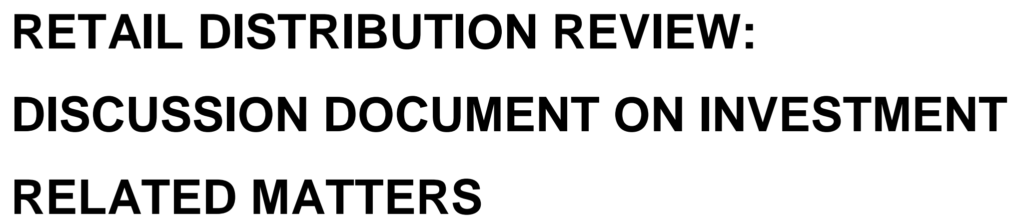
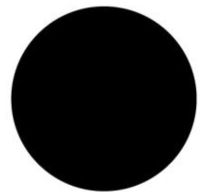


RETAIL DISTRIBUTION REVIEW: DISCUSSION DOCUMENT ON INVESTMENT RELATED MATTERS

June 2018



FSCA

Financial Sector
Conduct Authority

FSCA
Financial Sector Conduct Authority

SECTION 1. Background and context

The Financial Services Board's Retail Distribution Review published in November 2014 ('the initial RDR proposals") put forward a number of proposals to reform the regulatory framework for distribution of financial products, aimed at ensuring distribution models that:

- Support the delivery of suitable products and fair access to suitable advice for financial customers
- Enable customers to understand and compare the nature, value and cost of advice and other services 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
- Support sustainable business models for financial advice that enable adviser businesses to viably deliver fair customer outcomes over the long term.

A key focus of the RDR is to remove or mitigate certain inherent risks of conflict of interest between intermediaries and financial product or service providers on the one hand, and their customers on the other – notably the risk of conflicted advice.

Against that background, the initial RDR proposals included specific proposals aimed at clarifying the nature of the legal and business relationships between financial product and service providers. These included proposals aimed at a clearer categorisation of different types of financial advisers, and proposals aimed at reducing the risk of conflicted advice in certain outsourcing arrangements between product suppliers (for this purpose, including investment managers) and advisers. Since the publication of the initial RDR proposals, the FSB and the FSCA have published a series of status updates on the phased implementation of the RDR proposals.

This Discussion Document focuses on the impact of certain of the initial RDR proposals on the investments sector. The purpose of this Discussion Document is to:

- **Share our observations and current thinking** on specific initial RDR proposals insofar as they impact on the investments industry - in particular Proposal Z (relating to outsourcing activities to advisers) and Proposal K (relating to adviser categorisation) – in the light of stakeholder inputs received; and

- **Elicit stakeholder input** on possible regulatory measures to -
  - Define the activity of "investment management" and consider the extent to which investment management needs to be demarcated from other forms of discretionary investment mandate;
  - Clarify the nature of the legal and business relationships between different types of discretionary investment mandate holders, collective investment scheme management companies and investment advisers, and how best to structure these in the regulatory framework to achieve our RDR objectives; and
  - Provide for fee and remuneration arrangements in light of the above, to align with the RDR approach of aligning remuneration with actual activities performed and avoiding unnecessary duplication of costs for the end investor.

SECTION 2. Updated thinking based on input received

2.1. Initial proposals and earlier updates

The suggested regulatory measures put forward in this Discussion Paper have been prompted mainly by the wide-ranging and useful inputs we received to the following initial RDR proposal[1] (in particular the second paragraph of the proposal) and subsequent updates:

> *Proposal Z: Restricted outsourcing to financial advisers*
>
> *As a general standard, the outsourcing of product supplier functions or investment management functions or activities (as opposed to true intermediation activities connecting product suppliers and customers, as discussed in paragraph 4.1.2) to financial advisers will be prohibited, other than in the case of specific identified and regulated functions.*
>
> *Note that this proposal includes a prohibition on a CIS manager outsourcing investment management to an "authorised agent" (as defined in the Collective Investment Schemes Control Act) or to any intermediary through a third-party arrangement where that authorised agent or intermediary is also a financial adviser.*

In its December 2016 RDR Status Update, the FSB provided an update regarding Proposal Z in the investments space, highlighting the need to consider the appropriate categorisation of investment advisers within the RDR framework – notably in what circumstances an investment adviser could be regarded as a "product supplier" agent (PSA)[2] of an investment manager.

In the December 2016 update the FSB also flagged a number of concerns and intentions in relation to the complex structure of the current investment landscape, and the need to clarify these in licensing and regulatory frameworks. These included: A concern that the current FAIS regulatory framework does not clearly demarcate the respective roles and customer value propositions in cases where the same entity provides both advice and discretionary investment management services to the same customers; and our intention to therefore define and develop standards for the specific activity of "investment management". The FSB also expressed concern that the initial RDR proposals did not adequately address the potential conflict of interest risks that may apply to holders of discretionary investment mandates.

2.2. Observations based on inputs received

The initial proposal and updates summarised in section 2.1 elicited extensive feedback from a wide range of entities in the investment sector, including traditional investment managers, CIS management companies (both those offering third party co-branded structures - sometimes called "white label" structures - and those who do not); third party co-branded providers themselves; administrative FSPs (linked investment service provider or LISP platform operators); providers of so-called "model portfolios" or "wrap funds"; and a wide range of investment advisers more generally. Commentators ranged from substantial financial conglomerates to small "niche" discretionary mandate holders and individual advisers (both with and without Cat II licences).

Having considered all these inputs, our updated observations are as follows:

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[1] Proposal Z should be read with *Proposal J: Outsourced services on behalf of product suppliers to be more clearly defined and regulated.*

[2] Please see section 3.2 of this document for further detail on the RDR adviser categorisation approach.

(a) Our concerns regarding the complexity of current investment product distribution models, and consequent risks of conflicts of interest and customer confusion, are confirmed. This is particularly so in vertically integrated business models, where multiple components of the investment product value chain are provided within the same group of companies.

(b) We remain of the opinion that third party co-branding arrangements (commonly referred to as "white label" arrangements), whereby CIS management companies outsource investment management to intermediaries who are also financial advisers, pose conflict of interest risks. However we no longer propose to prohibit all such arrangements, but to seek alternative ways to mitigate these risks.

(c) We recognise that our focus on mitigating risks of conflicted investment advice should not focus only on third party co-branded models, but also consider the role of other types of discretionary mandate holders, such as so-called "model portfolio" or "wrap fund" providers.

(d) The nature and scope, and hence the likely value for money, of discretionary investment services provided by Category II FSPs varies significantly. We recognise that a number of advisers who also hold discretionary mandates are skilled investment professionals who provide value-adding services to their customers. Unfortunately however, the current very broad FAIS definition of a "discretionary FSP"[3] does not provide an effective mechanism for ensuring that such FSPs do indeed always perform a meaningful and value-adding service.

