



Retail Distribution Review Update

INSURANCE REGULATORY SEMINARS

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Presenter:

Leanne Jackson



Agenda

- The RDR process so far
- Our current thinking on adviser categorisation
- Update on RDR “Phase 1” proposals
- Next steps



The RDR process so far

- FSB RDR implementation steering committee – with 6 workstreams
- All stakeholder feedback reviewed, collated, summarised, debated
- Follow-up workshops with industry reference groups
- Focus now on adviser categorisation and Phase 1



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Adviser categorisation





Aspects that need review

Confusing terminology - especially “multi-tied” – will not help customers understand advice status

- If three tiers are retained, we will need to find a better name for the “middle” tier
- Consider using “agent” for tied advisers

Main test of independence should be extent of product supplier influence

- Will not proceed with minimum product / product supplier range criterion (Proposal M) – to be monitored by supervision instead

Scope of tied advice could allow limited “gap filling” where supplier licence does not cover product lines

- Not convinced that more general gap filling is required



Two tiers or three?

The jury is still out....

- Current proposal is 3 tier adviser categorisation model: Tied, multi-tied, IFA – we acknowledge this is complex
- Most commentators proposed a shift to two tiers, either:
 - Define “tied” – all other advisers non-tied / independent; or
 - Define “independent” – all other advisers tied / non-independent
- ASISA: - Retain three tiers (with gap filling for tied), and:
 - If one product supplier exercises influence, adviser will be tied
 - If more than one supplier exercises influence, all “influencing” suppliers are jointly & severally liable for advice, whether their product or not
- **FSB not convinced that any of these will fix current problems**



Conflict controls where there is product supplier influence

- Whether we adopt two tiers or three, concerns regarding conflicts arising from different levels of influence by different suppliers need to be resolved
- FSB has looked at the types of influence listed in Proposal N, to see how this risk can be mitigated in respect of “non tied” advisers
- Focus areas include:
 - Binders and outsourcing – stricter conflict controls needed (see later in this presentation)
 - **Production or sales targets**
 - **Ownership or other interests**
 - Other conflicted arrangements – covered by FAIS GC



Conflict controls: Production or sales targets

- Proposal is to prohibit these outright, except for tied advisers (where FAIS already disallows pure volume incentives)
- FSB shares advisers' concern that threat of product supplier cancelling intermediary contracts due (*only*) to low production creates a conflict – an implicit production target
- But we accept that it may not be commercially viable for suppliers to provide same services – and accept same accountability – for all advisers regardless of productivity
- FSB will consult on measures to enable advisers whose contracts are terminated / inactive due to low production to be able to offer reasonable ongoing customer service and earn ongoing contracted remuneration – subject to other relevant competency and remuneration eligibility criteria



Conflict controls: Ownership or similar interests

- Sharply conflicting views from commentators on whether these interests – by suppliers in advisers / advice firms, or vice versa – “automatically” lead to biased advice
- FSB current view is that mere existence of such interests need not automatically create bias in favour of the product supplier – but strong evidence hurdle required to prove non-biased advice
- Will require close supervisory scrutiny – including reporting on spread of products recommended – to clear this hurdle
- If bias is detected – remedial action required to restructure relationships, or adviser will need to become tied
- All of this also subject to further planned review of ownership relationships per Proposal GG



A possible two-tier alternative

- Two licence categories: (i) Registered product supplier agent; (ii) Registered financial adviser - adviser cannot be both
- Further work needed on customer facing “labels” and supporting descriptions
- Product supplier agent (replaces previous “tied adviser”):
 - not licensed in own right, but provides advice on licence of the product supplier – product supplier fully accountable for advice
 - may provide advice only on products of own product supplier / group – including “external” investment products on own supplier’s LISP platform
 - considering allowing agents to be juristic entities for group structure purposes – but with branding restrictions



A possible two-tier alternative (cont.)

