national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

RESPONSE TO KEY ISSUES

Response to key issues raised in public comments on the draft Regulations under the Long-term Insurance Act, 1998 and Short-term Insurance Act, 1998 published in December 2016 for public comment

2017

This document must be read in conjunction with the following documents published together with the final Regulations:

- Responses to comments on Long-term Insurance Act, 1998: Proposed amendment of Regulations made under section 72
- Responses to comments on Short-term Insurance Act, 1998: Proposed amendment of Regulations made under section 70

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1. BACKGROUND AND PROCESS

On 23 December 2016, National Treasury (NT) with the support of the Financial Services Board (FSB) published for public comment the proposed amendments to the Regulations made under the Long-term Insurance Act, 1998 ("LTI Act") and the Short-term Insurance Act, 1998 ("STI Act") ("draft Regulations") to give effect to a number of conduct of business reforms. These include reforms mooted in the Retail Distribution Review ("RDR"), specifically the Status Update: RDR Phase 1 published on 10 November 2015, and the draft amendments to the Binder Regulations published on 11 July 2014 for public comment until 1 September 2014, the finalisation of which was deferred until the publication of the detailed RDR Phase 1 proposals.

During the course of February 2017, the NT with the support of the FSB hosted industry workshops with the purpose of positioning the changes proposed in the draft Regulations. The due date for submission of comments was 22 February 2017 but an extension was granted to a number of commentators to 22 March 2017.

A total of 40 commentators provided feedback on the draft Regulations through the formal consultation process. The NT in conjunction with the FSB undertook a comprehensive review of all comments received.

Most comments focused on the proposed introduction of binder fee caps for financial advisers. During May and June 2017 the FSB engaged with the commentators that had made the most detailed submissions (South African Insurance Association (SAIA), Association for Savings and Investment South Africa (ASISA), Financial Intermediaries Association (FIA) and South African Underwriters Association (SAUMA)). These engagements were aimed at better understanding their comments and at making an informed decision on what would constitute reasonable and commensurate remuneration for the performance of binder functions and related activities, so as to mitigate any risk of the remuneration potentially resulting in conflicted advice.

Subsequently the FSB, with the endorsement of the NT, invited all commentators to attend a workshop on 21 July 2017 with the purpose of presenting and discussing the revised position on the proposed Regulations.

After the workshop, on 24 July 2017, revised proposals were circulated to all commentators for comment. Subsequently the FSB submitted its formal inputs on the draft Regulations, as informed by these engagements, to the NT.

Following the above process the NT made several changes to the draft Regulations. These changes were based on the comments received through the formal consultation process, further technical and non-technical inputs received from the main commentators and industry participants and the FSB's formal inputs. The purpose of this document is to explain the most significant changes that were made to the draft Regulations, to provide reasons why certain changes requested by commentators have not been made, and to position the rationale that informed the final Regulations.

2. RESPONSE TO KEY ISSUES

2.1 Definition of "services as intermediary"

To ensure a consistent approach is adopted when interpreting the LTI Act and STI Act, it was initially deemed prudent to align the definitions of "services as intermediary" across the Regulations made under the LTI Act and STI Act through the draft Regulations. These proposed amendments elicited a number of comments, amongst other things that the draft STI Act Regulations extended the definition of services as intermediary to include administrative services which, according to some commentators, did not previously fall within the definition.[1] Services as an intermediary are compensated by commission which is capped in law. It was argued by industry that administrative functions that are outsourced by an insurer to an intermediary currently constitute outsourced services and not intermediary services, and therefore the proposed definition would considerably increase the functions which an intermediary is required to perform without any corresponding compensation (over and above regulated commission) for services rendered.

Having considered all comments received and concerns raised, the decision was taken that the definition of "services as intermediary" under both the LTI Act and STI Act Regulations should not be aligned at this stage[2] pending further activity segmentation work to be done during later RDR phases to ensure that a comprehensive and holistic approach to remuneration is adopted.

However, the NT and FSB remain of the view that the existing definition of "services as intermediary" in both the STI Act[3] and LTI Act Regulations is broad and, provided all other elements of the definition are satisfied, includes both administrative type services and the provision of advice.

