
BOARD NOTICES • RAADSKENNISGEWINGS

BOARD NOTICE 181 OF 2017

REGULATIONS UNDER THE LONG-TERM INSURANCE ACT, 1998 (ACT NO. 52 OF 1998)

DRAFT DETERMINATION ON “EQUIVALENCE OF REWARD”

I, Caroline Dey da Silva, Deputy Registrar of Long-term Insurance, hereby, in terms of Regulation 3.2(5) of the Regulations made under section 72 of the Long-term Insurance Act, 1998 (Act No. 52 of 1998) as published under Government Notice R1492 in *Government Gazette* 19495 of 27 November 1998 and amended from time to time, give notice of the release, for public comment, of the draft determination in the Schedule that sets out when a person or long-term insurer would not be complying with the principle of “Equivalence of Reward” (“draft determination”).

Annexure A which accompanies the draft determination sets out the reasons for the draft determination. The draft determination together with Annexure A is available on the Financial Services Board's web site at <https://www.fsb.co.za>.

Comments on the draft determination must be submitted in writing on or before 11 December 2017 to the Financial Services Board c/o Jo-Ann Ferreira at FSB.INSDraftDeterminationEoR@FSB.co.za.



CD DA SILVA
DEPUTY REGISTRAR OF LONG-TERM INSURANCE

SCHEDULE

DETERMINATION IN TERMS OF REGULATION 3.2(5) OF THE REGULATIONS UNDER THE LONG-TERM INSURANCE ACT

1. Interpretation

In this determination, any word or expression to which a meaning has been assigned in the Long-term Insurance Act, 1998 (Act No. 52 of 1998) or in the Regulations shall have the meaning so assigned to it, and the following terms shall have the following meanings –

“ordinary remuneration” means any combination of -

- (a) a fixed recurring salary;
- (b) commission payable in monetary form that does not exceed the maximum commission that would have been payable to the representative if the representative had been an independent intermediary; and
- (c) standard benefits;

“Regulations” means the Regulations made under section 72 of the Long-term Insurance Act, 1998 (Act No. 52 of 1998) as published under Government Notice R1492 in *Government Gazette* 19495 of 27 November 1998 and amended from time to time;

“salary advance” means the payment of an intermediary's fixed monthly recurring salary, or a part thereof, within 31 days in advance of the normal contractual due date of that salary payment; and

“standard benefits” means forms of remuneration or consideration that are provided by the insurer on an ongoing basis and in a similar manner to all its representatives, or all representatives of a particular type, and include but are not limited to –

- (a) pension benefits;
- (b) medical scheme benefits;
- (c) leave benefits;
- (d) reimbursement of business travel expenses or business subsistence allowances based on a pre-determined tariff.

2. Remuneration or consideration not compliant with the principle of “Equivalence of Reward”

2.1. The Registrar hereby determines in terms of Regulation 3.2(5) that the following forms of remuneration or consideration provided by a long-term insurer or on behalf of a long-term insurer to the long-term insurer's representative for rendering services as intermediary, or any associate of such representative, do not comply with the principle of “Equivalence of Reward” -

- (a) any loan, advance, credit facility or similar arrangement (other than a salary advance) or any form of credit support, surety, guarantee or similar arrangement in relation to any debt incurred or to be incurred by a representative or any associate of a representative, on terms that are more favourable to the borrower than the terms the borrower can secure at arms' length from a licensed credit provider that is not an associate of the insurer;
- (b) any remuneration or consideration provided to a representative or an associate of a representative in exchange for the insurer or any other person being enabled to render services as intermediary in relation to policyholders of the insurer in respect of whom that representative had previously rendered such services, including but not limited to arrangements commonly described as "purchasing the representative's book of customers" or similar descriptions;
- (c) any remuneration or consideration not mentioned in (a) or (b) provided to a representative or an associate of a representative that, in aggregate, exceeds 15% of the representative's ordinary remuneration over a 12 month period. Without limitation, this includes the value of any bonuses or performance related awards, any travel, accommodation, or entertainment costs and any participation in share option schemes, profit share schemes or similar arrangements, but excludes standard benefits;
- (d) any arrangement that is substantially similar to, or structured to have a substantially similar effect to, any of the arrangements referred to in (a) to (c); and
- (e) any undertaking to pay any of the forms of remuneration or consideration referred to in (a) to (d) to a representative or an associate of a representative at any time in the future, whether contingent on the happening of a future event or not, and whether during the period that the intermediary agreement between the insurer and the representative is in effect or after the termination of such agreement.

