will therefore test the proposals in combination with one another. This testing will include careful assessment of how best to phase in the implementation of the different proposals. The impact of the revised FAIS competency model discussed earlier will also be relevant.

There was strong support for the proposal that product suppliers should be required to facilitate advice fee payments, through customer-authorized deductions from product values and / or contributions. It was also recognised that this will go a considerable way to mitigating the risk of customers' possible reluctance to pay explicit advice fees. Product suppliers cautioned that they would require sufficient time to make the necessary system changes, including considering the implications for outsourced administration platforms in certain business models. We were also alerted to avoid increasing customer bank costs by requiring separate debit orders for advice fees. The FSB accepts these points.

Some advisers expressed concern that, if the customer is entitled to instruct the product supplier to stop the advice fee, this could make cost recovery difficult if the customer reneges on an agreement to pay ongoing advice fees for services already provided. Although the FSB recognises this risk, we feel that this is a contractual matter to be resolved between the customer and the adviser and that the importance of empowering the customer to control deductions from their products outweighs this risk. We also point out that this model is already in place in regard to non-insurance investment products.

Feedback on the proposal that the regulator should publish a "safe harbour" benchmark guideline for advice fees was mixed. Some commentators argued that this would be a useful mitigation of the risk of some advisers charging unacceptably high fees, particular in the early stages when customers will have little or no view on what constitutes a reasonable advice fee. Others argued however that the setting of a benchmark would result in fees migrating to the upper level of any guideline, and thus reduce competition. The difficulty in setting these benchmark, given the wide range of potential levels of advice and the fact that there is little existing data to work from, was also highlighted. This concern led to some proposing that such benchmarks only be considered at a later stage, once more information is available regarding advice fee charging practices and their impact. The FSB agrees that the issue of how or when to set advice fee benchmarks will require further consultation.

Views were also mixed on the requirement for product suppliers to monitor and report data to the regulator on the advice fees they facilitate. Some commentators from the adviser perspective felt that this was an inappropriate interference by product suppliers in their relationships with their customers. Arguments on behalf of product suppliers were that they should not bear any responsibility in regard to advice fee arrangements which are purely a matter between adviser and customer. The FSB disagrees with both these arguments. We remain of the view that an appropriate degree of shared responsibility for customer outcomes arising from these arrangements is consistent with a commitment to TCF. We take this opportunity to clarify however that we would not expect product suppliers to intervene in advice fee arrangements (other than to act on the customer's instructions), but simply to monitor payments for purposes of providing information required by the regulator.

There was widespread support for proposals relating to customer consent, transparency and disclosure of advice fees and other remuneration.

(c) Remuneration arrangements between adviser firms and their individual advisers:

Although comment on this high level proposal was limited, some concerns were expressed that there should not be undue intervention into the freedom of contractual or employment arrangements within firms. The FSB will consult further on the extent to which standards regarding these arrangements are necessary to support the objectives of RDR. We point out that current FAIS requirements in relation to conflicts of interest already apply at both firm (FSP) and adviser level in different ways. Our particular concern would be to ensure that advisers acting as sole proprietors or on behalf of small adviser firms are not at an unfair disadvantage to those acting for larger firms in relation to advice fees, due to the fact that large firms may be better positioned to remunerate individuals over and above the actual quantum of advice fees earned by the firm, resulting in unlevel playing fields.²⁰

(d) General standard – no financial interests may be provided by product suppliers to intermediaries unless specifically provided for in the regulatory framework:

Proposal CCC elicited divergent comment. Those in support of the proposal were of the view that it was necessary to reduce scope for further abuses and conflicts of interest not explicitly addressed through other RDR proposals. Those opposed to the proposal mainly objected that it was too far-reaching, would be impractical to implement, and constituted

²⁰ See further detail at p.56 of the RDR discussion document.

unwarranted interference by the regulator in legitimate commercial arrangements and could stifle innovation. Suggestions were made by some to limit the proposal by identifying and carving out specific acceptable arrangements, or by adding a “materiality overlay”. Conversely, others suggested broadening the scope of the proposal to cover all forms of remuneration and not limiting it only to financial interests provided by product suppliers. The need to consider arrangements between entities within financial services conglomerates was also highlighted.

