



RDR: A status update

**Presentation for:
2016 Insurance Regulatory
Framework Seminar**

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Agenda

- Where are we now? An update on RDR Phase 1
- Future RDR Phases - An update on the following themes:
 - Adviser categorisation and forms of advice
 - Investments
 - Risk insurance (long-term & short-term)
 - Sales execution and other intermediary services
 - The low income market
 - Consumer Education
- Next steps



**Where are we now?
An update on Phase 1**



FAIS instruments addressing aspects of RDR

- FAIS General Code
 - Enhanced definition of “replacement” – including RA and annuity transfers (OO and QQ)
 - Possibly strengthened conflict of interest requirements as between FSPs and their representatives (SS, supports RR)
- FAIS Fit & Proper requirements
 - Competency standards for automated advice and execution of sales (including selling with a script) (B, D)
 - Product knowledge competency requirements (supports BB, CC, DD, EE)
- FAIS Regulations:
 - Adviser may not act on more than licence for same product classes (Y)



LTIA / STIA Regulations & PPRs

- Various RDR Phase 1 proposals covered, as per earlier presentation by Jo-Ann



Adviser categorisation & forms of advice



Two-tier adviser categorisation

- We confirm that there will be two main categories of financial adviser:
 - Product supplier agent (PSA): Not licensed in own right, authorised to provide advice on a product supplier's licence
 - Registered financial adviser (RFA): A firm or individual (sole proprietor) licensed to provide advice – not a product supplier
 - The provisional titles PSA and RFA will be consumer tested
 - No individual adviser or firm may operate in both capacities
- Timing: Phase 3



Strict approach to “gap filling”

- A PSA may provide advice only on products issued by the product supplier with which it has the agency relationship (“home” supplier) – plus products issued by other product suppliers in the same financial services group as the home supplier (“group” to be defined)
- Includes investment products distributed through a LISP (administrative FSP) within the group
- No “gap filling” will be permitted – other than a possible exception for fixed interest annuities where the only product differentiator is the annuity rate.



Strict approach to “gap filling” cont.

- For any other “gaps” in the home supplier’s offering, referrals may be used (see later slide)
- We will consult further on allowing a PSA to act as PSA for another product supplier operating in a product sector / line of business for which the home supplier / group is not licensed, provided:
 - All suppliers agree to the arrangement
 - Each product supplier is separately accountable for advice by the PSA (acting as each supplier’s agent) for advice on its own products
- Timing: Phase 3 (long-term insurance Proposal V in Phase 1)



Financial planning

- An individual adviser (RFA or PSA) may use the additional designation “financial planner” if the adviser has met all requirements for such designation set by a professional body recognised by SAQA and is a member in good standing of such association:
 - Currently only the Financial Planning Institute and its CFP designation meet this requirement, but it is open to other associations to apply to SAQA for the necessary approvals
 - Recognition of foreign equivalents will be considered, in consultation with SAQA and professional bodies
 - No clear case at this stage for applying the model to S-T insurance risk planning
- Timing: Phase 2 (will include conduct standards – not caps – for financial planning fees, in consultation with FPI)



“Low” (simplified) advice

- Feedback generally supported formal recognition of a “simplified” advice process. We are considering two options:
 - No regulatory change, but publish regulatory guidance to clarify that the extent of suitability analysis required is flexible depending on complexity of customer needs
 - Formally defining and setting standards for a simplified advice process in specific circumstances
- Challenge is not to undermine the quality of suitability analysis by creating inappropriate loopholes
- Timing: Phase 2 or 3, depending on option selected
- New FAIS fit & proper requirements set standards for “automated advice” (robo-advice)



Product supplier influence

- Principle:
 - Advice provided by an RFA should not be influenced by any product supplier or other third party
- Where legitimate business arrangements pose unavoidable risks of conflict, this must be mitigated
- Examples (not a closed list) of risk mitigation include:
 - Ownership relationships – close supervisory monitoring
 - Outsourced services – limitations, efficiency, enhanced governance & oversight, fee caps
 - Production targets – prohibited for RFAs (with further work underway on standards for contract terminations)



“Independent” advice

- No RFA firm or individual RFA adviser may describe itself or its advice as “independent” unless:
 - It has no direct or indirect ownership interest in any product supplier and no product supplier has any such ownership interest in it
 - It does not earn any direct or indirect remuneration from any product supplier other than regulated commission (where applicable) – i.e no binder fees, no outsourcing fees, no profit shares, no cell arrangements, no joint venture arrangements, etc.
 - No other relationship exists with any product supplier or other third party that could result in any product supplier influencing the advice provided.