3. Effective date and transitional arrangements

3.1 This determination takes effect on 1 January 2018.

ANNEXURE A - EXPLANATORY MEMO FOR DRAFT DETERMINATION ON "EQUIVALENCE OF REWARD"

1. Background and context

The current Part 3A of the Regulations under the Long-term Insurance Act, 1998 ("Part 3A") provides, in summary, that an independent intermediary as defined in Part 3A may only be remunerated for rendering services as intermediary in the form of commission in monetary form and, among other requirements, imposes maximum limits on the quantum of such commission. The limitation relating to commission in monetary form and the maximum caps do not apply directly to the remuneration of an insurer's "representative" as defined in Part 3A. Instead, Part 3A provides that a representative is appointed on conditions of employment or engagement by a long-term insurer complying with the principle of "Equivalence of Reward", in terms whereof the remuneration paid by an insurer, whether in cash or in kind, shall substantially be in accordance with the provisions of Part 3A.¹

The primary rationale for the requirement relating to the principle of equivalence of reward is to ensure that, while recognising that the contractual relationship between an insurer and its representatives² should allow for a degree of flexibility in remuneration arrangements, this should not result in representatives earning remuneration significantly in excess of the corresponding quantum of commission payable to an independent intermediary for rendering similar services. Put differently, the principle of equivalence of reward seeks to ensure a reasonably level playing field between the remuneration of representatives and independent intermediaries, to mitigate the risk that remuneration and consideration available to representatives creates opportunities for inappropriate regulatory arbitrage in favour of tied advice and distribution models.

Although Regulation 3.2(5) allows the Registrar of Long-term Insurance ("the Registrar") to determine that a person or long-term insurer is not complying with the principle of equivalence of reward, the Registrar has to date not issued such a determination. Notwithstanding, the FSB is, however, concerned about how and the extent to which the principle of equivalence of reward is or is not being applied in practice. The FSB's concerns in this regard are set out in more detail in our Retail Distribution Review (RDR), published in November 2014³. The RDR put forward the following proposal:

Proposal RR: Equivalence of reward to be reviewed:

Specific standards will be set to clarify and strengthen the principle of "equivalence of reward" as the basis on which long-term insurers may remunerate their tied advisers. These standards will include provisions:

¹ Note that the FSB and the National Treasury have recently consulted on amendments to Regulations. The proposed amended Part 3A substantively retains the above provisions. Whereas the current Part 3A applies the principle of equivalence of reward as part of the definition of "representative", the amended Part 3A includes a substantive provision prohibiting remuneration to representatives that is not consistent with the principle of equivalence of reward. Should the proposed amendments to the Regulations become effective, it would therefore not have any significant impact on the mooted Determination.

² These are typically employment relationships or similar agency mandates.

³ See page 55 of the RDR discussion document.

- *Confirming that the principle of equivalence applies at the level of each individual tied adviser.*
 - *Detailing the nature of remuneration and benefits to be taken into account in assessing equivalence. This will be based on a “total cost to company” approach, whereby all benefits payable to the adviser are taken into account in applying the principle – including commissions, fees, salary-based payments, allowances, medical and pension benefits, non-cash incentives, participation in conferences and events, share options, etc. So-called “sign-on bonuses” and all forms of production or other performance incentives or rewards, whether or not they are conditional or deferred, will also be included.*
 - *Providing for how to apply the principle of equivalence at appropriate time periods or across appropriate tranches of business, bearing in mind that the equivalent value of commission that would have been payable to a non-tied adviser can only be calculated with hindsight.*
 - *To clarify that the equivalence model relates to remuneration relating to life insurance risk benefits only (being the products in respect of which product supplier commission and fees remain payable), with remuneration relating to investment products being determined with reference only to the quantum of customer agreed advice fees paid. Any portion of a tied adviser’s “total cost to company” remuneration that is attributable to advice on or sale of investment products, may not in aggregate exceed the value of customer advice fees in fact paid by customers in respect of such products over an appropriate period.*
- The regulator will specifically monitor insurers’ application of equivalence of reward standards.*

