Treating Customers Fairly

Status Update:

Retail Distribution Review – status as at December 2016.

The Financial Services Board (FSB) published its Retail Distribution Review (RDR) discussion document in November 2014. Against the background of the Treating Customers Fairly approach to regulating conduct of business in financial services, the document proposed substantive reforms to the regulatory framework for financial advice and for distributing financial products to financial customers.

The RDR put forward a range of regulatory proposals, to be implemented in three broad phases. In November 2015 the FSB published an update on implementation plans for the Phase 1 RDR proposals, followed by a more general status update in December 2015.

Technical work, consultation processes and review of extensive stakeholder inputs has continued throughout 2016. This update document provides an overview of:

- The status of specific regulatory instruments to give effect to RDR Phase 1
- Our current thinking regarding proposals to be implemented in RDR Phases 2 and 3, including planned technical work.

1. Background

The Financial Services Board (FSB) published its Retail Distribution Review (RDR) discussion document in November 2014. Against the background of the Treating Customers Fairly approach to market conduct regulation, the RDR proposed a series of regulatory reforms aimed at ensuring distribution models that:

- Support the delivery of suitable products and provide fair access to suitable advice for financial customers
- Enable customers to understand and compare the nature, value and cost of advice and other services that intermediaries provide
- Enhance standards of professionalism in financial advice and intermediary services to build consumer confidence and trust
- Enable customers and distributors to benefit from fair competition for quality advice and intermediary services, at a price more closely aligned with the nature and quality of the service being rendered, and
- Support sustainable business models for financial advice that enable adviser businesses to viably deliver fair customer outcomes over the long term.

The paper confirmed that these reforms would be effected in *three broad phases*, aligned to the legislative timetable for implementing the overarching Twin Peaks financial services architecture. The FSB published an update on implementation plans for the Phase 1 RDR proposals in November 2015, followed by a more general status update in December 2015. Since the publication of those updates there have been further shifts in the Twin Peaks legislative timeline, with knock-on implications for the RDR implementation timeline. Technical work, consultation processes and review of extensive stakeholder inputs on the RDR proposals has also continued throughout 2016.

Section 2 of this update document provides an overview of the status of specific regulatory instruments to give effect to RDR Phase 1. Section 3 provides an update of our current thinking regarding the remaining RDR proposals, including planned technical work, grouped into six themes:

- Types of advisers and types of advice
- Investments
- Risk insurance (life and non-life)
- Sales execution and non-advice distribution
- Financial inclusion and the low income market
- Consumer education.

Appendix A sets out, in Table form, a status overview of the full set of the initial 55 RDR proposals.

2. Implementing RDR Phase 1

In the RDR Phase 1 Status Update published in November 2015, the FSB confirmed that formal consultation on the draft regulatory instruments to be used to give effect to Phase 1 would take place. The consultation process on certain of these instruments has commenced, and other instruments will be published for comment in December 2016 and in early 2017. Amendments to the following regulatory instruments are proposed:

- The General Code of Conduct for Authorised Financial Services Providers and Representatives, issued under the Financial Advisory and Intermediary Services Act 37 of 2002 (the *"FAIS General Code"*)
- Determination of Fit and Proper Requirements for Financial Services Providers, issued under the Financial Advisory and Intermediary Services Act 37 of 2002 (the *"FAIS Fit and Proper Standards"*)
- Financial Advisory and Intermediary Services Regulations, issued under the Financial Advisory and Intermediary Services Act 37 of 2002 (the *"FAIS Regulations"*)
- Regulations under the Long-term Insurance Act 52 of 1998 and Regulations under the Short-term Insurance Act 53 of 1998 (the *"LTIA and STIA Regulations"*)
- Policyholder Protection Rules under the Long-term Insurance Act 52 of 1998 and Policyholder Protection Rules under the Short-term Insurance Act 53 of 1998 (the *"Policyholder Protection Rules"* or *"PPRs"*).

This section summarises how each of these instruments will address specific RDR Phase 1 Proposals[1].

2.1. The FAIS General Code

Draft amendments to the FAIS General Code will be published for comment in early 2017. The amendments seek to give effect to the following RDR Proposals:

(a) Proposal OO: Product supplier commission prohibited on replacement life risk policies

A *definition of "replacement"* is to be included in the FAIS General Code. The definition will clarify that certain transactions in relation to a financial product (including variations of a

[1] Note that this document only focuses on how these regulatory instruments address RDR Proposals. Each set of amendments being consulted on also incorporates broader conduct of business reforms, not discussed in this document.

product) will constitute a replacement if they are effected *in anticipation of or as a consequence of* the purchase, investment in or variation of another financial product, irrespective of the sequence of the transactions. The term "variation" will also be defined for purposes of this definition, to clarify which types of product variations constitute a replacement.

The definition of "replacement" in the FAIS General Code does not only apply to the replacement of life risk policies as contemplated in RDR Proposal OO. The existing FAIS disclosure obligations in relation to replacements will continue to apply in all cases where an adviser recommends the replacement (as defined) of any financial product with another. The new monitoring obligations to be imposed on insurers in respect of replacements of life risk policies should be read together with the proposed new definition of "replacement" in the FAIS General Code (See section 2.5(c) below).

(b) Proposal QQ: Conflicted remuneration on RA transfers to be addressed

The proposed changes to the FAIS General Code will support this proposal by confirming that transfers of retirement annuities and living annuities from one provider to another constitute a replacement and are therefore subject to all relevant replacement disclosure obligations. The FSB is considering, as a next step, extending the product supplier monitoring obligations to be imposed for replacement of life risk insurance products (see section 2.5(c)) to also apply to retirement annuity and living annuity transfers.

2.2. The FAIS Fit and Proper Standards

Draft new FAIS Fit and Proper Standards were published for comment in October 2016 , with the comment period closing on 15 December 2016. Although the amendments do not explicitly reference RDR, they support the implementation of the following RDR Proposals:

(a) Proposal B: Standards for "low advice" distribution models

The Fit and Proper Standards are relevant to Proposal B to the extent that they define and recognise *"automated advice"* as a specific, customised form of advice requiring specific competency requirements.

(b) Proposal D: Standards for sales execution, particularly in non-advice distribution models

As put forward in Proposal D, the FAIS Fit and Proper Standards include a definition of *"execution of sales"*[2] and set differentiated competency standards for intermediaries performing this activity where it is carried out strictly in accordance with a *predetermined script*. To be eligible for the relatively less onerous competence requirements applicable to such scripted sales, rigorous governance, oversight and monitoring requirements must be satisfied. These include a requirement to ensure that the sales practices and techniques employed are not misleading, false or inappropriate to the expected target customers and will not result in unfair outcomes for customers.

Defining these specific types of sales processes paves the way for additional future standards more closely linking the use of these distribution models to particular product types.

(c) Proposals BB, CC, DD and EE: Various proposals relating to product supplier responsibility for advice and distribution

We have consistently emphasised that one of the intended outcomes of the RDR, and of our Treating Customers Fairly initiative more broadly, is to ensure appropriate sharing of responsibility between product suppliers and intermediaries for fair customer outcomes. This entails requiring product suppliers to monitor advice and distribution outcomes and put reasonable controls in place to promote fair treatment and mitigate miss-selling risks, regardless of the distribution channel they adopt. (See also section 3.1(g) below).

Among other product supplier responsibilities, our initial RDR Proposals BB, CC and DD provided that product suppliers must ensure that all forms of advisers providing advice on their products meet specific levels of generic and product specific training. In addition, Proposal EE requires product suppliers to ensure that individuals providing factual information on their products through non-advice sales execution models meet the requisite fit and proper standards. The new FAIS Fit and Proper Standards facilitate these RDR Proposals by defining and setting specific *competence standards in relation to "class of business training" and "product specific training"*. They also oblige an FSP, on request by a product supplier, to provide confirmation to that supplier that it or its representatives have

[2] "Execution of sales" is defined as "an intermediary service performed by a person on instruction of a client that results in the conclusion of an agreement to buy, sell, deal, invest or disinvest in, replace or vary one or more financial products".

obtained the requisite class of business and product specific training, where the product supplier requires the confirmation in order to ensure compliance with its own legal obligations.

Corresponding obligations need to be placed on different types of product suppliers disallowing them from permitting intermediaries to advise on or sell their products unless and until they have satisfied themselves that these product competency standards are satisfied. In respect of insurers, these obligations are being introduced through the amended PPRs (see section 2.5(a) below).

2.3. FAIS Regulations

Proposal Y: Advisers may not act as representatives of more than one juristic intermediary (adviser firm)[3]

This RDR Proposal requires an amendment to the FAIS Regulations, which will be consulted on in early 2017. Implementation of this amendment is subject to the approval of the Minister of Finance.

The Regulation will provide that an individual *may not be appointed as a representative by more than one FSP in respect of the same product classes*. We will consider whether additional standards are required to mitigate risks of conflict of interest and customer confusion in those cases where a representative will be permitted to act on more than one FSP licence.

The Financial Sector Regulation Act will also support implementation of this and other RDR Proposals relating to adviser categorisation, through consequential changes to the FAIS Act that will allow the Registrar to classify representatives into different categories.

[3] In addition to Proposal Y, the November 2015 Phase 1 Status Update also indicated that we would introduce stricter controls under FAIS to limit the extent to which the same Key Individual may act for multiple FSPs. This has now been done through the draft FAIS Fit and Proper Standards, which provide that such a Key Individual must be able to demonstrate that they have the required operational ability to effectively and adequately manage or oversee the financial services related activities of all the FSPs concerned.

2.4. The LTIA and STIA Regulations

Draft amendments to these Regulations were published for comment on 9 December 2016, with the comment period closing on 22 February 2017. The amendments seek to give effect to the following RDR Proposals[4]:

(a) Proposal V (long-term): Insurer tied advisers may no longer provide advice or services on another insurer's products

The definition of "representative" in Part 3A of the LTIA Regulations is to be amended to give effect to this Proposal. More particularly, the current part of the definition which (in summary) allows an insurer's representative to render services as intermediary in respect of another insurer's policies, where the insurers concerned have entered into an agreement allowing this, will be deleted. It will be replaced with a provision in effect allowing such agreements with another insurer only in relation to a *class of policies which neither the "home" insurer or another long-term insurer in its group of companies*[5] *is not registered to underwrite*.

The definition of "representative" will however allow representatives to continue rendering services in respect of existing policies of another insurer entered into in terms of a previously permitted agreement, subject to certain time limits, but not to enter into new policies.

Importantly, this *Proposal V is an interim measure* being introduced in Phase 1 of RDR to ease the transition from the current model to the final stricter approach to gap filling discussed in section 3.1(b).

(b) Proposals J, Z, AA and ZZ (long-term and short-term): Various proposals relating to strengthened standards and remuneration caps for binder and outsourcing arrangements

The amended LTIA and STIA Regulations will contain a range of measures to give effect to these RDR Proposals[6].

[4] Sub-headings indicate whether the amendment is incorporated in the LTIA Regulations, STIA Regulations, or both.

[5] The term "group of companies" will be defined for these purposes to refer to the corresponding definition in the Companies Act.

[6] This section is a high level summary of the proposed changes relating to binder and outsourcing arrangements – it should be read with the full text of the draft amended Regulations. Note that these new

A new Part 3C of the LTIA Regulations and Part 5B of the STIA Regulations, entitled *"Limitation on Remuneration for Outsourcing"* is to be introduced. This Part will, in summary, provide for the following:

- A *definition of "outsourcing"*, aligned with the corresponding definition in the Financial Sector Regulation Bill, but taking into account specific circumstances relating to insurance
- A *definition of "policy data administration services"* (being a specific form of "outsourcing" as defined)[7]
- Binder holders who have a binder function to enter into, vary or renew policies of the insurer, will not be permitted to earn any remuneration for policy data administration services, as such activities are deemed incidental to the binder function
- Remuneration for policy data administration services is to be *capped at 2%* of the premiums concerned
- Binder fees payable to non-mandated intermediaries who are licensed under FAIS to provide advice (or an associate of such an intermediary) will be *capped at 2%* of the premiums concerned, per type of binder activity
- Notwithstanding the preceding bullet point, the *Registrar may on application agree to binder fees in excess of the 2% cap*, in specific circumstances.

