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15 February 2016

Ms Leanne Jackson
Head: Market Conduct Strategy
Financial Services Board

By e-mail: FSB.RDRfeedback@fsb.co.za

Dear Ms. Jackson,

Status Update: Retail Distribution Review Phase 1

The FIA would like to thank the FSB for affording it the opportunity to comment on the *Status Update: Retail Distribution Review Phase 1* document. It also thanks the FSB for the extension of time afforded it for completion and submission of said comments.

As with our original RDR submission in 2015, it was found that the differences in operating models in the Short Term and Long Term Insurance sectors were such that in order to present relative and clear comments it was necessary to comment on each sector individually, which submissions you will find attached.

Similarly, while we have included some comments around the employee benefits and healthcare sectors, we do not believe that the document addresses the unique aspects of these markets and it is our opinion that considerably more thought needs to be given to these disciplines.

There are a number of principles, concerns and questions that apply across all of the business segments represented by the FIA's members which we detail below, including a number of these which were contained in our original submission:

- The FIA is guided by the following principles as set out by the World Federation of Insurance Intermediaries of which it is a member:

    - Intermediaries have the right to be remunerated fairly;
    - Market agreements, limiting / imposing means of remuneration are an infringement of basic free market principles; and
    - Intermediaries should be allowed to charge fees in addition to commission with agreement of both parties.

- The FIA is committed to and supports fair regulation that:

    - Creates consumer / client confidence and protection;

- Sustains and creates opportunities for all intermediaries in particular the small to medium-sized entities which play an integral part in the market dynamic;
    - Improves relationships between all stakeholders;
    - Encourages fair competition and protect the integrity of the market; and
    - Assists in ridding the industry of improper practices and practitioners.

- "Value" to the consumer / client is at the heart of the intermediary model and is entrenched in the FIA's "Code of Conduct" and "Code of Ethics".

- Remuneration should be:
    - Relative to the value added for advice and services; and should
    - Create a competitive levelling of the playing fields between different business models in the market.

- The FIA supports the principles of:
    - Free market enterprise;
    - The encouraging of self-regulation by insurers and intermediaries over "interventionist" regulation;
    - Anti-conglomerate;
    - Anti-monopoly;
    - Anti-price fixing; and
    - Conflict of interest management

The FIA therefore supports the RDR's primary aim, *"to ensure that financial products are distributed in ways that support the delivery of Treating Customers Fairly (TCF) outcomes – in particular to promote appropriate, affordable and fair advice and distribution of financial products in the retail markets through sustainable business models"* and in so doing promote an environment in which all stakeholders are offered a fair and equal opportunity to compete.

The current FAIS Act, TCF, Outsourcing and Binder Regulations are well founded and have played, and will continue to play, a major role in enhancing industry practices around professionalism, compliance, standards and disclosures on the part of the intermediary, all to the benefit of all stakeholders in the value chain. The FIA supports these pieces of legislation / regulation and encourages the Regulator to allow enough time for these to adequately bed down and achieve the purpose for which they were intended and to manage the outcomes by regular but fair enforcement thereof.

Since publication of the RDR Phase 1 Status Update we have received substantial communication, in strong terms, from our members that we have consolidated and now share with you below. Most of these issues go directly to the value to the insuring public through the intermediated model and question its future well-being under the RDR proposals. We would appreciate the FSB's response to the undermentioned points:

1. The National Treasury and FSB's statement of intent to introduce "more intrusive, invasive and pre-emptive regulation of banks and insurers" and to control the benefits offered, the pricing thereof, the remuneration paid for distribution and the structure of distribution models without any meaningful substantiation of the perceived ills and poor customer outcomes that have driven such a hard lined approach is questioned.

2. Has any further consideration been given to the development of a separate set of RDR proposals for Short Term insurance where activities, processes and customer requirements, and the manifestation of customer outcomes (where costs of delivery and administration has no bearing on the cover outcome), is significantly different from investment consulting and other forms of Long Term

insurance, this in the knowledge that Short Term insurance has been omitted from similar initiatives in other countries?

3.

