



# FAIS CONFERENCE March 2016



# Contents



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The Future of Market Conduct Supervision and what it means for FAIS

Trends in Compliance

Legislative Framework

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# **The Future Of Market Conduct Supervision And What It Means For FAIS**

# Where we have come from...



## **Supervisor:**

- ❑ Backward-looking
- ❑ Compliance-based
- ❑ “One-size-fits-all” – not risk-based
- ❑ “Industry silo” approach to regulation and supervision

## **Outcomes:**

- ❑ Despite rules, too many examples of poor customer outcomes
- ❑ Culture not customer-centric
- ❑ Conduct and integrity risks not proactively managed

# Where we are going...



## □ Guiding principles:

- Forward-looking
- Pre-emptive and proactive
- Outcomes focused
- Risk-based and proportionate
- Comprehensive and consistent
- Intensive and intrusive...

National Treasury  
*"A safer financial sector to serve South Africa better"*  
February 2011

# Mandate of the FSCA



□ **The objective of the Financial Sector Conduct Authority (FSCA) is to protect financial customers by:**

- ensuring that financial institutions treat financial customers fairly;
- enhancing the efficiency and integrity of the financial system; and
- providing financial customers and potential financial customers with financial education programs, and otherwise promoting financial literacy and financial capability.

# Conduct of business



## Forward-looking

- FSCA / firms to identify future conduct risks
- Market and consumer research

## Pre-emptive and proactive

- Not just responding to complaints
- On-site visits, thematic reviews, off-site reporting, mystery shopping
- Addressing risks at source (culture, governance, structural interventions)

## Outcomes focused

- Firms to demonstrate delivery of TCF outcomes
- On-site / off-site testing of TCF commitment
- Testing TCF in complaints handling

## Risk-based and proportionate

- Tiered regulatory framework based on risks to customer outcomes

## Comprehensive and consistent

- Expanding scope of conduct supervision
- Cross-cutting activity-based focus areas
- Consolidated legislative framework

## Intensive and intrusive

- Build up a centralised "conduct profile" of entities & groups
- Visible enforcement

# Activity-based focus areas



Culture and governance

Product value

Unfair contract terms

Misleading advertising/marketing

Ineffective disclosure

Conflicted advice

Poor claims handling

Poor complaints handling

Empowered customers

Technology and Data

Testing outcomes, rather than compliance 'tick-box'

Rebalancing of responsibilities:  
Increased scrutiny of the way firms develop products;  
Product provider oversight of chosen distribution channel

Fair outcomes can be achieved in different ways, through emphasising different TCF elements

# Implications for FSCA



## ❑ **Centralised capacity along 'functional' lines**

- Regulatory framework (standard setting), licensing; supervision, and enforcement functions organised centrally to ensure consistency

## ❑ **IT system support to drive efficiency**

- Information system upgrades to support efficient business processes and to enable analysis and identification of risks

## ❑ **Skills development to drive 'judgment-based' supervision**

- Outcomes focused approach requires supervisory judgment
- Need specialist support teams and skills development

## ❑ **Enhanced checks and balances**

- Expanded powers and 'judgment-based' approach require a robust system of review for consistency of regulatory decisions

## ❑ **Robust mechanisms for consultation and cooperation**

- Stakeholder consultation on standard setting
- Coordination with other regulators

# Highlights



*"While SA has made progress on market conduct within the current legal framework, these initiatives can be strengthened through structural change... In many instances poor market conduct practices are driven by inappropriate incentives. This is well illustrated by the deeply conflicted financial advisory industry...."*

A draft Market Conduct Policy framework for SA",  
National Treasury, December 2014

RDR - An example of this more interventionist approach to market conduct regulation

To ensure that financial products are distributed in ways that support delivery of TCF outcomes



# Retail Distribution Review Update



# Adviser categorisation

# Conflict controls



- ❑ Confusing terminology - especially “multi-tied” – will not help customers understand advice status
- ❑ Main test of independence should be extent of 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
- ❑ Focus areas of potential conflict include:
  - ❖ **Production or sales targets**
  - ❖ **Ownership or other interests**
  - ❖ **Binders and outsourcing** – stricter conflict controls needed (see later in this presentation)
  - ❖ **Other conflicted arrangements** – covered by FAIS GC

# 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.)



## ☐ Registered financial adviser (replaces previous “multi-tied” and “IFA” categories):

- licensed in own right to provide advice - provided advice firm is not also a product supplier
- licence holder 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/ no ownership interests either way/ no other forms of product supplier influence exist
- ❑ Being “independent” would not be a separate licence category
- ❑ 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



# 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 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
- ❑ 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



## *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 customer authorised by customer 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
- ❑ In interim – strict replacement monitoring obligations to be imposed :
  - 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
  - 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.

# Proposal QQ



## *Conflicted remuneration on RA transfers to be addressed*

- ❑ In the longer term, concerns are to be addressed by reduced early termination charges, prohibition of commission on new policies
- ❑ Concerns remain so 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
  - substantial non-cash incentives
  - lump sums paid as retention bonuses, restraints of trade or similar arrangements that may be disguised production incentives
- ❑ 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*

- ❑ RDR does not propose that insurers will move to up-front remuneration of advisers – will still be as-and-when premiums are received– what about selling without servicing
- ❑ Immediate concern is the s.8(5) fee under the STIA – currently no customer consent and purpose of fee unclear – inconsistent with RDR principles
  - Section 8(5) of STIA was repealed but repeal not yet effective
  - Fee to be replaced by advice fees but 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



- ❑ 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 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



**Next steps**

# Next steps



- ❑ **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
  - b) Revised Policyholder Protection Rules under LTIA and STIA
    - Consultation April 2016; Implementation July 2016
  - c) FAIS Fit & Proper requirements
    - Consultation March 2016; 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 include:
  - Binder thematic review and consultation on caps
  - New conduct of business returns for insurers and FAIS licensed FSPs



