FIA general / summary comments (combined), 24 March 2015

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Chapter 1
Comment: **<Chapter1>** We support the primary aim and objectives of the RDR proposals to ensure that financial products are distributed in ways that support delivery of TCF outcomes, promoting affordable and fair advice in the retail market through sustainable business models. However, the FIA is strongly in favour of a model that allows for free market forces to operate wherever possible. We also support the principle that the Supreme law governing Consumer Protection is the Consumer Protection Act 68 of 2008 (CPA) - all other legislation, including the FAIS Act 37 of 2002 , Short Term Insurance Act 53 of 1998 (as amended), the Medical Schemes Act of 1998 as it affects the healthcare adviser and the proposed changes envisaged to different legislation and regulations by the RDR is subservient to this legislation and should align itself to the principles, spirit and purpose of the CPA (which is in turn aligned to our Constitution Act 108 of 1996. We further support the notion that the retail distribution review principles apply equally to intermediated and non- intermediated insurers. However, we do have concerns as to whether the proposals will achieve the desired public protection rather than just adding complexity and costs to the market. In fact, we would query whether further consumer protection is a requirement of the average consumer and would question who we are

protecting and from what evil, given that we do not agree with the overall assumption that consumers are being adversely affected by what has been termed “conflicts of interest”.

It needs to be understood that in the investment world (and in some risk insurance situations) time is essential or losses may occur. Too much complexity is thus to be avoided wherever possible.

Following on from the above it appears as if the thrust of the RDR is focussed on individual customers, households and smaller businesses. However this is not clear and more clarity is required as to whom the RDR is aimed at and the extent to which the proposals by reference to "retail and wholesale" apply in the business, employee benefits and healthcare markets. Whilst footnote 3 provides an indication, more engagement is needed. ("Wholesale" is not a concept used in insurance but is referred to in reinsurance terminology.)

Depending on the response to the above it could stand to reason that the possible definitions could be aligned to that of the CPA, e.g. companies with annual turnovers of R2 000 000 or less or Assets of R3 000 000 or less?

There is a feeling that the Investment advisory and Long-term insurance sectors are the focal point for reform and that the Short-term sector is being included with much the same principles being applied.

Further statistical insight into the severity of "poor customer outcomes ", “widespread miss-selling" and "market failures" (as quoted) would serve to justify the need for the extent of the proposals as outlined in this document. This reference without statistical “proof” serves only to undermine the professional standing of the intermediary.

We note that the paper tends to make reference to terms such as “intermediary”, “broker” and “adviser” and we have adopted the term “adviser” across the board in the Long-term response and “broker” in the Short-term response as we feel that these terms are most appropriate (while recognising that there are also some other kinds of intermediary who do not offer advice as such).

More clarity is needed on the potential inclusion of various types of administrator.

At this stage the input provided is mostly only on the underlying principles as we believe that there will be a need for extensive ongoing discussion on most of the details.

</Chapter1>

Chapter 2

Comment:

<Chapter2>

2.2.5 Factual product information should be specifically included under the definition of intermediary services for which intermediaries are paid commission.

2.3.1/2 The current practice in the industry needs to be looked at so as to challenge the assumption that a Multi-tied insurance adviser / broker and Independent financial adviser / broker would not be "free of influence" of the product provider.

The fact that brokers earn commission from insurers has never been considered to create "influence or control" by the insurers or impact broker self-reliance, allegiance or affiliation. It has always been held that a professional broker / adviser with adequate disclosure can act for both sides.

Medical schemes commissions are spelt out in the Medical Schemes Act and controlled via the Minister of Health. Commission thus cannot act as a conflict in any way, while healthcare intermediaries are also subject to the strict conduct controls of the FAIS Act.

The critical issue of the classification of the various types of intermediary requires further debate and clarification and is discussed further on in this submission. We are not convinced that the three types proposed would serve the purpose nor that it would mean much to the typical consumer.

2.3.6. White labelling is currently addressed in terms of sec 4(3) of the LTIA and STIA.

2.4 Has consideration been given to the tax implications on the intermediary of the change from mostly only commission earnings from recognised companies to a combination of this and fees from a variety of sources?

2.4.1 In the short-term sector fee earning revenue is the sole source of revenue for many larger (corporate) brokers.

2.4.3 We believe that it will be necessary for the proposed reduction in up front commission to be phased in over a period of years to avoid mass closing of independent intermediaries who cannot adjust their cash flow situation. This will also give industry and regulator opportunity to evaluate whether the sub-objective of driving the nation's savings is being supported or hindered by the steps being taken. (This is particularly so with the use of long term insurance to create intergenerational wealth and in the savings – as opposed to investment – market where "selling" of products is thought to still be an important factor in guiding consumer behaviour.)