2.2 Definition of "representative"

LTI Act Regulations

The draft Regulations proposed an amendment to the definition of "representative" in the LTI Act Regulations to give effect to Proposal V of RDR. The current mechanism whereby insurers enter into arrangements to allow their representatives to provide services on one another's policies (enabled by the existing definition of "representative") is one of the key regulatory mechanisms underpinning "hybrid" advice models. These hybrid models result in distribution models that undermine the customer's ability to appreciate the capacity in which advice is provided and any potential conflicts of interest. It also creates an un-level playing field between representatives and independent intermediaries as the current

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[1] Specifically under the STI Act Regulations.

[2] Therefore, no amendment to the definition of "services as intermediary" is reflected in the final Regulations.

[3] As communicated in Note 1 under Part IV to the Explanatory document supporting the December 2016 consultation on the amendments to the Regulation, the Financial Services Laws General Amendment Act, 2013 repealed the definitions of "services as intermediary", "representative" and "independent intermediary" in the STI Act, but the repeal has not yet been made effective. The repeal will be made effective on the effective date of the amendments to the final Regulations. The current aforementioned definitions in the STI Act will therefore be repealed from the STI Act and be moved into the Regulations.

definition of "representative" allows a representative to potentially market as broad a range of long-term policies as an independent intermediary is able to market, but without the remuneration restrictions applicable to an independent intermediary. Amendment of the definition as proposed is a critical step to address the current harms being created by such distribution models and to level out the playing field between representatives and independent intermediaries.

Some commentators claimed that the proposed change to the definition of "representative" is premature in light of other pending RDR proposals, and that any limitations in the agent model be deferred until the full adviser categorisation model proposed under RDR is finalised. The concern was raised that because the impact of the final adviser categorisation model is not yet fully understood, the decision to become an independent intermediary (Registered Financial Adviser in the future model) is less viable.

The concern was considered but we retain the view that the amendment to the definition is consistent with the proposed broader two-tier adviser categorisation model to be implemented at a later stage of the RDR rollout. The proposed amendment is also fully consistent with the underlying rationale of drawing a clear distinction between tied and non-tied advice models. The fact that the final model may refine and expand elements of adviser categorisation (such as introducing new terminology and extending the principles to other industry sectors) is no reason to delay implementation of this component of the final model.

A further concern that was raised is that the classes of insurance business under the LTI Act are limited and the revised definition of "representative" will therefore not provide room for any meaningful "gap filling". More particularly, the definition in the draft Regulations does not allow for any possible future exceptions (some of which have been mooted as possibilities under the RDR proposals) to the strict limitations on the products that representatives may market. We acknowledge that this is a valid concern and that an "exception mechanism" must be provided for. For this reason the proposed amendment of the definition of "representative" has further been amended to provide that the Registrar can determine certain classes of insurance policies in respect of which representatives may be permitted to render services as intermediary.

It must also be noted that the amended definition itself provides for transitional arrangements. Representatives will be able to continue rendering services in respect of existing policies entered into through such arrangements.

STI Act Regulations

The Regulations under the STI Act currently define a "representative" as a natural person employed by or working for a short-term insurer for the purpose of rendering services as intermediary in relation to short-term policies entered into or to be entered into by the short-term insurer only. This definition differs from the existing definition contained in the LTI Act Regulations in that it does not provide for any "gap filling", and it does not enable a juristic person to be a representative.

Very limited amendments to the definition were proposed but various commentators nonetheless requested that the definition be expanded to include juristic persons. It was submitted that the engagement of juristic persons as representatives does not create conflicts of interest that cannot be mitigated and does not compromise the fair treatment of customers.