3.1 The concerns expressed in our original RDR submission about certain negative comments in the RDR, namely; “poor customer outcomes”, “widespread miss-selling” and “market failures”, remain unanswered and we again question as to what facts inform these statements which position the industry in a very poor light and which have resulted in further regulatory intervention?

3.2 Reports from the Ombudsman for Short Term Insurance and Ombudsman for Long Term Insurance show a declining ratio of complaints registered in respect of short term insurance claims, relative to the total number of claims paid, with fewer than three short term insurance complaints per 1000 (0,3%) of which fewer than a third of the cases were found to be incorrect decisions made by Insurers. Furthermore the number of complaints lodged at the FAIS Ombud and eventually ruled on is in actual fact a minute percentage of the vast amount of advice given on a daily basis by intermediaries.

3.3 Can the FSB demonstrate the outcomes of customer complaints pre and post the introduction of the FAIS Act, TCF and Binder Regulations?

3.4 We question whether decisions have been made on the strength of real data on “customer satisfaction” and on the number of pieces of advice given on a daily basis versus the complaints ratio, without which we question as to how informed regulation can be imposed.

3.5 Has research been done to determine how good or bad the customer product and service outcomes are as related and compared to intermediated business, direct models and also Binder/Outsource models?

3.6 The current Short Term market is both innovative and highly competitive and as such regular poor and abusive practices would not be easily tolerated by the buying public.

3.7 Have customer satisfaction surveys been done to determine customer perceptions of the industry and how these compare to the international experience?

3.8 How does the current menu of regulation for financial services stack up against international best practice and has sufficient cognisance been taken of the extent of the review in the UK, particularly post implementation?

3.10 Has any consideration been given to the consequences of a departure from established intermediated models in other countries (on which the South African model is based)? We are aware that changes are afoot, but many appear to be lagging and in particular what the FAIS Act has achieved?

4.

4.1 An over-abundance of rules-based regulation as is referred to in the RDR over and above the principles based FAIS Act, TCF and Binder and Outsourcing Regulations, will lead to the demise of innovation of which the intermediary is most often the catalyst and will create a shift towards standardisation of product, pricing and reward around insurer shelf products with the intermediary having little influence over offerings and outcomes to clients that are often designed to unfairly discriminated against customer segments.

4.2 Following on receipt of the Status Update we perceive further "scope creep" such as the introduction of the possible prohibition for commercial business practices and determination functions where it appears that little research has been done to substantiate the proposals now made?

5. Are we trying to regulate our way out of "conflicts" rather than managing and / or mitigating same?

6.

6.1 Have the impacts and unintended / negative consequences of caps and prescription on Outsource / Binder fees, reduction in commissions and prescription on advice fees to the intermediary channel been considered?

6.2 Have the FSB conducted any Activity Based Costing (ABC) studies to show the costs, by class of insurance, delivery, operation, loss leaders and long term sustainability and in particular the ever increasing cost of human capital and information technology where future development and associated costs linked to hard currency are a challenge? If not what informs the FSB on suggested remuneration models?

6.3 Has a historical analysis been undertaken regarding the actual cost of insurance over the past two decades? This is key as the cost of insurance, in real terms, and due to the very competitive markets and availability of capacity, has been declining resulting in lower real income for intermediaries exacerbated by capped commissions, increased governance and regulatory costs as well as ever-increasing risk complexities calling for higher skill levels, in particular in the commercial and corporate space.

6.4 What informs the FSB's proposals regarding what level of remuneration is conducive for the sustainability of the offering and or conducive to ensuring that the customer will keep on being offered innovative and new product solutions from the intermediary?

6.5 How did the FSB go about ensuring that generalisation and median calculation methods will sustain those providing a fair and superior offering to the customer?

7.

7.1 Has an economic impact study been carried out to determine the inevitable increase in costs, reduction in revenues and potential loss of human capital in the intermediated space versus the benefit to the customer not only due to the RDR, but with the ever-increasing amount of regulation?

7.2 We ask whether the FSB has considered what the cost to the consumer, the industry and its people is should the ever-present uncertainty of "what will be next" carries on for much longer? This is already stifling innovation and corporate activity.