# Trends In Compliance

# Introduction



- ❖ Rationale and Aim of FAIS Act
- ❖ Main Drivers
- ❖ Investigations and Trends
- ❖ FS Landscape
- ❖ Emergence of the JR
- ❖ Impact of RE on General Compliance

# Rationale and Aim of FAIS Act



- ❖ Policy board for Financial Services
- ❖ Compliance with international standards
- ❖ Nel Commission
- ❖ Complaints from customers
- ❖ Protection of customers
- ❖ Professionalisation of the Industry
- ❖ Genesys Analytic (cost benefit)
- ❖ International best practice

# Main Drivers



- ❖ Internal Processes
- ❖ Legislative Developments

# Internal Processes



- ❖ Staff Complement
- ❖ Registration phase
- ❖ Restructuring (1)
- ❖ System Development
- ❖ Supervision and Enforcement Phase
- ❖ Restructuring (2)

# Legislative Developments



- ❖ Section 7 Exemption 2004
- ❖ Board Notice 106 of 2008
  - 31 December 2009 cut off
  - Regulatory Examinations
- ❖ Code of Conduct
  - Conflict of Interest
  - Sign on bonuses
- ❖ General Laws Amendment Acts
  - Debarment by the Registrar
  - Non payment of levies
  - Referral to EC
  - 13(1)(c) Contracting with Product Providers

# Investigations and Trends



- ❖ Unregistered business
- ❖ Outside Mandate
- ❖ Section 12 of the GC
- ❖ Inflated value
- ❖ Licensing conditions
- ❖ Stock Trading Training Providers
- ❖ KI Operational Abilities
- ❖ RA on FSPs with Co

# Financial Services Landscape



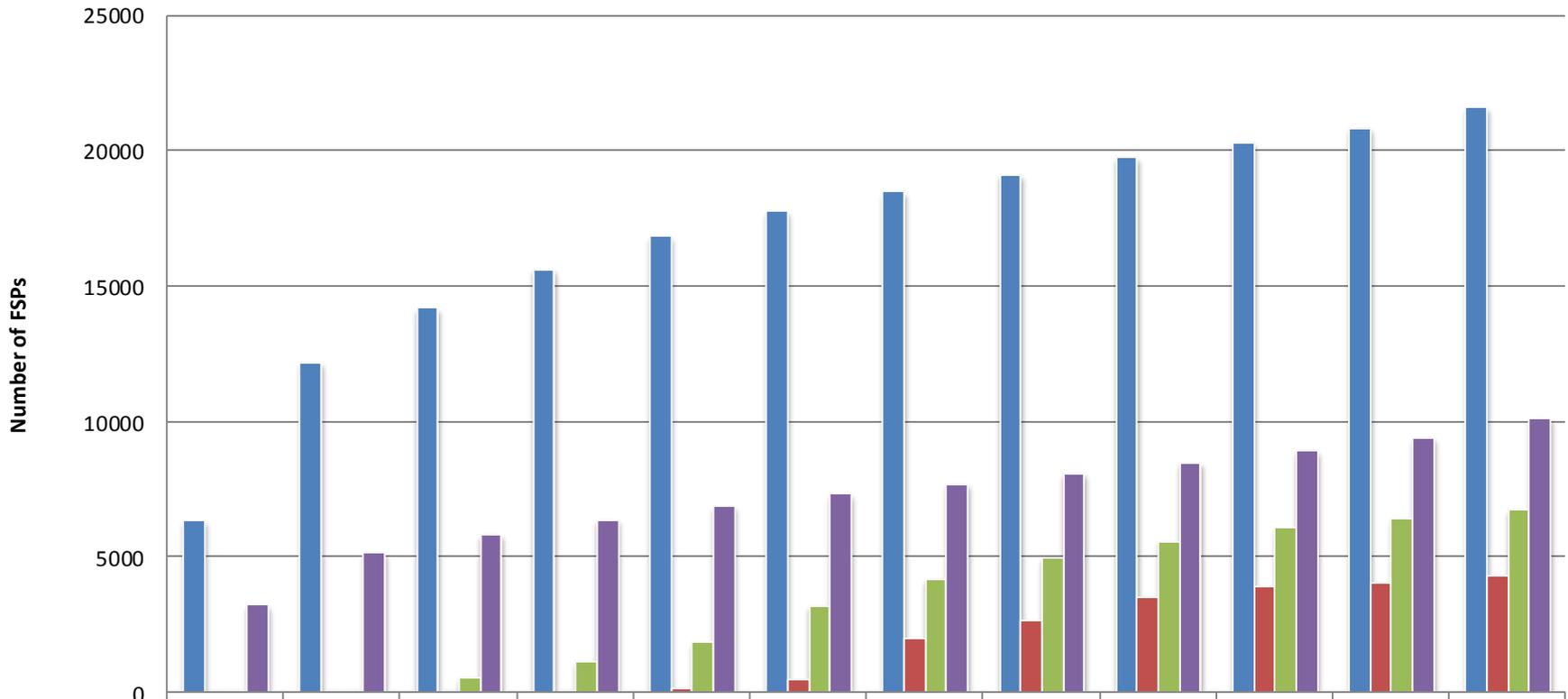
Authorised	10 513
Withdrawals	4 280
Lapsed	6 717
Representatives	167 007
KI's of FSPs	13 178
KI's of JR	11 592

- ❖ Many organisations:
  - were incorrectly authorised initially due to interpretation issues;
  - took a different legal form which will be discussed under juristic representatives – still exist as businesses
- ❖ Statistics show that 70% of SME's fail in first 2 years – account for some of the lapse ratio – but individuals go back to being employees of other FSPs
- ❖ A number of withdrawals are for honesty & integrity issues – this is the aim of FAIS