Although expanding the definition to include juristic representatives is currently being considered, we are of the opinion that it will be premature to expand the definition at this stage until further analysis of the effect of expanding the definition can be undertaken and the effect of such expansion is better understood. For this reason a decision on the inclusion of juristic representatives is deferred until later stages of the RDR implementation. The definition of "representative" in the STI Act Regulations will therefore revert to the current definition contained in the STI Act.[4]

2.3 Equivalence of reward (LTI Act Regulations)

The existing definition of "representative" refers to the equivalence of reward principle. The draft Regulations removed this principle from the definition and inserted a substantive requirement on equivalence of reward in the body of the Regulations (draft Regulation 3.2(4A)). Regulation 3.2(5) which provided that the Registrar may determine that a person or an insurer is not complying with the principle of equivalence of reward was amended so that the Registrar may determine particular forms of remuneration or consideration as not complying with the principle of equivalence of reward. This approach ensures that non-compliance with the principle of equivalence of reward and related determinations will constitute a contravention of the Regulations, rather than the current situation where the only effect of non-compliance is that the intermediary concerned is no longer classified as a representative but as an independent intermediary.

Some commentators raised the concern that the draft Regulations do not define or explain what this principle entails. After considering the comments, the draft Regulations were further amended to expand on what the principle entails, in a similar manner to that in the existing definition of "representative". Therefore, essentially the principle of equivalence of reward must be interpreted and applied as it has always been interpreted and applied (in accordance with the existing requirement). As noted in the RDR proposals, the intention is for additional standards relating to equivalence of reward to be developed in due course.

2.4 Commission on credit life schemes (LTI Act Regulations)

The draft LTI Act Regulations propose that the commission cap of 22.5% for credit life schemes "with administrative work" is removed and that the 7.5% commission cap that applies to all other credit life schemes be applied so as to give effect to Proposal AAA of RDR. The rationale is that administrative work carried out by an intermediary, that falls outside the scope of commissionable services as intermediary, should be remunerated through other means (e.g. permissible outsourcing fees and/or binder fees, as appropriate) and that the higher level of commission at 22.5% is therefore unnecessary.

[4] See footnote 3.

Commentators raised concerns with the proposed amendment and stated that this will result in policies with low premiums generating very little commission at the proposed cap of 7.5%, which is inadequate for the work involved. It was submitted that the cap may need to be adjusted and that more work is required to establish what the appropriate commission rate should be for this sub-set of policies.

However, no substantiated information on why the standard 7.5% commission cap is inadequate for services as intermediary in relation to such schemes was provided, specifically considering that additional binder activities and outsourcing can be remunerated separately. For this reason the view is retained that the 22.5% commission cap is not required

To allow existing structures and agreements time to align to the new commission levels and to enter into alternative binder and/or outsourcing arrangements, the amendment removing the 22.5% commission cap will only become effective 12 months after the effective date of the final Regulations. It should also be noted that an insurer will have the opportunity to apply for an exemption to the binder fee cap, for example in the case of low premium business, in the circumstances contemplated in the Regulations.

2.5 Replacement of risk policies (LTI Act Regulations)

Regulation 3.9A in the draft LTI Act Regulations introduced a commission clawback requirement / prohibition on paying commission where the insurer could not confirm that the intermediary followed due procedure (as set out in the Policyholder Protection Rules) when replacing a policyholder's risk policy to give effect to Proposal OO of the RDR.

At the time of publishing the draft Regulations the definition of "replacement risk policy" cross-referenced to the draft Policyholder Protection Rules which defined "replacement". In turn, the draft Policyholder Protection Rules defined "replacement" by cross-referencing to the definition of "replacement" as defined in the General Code of Conduct for Financial Services Providers and their Representatives made under the Financial Advisory and Intermediary Services Act, 2002 ("General Code of Conduct"). Concurrent with the process to amend the Regulations and Policyholder Protection Rules, the General Code of Conduct was also in the process of being amended and would, amongst other things, introduce a draft definition for replacement. The intention with this approach was to ensure alignment of terminology used for replacements across the Regulations, Policyholder Protection Rules and the General Code of Conduct.

However, at the time of publishing of the draft Regulations and the draft Policyholder Protection Rules, the draft amendments to the General Code of Conduct has not yet been published. Comments received indicated that it is difficult to comment on the proposed Regulation lacking an understanding of what would constitute a "replacement" for purposes of the Regulations.

