Annex 1

FINANCIAL ADVISORY INDUSTRY REVIEW

REPORT ON RECOMMENDATIONS OF
THE FINANCIAL ADVISORY INDUSTRY REVIEW PANEL
16 JANUARY 2013

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PREFACE

On 2 April 2012, the Monetary Authority of Singapore (MAS) announced the establishment of a Financial Advisory Industry Review Panel to conduct a fundamental review of practices in the Financial Advisory (FA) industry. Chaired by MAS, the Panel comprises 13 representatives from industry associations, consumer and investor bodies, academia, media and other stakeholders. The composition of the Panel is listed in the Appendix.

The Financial Advisory Industry Review (FAIR) aims to enhance the standards and professionalism of the FA industry[1] and improve efficiency in the distribution of life insurance and investment products in Singapore. The Panel focussed on five key thrusts:

(a) raising the competence of FA representatives;
(b) raising the quality of FA firms;
(c) making financial advising a dedicated service;
(d) lowering distribution costs; and
(e) promoting a culture of fair dealing.

In arriving at its recommendations, the Panel considered feedback from consumers and the industry through various channels, including surveys, emails, letters and the media. More than 1,300 responses were received. PricewaterhouseCoopers LLP was engaged by MAS to conduct a comparative study of the regulatory regimes and practices in other jurisdictions.

The recommendations of the Panel are detailed in the following sections.

[1] Financial institutions in the FA industry include banks, life insurance companies, capital markets services licence holders, licensed financial advisory firms and insurance broking firms.

1 THRUST ONE: RAISING THE COMPETENCE OF FINANCIAL ADVISORY REPRESENTATIVES

I. MINIMUM ACADEMIC ENTRY REQUIREMENT

1.1 The FA landscape has changed since the enactment of the Financial Advisers Act (Cap. 110) (FAA) in 2002. There is a proliferation of financial products in the market today, with wide variations in complexity and risk. Consumer demands have also evolved considerably, ranging from basic personal savings and insurance needs to complex multi-generational plans. Recognising this, several jurisdictions have raised the minimum academic entry requirement for FA representatives. Australia and the United Kingdom, for example, now require tertiary-level qualifications.

1.2 In Singapore, the minimum academic entry requirement for FA representatives has remained at four GCE 'O' Level credit passes since 2002. The industry has, however, been recruiting representatives with better qualifications. Currently, more than 80% of FA representatives have at least GCE 'A' level qualifications. This is consistent with the Singapore population becoming better educated, with the percentage of Singapore residents with GCE 'A' level or higher qualifications rising from 33% to 49% in the last 10 years.

Recommendations

1.3 The Panel recognises that educational qualifications should not be used as the sole measure of an FA representative's competence. Experience, technical knowledge and customer-centredness are also pertinent factors. Nonetheless, as financial products become more complex and to ensure that FA representatives can continue to meet the expectations of a more literate and sophisticated public, the Panel recommends that the minimum academic entry requirement for new FA representatives be raised from the current four GCE 'O' level credit passes to either: (i) a full certificate in the GCE 'A' level; (ii) an International Baccalaureate Diploma qualification; or (iii) a diploma awarded by a polytechnic in Singapore (or an equivalent qualification).

1.4 The Panel further recommends grandfathering all existing FA representatives who do not meet the proposed minimum academic entry requirement, in recognition of their experience and to ensure that services to their customers are not disrupted. FA firms are strongly encouraged to provide opportunities to these representatives to upgrade their skills and competency through on-the-job training, or to support them in acquiring relevant professional qualifications. In addition, for aspiring individuals who are interested to enter the FA industry but do not meet the new entry requirement, the Panel proposes that MAS work with educational providers such as the local polytechnics, to offer specialised diploma courses in Financial Advisory Services.

II. CONTINUING PROFESSIONAL DEVELOPMENT

1.5 Continuing Professional Development (CPD) plays a critical role in ensuring that FA representatives keep abreast of market and regulatory developments. Whilst all FA representatives are currently expected to undergo continuing education to remain fit and proper in their FA role, MAS has not mandated or prescribed the type of CPD programmes or the minimum number of CPD training hours that FA representatives must undergo annually. Instead, FA firms either follow their own CPD guidelines or abide by industry guidelines such as those issued by the Life Insurance Association, Singapore (LIA), which require all FA representatives advising on or arranging life insurance policies to meet a minimum of 30 hours of CPD training annually.

Recommendations

1.6 Given the importance of continuing education in reinforcing ethical practices and in updating representatives on market and regulatory developments, the Panel recognises the need to put in place a more structured and formalised CPD framework for the FA industry. In this respect, the Panel recommends that MAS consider making the following enhancements to the current CPD framework for FA representatives:

(a) Require FA representatives providing FA services on all types of investment products, including life insurance policies, to undergo a minimum of 30 hours of structured CPD training[2] on an annual basis;

(b) Require FA representatives who only advise on or arrange mortgage reducing term assurance policies and/or group term life insurance policies, to undergo a minimum of 16 hours of CPD training annually;

[2] Structured training can include attending seminars (including web-based presentations), lectures, conferences, workshops and courses (including e-learning courses).