# Financial Services Landscape



2004 - 2015

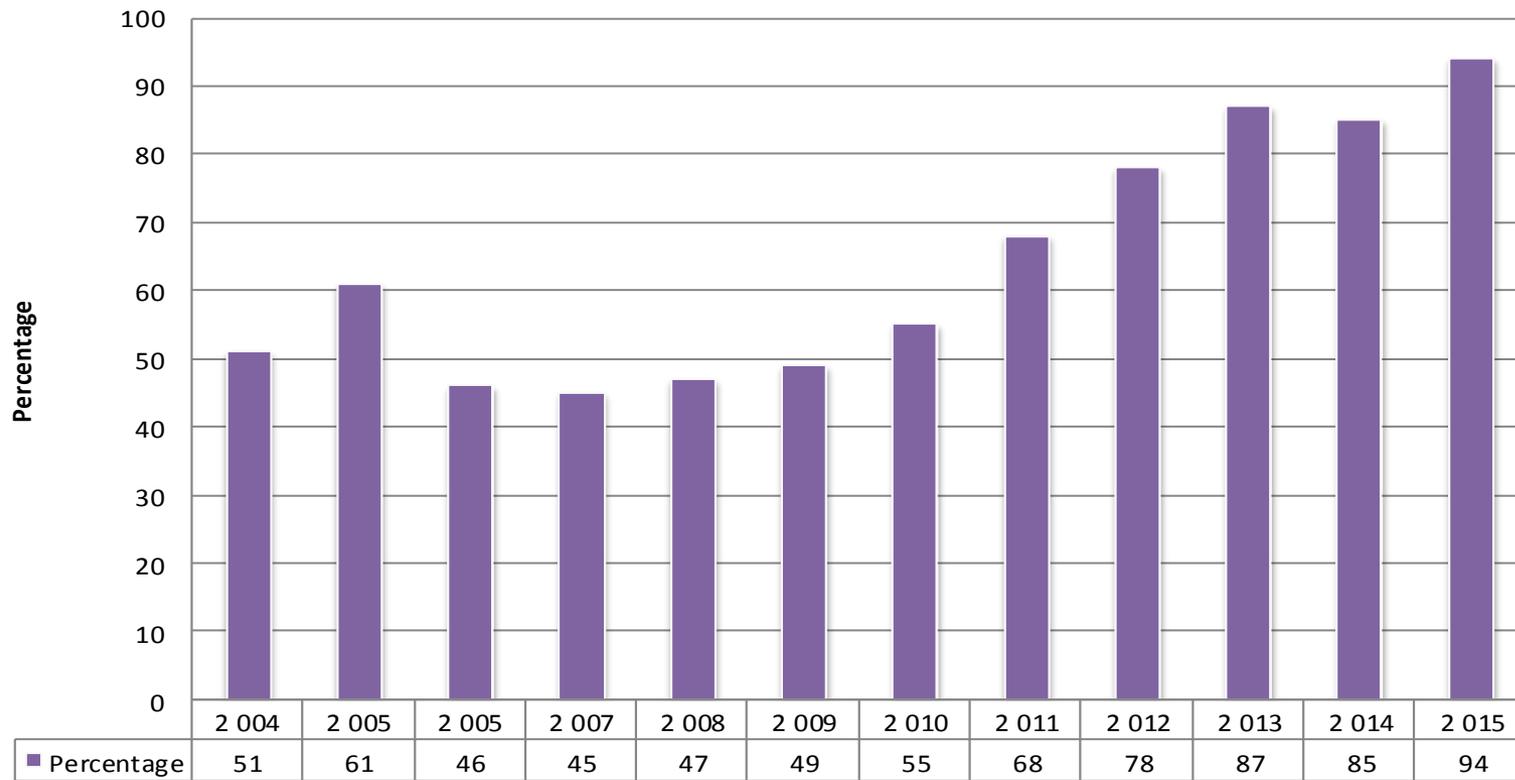


	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
■ Approvals	6333	12160	14167	15609	16807	17763	18458	19103	19733	20280	20829	21597
■ withdrawals	4	4	16	39	111	427	1976	2628	3491	3870	4046	4280
■ Lapsed	4	49	534	1138	1825	3178	4172	4936	5550	6043	6409	6717
■ Authorised	3209	5148	5809	6356	6847	7290	7674	8075	8465	8890	9365	10107

