# 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.