Particular concerns were raised regarding potential regulation of the distribution of non-financial “add-on” products and services, with some arguing that these should remain outside the ambit of financial sector regulation. Other comments acknowledged the risk of consumer abuse and potential conflicts arising from the “bundling” of these offerings with financial products and services and supported further consultation on appropriate controls around financial interest payable in this regard. The need for clarity on the future framework for cell captive arrangements was also flagged in this context.

As stated in the RDR discussion document, further consultation – which will be informed by the above comments – will take place. In response to comments regarding the breadth of the proposal, the FSB agrees that further discussion is needed on the extent to which this general “catch-all” standard is necessary over and above the explicit standards to be introduced through the remaining RDR proposals, and / or the extent to which Proposal CCC should be qualified to deal with specific types of financial interests. If retained, Proposal CCC could be effected through an appropriate conduct standard to be issued under the Financial Sector Regulation Act (i.e. in Phase 2 of the overall RDR implementation).

The FSB remains very concerned regarding conduct risks and conflicts arising from the distribution of “add-on” products and services coupled with core financial offerings. Recent prominent examples of abuse include unfair practices relating to the sale of warranties and “club memberships” together with credit offerings where we share concerns raised by the National Credit Regulator. Our consultation in regard to Proposal CCC will therefore include discussion regarding appropriate standards to mitigate these types of risks. The FSB recognises that these offerings may in some cases not constitute financial products or services. However, we feel strongly that the fact that they are marketed and distributed to financial customers together with financial products – often through financial product suppliers and / or using financial services distribution channels – warrants the focus of the financial services market conduct regulator.

2.7.2. Implementation phases for the overarching proposals

Recognising the close interlinkages between these overarching proposals and some of the more specific RDR proposals, implementation of and consultation on inter-related proposals will be aligned as necessary. Please therefore refer to the summary table in Section 3 of this paper for a high level indication of the sequencing of these proposals in relation to the remaining RDR proposals.

3. Summary of RDR implementation phases

The table below indicates at a high level the proposed phasing of the 55 RDR proposals, grouped according to the RDR themes outlined in this document.

It is important to note that the sequence of implementation of RDR proposals shown on this Table is based on current assumptions regarding the evolving timelines of broader Twin Peaks legislative reforms, in particular the coming into operation of the Financial Sector Regulation (FSR) Act and the subsequent Conduct of Financial Institution (CoFI) Acts. This means that, if those assumptions change:

- The duration of each Phase may be longer than the indicative dates set out in Section 1 of this document.
- Some proposals may be implemented in a later Phase than set out in the Table.
- Some proposals may be implemented in an earlier Phase than set out in the Table, particularly if the introduction of the FSR Act and / or the CoFI Act is delayed and implementation of the proposals is considered necessary to address practices that pose a high risk of poor customer outcomes. In such cases, proposals may be implemented using the regulatory instruments available to us at the time.

For example, where a proposal is scheduled for implementation in Phase 3 under the CoFI Act, but that Act takes materially longer to come into effect than assumed, we would consider implementing it through conduct standards under the FSR Act or through subordinate measures under current sectoral laws that may still be in force.

3.1. RDR implementation – a three phase process

RDR Theme	RDR Proposals	Phase 1	Phase 2	Phase 3	Comments
1. Adviser categorisation	A: Forms of advice defined, with related conduct standards		✓	✓	Some elements of this proposal to be introduced in Phase 2 together with aspects of the enhanced FAIS competency framework, and further elements in Phase 3 together with the final adviser categorisation model.
	C: Standards for “wholesale” product advice		✓		
	K: Types of adviser defined			✓	
	L: An IFA may advise on certain products on a multi-tied basis	N/A	N/A	N/A	Proposal no longer required as it is linked to Proposal M.
	M: Further input required on criteria for IFAs to offer sufficient product and product supplier choice	N/A	N/A	N/A	Proposal not being pursued. See reasons in the RDR Phase 1 Status Update.
	N: Criteria for IFAs to be free of product supplier influence			✓	Note however that some elements are linked to other proposals, for e.g. proposals on binders and outsourcing.
	O: Status disclosure to be made by IFAs			✓	
	P: Criteria for multi-tied advisers			✓	
	Q: Status disclosure to be made by tied advisers			✓	
	R: Criteria for tied advisers			✓	
	S: Status disclosure to be made by tied advisers			✓	
	T: Criteria for financial planners			✓	To be addressed through FAIS competency framework
	U: Status disclosure to be made by financial planners			✓	To be addressed through FAIS competency framework
	V: Insurer tied advisers may no longer provide advice or services in relation to another insurer’s products	✓			See detail in the RDR Phase 1 Status Update
W: “Juristic representatives” to be disallowed from providing financial advice			✓		