(e) Another consequence of the broad definition of a discretionary FSP is that it does not support the RDR activity-based approach, which requires that remuneration should be commensurate with the nature, extent and quality of actual services provided and should be paid by the user of such services. So for example charges currently described as "investment management fees" are sometimes deducted for services that are in fact more akin to investment administration services on the one hand, or for services that are in fact little more than investment advice on the other.

(f) The legal construct of the relationship between advisers and other entities is not always an accurate reflection of the actual nature of their business relationships. More particularly:

- In third party co-branding arrangements, the legal and regulatory construct is that the CIS management company outsources its investment management function (inherent in its CIS manager licence[4]) to the third party concerned. As such, the third party is in law managing the CIS portfolio/s[5] concerned in the name of[6] and on behalf of the CIS management company as its agent. It also follows (as confirmed by the relevant CIS Regulations) that the CIS management company retains full legal accountability for the investment

[3] A "discretionary FSP" is currently defined (in summary) as an FSP "that renders intermediary services of a discretionary nature as regards the choice of a particular financial product … but without implementing any bulking".

[4] This is why CIS management companies are not required to hold a separate FAIS Category II licence. The customer does not sign a discretionary mandate. Instead, investment discretion is exercised in accordance with the founding mandate (investment policy) of the CIS portfolio itself and is exercised either directly by the CIS management company or to a Category II FSP to whom the management company outsources the function. In third party co-branding arrangements these Category II FSP's are typically entities outside the CIS management company's own group, whereas in non-third party models the CIS management company typically (although not always) outsources investment management to a Category II FSP in its own group.

[5] These could include "fund of fund" portfolios.

[6] This is legally the case, notwithstanding that the portfolio is also co-branded by the third party.

performance of the portfolios concerned and for ensuring compliance with all regulatory requirements in relation to the management and administration of the investments by the third party. In reality however, the third party does not regard itself as – and does not behave as – the agent of the CIS management company in relation to the carrying out of its discretionary investment mandate. Instead, it regards the portfolio/s concerned as its own "product" which it offers to its own customers. Similarly, the investors do not typically see themselves as the customers of the CIS management company, but rather as the customers of the third party. Notwithstanding the legal construct, it is *de facto* an arrangement where the third party acts as the discretionary investment manager for its own customers, but "insources" the administrative (not discretionary investment management) capabilities[7] of the CIS management company to support it in doing so.

- In the case of model portfolio / wrap fund structures[8], on the other hand, there is typically no outsourcing arrangement in place between the CIS management company that provides the CIS portfolio/s being invested in and the Category II FSP. The customer signs a discretionary mandate with the Category II FSP. In many cases, the model portfolio / wrap fund is offered through an administrative FSP (LISP) platform. The customer (or the Category II FSP on the customer's behalf) therefore also signs a mandate with the LISP. Additional contractual arrangements are in place between the Category II FSP and the LISP, as well as between the LISP and the CIS management company concerned. Although the legal construct therefore differs from that of the third party co-branding model, the de facto business relationship between the Category II FSP and the customer is similar – the Category II provider regards the model portfolio / wrap fund concerned as its own "product", and the customer sees themselves primarily as the customer of the Category II FSP, not the customer of the LISP (despite also signing a mandate with the LISP) nor the customer of the management company.

Accordingly, the approach we have adopted to outsourcing standards under our RDR framework for other financial sectors, such as the recently strengthened binder regulations in the insurance sector, may not be effective or appropriate in the investment space, or at least not for all business models in the investment space. Instead, we need to identify regulatory interventions that are better suited to the realities of investment distribution models.

(g) Industry participants use inconsistent and sometimes inaccurate terms to describe their customer offerings and relationships with one another. For example:
- The terms investment manager; asset manager; fund manager; discretionary investment manager (or DIM); and discretionary fund manager (DFM), are sometimes used interchangeably but sometimes used to mean different things
- The terms wrap fund; model portfolio; broker fund; house view portfolio, are also sometimes used interchangeably but sometimes used to mean different things
- Some advisers talk about "outsourcing" discretionary services to DIMs / DFMs, whereas there is in fact no outsourcing arrangement between the adviser and the DIM / DFM at all, but at best a referral and / or fee sharing type of arrangement.

[7] These administrative capabilities relate primarily to unitisation and pricing of the participatory interests in the portfolio, compliance and reporting functions, and administration of taxation processes.

[8] Note that these do not include "fund of fund" models, which are approved CIS portfolios in their own right.

Question for stakeholder input:

Q1. Do you agree with our above observations regarding the investment landscape? If not, where do you disagree? Are there any additional considerations you believe we have overlooked that are necessary to inform our regulatory proposals?

SECTION 3. Matters for consultation

3.1. Defining and understanding different activities performed under a discretionary investment mandate

In the course of our RDR consultations, we have identified four broad categories of Category II FSP activities:

(a) So-called **"traditional" investment management**, typically entailing portfolio construction through analysing and selecting the underlying instruments (i.e. shares, derivatives, bonds, cash and property – whether local or foreign) making up one or more portfolios. This group typically provides one or both of the following investment management services:

  i. Discretionary investment management for CIS management companies on an outsourced basis on behalf of the management company, usually without interacting directly with particular CIS investors. The CIS management company appoints the investment manager to manage the assets in one or more of its CIS portfolios in accordance with the founding mandate (investment policy) of the portfolio concerned; and

  ii. Discretionary investment management of a portfolio of assets held for a specific investor (usually a pension fund, corporate or high net worth individual) on a segregated basis in accordance with a discretionary mandate agreed with the investor concerned.

(b) **Third party co-branded investment management (sometimes referred to as "white label" arrangements):** This activity is similar to the discretionary investment management carried out by traditional investment managers acting on behalf of CIS management companies (as described in paragraph (a) (i) above) and also entails the investment manager acting on behalf of the CIS management company in relation to managing one or more of the management company's portfolios. In this model however, the portfolios are co-branded with the brand of both the CIS manager and the third party investment manager, and are marketed and distributed by the third party investment manager (usually through its own Category I financial advisers, advisers in its group or third party distribution channels) to investors. In some cases, the third party investment manager itself is also a Category I financial adviser. These arrangements are often entered into with CIS management companies that wholly or partially specialise in third party co-branded structures. In many such models, the third party investment manager "owns" the distribution channel concerned, although the CIS management companies have varying degrees of involvement in supporting the distribution channel. Models also exist where the third party investment manager (with its related distribution channel) has a direct ownership interest in the CIS management company.