- We are also considering allowing for limited “gap fill” by product supplier agents as follows:
- Allow a product supplier agent (tied adviser) to act as an agent for more than one product supplier – but limited to one supplier per line of business
- Adviser could for e.g. be an agent of:
 - one L-T insurer for long-term risk insurance products
 - one S-T insurer for short-term insurance products
 - one supplier for savings & investment products
 - one medical scheme, etc.



A possible two-tier alternative (cont.)

- This “per line of business” model allows for a degree of “gap filling”, but minimises conflicts as products and suppliers do not compete
- Further work would be needed to decide:
 - does one supplier need to act as “lead” supplier for licensing and compliance purposes?
 - do product suppliers need to be informed of or approve other agency relationships?
 - what disclosure standards will apply re. adviser status?
 - how would we deal with case where one product supplier offers multiple lines of business?



A possible two-tier alternative (cont.)

- Registered financial adviser (replaces previous “multi-tied” and “IFA” categories):
 - licensed in own right to provide advice (sole proprietor) or provides advice on licence of an authorised advice firm provided advice firm is not also a product supplier
 - licence holder (sole prop or advice firm) is accountable for advice provided – although applicable RDR product supplier responsibility requirements will also apply
 - will need to comply with all the conflict of interest controls (discussed earlier) to mitigate risk of different levels of influence by different suppliers



A possible two-tier alternative (cont.)

- A registered financial adviser / adviser firm may also describe itself or its advice as “independent”, provided that:
 - no binder or outsource arrangements with any product supplier exist
 - no product supplier holds any ownership or similar interest in the adviser / firm, and the adviser/ firm holds no such interest in any product supplier
 - no other forms of product supplier influence exist
- Being “independent” would not be a separate licence category – rather an additional label / descriptor that a registered financial adviser may use if it meets the above standards



A possible two-tier alternative (cont.)

- Either a registered financial adviser or a registered product supplier agent may also describe themselves as a “financial planner”, provided they meet the applicable standards for financial planning
- The principle that degree of product supplier responsibility in relation to advisers will be aligned to degree of influence, will be retained – Proposals BB, CC and DD to be revised to align with this 2-tier model, if adopted



Update on RDR Phase 1 proposals



Updated views on Phase 1 proposals

- 14 RDR proposals were proposed to be implemented using current regulatory frameworks – i.e. before implementation of the Financial Sector Regulation (FSR) Act
- FSR Act timelines have shifted – Bill tabled in Parliament on 27 October 2015, effective date expected late 2016
- Overall timeline therefore moves out by approximately 6 months, with RDR Phase 1 implementation (per following slides) now proposed for July 2016 – with some effective dates still subject to consultation
- The updated approach to Phase 1 proposals in the following slides is not final – each measure still subject to specific consultation



Proposal V

Insurer tied advisers may no longer provide advice on another insurer's products

- We intend to proceed with this proposal
- But will consider allowing “gap fill” for cases where the insurer’s insurance licence does not allow it to offer particular types of insurance product classes – for e.g. if an insurer (as insurer) is licensed for assistance policies only, it may enter into agreement with another (external) insurer to allow its advisers to market non-assistance policies
- Primary insurer remains accountable for advice, as currently
- Note that all FAIS requirements remain applicable – i.e. primary insurer and advisers would need to meet fit & proper standards for the products concerned



Proposal Y

Advisers may not act as representatives of more than one juristic intermediary (adviser firm)

- Proposal may be modified - disallow advisers from being a representative on more than one FSP licence where the FSPs concerned are licensed for the same FAIS product categories - for e.g. a representative of FSP A may only be appointed as a rep of FSP B for product categories for which FSP A is not licensed
- This should accommodate most valid arguments raised – for e.g. the ability to obtain experience under supervision for new products and certain group structures
- **New:** Same legal entity will not be permitted to hold more than one FSP licence
- **New:** Will also tighten fit & proper operational requirements and supervision of KIs to prevent “rent a KI” models



Proposals Z and AA

Restricted outsourcing to financial advisers; Certain functions permitted to be outsourced to financial advisers

- Stricter controls for outsourcing by insurers to advisers - except for funeral administration, where outsourcing controls will be addressed in later phases together with work on Proposal TT and microinsurance
- Outsourcing controls for other sectors – notably outsourcing of investment management – to be deferred to next phase of RDR



Proposals Z and AA (cont.)

