2.7. Overarching RDR proposals

This section discusses RDR proposals that are cross-cutting and do not fall squarely within any of the above themes but cut across a number of them. Proposals in this category are:

- *Proposal GG:* Ownership standards to be reviewed to assess conflicts of interest.
- *Proposal HH:* General disclosure standards in relation to fees or other remuneration.
- *Proposal JJ:* Standards for up-front and ongoing product advice fees.
- *Proposal KK:* Additional standards for ongoing advice fees.
- *Proposal SS:* Standards for remuneration arrangements between adviser firms and their individual advisers.
- *Proposal LL:* Product suppliers to facilitate advice fees.
- *Proposal CCC:* General standard – no financial interests may be provided by product suppliers to intermediaries unless specifically provided for in the regulatory framework.

2.7.1. Key stakeholder feedback and initial responses on these overarching proposals

(a) Ownership relationships:

Comments on the proposal to review ownership relationships mainly focused on concerns that such relationships should not be unduly interfered with. Although the need to manage conflicts of interest was generally recognised, some commentators argued that such conflicts are not inherent in all ownership relationships. Counter arguments were however raised that ownership arrangements between product suppliers and advisers, in particular, inevitably result in biased advice in favour of the product supplier concerned. A number of stakeholders urged the FSB to make use of the future regulatory and supervisory framework for conglomerate and group structures and significant ownership, as provided for in the Financial Sector Regulation Bill and the Insurance Bill, to gain further insight into group relationships before proposing any specific interventions. It was also argued by some that any potential conflicts arising from ownership relationships could be adequately managed through clear disclosure. Clarity was requested on the future regulatory framework for cell captive insurance models in particular.

The FSB has indicated in the RDR Phase 1 Status Update that our current thinking regarding ownership arrangements between product suppliers and advisers is that the mere existence of such arrangements does not automatically result in influence over the advice concerned, but that there is a srong presumption that such influence arises. Accordingly, we pointed out that strict standards and supervisory scrutiny would be required to demonstrate absence of such bias.

Despite this position, the FSB remains of the view that further work is required to determine whether any particular types of ownership or similar arrangements constitute material inherent conflicts of interest requiring further risk mitigation measures. Information gathered through the supervisory and regulatory tools for conglomerate / group supervision discussed above, will provide input into this review. Information gathered through future enhanced FAIS conduct of business reporting – which will include reporting on relationships with product suppliers and the mix of products and suppliers offered by advisers – will also be taken into account. We are not persuaded that, should such material conflicts be identified, disclosure alone is an adequate control.

(b) Proposals relating to advice fees:

Feedback largely supported the principle that advisers should be explicitly remunerated for the provision of advice, and shared the FSB's concern that current remuneration regulations do not recognise the extent or quality of advice provided or enable customers to appreciate the value of advice. Concerns with the proposals related largely to the combined impact of introducing advice fees and reducing or prohibiting product supplier commissions. As discussed under some of the RDR themes earlier in this document, concerns highlighted included the view that many customers would be unable or unwilling to pay advice fees, and that this would therefore have a knock-on negative impact on the sustainability of adviser businesses. Related concerns, also discussed earlier in this document, were barriers to entry for new advisers and the creation of an "advice gap" for certain groups of customers.

It was pointed out that the risk of such impacts cannot however be fully assessed until the FSB provides greater clarity on the future commission caps (for life risk insurance and short-term insurance); on the future equivalence of reward dispensation for insurer agents; and on the special remuneration dispensation for the low income market. Strong arguments were also put forward that the impact of the shift to advice fees should be mitigated by implementing the shift in phases, not on a "big bang" basis.

The FSB recognises the interconnectedness of these proposals and our technical work on finalising them will therefore test the proposals in combination with one another. This testing will include careful assessment of how best to phase in the implementation of the different proposals. The impact of the revised FAIS competency model discussed earlier will also be relevant.

There was strong support for the proposal that product suppliers should be required to facilitate advice fee payments, through customer-authorised deductions from product values and / or contributions. It was also recognised that this will go a considerable way to mitigating the risk of customers' possible reluctance to pay explicit advice fees. Product suppliers cautioned that they would require sufficient time to make the necessary system changes, including considering the implications for outsourced administration platforms in certain business models. We were also alerted to avoid increasing customer bank costs by requiring separate debit orders for advice fees. The FSB accepts these points.

Some advisers expressed concern that, if the customer is entitled to instruct the product supplier to stop the advice fee, this could make cost recovery difficult if the customer reneges on an agreement to pay ongoing advice fees for services already provided. Although the FSB recognises this risk, we feel that this is a contractual matter to be resolved between the customer and the adviser and that the importance of empowering the customer to control deductions from their products outweighs this risk. We also point out that this model is already in place in regard to non-insurance investment products.