(c) **"Model portfolio" management:** This entails selecting and designing customised or "model" portfolio solutions for groups of customers or individual customers, in most cases comprising a selection of participatory interests in existing CIS portfolios. The model portfolio may however also include non-CIS investments, such as individual securities or other instruments. Where the model portfolio solution comprises CIS portfolios offered by a number of different providers, the model portfolio provider is usually referred to as a "multi-manager". Similarly to third party co-branding investment managers, these providers also market and distribute their model portfolios to investors through their own Category I licence; through Category I financial advisers in their group; or through unrelated distribution channels.

(d) **Mandates held mainly for convenience:** These entities perform no or very little actual portfolio construction, design or selection, but obtain a discretionary mandate from customers primarily for the sake of convenience, to obviate the need to obtain new written instructions from the customers whenever portfolio switches between existing structures are made – typically for purposes of rebalancing the composition of the portfolio to align with the customer's previously

selected asset allocation.

Note that in many cases the same entity performs more than one of activities (a) to (d) above.

> ***Question for stakeholder input:***
> *Q2. Please let us know whether you agree or disagree with our categorisation of investment management activities into the four broad groupings set out above and our description of each type of activity? If you disagree, where do you disagree and how would you group or describe the activities differently? Suggestions on the appropriate terminology to describe each category of activity will also be welcome.*

Despite the very different range and scope of the four broad business propositions outlined above, in the current FAIS framework all such entities hold the same licence – a Category II discretionary FSP licence – and would all be able to charge investment management fees for their services. We therefore believe that it is necessary for the licensing framework – and associated qualifying criteria and conduct standards - to distinguish more clearly between these types of activities.

> ***Question for stakeholder input:***
> *Q3. Do you agree in principle that the current criteria for a FAIS Category II licence are overly broad and that it is necessary for the regulatory framework to distinguish more clearly between different types of discretionary investment mandate activities? If you disagree, please explain why.*

Regulatory measures we are considering include:

Measure 1: Define the typical activities and combinations of activities, over and above merely holding a discretionary mandate from a customer, which can accurately be described as "investment management". Possible activities include:

- Asset selection ("stock picking") from a universe of underlying instruments, including shares, derivatives, bonds, cash and property, whether local or foreign;
- Structuring combinations of such selected assets into portfolios ("portfolio construction") designed to achieve different investment objectives, whether by class of asset, industry sector, type of investment strategy or style, or combinations of these – which may or may not entail structuring portfolios to meet different investment risk profiles;
- Research and analysis of assets and their issuers / providers, to inform the above asset selection and portfolio construction activities; and
- Performing the above activities on an ongoing basis to ensure that the portfolios concerned perform in accordance with agreed mandates – being either the investment policy of a particular CIS portfolio, or a segregated mandate from a particular customer.

Measure 2: Test the different types of discretionary activities summarised in paragraphs (a) to (d) above, against the definition of "investment management" to determine which activities can most accurately be described as investment management activities so defined.

The FSCA's initial views are as follows:

- So-called traditional investment managers are likely to meet the definition
- Third party co-branding investment managers are likely to meet the definition
- Model portfolio providers may or may not meet the definition, depending on their particular service offerings, and consideration should be given to whether they should be separately categorised
- Mandates held mainly for convenience are unlikely to meet the definition. The value proposition of such mandates going forward should be considered, including whether they should be separately defined or categorised.

Measure 3: Set appropriate fit and proper standards – including both operational and competence requirements - **to qualify for the new definition of "investment management".** Discussion will be required as to whether these requirements should be more rigorous than the current FAIS Category II and, where applicable, Category IIA licence and conduct requirements. The competency requirements would include appropriate "line of business" training focused on the activities that are defined as core to the activities comprising investment management.

Measure 4: Create a different licence category for entities that perform activities currently classified as Category II, but which will not meet the new "investment management" definition. A possible designation is **"model portfolio provider" (MPP)**. This will also entail identifying and defining the activities or combinations of activities concerned. Possible activities include:

- Selecting and combining existing investment portfolios (being CIS portfolios or portfolios constructed by one or more "investment managers" as redefined) to form customised portfolio solutions designed to achieve the investment objectives of individual customers or groups of customers ("model portfolio construction"). Such combinations of portfolios may be structured by class of asset, industry sector, type of investment strategy, or combinations of these and will often entail structuring portfolios to meet different investment risk profiles;
- Research and analysis of existing investment portfolios and the investment managers who construct them, including due diligence on the investment managers, to inform the above model portfolio construction decisions;
- The model portfolio provider may or may not enter into an arrangement with a Category III FSP (LISP) to offer its model portfolio/s on the LISP's platform;
- Performing the above activities, as well as ongoing monitoring of the performance of the underlying investment portfolios against their underlying mandates, on an ongoing basis to ensure that the model portfolios concerned perform in accordance with agreed customer mandates – being the discretionary mandate between the customer concerned and the model portfolio provider.

Note that the above activity description assumes that a "model portfolio" only comprises combinations of existing underlying pooled portfolios, rather than non-pooled assets such as directly held securities or instruments. This raises the question as to how, under the approach discussed above, the provider of a portfolio comprising both existing pooled investments and non-pooled investments should be categorised? Would their activities fall outside the more limited scope of an MPP and require them to be licensed as an investment manager (because they will be performing actual asset selection / "stock picking") rather than an MPP?

Note that it would be permissible for the same entity to act as both an investment manager (as per the proposed new definition) and an MPP. If different licence standards are to be set for investment managers and MPPs, an entity that meets the licensing standards for an investment manager would in all likelihood also meet the standards required to be licensed as an MPP, so separate licences would not be required. The licence holder would however be required to ensure that any individuals operating on its licence meet the standards applicable to the specific activity they perform.

Measure 5: Set appropriate fit and proper standards – including both operational and competence requirements - **to qualify for the new definition of "model portfolio provider".** Discussion is required as to whether these should be somewhat less rigorous than the requirements to be proposed for "investment management". The competency requirements would include appropriate "line of business" training focused on the activities that are defined as core to model portfolio provision. Requirements could also include an obligation for MPPs to provide prescribed minimum disclosure documents in respect of their model portfolios, similar to the "MDDs" required in respect of CIS portfolios.

Question for stakeholder input:
Q4. Please provide your views on the correctness, feasibility and likely effectiveness of each of the possible approaches to discretionary investment mandate categorisation (Measures 1 to 5) set out above. Please let us know if you have any alternative categorisation suggestions.