(c) Require FA representatives to undergo four hours of training on Ethics and eight hours of training on Rules and Regulations as part of their overall 30 or 16 hours of CPD training, as the case may be; and

(d) Work with the Institute of Banking and Finance (IBF) and the Singapore College of Insurance (SCI) to offer CPD training on Ethics as well as Rules and Regulations; and for similar training offered by training providers (including in-house training units of FA firms) to be accredited by IBF and/or SCI.

2 THRUST TWO: RAISING THE QUALITY OF FINANCIAL ADVISORY FIRMS

I. BACKGROUND

2.1 There are currently over 60 licensed Financial Advisory Firms (LFAs) in Singapore. Most LFAs offer products such as Collective Investment Schemes (CIS) and life insurance policies from a number of product manufacturers, and provide an additional channel for consumers seeking financial advice. Unlike other FA firms such as banks and life insurance companies which are generally well resourced, LFAs vary significantly in size. Consequently, the quality of management, staff strength, compliance arrangements and financial resources vary significantly amongst LFAs.

2.2 LFAs play a growing role in Singapore's FA industry. It is important to ensure that they have appropriate structures and adequate resources to deliver their services. LFAs should also be focussed on providing quality financial advice to enable their customers to make sound financial decisions. As such, the Panel is of the view that it is timely to review the admission criteria and ongoing requirements for LFAs. The Panel recommends that MAS enhance the competency, compliance and financial requirements of LFAs, and impose restrictions on the scope of non-FA activities conducted by LFAs.

II. COMPETENCY REQUIREMENTS

2.3 Currently, MAS requires the Chief Executive Officers (CEOs) of LFAs to have at least five years of relevant working experience, of which at least three years must be in a managerial capacity.

Recommendations

2.4 Given the increasing demands of managing an FA firm, the Panel recommends that MAS require CEOs of LFAs to have a minimum of 10 years of relevant working experience, of which at least five years are at a managerial level.

2.5 The Panel also recommends that LFAs employ a minimum of three full-time, resident professionals with at least five years of relevant experience each. This will ensure that LFAs have sufficient expertise and manpower to attend to the needs of a more sophisticated retail public. Both management staff (including the CEO and directors) and representatives can be counted towards the fulfilment of this requirement.

III. COMPLIANCE ARRANGEMENTS

2.6 Whilst LFAs are currently required to have adequate internal compliance systems and processes commensurate with the size and complexity of their businesses, the Panel notes that only about 40% of LFAs have independent and dedicated compliance functions. The Panel is of the view that it is important for LFAs to have effective compliance arrangements that ensure compliance with the laws, adherence to control measures, as well as promote good practices and professional standards.

Recommendations

2.7 Ideally, all LFAs should have independent and dedicated compliance arrangements. Nonetheless, the Panel is cognisant that it may not be economically feasible for smaller firms to maintain a dedicated compliance function. As such, to ensure that compliance arrangements are effective, the Panel recommends that all LFAs should minimally put in place a compliance function that is independent of their advisory and sales functions. For example, compliance officers should not take on conflicting roles, such as concurrently being appointed FA representatives, or having any front-office responsibilities. Larger LFAs which generate annual gross revenue of more than S$5 million or have more than 20 FA representatives should further ensure that they have dedicated staff for their compliance function.

IV. FINANCIAL REQUIREMENTS

Minimum Financial Requirements

2.8 LFAs that advise on futures contracts, foreign exchange contracts or leveraged foreign exchange contracts are currently required to have paid-up capital[3] of not less than S$300,000. LFAs that undertake other FA activities are required to have paid-up capital of not less than S$150,000.

[3] Paid-up capital comprises ordinary shares and non-redeemable preference shares that have been fully paid for.

2.9 The Panel notes that the current capital requirement does not take into account capital erosion due to operational losses or dividend payouts. In addition, the minimum capital requirement should also be re-calibrated, drawing lessons from the study of risk exposure faced by LFAs during the 2008 financial crisis.

Recommendations

2.10 The Panel recommends imposing a "base capital[4]" requirement instead of a "paid-up capital" requirement on LFAs, so that profits or losses will be factored in when assessing the financial health of these firms.

2.11 In addition, the Panel notes that LFAs advising on futures contracts, foreign exchange contracts or leveraged foreign exchange contracts are currently subject to a higher minimum financial requirement as these products have traditionally been deemed to be more complex or risky. The Panel recommends calibrating the minimum financial requirement according to the type of FA services provided by LFAs, instead of the type of investment product that LFAs advise on.

2.12 The Panel recognises that LFAs that are pure research houses issuing or promulgating research analyses or reports concerning investment products generally pose lower market conduct and litigation risks. This is because research reports are generally not tailored to the specific investment objectives or risk profiles of customers, and pure research houses typically do not have direct influence over the investment decisions of customers. As such, the Panel recommends that a minimum base capital of S$250,000 be imposed on pure research houses that only issue or promulgate research analyses or reports concerning investment products. For LFAs which conduct all other types of FA activities, the Panel recommends that they be required to maintain a minimum base capital of S$500,000. In proposing this quantum, the Panel took into consideration the exposure of LFAs to customer claims during the 2008 financial crisis and the adequacy of their total capital and Professional Indemnity Insurance (PII) coverage.