Further technical work and consultation will take place before finalising the quantum of the proposed caps for binder and outsourcing activities.

Part 6 of the LTIA and STIA Regulations (the current "Binder regulations") will, among other changes, be amended to provide in summary as follows:

- An insurer may not - in respect of long-term insurance policies or short-term personal lines insurance policies - have a binder agreement with a non-mandated intermediary who is licensed under FAIS to provide advice, other than for the binder activities of entering into, varying or renewing a policy or settling claims under a policy

provisions will apply over and above a number of existing requirements applicable to binder and outsourcing arrangements.

[7] "Policy data administration services" will be defined as meaning "the managing, recording and updating of policy and policyholder data of an insurer on behalf of that insurer in a manner that (a) ensures complete integration between the information technology system of the insurer and the person that provides the services; and (b) enables the insurer to have continuous access to accurate, up-to-date, complete and secure policy and policyholder data."

- An insurer may not – in respect of short-term commercial lines insurance policies - have a binder agreement with a non-mandated intermediary who is licensed under FAIS to provide advice[8]
- A binder agreement must require the binder holder to provide the insurer *at least every 24 hours* with timely, comprehensive and reliable data to ensure that the insurer is able to comply with any regulatory data management requirements
- Insurers are required to meet a range of *governance, oversight and record keeping* obligations in relation to the binder holder and the binder activities
- The Registrar may on application by an insurer grant *exemptions* from certain of the requirements of Part 6, including the prohibitions on entering into binders with intermediaries licensed to provide advice in relation to certain types of policies, in specific circumstances.

A new Part 3D of the LTIA Regulations and Part 5D of the STIA Regulations titled *"General Principles for Determining Remuneration"* is to be introduced. This Part will, in summary, provide that all intermediary remuneration[9] must:

- be reasonably commensurate with the actual service, function or activity performed
- not result in any service, function or activity being remunerated again
- not be structured in a way that may increase the risk of unfair outcomes for policyholders; and
- not be linked to the monetary value of claims for policy benefits repudiated, paid, not paid or partially paid.

(c) Proposal OO (long-term): Product supplier commission prohibited on replacement life risk policies

As discussed in more detail in paragraph 2.5(c) below, the LTIA PPRs are being amended to impose monitoring obligations on insurers in relation to life risk policy replacements, pending a final decision on whether or to what extent commissions on such replacements should be limited. In addition to these monitoring obligations, the LTIA Regulations will require that an insurer *either may not pay commission* in respect of a life risk replacement policy unless it is satisfied that the adviser has complied with the relevant FAIS disclosure

[8] Before finalising this proposed prohibition on advisers holding binder agreements for commercial lines business, the FSB will carry out further analysis of the type and number of commercial lines binder agreements in place with advisers and consult further on the potential impact of such a prohibition.

[9] Note that the principles set out in this Part do not only apply to remuneration for the various forms of binder and outsourcing arrangements provided for in the Regulations, but also apply to remuneration for "services as intermediary" (i.e. including commission) as well as to the so-called "section 8(5) fees" under the STIA (Also see section 2.4(f) below).

obligations *or, if commission is paid, it must be recovered* from the adviser if it is established that these disclosure standards have not been met.

This LTIA Regulation change must therefore be read together with the PPR change discussed in section 2.5(c) and the new definition of "replacement" to be included in the FAIS General Code, as discussed in section 2.1(a).

(d) Proposal PP (long-term): Commission regulation anomalies on "legacy" insurance policies to be addressed

The amendments to the LTIA Regulations (Part 5A and a new Part 5C of the LTIA Regulations) will give effect to RDR Proposal RR in the following ways:

- Providing for the *progressive reduction over time of the maximum causal event charges* that can be applied to legacy contractual savings policies
- Providing that any *variable premium increase* on or after 1 May 2017 in respect of investment policies must be regarded as a separate policy for purposes of calculating causal event charges and commission entitlements. The effect is that these increases will be subject to the same commission and causal event charge basis as new policies
- Introducing *general fairness principles* that insurers will be obliged to apply when calculating causal event charges in the case of multiple causal events[10].

(e) Proposal RR (long-term): Equivalence of reward to be reviewed

As discussed in more detail in section 3.3(e), full implementation of Proposal RR at individual adviser level is to be implemented at a later stage together with the broader changes to remuneration for life risk products.

In preparation for this implementation, Part 3A of the LTIA Regulations is to be amended to clarify the operation of the principle of Equivalence of Reward. Currently, the principle of Equivalence of Reward is only provided for within the definition of a "representative" – in effect, one of the defining characteristics of representatives is that they are remunerated in accordance with this principle. Under the amended Regulations, the reference to Equivalence of Reward will be removed from the definition of "representative" and replaced with an explicit provision to the effect that no remuneration or consideration shall, directly or indirectly, be provided to, or accepted by or on behalf of, a representative for rendering services as intermediary, otherwise than in accordance with the principle of Equivalence of Reward as determined by the Registrar. The Regulations will also contain a provision

[10] These principles largely reflect the provisions of the current Directive 153.A.ii (LT).

explicitly enabling the Registrar to determine that particular forms of remuneration or consideration, whether in cash or in kind, comply or do not comply with the principle of Equivalence of Reward.

The effect of this change is that the *consequence of a failure to comply with the principle of Equivalence of Reward (as determined by the Registrar) will change*. Currently, such a failure in effect results in the intermediary concerned no longer being regarded as a "representative". Going forward, a failure to comply will constitute a clear contravention of the Regulations by both the insurer and the intermediary concerned.

(f) Proposal UU (short-term): Remuneration for selling and servicing short-term insurance policies

The current *section 8(5) of the STIA*[11], which provides for an additional fee to be paid to an intermediary by the policyholder, over and above commission, binder or outsourcing fees from the insurer, *will be replaced* by a new Part 5C of the STIA Regulations. This Part 5C will continue to permit such an additional fee to be paid by the policyholder, but subject to the following safeguards:

- The fee must relate to an *actual service* provided to a policyholder, which service is *not part of the "services as intermediary"* for which commission is payable
- The fee must not relate to any other service for which the intermediary has been remunerated by another person
- The fee must be reasonable and commensurate with the service rendered
- The *amount and purpose* of the fee must be *explicitly agreed to by the policyholder* in writing.

This provision is intended to address our concerns that the purpose and appropriateness of current so-called "section 8(5) fees" is in many cases unclear and apparently unjustified. Once the broader remuneration model for short-term insurance policies is finalised (as discussed in section 3.3(c)), the need to retain or further amend this Part 5C will be reviewed.

(g) Proposal AAA (long-term): Commission cap for credit life insurance schemes with "administrative work" to be removed

[11] Section 8(5) was repealed by the Financial Services Laws General Amendment Act No. 45 of 2013 but the repeal has not to date come into effect. The repeal will now be made effective and replaced by this new Part 5C of the STIA Regulations.

The Table to Part 3A of the LTIA Regulations, which sets out the commission caps applicable to different types of policies, will be amended to give effect to this Proposal. The current line items on the Table in respect of policies in a group scheme which is a credit scheme "with administrative work", providing for as-and-when commission capped at 22.5%, will be deleted. The effect will be that *all such policies will be subject to an as-and-when commission cap of 7.5%*. As a result, additional remuneration in respect of the administration of such policies will only be payable if the revised standards relating to either binder arrangements or other outsourcing arrangements, as the case may be, are met. (See section 2.4(b) above).

2.5. Policyholder Protection Rules (PPRs)

Draft amendments to the PPRs will be published for comment on 15 December 2016, with a comment period up to 22 February 2016. The amendments seek to give effect to the following RDR Proposals[12]:

(a) Proposals BB, CC, DD and EE (long-term and short-term): Various proposals relating to product supplier responsibility for advice and distribution

Although further product supplier responsibility measures will be introduced in due course as the adviser categorisation model is finalised, the Phase 1 PPR amendments will already enhance product supplier responsibility in respect of intermediary conduct in various ways.

In addition to the existing requirement that an insurer may only enter into an intermediary agreement with an intermediary who has the requisite FAIS licence or authorisation, the PPRs will now also specifically provide that no such agreement may be entered into unless and until the intermediary complies with *applicable FAIS competency requirements.* These include the new FAIS Fit & Proper Standards in relation to line of business and product specific training.

New PPRs relating to *advertising, brochures or similar communications* also require insurers to ensure that any intermediary or other third party that distributes or promotes its policies on its behalf has appropriate processes in place to ensure that any advertisements, brochures or similar communications in respect of such policies are not misleading,

[12] Sub-headings indicate whether the amendment is incorporated in the LTIA PPRs, STIA PPRs, or both.

contrary to public interest or contain an incorrect statement of fact, and prominently include the name of the insurer.

New PPRs relating to *complaints management* require an insurer's complaints management process to meet specific standards for managing complaints relating to the insurer's service providers. The definition of "service provider" includes intermediaries marketing or distributing the insurer's products.

(b) Proposal FF (long-term and short-term): General product supplier responsibilities in relation to receiving and providing customer related data

Proposal FF includes requirements in relation to customer information which product suppliers should make available to intermediaries, as well as customer information that advisers should make available to product suppliers.

The PPRs governing arrangements between insurers and intermediaries give effect to the first-mentioned part of Proposal FF by *requiring an insurer, at the request of an intermediary that is authorised by a policyholder, to provide either that intermediary or the policyholder with the information* referred to in the authorisation. This applies irrespective of the fact that the intermediary does not have an intermediary agreement with that insurer. Where the insurer elects to provide the information to the policyholder rather than the intermediary, the insurer must also provide the policyholder with a fair and objective explanation as to why the information was not provided to the intermediary.

The standards in the LTIA and STIA Regulations relating to binders and outsourcing give effect to the second part of the Proposal by introducing requirements in relation to *data management and access* (See section 2.4(b) above). We are giving further consideration to additional standards that may be required in relation to ensuring that product suppliers have appropriate access to customer information held by intermediaries in other situations.

(c) Proposal OO (long-term only): Product supplier commission prohibited on replacement life risk policies

Our initial RDR Proposal OO was that product supplier commission on replacement life risk policies should be entirely prohibited. In response to feedback, we confirmed in our Phase 1 Status Update that the decision whether to implement such a commission prohibition – or any other change in the commission model for replacements – will be deferred until the overall final remuneration model for life risk policies is settled. We therefore proposed, as

an interim Phase 1 measure, to impose *replacement*[13] *monitoring obligations on the insurers* concerned. To give effect to this interim approach, the PPRs will provide (in summary) that:

- An insurer must, before entering into a life risk policy, ascertain from the intermediary whether it is a replacement policy
- If it is a replacement policy, the insurer must obtain a copy of the replacement advice record required by the FAIS General Code and provide a copy of this record to the insurer who issued the policy that is being replaced
- A managing executive of the insurer must confirm in writing that the replacement advice record complies with the applicable FAIS disclosure requirements and indicates that the intermediary took reasonable steps to satisfy himself or herself that the replacement policy is more suitable to the policyholder's needs than retaining or modifying the policy that was replaced
- If at any time an insurer establishes that an intermediary failed to disclose to the insurer that a policy is a replacement policy the insurer must report such non-disclosure to the Registrar
- If the non-disclosure is established within a period of 6 months from the date on which the insurer entered into the replacement policy, inform the policyholder that they are entitled to a new "cooling off" period in relation to the policy.

The PPRs also provide that the Registrar may determine the format for a replacement advice record or other notification required by this rule. We are considering developing a prescribed standardised replacement advice record for purposes of these rules.

These PPR provisions should be read together with the new definition of "replacement" in the FAIS General Code and the new LTIA Regulation requiring insurers to either withhold or claw back commission on a replacement policy where the requisite disclosure standards are not met (See sections 2.1(a) and 2.4(c) above).

[13] Note that for purposes of these PPR replacement requirements the PPRs will apply the same definition of "replacement" as the definition that is to be included in the amended FAIS General Code, as discussed in section 2.1(a). The PPR provisions will however only apply where the replacement is in respect of a life risk policy.