In response to industry comments received in respect of the above proposal, the FSB subsequently confirmed that full implementation of RDR Proposal “RR” will be deferred until broader RDR proposals dealing with the future remuneration model for long-term insurance are closer to finality. The FSB did however highlight that, despite this deferral, we remain concerned that a number of current practices in relation to tied adviser remuneration give rise to inappropriate distortions in the advice market, posing risk of unintended levels of migration from independent to tied models. Accordingly, the FSB advised that, as an interim measure pending full implementation of Proposal RR, we intend to clarify certain practices that the Registrar regards as inconsistent with the principle of equivalence of reward, using mechanisms provided for in Part 3 of the Regulations to the Long-term Insurance Act, 1998⁴.

This draft determination is the outcome of the above process.

2. Key provisions of the determination

Against the background outlined above, the determination sets out which forms of remuneration or consideration the Registrar regards as not being substantially in accordance with the provisions of Part 3A of the Regulations to the Long-term Insurance Act, and accordingly as not being compliant with the principle of Equivalence of Reward.

The determination identifies two specific forms of remuneration or consideration that would enable an insurer to provide its representatives with potentially significant financial advantages that it is not able to provide to independent intermediaries.

⁴ See pages 33 to 36 of the *Status Update: Retail Distribution Review Phase 1*, published in November 2015 for further detail.

Accordingly, such arrangements are clearly not substantially aligned with the provisions of Part 3A and not in compliance with the principle of Equivalence of Reward. These arrangements are⁵:

- The provision to a representative of various forms of credit or access to credit on terms that are more favourable than those available on an arms' length basis; and
- Arrangements whereby an insurer in effect "buys the representative's book of business" from that representative when the representative's intermediary agreement with the insurer comes to an end. The policyholders making up such "book" are already customers of the insurer concerned by virtue of its agency relationship with the representative, and the insurer is already obliged to ensure appropriate ongoing service to such policyholders, regardless of whether or not the intermediary agreement with the representative remains in place. Accordingly, the rationale for the insurer remunerating the representative for, in effect, retaining access to its own customers is unclear.

In addition to addressing the above specific remuneration arrangements, the determination includes a more general limitation⁶ providing, in effect, that remuneration arrangements where more than 15% of a representative's overall remuneration comprises benefits that are not generally provided to all of the insurer's representatives (or all representatives of a particular type), do not comply with the principle of equivalence of reward. This provision is intended to address other remuneration arrangements (over and above those specifically identified above) through which insurers could provide benefits to selected representatives that it would not be permitted to offer to independent intermediaries. The provision also seeks to ensure a reasonable degree of equivalence with the requirement in Part 3A that an independent intermediary may only be remunerated through "commission in monetary form", while recognising that Part 3A contemplates that a representative may be remunerated "in cash or in kind". The provision seeks to clarify that, in order for remuneration "in kind" to be consistent with the principle of equivalence of reward, it should largely comprise benefits typically available to the insurer's representatives generally in the normal course of their employment / tied agency relationship with the insurer, rather than including a significant proportion of non-standard benefits that are available only to select representatives⁷.

The determination contains additional provisions confirming that non-compliance with the principle of equivalence of reward extends, in summary, to arrangements that⁸ –

- are substantially similar in effect to those identified in the determination; or
- entail an undertaking to provide the identified forms of remuneration or consideration in the future.

Lastly, the determination sets out the effective date of its application, including the extent to which it applies to arrangements entered into before the effective date.

⁵ See paragraphs 2.1(a) and (b) of the draft determination.

⁶ See paragraph 2.1(c) of the draft determination.

⁷ See the proposed definitions of "ordinary remuneration" and "standard benefits".

⁸ See paragraphs 2.1(d) and (e) of the draft determination.