In particular, please provide your views on –

(i) whether or not different, more rigorous fit and proper standards (including competency financial soundness and operational ability requirements)should apply to investment managers (to be defined) as compared to model portfolio providers (MPPs) and why you hold this view;
(ii) if you agree that different standards should be set for investment managers and MPPs, which standards should apply to providers of a portfolio comprising both existing pooled investments and directly held non-pooled assets?;
(iii) if you agree that different standards should be set for investment managers and MPPs, please provide suggestions on what the key differences between these standards should be; and
(iv) regardless whether you believe that investment managers and MPPs should be subject to different fit and proper standards, whether the current FAIS fit and proper standards for Category II FSP's are adequate and appropriate for investment managers, MPPs, or both or whether you believe any amendments would be required in light of the measures proposed in this paper.

Measure 6: Consider whether entities that hold discretionary mandates primarily for convenience purposes, without performing either "investment management" or "model portfolio provider (MPP)" activities as discussed above, should continue to be regarded as performing a discretionary activity. Arguably, by more clearly defining the activities required for investment management and / or model portfolio management, the so-called "convenience" mandate holder would no longer meet the applicable licence criteria. These types of mandate holders would therefore either naturally fall away, or could continue to exist but be defined and categorised as an activity separate from investment management / portfolio management. If these types of mandates are to continue, then consideration could be given to disallowing the charging of any type of investment management fee or other remuneration for such services. Given that these entities would typically also be investment advisers, the argument would be that the discretionary mandate in these cases is purely ancillary to the investment advice services, intended primarily to ensure that the portfolio composition remains in line with the advice previously provided, and should therefore not be eligible for a fee over and above the advice fee agreed to by the customer.

Our current thinking is that there is a case to be made for retaining these types of mandates, provided that:

- These intermediaries are not regarded as exercising investment discretion but rather as holding a more limited authority to perform specified services under a written "standing authorisation" from a customer, without having to obtain the customer's separate written instruction on each such occasion;
- The transactions to be executed under such an authorisation would be limited to those required to rebalance the client's portfolio - at certain pre-agreed periods of time back to the percentage fund exposures and / or asset allocation (in the existing selected portfolios / underlying assets) that the client originally agreed to, or to place additional investments into the same portfolios that the client originally agreed to;
- The intermediary is not regarded and may not describe itself as an investment manager or a model portfolio provider, as the case may be (unless they also in fact hold such licences);
- The intermediary may not receive a fee for this service over and above an advice fee negotiated with and agreed to by the customer; and
- The intermediary will be required to meet the same fit and proper standards as required for advice in relation to the types of investment products concerned.

Question for stakeholder input:
Q5. Do you agree that so-called "mandates for convenience" should continue to be permissible? If not, why not? If yes, please provide your views on the proposed provisos set out under Measure 6. Do you agree that this activity is ancillary to advice provided in relation to the investments concerned?

3.2. Categorising investment advisers within an RDR framework

The observations discussed in Section 2 of this discussion document make it clear that there is a need to understand the actual contractual and business relationships between the various links in the investment product value chain, and ensure that the regulatory framework is consistent with these. This raises the particular question of how financial advisers providing advice on investment products should be categorised within our future RDR adviser categorisation model, to best reflect the nature and status of the advice they provide and their relationship with other components of the financial product value chain.

In summary, the proposed RDR adviser categorisation model distinguishes between:

- Product supplier agents (PSAs), who operate on the licence of a product supplier and may provide advice on the products of that product supplier (and other product suppliers in its group) only; and
- Registered financial advisers (RFAs), who will be separately licensed in their own right to provide advice on whatever products their licence permits, and are not limited to offering the products of any particular product supplier/s.

Importantly, the same entity will not be permitted to operate as both a PSA and an RFA. A clear choice between the two categories of adviser will be required.

In previous RDR publications, we raised the question whether, and if so in what circumstances, an investment adviser should be regarded as a product supplier agent (PSA) in the above model. More particularly, we said we will consult on whether, in certain cases, an investment adviser should be regarded as the PSA of an investment manager (currently a Category II FSP). In subsequent stakeholder engagements, the further question has arisen whether, in certain cases, an investment adviser should be regarded as the PSA of a CIS management company, or even of a LISP (Category III FSP).

Note that classification as a PSA means that the product supplier concerned is itself licensed to provide advice, with the adviser doing so on its behalf as its agent, and that the product supplier is fully accountable for the quality of the advice and all associated compliance obligations.

In the current FAIS regulatory framework, a Cat II FSP is regarded as a form of intermediary, not a product supplier. Related to this, investment portfolios are not currently regarded as "products" for FAIS purposes[9]. Instead, the FAIS product definitions refer only to the underlying assets within a portfolio – and, in the CIS case, the participatory interests in the CIS portfolio. The RDR categorisation as a PSA, on the other hand, entails acting as agent of a "product supplier" and advising on that supplier's "products". Accordingly, changes to the current regulatory framework and / or the RDR categorisation model would be needed if advisers were to be regarded as PSAs of an investment manager[10].

Similar regulatory framework challenges apply if an adviser were to be regarded as a PSA of a Cat III FSP (a LISP platform provider). Cat III FSPs are also currently regarded as intermediaries, not product suppliers and their platform / bulking activities are regarded as an intermediation service in

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[9] In practice however, many investment managers describe and position their portfolio offerings as their "product", and financial customers think of their investment in such offerings as an investment "product" they have "bought" from the investment manager.

[10] Note however that the future Conduct of Financial Institutions (COFI) Act is expected to define the term "portfolio" as well as to expand the definition of "advice" so as not to be limited to underlying assets only. These changes will potentially support the positioning of an investment portfolio as a financial product for advice purposes.

relation to underlying products and portfolios, not as a "product"[11]. This creates the following anomaly for purposes of our RDR adviser categorisation: Our proposal is that although a PSA is limited to providing advice on the products of product suppliers in its own group, this includes "open architecture" investment offerings offered through a LISP platform administered by a Cat III FSP that is part of the group. In the current framework however, the Cat III is not a "product supplier" and does not offer a "product".

Regarding an adviser as the PSA of a CIS management company does not pose these regulatory framework difficulties. CIS management companies are already product suppliers for regulatory purposes, and participatory interests in CIS portfolios are already defined as financial products. There would therefore be no regulatory obstacle to a CIS management company appointing an adviser as its PSA. However, in practice, there are few if any business models we are aware of where a CIS management company appoints its own agents to provide advice on its behalf and takes accountability for such advice. Even in third party co-branded models, the third party investment manager is legally the agent of the CIS management company in relation to the investment management activities it performs (through an investment management outsourcing arrangement), but where that third party investment manager also provides advice, it does not usually do so as agent of the CIS management company.

An additional consideration is that CIS management companies are currently exempt from FAIS in relation to any advice activities that the management company performs. The rationale for this exemption was that CIS legislation provides sufficient investor protection to mitigate the risks of the management company itself providing advice in the course of its ordinary CIS management and administration activities[12]. This exemption would however create an anomaly that would need to be addressed if a CIS management company were indeed to adopt a business model of appointing its own PSAs to provide advice on its behalf.