Subsequently, a draft definition of "replacement" was circulated to commentators and they were requested to use this definition when commenting on the draft Regulations. Limited comments were received on the proposal and only limited concerns were raised. The main concern raised was that it is impractical to require a managing executive of an insurer to provide the required confirmation.

All comments were considered and the final Regulations only refer to the confirmation required in respect of replacements as contemplated in the Policyholder Protection Rules.[5] The substance of the confirmation procedure will be addressed in the Policyholder Protection Rules.
The final Regulations provide for transitional arrangements for Regulation 3.9A. Insurers will be provided a 6 month period to ensure that they have all the necessary systems in place to comply with Regulation 3.9A.

2.6 Policy data administration services

The draft Regulations introduced and defined the concept of "policy data administration services". As discussed above, our view is that the definition of "services as intermediary" in the Regulations includes administration services (which would include policy data administration services) and that such services are subject to the maximum allowable limits for commission ("commission caps") contemplated in the Regulations. Recognising the amount of work that goes into policy data administration and the costs involved if such services are rendered in an efficient manner, the draft Regulations proposed to provide for additional remuneration over and above commission to be payable for such services if the services are done in a way that improves efficiency.

However, recognising that fees paid for policy data administration services ("PDAS") to non-mandated intermediaries that also provide financial advice ("NMI advisers") create an inherent conflict of interest similar to that created by binder fees, it was proposed to cap fees paid in respect of PDAS to NMI advisers. The fee cap for PDAS reflected in the draft Regulations was 2%. The cap was informed by the fact that policy data administration is operationally largely similar to the binder function of "entering into" a policy[6]. The fee cap for PDAS was therefore aligned with the proposed fee cap for the binder function of "entering to" (which was initially reflected as 2% in the draft Regulations).

Numerous comments were received in relation to the introduction of PDAS and the proposed fee caps for PDAS and diverging views were expressed on how such services must be classified.[7] The majority of commentators raised concerns with the proposed fee cap. They argued that the proposed 2% fee cap is too low, does not adhere to the principle of commensurate remuneration, was not informed by scientific evidence and is premature considering the current activity segmentation process which is being done as part of further technical work under RDR.

The NT remains of the view that the fee cap for PDAS should be similar to the fee cap applicable to the "entering into" binder function. However, in light of the diverging views on how PDAS should be classified, including the ambiguity of the extent to which

[5] i.e. all references to the "managing executive" having to sign-off on replacements have been removed from the Regulations.
[6] i.e. the function referred to in section 49A(1)(a) of the LTIA Act and section 48A(1)(a) of the STI Act.
[7] e.g. outsourcing versus services as intermediary.

administration type services fall within the definition of services as intermediary, it has been decided, at this stage, to maintain the *status quo* by not classifying PDAS and introducing a mechanism for fees for PDAS and to reconsider the introduction thereof as part of the Tranche 2[8] amendments to the Regulations - at which time the activity segmentation process which is being undertaken as part of further technical work under RDR will be at a more advanced stage.

2.7 Binder Regulations

Background

On 11 July 2014, the National Treasury published draft amendments to the Binder Regulations for public comment until 1 September 2014. Comments were received but the finalisation of the draft amendments was deferred to further incorporate proposals made under RDR Phase 1 affecting the Binder Regulations.

Proposals made under RDR, together with lessons from supervisory activities and recent insurer failures, informed further amendments to the draft Binder Regulations. The following positions informed the draft Regulations:

- The inconsistent interpretation and application of the general principle that outsourcing fees (including binder fees) must be reasonable and commensurate to the activity or function performed, has given rise to particular risks of conflict of interest where functions and activities are outsourced to financial advisers. In order to ensure consistency of application, mitigate conflicts of interest and promote fair customer outcomes, amongst other things, binder fees paid to NMI advisers will be capped.[9]

- NMI advisers are generally not specialist underwriters and typically do not have the necessary skills and expertise to perform full underwriting functions. Outsourcing these functions to NMI advisers therefore exposes insurers to inappropriate underwriting and reinsurance risk. For this reason it was initially proposed that the outsourcing of underwriting functions (contemplated in section 49A(1)(b) – (d) of the LTI Act and section 48A(1)(b) – (d) of the STI Act) to NMI advisers should be prohibited.

