

2.3. Theme 3: Long-term insurance risk

This theme considers the impact of the RDR proposals on the distribution of long-term insurance policies that provide risk benefits such as benefits payable on death, disability or health events. The theme covers proposals relating to adviser remuneration in relation to these products generally, as well as specific proposals relating to policy replacements, certain credit life policies and the equivalence of reward between tied insurance advisers and other advisers. It also deals with proposals on outsourcing arrangements between advisers and long-term insurers.

2.3.1. Key stakeholder feedback and initial responses for Theme 3

(a) Ongoing product servicing:

In response to Proposal E, relating to standards for ongoing product servicing, the majority of commentators felt it would be important to identify the particular types of post-sale servicing activities envisaged. There was a general concern that, given the nature of long-term risk policies, post-sale servicing transactions are usually infrequent and unpredictable and that it would therefore be difficult to set clear standards in this regard. The point was also made that the extent of ongoing servicing required may differ per product type and for different distribution models. For example, in the case of products sold on a non-advice "single need" basis – such as credit life, travel or cell phone insurance – commentators argued that there is little need for ongoing post-sale service.

(b) Mix of up-front commission and ongoing service fees:

Views on the proposal that remuneration for selling and servicing risk life products would be a mix of up-front commission and as-and-when service fees (Proposal NN), were mixed. Although a number of commentators accepted the concept in principle, the concerns raised in relation to Proposal E were relevant here too. Concerns were raised that it was unclear what particular ongoing services advisers would be required to provide to be eligible for the as-and-when service fees. Insurers in turn raised concerns that it was unclear what was expected from them in relation to monitoring such ongoing service.

As noted in the RDR document itself, the FSB recognises that further consultation will be required on this point. This will include a discussion on whether it is correct to characterise

the as-and-when remuneration component as a payment for ongoing service, or whether it should instead be regarded as a deferred payment of the commission (in other words deferred remuneration for selling the policy, as opposed to for ongoing service). The FSB recognises that it would be simpler to regard the as-and-when component as deferred commission, and that it will be difficult to prescribe particular types of ongoing service, but we are concerned that this approach would mean that advisers who provide no ongoing service at all would be entitled to the same as-and-when remuneration as those who do provide such service. This result would not be consistent with the activity-based remuneration framework envisaged by the RDR. We would therefore like to continue exploring an appropriate link between the entitlement to as-and-when remuneration and at least some degree of ongoing service.

We also noted some confusion in the comments between the proposals relating to remuneration for ongoing servicing (payable by the insurer and built into the premium charged to the customer), as opposed to remuneration for ongoing advice (payable by the customer, although it could be facilitated by the insurer) and recognise that clarification is needed.

The main objections to the proposed shift from fully to only partially up-front remuneration for life risk products centred around negative impacts on adviser cash flow, linked to barriers to entry for new advisers. Most commentators requested that, if such an approach is adopted, it should be phased in over time to minimise these impacts, and that exceptions should be considered for new entrants. Various phasing-in permutations were put forward. There was however strong support for the fact that at least some up-front commission is proposed to be retained, although there were minority views that all commission on life risk policies should be payable on an as-and-when basis. A smaller minority argued that commission on these products should be prohibited, in line with the proposal for investment products.

The FSB intends to proceed with the implementation of a partially up-front remuneration model for these products, but in a phased manner (see paragraph 2.3.2 below).

A number of concerns were also raised that customers would not be willing to pay advice fees in respect of risk products and that, if the overall level of sales commission on these products was reduced as proposed, advisers would be substantially worse off as they would not be able to make up the difference in earnings from advice fees. Commentators

recognised however that the potential impact could only be assessed once more detail on the proposed new commission caps becomes available.

A number of practical, technical concerns were raised in response to the proposal that the up-front commission component must be payable at the start of the policy, not split between the first and second year.

Consultation in the course of 2016 for this theme will focus largely on technical testing of the impacts of different commission cap levels on different levels and types of adviser sales activity and different product combinations, including potential phasing in of new caps. A number of insurers have already undertaken initial impact testing in relation to their adviser channels, based on preliminary assumptions. The Actuarial Society of South Africa has also offered support in this regard. The FSB will work with these insurers and associations to take this testing further.

(c) Premium collection:

Specific comments regarding proposed standards in relation to premium collection (Proposal F) are discussed under Theme 4 below on short-term insurance, as this was the focus of most feedback on this proposal. Some of the feedback was however also relevant to the life insurance risk space.

2.3.2. Implementation phases for Theme 3

(a) Phase 1

As discussed in the RDR Phase 1 Status Update, the following proposals fall within Phase 1 and next steps for these proposals are set out in that document:

- *Proposals J¹⁵, Z and AA:* Proposals relating to standards for outsourced services and restricted outsourcing to financial advisers.
- *Proposal OO:* Product supplier commission prohibited on replacement life risk policies (see also Phase 2 below).
- *Proposal RR:* Equivalence of reward to be reviewed (see also Phase 3 below).
- *Proposal ZZ:* Binder fees payable for multi-tied intermediaries to be capped¹⁶.

¹⁵ Although not explicitly identified as a Phase 1 proposal, Proposal J is closely linked with Proposals Z and AA.

¹⁶ See detail under Theme 4 below on short-term insurance.

- *Proposal AAA*: Commission cap for credit life insurance schemes with “administrative work” to be removed.

(b) Phase 2

As noted in the RDR Phase 1 Status Update, the FSB recognises that the prohibition of commission on replacement policies cannot be implemented until such time as standards relating to advice fees are in place. Interim controls to mitigate the risks of inappropriate incentive driven replacements will therefore be introduced in Phase 1. We will however consider the introduction of remuneration based interventions during Phase 2, coupled with provision for advice fees in relation to replacement advice.

The FSB also intends to implement Proposal F, restricting premium collection to qualifying intermediaries, in Phase 2¹⁷.

(c) Phase 3

Implementation of the future commission levels for life risk policies – including a combination of up-front and on-going remuneration – will commence in this Phase. It is likely to be phased in over a period of two to three years thereafter, subject to the outcome of technical impact testing. For example, the maximum proportion of up-front remuneration in the first year of implementation may be higher than 50% of the total, reducing to 50% over a two to three year phasing-in period. The final commission model will also reflect the outcome of consultations regarding how best, if at all, to distinguish between remuneration for selling the policy and remuneration for on-going servicing.

Full implementation of equivalence of reward standards, including confirmation of the extent to which the principle of equivalence of reward is to be applied at individual adviser level, will also occur in Phase 3. Consultation will inform possible exceptions to accommodate new advisers and / or advisers operating in the low income market, where the imposition of strict equivalence standards at individual level may not be sustainable or could pose barriers to adviser entry and inhibit customers' access to advice.

¹⁷ See further discussion on Proposal F under Theme 4 relating to short-term insurance. Also note that the FSB intends to address current inconsistencies between premium collection requirements in the Long-term Insurance and Short-term Insurance Acts.