2.13 Balancing the importance of ensuring that LFAs are adequately capitalised and the need to minimise impact to the industry, the Panel further deliberated on alternatives to

[4] Base capital comprises share capital and any unappropriated profit or loss in the latest audited accounts of the firm, less any interim loss in the latest accounts and any dividend that has been declared since the latest audited accounts of the firm.

the minimum base capital requirement. The Panel recommends that LFAs (other than pure research houses) be given the option to maintain a lower minimum base capital of S$300,000, subject to them obtaining additional PII coverage of S$500,000 (please refer to paragraphs 2.20 and 2.21 for details on the minimum PII requirements). This takes into account the fact that PII is not a perfect substitute for base capital, but accords LFAs with added flexibility in designing their capital structure.

2.14 The table below summarises the proposed minimum base capital requirements for LFAs:

	Minimum Base Capital Requirement
Pure Research Houses	S$250,000
Other LFAs	S$500,000; or S$300,000 and an <u>additional</u> PII coverage of S$500,000

<u>Continuing Financial Requirements</u>

2.15 LFAs are currently required to maintain a net asset value (NAV) of not less than the higher of:

(a) One-quarter of their relevant annual expenditure[5] of the immediately preceding financial year, or

(b) Three quarters of the required minimum paid-up capital[6].

2.16 The Panel notes that these continuing financial requirements do not take into account the extent to which an LFA holds illiquid assets, and hence, do not adequately reflect the LFA's ability to meet its short-term financial obligations.

Recommendations

2.17 The Panel recommends requiring LFAs to maintain minimum financial resources adjusted for illiquid assets, to ensure that LFAs have the available liquid resources to cover operational risks.

[5] Relevant annual expenditure is total expenditure of the LFA less staff bonuses, employees' and directors' shares in profits and commissions or fees paid to its representatives.

[6] The minimum paid-up capital for LFAs that provide FA services relating to futures contracts, foreign exchange contracts or leveraged foreign exchange contracts, is S$300,000. Other LFAs are required to have a minimum paid-up capital of S$150,000.

2.18 Separately, the Panel notes that expenditure is currently used as a proxy in measuring an LFA's ongoing operational risks. Using expenditure as a proxy in the calculation of continuing financial requirements may discourage spending on middle- and back-office operations such as the compliance function. The Panel recommends using gross revenue as a proxy for measuring ongoing operational risks as it better reflects an LFA's scale of activities. It further recommends that LFAs maintain financial resources that are the higher of:

(a) 10% of the average audited gross revenue in the three immediate preceding financial years; or

(b) S$150,000.

<u>Professional Indemnity Insurance</u>

2.19 Currently, all LFAs are required to have an in-force PII policy with a minimum coverage of S$500,000 and a deductible of not more than 20% of the LFA's NAV at the end of its immediately preceding financial year.

Recommendations

2.20 The Panel recommends calibrating the PII requirements such that they take into account the type of FA services that the LFAs provide, their clientele, as well as the scale and size of their operations. The proposed PII requirements are summarised in the following table:

Type of LFA	Minimum PII Coverage Required
LFAs with annual gross revenue of up to S$5 million	S$1 million
LFAs with annual gross revenue greater than S$5 million	20% of the audited gross revenue of the preceding financial year
Pure Research Houses	S$500,000
LFAs serving only accredited investors	Not mandatory but encouraged

2.21 The Panel also recommends capping the deductible for the PII policy at 10% of the LFA's base capital. This is to prevent LFAs from obtaining PII policies with very high deductibles in order to pay lower premiums, thereby affecting their ability to pay the deductibles when making claims.

2.22 The Panel's recommendations in the preceding paragraphs aim to better safeguard the interests of consumers by ensuring that LFAs are financially sound, and exercise strong management and compliance oversight of their operations. Other than the competency requirement for CEOs (in paragraph 2.4), the Panel recommends imposing all the other proposed requirements on existing LFAs to ensure a level playing field between new and existing LFAs.

V. NON-FA ACTIVITIES CONDUCTED BY LFAs

2.23 LFAs play an important role in providing quality advice to enable their customers to make sound financial decisions. However, the Panel notes the prevalence of FA firms engaging in non-FA activities, such as advising on financial products which are not regulated under the FAA. Some of these non-FA activities may be in conflict with the provision of FA services or bring disrepute to the FA industry.

2.24 To raise the professionalism of the FA industry and ensure that LFAs remain focussed on conducting FA activities for which they are licensed, the Panel recommends that LFAs be restricted to conducting the following non-FA activities:

- (a) Acting as introducers or making referrals on non-FA activities to financial institutions licensed by MAS; and
- (b) Providing training and consultancy services on financial planning or financial literacy, subject to the following conditions:
  - (i) Where financial products are covered in the scope of such training and consultancy services, they should be limited to investment products regulated under the FAA; and
  - (ii) Disclosure on whether financial advice will be provided in the course of the training or consultancy, should be made to customers.