Tighter controls being considered for outsourcing by insurers to advisers:

- Adviser who holds binder to “enter into, vary or renew” policies may not also earn outsourcing fees for policy administration – this is implicit in binder function
- Other advisers may not earn outsourcing fees for policy administration unless parties prove administrative efficiency that enables “real time” data capture – through direct capturing on insurer platform
- Fees for such outsourced policy administration will also be capped, after further consultation on cap level – initially proposed as 2% of premium
- Conduct standards for outsourcing to be strengthened to further minimise conflicts and quality of insurer oversight



Proposal FF

General product supplier responsibilities in relation to receiving and providing customer related data

- Product supplier access to data held by advisers – to be addressed through Proposals relating to product supplier responsibility. Will require reasonable co-operation from advisers.
- Product supplier access to data held by binders and outsource parties – addressed through binder and outsourcing requirements
- Adviser access to data held by product suppliers: Where supplier receives customer authorised request to release info to an adviser with whom it has no intermediary agreement, supplier must either:
 - Comply with the request; or
 - Decline request, but provide info direct to customer with a fair and objective explanation



Proposal 00

Product supplier commission prohibited on replacement life risk policies

- Commission related interventions will be deferred to later RDR phase, to align with implementation of advice fee standards
- In interim – strict replacement monitoring obligations to be imposed on insurers for long-term risk policies with up front commission, including:
 - clear definition of “replacement” for these purposes
 - new insurer may not release commission or any other fees until it has confirmed in writing (with copy to old insurer) that replacement advice record meets specific requirements
 - failure to report replacements attracts commission clawbacks; appropriate regulatory action; extended cooling-off periods



Proposal 00 (cont.)

- Statistical reporting on replacements will be required by old and new insurers and advisers
- Supervisory scrutiny of replacement controls will be strengthened



Proposal PP

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

- Changes to long-term insurance commission regulations to remove anomalies relating to variable premium increases on legacy policies will proceed as proposed
- Engagement with the long-term industry to further improve early termination values will also proceed as proposed. There are two aims:
 - Removing or substantially reducing early termination charges on new policies issued after RDR proposals to remove commission on investment policies; and
 - Further reduction of early termination charges on policies already in force



Proposal QQ

Conflicted remuneration on RA transfers to be addressed

- In the longer term, concerns to be addressed by reduced early termination charges and prohibition of commission on new policies – but concerns remain in the interim
- Revised replacement standards will enhance disclosure requirements on transfers of RAs, preservation fund policies and living annuities – including for prescribed transfer documents to be signed off by trustees, where applicable
- **New:** FSB recognises 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. The position will be reconsidered.



Proposal RR

Equivalence of reward to be reviewed

- Full implementation at individual adviser level to be deferred to later phases of RDR, together with long-term insurance risk product commission model
- But the FSB is becoming increasingly concerned regarding abuses – particularly since prohibition of sign-on bonuses
- In interim, current LTIA mechanisms for Registrar to determine practices that are not in line with the equivalence principle – and to issue notice that specific persons or insurers are not complying – will be used



Proposal RR (cont.)

Equivalence of reward to be reviewed

- Initial focus likely to be on:
 - substantial non-cash incentives - including overseas trips, paying-off adviser debts, share options and similar schemes
 - lump sums paid as retention bonuses, restraints of trade or similar arrangements that may be disguised production incentives
 - particularly where these benefits are offered to select individuals, materially out of line with benefits available to other tied advisers of the insurer fulfilling similar functions
- A review of existing tied adviser remuneration models will be undertaken to inform the final equivalence of reward model



Proposal UU

Remuneration for selling and servicing short-term insurance policies

- **To clarify:** RDR does not propose that insurers will move to up-front remuneration of advisers – any future remuneration payable by insurers will be as-and-when premiums are received, but subject to new caps
- Further consultation planned for next RDR phase on whether this as-and-when remuneration should be split between separate caps for “selling” (commission) and “servicing” (service fee) as per initial RDR proposal - or whether a single commission cap should cover both
- Immediate concern is the s.8(5) fee under the STIA – currently no customer consent and purpose of fee unclear – inconsistent with RDR principles



Proposal UU (cont.)