Measure 7: Provide for the possibility of an adviser being categorised as the PSA of an investment manager (to be defined as discussed above) or a LISP by –

either -

(a) Refining the RDR adviser categorisation model, by providing that a PSA may operate either as the agent of a financial product supplier or a financial service provider[13]. This would obviate the need to regard investment managers as "product suppliers" or to regard the investment portfolios they offer as financial "products". In the case of a LISP, this approach would similarly obviate the need to regard a LISP as a "product supplier". Instead, both investment managers and LISPs could continue to be regarded as service providers, but would be able to appoint PSAs. Accordingly, this approach would be more consistent with the current regulatory framework. In financial groups, this would mean that a PSA could provide advice on any financial product or financial service offered by any licensed entity – including investment managers and LISPs - in the group. Note however that this approach would require an extension of the current definition of "advice" beyond purely recommendations relating to identified financial products, but also include recommendations of identified financial services;

or -

[11] Some commentators have argued that, in practice, a LISP plays a similar role in relation to administering investments to that of a CIS management company (which is indeed a product supplier), except that it uses the method of "bulking".

[12] The current definition of "administration" in the Collective Investment Schemes Control Act includes advice.

[13] Definitions of financial product provider and financial service provider would be linked to those used in the Financial Sector Regulation Act.

(b) Expanding the definition of "financial product" to include the investment portfolios offered by investment managers[14]. The effect of this would be that investment managers would be regarded as product suppliers for regulatory purposes, and could appoint PSAs as their agents to provide advice on their products (i.e. their portfolios). This approach would obviate the need to extend the scope of a PSA beyond advice on "products". Note however that this approach does not comfortably lend itself to the possibility of an adviser being able to operate as the PSA of a LISP – it is difficult (although arguably not impossible) to position a LISP's services as a "product" and a LISP as a "product supplier".

Regardless of whether (a) or (b) above is adopted, all other implications of being a PSA would apply in either approach, namely: The investment manager or LISP concerned (or another entity in the group) would need to be licensed to provide advice, with the individual advisers concerned acting as their agents (individual PSAs). The investment manager or LISP concerned would be fully responsible for the advice provided by its PSAs in relation to its services / products. The PSAs would also only be permitted to offer the services / products (i.e. the investment portfolios – or co-branded investment portfolios where applicable) of that investment manager only; or the platform services of that LISP only; or the products or services of other entities in the same group only.

Question for stakeholder input:
Q6. Which of option (a) or (b) under Measure 7 above do you believe would be most appropriate to provide for the possibility of an investment adviser acting as the PSA of an investment manager or LISP? If you do not believe that either option is appropriate or necessary, please explain why and let us know if you have any alternative suggestions. In particular, please indicate whether or not you believe it is necessary to provide for the situation where an investment adviser could act as the PSA of a LISP and why you hold this view.

Measure 8: Consider how to apply Measure 7 to model portfolio providers (MPPs) as contemplated in section 3.1(c) above. This assumes that MPPs would hold a separate type of licence from investment managers (including third party co-branding investment managers). If so, either option (a) or (b) under Measure 7 could equally be used to allow an investment adviser to operate as the PSA of an MPP in a similar way to where an investment adviser could act as the PSA of an investment manager. In other words, using option (a) an MPP would be regarded as providing a financial service (model portfolio provision) and the PSA would provide advice on such services; or using option (b) the model portfolios of the MPP would be regarded as "products" and the MPP as a "product provider". Under either approach, an investment adviser appointed as a PSA of the MPP would provide advice only on the model portfolios of that MPP or on other products or services provided by other entities in the MPP's group.

Question for stakeholder input:
Q7. Would your answer to Question 5 above in relation to allowing an investment manager to appoint a PSA be the same in relation to allowing an MPP to appoint a PSA as discussed under Measure 8? If not, why not?

Measure 9: In light of Measures 7 and 8 above, **confirm that an investment manager (either a traditional investment manager or a third party co-branding investment manager) and / or an MPP may utilise multiple distribution channels for the distribution of its portfolios / model portfolios to investing customers if it so wishes.** These include:

- Establishing its own PSA channel – either by also holding an advice licence itself, or having a

[14] Please also see footnote 10 above.

PSA entity in its group. In this case, the investment manager / MPP is fully accountable for any advice provided by the PSAs. The PSA channel will also only be able to offer the investment manager / MPP's own portfolios, or other products or services provided by other entities within the group (including a LISP platform);

- Having an ownership interest in or association with an RFA channel. In this case, the regulator would monitor the extent to which the RFA channel promotes the investment offerings of the investment manager / PPM itself, as opposed to offerings from outside the group, in order to assess whether the advice provided remains sufficiently objective to warrant ongoing categorisation as an RFA (as opposed to a PSA). Note that in such a model the RFA channel would not be able to describe its advice as "independent";
- Having no PSA channel and no relationship with an RFA channel, with its portfolios being marketed on a fully arms' length basis by RFAs; or
- Combinations of the above.

> ***Question for stakeholder input:***
> *Q8. Do you agree that all of the distribution model options described in Measure 9 should be available to all investment managers and MPPs and do you agree with the descriptions of each model? If not, why not?*

Measure 10: Clarify the nature and implications of the outsourcing relationship between the CIS management company and a third party co-branding investment manager and their respective regulatory responsibilities[15]. Provisions we are considering include the following:

- Setting clear standards on the responsibilities of the CIS management company in relation to the third party investment manager and the co-branded "white labelled" portfolios concerned. These standards will confirm that the CIS management company retains full accountability for all aspects of the third party manager's outsourced investment management activities and the performance of the portfolios concerned. Standards will also include governance and oversight requirements, operational requirements and data sharing requirements[16].
- Confirming that a CIS management company may only enter into a third party co-branding arrangement – or any other outsourced investment management arrangement - with an investment manager that meets the new definition of that activity and is licensed accordingly[17].
- Clarifying that the third party investment manager acts as the agent of the CIS management company specifically in relation to its investment management activities, but not in relation to any advice provided by the third party investment manager or its associates (unless of course they are appointed by the CIS management company as its PSA – see Measure 11 below). Note however that this does not imply that the CIS management company may wash its hands of all responsibility in relation to advice provided by the third party investment manager on the outsourced portfolios concerned. As with any other product supplier, the CIS management company will in terms of our overall RDR proposals be expected to take reasonable steps to mitigate the risks of poor advice provided by intermediaries marketing its products[18]. The fact that the CIS management company has entered into a co-branding arrangement with the third

[15] Note that these requirements would apply equally to so-called "incubator" white label models, as provided for in the existing CIS regulatory framework.