2.25 The Panel further recommends that the gross revenue generated by LFAs from their non-FA activities be capped at 5% of their annual total FA revenue.

VI. FA ACTIVITIES OF INSURANCE BROKING FIRMS

2.26 Insurance broking firms registered under the Insurance Act (Cap. 142) are currently exempt from the need to hold a financial adviser's licence for any FA activities that they conduct. Their FA activities are mostly limited to the sale of group life insurance policies to their corporate customers, which is a complementary activity to their general insurance broking business. However, over time, some have moved away from their core business of general insurance broking to providing the full range of FA services, including advising on individual life insurance policies and CIS. These firms may not have adequate management expertise and resources to support the proper conduct of the full range of FA activities.

Recommendations

2.27 The Panel recommends that insurance broking firms providing the full range of FA services be required to meet requirements on compliance, management expertise and financial soundness, similar to those imposed on LFAs. Otherwise, the FA activities of these firms should be restricted to:

(a) Group life insurance policies; or

(b) Incidental individual life policies arranged for the owners/directors/staff of their corporate customers for whom they are already servicing in respect of their general insurance or group life insurance policies.

2.28 In addition, the Panel recommends that the gross revenue from (a) and (b) in paragraph 2.27 should not exceed 25% of the insurance broking firm's annual total revenue, and the brokerage income derived from (b) should not exceed S$200,000 per annum.

3 THRUST THREE: MAKING FINANCIAL ADVISING A DEDICATED SERVICE

3.1 Currently, about 20% of FA representatives engage in economic activities other than financial advising. The non-FA activities conducted by FA representatives pose three key risks to the FA profession. First, some of these activities may be in conflict with their role as an FA representative. For example, an FA representative may concurrently be a moneylender. In such a situation, the representative may be incentivised to advise his customer to borrow excessively to invest. Second, some activities may bring disrepute to the profession. Third, a representative holding multiple jobs may not be able to focus fully on his FA role, thereby undermining the quality of advice and service to his customers.

3.2 It is also common for FA firms to engage third parties such as lawyers and real estate agents to introduce customers to them. This will broaden the catchment area for FA services and help promulgate financial planning. However, employing the services of such introducers can result in risks that are similar to those described in paragraph 3.1.

3.3 In addition, it may not be clear to customers whether they are dealing with an 'introducer' or an 'FA firm'. If the introducer is also an FA firm and provides customers with product information while effecting an introduction, customers may perceive the provision of information as financial advice. This problem is exacerbated by volume-based fee structures, where introducers are rewarded based on the number of successful introductions, or based on a percentage of the customer's premiums or investment amounts arising from the successful introductions. Such fee structures are common, and may push introducers to cross the line from 'introducing' to 'advising' so as to increase their remuneration.

Recommendations

3.4 The Panel recognises that individual situations differ. Instead of MAS prescribing the type of non-FA activities that representatives are allowed to engage in, or who can act as an introducer, FA firms should take responsibility for assessing individual situations and ensuring that the risks explained in paragraphs 3.1 to 3.3 are addressed.

3.5 To ensure that FA representatives maintain a high level of professionalism and competence in conducting business with customers, the Panel recommends the following:

(a) FA firms should only recruit representatives whose professional focus is primarily on their FA role;

(b) Where FA representatives are involved in non-FA activities, FA firms should assess and be satisfied that these non-FA activities:

(i) do not conflict with their business,

(ii) do not tarnish their image or that of the FA industry, and

(iii) will not cause the representatives to neglect their FA role; and

(c) Prior to appointing individuals who have other gainful employment as FA representatives, FA firms should ensure that these individuals have obtained their other employers' approval to be appointed as FA representatives. For existing representatives, FA firms should ensure that these representatives have disclosed their FA representative status to their other employers.

3.6 The Panel also identified the following examples of non-FA activities that clearly do not fulfil the criteria set out in paragraph 3.5(b):

(a) moneylending;

(b) promoting junkets for casinos;

(c) selling real estate; and

(d) marketing financial products that are not regulated under the FAA.

3.7 For better accountability over the quality and conduct of introducers, the Panel recommends that MAS:

(a) Require FA firms to implement measures to ensure that:

(i) no conflicts of interest arise from the appointment of introducers; and

(ii) the appointment of introducers will not tarnish the image of the FA firms or FA industry;

(b) Prohibit fee structures for introducers which are tied to successful introductions, or the volume of sales and/or transactions. Examples of acceptable remuneration structures include a fixed fee per introduction (regardless of whether the introductions are successful), or a flat fee for a specified time period;

(c) Disallow introducers from providing product information to customers;

(d) Prohibit FA firms from acting as introducers on investment products for which they are permitted to provide advice. For example, an FA firm which is permitted to advise on life insurance policies would be deemed to be ‘advising’ and not ‘introducing’, if it refers customers to another FA firm in respect of life insurance policies; and

(e) Require introducers to make the following written disclosures to customers:

(i) that the introducer is carrying out introducing activities for the FA firm;

(ii) that the introducer cannot give and has not given advice on the product that is provided or sold by the FA firms to customers;

(iii) whether there are potential conflicts of interest arising from the introducing activity, such as whether the introducer, its directors and/or shareholders have any direct or indirect stake in the FA firm, or whether the introducer has any relationship with the FA firm or any of its representatives; and

(iv) the amount and basis of remuneration received by the introducer for carrying out the introducing activity.