</Chapter2>

Chapter 3

Comment:

<Chapter3>

3.1.1 The risk is significantly lower in the short-term sector where there is far less opportunity and motivation for product miss-selling, product rolling and long period lock-in.

3.1.2 Commissions are uncapped in many other countries, for example in Australia where there is very stringent "TCF" type regulation but without interference on revenue earning. Before introducing capping across other forms of broker remuneration an understanding should be obtained of how serious this risk is and how it is mitigated elsewhere. Control by way of such regulation differentiates the South African market from other countries and inhibits free market enterprise.

3.1.3 Inadequate oversight exercised by certain insurers in binder relationships. Such cases need to be identified for improvement by the affected insurers. It is the insurer who has the final say as to whom they contract with and should be exercising the correct due diligence and oversight principles. We support the principle of "self-regulation" as opposed to "rules based" prescriptive regulation where all are unfairly "tarred with the same brush".
The Binder regulations and Outsource Directives are relatively new and in some areas incomplete and it is recommended that a settling in window be considered during which time shortcomings be identified and addressed.

There is also a need to understand the "wholesale" buyer's obligation under any other legislation and the risks it seeks to mitigate. Often the benefits under a "group scheme" in terms of price and benefits are more advantageous than where individually purchased.

In the healthcare space the key to the advice service is to come up with a solution that both meets the needs and requirements of the employer and also, through the use of available options, addresses the most important needs of the individuals involved.

3.1.5 The reference to "as a result the employer may not be particularly concerned about the advice" under wholesale models is a very broad and unfair statement across all employers and needs substantiating by statistical evidence if they are intended to form part of the RDR. (It is submitted that if the employer were not concerned they would then just not participate in a voluntary environment such as currently exists and may be deterred from continued participation in the future if faced with onerous controls.)

3.3.3 Services as Intermediary (last paragraph in the first column) does not include "advice" and has been dropped from the STIA.

3.3.4 The FAIS Act sec 13(1)(c) sets out and determines the actions of Juristic Representatives.

We disagree with the statement that commission paid as a percentage of premiums creates inherent problems. We believe that it offers a quantifiable amount that can be used as an industry standard. Short-term insurance brokers and intermediaries have built a sustainable industry through this model and it is something that the long-term insurance industry can use as a model going forward.

We therefore disagree with the following statements:

1. The low visibility of commissions also undermines accountability for the quality of advice and customer's rights to recourse are not always clear. As customers may not always be aware whether or how much they are paying for advice, or that they are paying for it at all, there is a weaker accountability mechanism when it comes to the quality of advice. (See 3.1.2 on page 21 of the RDR Paper)

Reasons for our disagreement:
The quality of advice and accountability of advisers have been constantly and aggressively scrutinised and highlighted through the FAIS Ombud's Office. Customers of financial advisers and intermediaries are well aware of their rights to recourse when it comes to financial advice.

Through consumer education programs, disclosure documents reflecting the details of the FAIS Ombud and the media, the FAIS Ombud's existence and rulings have been well published.

We respectfully submit that commissions or low visibility of commissions has nothing to do with undermining accountability for the quality of advice. In our opinion, rights to recourse are very clear, and if not, it is as a result of lack of disclosure in terms of section 4 and 5 of the General Code of Conduct or incorrect procedure when a client does complain to the FSP concerned, for which there are consequences. In our opinion the accountability mechanism through the FAIS Ombud's Office is extremely strong regardless of the fees and / or commission structures.

2. Commission paid as a percentage of premiums can lead to miss-selling, as there is an incentive for the intermediary to sell the highest premium / contribution possible, including unrealistic contractual escalations.

The reality is that providers are extremely aware that customers always look for the cheapest premium. If there is one area that providers have to be competitive, it is premium. We believe that market forces supporting lower premiums are far stronger than any regulatory intervention. We do not believe that miss-selling happens when providers see opportunities to propose higher premiums. On the contrary, there is much more evidence of miss-selling taking place where providers go for the cheapest premium and getting the business, but failing to properly educate the customer on the terms, conditions, risks and exclusions. Both customers and financial services providers tend to default to price.

3. Commission paid as a percentage of premiums may not be commensurate with the cost of the actual services provided.

4. In our opinion, if advice risk is included in the calculation of the cost of financial services provided, providers will always be at a loss when it comes to rendering financial services to customers. We do not believe that commission paid as a percentage of premium must necessarily be commensurate with services rendered, but we do believe that if it factors in some of the advice risk that the customer attracts to the FSP, it will be more in line for the bigger clients. For small clients, providers are taking on more risk than they should and they are never fully compensated for that.

5. If the argument is that customers who "pay" a percentage of a big premium in commission are cross-subsidising customers who are paying small premiums the following counter-arguments should be taken into account:

(i) Customers paying bigger premiums by definition obtain larger amounts of cover in the risk space or the insurer is taking on more risk, or the client has accumulated larger investment amounts in the investment space, which attracts more advice risk to the business. Therefore, the bigger the premium, the greater the advice risk is. In view of greater advice risk one cannot only compare services rendered to customers paying a large premium to services rendered to customers paying smaller premiums. We should never compare cash flow in a business to services rendered without taking into account the initial and ongoing advice risk.