[16] The intention would be to align these requirements, to the extent appropriate, with corresponding outsourcing requirements imposed on insurers in relation to binder holders and other outsourced administration providers.

[17] Note that, in addition to the accountability borne by the CIS management company that outsources its investment management activity to the third party investment manager, the third party is itself also accountable for its own conduct in accordance with its licence as an investment manager.

[18] See initial RDR Proposals BB to EE in relation to product supplier responsibility.

party investment manager will mean that the CIS management company will be expected to play a more proactive role in such risk mitigation than it would in relation to investment advisers marketing its portfolios on a fully arms' length basis[19].

- Note too that any advice provided by a third party co-branding investment manager – even where it operates as an RFA - would not be able to be described as "independent", as a result of its outsourcing relationship with a product supplier (the CIS management company).[20]
- Confirming that the CIS management company's accountability for the investment management activities of the third party co-branding investment manager also extends to the use of any LISP platform in relation to the co-branded portfolios concerned. In other words, the CIS management company's responsibilities in relation to the use of a LISP for co-branded portfolios would be the same as in relation to any other situation where a CIS management company offers its own (not co-branded) portfolios through a LISP.

> ***Question for stakeholder input:***
> *Q9. Please provide your views on the correctness, feasibility and likely effectiveness of each of the possible provisions set out under Measure 10 to regulate CIS white label arrangements. Please let us know if you have any alternative suggestions.*

Measure 11: Confirm that a CIS management company may, if it so wishes, appoint a PSA to provide investment advice as its agent. This could include appointing a third party co-branding investment manager (that also has a Category I licence to provide advice) with whom the CIS management company has an outsourcing arrangement, as its PSA in relation to the co-branded portfolios concerned[21]. As with any other PSA, such an adviser would be limited to marketing the portfolios of the CIS management company only (including the co-branded portfolios), or the products / services of other entities in the CIS management company's group. This approach may require a change or clarification of the scope of the current FAIS exemption of CIS management companies, to confirm that the management company and the PSA would indeed be subject to relevant FAIS obligations relating to the provision of advice if this type of distribution model is selected by the management company. It would also require an amendment to CIS legislation to remove "advice" from being regarded as part of the scope of the CIS management company's administrative activities.

> ***Question for stakeholder input:***
> *Q10. Do you agree that a CIS management company should be able to appoint a PSA to provide advice on its portfolios? If not, why not? If yes, do you agree with the above description of the implications of such an arrangement?*

Measure 12: **Clarify the adviser categorisation implications of using a LISP platform outside the adviser's group – in particular in relation to PSAs within the group.** As explained previously, a PSA will be limited to providing advice on the products or services of entities within its own group only. If the regulatory measures suggested in this paper are followed, this would include

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[19] This is consistent with our various RDR communications where we have indicated that the extent of a product supplier's responsibility for advice provided in relation to its products should be commensurate with the risk of such advice being influenced by the product supplier.

[20] This is consistent with our RDR approach where we have indicated that certain relationships – including outsourcing relationships – between financial advisers and product suppliers will disqualify the advice concerned from being described as "independent".

[21] Note however that this would only be permissible where the third party co-branding investment manager concerned does not also provide advice on any other portfolios it may also manage in its own name or though another third party co-branding arrangement with another CIS management company.

investment portfolios and / or model portfolios offered by entities within the group. This would also extend to other portfolios / model portfolios provided by investment managers or MPPs outside of the adviser's group, but only if such external portfolios are offered on a LISP platform operated by a group entity. Concerns have however been raised that this approach places PSAs in groups that do not have their own LISP platform, at a competitive disadvantage to PSAs in groups that do have a LISP platform. In particular, the concern has been raised that, in order to offer investment products requiring an underlying life insurance licence, such as living annuities and underwritten retirement annuities or preservation funds, advisers need access to a LISP that is part of a group that also holds the requisite life insurance licence. Accordingly, a PSA in a group that does not have a LISP and a life licence would – so the argument goes - no longer be able to offer such products.

The following are regulatory options that could be considered in response to this concern:

(a) Maintain a strict "no gap filling" approach to PSAs, disallowing a PSA from offering products / portfolios through a LISP platform outside its group. Advisers wishing to provide advice on products / portfolios through an external LISP platform will therefore have to act as RFAs, not PSAs. As a result, such advisers will also need to be able to demonstrate that their advice is not biased in favour of their own group's other offerings. This approach would be potentially problematic, for example, in the case of an MPP that wants its advisers to offer only its own model portfolio solutions for discretionary investments, but use an external LISP for annuities or retirement products where it does not hold the requisite licence. Referrals to other advisers / investment managers who do have access to such products would however be possible;

(b) Allow the PSA channel to advise on products / portfolios on an external LISP, but only where -
- There is no LISP platform within the home group;
- An investment manager or MPP within the home group has structured the portfolio / model portfolio concerned and accepts full accountability for its performance and for the advice provided by the PSAs on such portfolios; and
- An investment manager or MPP, or other appropriate entity within the home group, has undertaken an adequate due diligence of the LISP concerned (see Measure 14 below); or

(c) Allowing the PSA channel to advise on products / portfolios on an external LISP, but only where the criteria in (b) above apply and the group concerned is below a certain size and scale. The rationale for such an approach would be to recognise that the establishment of an "in-house" LISP has cost implications for smaller businesses, but to encourage those who have the capacity to do so to set up their own LISP platform if they wish to use a PSA model.

Question for stakeholder input:
Q11. Which of options (a) to (c) under Measure 12 above do you believe would be most appropriate to deal with the implications for PSAs of using a LISP platform outside their group? If you do not believe that any of these options is appropriate, please explain why and let us know if you have any alternative suggestions.

Measure13: Clarify the adviser categorisation implications of acting as a third party co-branding investment manager as well as holding another type of discretionary mandate.
Models where a Category II FSP manages co-branded portfolios through a CIS management company that is not part of the same group, but also manages its own segregated and / or model portfolios, are not uncommon. Similarly to the concerns raised under Measure 12 in relation to the use of external LISPs, this raises questions regarding the scope of advice that a PSA channel operating in such a group would be permitted to provide. Our proposed approach to this situation is as follows:
- The fact that the co-branded portfolio is managed on an outsourced basis on behalf of an external CIS management company should not prohibit the PSA channel of the third party co-branding investment manager from providing advice on such portfolios. Such a prohibition

would ignore the practical reality that the third party investment manager itself structures the co-branded portfolio [22]– it is therefore for practical purposes an "in-house" offering of the PSA's group.