4 THRUST FOUR: LOWERING DISTRIBUTION COSTS

I. BACKGROUND

4.1 Distribution costs are paid by product manufacturers to distributors for their sales efforts and for servicing customers. Distributors, in turn, pay the commissions and production bonuses of their FA representatives, their supervisors and managers, and any other benefits and allowances that such persons may be entitled to. Distribution costs, whether explicitly set out as front-load fees of CIS or implicitly embedded in the costs of products as in the case of most insurance products, are ultimately borne by consumers.

4.2 With the assistance of PricewaterhouseCoopers LLP, the Panel conducted a comparative study of distribution costs across different jurisdictions. The findings were mixed. In general, distribution costs for plain investment products like CIS and securities are competitive in Singapore. However, distribution costs for life insurance products tend to be higher in Singapore as compared to other jurisdictions such as the United States, Italy and Germany. More complex investment products like structured notes and structured deposits cannot be easily compared. The Panel suggests that MAS study these areas further.

4.3 Two factors may have contributed to the more competitive pricing for plain investment products. First, it is easier for customers to compare prices across plain investment products. Life insurance products tend to have many features and variations that may obfuscate comparison. Second, there is more price competition across the distribution channels for CIS and securities. The same CIS may incur a different distribution cost depending on whether it is sold through a bank, an LFA or an electronic platform. By giving customers a choice of channels, competitive forces help determine the pricing in each channel. In comparison, the life insurance market is more complicated. Whilst life insurance products are sold through multiple channels, a common price is usually set for each product across all channels. As such, price competition in the life insurance market may be inhibited.

4.4 The Panel considered capping or abolishing commissions as a way to reduce costs of life insurance products to consumers. Whilst these approaches may have their merits, the Panel is mindful of possible unintended consequences. Jurisdictions that employ commission caps, such as New York and Malaysia, have observed price rigidity, as commissions gravitate to and remain at the caps. Singapore experienced the same before caps on commissions were removed in 2002. After the caps were removed, distribution costs for products such as whole life policies, trended lower. Commissions for whole life policies are approximately 130% (of average annual premiums) today, lower than the 160% commission cap that was in place prior to 2002. An even more radical idea is to abolish commissions entirely and move to a 'fee-only' model. While the United Kingdom and Australia have adopted this model, it may be premature to impose a 'fee-only' model in the Singapore market. From a survey conducted by MAS, 80% of the respondents indicated that they would not pay a fee for financial advice. Thus, a 'fee-only' model may result in more Singaporeans being under-advised or under-insured. It is also not clear that fees will be lower than commissions. Indeed, it is possible that consumers may end up paying more.

4.5 The Panel is of the view that prices set by competitive market forces are more optimal than those artificially imposed through administrative measures. To this end, the Panel believes that the lessons on comparability and cross-channel price competition in the CIS market can be applied to the life insurance market. These are discussed in the following sections. The Panel has also made recommendations with a view to enhance transparency in the sale of investment and life insurance products.

II. COMPARABILITY OF PRODUCTS

4.6 Currently, consumers can compare the key features of CIS offered in Singapore via product comparison portals available on investment platforms and websites. There is no similar portal for comparing life insurance and critical illness insurance products.

Recommendations

4.7 To enable consumers to compare life insurance and critical illness insurance products and to foster greater competition in the life insurance market in Singapore, the Panel recommends that LIA work with MAS to design and develop a web aggregator for life insurance and critical illness insurance products, with certain key features, for example:

(a) The ability to generate a list of life insurance and critical illness insurance products from different life insurance companies based on the personal information of consumers (such as their age, gender and smoker status), and their desired product features (such as sum assured, benefits, and duration of the policy);

(b) Comparison of the key features and benefits of insurance products, including annual premiums, guaranteed benefits, number of years for the policy to break even, risks and limitations, historical annual investment returns and expense ratios of participating funds and other features such as credit ratings of life insurance companies; and

(c) Tools for consumers to calculate the affordability of premiums and adequacy of insurance coverage.

4.8 The Panel recognises that implementing a comprehensive web aggregator for all life insurance and critical illness insurance products is a complex undertaking. Hence, the Panel suggests that MAS and LIA consider developing the web aggregator in phases, starting with a set of simpler products.

III. ACCESSIBILITY OF PRODUCTS

4.9 Currently, most consumers only purchase life insurance products after being approached by FA representatives instead of initiating these purchases on their own. Most FA representatives are remunerated for the sale of products, in the form of commissions which are included in the premiums paid by consumers. The Panel recognises that the current commission-based remuneration structure motivates FA firms and their representatives to seek out consumers who could benefit from FA services, and caters to the needs of passive consumers for whom "insurance is sold, and not bought".