- Supervisory experience has shown that fee generation remains one of the primary motivations for the provision of binder mandates to NMI advisers, often at the expense of operational efficiencies. In addition, supervisory experience, findings of a thematic review of binder arrangements and recent insurer failures have shown that conduct standards for binder arrangements require significant strengthening. Of particular concern is the inadequate level of ongoing oversight exercised by insurers over binder holders as well as the poor quality of data being accessed by insurers

[8] On details of what the Tranche 2 amendments entail please refer to the Explanatory document supporting the December 2016 consultation on the draft Regulations.
[9] Also refer to paragraph 3.1.3 and 4.3.5 of the RDR document that was published in 2014 for more detail in this regard.

from binder holders.

- The desirability of short-term insurers entering into binder agreements with NMI advisers in respect of commercial lines business was questioned as the specialist skills required for most commercial covers, outsourcing core underwriting and / or benefit design to potentially conflicted financial advisers, introduces unnecessary underwriting and reinsurance risk. For this reason, it was initially proposed that the entering into of commercial binders with NMI advisers should be prohibited.

Binder fee caps and prohibition on NMI advisers taking on certain binder functions
In light of the above concerns, the draft Regulations introduced the following prohibitions applicable to NMI advisers performing binder functions:

- Binder functions contemplated in section 49A(1)(a) of the LTI Act/ section 48A(1)(a) of the STI Act ("entering into function") and section 49A(1)(e) of the LTI Act/ section 48A(1)(e) of the STI Act ("settling claims function") performed by NMI advisers will be capped at 2% per function.
- NMI advisers and/or an associate of an NMI adviser will be prohibited from performing the functions contemplated in section 49A(1)(b) – (d) of the LTI Act and section 48A(1)(b) – (d) of the STI Act ("underwriting functions");
- NMI advisers will be prohibited from performing binder functions in respect of commercial lines policies.

A significant amount of comment was received on these proposed amendments (please refer to the comment matrices in this regard) and commentators were generally not in support of the proposals.

Commentators questioned the fee cap level and it was put forward that it is unclear how the cap was determined and that the proposed cap is inappropriate and not viable. It was also questioned why the fee cap applies to NMI advisers but not NMI's that are not advisers. Various arguments were put forward that commercial binders should be allowed for NMI advisers and that NMI advisers should not be prohibited from performing the underwriting functions.

In light of the comments the FSB engaged with industry to better understand the comments and form an informed view on what would constitute reasonable and commensurate remuneration for the performance of binder functions and related activities so as to mitigate any risk of the remuneration potentially resulting in conflicted advice.

The intention was to give effect to the principle that, to mitigate the risk of conflicted advice, binder holders should not be remunerated substantially differently by different insurers for performing similar activities. The further engagements that took place with industry explored a solution that would achieve a common understanding across role players on what would constitute a "reasonable and commensurate" fee for specific binder and binder-related activities and detailed criteria that may be considered by the FSB when determining whether remuneration meets these principles.

The outcomes of the further engagements were considered in conjunction with information obtained by the FSB through Information Request 3 of 2016 (LT&ST&LL) (Binder functions and binder fees).

Following the further industry submissions, it is still believed that the introduction of caps on binder fees is necessary to mitigate the inherent conflicts of interest for binder holders who are NMI advisers. The approach is designed to ensure that an adviser will recommend an insurer, or product, based on the client's needs and not based on which insurer pays the highest binder fee. Based on the information received, the proposed binder fee caps for NMI advisers were revised as follows:

<table>
<tr><th colspan="2">BINDER FUNCTION</th><th>MAXIMUM FEE PAYABLE</th></tr>
<tr><td rowspan="3">Enter into, vary or renew a policy – section 49A(1)(a) ("function (a)")

Determine the wording of a policy - section 49A(1)(b) ("function (b)")

Determine premiums under a policy - section 49A(1)(c); ("function (c)")

