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FSB Status Update, RDR Phase 1

(Numbering follows FSB document numbering)

NB: This commentary is specific to the short term business of the FIA membership.

3. Adviser categorisation

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

3.1 (a). We support the use of a two tier categorisation being that of the **Agent** (aligned to the Insurer) and **Insurance Broker** where the description and role of the **Insurance Broker** is already well understood by the customer.

We acknowledge your comment that the term "independent" is of little relevance to customers in determining the categorisation of the entity. However its prohibition across an entire entity where one division uses a binder to service one client segment only is likely to create unnecessary identity problems.

3.1 (b) Proposal M – we support the FSB's comments that this proposal will not be pursued in its current form. Cognisance needs to be given to those Insurance Brokers who specialise and are skilled in one class of business, e.g. aviation insurance, where all of the business can be placed with one insurer and where that broker will provide advice and a full service offering. This entity, in this instance, should still be classified as an Insurance Broker and not as an Insurer Agent. Where certain classes of insurance are offered only by a limited number of Insurers, the lack of choice in the market should not unfairly prejudice the Insurance Broker, who in this case should not be deemed to be an Agent of the Insurer. We maintain that the risk to clients should be managed by appropriate disclosure as to market view, as required under FAIS.

3.1 (c) Proposal R. We support the concept of "gap filling" across different segments and lines of business as well as that of the Indian model – "where a tied adviser (product supplier agent) should be able to act as the agent of one product supplier per line of business". However we believe the concept should also be considered across client segments within short term insurance (mainly personal vs commercial) where the "home" supplier / group does not offer the line of business concerned. FAIS implications will need to be considered.

3.2 A two-tier or three tier adviser categorisation

We support the two tier model as per 3.1 (a) above.

The definitions need to be clear to the customer and indicate where the accountability lies and to whom they will look to for any redress and fulfilment.

The "own licence" (captive) category where products are sold directly to that organisations' customers should be classified as an Agent relationship. However cognisance needs to be

given in the instance involving a Group of Companies and where the Group has an “own licence” for third party business and an “Insurance Broker”, operating at arms-length of the “own licence”, and who offers a full broking service of sales, service and advice, including, as an option, the “own licence’s” product as an option. In this instance the categorisation should be that of Insurance Broker.

In order to ensure consistency any changes that are effected must be carried through to the Cell Captive Review where appropriate.

We concur that the term “independent” is of little significance in terms of the categorisation.

The Insurance Broker takes accountability for advising on and recommending different Insurers’ products / cover dependent on the outcome of the needs and requirement of the customer and or business. Depending on the nature of the customer’s risk profile this will require varying levels of skill and could extend to having the portfolio placed with a combination of Insurers offering a range of specialist covers.

The Insurance Broker has a primary responsibility to ensure the right levels of risk management, risk transfer, cover, terms and cost and that the best markets from a solvency, reputation and value add have been secured. With the obligation for fulfilment of the mandate clearly on the Insurance Broker the customer would look to the Insurance Broker for any redress related to Advice and therefore it is unlikely that there should be any Insurer influence.

Whilst a customer can hold the Insurance Broker responsible for the “advice” portion of the services, the policy fulfilment obligations lie with the Insurer. The contract between the customer and Insurance Broker would determine the level of service required. Accountability of the Insurer in respect of their product must be clearly set out for the customer.

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

3.3 (a) Clarity is required on the interpretation of the term “agency or similar mandated relationship” as in practice, for an Insurance Broker to deal with an Insurer there is a requirement for an “Intermediary Agreement” to be in place. This situation does not create supplier influence but allows access to a range of products on which to advise and also sets the “rules of engagement”. The mere existence of the contract cannot be construed to constitute an Agency relationship. Any such agreement should not be seen as to conclude that a “tied” relationship or agency has been created when all that has been agreed is a terms of reference business agreement, allowing the Insurance Broker to introduce business to the Insurer.

3.3 (b) Whilst we agree that sales / production targets should not be imposed by Insurers on Insurance Brokers at the expense of continuation of doing business, we believe that there should be a commercial decision between the parties as to what type of business arrangements are entered into.

We question whether it is the FSB’s intention that the setting of and agreeing to targets for any reason whatsoever means that Insurance Broker status is forfeit and the entity becomes an Insurance Agent?