# FSP Retention



## Retention



# Emergence of the JR



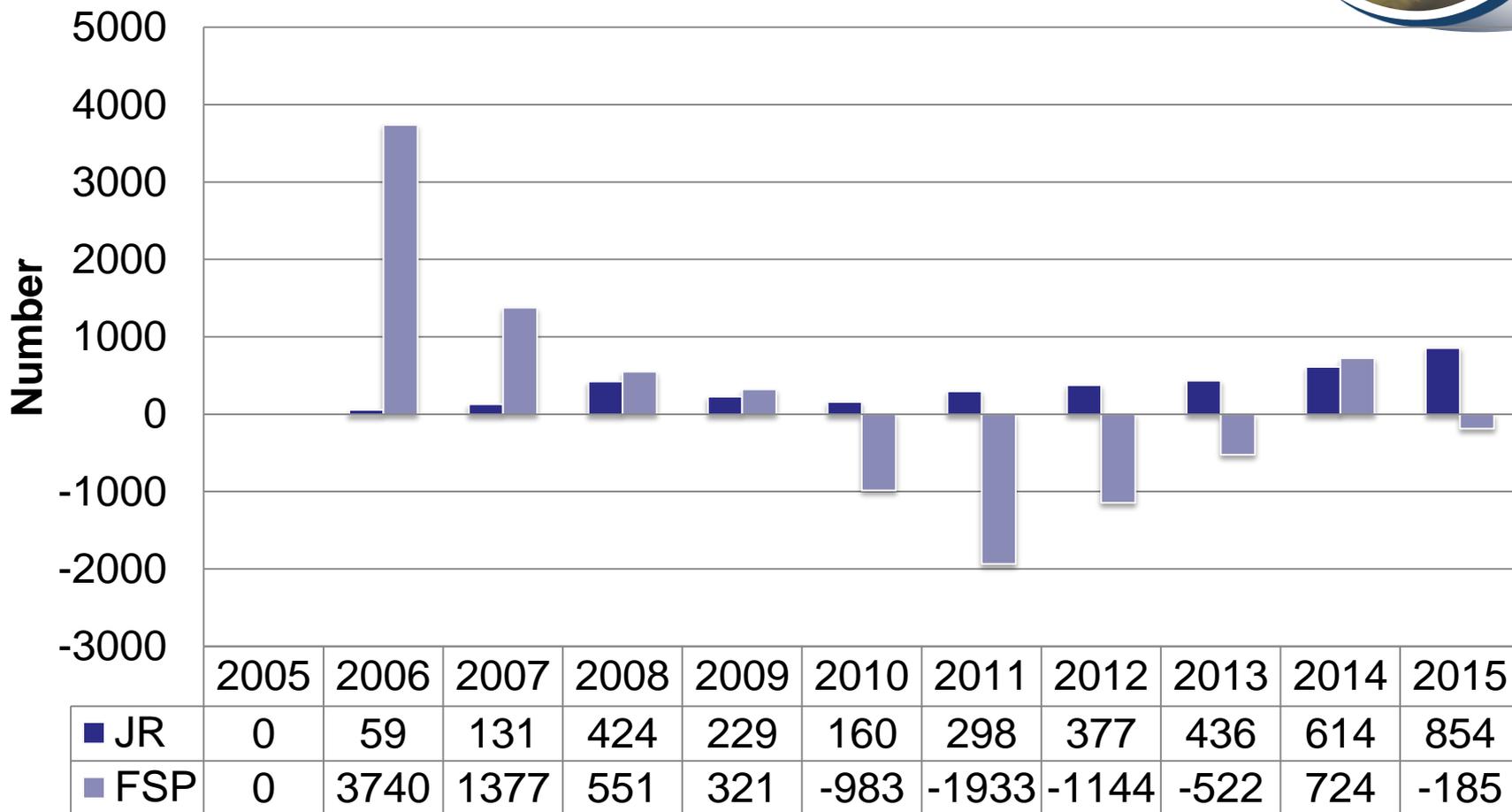
## The FSP

- ❖ Strict fit and proper requirements
- ❖ Annual levy payment
- ❖ Onsite visits
- ❖ Statutory returns submission
- ❖ Compliance officer

## JR Solution

- ❖ Financial soundness not required
- ❖ Platform fees
- ❖ No visits by the FSB
- ❖ No submission of statutory returns
- ❖ No compliance officer