Customers paying bigger premiums may bring more revenue, but the FSP should be rewarded for the additional risk it carries. These customers may be profitable, but the same customers can potentially ruin a business if the FAIS Ombud should find against the FSP if a complaint at the Ombud should prove to be successful.

(ii) The real issue is that customers who are paying lower premiums are not profitable and should in fact pay more for the services rendered to them. In fairness, customers who pay smaller premiums should either pay more for "advice" or "planning" or, if they cannot afford it, the only way for them to receive advice or ongoing services is for providers to use the cash flow offered by customers to "subsidise" customers who pay larger premiums. This would not prejudice the "bigger" clients, simply because the fees or commission earned off their premiums would be fully justified because of the advice risk component. However, at the same time the client who cannot afford a higher premium or to pay for advice risk is able to receive advice and ongoing services.

We fully agree that there are imbalances that exist in responsibilities and accountability of product supplier and intermediaries' accountability for customer outcomes. FAIS Ombud determinations have made it clear that financial services providers are being held accountable for institutional / product supplier failure and the RDR needs to establish a level playing field of accountability of all stakeholders (providers and product suppliers) when it comes to fair outcomes to customers

Reference is made to multi-manager funds, but it is unclear from the comment whether a multi-manager fund is seen to be an independent investment decision or not. It is our submission that a multi-manager solution could well be an independent investment decision provided certain requirements are met.

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Chapter 4
(general comments)

Comment:

<Chapter4>

The concept of separating advice from intermediary services and then to further separate intermediary service into sales execution from on-going product maintenance and servicing is new both in SA and globally. Significant engagement needs to take place to ensure that:

a) The massive effort and cost involved in the separation and its ongoing administration will create commensurate value for clients, (will the cost outweigh the benefits?); and
b) All the consequences are properly understood and addressed.

The comments regarding an adjustment to commission are noted. It is essential that an appropriate investigation should take place to justify the rationale behind the quantum of the proposed "cap" in view of the significant changes to operational models that have occurred over the years since the levels were capped some 40 years ago.

A failure of the current capping of commissions is that the "cap" becomes the norm irrespective of the activity or value added to the client. Of particular importance to this approach, is an undertaking to measure the true cost of insurance when compared to historic periods. It is our contention that, in the majority of cases, short term insurance in particular has become relatively cheaper across the spectrum resulting in an automatic reduction, in real terms, of the overall income earned by intermediaries.

The concept of an activity based approach to be followed in defining advice, services and remuneration is supported in principle provided innovation is not stifled due to an inability to obtain appropriate reward for risk and endeavour.

In particular, further work needs to be done on expanding the scope of the definition of consulting and client services, especially in the healthcare space where facilitating further wellness initiatives from intelligent data received in order to ensure that members apply their wellness programmes in an appropriate manner that meets the employer's requirements as well is an important aspect of the service/advice.

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Chapter 5

Comment:

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We support the process of consultation and debate that we trust will proceed in reasonable time frames in order to support well informed strategic planning by broker firms in striving to provide continuity of delivery of services and advice to clients within sustainable business models. However, haste must not compromise good decision making if the envisaged model is to meet the strict requirement of "rational law making" and stand the test of time.

We are concerned about the phase 1 implementation planned for March to October 2015, as this leaves very little time for consideration of the public comments on the RDR proposals, nor does it allow time for any public consultation on any of the subordinate legislation that will need to be developed to give effect to the listed proposals.

Such a fast implementation timetable could lead to significant unintended consequences. For an example of such unintended consequences see proposal OO, a proposal that informs a number of Phase 1 intended changes.

Should the limitation on advisers of proposal Y be implemented it will lead to many FSPs not complying with the FAIS requirement of ensuring continuation of their businesses as advisers will not be able to be appointed across licences.

The FSB will therefore either have to scrap the requirement in the FAIS Act, develop another mechanism or acknowledge that RDR means the death of small FSPs.

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Chapter 6

Comment:

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We look forward to participating in the consultative process going forward in order to create client trust and ensure fair outcomes for all stakeholders.

The financial planning arena is a tripartite arrangement and, while RDR is ensuring that the product provider will receive all the information they require through proposal FF and that the consumer will receive a significant amount of additional information, the current RDR proposals do not ensure that providers supply advisers with sufficient information regarding products or even the costs thereof.

In addition recent decisions by the FAIS Ombud create the impression that the FSB sees the adviser as the guarantor of last resort for all provider failings. Although we disagree with the position, it is even less sustainable given the refusal or inability of providers to provide the relevant information.

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