3.3 (c) and (d) We agree that ownership does not necessarily infer undue influence and agree that strict supervisory review of all such arrangements coupled with clear disclosure and proper governance and standards should be introduced to ensure sound business practice.

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Is it the FSB's primary concern that only the "advice" component creates conflict of interest and that this would not apply in "non-advice" scenarios, e.g. where only intermediary services are rendered?

3.3 (e) – Agree.

3.3 (f) – No comment.

3.3. (g) – No comment (this comment falls away due to the decision not to pursue Proposal M).

3.4 A possible revised categorisation model

3.4 (a), (b),(d) > (h) & (n) Agree

3.4 (c) Subject to our comments in 3.1.(c)

3.4 (f) We would be keen to understand the possible emergence of "equivalence of reward" models in the short term segment and would support that these entities be subject to the principle of equivalence of reward.

3.4 (i) As previously detailed, the term "independent" should have very little influence on customers in determining the categorisation of the entity.

3.4 (k) The assertion that Insurers have any influence over advice, other than pure product information, provided by Insurance Brokers is misplaced and this does not adequately recognise the customer expectations in respect of which party is responsible for redress. In this regard we would stress that the mere placing of a client risk onto a binder arrangement does not abdicate an Insurance Broker from its responsibility for advice (under the FAIS definition) provided to the customer coupled with appropriate disclosure of market view.

Apart from information about their own products, Insurers do not have the necessary skills and experience to have oversight of Insurance Broker activities and are not capable of objectively assessing the validity and appropriateness of advice, irrespective of their knowledge of the scope and extent of their own products.

It will be essential to segment advice into judgemental (part of customer advice and services) and product information (part of intermediary services) where the Insurer should be expected to exercise some level of control.

4. Phase 1 proposals

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

This is applicable to Long Term.

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

We are happy with the FSB comments and look forward to being part of the consultative process going forward as described in "(b) Next steps for proposal Y" in particular with regard to the accountability and remuneration issues.

4.3 Proposal Z: restricted outsourcing to financial advisers and Proposal AA: Certain functions permitted to be outsourced to financial advisers.

(a) Updated FSB view

(i) & (ii) – Agree

(iii) Clarity is required re the intention here as well as the FSB's understanding of "real time data" which could be channelled via an in-house or third party system (data switching) and where no duplication of effort occurs, versus "direct capturing onto an Insurer's IT platform".

The proposals state that in order to demonstrate efficiency the parties will need to ensure that the adviser has the operational capability to affect real-time updates of policy records through direct capturing onto the insurers IT platform. Why is it necessary to have a real time capability and why must it be done directly on the Insurer System? The practice currently is for the parties to agree on the minimum data required by the Insurer (guided by the recently released Data Standards document) and then for the Binder Holder / Insurance Broker to send that information through to the Insurer.

Clarity is sought as to who will bear the cost of system development should real-time capturing or system integration be prescribed - the impact on customers may be contrary to the principle of fair outcomes for customers by way of increased premiums or a complete withdrawal of the product that would otherwise been a valuable client alternative replaced by an Insurer shelf product. The services that certain Insurance Brokers are able to provide ensure that the customers' rights are adequately protected. Speed of execution is required for most transactions.

Real-time data does not make sense in the context of a Binder as the whole principle of the Binder is that the Adviser places the Insurer on risk before the Insurer becomes aware of it. The use of real time and Continued Access should be delineated as they cover different transactional purposes. If Data requirements are real-time- then what is the purpose of the "Enter into" component of the Binder?

A number of Insurance Brokers and Third Party System providers have developed sophisticated delivery systems which cannot be matched by a number of Insurers. In fact some insurers may not have the strategic appetite to operate own systems and rely on such third party arrangements to provide the operational solution and the detail for business and regulatory control and reporting. This is facilitated through the principle based nature of current regulations.

We agree that the capturing of data should be subject to data transfer standards such as that of ACORD but make the point that the critical issue should be the transfer of data by the Binder Holder and the correct utilisation of the data by the Insurer and that the methodology should be not be prescribed so long as insurers are always in a position to fulfil all obligations under their policies and all regulatory reporting obligations.

It must be taken into consideration that many Insurance Brokers, with the agreement of Insurers, have their own bespoke policy wordings and schedules which do not support capture directly onto an Insurer system in direct accordance with required data exchange standards.