(d) Proposal VV (short-term and long-term): Conditions for short-term insurance cover cancellations

Note that although Proposal VV initially applied only to short-term insurance policies, the draft new PPRs in relation to cover cancellations *apply equally to long-term and short-term insurance*.

The PPRs provide (in summary) that, where the insurer terminates a policy for reasons other than non-payment of premiums or a change in risk profile that contractually entitles it to terminate the policy, the insurer will remain liable under the policy for specific periods until prescribed requirements regarding notice to the policyholder or proof that the policyholder has secured alternative cover are met.

The PPRs also contain specific requirements in relation to the termination of group schemes by either the insurer or the policyholder.

3. An update on RDR Phases 2 and 3

Since the publication of the RDR Phase 1 Status Update and the General Status Update in late 2015, extensive discussions with a wide range of industry stakeholders and analysis of input has taken place. These engagements have resulted in:

- Revising or refining our initial proposals in some cases
- Reinforcing our initial views in other cases
- Helping us identify issues that require further technical work and analysis.

Sections 3.1 to 3.6 provide an update on this thinking, grouped into six identified themes.

3.1. Types of advisers and types of advice

(a) A two-tier adviser categorisation confirmed

Proposal K of the initial RDR discussion document proposed a three tier adviser categorisation: A distinction between tied, multi-tied and independent financial advisers. In our RDR Phase 1 Status Update of November 2015, we advised that we were reviewing this approach and considering a simpler, two-tier model.

We confirm that a two-tier model is our preferred approach. Two main categories of financial adviser are now proposed, namely:

- *Product Supplier Agents (PSAs)* will not be licensed in their own right to provide financial advice. Instead, they will provide advice as agents of a financial institution that provides financial products. That product supplier will in turn be licensed to provide advice, over and above any other licence it holds to issue financial products. The PSA will therefore operate on the product supplier's licence, with the product supplier bearing full responsibility for both the advice provided by its agent and the product it has provided. A PSA may provide advice only on the products of the product supplier by whom it has been appointed as an agent (the "home product supplier") or other product suppliers forming part of the same group as the home supplier. A definition of "group" will be stipulated for these purposes. (See the discussion on "gap filling" in section 3.1(b) below for further details regarding which product suppliers' products a PSA may provide advice on).
- *Registered Financial Advisers (RFAs)* will be licensed in their own right to provide financial advice. An RFA may be either a natural person (a sole proprietor) or a legal entity (an RFA firm). An RFA firm will in turn appoint financial advisers to provide

advice on its behalf, and will be responsible for the advice provided by those representatives. The RFA licensing model is therefore similar to the current Financial Services Provider licensing model under the FAIS Act, except that RFA's will not also be product suppliers.

- *No financial adviser may act as both a PSA and an RFA* (or representative of an RFA)[14].

The use of the terms "Product Supplier Agent" and "Registered Financial Adviser" are not final. Final descriptors for the two licensing tiers will be confirmed after we have carried out consumer testing. Our aim is to prescribe descriptors that will make the scope and status of advice provided, and who will be accountable if poor advice is provided, as clear as possible to customers.

We have been asked to provide clarity on which product supplier licence/s a PSA will need to be appointed to in the case of group structures comprising multiple product suppliers. Further practical detail will be consulted on, but our intention is to be pragmatic and not to impose unduly burdensome requirements. The intent will be to ensure that adequate governance arrangements are in place to demonstrate that appropriate structures (including appropriate accountability of key individuals) exist to ensure clear product supplier oversight and accountability for all advice provided and all products offered. We confirm that we will not prescribe that the group holding company must be the relevant licence holder.

We confirm that we have *no objection in principle to having both PSA and RFA distribution channels operating in the same group structure*. For example, it will be permissible for a product supplier to provide advice on its products through PSAs, and also to have an ownership interest in one or more RFA firms[15]. However, in such group structures, *we will pay particular supervisory attention to the intra-group relationships* between all such entities, including particular focus on:

- Any cross-subsidisation of expenses or sharing of profits
- The extent to which the different distribution channels support the group's own financial products versus the products of external suppliers
- Any referrals or leads between different group entities

[14] In this document, for ease of reading, we will use the term "RFA" to describe both an RFA firm and an individual adviser acting as a representative of an RFA firm – unless the context suggests otherwise.

[15] Also see the discussion in sections 3.1(e) and (f) below regarding the implications of ownership relationships between product suppliers and RFAs.

- The basis upon which the target market for each channel is identified and, in the event that the same customer is encouraged to transact through multiple channels, the measures in place to ensure that the nature and status of advice remains clear in each case
- The quality of governance and other controls in place to mitigate risks of potential conflicts of interest arising from any such relationships.

The purpose of this enhanced level of supervisory scrutiny will be to ensure that so-called "multi-channel" group structures do not undermine our RDR objectives by perpetuating conflicts of interest evident in current "hybrid" distribution models and confusing customers as to the status and scope of the advice or services that they receive from any particular channel.

(b) Strict approach to "gap filling"

The initial RDR Proposal R stipulated that a PSA (then referred to as a "tied agent") would not be permitted to provide advice on any financial products other than those issued by its home supplier or another product supplier forming part of the home supplier's group. Some commentators supported this strict approach, while others argued that the approach should be relaxed to allow PSAs to "gap fill" by recommending products of other suppliers where the home supplier's product range does not meet customer needs for various reasons, subject to the approval of the home supplier.

Having considered these inputs, we remain of the view that *a strict approach to "gap filling" is more consistent with our objective of ensuring clarity on the status of advice provided*. Financial advisers who choose to act as PSAs must therefore be comfortable with limiting the scope of their advice accordingly and ensuring that their customers understand and accept this[16]. We believe that a financial customer who chooses to obtain advice from a PSA should have the assurance that the product supplier concerned is accountable for the advice provided, the design and performance of the relevant product, and the ongoing customer experience, throughout the lifecycle of the product. Put differently, *in PSA advice models the product supplier is held accountable for delivery of all six Treating Customers Fairly outcomes*, rather than sharing this accountability with other players. If a PSA were to be permitted to recommend another product supplier's products this would not be achieved

[16] In practice, many product supplier groups offer a broad range of financial products and services that are able to meet a reasonably wide range of customer needs. We therefore do not believe that disallowing "gap filling" will unreasonably limit customer choice for customers who obtain advice from PSAs.

as the home supplier's accountability would be limited to the suitability of the advice and exclude actual product and service responsibility.

There are two deviations currently proposed from this strict approach to "gap filling":

- A PSA will be permitted to provide advice on *investment portfolios of "external" product suppliers offered on the platform of an Administrative FSP* that forms part of the home supplier's group. We acknowledge that this is a deviation from our intent to align responsibility for advice provided with responsibility for product performance. However, given the prevalence of "open architecture" offerings as the preferred form of investment solution design both in South Africa and globally, and various other RDR measures to reduce the risk of conflicts of interest in relation to investment advice, we believe that this deviation is justified. We also propose to strengthen the responsibility of these PSA home suppliers to carry out adequate due diligence on the portfolios concerned before allowing their PSAs to advise on them.
- *Tied agents of long-term insurers* (currently defined as "representatives" of the insurer) will be permitted to offer the products of another long-term insurer only in cases *where the home insurer is not licensed (under the Long-term Insurance Act) to issue the class of policy*[17] *concerned*. (This is in terms of RDR Proposal V, discussed in section 2.4(a) above). As noted in section 2.4(a), this is an *interim measure* being introduced in Phase 1 of RDR to ease the transition from the current model[18] to the final stricter approach to gap filling.

We are also considering *two further possible deviations* from the strict approach to "gap filling", on which we will consult in more detail:

- In our RDR Phase 1 Update we advised that *we are considering a model in which a PSA of one product supplier will also be permitted to act as a PSA of one or more other product suppliers operating in a completely separate, non-competing line of business* or financial services sector[19]. Mixed responses were received. In general, intermediaries were broadly in favour of exploring such a model, while product suppliers were broadly opposed to it (or only prepared to support it subject to material changes). In light of these inputs, we intend to consult further on the feasibility of adopting this model

[17] Note that for purposes of this provision "class of policy" refers to a class of policy as recognised in the LTIA.

[18] Currently, long-term insurer representatives are permitted to offer any products of any other long-term insurer with whom the home insurer has entered into an arrangement. See the discussion on RDR Proposal V under section 2.4(a) above.

[19] See further detail in the RDR Phase 1 Status Update, November 2015, which also requested feedback on various specific practical implications of such a model.

subject to two key criteria: (i) Each product supplier must be responsible for the advice provided by the PSA - who acts severally as each product supplier's agent[20] – on its own products (in other words a true "multi-tied" arrangement); and (ii) all product suppliers involved must be aware of and agree to the arrangement.

- Some commentators argued that "gap filling" should be permitted in respect of highly commoditised products, where product pricing is the only real product differentiator. *Fixed interest compulsory annuities* were highlighted as a particular example of this, where products of different suppliers are identical other than as to their publicly available annuity rate from time to time. We will consult further on options in this scenario.

In all other cases where a product supplier identifies gaps in its product range that it wishes to bridge, *referrals may be used*. (See further discussion in section 3.4(c) below).

(c) Financial planning

As previously communicated, an individual adviser (RFA or PSA) will be permitted to use the additional designation "financial planner" if the adviser has met specific standards. We confirm that we intend to rely on the apropriate regulatory frameworks and standards of South African education authorities in this regard, rather than devising separate criteria.

Accordingly, we propose that a financial adviser will be permitted to describe themselves as a "financial planner" provided the adviser meets all requirements for such designation set by a *Professional Body recognised by the South African Qualifications Authority (SAQA)* and is a member in good standing of such Professional Body. It follows therefore that the use of the descriptor "financial planner" will in effect be reserved for financial advisers who meet the professional competency and professional conduct standards set by the relevant Professional Body for such a designation.

Currently only the Financial Planning Institute (FPI) and its Certified Financial Planner (CFP) designation meet this requirement in relation to financial planning. It is however open to other associations to apply to SAQA for the necessary approvals. Recognition of foreign equivalents will also be considered, in consultation with SAQA and relevant Professional Bodies.

[20] Some commentators argued that this model would only be acceptable to them if a single product supplier (the "home supplier") will be responsible for the advice provided by the PSA, even on the other supplier's products. We believe that this would defeat the purpose of aligning responsibility for advice, product and service and is therefore no different to the "gap filling" models currently prevalent in the long-term insurance sector.

In the initial RDR discussion document we indicated that, in the short-term insurance sector, the activity of "risk planning" by financial advisers was a potential equivalent of "financial planning" in the long-term insurance and investments space. Our subsequent consultations and analysis has however not presented a clear case for recognising short-term insurance "risk planning" as a form of financial advice distinct from short-term insurance product advice. We do however invite further input on the feasibility of formally recognising an equivalent of "financial planning" (with approved professional designations through a recognised professional body) outside the long-term insurance and investments environment.

More broadly, as part of our ongoing work on refining the competency framework and enhancing professionalism for financial advice, the FSB also intends to continue to actively work with SAQA and its structures – and relevant industry participants - as they develop frameworks for various levels of qualifications and designations in the financial sector.

(d) "Low" (simplified) advice

Stakeholder feedback on earlier RDR consultation material has been mostly in favour of formally recognising a "simplified" advice process in certain circumstances. Support for this approach is typically based on arguments that the current FAIS provisions (and the way they are interpreted by the FSB and the FAIS Ombud) impose a complex, "one-size-fits-all" suitability analysis requirement which makes compliance unduly onerous where a customer's particular financial need is straightforward and / or a full assessment of the customer's personal circumstances is not necessary.

The FSB is *considering two alternative responses* to this input:

- *No formal regulatory change* required. Instead, we would issue *regulatory guidance* to clarify that the current FAIS suitability analysis requirements are already flexible enough to allow an adviser to tailor the extent of a needs analysis (including the analysis of a customer's risk profile) depending on the complexity of the particular customer's financial situation, product experience and objectives[21]. Such guidance would include examples of good and poor practices in specific scenarios; or
- *Formally provide for a "simplified" advice process* requiring a relatively less rigorous suitability assessment in appropriate cases. Further consultation would be required to confirm such cases, which could possibly include distribution models where sale of a financial product is bundled with another transaction – such as credit, "gadget" or travel

[21] Consideration may also be given to enhancing the language used in the FAIS General Code to further clarify this intent.

insurance, or other models where it is clear from the context that the advice relates to meeting a very specific customer need. International examples for such a differentiated approach to levels of advice include the Australian distinction between "personal advice" and "general advice"[22].