4.10 The Panel notes, however, that the current commission-based model does not provide other consumer segments, including consumers who are self-directed or who may wish to pay a fee for independent financial advice, the option of buying life insurance products directly from life insurance companies without incurring commissions.

Recommendations

4.11 The Panel recommends that in addition to the current commission-based channel, life insurance companies catering to the retail market[7] should make available 'basic insurance' products to meet the primary protection needs of most Singaporeans. These products should be sold through a direct channel (i.e. sold directly by the life insurance

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[7] This excludes the Defined Market Segment insurance companies which serve specialised life insurance segments.

companies) without financial advice and at nominal administration charges. In addition to catering to consumer groups mentioned in paragraph 4.10, it will introduce greater price competition between the direct and commission-based channels.

4.12 For a start, the 'basic insurance' products could include term life, whole life (excluding investment-linked policies) and standalone critical illness insurance products. Term life and whole life 'basic insurance' products could include total permanent disability and critical illness benefits. Such 'basic insurance' products should have standardised features and benefits (including standard definitions for total permanent disability and critical illness benefits), which are simple for consumers to understand and compare.

4.13 To mitigate the risk of 'mis-buying', the Panel recommends that life insurance companies assign an FA representative or a customer service staff to perform the following roles as safeguards:

(a) Provide the customer with basic information on the policy terms, warnings and disclaimers in relation to the product;

(b) Ensure that the customer has checked whether he can afford the product and whether the insurance coverage is adequate to meet his needs; and

(c) Assist the customer to make the necessary declarations, including pre-existing medical conditions.

4.14 The Panel holds the view that it is possible for the current distribution model in Singapore to co-exist with the proposed direct channel for 'basic insurance' products. Consumers, particularly those who are self-directed or who do not require financial advice, now have a choice to purchase an insurance product directly from the life insurance company rather than through a tied agency, a bank or an LFA. However, consumers who prefer customised 'non-basic insurance' products or who need help in financial planning can still approach an FA representative for advice. This will help to ensure that Singaporeans can acquire adequate insurance coverage.

IV. TRANSPARENCY OF PRODUCTS

4.15 Consumers need clear and adequate information on investment and life insurance products to make informed financial decisions. The Panel notes that the format and content of existing disclosures for these products can be further improved, to make it simpler and easier for consumers to read and understand.

4.16 For investment and insurance products that are bundled, the Panel is of the view that it is important for consumers to be made aware of the different features (such as protection, savings or investment) that make up these products. Such bundled products include whole life insurance policies and endowment plans.

Recommendations

4.17 To enhance the quality and relevance of information provided to consumers and enable them to make better informed decisions, the Panel recommends that:

(a) For CIS, fund managers disclose the trailer fees[8] paid to FA firms in the Product Highlights Sheet. This would facilitate easy comparison by consumers of trailer fees paid to different FA firms. Currently, there is no standard practice for the disclosure of trailer fees;

(b) For participating life insurance products, life insurance companies disclose the management, distribution and other expenses as a combined total expense ratio, averaged over three years in the Product Summary. This is important information for participating policyholders as these expenses borne by the participating fund will affect the returns on their policies. Currently, the investment expense ratio is disclosed in the Product Summary;

(c) When recommending bundled life insurance products, FA representatives disclose to consumers:

    (i) an alternative option of purchasing an unbundled term life insurance product (with similar coverage) and placing the premium savings (of an amount equal to the difference between the premiums for the bundled life insurance product and the comparable term life insurance product) in a fixed deposit. This should be disclosed in a standard template to be prescribed by MAS; and

    (ii) the salient features[9] of the bundled life insurance product vis-à-vis a term life insurance product.

    The proposed disclosure in (i) would alert consumers to the option of purchasing term insurance, especially if their primary reason for purchasing

[8] Currently, the subscription fees, which are what the distributor earns from the sale of CIS, are required to be disclosed in the Product Highlights Sheet.

[9] For term life insurance products, the death benefit is the basic sum assured. For whole life insurance products, policyholders may receive bonuses, which are non-guaranteed. As such, the death benefit for whole life insurance products may be more than the basic sum assured.

the life insurance product is to meet protection needs. The proposed disclosure in (ii) would highlight to consumers the key differences between bundled life insurance and term insurance products;

(d) For life insurance policies, life insurance companies add a cover page to the Benefit Illustration and Product Summary to prominently disclose the following pertinent information to consumers:

- (i) total distribution costs of the life insurance product and the number of years for which distribution costs are to be paid;
- (ii) illustrative rates of returns of the product (including a warning that illustrated rates of return are not guaranteed);
- (iii) a warning that if the customer surrenders his policy before a certain year, the amount he receives (based on the guaranteed return) will be lower than the premiums paid;
- (iv) average expense (management, distribution and other expenses) ratio of the participating fund over the last three years;
- (v) 14-day free-look period; and
- (vi) website address of the web aggregator; and

(e) Customers sign on the cover page of the Benefit Illustration and Product Summary acknowledging that they have read and understood the Benefit Illustration and Product Summary, including the information highlighted on the cover page, to alert them that these documents are important and draw their attention to the contents.