Determine the value of policy benefits under a policy - section 49A(1)(d) ("function (d)")</td><td>Function (a) only</td><td>3.5%</td></tr>
<tr><td>Function (a) and one or more of functions (b) – (d)</td><td>5%</td></tr>
<tr><td>One or more of functions (b) – (d) only</td><td>0%</td></tr>
<tr><td colspan="2">Settle claims under a policy – section 49A(1)(e)</td><td>4%</td></tr>
</table>

The need to allow NMI advisers to perform "limited underwriting" functions was a strong recommendation from the industry comments and further engagements. "Limited underwriting" entails the NMI being provided with discretion to apply certain risk factors, underwriting criteria or a ratings methodology that has been pre-determined by the insurer. The outright prohibition on NMI advisers performing underwriting functions has therefore been removed. Instead, the risks concerned are to be dealt with through binder fee caps and increased governance requirements. The view is however retained that NMI advisers should not be acting as specialist underwriters, although their ability to apply limited underwriting is acknowledged. Limited underwriting, however, will only be applicable where an NMI adviser is also performing the "entering into" function. For this reason the fee cap table above only allows an NMI adviser to be remunerated for performing the underwriting functions if they are performed in conjunction with the entering into function (capped at 5% if both 'entering into' and underwriting functions are performed). NMI advisers are *de facto* prohibited from performing specialist underwriting functions – to the exclusion of the "entering into" function - through a 0% fee cap. According to the industry feedback received it appears as if the 0% fee cap for performing underwriting functions only will not have an impact on current business models as there are currently no stated examples of NMI advisers performing underwriting functions only (in other words, essentially all NMI advisers performing underwriting functions do so in conjunction with the "entering into" function).[10] Where only the "entering into" function is performed by an NMI adviser, the fee is capped at 3.5%. The fee cap for the claims settlement function is 4%.

To manage the impact on industry, the above requirements will be subject to a transitional period. The transitional period will be staggered to address the risk of binder functions proliferating between the publication of draft Regulations and the publication of the final Regulations with the intent of regulatory arbitrage. The fee cap requirements will be introduced in the following phases:

- Binder agreements entered into pre-1 January 2017: 12 months after the effective date
- Binder agreements entered into between 1 January 2017 – 1 January 2018: 6 months after the effective date
- Binder agreements entered into post-1 January 2018: Immediately

It is important to note that the general remuneration principles applicable to binder functions[11] remain applicable irrespective of the above caps. The above fees can therefore not become the default fees payable for binder functions rendered by a NMI adviser as the general remuneration principles entail that remuneration for binder fees must be reasonable and commensurate with the actual cost of performing the binder function (taking into account the nature of the function and the resources, skills and competencies reasonably required to perform it).

The final Regulations still provide an insurer with the opportunity to apply for exemption from the fee cap if the insurer is able to demonstrate that the general remuneration principles applicable to binder functions are met. Concerns were raised by industry that –

- the binder fee caps will not be appropriate in respect of low premium policies as the fee will be too low and not reasonable and commensurate to the actual cost of performing the binder function, and could therefore have undesirable consequences for the low income/premium market; and
- the binder fee cap should not apply to NMI's that are authorised for advice in terms of the FAIS Act, but to NMI's that actually provide advice in respect of the particular policies to which the binder functions relate (as that is the situation in which an inherent conflict of interest exists).

We believe that, in the instances above, the exemption mechanism can be utilised to justify the payment of a higher fee. Where the proposed cap is not reasonable and commensurate to the actual cost of performing the binder function due to the low value of the premiums, there could well be sufficient reason to justify a higher fee cap. Also, where the NMI which is authorised for advice will not be providing advice in respect of the policies for which it is performing binder functions, then it will be able to show that no conflict of interest exists and a higher fee can potentially be justified.

Governance, operational and oversight requirements

[10] Besides, an insurer can apply for exemption of there is an exemption to this general rule.
[11] See discussion under the following paragraph.

The draft Regulations introduced additional governance and oversight requirements with the purpose of mitigating the risk of -

- binder functions being outsourced by insurers in response to demands from NMI's to be provided with an additional income stream (which ultimately results in additional business to the insurer) instead of improving operational efficiencies;
- inadequate oversight exercised by insurers over binder holders; and
- poor quality of data being accessed by insurers from binder holders.

