



RDR: A status update

**Presentation for:
FAIS Conference
March 2017**

**Leanne Jackson
Market Conduct Strategy
Adviser**



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 (among other reforms):

- Insurer reps (tied agents) may no longer market another insurer's policies unless their own insurer is not licensed to issue the policy type (an interim measure)
- Replacement controls on life risk policies – new insurer to monitor disclosures, no commission if disclosure standards not met (interim measure)
- 22.5% commission cap on credit life schemes “with administrative work” scrapped, all schemes now at 7%



LTIA / STIA Regulations & PPRs cont.

- Clarify consequences of non-compliance with “equivalence of reward” (preparatory measure)
- Commission on variable premium increases on “legacy” investment policies aligned with other post 2009 policies
- Detailed requirements for binders and other outsourcing agreements to ensure operational efficiencies are in fact achieved, adequate insurer oversight and governance, and effective data management and sharing



LTIA / STIA Regulations & PPRs cont.

- Caps on binder and outsourcing fees for advisers – will be further consultation on quantum of caps – exemptions can be motivated subject to strict criteria
- Replace current short-term insurance “section 8(5)” fees with a fee subject to policyholder safeguards

These LTIA / STIA changes are planned to take effect in the 2nd quarter of 2017, with appropriate transitional provisions where necessary



Adviser categorisation & forms of advice



Two-tier adviser categorisation

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 capacity

•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 (Proposal V for long-term insurance in Phase 1)



Financial planning

- An individual adviser (RFA or PSA) may also use the designation “financial planner” if they have 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 (Timing: Phases 2 / 3)

• We are considering allowing PSAs to be structured as juristic entities. Possible conditions could be:

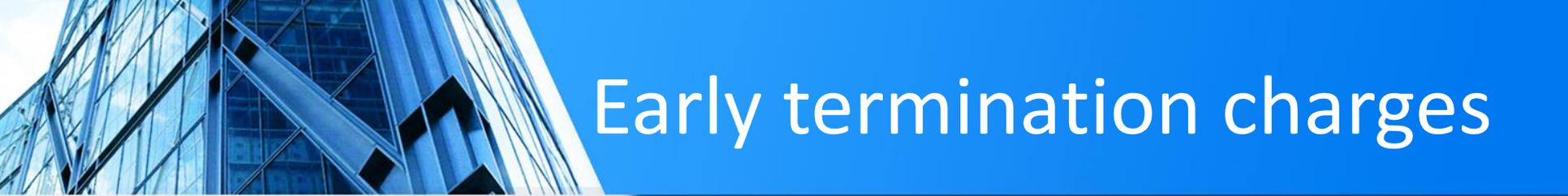
- Rigorous product supplier oversight measures
- PSA to use product supplier branding and meet specific operational requirements
- Limiting or disallowing use of juristic PSAs if the entity is not part of the product supplier's group

• Reviewing circumstances in which JRs may be used in non-advice models (Timing: Phase 2)

- Where allowed, these will be subject to strengthened operational requirements



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

A photograph of a modern glass skyscraper with a blue sky background, partially visible on the left side of the slide.

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



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
- Industry workshops kicked off in December 2016



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
- Timing: 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.



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



Next steps



Next steps

An RDR status update was published in December 2016, providing 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 has begun and will continue over the first quarter of 2017
- 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?