2.6. Theme 6: Low income market

The focus here is mainly on RDR Proposal TT relating to the development of a special dispensation for product distribution in the low income market. This FSB workstream is however also mandated to consider financial inclusion imperatives more broadly. Proposal TT therefore forms part of a holistic approach to transformation and inclusion for the financial sector in line with the National Development Plan 2030.

Meaningful inclusion will require a multi-prong approach focusing on innovative solutions for distribution and delivery, proportionate regulatory frameworks that do not create barriers to entry, as well as consumer education. Customers in the low income sector need access to advice, which means that any regulatory proposal should not create unnecessary barriers to entry to providers who wish to service this segment. In this regard proposal TT considers not only access to advice but also sustainability of advice businesses in this sector. There is a need to find a balance between remunerating advisers sufficiently so that they are encouraged to service the low income sector whilst ensuring access to fair and affordable advice and products that deliver fair outcomes for customers.

Proposal TT, as set out in the initial RDR discussion document, suggested that additional consultation and technical work should be undertaken to determine an appropriate remuneration dispensation for product suppliers and intermediaries serving low income customers, in respect of life insurance risk products and investment products. Elements to be considered in carrying out this work included:

- Product standards to allow products to qualify for this dispensation, including in relation to: Benefit types, premium / contribution limits, product terms and charges. In particular, such product standards will either prohibit or significantly reduce the extent to which product suppliers may recover any up-front commissions payable from product values in the form of early termination charges.
- Inter-relationship between this dispensation and policy proposals in respect of microinsurance and tax free savings products.
- The types of intermediary and advice services qualifying for this dispensation.
- Permissible commission limits.
- Permissible product supplier / intermediary relationships.

In addition, comment was invited on the extent to which a special remuneration dispensation is required for the low income market in respect of personal lines short-term insurance products.

2.6.1. Key stakeholder feedback and initial responses for Theme 6

All commentators on proposal TT were in support of a different dispensation for the low income sector in order to avoid any "advice gap" that could potentially result from the introduction of an advice fee based remuneration structure or changes to commission structures. The majority of commentators were of the opinion that the low income sector should not be defined based on customer demographic segments (such as "LSM" levels) or income levels but favoured a product definition approach. A product approach also ties in with the approach to developing the enhanced FAIS competency model as discussed earlier in this paper. The development of product standards and criteria that define the products that will be eligible for the special dispensation for this market is therefore critical. Also regarded as critical by stakeholders were market appropriate remuneration models, disclosures and competency requirements for advisers.

Stakeholders also highlighted the necessity of aligning Proposal TT with many of the other proposals under RDR and in this regard agreed that the timing of a special dispensation for the low income sector needs to take place in parallel with other proposed changes to remuneration for advice and intermediary services.

Some specific feedback areas included:

(a) Remuneration models:

Commentators were opposed to a fee based model in the low income sector and there was general support for consideration of as-and-when commission structures, salaried advisers and / or building remuneration into the premium. Any change to the approach on equivalence of reward will need to accommodate remuneration models agreed to for the low income sector.

(b) Product standards:

The criteria for product standards are critical. Some raised a concern that defining product by limits on underwriting could result in underwriting at claims stage or higher premiums, while others felt that defining products by maximum premium size could drive mis-selling of multiple products. Product suppliers argued that the cost of designing, building and marketing products is significant and is the same whether the market is low income or affluent. It is therefore crucial that remuneration models support the continued research, development and investment into such products.

(c) Advice:

Commentators all agreed that there is a need for sufficiently comprehensive financial needs analysis in the low income sector and that while low income market customers typically have limited financial insights and resources, they have a range of needs that should be assessed and prioritised. Advisers in the low income segment of the market play an important role by providing financial education and assisting with prioritising customer needs according to financial means. Remuneration models and competency requirements must therefore not create barriers to entry into the advice market and should ensure that access to such services is sustainable. There were also requests to consider a more proportionate model for the regulation of advice to reduce costs of compliance.

The FSB agrees that all of the above comments require careful consideration.

2.6.2. Implementation phases for Theme 6

The FSB recognises that full implementation of Proposal TT needs to coincide with implementation of a number of other RDR proposals including MM (the prohibition of product supplier commissions for advice on investment products), Proposals JJ, KK and LL (related to standards for advice fees) and equivalence of Rreward (Proposal RR). The proposal on a special dispensation for remuneration in the low income sector also needs to align as previously indicated with the enhanced adviser competency model being designed under FAIS.

(a) Phase 1

Consultation with industry reference groups on the proposals under this theme will continue during the first half of 2016.

In line with the stakeholder feedback that this market should not be defined based on income or customer demographics but rather be segmented based on product, consultation on product criteria that would define which products would qualify for a different remuneration dispensation will commence in this phase. This will include consultation on the types of intermediary and advice services qualifying for this dispensation.

Research and consultation as to whether or to what extent short-term insurance policies should be subject to a special dispensation in the low income market will also be completed in this phase.

This work will also align with the FAIS competency model discussions on how best to align competency requirements with different product categories, which will also occur in this phase.

(b) Phase 2

Consultation on product definitions will continue in this phase and will be extended to determine the appropriate remuneration models for this segment, linking remuneration models to product features and charges.

Depending on the outcome of Phase 1 discussions, Phase 2 will see the introduction of permissible commission limits or alternative remuneration structures in line with other RDR proposals for short-term insurance products and lump sum investment products.

Phase 2 will also see work commence on permissible commission limits or alternative remuneration structures for recurring contribution investment products. In particular, there will be a focus on ensuring that applicable product standards and remuneration structures will either prohibit or significantly reduce the extent to which product suppliers may recover any up-front commissions payable from product values in the form of early termination charges.

It is also expected that implementation of the enhanced FAIS competency framework will start during the Phase 2 period. This means that certain aspects of the proposals relating to levels of advice will be introduced during this phase.

Proposals that will be addressed in phase 2 on which Proposal TT has a direct dependency – some of which will be addressed through the FAIS competency framework during this phase – are:

- *Proposal A:* Forms of advice defined, with related conduct standards.
- *Proposals B and D:* Standards for "low advice" and non-advice sales execution.

- *Proposal MM:* Remuneration for selling and servicing investment products (to the extent that a low income market dispensation may be required for lump sum investments).
- *Proposal UU:* Remuneration for selling and servicing short-term insurance policies (to the extent that a low income market dispensation may be required for short-term insurance).
- *Proposals BB, CC, DD and EE:* Product supplier responsibility for different types of advice / distribution (Particularly in relation to product specific training).

(c) Phase 3

Implementation of the dispensation designed in phases 1 and 2 commences in this phase, taking account of the need for alignment with other Phase 3 implementation timelines.