The additional governance requirements did not attract a significant amount of comment and were generally supported. However, the operational requirement relating to 24 hour data exchange did attract extensive comment, with commentators generally arguing that although they agree that this should be the future approach, the industry is not currently in a position to comply with this requirement and that it is a significant change from the current 90 day requirement.

The data exchange requirements were reconsidered, specifically in the light of the amendments applicable to binder fee caps discussed above and the removal of certain prohibitions. The requirements have been clarified and strengthened to further mitigate remaining risks.

To further enhance binder function governance, the Regulations now also provide that an insurer must not enter into a binder agreement unless the outsourcing of the binder function is intended to promote the delivery of fair outcomes to customers, would not result in a duplication of administrative efforts or costs for the insurer, and would not impede the insurer's ability to, on an ongoing basis, identify, assess, manage and report on the risks of poor customer outcomes potentially arising from the manner in which the insurer conducts its business. This requirement codifies good business practice and will reduce the risk of insurers outsourcing binder functions with the sole purpose of securing distribution as opposed to improving efficiency.

In addition to the above, the draft governance and oversight requirements that were contained in the draft Regulations have been amended to be clearer. Although the requirements are similar to what was proposed in the draft Regulations, the wording has been amended to be more explicit.

Also as part of the governance requirements, it is required that there must be integration between the information technology system of the insurer and the information technology system of the binder holder. This is an operational requirement which links in to the 24 hour data exchange requirement discussed above. The comments on the 24 hour data exchange requirement were considered, but the view is maintained that because data is a critical aspect – demonstrated by a recent failure of an insurer where data quality failings were a key contributory factor - the 24 hour data exchange provision will be retained.

However, acknowledging that the industry will have to change existing practices to meet this requirement, the effective date for integration and the 24 hour data exchange requirements has been deferred for 24 months.

Reporting

Further, to enable the regulator to have more detailed information on binder agreements and to monitor compliance with the binder regulations (including binder fee caps and general principles for determining remuneration) it was deemed necessary to insert a requirement that an insurer must, at least 30 days before entering into a binder agreement, notify the Registrar of the proposed binder agreement.

2.8 General principles for determining remuneration

The draft Regulations introduced general principles for determining remuneration which are applicable to, amongst other things, binder functions and services as intermediary.

Some commentators submitted that the principles are too vague and should be expanded on. We considered introducing criteria that support and elaborate on the application of the principles and engaged industry on the proposed criteria. Through these engagements industry raised several concerns with the proposed criteria and strongly objected to the fact that the general principles will apply to services as intermediary. The objections raised indicated amongst other things that the application of the general principles to services as intermediary/commission without an assessment of the impact that it will have on industry could have unintended negative consequences, particularly for small to medium adviser firms. Other commentators raised the concern that it is premature to apply such principles to services as intermediary pending the outcome of the activity segmentation process being undertaken as part of further technical work under RDR.

Taking into account the concerns raised, the more detailed criteria have been omitted from the Regulations and the general principles have been retained but made applicable to binder functions only. The general principles for remuneration that were proposed in the draft Regulations are largely aligned to the remuneration principles contained in Directive 159.A.i (LT&ST) ("Directive 159"), the latter applying to all forms of outsourcing. In the interim the general principles for determining remuneration that will be applicable to binder functions as introduced through the amendments to the Regulations will have to be applied concurrently with the general remuneration principles contained in Directive 159. In the Tranche 2 amendments, the general remuneration principles applicable to outsourcing will be transferred into the Regulations and Directive 159.A.i will be repealed.

There is still a real concern that, due to the existing ambiguities in the definition of services as intermediary as discussed above, divergent approaches are adopted in classifying certain activities and paying remuneration (commission vs outsourcing fees) for such activities. This could lead to inconsistency and the potential continuation or even exacerbation of inherent conflicts of interest leading to unfair outcomes for policyholders.