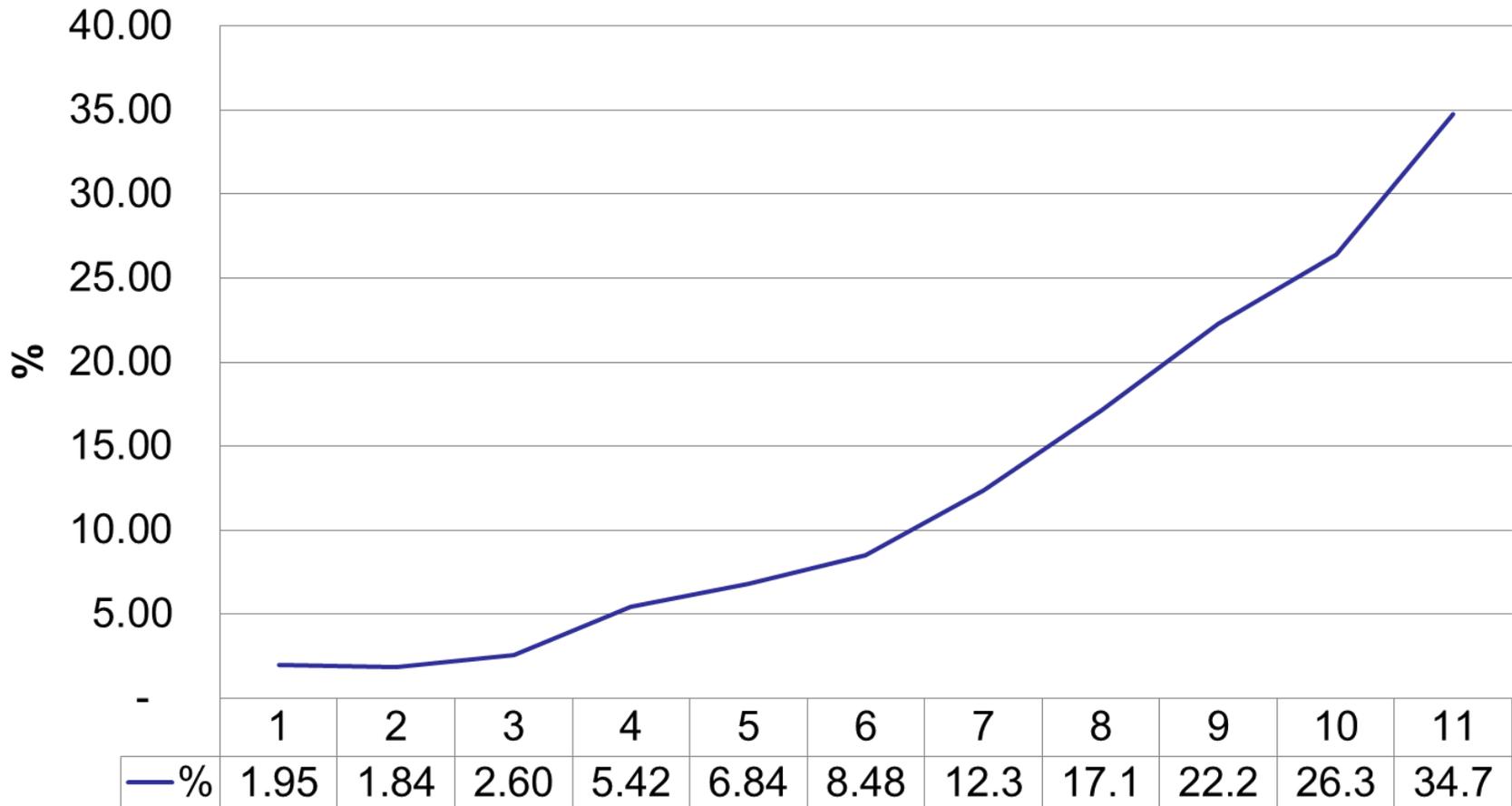
# JR vs FSP Growth



# JR as a % of FSP



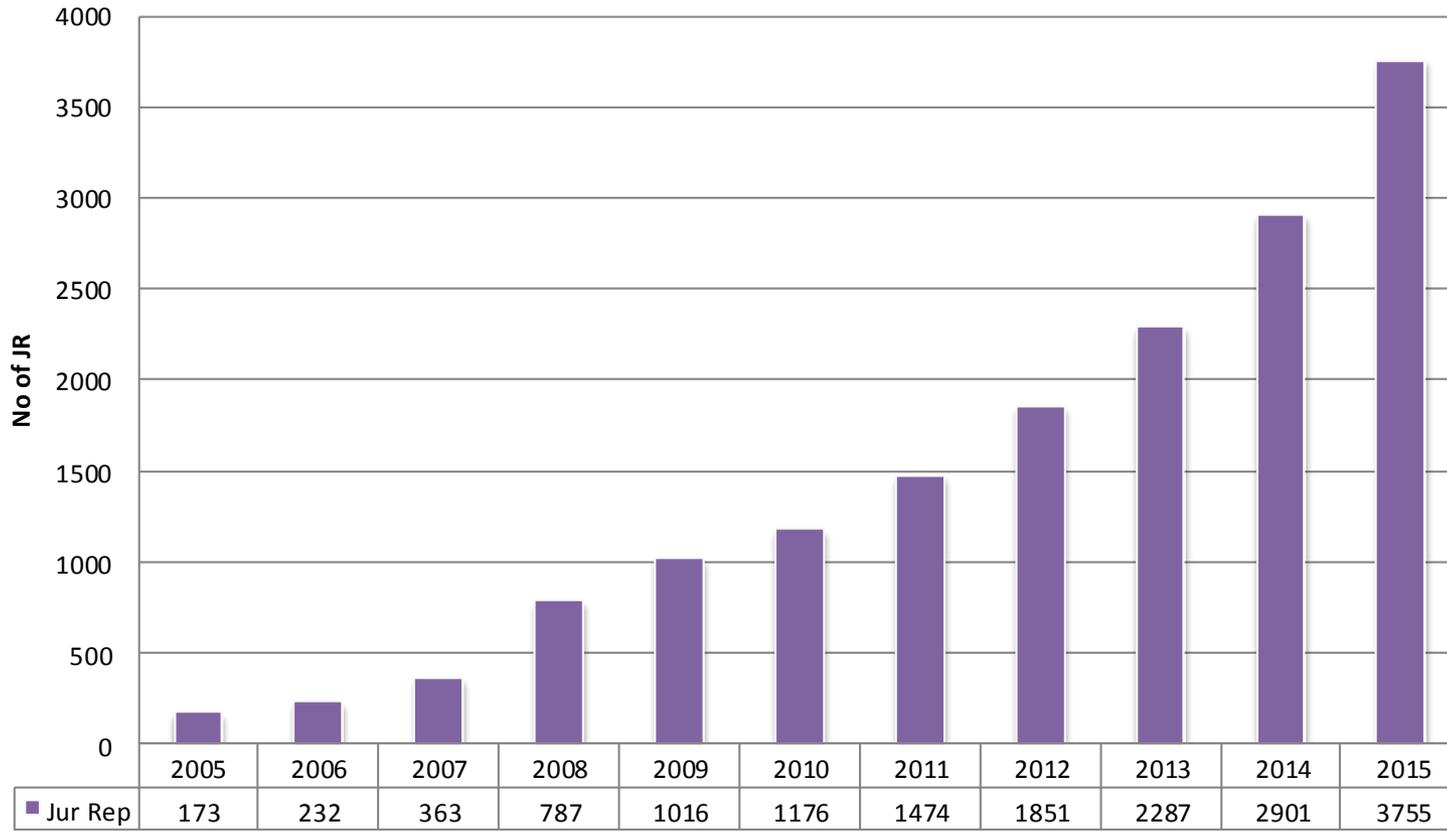
## JR AS % OF FSP



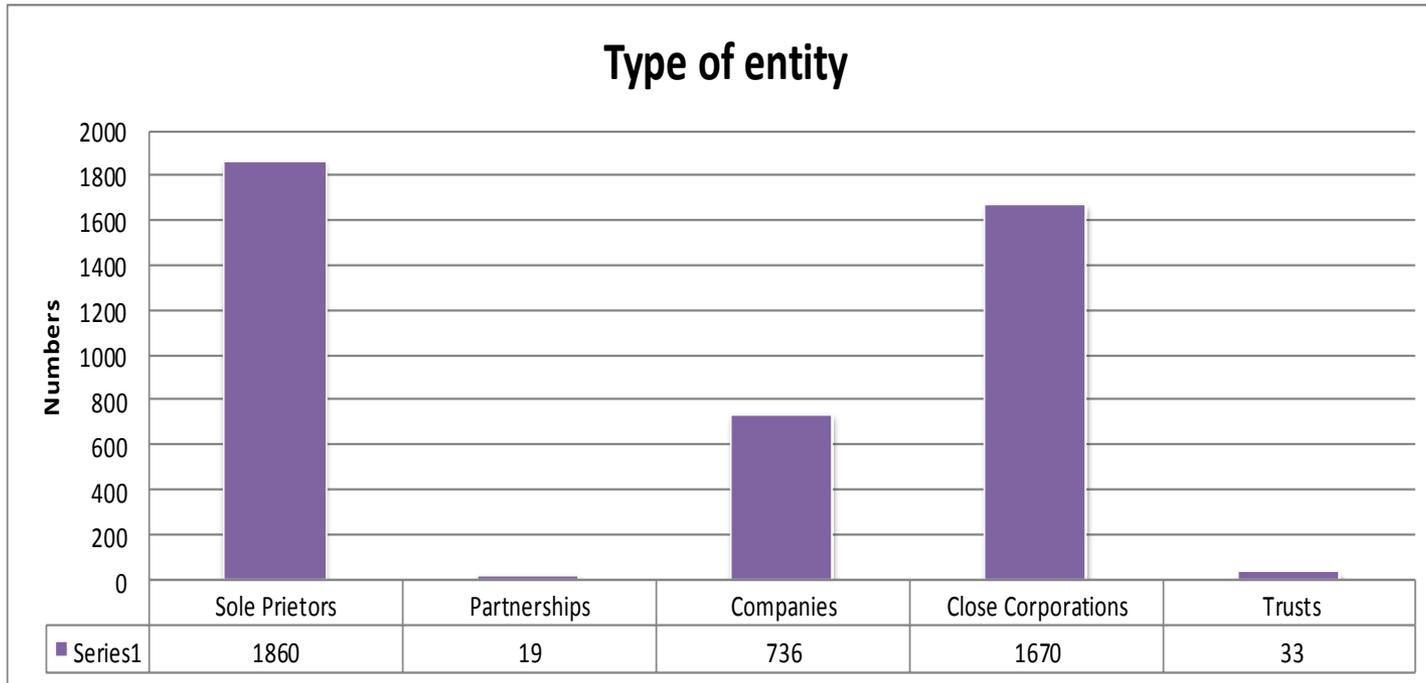
# JR Growth



## JR Growth



# Withdrawn Licences



- ❖ Sole props and CC's became representatives of FSPs, unless if they were withdrawn and debarred for honesty and integrity