Product supplier responsibility

- Principles:
 - Product suppliers and advisers share responsibility for customer outcomes
 - Greater risk of product supplier influence over advice means increased levels of product supplier responsibility
- What does this mean in practice?
 - A greater degree of proactive product supplier monitoring of customer outcomes will be required where ownership, outsourcing or other risks of influence exist
 - Possibly less intensive, more reactive approach for fully arms' length relationships
 - Full product supplier accountability remains for PSAs



Juristic representatives

- We remain of the view that these structures are not desirable in RFA advice models
- We are considering allowing PSAs to be structured as juristic entities. Possible conditions could be:
 - Rigorous product supplier oversight measures
 - PSA to use product supplier branding and meet specific operational requirements
 - Limiting or disallowing use of juristic PSAs if the entity is not part of the product supplier's group
- Reviewing circumstances in which JRs may be used in non-advice models
 - Where allowed, these will be subject to strengthened operational requirements
 - Timing: Phase 2



Investments





Early termination charges

- LTIA Regulations will bring further phasing down of legacy causal event charges
 - Timing: Phase 1, with phased implementation
- Review of causal event charges on new investment policies will be informed by technical work, aligned to abolition of commissions
 - Timing: Phase 2 for lump sums, phase 3 for recurring contributions



Investment platforms

- No changes proposed to initial RDR proposals, i.e:
 - All rebates prohibited – “clean” pricing
 - No remuneration for platform provider (LISP) other than platform fees paid by customer
 - Considering need to address some current practices that apparently circumvent RDR proposals
- We will consult further on proposals regarding uniform pricing and equally prominent display of all platform offerings, based on feedback
- Timing: Phase 2



Remuneration for advice

- Prohibition of commissions and shift to advice fees being phased in:
 - Lump sum investment products – Phase 2
 - Recurring payment investment products – Phase 3
- Remuneration for compulsory annuities:
 - Considering an annuity purchase amount below which commission can still be paid (for all compulsory annuity types)
 - Exceptions for low income market recurring investments (not lump sums) will apply:
 - To be informed by technical work, but likely to be based mainly on a simple contribution size threshold.



FAIS Cat I and II licences

- Need to better clarify distinction between FAIS Category I and Category II licence criteria:
 - Considering defining “investment management” as a specific licensed activity
 - Will identify specific activities that comprise “true” investment management, rather than current broad reference to a discretionary mandate
- Also considering need to address risks of conflict of interest when exercising discretion
 - For e.g. where an investment manager uses a discretionary mandate to place investments in portfolios it manages.



Outsourcing investment management to advisers

- We remain of the view that an RFA should not be able to earn advice fees for recommending any product / portfolio that they also earn investment management fees on (directly or indirectly)
- We are considering whether / when an adviser could be regarded as a “PSA” of an investment manager (i.e the investment manager would have similar responsibilities to a product supplier in such cases)
- Intention is not to disallow the use of white labels for “incubator” purposes to support new entrants.



Risk insurance



Binders and outsourcing

- A significant risk of conflict exists where an RFA also earns binder or outsourcing fees from suppliers whose products it recommends
- Hence the risk mitigation measures being introduced through the insurance PPR and Regulation changes (discussed in Jo-Ann's earlier presentation)



Premium collection

- We agree with feedback that premium collection should be seen as an outsourced service on behalf of the insurer
- This approach will apply once we have set qualifying operational criteria for premium collection – possibly also a fee cap for premium collection
- Until then, premium collection is regarded as part of “services as intermediary” – i.e. subject to current commission caps, no separate remuneration payable
- Timing: Phase 2.



Remuneration: Short-term

- Stricter criteria for earning s.8(5) fees being introduced through Phase 1 STIA Regulation changes
- Next step will be to confirm new S-T commission caps and set standards (not caps) for advice fees
- Still considering whether separate caps should be set for remuneration for selling vs. remuneration for ongoing policy servicing, or whether both should be included in a combined cap – either way, both will be payable as-and-when premiums are paid



Remuneration: Short-term (cont.)

- Future commission caps and model will be informed by technical activity segmentation work underway – knock on effects of other remuneration caps are a key consideration
- Initial findings of activity segmentation:
 - Significant duplication and overlaps in activities for which intermediaries are remunerated
 - Inconsistent interpretation of differences between “services as intermediary”; outsourced activities; binder activities
 - Current remuneration levels for binders & outsourcing are largely based on prevailing market practice – little evidence of robust activity based costing linked to actual cost of activities
- Timing: Phases 2 and 3 - appropriate transition / phasing in measures aligned to implementation of binder and outsourcing fee caps and enhanced conduct standards.



Remuneration: Life risk

- Technical work planned to inform future L-T commission caps and model, including activity segmentation similar to S-T approach
- Will take into account the combined effect of:
 - Introduction of advice fees for life risk products
 - Equivalence of reward proposals for individual PSAs
 - Abolition of commissions on investment products
 - Strict approach to 'gap filling' for PSAs
 - Possible abolition/reduction of commission on replacements
- Kick-off industry workshops scheduled for December



Remuneration: Life risk (cont.)