Feedback on the proposal that the regulator should publish a "safe harbour" benchmark guideline for advice fees was mixed. Some commentators argued that this would be a useful mitigation of the risk of some advisers charging unacceptably high fees, particular in the early stages when customers will have little or no view on what constitutes a reasonable advice fee. Others argued however that the setting of a benchmark would result in fees migrating to the upper level of any guideline, and thus reduce competition. The difficuly in setting these benchamark, given the wide range of potential levels of advice and the fact that there is little existing data to work from, was also highlighted. This concern led to some proposing that such benchmarks only be considered at a later stage, once more information is available regarding advice fee charging practices and their impact. The FSB agrees that the issue of how or when to set advice fee benchmarks will require further consultation.

Views were also mixed on the requirement for product suppliers to monitor and report data to the regulator on the advice fees they facilitate. Some commentators from the adviser perspective felt that this was an inappropriate interference by product suppliers in their relationships with their customers. Arguments on behalf of product suppliers were that they should not bear any responsibility in regard to advice fee arrangements which are purely a matter between adviser and customer. The FSB disagrees with both these arguments. We remain of the view that an appropriate degree of shared responsibility for customer outcomes arising from these arrangements is consistent with a commitment to TCF. We take this opportunity to clarify however that we would not expect product suppliers to intervene in advice fee arrangements (other than to act on the customer's instructions), but simply to monitor payments for purposes of providing information required by the regulator.

There was widespread support for proposals relating to customer consent, transparency and disclosure of advice fees and other remuneration.

(c) Remuneration arrangements between adviser firms and their individual advisers:

Although comment on this high level proposal was limited, some concerns were expressed thst there should not be undue intervention into the freedom of contractual or employment arrangements within firms. The FSB will consult further on the extent to which standards regarding these arrangements are necessary to support the objectives of RDR. We point out that current FAIS requirements in relation to conflicts of interest already apply at both firm (FSP) and adviser level in different ways. Our particular concern would be to ensure that advisers acting as sole proprietors or on behalf of small adviser firms are not at an unfair disadvantage to those acting for larger firms in relation to advice fees, due to the fact that large firms may be better positioned to remunerate individuals over and above the actual quantum of advice fees earned by the firm, resulting in unlevel playing fields. [20]

(d) General standard – no financial interests may be provided by product suppliers to intermediaries unless specifically provided for in the regulatory framework:

Proposal CCC elicited divergent comment. Those in support of the proposal were of the view that it was necessary to reduce scope for further abuses and conflicts of interest not explicitly addressed through other RDR proposals. Those opposed to the proposal mainly objected that it was too far-reaching, would be impractical to implement, and constituted

20 See further detail at p.56 of the RDR discussion document.

unwarranted interference by the regulator in legitimate commercial arrangements and could stifle innovation. Suggestions were made by some to limit the proposal by identifying and carving out specific acceptable arrangements, or by adding a "materiality overlay". Conversely, others suggested broadening the scope of the proposal to cover all forms of remuneration and not limiting it only to financial interests provided by product suppliers. The need to consider arrangements between entities within financial services conglomerates was also highlighted.

Particular concerns were raised regarding potential regulation of the distribution of non-financial "add-on" products and services, with some arguing that these should remain outside the ambit of financial sector regulation. Other comments acknowledged the risk of consumer abuse and potential conflicts arising from the "bundling" of these offerings with financial products and services and supported further consultation on appropriate controls around financial interest payable in this regard. The need for clarity on the future framework for cell captive arrangements was also flagged in this context.

As stated in the RDR discussion document, further consulation – which will be informed by the above comments – will take place. In response to comments regarding the breadth of the proposal, the FSB agrees that further discussion is needed on the extent to which this general "catch-all" standard is necessary over and above the explicit standards to be introduced through the remaining RDR proposals, and / or the extent to which Proposal CCC should be qualified to deal with specific types of financial interests. If retained, Proposal CCC could be effected through an appropriate conduct standard to be issued under the Financial Sector Regulation Act (i.e. in Phase 2 of the overall RDR implementation).

The FSB remains very concerned regarding conduct risks and conflicts arising from the distribution of "add-on" products and services coupled with core financial offerings. Recent prominent examples of abuse include unfair practices relating to the sale of warranties and "club memberships" together with credit offerings where we share concerns raised by the National Credit Regulator. Our consultation in regard to Proposal CCC will therefore include discussion regarding appropriate standards to mitigate these types of risks. The FSB recognises that these offerings may in some cases not constitute financial products or services. However, we feel strongly that the fact that they are marketed and distributed to financial customers together with financial products – often through financial product suppliers and / or using financial services distribution channels – warrants the focus of the financial services market conduct regulator.

2.7.2. Implementation phases for the overarching proposals

Recognising the close interlinkages between these overarching proposals and some of the more specific RDR propsals, implementation of and consultation on inter-related proposals will be aligned as necessary. Please therefore refer to the summary table in Section 3 of this paper for a high level indication of the sequencing of these proposals in relation to the remaining RDR proposals.