# Observation and Comments



## ❖ **The size of the JR**

- Financial soundness

## ❖ **Sole Proprietors with large JR**

- Business continuity
- Operational ability

## ❖ **Some FSP with hundreds of JR**

- Operational ability
- Financial soundness

## ❖ **Comments:**

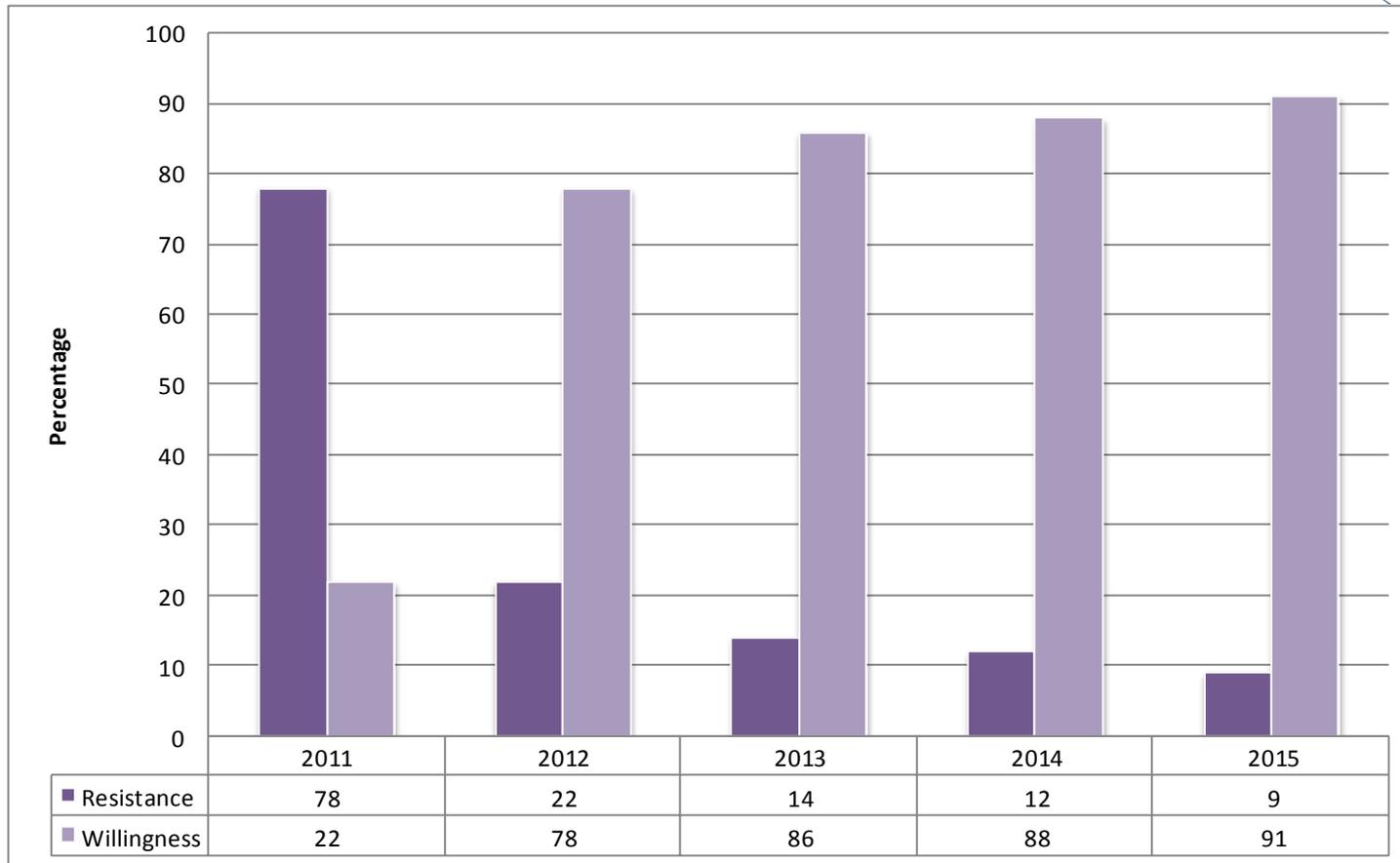
- Introduce financial Soundness requirements for JR
- Prohibit sole prop JR relationships
- 13(1)(c) prohibitions