- Still considering how best to link ongoing commission to ongoing service – raises questions of when / how to allow redirecting of ongoing commissions
- Timing: Phase 3
 - But with new commission caps and shift from 100% up-front to 50% up-front commission to be phased in over time



Equivalence of reward

- Final model (EoR principle applied at the level of individual PSAs) will be informed by technical work
- We will consult on extending the EoR principle to short-term insurance – we observe an increased interest in tied advice models in the S-T sector
- EoR is only relevant to insurance PSAs, but there is a need to avoid unintended arbitrage if RFAs are eligible for more generous remuneration than PSAs once EoR is fully implemented – particularly where ownership relationships with product suppliers exist
- This will inform broader work on standards for remuneration arrangements between RFA firms and their advisers.



Policy replacements

- Effectiveness of Phase 1 replacement controls (stricter insurer monitoring) will be monitored to inform whether / when commission interventions are required
- Technical work on impacts of different commission approaches for replacements (and timing) will be undertaken in due course to inform the final position.



**Sales execution &
intermediary services**



Non-advice sales execution

- New FAIS fit & proper requirements recognise that tailored competence standards are necessary for non-advice distribution models, by introducing:
 - Competence standards for “execution of sales” - i.e. non-advice, execution only distribution models
 - Specific competence standards for execution of sales through a set “sales script” model
 - Linking competency requirement in these models (to a degree) to product complexity.
- Further work planned on refining the link between non-advice sales and specific product types
- Timing: Phases 2 and 3.



Product comparison & aggregation

- Standards for these services, based on international standards, to be introduced in Phase 2.



Referrals & leads

- Focus has been on context of the proposed strict approach to “gap filling” for PSAs
- Will consult on allowing PSAs to fill “gaps” by referring customers to another product supplier, provided that:
 - Home supplier must have rigorous governance process to select such suppliers and products, including due diligence
 - Governance process must ensure conflicts of interest are avoided – i.e. referral must be objective, not unduly influenced by other relationships, “quid pro quo” deals, etc.
 - Home supplier must demonstrate that the referral is necessary due to an identified customer need that cannot be met by its own product range



Referrals & leads (cont.)

- Alternatively, referral to an RFA (as opposed to a product supplier) who is able to advise on an appropriate product is possible – again provided due diligence on the RFA has been carried out
- Further work to be done on remuneration standards for referrals and leads. Current thinking is that:
 - The adviser (or its product supplier in the case of a PSA) may earn a referral fee but may not earn any advice fee for the referral
 - Where commission caps apply, the aggregate of commissions and referral fees to all parties may not exceed the cap
- Timing: Phase 2.



The low income market





Low income market

- This Proposal will form part of the broader financial inclusion strategy being formulated by the FSB and to be progressed by the future Financial Sector Conduct Authority
- From a narrow RDR perspective, technical work will inform:
 - the premium threshold below which sales of recurring contribution investment products may still be eligible for commission
 - Whether any other product standards are required to be eligible for such commissions – for e.g. further limitations on termination charges, degree of investment risk, etc.

The logo for TSB Bank, featuring the letters 'TSB' in a bold, white, sans-serif font. The letters are illuminated from within, and the 'B' contains a small image of a landscape with trees. The logo is mounted on a light-colored, textured wall.

TSB



Consumer education



Consumer education on RDR

We have set up an RDR consumer education workstream, with industry participation, to help customers understand:

- The value of fair, quality financial advice and the risks of not getting advice
- The levels of service and skill to expect from financial advisers
- The types of advisers and advice available, who they can hold to account for poor advice, and recourse mechanisms
- How they will pay for financial advice in future (compared to how they are paying now)
- Their responsibility to check adviser credentials and ensure they understand the value proposition



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Next steps



Next steps

- An RDR status update will be published before the end of 2016, with further detail on:
 - Technical work planned and in progress
 - Regulatory instruments to be used for Phases 2 and 3 and their timing
 - Phase 2: Will use a combination of existing sectoral instruments and, where necessary, conduct standards under the Financial Sector Regulation Act – during 2017 / 2018
 - Phase 3: Will comprise measures that are best introduced once the overarching Conduct of Financial Institutions (CoFI) Act is in place – anticipated in 2018



Next steps

- Consultation on the various instruments comprising the Phase 1 proposals will start before year end, with adequate feedback time into 2017 (Consultation on FAIS fit & proper requirements already underway)
- Dependencies on the broader Twin Peaks legislative timetable remain - particularly for Phase 3 proposals
- Phase 2 and 3 timelines will also be informed by technical work – and consulted on
- It is important to get RDR done – but equally important to get it right!



Questions?