Regardless of the approach adopted, our focus will be on ensuring that the quality and availability of suitability analyses, including in the case of the bundled transactions mentioned above, is not unfairly compromised. Consultation will also be required on the extent to which specific remuneration standards would be required in "simplified advice" models. The question arises, for example, whether and to what extent it is appropriate to charge advice fees in such models.

(e) Product supplier influence

The FSB would like to emphasise that, as a guiding principle, *advice provided by RFAs should not be subject to influence* by or bias in favour of any products, product suppliers or other third parties, but should be informed solely by identified customer needs. We do however recognise that certain legitimate business arrangements may pose unavoidable risks of conflicts of interest, including perceived conflicts, which must be mitigated[23].

As we have highlighted previously, some key examples of arrangements that pose such risks, and RDR measures proposed to mitigate them, are the following:

- *Ownership relationships:* Where any form of ownership or other commercial interest exists beween the RFA and a product supplier, the risk of potential bias in favour of that product supplier's products or services is increased. This applies regardless of whether the product supplier holds such an interest in the RFA, or vice versa, and includes cases where the interests are held indirectly. The potential for bias arising out of such interests is not confined to "product suppliers" in the strict sense of the word. For example where ownership or similar arrangements exist between an RFA and an investment manager, bias in favour of the investment manager's portfolio offerings could equally arise. (See further discussion in section 3.2(e)). Enhanced supervisory actions will be undertaken to monitor the effectiveness of controls to mitigate the risks of potential conflicts of interest, including closer scrutiny of reported data on sales and

[22] See the Australian "Corporations Act, 2001".

[23] Note that these mitigation measures will include but not be limited to requirements for clear disclosure of the relationships concerned.

advice patterns by RFAs where such relationships exist than in cases where they do not. (Also see the discussion on product supplier influence in section 3.1(g) below).

- *Outsourced services (including binders):* Our historic and recent supervisory experience consistently reveals significant risks of poor customer outcomes in outsourced business models – including but not limited to risks of conflicted advice. These risks are sought to be mitigated by the range of RDR proposals aimed at limiting and defining the types of services that may be outsourced to financial advisers; placing caps on remuneration for such services; and significantly strengthening governance and operational efficiency requirements in these models. In Phase 1 of RDR, these risk mitigation measures are targeted at the insurance industry, where these outsourcing models are most prevalent (See discussion in section 2.4(b) above). In future RDR phases, our attention will expand to stricter risk mitigation measures for outsourcing in other sectors. The pending Financial Sector Regulation Act significantly enhances our toolkit in this regard, with a clear definition of what constitutes an "outsourced arrangement" and strengthened regulatory and supervisory powers in respect of such arrangements.
- *Production targets*: As advised in our 2015 RDR updates, we recognise that the setting of volume / quantity-based targets for RFAs by product suppliers (or LISPs and investment managers) presents a significant risk of conflicted advice. It is therefore our intention to prohibit the setting of such targets. We have however identified a need for further discussion on how best to mitigate risks of conflicted advice or compromised customer service where contractual relationships between product suppliers and advisers, and between RFA firms and their individual advisers, come to an end. Difficult questions arise regarding entitlement to and redirecting of ongoing remuneration; fair incentives for advisers to provide ongoing advice and service to customers; and the need to respect freedom of contract in these situations. We have identified a number of practical scenarios that require fair and pragmatic solutions in this regard, on which we will consult further[24].

Importantly, the above is *not a closed list* of arrangements that could result in actual or potential product supplier influence over an RFA's advice. As part of our current and planned technical work, we continue to review a number of potentially conflicted business

[24] For example: Recent amendments to s13(1)(c) of the FAIS Act and planned corresponding amendments to the PPRs, clarify that contractual relationships between product suppliers and intermediaries exist at the level of the FAIS licence holder (FSP), not at the level of its representatives. It follows that ongoing product supplier commissions are due to the FSP, regardless of whether the individual representative remains contracted to it or not. What does this mean for customers who wish to continue being served by the individual adviser concerned, without replacing their existing products? Various other permutations exist.

models to assess whether these risks will be sufficiently adddressed by our RDR proposals, or whether further interventions are warranted. Models we have flagged for further scrutiny include:

- *Third party cell captive arrangements:* Details relating to the specific risks sought to be mitigated where financial advisers share in dividends as cell owners were set out in the *Third Party Cell Captive Insurance and Similar Arrangements Discussion Paper* that was published in 2013. Informed by the RDR proposals on product supplier influence, specific measures to mitigate conflicts of interest in these models will be set out in a final *Third Party Cell Captive Discussion Document*, which will be published shortly
- *Arrangements for use of "intellectual property", "brand access", "shelf space" and similar* models between advisers / distributors / product suppliers: These arrangements often entail material income streams which are positioned as falling outside the controls applicable to commissions and outsourcing or binder fees
- *Reinsurance arrangements:* These arrangements can be structured to create indirect, potentially conflicted intra-group incentives. For example, where a financial adviser in Group A can sell policies underwritten by Insurer X, who then reinsures a portion with Insurer Y, and insurer Y is also part of Group A. This is a way for Group A to share in the profits from the sale of the policies, creating the risk that the financial adviser's recommendation of insurer X's product is potentially conflicted.

(f) "Independent" advice

No RFA[25] may use the term "independent" to describe itself or the advice it provides, unless it is able to demonstrate that it has *no relationship with any product supplier* that could be perceived as enabling a product supplier to influence its advice. In other words, none of the relationships discussed in section 3.1(e) above in regard to product supplier influence may be present. It follows that 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 influence over the advice provided.

[25] Clearly the term "independent" can never be applied in relation to a PSA.

Some commentators argued that this in effect creates a "third tier" of licensing for those advisers who are permitted to use the term "independent". We disagree. The use of the term "independent" is not linked to a licensing category, but will simply be reserved (through conduct standards) to ensure that it is only used in circumstances where it can be justified.

(g) Product supplier responsibility

Our approach to product supplier responsibility is based on the principle that the degree of *responsibility that a product supplier bears for advice provided on its products should correlate to the degree of risk that the advice could be influenced* by the product supplier.

It follows that a product supplier is fully accountable for any advice provided by its PSA. In addition to the current responsibility for ensuring that products recommended by the PSA are suitable to a particular customer's needs, we expect product suppliers selling their products through PSAs to *take particular care to ensure there is no miss-selling* resulting from the PSA only being able to sell the home supplier's products.

Where RFAs are concerned, we have highlighted in section 3.1(e) above that there are certain business relationships that pose an increased risk of product supplier influence. Accordingly, where any such relationships exist, we would expect a product supplier to carry a greater degree of responsibility for an RFA's advice on its products than in cases where the relationship is entirely at arm's length. In practice, this means that a greater degree of proactive product supplier monitoring of customer outcome indicators will be required where any degree of ownership, outsourcing or other risks of influence exist. From a supervisory perspective, we will also pay more attenion to the processes such product suppliers have in place to ensure fair customer outcomes.

This is not to say that, where no influence relationship exists, the product supplier has no responsibility for ensuring fair customer outcomes in relation to advice provided. As we have consistently pointed out, *product suppliers and advisers should always appropriately share responsibility for customer outcomes*. Where the relationship between the product supplier and the adviser is however truly at arm's length, it is reasonable to require that the product supplier may use less rigorous, more reactive measures to mitigate risks of poor advice by an RFA.

(h) Juristic representatives

The initial RDR Proposal W stipulated that juristic representative entities will not be permitted to provide financial advice. We also indicated that further consideration would be given as to whether and to what extent the use of juristic representatives should be perpetuated in non-advice ("intermediary services only") distribution models.

We remain of the view that *juristic representative structures* add unnecessary complexity and are *not desirable in non-tied advice models*. An RFA will accordingly not be permitted to appoint juristic entities to provide advice on its behalf.

We are *considering allowing PSAs to be structured as juristic entities*. Valid motivations have been put forward for allowing product supplier groups to structure their tied distribution channels in a specific legal entity. We are however less convinced of the appropriateness of allowing an entity outside of such group structures to be appointed as a juristic PSA. We will therefore consult further on permitting juristic PSAs but subject to specific conditions.

Likely *conditions for allowing a PSA to be structured as a juristic entity* include:

- Requiring the PSA entity to use the product supplier's branding – either as its only brand or as the primary brand (i.e. of greater prominence than any additional brand the PSA entity may use)
- Rigorous product supplier oversight measures of the PSA entity's conduct – no less rigorous than for individual PSAs[26]
- Specific financial and operational requirements for the PSA entity. In addition to operational requirements broadly similar to those for an RFA firm, consideration could for example be given to requiring the PSA entity to have adequate data management frameworks in place, including ensuring data sharing capabilities with the home product supplier[27].
- Requiring the PSA to be part of the product supplier group[28] and subject to its corporate control and corporate governance frameworks

[26] Among other requirements, the new FAIS Fit and Proper standards will provide that representatives may not further sub-delegate any activity that relates to the rendering of financial services. They also provide that the appointment of a representative may not result in key decision making responsibilities being removed from the FSP itself. Such provisions would be pertinent in the event of PSAs being permitted to operate as juristic entities.

[27] In this regard, a similar approach could be adopted to the data sharing requirements being imposed through the LTIA and STIA Regulations for binder and outsourcing arrangements.

[28] As noted in section 3.1(a), "group" is to be appropriately defined for these purposes.

- Specific conflict of interest controls in cases where the product supplier group contains both PSA and RFA entities. (Also see the discussion in section 3.1(a) above regarding permitting both PSA and RFA models in the same group structure. The risks highlighted in that discussion are potentially increased where a juristic PSA model is used).

Where non-advice models are concerned, we are reviewing the circumstances in which juristic representative models are effective and appropriate and will consult further on this point. Where such structures are permitted, specific financial and operational requirements and rigorous oversight measures by the RFA concerned will be prescribed[29].

3.2. Investments

(a) Early termination charges

Proposal MM, in addition to prohibiting product supplier commissions in respect of investment products (subject to a special dispensation for the low income market under RDR Proposal TT) also prohibits product suppliers from including any costs associated with intermediary remuneration in product charging structures, whether in the form of ongoing charges or early termination charges.

Section 2.4(d) above summarises the further reduction in early termination charges on "legacy" long-term insurance investment products, through the amended LTIA Regulations. Regulation of early termination charges on new insurance investment products will be informed by specific technical work currently underway. Implementation of these regulatory changes will be aligned with the timing of the abolition of commissions on these products (See section 3.2(c) below).

Further consultation will also take place on whether or to what extent any early termination charges will continue to be permissible on insurance investment products that will remain eligible for commissions in terms a specific dispensation for the low income market . (See also section 3.5 below).

[29] Similarly to possible conditions for allowing PSAs to be structured as juristic entities, these operational requirements could include appropriate data management frameworks.

(b) Investment platforms

Our views in relation to investment platforms remain as reflected in the initial RDR proposals G and YY. In effect, this means that we remain of the view that this form of distribution should be subject to *"clean pricing"* of the investment offerings concerned, stripping out any rebates or other third party remuneration from product suppliers or investment managers.

The initial RDR discussion document further proposed that platform administration fees should be the same for all platform offerings and that all offerings should be featured with equal prominence on the platform menu. We have received specific inputs on these points, arguing that differentiated pricing and platform positioning may be justified in certain circumstances. We will engage further on these issues to take a view on whether such differences are indeed appropriate in certain circumstances, without creating unacceptable conflicts of interest.

We have also been asked for clarity on whether the term "investment platform", for purposes of RDR proposals G and YY, refers only to Administrative FSPs as currently defined in terms of the FAIS Act (their defining feature being the activity of aggregating funds or financial products of clients when selling such products or investing in or buying financial products, and then allocating those proceeds or products to each customer separately). We confirm that RDR Proposals G and YY apply specifically to Administrative FSPs. However, we will give further consideration to whether other mechanisms for offering investment product options, sometimes also referred to as "platforms", require further scrutiny to ensure that they are consistent with our RDR objectives.