5 THRUST FIVE: PROMOTING A CULTURE OF FAIR DEALING

I. BACKGROUND

5.1 MAS issued the Guidelines on Fair Dealing – Board and Senior Management Responsibilities for Delivering Fair Dealing Outcomes to Customers, setting out five fair dealing outcomes, on 3 April 2009. Whilst most FA firms claim to have adopted fair dealing principles in their business dealings with consumers, they may not be enforced in practice. A mystery shopping exercise conducted by MAS at the end of 2011 found that one-third of the FA representatives who were surveyed gave "clearly unsuitable" advice to the mystery shoppers. Other key findings of the exercise included the failure to conduct comprehensive fact-finds, and inadequate disclosures made to customers.

5.2 The Panel believes that the most effective approach to shaping behaviour is through the remuneration of FA representatives, focussing management attention on fair dealing and getting industry associations involved.

II. COMMISSION PAYOUT STRUCTURE OF REGULAR PREMIUM LIFE INSURANCE PRODUCTS

5.3 The distribution costs of CIS are quite evenly spread, with a front-end sales charge of 3% to 5.5% of assets under management (AUM) in the first year and a trailer fee of 0.1% to 0.9% of AUM per annum for the subsequent years. In comparison, distribution costs of regular premium life insurance products are typically heavily front-loaded, with about 49% to 55% of the total commissions paid in the first year. Over the long term, this creates a misalignment of interests between FA representatives and their customers.

Recommendations

5.4 To better align the interests of FA firms and representatives with that of their customers, the Panel recommends spreading commission payouts for regular premium life insurance policies more evenly as follows:

(a) For regular premium life insurance policies with tenure of six years or longer, commissions should be paid over a minimum period of six years; and

(b) For policies with tenure of less than six years, commissions should be paid over the duration of the policies.

5.5 The Panel also recommends imposing a 40% cap on the total commissions (including any overriding commissions) payable to the FA firm and its representatives in the first year of any regular premium life insurance policy, and for the remaining commissions to be distributed evenly over the subsequent years during which commissions are to be paid. Capping total commissions at 40% would lower the first year's distribution costs, thereby allowing life insurance companies to increase the surrender value of the policy in the initial years.

5.6 The Panel is cognisant that the proposed re-distribution of commissions from the first year to subsequent years, as well as the 40% cap in the first year, will have an impact on the income of FA representatives in the initial years of implementation. In this regard, the Panel recommends adopting a two-year phased-in approach to ease the transition for the industry. In the first year of implementation, the commissions to be paid out in the first year of the policy could be capped at 50% of total commissions, followed by 40% in the second year of implementation. The Panel also encourages FA firms to explore other measures to minimise the impact of the proposed change on the income of FA representatives, especially for new entrants. Some examples of possible measures include providing a training allowance for new entrants, introducing a base pay for FA representatives, or re-distributing the ratio of the commissions paid to the FA representatives and their supervisors and managers in the first year.

III. BALANCED SCORECARD FRAMEWORK FOR REMUNERATION OF FA REPRESENTATIVES

5.7 Currently, representatives of FA firms are largely remunerated for their sales performance, with about 75% of FA representatives being remunerated mostly or entirely based on their sales volume. Similarly, the supervisors and managers of these FA representatives are rewarded mainly for the sales performance of their representatives. The Panel notes that whilst some FA firms have introduced non-sales key performance indicators (KPIs) in determining the remuneration of their representatives, there are wide variations in the type of non-sales KPIs used by FA firms. Many of these KPIs measure service standards and quality of processes, rather than the suitability of recommendations provided to customers.

5.8 The Panel feels that an incentive structure that relies primarily on sales volume may incentivise FA representatives to push sales with little or no regard for the suitability of products for their customers. However, the Panel also recognises that a total ban on remuneration based on sales volume may inadvertently exacerbate the lack of financial and protection planning by consumers, as FA representatives may not be motivated to seek out consumers who could benefit from FA services.

Recommendations

5.9 For better alignment of interests between FA representatives and their customers, the Panel recommends that all FA firms adopt a balanced scorecard framework for remunerating their representatives, as well as the supervisors and managers of these representatives, and for MAS to prescribe minimum standards on the following:

(a) Types of non-sales KPIs to be incorporated;

(b) Methods for measuring the non-sales KPIs; and

(c) Weights to be assigned to each non-sales KPI.