We support good governance and the mitigation of any potential conflicts of interest with regard to outsourcing arrangements which we do not regard as pure income streams but that of efficient service delivery and facilities in which to introduce business to Insurers.

Experience has shown that in many cases the administrative service delivery on the part of Insurers is inefficient in terms of both delivery and accuracy which puts a burden on the Insurance Broker in terms of time to deliver the product and contract to the customer as well as its potential FAIS and professional indemnity exposure. This may have the consequence of

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not being more cost-effective but promotes efficiencies, accuracy and adherence to the principles of FAIS and TCF.

In summary we maintain that regulatory requirements should be principle based (as they are currently) with operational detail left to Insurers and their Binder holders to agree according to their individual strategic and operational business models.

(iv) Agree

(v) We are opposed to the principle of capping of "outsourced remuneration" which, as in all other business transactions, should represent a fair and competitive cost to the party that outsources the activity and allow the party fulfilling the outsourcing function sufficient margin to provide an efficient service.

The FSB has stated that it is not convinced that the examples it was provided with in relation to Outsource Services warrant specific exemptions. A clear definition of what constitutes "insurer obligations / services" be required to ensure that there is clarity.

The FSB has indicated that it will consult on the question of outsourcing of non-insurance activities to advisers. It is our view that outsourcing relates to activities that an insurer would ordinarily perform itself. It would be outside of the mandate of the FSB to try to regulate these other services. The results of these services do not always translate to the sale of a financial product.

We welcome further debate on this issue and request being included in the team that conducts the "technical work".

(b) Next steps for Proposals Z and AA

(i) We will study and comment more specifically on the Binder Thematic Review document, which was published on the 15th December 2015, and where we have not had time to assimilate all comments, except to say that despite a sound set of regulations (Binder Regulations and supported by the Outsource Directive 159.A.(i)) there appears to have been insufficient enforcement of the Regulations on those who continue to transgress. We note the recent increased monitoring and believe this will lead to improved awareness, enforcement and compliance.

(iii) The review of outsourcing of non-insurance activities should be excluded from the RDR altogether. These services (if not insurance activities) should not be subject to standards imposed by the Regulator.

We request that we be included in further consultation on this point.

Proposal F – Premium Collection. Whilst this proposal is not dealt with as part of Phase 1 and is commented on in the General Status Update, if it is intended to consider making this an Outsourced service then we would suggest that it may be appropriately handled in conjunction with other outsourced services in terms of proposal Z/AA.

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

(a) Updated FSB view

(i) Care that insurers must only have access to (all) information that relates to the policies underwritten by them but not to customer information that has no bearing on their particular policies. Access can never extend to comparative advice provided by insurance brokers.

(iii) Supported and particularly where this applies to the “non-intermediated” insurers.

(b) Next steps for Proposal FF

Further clarity is sought on these proposals. While it is accepted that Insurers require customer information, the utilisation of that information for cross selling and other non- TCF related activities must be restricted. Insurers have been using the data issue as a reason for contacting Customers directly for such purposes. Clear guidelines need to be established to ensure that the requirements are not used for purposes other than for the intended purpose.

We request to be included in the consultation process on this point.

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

N/A to Short Term

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

N/A to Short Term

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

N/A to Short Term

4.8 Proposal RR: Equivalence of reward to be reviewed

Whilst this Proposal refers to the Long Term segment we believe that this practice is emerging in the Short Term segment and that where this is happening this proposal needs to be made relevant.

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

We support the principle of commission being paid “as and when”.

(a) Updated FSB view

Considering that in today’s sophisticated insurance market it is required of Insurance Brokers, particularly in the commercial lines markets, to provide their customers with risk management and insurance consulting services, which are beyond the services typically associated with the placement and servicing of a policy contract. Brokers offer these services, not compensated for by commissions, as part of their expanding role as insurance professionals responding to their customers’ risk needs.

In the light of the above the FIA have followed the World Federation of Insurance Intermediaries (WFII) in adopting the following principles regarding remuneration of insurance brokers:

Principle 1

Every insurance broker has the right to be remunerated fairly for his or her services.

Principle 2

Any remuneration or compensation for services as a broker should be considered as an issue between the parties.