(c) Remuneration for investment product advice

As indicated in our December 2015 General Status Update, the intention is to implement the *prohibition on investment product commission in two steps*, namely by first disallowing commissions on lump sum investment products and thereafter on recurring contribution investments. Our view is that this staggered approach will smooth the impact of the shift away from commissions for affected financial advisers.

In the case of recurring contribution investments, the prohibition of commissions will be subject to the low income market exception contemplated in RDR Proposal TT (See section 3.5 below). We do not propose a low income exception to allow commissions for any lump sum investment products.

We have previously highlighted an anomaly regarding remuneration in respect of *compulsory annuity products:* If such annuities are regarded as investment products for RDR purposes, adviser remuneration in respect of these products will be restricted to advice fees only. In the case of living annuities, advice fees are typically structured as an ongoing fee for ongoing advice, recovered from the living annuity's investment value from time to time. In the case of fixed interest annuities, the inflexible nature of the product means that ongoing advice fees cannot easily be motivated, thus effectively restricting adviser remuneration to an up-front advice fee – which a number of customers may be reluctant to pay. The abolition of commissions could therefore inappropriately skew advice toward living annuities. On the other hand, if commissions were to continue to be permitted on fixed interest annuities only, this could conversely inappropriately skew advice toward these products.

To limit these risks of regulatory arbitrage, we are *considering permitting a level of commission to continue being payable for any compulsory purchase annuity* sale (both fixed interest and living annuities) *below a certain purchase price threshold*. The compulsory nature of these products and the fact that the investment size is determined by the proceeds of the customer's retirement savings pay-out, arguably limit the risks of commission-driven "over-selling". Such an approach is also consistent with broader retirement sector reform objectives encouraging annuitisation. We will consult further on this option, including an appropriate threshold.

(d) FAIS Category I and II licences

The various RDR proposals in relation to the investment sector have raised questions from a number of investment industry players regarding how these proposals will impact their particular business models. Review of these models has highlighted the complexity of the current investments industry, including complex inter-relationships between product suppliers, investment managers, platform providers, financial advisers and their groups. In particular, it has become clear that the current FAIS regulatory framework does not clearly demarcate the respective roles and customer value propositions in cases where the same entity is licensed in both FAIS Categories I and II and provides both advice and discretionary investment management services to the same customers.

We therefore intend to define and develop *standards for the specific activity of "investment management"*, identifying those activities that differentiate investment management from the current broad FAIS reference to rendering intermediary services "of a discretionary nature". This work will require an activity analysis of the different elements of the

investment product value chain – such as asset selection, asset allocation, portfolio construction, the role of platforms, investment advice, etc. This will enable us to take a view on the regulatory treatment appropriate for each service. We hope to resolve the current unintended situation where a fully fledged investment management firm using sophisticated asset selection and related methodologies to fulfill discretionary customer mandates, holds the identical licence (and can earn the same forms of remuneration) as a financial adviser who holds a discretionary customer mandate but does not in fact undertake any actual investment management processes.

We are also concerned that our initial RDR proposals may not adequately address the potential *conflict of interest risks that may apply to holders of discretionary investment mandates* (whether by "true" investment managers or otherwise). The current FAIS framework places the exercise of such discretion outside the scope of advice – discretion involves the intermediary making a decision (in terms of a mandate) on the customer's behalf; whereas advice entails the customer making his or her own decision, informed by the intermediary's recommendation. FAIS does nevertheless require a Discretionary FSP (Category II intermediary), prior to entering into a mandate, to obtain information from customers regarding their financial circumstances, needs and objectives and to identify financial products accordingly[30]. This confirms that FAIS does recognise the risk of a Category II intermediary exercising discretion in a way that is not suitable to customer needs. However, our various RDR proposals aimed at further reducing the risks of unsuitable outcomes, are mainly focused on advice and do not apply directly to discretionary mandates. For example, RDR will address the conflict of interest risks inherent in an adviser recommending investments on which the adviser may also earn management fees (See section 3.2(e) below). However, it does not necessarily address conflict of interest risks inherent in an investment manager (who is not also directly advising the customer) using a discretionary mandate to place investments in those portfolios that it manages. We will consult on whether there is a need to strengthen our RDR proposals to address the potential conflict of interest risks in such cases.

(e) Outsourcing investment management to advisers

We remain of the view that an *RFA should not be able to provide advice on any product or portfolio in respect of which they also perform outsourced investment management services*. We therefore intend to proceeed with our initial proposal to disallow the outsourcing of investment management to a FAIS Category II intermediary who also

[30] See the FAIS Code of Conduct for Discretionary and Administrative FSP's, Part II, Section 3.

provides advice on the portfolios concerned – for example through “white label” models. As pointed out in our 2015 General Status Update, it is not however our intention to discontinue the current mechanism of using white labelling for ”incubator” purposes to support new entrants – provided that these models do not entail potential conflicts of interest that other RDR proposals seek to curtail.

We are also *considering whether or in what circumstances an adviser could be regarded as a “PSA” of an investment manager*. In other words, in what circumstances, if any, should an investment manager bear similar responsibility in relation to advice provided on the investments it manages to the responsibility a product supplier bears for advice provided on its products by its PSAs? For example, where an arrangement (including an intra-group arrangement) exists in terms of which an adviser recommends investments managed only by a particular investment manager, the adviser should arguably be regarded as “tied” to that investment manager and the investment manager should be accountable for the advice concerned.

Final standards in relation to outsourcing and other aspects of the relationships between investment managers and advisers in the investments space will also be informed by the work discussed in section 3.2(d) above regading the refinement of FAIS Category II licences.

3.3. Risk insurance (life and non-life)

(a) Binders and outsourcing

We have pointed out in section 3.1(e) that arrangements where product suppliers outsource functions to financial advisers pose particular risks of product supplier influence and conflicted advice. These arrangements are common in the insurance sector, particularly in the short-term insurance market. Despite the conflict of interest risks inherent in these arrangements, the FSB recognises that properly structured and governed outsourced arrangements can deliver value and service efficiencies for customers.

Our view therefore is that these arrangements are permissible, provided that *efficiency and customer value* can indeed be demonstrated and that conflicts of interest risks are significantly minimised. Our regulatory proposals for binder and outsourcing arrangements in the insurance sector, summarised in section 2.4(b) above, therefore focus on:

- Insurer accountability, governance and oversight

- Operational efficiency, including rigorous data sharing standards
- Delivery of fair customer outcomes
- Remuneration caps to address remuneration bias in respect of these services.

Significant technical work, with input from various industry role players, is currently underway to address the aspects listed above. Further consultation will take place as the technical work progresses. The immediate focus of the technical work relates to the non-life (short-term) sector. However, as discussed in section 3.3(d), discussions are underway to extend this work to the life insurance (long-term) sector.

(b) Premium collection

In line with RDR Proposal F, our intention remains to limit premium collection only to intermediaries who meet specific qualifying criteria. A number of commentators on our initial proposal argued that premium collection should not be regarded as an intermediary service but rather as *an outsourced service on behalf of the insurer*. We agree. The qualifying criteria for premium collection will therefore have a similar emphasis on governance, oversight, operational efficiency and fair customer outcomes to the broader outsourcing standards – together with specific operational requirements to safeguard the money collected. Further technical work will be undertaken to determine whether remuneration for premium collection should be subject to a prescribed cap and, if so, the appropriate level of such a cap.

Once these qualifying criteria are set, necessary amendments to the current LTIA and STIA definitions of "service as intermediary" will be made to exclude premium collection from the ambit of the definition[31]. At that stage, qualifying intermediaries will be permitted to earn a separate fee for premium collection (possibly subject to a cap), over and above applicable commission.

In the interim however, we confirm that premium collection remains within the ambit of "services as intermediary" and no remuneration outside of current commission levels is payable for the service.

(c) Remuneration: Non-life (short-term) insurance

Our view remains that product supplier remuneration for selling and servicing short-term insurance policies should be payable as a percentage of premium, as and when premiums

[31] A change to the FAIS Act definition of "intermediary service" may also be required.

are paid, and subject to a regulated cap. We also remain of the view that the appropriate commission cap should be reviewed, in light of the fact that advisers will also be able to earn advice fees from customers and the cost of providing advice therefore no longer needs to be factored into the commission cap. Our initial RDR Proposal UU therefore remains in place.

We recognise that the commission cap review needs to take account of the knock-on impact on adviser earnings of our other RDR remuneration proposals, in particular the limitations and caps being imposed in respect of binder and outsourcing arrangements. The final remuneration model needs to provide fair and sustainable remuneration for intermediaries that are commensurate with the cost and quality of the services they provide – whether to customers or product suppliers.

We are therefore, in consultation with short-tem insurers and intermediaries, carrying out detailed technical work to determine the types of activities for which intermediaries are currently remunerated. The outcome of this work will be an *activity segmentation* framework for short-term insurance which demarcates between:

- Advice (a service to the customer)
- Other services to the customer
- Services that truly "intermediate" between the customer and the insurer
- Services to the insurer (split between binder services and other outsourced services)
- Other services to the insurer not explicitly provided for in the current regulatory framework.

This framework will then be used as a basis to *determine how and by whom intermediaries should be remunerated for each of the identified services*. It will also help us determine whether any additional conduct standards need to be developed in respect of these activities to mitigate potential conflicts of interest and to enhance customer outcomes. The exercise is also helping us to understand the knock-on effect of our proposed binder fee caps on other remuneration streams currently available to intermediaries. As part of the exercise, we have reviewed the level of activity based costing that is currently applied by insurers and intermediaries in determining appropriate remuneration levels for the different types of activities.

A specific question, raised in our previous RDR updates, that we would like the activity segmentation to answer is whether product supplier remuneration should be subject to separate commission caps (both payable as and when premiums are paid) for selling a

policy and for ongoing service respectively, or whether both activities should be addressed through a single commission cap. This debate remains open.

The *preliminary key findings of the activity segmentation exercise in the short-term insurance industry* include:

- Significant duplication and overlaps in activities for which intermediaries are remunerated, posing a real risk that some intermediaries are paid more than once for performing the same activity
- Inconsistent interpretation of the distinction between "services as intermediary" as defined in the STIA (i.e. services currently intended to be covered by commission caps) and outsourced activities. In some cases there is also an inconsistent interpretation of the distinction between binder activities and other outsourced activities
- Current remuneration levels for binders and outsourcing are largely based on prevailing market practice ("negotiable" rates proposed by the outsource provider in exchange for placing business with a particular insurer), with little evidence of robust activity based costing linked to the actual cost of activities being performed.

These preliminary findings reinforce our view that, in many cases, current remuneration practices do not correctly reflect the value and cost of intermediaries' activities; do not drive efficiency for customers and insurers alike; do not support sustainable intermediary business models; and increase the risk of conflicted financial advice.

This technical work will continue and will be expanded to the long-term insurance sector.

(d) Remuneration: Life risk (long-term risk) insurance

The key features of our initial RDR Proposal NN remain unchanged – namely that product supplier remuneration for selling and servicing long-term risk insurance policies should be payable as a percentage of premium, with a maximum of 50% payable up front and the remainder payable as and when premiums are paid, and subject to a regulated cap[32]. We also reconfirm that the appropriate commission cap will be reviewed, in light of the fact that advisers will also be able to earn advice fees from customers and the cost of providing advice therefore no longer needs to be factored into the commission cap.

[32] For avoidance of doubt, we confirm that the proposed shift from full up-front commission to 50% up-front relates to those types of individual policies that are already eligible for up-front commissions. We do not propose a shift to up-front commissions for policies that are already subject to as-and-when commissions.

Similarly to our approach to short-term insurance remuneration, we appreciate that the impact of the life risk remuneration changes needs to be assessed together with the impact of our broader RDR proposals. More particularly, we recognise that the final remuneration model for life risk products needs to consider the combined impact of Proposal NN and proposals relating to:

- The introduction of advice fees for life risk products
- Equivalence of reward proposals for remunerating individual PSAs
- The abolition of commissions on investment products (recognising that many advisers operate in both the life risk and investment sectors)
- Proposed limitations and fee caps on binder and outsourcing arrangements[33]
- Our proposed strict approach to "gap filling" for PSAs
- The possible abolition or reduction of commission on life risk policy replacements
- A special dispensation for the low income market.