As a result, a requirement was inserted requiring an insurer to notify the Registrar of any proposed arrangement to pay remuneration to a NMI adviser for services other than binder functions and services as intermediary at least 30 days before the insurer enters into such arrangement. This will enable the Registrar to monitor the types of arrangements prevailing in the market and to intervene where a proposed arrangement is incorrectly classified (and remunerated) by an insurer.

2.9 Remuneration payable by policyholder to independent intermediary (STI Act Regulations)

The Financial Services Laws General Amendment Act, 2013 repealed section 8(5) of the STI Act, but the repeal has not yet been made effective. The intention was to provide a similar requirement to section 8(5) in the STI Act Regulations and to make the repeal of section 8(5) effective on the effective date of the final Regulations.

For this reason Part 5C in the draft Regulations provided requirements relating to remuneration payable by a policyholder to an independent intermediary, which was intended to substitute the current section 8(5) of the STI Act subject to certain additional safeguards. This approach would also give effect to Proposal UU of RDR (Remuneration for selling and servicing short-term insurance policies).

Several commentators appear to have misunderstood the intention of the proposed Part 5C and interpreted it as providing a mechanism to charge advice fees. As indicated previously, the definition of "services as intermediary" is sufficiently wide to include advice, specifically where such advice leads to the entering into of a policy. Part 5C did not purport to exclude advice from the ambit of the definition of "services as intermediary" in any way. It must be noted that the existing Commission Regulations provide that no consideration may be paid for rendering services as intermediary (to an independent intermediary in the case of the LTI Act Regulations) unless it is paid as commission in monetary form.[12] The Commission Regulations also provide that the commission payable for rendering services as intermediary may not exceed the prescribed maximum irrespective of how many persons render services as intermediary in relation to the policy.[13] Therefore, the current Regulations prohibit advice fees in addition to the maximum allowable commission. For the foreseeable future, advice will remain part of the definition of services as intermediary, and therefore subject to the commission caps, and separate remuneration for advice will only be accommodated in future phases of RDR.

For purposes of the final Regulations, however, the proposed Part 5C has been removed from the ambit of the Regulations. Instead, a largely similar provision will be inserted into the Policyholder Protection Rules. The revised requirement to be inserted into the Policyholder Protection Rules will place an obligation on insurers, in the case where they facilitate the deduction of an additional fee charged by intermediaries to policyholders for services (other than services as intermediary) rendered by intermediaries to policyholders, to ensure that the fee meets certain requirements. The reason for moving this requirement to the Policyholder Protection Rules was because the Regulations deal with remuneration arrangements between insurers and intermediaries, whereas fees paid by a policyholder to an intermediary constitute an arrangement between such parties, and the insurer is not a party to such agreement. Further, the requirement does not place a limitation on the insurer in respect of paying fees,[14] it merely places an obligation on the insurer to implement

[12] Regulation 5.1. The LTI Act Regulations has a similar provision.
[13] Regulation 5.2 and 5.3. The LTI Act Regulations has a similar provision.
[14] Such requirements are typically dealt with in the Regulations.

certain checks and balances aimed at policyholder protection when it takes the decision to facilitate the deduction of fees emanating from the agreement between the intermediary and the policyholder.

2.10 Part 4 – Limitation on provisions of certain policies (LTI Act Regulations)

The proposed amendments to Part 4 did not attract any significant comments. The comments received on the proposed amendments to Part 4 did however inform a few relatively minor changes that have been provided for in Part 4 of the final Regulations.

2.11 Part 5 – Causal events (LTI Act Regulations)

Limited comments were received on the proposed amendments to Part 5. The most significant comments received on this Part related to the definition of "universal whole of life policy" and the application of variable premium increases to universal whole of life policies. There was also a request that Part 5A provides for an administrative charge similar to Part 5B. The comments were considered and most of the comments have been accommodated in the final Regulations. The effective date for the changes in the maximum causal event charges remains 1 January 2018.

3. CLOSING

The final Regulations will become effective on 1 January 2018. National Treasury and the Financial Services Board would like to take this opportunity to thank all commentators and industry participants for the positive and collaborative approach adopted in formulating these Regulations.