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Recommendations of the Financial Advisory Industry Review Panel in Singapore

Milliman

The Financial Advisory Industry Review (FAIR) Panel ('the Panel') was established in April 2012, with the aim of conducting a comprehensive review of the Financial Advisory (FA) industry in Singapore (See **Milliman E-Alert dated March 30, 2012**). FAIR was conducted with the primary aims of enhancing the standards and professionalism of the FA industry and improving efficiency in the distribution of life insurance and investment products in Singapore.

Following deliberations lasting eight months, 28 recommendations were made by the FAIR Panel of 14 members drawn from industry, consumer bodies, the media and academia and chaired by the Monetary Authority of Singapore. The recommendations were summarised under the following five key headings.

1. Raising the competence of financial advisory representatives

The minimum entry requirement for new FA representatives (only) is to be enhanced from four GCE 'O' level passes to a full GCE 'A' level certificate, an International Baccalaureate (IB) or a diploma. The FAIR Panel estimated that approximately 80% of FA representatives already meet with the new requirement. Notwithstanding this, existing FA representatives not meeting the requirement will be permitted to continue to operate. Despite arguments against this move, the Panel felt that the new requirements were better suited to a future environment of more sophisticated products and more complex customer needs.

A requirement for 30 hours of Continuing Professional Development (CPD) per annum has also been introduced, of which eight have to be based on rules/regulations and four hours on ethics.

2. Raising the quality of financial advisory firms

The Panel has proposed raising the minimum working and managerial experience of Chief Executive Officers of Licensed FA firms (LFAs) to 10 years and five years respectively. The recommendations also include a requirement to employ at least three resident, full-time and experienced professionals to ensure sufficient experience and resources. The larger LFAs will need to have a dedicated compliance function.

Enhanced requirements are proposed on the minimum level of base capital, financial resources and professional indemnity insurance cover, according to the size of the LFA.

Consistent with comments made at the start of FAIR, the Panel proposes to restrict the types and scale of non-FA activities that LFAs may undertake. Furthermore, insurance broking firms are restricted in the scale of FA business they undertake unless they have demonstrated capacity to conduct the full range of FA activities.

3. Making financial advice a dedicated service

To ensure that FA representatives maintain a high level of professionalism, the Panel recommended FA firms to only recruit representatives whose professional focus is on their FA role. The Panel put forward a list of principles that FAs have to satisfy, with the aim of identifying and addressing conflicts of interest which may 'tarnish the image of the industry' and divert focus away from their FA role. Some specific roles are identified as being unsuitable, including money lending, promoting junkets for casinos, selling real estate and marketing investment products that are not regulated under the Financial Advisers Act (FAA).

Rules to restrict the acts of 'introducers' are also proposed, with a view to ensuring that there is no conflict of interest, to ban remuneration structures for introducers that are linked to sales volumes and to prohibit introducers providing customers with any product information. The Panel has also prohibited FA firms from acting as introducers to investment products which they provide advice on.

4. Lowering distribution costs

The Panel received evidence that while distribution costs for collective investment schemes and securities in Singapore were competitive compared to a sample of other jurisdictions, life insurance distribution costs tended to be higher. With the aim of lowering the distribution costs, the Panel considered and rejected the idea of imposing a hard cap on commissions, as well as replacing commission completely with fee-based advice. Reasons cited included that commission levels would likely migrate to the capped levels as evidenced by previous commission caps in operation in Singapore. This would require the cap to be set at the 'right' level. The Panel expressed concerns about the appetite of consumers to pay fees for advice and that it was not necessarily the case that fees would be lower than commissions.

The preference was to increase regulation that encourages competitive forces. To this end, the recommendations include a requirement for insurers to make certain basic products available through a direct channel. A web aggregator for consumers to compare life insurance and critical illness insurance products from different insurers will also be developed by the Life Insurance Association in conjunction with the Monetary Authority of Singapore (MAS).

In addition, the disclosure of trailer fees paid to FA firms should be included in the Product Highlights Sheet. Disclosure of the total expense ratio of the participating fund, averaged over three years should also be listed in the Product Summary.

For sales of bundled life insurance products, the Panel requires FA representatives to disclose an alternative option of purchasing a term product and placing the savings in a fixed deposit, with the features of a bundled product.

The Panel also recommended that insurers add a cover page to the Benefit Illustration and Product Summary, which should disclose the total distribution costs, relevant warnings, the average expenses ratio of the participating fund, the 14-day free-look period and the URL of the web aggregator.

5. Promoting a culture of fair dealing

The final series of recommendations addressed the need to develop a culture of fair dealing, which the Panel recognized cannot be addressed by rules alone.

A 'mystery shopping exercise' conducted by the MAS revealed that one third of FAs gave 'unsuitable advice' and, in order to address this situation, the Panel advised FA firms to ban product-specific incentives as these may bias their advice to clients. The Panel has also requested FA firms to adopt a balanced scorecard remuneration framework for FA representatives. Key performance indicators to measure a firm's achievement of fair dealing outcomes are recommended, with results being shared with the MAS and disclosed to the public.

After reviewing the commission payout structure, the Panel recommended imposing caps on the total commissions payable in the first year for life insurance products, and requiring the remaining commissions to be distributed evenly over the subsequent years.

In addition, the Panel proposed to incorporate fair dealing responsibilities of Board and Senior Management into MAS' risk assessments and regulatory reviews of FA firms. The Panel also recommended FA firms to maintain minimum standards in their complaints handling and resolution processes.

Conclusions

At the time that FAIR was launched there was much nervousness in the industry, particularly around the possible replacement of commissions with fee-based advice, with potentially huge ramifications for existing distribution models, and the agency model in particular. The industry reacted to this by setting out the possible adverse implications of such a move, with much lobbying of the Panel, both collectively and individually.

The end result is a series of recommendations which are primarily aimed at improving the quality of advice, which is hoped to increase the public awareness of insurance and what customers are buying. The agency channel will remain largely intact, with some changes in commission structure. The recommendations are going to perhaps have a greater impact on the 62 financial advisory firms, enhancing their compliance burden further.

Positive developments for consumers would appear to be the requirement for insurers to promote and develop direct insurance models and for the development of an industry web aggregator. Enhanced disclosure should also help consumers better understand the products they are buying.

Insurers that have smaller participating funds may be at a disadvantage when disclosing expense ratios, which may prompt some to look for alternative participating structures, such as unitised with profits products.

Overall FAIR provides some constructive changes to the industry, and will be seen as setting further benchmarks for the region. On the assumption that the recommendations are implemented, companies can expect the comfort that few other changes are likely in the next five years or so, which can be the expected timeline before the MAS seeks to carry out its next extensive review.

Contact details

If you have any questions about this e-Alert, please contact:

Richard Holloway
Managing Director South East Asia & India Life
180 Cecil Street, #10-01 Bangkok Bank Building
Singapore 069546
Office +65 6327 2301
Fax +65 6221 0642
Mobile +65 9732 0150
Email **richard.holloway@milliman.com**

Wen Yee Lee
Consulting Actuary
180 Cecil Street, #10-01 Bangkok Bank Building
Singapore 069546
Office +65 6327 2302
Fax +65 6221 0642
Mobile +65 9655 6829
Email **wenyee.lee@milliman.com**