Technical work in consultation with industry representatives is therefore planned to perform this impact assessment, which will in turn inform the final life risk remuneration standards. The technical work will include an *activity segmentation* exercise, corresponding to the exercise underway for the short-term insurance sector (see section 3.3(c) above). We also confirm that the *shift from fully up-front to 50% up-front commissions will be phased in* over an appropriate transitional period. The planned technical work will also be used to determine the phasing in approach.

Similarly to the debate relating to short-term insurance, further debate is still required on whether and how to distinguish between product supplier remuneration for selling a policy and for ongoing service respectively, and the activity segmentation exercise will consider this question. In the long-term insurance sector, this debate also raises questions of when and how ongoing remuneration should be able to be redirected to an adviser other than the adviser who initially sold the policy.

Specific further consultation will also take place on detailed aspects of Proposal NN in response to specific concerns raised by commentators. These include our proposals that the up-front commission component should be paid in a single payment and that commission for regular contractual premium escalations should be included in the up-front commission calculation.

[33] These arrangements are however relatively less prevalent in the long-term insurance sector than the short-term sector.

(e) Equivalence of reward

As noted in section 3.3(d), the planned technical work to determine the final remuneration model for life risk products will include work on the final Equivalence of Reward (EoR) model put forward in RDR Proposal RR – namely the proposal that the EoR principle should apply at the level of each individual insurer PSA.

The underlying rationale for the EoR principle is to ensure a *reasonably level playing field* between the maximum (capped), "cash only" commissions available to RFAs for selling long-term insurance policies, and the more flexible types of remuneration benefits available to PSAs. We therefore pointed out in the initial Proposal RR that going forward the EoR principle is specific to life risk policies, being the products that will remain eligible for capped product supplier commission. In the case of investment products, for which uncapped customer advice fees will be the only remuneration available to the adviser (unless the special dispensation for the low income market applies), EoR accordingly does not apply. We suggested instead that the portion of a PSA's remuneration attributable to investment product sales should not in aggregate exceed the value of customer advice fees actually paid in respect of investment products sold by that adviser. Failing such a mechanism, there will be no regulatory limit on the extent to which PSAs (particularly those appointed by large insurers) will be in a position to earn forms of remuneration in respect of investment products that is substantially in excess of the advice fees that many RFAs will be able to demand. The feasibility and practical implications of this approach to PSA remuneration for investment products does however require further consultation, which will take place.

We also confirm that we plan to consult on whether there is a need to *extend the EoR principle to the short-term insurance sector*. A number of commentators were in support of doing so, and we have also observed an increased interest by short-term insurers in adopting tied (PSA) advice models.

Although EoR applies to remuneration arrangements specifically between an insurer and its PSAs, we are also conscious of the need to avoid unintended arbitrage in the event that – once EoR is fully implemented for PSAs – an individual adviser in an RFA firm may be eligible for more generous remuneration than a PSA. To illustrate: Once the final EoR model is in place, a PSA selling life risk policies will in aggregate not be able to earn substantially more remuneration than the equivalent value of the maximum commission cap available to an RFA, plus the value of any advice fees paid by customers on those policies. An RFA firm selling the same policies will be able to earn the relevant maximum capped

cash commission, plus customer advice fees. So far, equivalence is achieved. However, RDR does not limit the remuneration that the RFA firm may in turn pay its individual adviser in respect of the risk policies he or she sells. There is therefore no regulatory limit on the individual adviser's remuneration and no mechanism for such remuneration to be equivalent to that available to an individual PSA (which will be limited by the EoR standards). The likelihood of individual RFAs earning potentially disproportionate remuneration is higher in the case of large RFA firms, or RFAs forming part of larger financial services groups, where cross-subsidies are available. We are considering whether this scenario presents risks of poor customer or industry outcomes which may warrant regulatory intervention in the *remuneration arrangements between RFA firms and their individual advisers*.

Where arrangements between RFA firms and their advisers are concerned, we are also considering strengthening the current *FAIS General Code conflict of interest measures*. Currently, the General Code sets strict limits on financial interests that may be received from third parties, but has relatively less stringent requirements for remuneration payable by an FSP to its own representatives. These requirements in effect provide that an FSP must ensure that it does not incentivise its representatives to favour particular products or product suppliers over others (where the representative has a choice of product or supplier) and does not inappropriately incentivise quantity of sales at the expense of quality measures.

We are considering whether these current FAIS provisions need to be strengthened under the RDR to further mitigate the risk of conflicted remuneration arrangements between RFAs and their individual advisers, as well as between product suppliers and their PSAs. Among other measures, we are considering an explicit obligation[34] on RFA firms or product suppliers of PSAs (as the case may be) to have measures in place to *mitigate the risk of individual advisers "pushing" products* to secure a sale in cases where the more appropriate route would have been not to recommend a product or transaction at all, or to have informed the customer that the particular adviser was not able to recommend a suitable product or transaction.

(f) Policy replacements

As confirmed in the November 2015 Phase 1 Update, consideration of removing or limiting commissions on life risk policy replacements, initially scheduled for Phase 1, is deferred

[34] This obligation is currently implicit in general FAIS General Code obligations relating to suitable advice.

pending further technical work on the overall remuneration model for life risk products, including the implementation of advice fees for such products. Instead, more stringent disclosure, reporting and insurer monitoring obligations in relation to these replacements – including disallowing commissions in cases where required disclosure standards are not met - will be implemented through the LTIA PPRs and Regulations in the interim, as summarised in section 2.

The technical work on the life risk remuneration model (see section 3.3(d) above) will include an assessment of the impacts of different possible remuneration interventions for replacements. The effectiveness of the interim replacement controls and replacement related reporting data will also be monitored. These findings, together with the impact assessment work, will inform our final view on whether or when commission interventions may be required.

3.4. Sales execution and non-advice distribution

(a) Non-advice sales execution

RDR Proposal D indicated that a definition of "sales execution" will be included in the regulatory framework. A *definition of "execution of sales"* has now been proposed in the draft amendments to the FAIS Fit and Proper requirements summarised in section 2.4, recognising that tailored competence standards are necessary in non-advice distribution models. In particular, the Fit and Proper requirements set specific competence standards where sales execution is effected through a predetermined "sales script". These Fit and Proper proposals are also a first step toward linking the use of these distribution models to the degree of product complexity.

Next steps will be to refine the link between non-advice sales and specific product types, as initially proposed. The explicit recognition of sales execution as a regulated activity, including scripted sales, also paves the way for setting targeted conduct standards – including remuneration standards - for these distribution models.

As indicated in RDR Proposal WW, remuneration standards for sales execution should be commensurate with the fact that these models do not entail advice and, usually, also do not entail ongoing service or product maintenance. Clearly therefore no advice fees should be payable in such models. In the case of non-advice non-life (short-term) insurance and life risk (long-term risk) insurance sales, it should also follow that the aggregate remuneration

payable to the distributor should not exceed the equivalent of the commission payable by an insurer for the "sales" component of an intermediary's activities. Further consultation is however required on the extent to which more explicit remuneration standards – including caps – are required in these models.

Specific consultation is also required on appropriate *remuneration standards for non-advice sales of investment products*. RDR Proposal MM limits remuneration for selling and servicing investment products to customer advice fees only. However, the RDR discussion document recognised that this proposal only applies to intermediated distribution models that do in fact entail the provision of advice[35]. We did not elaborate further on remuneration for non-advice investment sales. Where the product is distributed directly by the product supplier – for example through its website or by its own call centre – the question of intermediary remuneration arguably does not arise. However, where a third party distributor is used to distribute the investment products, the appropriate remuneration model needs to be debated. Further research is required on the extent to which such distribution models currently exist and how they are remunerated[36].

Our *proposals regarding the use of juristic intermediaries may also impact non-advice distribution models*. Currently, non-advice models are commonly used by distributors whose core business is not the distribution of financial products – for example retailers offering a financial product together with another product or service. Such distributors are also often appointed as juristic representatives of the financial product supplier concerned. They argue that, due to the non-core nature of their financial service activities, it is not operationally feasible for them to be licensed as FSPs under FAIS in their own right. As mentioned in section 3.1(h), we are reviewing the circumstances in which juristic representative models should be permissible for non-advice product distribution, including questioning the desirability of allowing a juristic entity that is not part of the product supplier group to operate as a PSA.

(b) Product comparison and aggregation

Our intention to implement Proposal H by introducing explicit standards for product comparison and aggregation services, informed by relevant international standards, remains unchanged. Note that, where the service entails automated advice – for example a web-based comparison tool that culminates in recommending a particular product – the

[35] See p.51 of the initial RDR discussion document.

[36] Note that no-advice ("sales execution" only) distribution models should be distinguished from the "automated advice" model provided for in the FAIS Fit and Proper amendments discussed earlier.

new FAIS Fit and Proper standards regarding automated advice will also apply. (See section 2.2(a) above). Further technical work and consultation will take place regarding appropriate remuneration standards for these services.

(c) Referrals and leads

As pointed out in section 3.1(b), the FSB proposes that product suppliers will be able to consider using referrals to other product suppliers or advisers in cases where they believe that their own PSAs are not able to recommend a product of the home supplier that meets a particular customer's needs, particularly in light of our proposed strict approach to "gap filling" by PSAs[37].

We plan to consult on *allowing product suppliers who use PSAs to fill "gaps" by referring customers to another product supplier*, provided that:

- The home supplier must have rigorous governance processes in place to select such suppliers and products, including carrying out adequate due diligence on the product and supplier concerned
- These governance processes must ensure that the referral does not create potential conflict of interest risks – for example measures to ensure that the referral is objective, not influenced by other relationships with the supplier concerned, not subject to conflicted "quid pro quo" arrangements between product suppliers, etc.
- The home supplier must be able to demonstrate that the referral is necessary due to a pre-identified customer need that cannot be met by its own product range. For example, referrals must not be carried out on an ad hoc basis in response to isolated customer or adviser complaints.

Alternatively, referral to an RFA (as opposed to a product supplier) who is able to advise on an appropriate product can be considered – again provided appropriate governance and due diligence processes are in place to inform the selection of the RFAs concerned.

Further consultation will be carried out on remuneration standards for referrals and leads. Our current thinking is that the adviser (or its product supplier in the case of a PSA) making the referral 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 should not exceed the applicable commission caps.

[37] Note however that the use of referrals is not confined to PSA models.

We are concerned that referrals within financial services groups – for example referrals by a PSA to an RFA entity within the same group – may pose conflicts of interest. We are therefore considering whether specific additional standards or limitations may need to be imposed for such intra-group referrals.

3.5. Financial inclusion and the low income market

As we noted in the December 2015 RDR General Status Update, the implementation of RDR Proposal TT is being treated as part of a broader, more holistic approach to financial inclusion and transformation of the financial sector. The importance of this broader approach has been reinforced by the Financial Sector Regulation Bill, which includes financial inclusion and financial sector transformation as two of the Bill's explicit objects[38].

We reconfirm that we recognise the interconnectedness between Proposal TT and a number of other RDR Proposals, in particular those relating to intermediary remuneration models. Our planned technical work on these remuneration proposals, discussed elsewhere in this document, will therefore include consideration of how best to implement Proposal TT in the context of our policy objectives in relation to inclusion and transformation.

3.6. Consumer education

The FSB recognises that for the RDR to achieve its objectives, particularly the objective of improving trust and confidence in financial services, it will be essential for financial customers to understand how their interaction with the financial services industry will change and how these changes will support them in realising their financial goals.

We have therefore set up a *dedicated RDR consumer education workstream*, tasked with developing action plans to help financial customers understand:

- The value of fair, good quality financial advice and the risks of not getting advice

[38] See s.7(1) of the Bill. In the Bill, ''financial inclusion" is defined to mean that "all persons have timely and fair access to appropriate, fair and affordable financial products and services" and "transformation of the financial sector" to mean "transformation as envisaged by the Financial Sector Code for Broad-Based Black Economic Empowerment issued in terms of section 9(1) of the Broad-Based Black Economic Empowerment Act, 55 2003 (Act No. 53 of 2003)".