RDR Theme	RDR Proposals	Phase 1	Phase 2	Phase 3	Comments
	X: Standards for adviser firms			✓	To be implemented together with adviser categorisation model.
	Y: Advisers may not act as representatives of more than one adviser firm	✓			See detail in the RDR Phase 1 Status Update
	BB: Product supplier responsibility for tied advisers		✓	✓	Some elements of product supplier responsibility to be introduced in Phase 2 together with aspects of the enhanced FAIS competency framework, and further elements in Phase 3 together with the final adviser categorisation model.
	CC: Product supplier responsibility for multi-tied advisers		✓	✓	Some elements of product supplier responsibility to be introduced in Phase 2 together with aspects of the enhanced FAIS competency framework, and further elements in Phase 3 together with the final adviser categorisation model.
	DD: Product supplier responsibility for IFAs		✓	✓	Some elements of product supplier responsibility to be introduced in Phase 2 together with aspects of the enhanced FAIS competency framework, and further elements in Phase 3 together with the final adviser categorisation model.
	FF: General product supplier responsibilities in relation to receiving and providing customer related data	✓			See detail in the RDR Phase 1 Status Update
	II: Standards for financial planning / risk planning fees		✓		To be addressed aligned with implementation of FAIS competency framework
2. Investments	E: Standards for ongoing product servicing			✓	
	G: Revised standards for investment platform administration		✓		
	J: Outsourced services on behalf of product suppliers to be more clearly identified and regulated		✓		
	Z: Restricted outsourcing to financial advisers		✓		
	AA: Certain functions to be permitted to be outsourced to financial advisers		✓		

RDR Theme	RDR Proposals	Phase 1	Phase 2	Phase 3	Comments
	MM: Remuneration for selling and servicing investment products		✓	✓	Prohibition on commissions for lump sum investments to be implemented in Phase 2, and for recurring contribution investments in Phase 3
	PP: Commission regulation anomalies on “legacy” insurance policies	✓	✓	✓	Anomalies regarding variable premium increases and RA transfers to be implemented in Phase 1, as per the RDR Phase 1 Status Update. Further reductions of causal event charges on new and legacy savings products to be phased in over Phase 2 and 3.
	QQ: Conflicted remuneration on RA transfers to be addressed	✓			See detail in the RDR Phase 1 Status Update
	YY: Remuneration for investment platform administration		✓		
3. Long-term insurance risk	E: Standards for ongoing product servicing			✓	
	F: Insurance premium collection to be limited to qualifying intermediaries		✓		
	J: Outsourced services on behalf of product suppliers to be more clearly identified and regulated	✓			See detail in the RDR Phase 1 Status Update
	Z: Restricted outsourcing to financial advisers	✓			See detail in the RDR Phase 1 Status Update
	AA: Certain functions permitted to be outsourced to financial advisers	✓			See detail in the RDR Phase 1 Status Update
	NN: Remuneration for selling and servicing life risk policies			✓	
	OO: Product supplier commission prohibited on replacement life risk policies	✓	✓		Interim replacement controls to be implemented in Phase 1, as per the RDR Phase 1 Status Update, and remuneration based interventions in Phase 2.
	RR: Equivalence of reward to be reviewed	✓		✓	Interim equivalence standards to be implemented in Phase 1, as per the RDR Phase 1 Status Update, and full implementation in Phase 3.
	ZZ: Binder fees payable to multi-tied intermediaries to be capped	✓			See detail in the RDR Phase 1 Status Update
	AAA: Commission cap for credit life insurance schemes with “administrative work” to be removed	✓			