- Section 8(5) of STIA was repealed by Financial Services Laws General Amendment Bill 2013 – but repeal not yet effective
- Repeal to come into effect together with other STIA Regulation changes discussed today
- Fee to be replaced by advice fees when RDR advice fee standards come into effect
- In interim, repeal to be combined with an alternative mechanism requiring customer to agree fee – and its purpose – in advance
- Charging of these fees (and their purpose) and related disclosures will be monitored



Proposal VV

Conditions for short-term insurance cover cancellations

- Intent is to proceed with the proposal, with some changes:
- Cancellation by intermediary: Clarify that explicit consent by each customer is required – considering a review of standards where adviser holds a discretionary mandate
- Cancellation by insurer: Insurer remains on risk for shorter of:
 - 30 days after insurer receives proof that customer is aware of cover cancellation; and
 - period until insurer receives proof that customer has new cover



Proposal ZZ

Binder fees to multi-tied intermediaries to be capped

- Very divergent feedback received – FSB intends to proceed with binder caps, but with further technical work to finalise levels of caps
- Conduct standards for binders – especially with advisers – to be strengthened. Focus on improved insurer oversight and operational efficiency.
- Considering disallowing binders with advisers (as opposed to underwriting managers) for purposes other than the “entering into, vary or renew” and “claims settlement” binder functions
- Questions re. appropriateness of binder agreements with advisers for S-T commercial lines business generally: – service efficiency gains not obvious; unclear whether sufficient specialist skills to mitigate underwriting and reinsurance risk; caps to mitigate conflicts difficult to set



Proposal AAA

Commission cap for credit life insurance schemes with “administrative work” to be removed

- Intend to proceed with the proposal to cap all credit life group scheme commissions at 7.5% as-and-when
- Longer term, future insurance segmentation to clarify types of group models permitted in credit insurance market – but current model poses risk of abuse
- In line with updated Proposals Z and AA – adviser only able to earn outsourcing fees (over and above commission) for credit life policy administration if “real time” information updates are in place or through a permissible binder arrangement



Proposal BBB

Outsourcing fees for issuing insurance policy documents

- This proposal is to be withdrawn
- This service is only operationally justified where a binder to “enter into, vary or renew” is in place or an outsourcing agreement for policy admin with “real time” data exchange
- In both these cases, issuing policy documents will be incidental to the binder / outsource activities



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Next steps





Next steps

- RDR Phase 1 update document to be published in next two weeks – feedback welcome, but will be specific consultation
- The following are the main regulatory instruments to be used to give effect to the updated Phase 1 approach in the preceding slides:
 - (a) Revised Regulations under new Insurance Act, LTIA/STIA
 - Consultation March 2016; implementation July 2016
 - Plan is to combine consultation with changes required for Insurance Act for convenience – but most not a dependency, RDR timelines can precede Insurance Act



Next steps (cont)

(b) Revised Policyholder Protection Rules under LTIA and STIA

- Consultation April 2016; Implementation July 2016

(c) FAIS Fit & Proper requirements

- Consultation November 2015; Implementation July 2016

(d) FAIS General Code of Conduct changes

- Consultation April 2016; Implementation July 2016

(e) Directive to be issued by L-T Registrar regarding equivalence of reward

- Consultation early Q1 2016; Implementation immediate (with transition measures)



Next steps (cont)

- Despite overall implementation target date of July 2016, implementation of some specific measure will be consulted on – together with transition measures where necessary to allow for changes to business models and systems
- In addition to regulatory measures – various supervisory activities are also planned, including:
 - Publication of binder thematic review
 - A range of specific reviews needed to finalise proposals
 - New conduct of business returns for insurers and FAIS licensed FSPs
- High-level implementation update for remaining RDR proposals to be published by end 2015



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Questions?