- 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 available
- How they will pay for financial advice in future, compared to how they are currently paying for it
- Their responsibility to make sure they review their adviser's credentials, understand the nature and scope of services the adviser will provide, and demand delivery of the service promised.

The workstream will work together with industry stakeholders, using the structures of the multi-stakeholder Market Conduct Regulatory Framework Steering Committee, to agree how the financial services industry can support us in ensuring consistent delivery of these messages.

4. Next steps and comments

4.1. The next steps in the RDR implementation journey are:

- ***Implementing Phase 1:*** Details of the regulatory instruments and consultation processes planned and underway for RDR Phase 1 are set out in Section 2 of this document. It is important to note that, for some of the requirements proposed, this consultation *includes consultation on the transition periods* that affected regulated entities (whether product suppliers or intermediaries) may require to implement them. In these cases, the dates by which actual compliance with the relevant requirements is required will be confirmed once these inputs have been reviewed.

- ***Ongoing technical work:*** As discussed in Section 3 of this document, additional technical work will be carried out to complete the detail of various Phase 2 and 3 RDR proposals. Where required, technical work will not only inform the final regulatory position, but also transition or phasing in measures[39]. This technical work will be carried out in consultation and collaboration with industry representative bodies and relevant experts.

- ***Formal consultation on Phase 2 or 3 regulatory instruments:*** As and when details of final regulatory proposals are decided on, these will be appropriately incorporated into draft legislative or regulatory instruments, and formal consultation on any such instruments will follow.

4.2. What is the distinction between RDR Phases 2 and 3?

As previously communicated, the FSB's intention is to align the implementation of our RDR reforms with broader changes to the financial sector legislative architecture under a Twin Peaks model, as well as other overarching market conduct regulatory reforms. This means that aspects of the RDR implementation timeline are unavoidably dependent on timelines of these broader processes, some of which are outside of the FSB's control.

[39] For example, see the discussion in section 3.3(d) confirming that changes to life risk insurance commission caps are likely to be phased in over a number of years, rather than being introduced on a "once-off" basis.

Subject to those dependencies, our *updated thinking on the distinction between RDR Phases 2 and 3* is as follows:

- ***Phase 2 Proposals:***

In previous updates, we have indicated that RDR Phase 2 is planned to be implemented once the proposed Financial Sector Regulation Act (FSRA) becomes law. The FSRA will confer standard setting powers on the two new "Twin Peaks" regulatory authorities, namely the Financial Sector Conduct Authority (or "FSCA", which will replace the FSB) and the Prudential Authority. However, even after the FSRA is promulgated, current financial sector laws and the FSB's current powers to make subordinate legislation under those laws will – in the medium term – also remain in effect. In effect, once the FSRA is in operation, the FSCA will have a choice of which regulatory instruments to use: Either existing types of instruments issued under existing laws, or conduct standards issued under the FSRA.

We therefore expect that the majority of the RDR Phase 2 proposals will be implemented by using powers under existing financial sector laws – for example further changes to various subordinate instruments under the FAIS Act, Long-term or Short-term Insurance Acts, Pension Funds Act, Collective Investments Schemes Control Act, etc. Note that these RDR changes can therefore be made either before or after the FSRA comes into operation. However, once the FSRA is in operation, for certain RDR Phase 2 Proposals that cut across various financial sectors (but which we believe should not be deferred to Phase 3), or in cases where existing financial sector laws do not confer the necessary authority to make the changes, there will be an option to implement RDR Phase 2 changes through FSCA conduct standards issued in terms of the FSRA.

The FSRA is currently at a relatively advanced stage of the legislative process and it is hoped that it will be promulgated by the end of the first quarter of 2017.

- ***Phase 3 Proposals:***

As previously communicated, RDR Phase 3 is targeted for implementation once the future Conduct of Financial Institutions Act (COFI Act) is in place. The COFI Act is expected to repeal a number of existing financial sector laws and consolidate and strengthen the conduct of business related provisions they contain in a single, overarching conduct of business law. The COFI Act is also expected to introduce a new, more activity-based licensing framework for financial institutions. Once the COFI Act comes into effect, the primary regulatory instrument available to the FSCA will be conduct standards issued under the COFI Act.

National Treasury is in the early stages of planning the COFI framework, in consultation with the FSB and the South African Reserve Bank. Public consultation on a draft Bill is scheduled to take place during 2017, with promulgation expected in the course of 2018.

Those RDR changes targeted for Phase 3 are therefore, in the main, those changes that fundamentally affect the licensing status of regulated entities – for example proposals relating to or dependent on the new RDR adviser categorisation model.

Please note however that the Proposals implemented in Phases 1 and 2 using existing requlatory instruments will also, in due course, be merged into the future overarching COFI regulatory framework as provisions of the COFI Act or conduct standards.

4.3. Comments welcome on this status update

The FSB welcomes comments on **Sections 3 and 4 and Appendix A**[40] of this document from any interested persons. It would be appreciated if any comments or questions for clarification could be submitted by e-mail to FSB.RDRfeedback@fsb.co.za or by post to Ms Hannelie Hattingh, Senior Specialist: Market Conduct Strategy, Financial Services Board, PO Box 35655, Menlo Park, 0102 by no later than **31 March 2017.**

[40] As explained in Section 2, the proposals summarised in that section are subject to separate formal consultation processes.

Appendix A: Status overview of the full set of RDR proposals

The table below provides a snapshot of the current status of each of the initial 55 RDR regulatory proposals put forward in November 2014. It includes a summary of key changes in thinking (if any) since the initial proposal. These summaries are however at a very high level and we recommend that they be read together with the detail in the body of the document as well as with our November and December 2015 updates. The column headed "Ref in this document" provides cross-references to the sections / paragraphs in this update document where the proposal concerned is discussed in greater detail (where applicable).

No.	Initial proposal heading	Key changes / updates since initial RDR	Phase 1	Phase 2	Phase 3	Ref. in this document
A	Forms of advice defined (financial planning, up-front product advice, ongoing product advice), with related conduct standards	• We are no longer proposing formal separate definitions of up-front & ongoing product advice, but standards will be set for the provision of ongoing advice • Financial planning is to be defined with reference to professional body standards (see proposal T)		□	□	3.1(c)
B	Standards for "low advice" distribution models	• This terminology is likely to change to "simplified" or "general" advice • We are considering either: Guidance to clarify that different levels of advice / needs analysis are already possible under FAIS; or formal creation of a new form of advice		□	□	3.1(d)
C	Standards for "wholesale" financial advice	• Standards under the FAIS General Code will be considered • In the longer term, the COFI Act licensing framework will distinguish between retail and other forms of customers, with related differentiated conduct standards		□	□	
D	Standards for sales execution, particularly in non-advice distribution models	• FAIS competency standards are being set for sales execution, with specific standards for selling per a script • Further standards are being considered, including linkage to product		□	□	2.2(b) 3.4(a)

No.	Initial proposal heading	Key changes / updates since initial RDR	Phase 1	Phase 2	Phase 3	Ref. in this document
		complexity				
E	Standards for ongoing product servicing	• Standards for specific types of servicing are being strengthened for insurers, including specific requirements for insurers to adopt TCF standards (see PPRs) • Further standards for other sectors are planned • Cross-cutting service standards will be introduced under COFI		▯	▯	2.5(a)
F	Insurance premium collection to be limited to qualifying intermediaries	• Premium collection will in due course be regarded as an outsourced service to insurers, subject to specific outsourcing standards for qualifying intermediaries • We are considering whether a specific fee cap for premium collection is required		▯		3.3(b)
G	Revised standards for investment platform administration	• These standards are to be addressed through amendments to the FAIS Code of Conduct for Administrative FSPs • Further consultation is planned on specific proposed measures regarding equal platform fees and equally prominent display of all platform offerings • We are considering whether further standards are required for other types of “platforms”		▯		3.2(b)
H	Standards for product aggregation and comparison services	• These standards are to be introduced, based largely on international precedents		▯		3.4(b)
I	Standards for referrals and lead generation	• Standards will be proposed for product suppliers to allow PSAs to refer customers to other product suppliers or to an appropriate RFA, subject to governance requirements, in light of the strict approach to PSA “gap filling”		▯		3.4(c)

No.	Initial proposal heading	Key changes / updates since initial RDR	Phase 1	Phase 2	Phase 3	Ref. in this document
		• Disclosure standards are to be developed for referrals and leads more broadly • Further technical work is planned on remuneration standards				
J	Outsourced services obo product suppliers to be more clearly identified and regulated	• The Insurance Regulations will further refine types of permissible binder and outsourcing arrangements; governance and oversight standards; data sharing standards; and fee caps. This includes defining and setting standards for outsourcing of "policy data administration services" • Outsourcing of investment management to financial advisers providing advice on the same products is to be disallowed. Detailed standards will be informed by technical work on defining and clarifying the scope of the "investment management" activity	□	□		2.4(b) 3.2(e)
K	Types of adviser defined: Independent (IFA), multi-tied or tied	• This proposal has been changed from an initial three-tier adviser categorisation model to a two-tier model: Product supplier agents (PSAs) and registered financial advisers (RFAs). This terminology will be consumer tested • An adviser may only act in one of these capacities • Use of the descriptor "independent" will not be a separate licence category, but will only be permitted where no relationships exist that could result in product supplier influence			□	3.1(a) 3.1(f)
L	An IFA may advise on certain products on a multi-tied basis	• The proposal is no longer required in light of the revised adviser categorisation model				
M	Further input required on criteria for IFAs to offer sufficient product and product supplier choice	• This proposal will not be pursued. No formal requirements will be set regarding the spread of product suppliers and / or products recommended by RFAs • Supervisory reporting by and monitoring of RFAs (including in relation				3.1(e)

No.	Initial proposal heading	Key changes / updates since initial RDR	Phase 1	Phase 2	Phase 3	Ref. in this document
		to the spread of products / suppliers they recommend) will be undertaken to assess risks of product supplier influence				
N	Criteria for IFAs to be free of product supplier influence	• In light of the revised adviser categorisation, this proposal now relates to RFAs (not IFAs) • The underlying principle is that RFAs should be wholly free of product supplier influence. However various other RDR proposals introduce measures to mitigate risks of conflict of interest, where certain business relationships with product suppliers exist • These relationships include (but are not limited to): ○ ownership relationships (risk of influence to be monitored through close supervision) ○ production / volume related targets (to be disallowed – but with further work planned to ensure customer, adviser and product supplier interests are balanced when contractual relationships are terminated) ○ binder and outsourcing arrangements (risk of influence to be mitigated through efficiency and governance requirements and fee caps) • Various other potentially conflicted relationships (for e.g. through cell captive or reinsurance models) are also being reviewed				3.1(e)
O	Status disclosure to be made by IFAs	• In light of the revised adviser categorisation, this proposal now focuses on the circumstances when an RFA will be permitted to describe its advice as “independent”. In effect, this will be where none of the relationships discussed under Proposal N exist				3.1(f)

No.	Initial proposal heading	Key changes / updates since initial RDR	Phase 1	Phase 2	Phase 3	Ref. in this document
P	Criteria for multi-tied advisers	• In light of the revised adviser categorisation, this Proposal now deals with criteria for RFAs				3.1(a)
Q	Status disclosure to be made by multi-tied advisers	• In light of the revised adviser categorisation, this Proposal now deals with status disclosure by RFAs. Disclosure standards will be introduced together with implementation of the final adviser categorisation model				3.1(a)
R	Criteria for tied advisers	• In light of the revised adviser categorisation, this proposal now deals with criteria for PSAs • PSAs will be limited to providing advice on their home supplier and its group's products only – i.e. a strict approach to "gap filling" (see detail of possible limited exceptions in the body of this document)				3.1(a) 3.1(b)
S	Status disclosure to be made by tied advisers	• In light of the revised adviser categorisation, this Proposal now deals with status disclosure by PSAs. Disclosure standards will be introduced together with implementation of the final adviser categorisation model				3.1(a)
T	Criteria for financial planners	• Either RFAs or PSAs will be permitted to use the additional designation "financial planner", provided they meet the requirements for such a designation as set by a Professional Body approved as such by SAQA • Currently this applies only to the FPI and its CFP designation, but other bodies are free to apply to SAQA for the relevant approvals. We will also consider foreign equivalents, in consultation with SAQA • Currently we see no clear case for an equivalent approach in the short-term insurance sector specifically, but we are open to discussion				3.1(c)
U	Status disclosure to be made by financial planners	• Disclosure standards will be introduced together with implementation of the final standards for financial planning				3.1(c)