# Impact of RE on Compliance



- ❖ Regulatory Approach
- ❖ Important Statistics
- ❖ General Observation

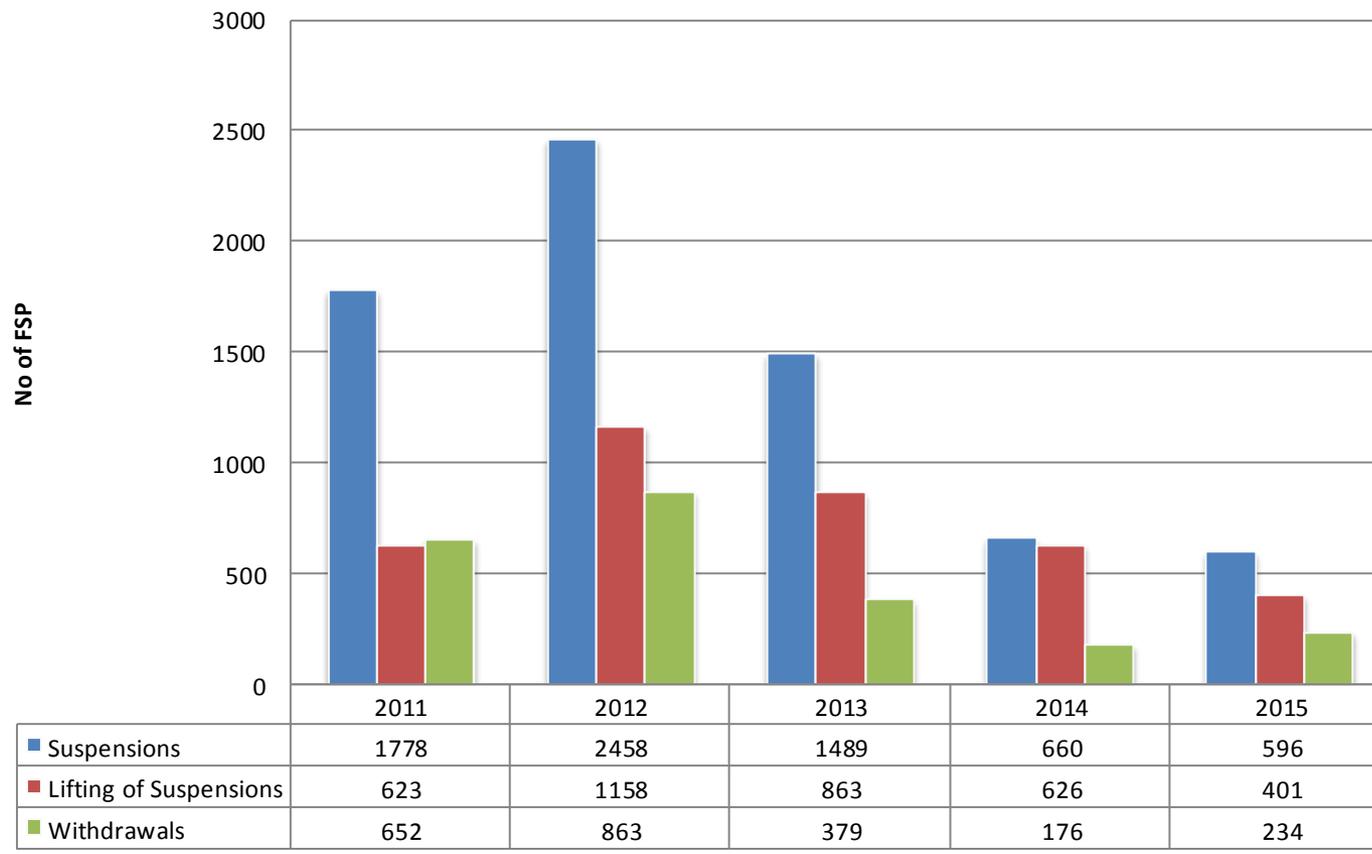
# Resistance vs. Willingness



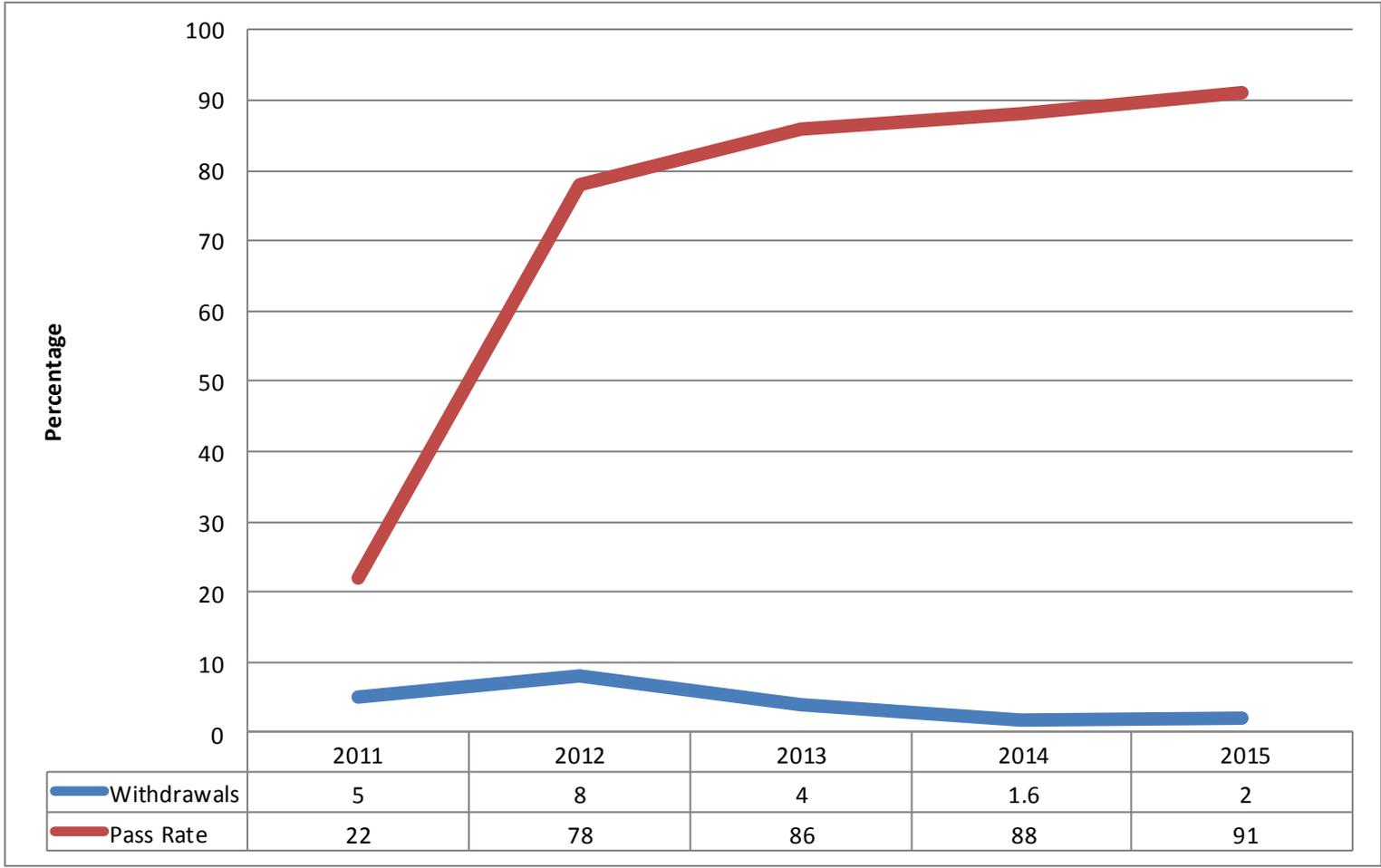
# Regulatory Action



## Regulatory Action



# Pass Rate vs. Withdrawals



# Observations



- ❖ The Quality of Engagement
- ❖ The General Compliance
- ❖ Level of professionalisation improved and will continue to improve
- ❖ Level of engagement with customers improved but not yet at a stage where we are collating customer data at the level we want



# Legislative Framework

# Overview



**Recap of recent Amendments**

**FSR Consequential Amendments**

**RDR Phase 1 Amendments**

**Omnibus Bill**

**Regulatory Framework Plan 2016**

# Recent Amendments



## Section 13(1)(c)

*"A representative may not render financial services or contract in respect of financial services other than in the name of the FSP of which such person is a representative"*

### Rationale for requirement

- ❖ Ensure consumers know with whom they are contracting and who is ultimately responsible to perform in terms of the contract
- ❖ Remove any uncertainty as to whether the representative is acting for or on behalf of a principal
- ❖ Prevent the undesirable business practice of *"renting a licence"*.
- ❖ Ensure all monies received by a FSP and its representatives are reported on by the auditor of the FSP

# Recent Amendments



## Impact of s 13(1)c) on tripartite agreements

- ❖ **Circular 4/2015** - Application of section 13(1)(c) on agreements in which representatives are cited



# Recent Amendments



## Sign-on bonus prohibition

- ❖ Published by Board Notice 146 of 2014 on December 2014
- ❖ Prohibit offering or receiving, directly or indirectly upfront or deferred, and with or without conditions, any financial interest as an incentive to become a provider including-
  - compensation for loss of benefit or cost associated with establishment of provider's business
  - a loan, advance, credit facility or other similar arrangement
- ❖ Prohibition on-
  - receiving only applicable to Category I providers