- It follows that the PSA channel within a group that manages a combination of co-branded portfolios as well as its own segregated portfolios and / or model portfolios will be able to provide advice on all such offerings – as well as any other products or services of entities within the group.
- If any such portfolios are offered on an external LISP the options discussed in Measure 12 above are applicable.

Question for stakeholder input:
Q12. Do you agree that the details under Measure 13 correctly describe the adviser categorisation implications of acting as a third party co-branding investment manager as well as holding another type of discretionary mandate? If not, why not? Are there any additional implications we have not identified that might influence the adviser categorisation in these business models?

Measure 14. Set clear requirements for due diligence reviews to be carried out before various contractual arrangements between parties in the investments value chain are entered into. Arrangements requiring appropriate due diligence reviews include:

- A CIS management company to perform a due diligence review on any investment manager to whom it outsources any investment management function – including but not limited to outsourcing to a third party co-branding investment manager.
- A CIS management company, investment manager or MPP to perform a due diligence review on a LISP before placing any of its portfolios / model portfolios on the LISP's platform.
- A LISP to perform a due diligence review of any CIS management company, investment manager or MPP before accepting its portfolios onto the LISP platform.
- An MPP to perform a due diligence on any underlying investment manager and / or CIS management company whose portfolios it utilises to construct its model portfolios.
- A financial adviser (other than a PSA) to conduct a due diligence on any investment manager, MPP or CIS management whose investment offerings it selects to recommend to its customers, including being able to demonstrate the selection process it uses.
- A general requirement for any CIS management company, investment manager or MPP to satisfy itself that any distribution channel it selects to distribute its investment offerings is suitable.

Note that any due diligence referred to above extends beyond simply confirming that the entity concerned holds the requisite licences. It should take into account the "fit" with the business model and investment offerings concerned, with due regard to the delivery of fair outcomes for the target investor base concerned.

Question for stakeholder input:
Q13. Do you agree that an appropriate due diligence review should be required in all of the scenarios set out under Measure 14? Are there additional arrangements requiring due diligence that we have not mentioned? Do you have any suggestions as to what such due diligence requirements should comprise?

[22] Bear in mind that our proposed activity-based definition of "investment manager" would ensure that this is the case.

3.3. Implications for remuneration and charging structures

In our initial RDR proposals, the following principles for intermediary remuneration were identified as necessary to support the desired RDR outcomes[23].

Intermediary remuneration:

Greater clarity on the activities that make up advice, intermediation and outsourced services respectively, as well as on whose behalf the services are rendered, creates the foundation for a clearer set of principles and rules for intermediary remuneration.
To achieve the desired RDR outcomes, it is proposed that the future regulatory framework for intermediary remuneration should meet the following criteria:

- *Intermediary remuneration should not contribute to conflicts of interest that may undermine suitable product advice and fair outcomes for customers.*
- *As part of this aim, intermediary remuneration should not undermine reasonable customer benefit expectations or inhibit customers' access to their savings (such as through early termination charges designed to recover commission costs).*
- *The regulatory framework should recognise the range of services available, the related remuneration for these, and who may pay or receive it.*
- *All remuneration must be reasonable and commensurate with the actual services rendered.*
- *Remuneration structures should strike a balance between supporting ongoing service and adequately compensating intermediaries for up-front advice and intermediary services.*
- *Ongoing fees and / or commission may only be paid if ongoing advice and services are indeed rendered.*
- *An intermediary may not be remunerated for the same or a similar service twice.*
- *All fees paid by customers must be motivated, disclosed and explicitly agreed to by the customer.*
- *The different types of services and fees should be readily comparable by customers; and*
- *Remuneration structures should promote a level playing field between different types of intermediaries providing similar services.*

The initial RDR proposals also make the following very important point in relation to remuneration and charging structures in the investments space: *The potential consumer impact of unfair or inappropriate charging structures is particularly important in the investment product space, where product, distribution and advice related costs all have a direct impact on the ability of products to meet reasonable customer benefit expectations.*[24]

Existing RDR remuneration related proposals applicable to the investments sector

Against this background, the following remuneration related measures specifically applicable to the investments sector are already included in our initial RDR proposals. We intend to proceed with setting standards in respect of each of these proposals, subject to applicable refinements arising from previous and future consultation processes:

- *Proposal HH:* General disclosure standards in relation to fees or other remuneration

[23] See pp. 47 to 48 of the initial RDR proposals. Also note that a number of these principles are included in proposed revisions to the FAIS General Code of Conduct.

[24] See p.51 of the initial RDR proposals.

- *Proposal JJ:* Standards for up-front and ongoing product advice fees
- *Proposal KK:* Additional standards for ongoing advice fees
- *Proposal LL:* Product suppliers to facilitate advice fees
- *Proposal MM:* Remuneration for selling and servicing investment products
- *Proposal SS:* Standards for remuneration arrangements between adviser firms and their individual advisers
- *Proposal TT:* Special remuneration dispensation for the low income market
- *Proposal YY:* Remuneration for investment platform administration.

Possible additional regulatory measures in relation to remuneration and charging structures in the investment sector:

In addition to the above-mentioned earlier RDR proposals, we also need to consider additional implications for the remuneration and charging structures of investment related products and services, arising from the various regulatory measures proposed in this paper.

We are considering the following additional regulatory measures:

Measure 15. Engage with ASISA and other stakeholders on how best to use and / or enhance the ASISA Effective Annual Cost (EAC) disclosure mechanism to ensure effective customer understanding of the quantum and impact of all "layers" of charges in the investment value chain[25]. This would include all investment manager and MPP charges, any other administrative charges, LISP platform charges and advice fees.

> ***Question for stakeholder input:***
> *Q14. Do you support the use of ASISA's EAC cost disclosure mechanism as proposed and do you have any suggestions as to how it could be applied or adapted to support the desired RDR outcomes regarding cost transparency in the investments sector?*

Measure 16. Consider how best to mitigate the risk of inappropriate duplication of fees and charges by different entities in the investment value chain. Questions to consider include:

- In third party co-branded models, how do we ensure that the fees charged by the CIS management company and the third party investment manager respectively are appropriately allocated between them and are reasonably commensurate with the respective activities they perform? How do we ensure that the total cost is reasonably consistent with the fees charged by the CIS management company on any other portfolio in a similar asset category?
- In MPP models, how do we ensure that the fees charged by the MPP for its model portfolio management and those charged by the relevant CIS management company and / or traditional investment manager respectively are appropriately allocated between them and are reasonably commensurate with the respective activities they perform?