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Principle 3

Legislation or concerted market agreements limiting or imposing the rate or the means of remuneration is considered by the WFII as a serious infringement of basic free market principles and would be against international market practice.

Principle 4

Intermediaries should be allowed to charge fees in addition to, in lieu of, or in combination with commissions. In such case, the customer should be informed and be in agreement.

In terms of the Short-term Insurance Act (Part 5, Sec 48), commission is paid *"for rendering services as intermediary"* which is defined as *"any act performed by a person –*

(a) the result of which is that another person will or does or offers to enter into, vary or renew a short-term policy; or

(b) with a view to :

(i) maintaining, servicing or otherwise dealing with;

(ii) collecting or accounting for premiums payable under; or

(iii) receiving, submitting or processing claims under;

A short-term policy;"

The FSB's view *"The maximum cap for such remuneration – to be determined after further technical work – is expected to be lower than current commission caps. This is because the remuneration paid by the insurer will no longer include a provision for advice."* This presupposes that the premiums will reduce proportionately?

This view does not stand up to the requirements of the Short Term Insurance or FAIS Acts where the provision of Advice is not identified as an activity for which commission is paid.

The splitting of commission into sales and service should not be considered due to the range, size and complexity of some of the products versus the simple nature of mainly personal type policies, i.e. large commercial versus personal lines. The challenge will be that of determining the equitable rate of remuneration as would apply to say a large commercial portfolio versus a personal lines policy so as to avoid a "one size fits all approach". The other concern is that setting a maximum cap will default to the highest permitted.

Going forward the challenge will be to split out product (factual) advice from that of true recommendations, opinions, research, risk management and portfolio structuring on future courses of action for which an advice fee should be agreed with the customer.

The FSB is *"concerned that so-called "section 8(5) fees" are inconsistent with RDR objectives as their purpose is unclear and customers consent to the fee is not a requirement."*

It is our view that the Section 8(5) Advice fee should be disclosed to the customer with details as to the services it supports and is separately stated on the quotation / terms and policy schedules and agreed as part of the cost of the insurance solution provided to the customer.

The final point in the original Proposal UU states that Insurers will be required to demonstrate how they have adjusted product charges on products sold after the applicable effective date, in light of the changes in level and structure of commissions. This proposal is welcome and

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will assist consumers in making more informed choices. However this comment should not be seen as a concession that we support a reduction in commission levels – certainly not without a detailed activity based remuneration review across all broker activities.

It is submitted that in so far as Intermediaries are required to be transparent about the services rendered and commission and other fees earned, Insurers (more especially the Direct insurers) should be placed under the same obligations so that Customers can understand at a granular level what portion of the "premium" paid is allocated to "risk". To ensure that there is no gauging of the market, it is suggested that technical work is undertaken to determine the impact of commission reduction on the premium charged by insurers. It would be reasonable to expect that premium rates would reduce proportionately.

(b) Next steps for Proposal UU

The current capped commission rates were determined many years ago from which time the industry dynamics, range of products and delivery methodologies have changed significantly. Costs have increased due to compliance and governance requirements while the unit cost of insurance has reduced due to intense competition – both resulting in lower per unit earnings to the broker.

In view of the abovementioned and that of the FSB's concerns of all forms of remuneration, we strongly recommend that the entire process (from customer advice to policy sales, support and claims be properly analysed by activity type. From this point we can determine which activities are remunerated by what revenue streams. Remuneration levels can then be properly informed on a reasonable rate of return basis.

The exercise needs to be done properly and holistically by means of a joint industry / regulatory initiative and if necessary the inclusion of professional input and co-related global markets. Global practices need to be considered as many of customers require coverage and or markets beyond the South African Insurance market and to depart from global practices would create significant difficulties.

We would welcome being part of such a project team.

The exercise needs to extend to activity types comprising other broker services to customers for which, together with a fee for "advice", broker service fees are charged for under Sec8(5) and or the proposed Advice fee.

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

(a) Updated FSB view

It is accepted that a non-mandated intermediary (n-mi), as defined in "Part 6 - Binder Agreements" of the STIA Regulations, and Insurance Brokers working outside of the Binder regimen who are subject to the FAIS General Code of Conduct, cannot cancel a policy without the consent of the customer.