RDR Theme	RDR Proposals	Phase 1	Phase 2	Phase 3	Comments
	BBB: Outsourcing fees for issuing insurance policy documents	N/A	N/A	N/A	Proposal not being pursued. See reasons in the RDR Phase 1 Status Update.
4. Short-term insurance	E: Standards for ongoing product servicing		✓		
	F: Insurance premium collection to be limited to qualifying intermediaries		✓		
	J: Outsourced services on behalf of product suppliers to be more clearly identified and regulated	✓			See detail in the RDR Phase 1 Status Update
	Z: Restricted outsourcing to financial advisers	✓			See detail in the RDR Phase 1 Status Update
	AA: Certain functions permitted to be outsourced to financial advisers	✓			See detail in the RDR Phase 1 Status Update
	UU: Remuneration for selling and servicing short-term insurance policies	✓	✓		Removal of section 8(5) fees to be implemented in Phase 1, as per RDR Phase 1 Status Update, and broader remuneration changes in Phase 2.
	VV: Conditions for short-term insurance cover cancellations	✓			See detail in the RDR Phase 1 Status Update
	ZZ: Binder fees payable to multi-tied intermediaries to be capped	✓			See detail in the RDR Phase 1 Status Update
	BBB: Outsourcing fees for issuing insurance policy documents	N/A	N/A	N/A	Proposal not being pursued. See reasons in the RDR Phase 1 Status Update.
5. Sales execution and other intermediary services	B: Standards for “low advice” distribution models		✓	✓	Some elements of this proposal to be introduced in Phase 2 together with aspects of the enhanced FAIS competency framework, and further elements in Phase 3 together with the final adviser categorisation model.
	D: Standards for sales execution, particularly in non-advice distribution models		✓	✓	Some elements of this proposal to be introduced in Phase 2 together with aspects of the enhanced FAIS competency framework, and further elements in Phase 3 together with the final adviser categorisation model.
	H: Standards for product aggregation and comparison services		✓		
	I: Standards for referrals and lead generation		✓		
	EE: Product supplier responsibility for non-advice sales execution		✓	✓	Implementation to be aligned with Proposal D

RDR Theme	RDR Proposals	Phase 1	Phase 2	Phase 3	Comments
	WW: Remuneration for non-advice sales execution		✓	✓	Implementation to be aligned with Proposal D
	XX: Remuneration for referrals, leads and product aggregation and comparison services		✓		Implementation to be aligned with Proposal H
6. Low income market	TT: Special remuneration dispensation for the low income market			✓	
7. Overarching proposals (proposals that cut across all of the above themes)	GG: Ownership standards to be reviewed to assess conflicts of interest	✓	✓	✓	Ongoing and aligned with other proposals as appropriate.
	HH: General disclosure standards in relation to fees or other remuneration		✓	✓	Implementation aligned with the introduction of relevant remuneration related standards.
	JJ: Standards for up-front and ongoing product advice fees		✓	✓	Advice fee standards in respect of lump sum investments, short-term insurance and life risk replacement products to be introduced in Phase 2, and for remaining cases in Phase 3.
	KK: Additional standards for ongoing advice fees		✓	✓	Advice fee standards in respect of lump sum investments, short-term insurance and life risk replacement products to be introduced in Phase 2, and for remaining cases in Phase 3.
	LL: Product suppliers to facilitate advice fees		✓	✓	Advice fee standards in respect of lump sum investments, short-term insurance and life risk replacement products to be introduced in Phase 2, and for remaining cases in Phase 3.
	SS: Standards for remuneration arrangements between adviser firms and their individual advisers		✓	✓	Implementation aligned with final adviser categorisation model and specific remuneration models.
	CCC: General standard – no financial interests may be provided by product suppliers to intermediaries unless specifically provided for in the regulatory framework		✓		Possible introduction as a general conduct standard under the FSR Act.

4. Comments on this document

As explained in Part 1, this document provides a high level status update on the FSB's approach to implementing the RDR proposals, including process and planned next steps. It is not intended to provide a detailed update on the content of the proposals. Such detail will be communicated and consulted on as the future phases of the RDR implementation process are rolled out. The purpose of this document is therefore mainly for information, and the FSB does not expect comprehensive comment on its contents.

Nevertheless, we welcome any comments or questions for clarification that stakeholders may have. Please feel free to submit these 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. Given the purpose of the document, no deadline is set for comments.