No.	Initial proposal heading	Key changes / updates since initial RDR	Phase 1	Phase 2	Phase 3	Ref. in this document
V	Insurer tied advisers may no longer provide advice or services in relation to another insurer's products	• This proposal is to be implemented through pending changes to the LTIA Regulations, with an exception for product classes that the "home" insurer is not authorised under the LTIA to underwrite • This is an interim proposal, pending the final approach to "gap filling" for PSAs • Advisers will be able to continue servicing customers on existing policies entered into through previously permitted arrangements	☐			2.4(a) 3.1(b) 2.4(a)
W	"Juristic representatives" to be disallowed from providing financial advice	• This proposal remains in place • We are considering a possible exception to allow a PSA (not an RFA) to be set up as a juristic entity, but subject to conditions. Conditions to be consulted on include a requirement to use the product supplier's branding; strict oversight, operational and financial requirements; and only allowing such structures if they are part of the product supplier's group • We are also reviewing conditions for when juristic representatives will be permitted in non-advice distribution models		☐		3.1(h)
X	Standards for juristic intermediaries (adviser firms)	• Standards are to be aligned, where necessary, with the implementation of other related RDR proposals			☐	3.1(h)
Y	Advisers may not act as representatives of more than one juristic intermediary (adviser firm)	• This proposal will be introduced through a change in the FAIS Regulations • An adviser will be permitted to operate on more than one RFA licence only where the first RFA is not authorised under FAIS for the product category concerned. This exception is being granted to allow advisers to gain experience under supervision on new product categories. Further consideration will be given to the extent to which further limitations may be required in the final adviser categorisation model.	☐			2.3

No.	Initial proposal heading	Key changes / updates since initial RDR	Phase 1	Phase 2	Phase 3	Ref. in this document
Z	Restricted outsourcing to financial advisers	• See Proposal J	☐	☐		2.4(b) 3.2(e)
AA	Certain functions permitted to be outsourced to financial advisers	• See Proposal J	☐	☐		2.4(b) 3.2(e)
BB	Product supplier responsibility for tied advisers	• The underlying principle is that product suppliers and advisers must reasonably share accountability for customer outcomes, with the extent of product supplier responsibility aligned to the extent of the product supplier's potential influence over the advice • Product suppliers are therefore fully accountable for advice provided by their PSAs		☐	☐	3.1(g)
CC	Product supplier responsibility for multi-tied advisers	• In light of the revised adviser categorisation, this proposal now deals with product supplier responsibility for RFAs • The underlying principle is that product suppliers and advisers reasonably share accountability for customer outcomes, with the extent of product supplier responsibility aligned to the extent of the product supplier's potential influence over the advice • Product suppliers will therefore be expected to take more proactive responsibility for advice provided by RFAs where any of the potential influence relationships referred to under Proposal N exist. Relatively less onerous responsibilities may apply where the relationship between product supplier and RFA is truly at arm's length		☐	☐	3.1(g)
DD	Product supplier responsibility for IFAs	• In light of the revised adviser categorisation, this proposal falls away in its current form. However, see Proposal CC				3.1(g)
EE	Product supplier responsibility for non-advice sales execution	• Standards will to be set together with Proposal D and will include product supplier responsibility for ensuring that relevant FAIS Fit and Proper standards are met • An underlying principle is that product suppliers should pay particular attention to suitability of products for the target market when using	☐	☐	☐	

No.	Initial proposal heading	Key changes / updates since initial RDR	Phase 1	Phase 2	Phase 3	Ref. in this document
		non-advice distribution models • The new Insurance PPRs will impose governance standards in respect of product development, including in respect of the suitability of products and distribution models for the target market				
FF	General product supplier responsibilities in relation to receiving and providing customer related data	• This proposal will be implemented for insurers through the pending PPR changes. An insurer will be required to give customer information to an adviser when authorised to do so by the customer; alternatively the requested information may be provided directly to the customer with an explanation of why it was not provided to the adviser	□			2.5(b)
GG	Ownership structures to be reviewed to assess conflicts of interest	• It is accepted that ownership structures between advisers and product suppliers do not automatically result in product supplier influence or conflicted advice, but they do increase the risk of these conflicts arising. These relationships will therefore be subject to close supervisory scrutiny	□	□	□	3.1(e)
HH	General disclosure standards in relation to fees or other remuneration	• Disclosure standards are to be refined as the various RDR remuneration models are finalised • The new Insurance Regulations will introduce general principles for all forms of intermediary remuneration in the insurance sector	□	□	□	2.4(b)
II	Standards for financial planning / risk planning fees	• These standards are to be developed together with standards under Proposal T and broader standards for advice fees (see Proposal JJ)		□		3.1(c)
JJ	Standards for up-front and ongoing product advice fees	• These standards will be developed as the various RDR remuneration models are finalised		□	□	
KK	Additional standards for ongoing advice fees	• These standards will be developed as the various RDR remuneration models are finalised • As a principle, ongoing fees must be linked to ongoing service		□	□	

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LL	Product suppliers to facilitate advice fees	• These standards are to be developed as advice fee standards are finalised (See Proposal JJ) • Required forms of fee facilitation are likely to be: Deduction from product values; and collection of the fee together with the premium / contribution • Further consultation is planned on the extent to which product suppliers should monitor and / or report on advice fees they facilitate		□	□	
MM	Remuneration for selling and servicing investment products	• The prohibition of product supplier commissions on investment products is to be implemented in two phases: First for lump sum investments; then for recurring contribution investments • We will consult on allowing a level of commission to still be available for compulsory annuities below a purchase price threshold, to avoid arbitrage between fixed interest and living annuity sales if only advice fees are available • The commission prohibition on investments will be subject to a special dispensation for recurring contribution investment (savings) products sold in the low income sector (See Proposal TT). No special dispensation is currently contemplated for lump sum investments sold into the low income sector		□	□	3.2(c) 3.5
NN	Remuneration for selling and servicing life risk policies – mix of up-front commission and as-and-when service fees	• The current intent is to proceed with this proposal largely as initially proposed, although we are considering the extent to which commission caps should distinguish between remuneration for selling the policy and remuneration for ongoing service • Consultation and technical work to assess impacts of this proposal and develop detailed standards (including appropriate commission caps) has commenced • The shift from full up-front to 50% up-front commission for individual			□	3.3(d)

No.	Initial proposal heading	Key changes / updates since initial RDR	Phase 1	Phase 2	Phase 3	Ref. in this document
		life risk policies will be phased in over time				
OO	Product supplier commission prohibited on replacement life risk policies	• A decision on whether and to what extent to proceed with this proposal is deferred to finalisation of the broader remuneration model for life risk policies • In the interim, the pending LTIA Regulations and PPRs introduce strict insurer monitoring obligations for life risk replacements and a prohibition on commissions unless strengthened replacement disclosure obligations are met. The final decision on a remuneration intervention will also be informed by experience of this interim approach				3.3(f) 2.1(a) 2.4(c) 2.5(c)
PP	Commission regulation anomalies on "legacy" insurance policies to be addressed	• Pending amendments to the LTIA Regulations will introduce a gradual phasing down of maximum causal event charges on legacy insurance investment products • The LTIA Regulations will also remove legacy commission anomalies on variable premium increases so that these increases are treated similarly to new policies for commission and causal event purposes • Further technical work on reducing causal event charges on future policies will be undertaken together with the finalisation of the broader remuneration model for investment products				2.4(d) 3.2(a)
QQ	Conflicted remuneration on retirement annuity transfers to be addressed	• Pending changes to the FAIS General Code will define "replacement" to include retirement annuity and living annuity transfers • We are considering extending the insurer monitoring controls being introduced for life risk replacements (see Proposal OO) to product suppliers in respect of these transfers				2.1(b)
RR	Equivalence of reward (EoR) to be reviewed	• Comprehensive EoR standards at individual insurer PSA level will be introduced together with the final remuneration model for life risk				3.3(e)

No.	Initial proposal heading	Key changes / updates since initial RDR	Phase 1	Phase 2	Phase 3	Ref. in this document
		policies • In the interim, LTIA Regulations will be amended to clarify the Registrar's powers in relation to EoR and the consequences of non-compliance with EoR standards • Current PSA (insurer representative) remuneration practices are to be reviewed as part of technical work to finalise the remuneration model				2.4(e)
SS	Standards for remuneration arrangements between adviser firms and their individual advisers	• In addition to EoR standards for insurer PSAs on life risk policies, we are considering the need for further standards on other remuneration arrangements within RFA firms, to mitigate unintended risks of arbitrage between RFA and PSA remuneration options • We are considering strengthening the current FAIS General Code Conflict of Interest provisions as applicable to remuneration arrangements between FAIS FSPs and their individual representatives • Further standards are to be developed as broader remuneration models are finalised		□	□	3.3(e)
TT	Special remuneration dispensation for the low income market	• This proposal is being pursued as part of a holistic financial sector transformation and inclusion strategy, supported by explicit mandates in the Financial Sector Regulation Bill • For recurring contribution retail investment products, the low income dispensation is likely to include a contribution size cap below which product supplier commissions will remain available, with further consideration of the extent to which this dispensation should be linked to specific product types or product features			□	3.5 3.2(c)
UU	Remuneration for selling and servicing short-term insurance policies	• The current intent is to proceed with this proposal largely as initially proposed, although we are considering the extent to which commission caps should distinguish between remuneration for selling	□	□		3.3(c)

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		the policy and remuneration for ongoing service (with both payable on an "as-and-when" basis) • Consultation and technical work to assess impacts of this proposal and develop detailed standards (including appropriate commission caps) has commenced. A detailed intermediary activity analysis has been undertaken to inform this work • As a first step, the STIA Regulations will replace the current "section 8(5) fees" with a mechanism for allowing advisers to earn fees from customers over and above commission, provided they relate to an agreed service to the customer that is not already covered by commission and meets other prescribed requirements. In the final remuneration model, this mechanism is likely to be removed in light of the availability of advice fees				2.4(f)
VV	Conditions for short-term insurance cover cancellations	• This proposal is being implemented through the revised PPRs. The proposal has been extended to also apply to long-term insurance policies	□			2.5(d)
WW	Remuneration for direct non-advice sales execution	• These standards will be developed together with standards for proposals D and EE		□	□	3.4(a)
XX	Remuneration for referrals, leads and product aggregation and comparison services	• These standards will be developed together with standards for proposal H		□		3.4(b) and (c)
YY	Remuneration for investment platform administration	• The intention remains to pursue this proposal largely as initially proposed, being a shift to "clean pricing" and removal of rebates, together with implementation of Proposal G		□		3.2(b)
ZZ	Binder fees payable to multi-tied intermediaries to be capped	• In light of the revised adviser categorisation, this proposal now applies to all binder holders authorised to provide financial advice • The draft Insurance Regulations propose a fee cap of 2% for each permissible type of binder agreement with an adviser. The final	□			2.4(b)

No.	Initial proposal heading	Key changes / updates since initial RDR	Phase 1	Phase 2	Phase 3	Ref. in this document
		quantum of this cap is still subject to completion of consultation and technical work underway				
AAA	Commission cap for credit life insurance schemes with “administrative work” to be removed	• This Proposal is to be implemented through the pending changes to the LTIA Regulations. The commission cap for all credit life schemes will in future be 7.5%, with any additional remuneration for outsourced administration only available if the relevant outsourcing or binder arrangement standards are met	□			2.4(g)
BBB	Outsourcing fees for issuing insurance policy documents	• This proposal is not being pursued, in light of broader proposals relating to outsourcing				
CCC	General standard: No financial interests may be provided by product suppliers to intermediaries unless specifically provided for in the regulatory framework.	• This general standard is being considered for inclusion as a conduct standard under either the FSRA or COFI		□	□	