The real issue and concern of the Insurance Broker is that in the instance where the n-mi or Insurance Broker initiates a move of policy/is due to circumstances of necessity where the current Insurer's product is no longer competitive or where they have introduced restrictive cover or terms and or it could be where the solvency rating is under threat and where the Insurance Broker is unable to contact the customer within the required time frames, that should the Insurance Broker not act in the customers best interests they are exposed.

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These circumstances also arise outside and apart from the movement of books (where attention is currently focussed) and apply where product changes arise (at the instance of say Binder Holders or Insurers) and need to be communicated to customers. We contend that existing communication protocols are effective and when correctly applied do not create downside risk for customers. In fact they create advantage through Insurance Brokers acting in the best interests of their customers.

This requires further interactive engagement with the industry in the context of the draft Directive on the Cancellation and transfer of policies.

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

(a) Updated FSB view

We maintain our views as detailed in the original RDR comments submitted, the essence being that we do not subscribe to the capping of fees for reasons stated, as this will not address the many shortcomings as detailed in the Binder Thematic Review.

(i) We believe that the Insurers "giving" out Binders and Outsourcing contracts should display a far more stringent entry criteria in accordance with the requirements and principles of the Binder regulations and Directive 159.A.(i)) and we agree with the FSB's views that a far more rigid regimen of governance and controls should be exercised in the ongoing management and oversight of these arrangements. We furthermore agree that the quality of data needs addressing and should be addressed as noted in our comments under 4.3 above as part of the entry criteria for qualifying to operate these type arrangements. This together with the current TCF and FAIS, which is sound regulation, should ensure that proper practice and business sense should prevail.

It is our view that Outsourcing arrangements, (including Binders), should be an enabling and value adding facility and not one of entitlement.

(ii) We do not believe that a "blanket" prohibition on Binder functions other than those of "enter into, vary and renew" and "claims settlement" functions should be enforced and that each binder function outsourced should be handled on its merits and be part of the upfront due diligence process.

It is timeous that as part of the ongoing technical work in this regard that the current Binder functions be reviewed so as to determine their relevance and clarity of definition. In particular we disagree that the Determination functions be prohibited.

(iii) Regarding Commercial Binders it is our view that Binders have a place in the market and that the correct upfront "selection" criteria should be exercised by Insurers to determine the functions that could be allowed. Clearly this will be influenced by the types of risks, limits and premiums and also skills and capabilities of the Binder Holding entity and in particular for those classes and size of risk that attract high volumes and low premiums. We believe that this is part of an Insurer's business practice and therefore should not be regulated so as to prohibit such arrangements in the commercial space.

(b) Next steps for Proposal ZZ

We welcome the opportunity to participate in further technical work and discussions to be held with regard to the investigation into the appropriateness of the fee structures and in this regard we would support a review of the various "Binder activities" to confirm their relevance and clarity of definition.

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The capping of commission has in the past led to the maximum allowed levels becoming the standard. It is submitted that it would be preferable to rather determine whether the payment is commensurate to the services being rendered as per the principles as set out in the Binder Regulations.

The entity earning the fee as well as the entity paying the fee must justify why the fee is set at a particular percentage. Capping of fees will result in the higher percentage being applied as the standard. The FIA submits that this seems to contradict the intention of the, Outsourcing directive and Binder regulations that all have at the core, that amounts payable should be reasonable and commensurate to the services being rendered.

We recommend that a joint industry / FSB work group be convened to better understand the Commercial business model and then determine the rationale for Binders/Outsourcing models.

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

N/A to Short Term.

4.13 Proposal BBB: Outsourcing fees for issuing insurance policy documents

We note that this proposal has been dropped.

However we cannot agree with the FSB's comments that *"it would be more efficient and less costly for the insurer to provide the policy document directly to policyholder, rather than place this administrative responsibility (and cost) on the adviser."* Clarity around this comment is sought.

The Insurance Broker has an obligation to the customer to review and confirm the correctness of the policy issued by the insurer and also to ensure that there is a full understanding of the policy terms and conditions.

The nature, complexity and degree of accuracy required in issuing commercial policies, in particular "multi-layer" policies, and which would be despatched directly to customers by Insurers would expose Insurance Brokers to increased levels of Professional Indemnity losses as well as severe reputational issues.

Kind Regards,

Justus van Pletzen

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