7.3 Should the FSB not now consider a time for consolidation of the sound regulation that is in place and work towards an effective enforcing thereof and give the broader economic uncertainties time to stabilise rather than forge ahead with the current RDR irrespective of the many uncertainties that seem to be based on perceptions rather than empiric proof and study of the benefits and or shortfalls of the current insurance and specifically product distribution markets? A good example is the Binder

Thematic Review where the essence of the Regulation is sound but the application and enforcement is clearly lacking, which could create unintended consequences for the sustainability of the Binder/Outsource models and further regulatory pressures on the many Binder holders who are creating efficiencies and quality outcomes for customers.

7.4 We are concerned that the extent (cost and complexity) of the regulatory framework could contribute to the potential demise of South Africa's smaller SMME FSPs with consequent adverse implications on the national employment situation.

8. We are concerned that the new regimen of regulatory controls will prove a barrier to entry of new, and in particular small to medium sized entities (SMMEs).

9.

9.1 We question as to the definition of 'who' the "consumer" is, i.e. does this follow the definition as contained in the Consumer Protection Act, i.e. individuals and SMME businesses with a turnover of less than R2m per annum and any franchise business?

9.2 We take note of the FSB's comments around the applicability of the RDR to commercial lines business as contained in the RDR General Review 2.4.1(d). We also refer to our original comment that the term "wholesale" is not understood in short term insurance and we again question the meaning of this when used in the RDR in the context of (and possibly opposite to) "retail"?

10. Have the FSB established the size of the current market by segment and sub-section of business, by intermediary and direct, and how each Rand of premium paid is spent by the insurer in order to test the value to the customer of their insurance spend?

11. Have the FSB conducted research as to the price sensitivity of insurance products and determined how the customer takes his / her price decision? Is this decision taken blindly or tested by getting alternative quotations and is it decided on the total gross payment or the breakup of the cost into premium, commission, advice and service?

12.

12.1 Have the FSB done a matrix which demonstrates the volumes of "outsourcing" to Binders and or Outsource activities by product and Insurer and determined the reasons therefore?

12.2 Does this matrix demonstrate what is being done and charged for these services, what are the differentiators per Binder service offered and how does this factor compare to similar products when not outsourced?

13. What informs the implied assertion that intermediaries and Binder holders in particular are profiteering at the expense of poor customer outcomes? Does the FSB study and compare the financial statements of all FSPs reporting on the capital employed, net profits and human capital employed in the different classes of business and models of delivery, intermediated, non-intermediated, with Binder and or UMA?

14. Has a study been conducted comparing the value to client of broker products to insurer shelf products?

15. Have the FSB done a study showing the changes in the people demographics in insurance in South Africa to demonstrate levels and the movement of expertise to establish whether there are sufficient qualified and fit and proper people entering the industry to ensure competent delivery to customers?

16. Have the FSB given thought to the possibility that their current thinking may have been unduly influenced by a conglomerate of insurers and or more specifically the areas where they lead the market to create a “captive” market thereby blocking other insurers and or new entrants to the market from participation, i.e. an oligopoly that in itself smacks of anti-competitive behaviour?

17. Will the FSB be aligning the RDR and future possible regulation with the trends reported on at the World Economic Forum held in Davos and will the FSB be altering its regulatory approach to ensure that the South African financial services customers benefit from the “4th World Industrial Revolution”?

The above represents a taste of what we have received from our member base that ranges from small and local brokerages, through national broking firms to those with global parentage. We would be remiss in not bringing this to the FSB’s attention, thereby alerting the Regulator to market sentiment.

If the intermediary industry is to be extensively remodelled it’s essential that this be informed by a thorough study of the value-add role and activities of the insurance broker in today’s environment. Until this is completed we will strongly oppose the introduction of changes, particularly those that are linked and interdependent.

In the meantime we will continue to participate actively in all FSB engagements with the industry which we urge should become more detailed, constructive and outcomes-based for the participants in order to properly inform the future direction of the RDR.

In particular we advocate the appointment of an industry task team to address activity definition and delineation and activity-based remuneration. We also encourage the FSB to think about establishing a permanent industry advisory council under the auspices of the FSB.

Kind Regards,

Justus van Pletzen