5.10 The Panel recommends that MAS work with the industry to incorporate the following key points in the remuneration structure for FA representatives, as well as their supervisors and managers:

(a) Non-sales KPIs should measure the quality of the advisory and sales process and suitability of recommendations, as opposed to emphasising on service standards;

(b) Measurement of non-sales KPIs should be conducted by a party that is independent from the FA business unit, and not carried out solely by the supervisors and managers of the FA representatives. This is because supervisors and managers may be conflicted as their remuneration tends to be correlated with the sales performance of the FA representatives under their supervision;

(c) Weights assigned to non-sales KPIs should reflect the primary role of FA representatives in providing customers with good quality advice and suitable recommendations, rather than driving up sales volume; and

(d) Where FA representatives fail to meet the non-sales KPIs, their supervisors and managers should incur heavier penalties in the form of larger deductions from their remuneration. This is to take into account the fact that supervisors and managers have an important role to play in supervising the provision of

FA services by their representatives. This principle will apply unless FA firms can clearly demonstrate that the failure of the FA representatives to meet non-sales KPIs is not due to poor supervisory oversight by their supervisors and managers.

IV. BANNING PRODUCT-SPECIFIC INCENTIVES

5.11 It is common for FA representatives to receive incentives for the successful sale of specific products. These incentives can be in the form of cash or non-cash benefits (such as overseas trips, hotel stays, prizes and vouchers) and are given over and above the typical commissions paid for the sale of such products. These product-specific incentives may encourage FA representatives to recommend products that pay them the highest total remuneration even though another product which pays them less remuneration may be cheaper or more appropriate for the customer. Such incentives could also encourage representatives to engage in improper switching of products, at the expense of their customers.

Recommendation

5.12 To minimise any potential conflicts of interest that may arise when product-specific incentives are offered to FA representatives, the Panel recommends banning payment of product-specific incentives to FA representatives that are:

(a) Tied to the sales volume of a specific investment or life insurance product; and

(b) Over and above the typical commissions paid for selling that investment or life insurance product.

V. STRENGTHENING ACCOUNTABILITY FOR FAIR DEALING

5.13 The Panel notes MAS' observation that whilst most FA firms have put in place fair dealing policies and processes to guide their interactions with customers, more needs to be done to forge a culture of fair dealing. Based on the fair dealing thematic inspections conducted in 2011, MAS noted that the Board and Senior Management of some FA firms could play a more pro-active role in promoting and strengthening a culture of fair dealing within their organisations.

Recommendation

5.14 The Board and Senior Management of FA firms play a pivotal role in inculcating a culture of dealing fairly with customers throughout the firm. As such, the Panel recommends incorporating the assessment of Board and Senior Management's efforts in promoting a culture of fair dealing within their organisations into MAS' risk assessments and regulatory reviews of FA firms.

VI. ENHANCING CONSISTENCY IN COMPLAINTS HANDLING AND RESOLUTION PROCESSES

5.15 It is important for FA firms to have robust systems to address customer complaints in an independent, prompt and effective manner. This provides assurance to customers that their concerns and feedback are dealt with fairly and professionally.

Recommendation

5.16 To ensure consistent minimum complaints handling and resolution (CHR) standards across FA firms, the Panel recommends that MAS consider strengthening regulatory requirements on FA firms in respect of their CHR processes. This could include requirements to ensure the independent and prompt resolution of complaints. For instance, the business unit resolving complaints should be independent of the unit against which the complaint is made. Further, an FA firm should set and publicly disclose a reasonable timeframe it expects to resolve most complaints.

VII. ACTIVE INVOLVEMENT OF INDUSTRY ASSOCIATIONS IN PROMOTING FAIR DEALING

5.17 Industry associations play an important role in setting standards of good practice for their members. Industry associations in the FA industry can contribute to promoting fair dealing in several ways, including conducting regular mystery shopping exercises, customer surveys and other studies to identify areas for improvement.

Recommendations

5.18 The Panel recommends that industry associations in the FA industry be involved in assessing and monitoring the implementation of fair dealing initiatives by their members. These could include:

- (a) Formulating a set of KPIs to measure achievement of the fair dealing outcomes;
- (b) Establishing monitoring mechanisms through customer surveys and mystery shopping exercises to measure progress in this area; and
- (c) Sharing the results of these assessments with the public and MAS on a regular basis.

Appendix

COMPOSITON OF THE PANEL

Chairman

- Mr Lee Chuan Teck, Assistant Managing Director (Capital Markets Group), Monetary Authority of Singapore

Panel Members

- Mr Esmond Choo, Chairman, Securities Association of Singapore
- Ms Genevieve Cua, Wealth Editor, The Business Times
- Mr David Gerald, President, Securities Investors Association (Singapore)
- Mr Lester Gray, Chairman, Investment Management Association of Singapore
- Mr Piyush Gupta, Chairman, The Association of Banks in Singapore
- Ms Aurill Kam, Deputy Chief Counsel (Litigation), Attorney-General's Chambers
- Professor Francis Koh, Deputy Dean, Lee Kong Chian School of Business, Singapore Management University
- Mr Kuo How Nam, President, Credit Counselling Singapore
- Mr Augustine Lee, President, Association of Financial Advisers
- Mr Ong Ye Kung, Director (Group Strategy & Development), Keppel Corporation Limited
- Mr Seah Seng Choon, Executive Director, Consumers Association of Singapore
- Mr Tan Hak Leh, President, Life Insurance Association, Singapore
- Mr Yee Ping Yi, Chief Executive Officer, Central Provident Fund Board