> ***Question for stakeholder input:***
> *Q15. Please provide your views on the questions raised under Measure 16 in relation to mitigating the risks of duplication of charges. Are there any other risks of inappropriate duplication of fees and charges in the investments sector that we should be considering?*

Measure 17. Consider how best to mitigate the risk of conflicted advice in cases where an

[25] Note that EAC based disclosures do not however replace any other cost disclosures required by regulation or international standards.

investment manager or an MPP, or an adviser forming part of the same group as the investment manager or MPP, provides advice to customers in relation to their own (or own group's) portfolios / model portfolios, but are not structured as a PSA – in other words, where they purport to provide "non-tied", objective advice in relation to their own / own group's offerings?

Possible regulatory responses – or combinations of responses - include:

- In such business models, set clear standards requiring the adviser and the portfolios / model portfolios concerned to carry the same branding and for the relationship between the adviser and the investment manager / model portfolio provider to be prominent in all marketing and advertising material;
- Disallow an investment manager or MPP from holding a licence for advice in its own right – i.e. require that any advice provided in relation to the portfolios / model portfolios concerned must be provided by a separate legal entity (which may or may not be part of the same group);
- If an investment manager or MPP is permitted to provide advice through the same licence, disallow the charging of both advice fees and investment / portfolio management fees in relation to the portfolio/s concerned – i.e. require that only one fee be chargeable in such models covering both the investment management / portfolio management and advice activities;
- If both advice fees and investment / portfolio management fees are chargeable, oblige the adviser to obtain the customer's explicit consent to not only the advice fee but also any other fee chargeable by any other entity in the group; and/or
- Disallow any sharing or splitting of advice fees and investment manager / MPP fees between the advice operations and the investment manager / MPP operation – i.e. ensure that there is an explicit distinction between these sets of fees and the services to which they relate.

Related questions are: Should the above approaches differ between traditional investment managers, third party co-branding investment managers, and MPPs respectively? Do the risks of conflicted advice in these respective models differ and if so how?

Question for stakeholder input:
Q16. Please provide your views on each of the possible regulatory responses noted under Measure 17 in relation to mitigating the risks of conflicted advice. Are there any other risks of conflicted advice in the investment sector that we should be considering?

Measure 18: Clarify the responsibilities of various entities in the investment value chain in relation to facilitation and monitoring of advice fees and other charges. Provisions we are considering include:

- Confirming that all of the following entities will be required to facilitate the deduction and payment of advice fees to an adviser, when instructed to do so by the customer concerned: Insurers, CIS management companies, LISP platform providers and, where applicable, investment managers themselves. The rationale for obliging these entities to facilitate fee deductions would be to mitigate the risk that an adviser's recommendation of an investment offering will be influenced by the ease of being able to access advice fees, rather than by the suitability of the investment for its customer.
- Prescribing the minimum advice fee structures that these entities will be required to facilitate. Current thinking is that these should include providing customers with the option of requesting once-off, monthly or annual advice fee facilitation through any of the following mechanisms:
    - A once-off fee added to a lump sum contribution and then paid across to the adviser;
    - Ongoing fees added to regular investment contributions and then paid across to the adviser at the same frequency as the regular contribution. (We do not propose that this needs to be through a separate debit order); and
    - Ongoing deductions from investment values, expressed as a percentage of the

investment value of the portfolio concerned[26].

- Requiring these entities to monitor average advice fee levels on an aggregated basis and report these to the regulator. This is likely to include specific reporting of cases where the fee level is unusually high as compared to the norm for the type of service concerned, in the experience of the reporting entity. The purpose of such reporting would be to support the FSCA in monitoring advice fee trends and in detecting "outlier" fee charging practices, in order to mitigate conduct risks. We will consult further on the structure and detail of such reports and provide guidance if necessary.
- Possibly extending the facilitation and / or monitoring and reporting obligations beyond advice fees to also apply to MPP fees (depending on whether these are chargeable separately from advice fees).

> ***Question for stakeholder input:***
> *Q17. Please provide your views on the correctness, feasibility and likely effectiveness of each of the possible provisions set out under Measure 18 in relation to facilitation and monitoring of fees and charges. In particular, do you agree that the provisions should extend beyond advice fees, and if so in what circumstances? Please let us know if you have any alternative suggestions.*

Measure 19: Consider the appropriate remuneration mechanism for "automated advice". Recent amendments to the Determination of Fit and Proper Requirements under the FAIS Act define automated advice (sometimes referred to as "robo advice"), clarifying that it is regarded as a form of advice under the current FAIS framework. In principle, such "robo advice" should therefore be able to attract an advice fee. This raises the question how to ensure that any such fee is reasonably commensurate with the automated service provided.

> ***Question for stakeholder input:***
> *Q18. Please provide your views on the appropriate remuneration model for automated advice services.*

Measure 20: Consider the appropriate remuneration model for distribution of investment products through non-advice models. RDR proposal MM stipulates that no remuneration may be paid to any intermediary for selling or servicing investment products, other than advice fees agreed to by the customer (subject to a special dispensation to be developed for the low income market under proposal TT). However, as noted in our initial RDR proposals, because proposal MM deals with advice fees, it follows that as currently positioned it only applies to intermediated distribution models that do in fact entail the provision of advice. This begs the question whether there is a need for a different remuneration / charging model for distribution of investment products on an "execution only", non-advice basis.

> ***Question for stakeholder input:***
> *Q19. Please provide your views on the appropriate remuneration model for non-advised investment product sales. Inputs on the current extent and structure of such models will be appreciated.*

Measure 21. In addition to our concerns regarding the risk of conflicted advice in relation to investment products, we are also concerned that **the exercise of a discretionary mandate – even where no advice is provided – can result in a conflict of interest** where the mandate is used by the investment manager or MPP concerned to select portfolios / model portfolios offered by the

[26] We will consider whether this facility requires amendment to any applicable legislation limiting the deduction of amounts from the value of investment, savings and retirement products.

mandate holder itself or its associates. The conflict of interest risk arises particularly where fees are payable for the management of a segregated / customised client portfolio (or model portfolio) as a whole, in addition to investment management fees on the underlying investments. We are therefore considering how best to mitigate the risk of conflicts of interest in these cases.

Question for stakeholder input:
Q20. Please provide your views on how best to mitigate the risk of conflicted exercise of discretion in the situation discussed under Measure 21. Inputs on the current extent of such models – i.e. where investment management fees are charged by both the model portfolio provider and the underlying investment manager/s - will be appreciated.

SECTION 4. Next steps

Stakeholder input on the specific questions raised in this Discussion Document will inform the development of draft subordinate legislation in relation to our various RDR proposals impacting the investments sector. Such draft subordinate legislation will in turn be preceded by additional consultation, as prescribed for the type of regulatory instrument concerned.

Please provide your input by using the attached Feedback Template. Responses should be submitted to FSCA.rdrfeedback@fsca.co.za by no later than 17 August 2018.