  - offering applicable to all persons that offers a sign-on bonus to a person as an incentive to become a Category I provider
- ❖ **Prohibition does not apply to new entrants**

# Recent Amendments



## **Rationale for sign-on bonus prohibition**

- ❖ Reduce incentive-driven churning of financial products
- ❖ Ensure fair outcomes to consumers
- ❖ Ensure advice is appropriate by explicitly addressing any potential conflict of interest that may undermine a provider's duty to act in the best interest of client

# FSR FAIS consequential amendments



## SIGNIFICANT PROPOSED AMENDMENTS

- ❖ Definition of “intermediary services” & deletion of product supplier exclusion
  - The proposed amendments-
    - remove the requirement that the person performing the activities must do so in an agency capacity; and
    - remove the requirement that the service has to be rendered in a tripartite situation in which a product supplier figures.
  
- ❖ Inclusion of “pooled investments” as a financial product
  
- ❖ Section 14(1) Debarments

# RDR Phase I Amendments



## **Proposal Y**

*Advisers may not act as representatives of more than one FSP*

### ❖ Exception to Proposal Y-

- Advisers may act as representatives of more than one FSP but only to the extent that the FSPs concerned are not licensed for the same product categories

### ❖ Operational ability of key individuals

## **Proposal OO**

*Product supplier commission prohibited on replacement life risk policies*

### ❖ Definition of “replacement”

# 2016 Regulatory Framework Plan



1. Revision of Fit and Proper Requirements  
Released for consultation – closing date for comments: **15 March 2016**
2. Revision of Professional Indemnity Requirements  
Released for consultation – closing date for comments: **28 February 2016**
3. Determination of compliance officer regulatory examination requirements
4. Private Equity Code of Conduct
5. Complaints management requirements
6. Advertising & marketing requirements
7. Implementation of recommendations made by International Standard Setting Bodies
8. New competency model