

Ravi Menon: Financial advisory services – putting the customer first

Keynote address by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at the Life Insurance Association 50th Anniversary Gala Dinner, Singapore, 26 March 2012.

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LIA President, Mr Tan Hak Leh

Distinguished guests, ladies and gentlemen, good evening.

Role of life insurance and financial advisory services

Saving for the future, investing for returns, and protecting against risk – these are the fundamentals of managing our finances. Yet so few of us do it well. We are far better at earning an income than investing it and protecting against risk.

To make matters worse, many life insurance and investment products are often not easy to understand. Many people are not financially savvy. And many of those who are, do not have the time to review the range of insurance and investment products available, and understand what is best suited for their needs. This is where financial advisory service comes in. Financial advisers can help people identify their insurance and financial planning needs and recommend suitable products.

The roles of insurers and financial advisers are intimately intertwined. It must be so. Insurance protects dependants. Investments grow savings and wealth. How can we buy insurance without regard to our broader investment portfolio? Likewise, how can we invest without considering how well we are protected against death or disease? Life insurance and financial advisory services go hand in hand.

This was why MAS introduced the Financial Advisers Act, or FAA, ten years ago. The FAA was a landmark regulatory reform, providing for consistency in the regulation of persons engaged in advisory activities:

- across sectors: in insurance companies, banks, stockbrokers, and financial advisory firms; and
- across products: life insurance, securities, futures, and unit trusts.

Two years before the FA Act, an industry-led committee, the Committee for the Efficient Distribution of Life Insurance, or CEDLI, made far-reaching recommendations on minimum standards for the advisory process, and the competency of insurance agents.

The FAA and CEDLI together helped transform the landscape for financial advisory services in Singapore. They have contributed to greater consistency and better quality in the advisory services provided on both life insurance and investment products. Disclosure practices have also improved.

Life insurance coverage and financial investments among Singaporeans have grown over the last decade.

- Life insurance as a percentage of the total assets of Singaporeans has nearly doubled from about 4% in 2000 to 7% in 2011.
- Financial investments as a percentage of the total assets of Singaporeans has increased from about 14% in 2000 to 17% in 2011.

But there are important gaps to fill.

We need to do better

We have a large protection gap. The average Singaporean is still grossly underinsured.

- A 2009 study by the Nanyang Technological University found that the existing life cover of the average Singaporean is only about a third of what his dependants will need in the event of his early death.

The insurance industry should reflect on these findings and take up the challenge to narrow the shortfall in protection coverage.

Likewise, there is room to do more within the financial advisory industry.

- According to a study by the Nielsen Company, which issued the Global Ageing Report in February 2011, only 14% of Singapore consumers surveyed felt that they were financially ready for retirement. This is lower than the Asia Pacific and global averages of 22% and 18% respectively.

Financial planning has to go beyond advising on investment products to evaluating the life cycle needs of an individual, including for retirement.

Putting the customer first

We must build the customer's trust and confidence in life insurance and financial advisory services. MAS has been working closely with the industry to help bring this about. The key thrusts of our approach are as follows:

- Raise the competence of financial advisory representatives
- Raise the quality of financial advisory firms
- Make financial advice a dedicated service
- Lower distribution costs of insurance products
- Promote a culture of fair dealing

Let me share with you the actions we have taken to-date in each of these areas. I will also announce the steps MAS intends to take, as part of a comprehensive review of the financial advisory industry that we are launching. We call this new effort, "FAIR", or the Financial Advisory Industry Review.

FAIR will essentially build on the foundations laid by CEDLI and the FA Act ten years ago. It has two main objectives:

- first, to enhance the professional standing and competence of financial advisers; and
- second, to create a more competitive and efficient system for the distribution of life insurance and investment products.

The overriding aim of FAIR is to protect and benefit the consumer. Putting the customer first – that must be at the heart of all our efforts.

Raising the competence of FA representatives

Let me begin with the competence of financial advisory representatives. MAS has been working with the FA industry to raise the skills, knowledge and expertise of representatives to serve customers better. The two aspects of this effort are:

- improving the product knowledge of FA representatives; and
- raising the entry requirements for FA representatives

Product knowledge of FA representatives

We have introduced new examination modules to ensure that FA representatives have sufficient knowledge of the wide and complex range of investment and insurance products currently available in the market. Most firms and FA representatives understand and support the need to raise knowledge and skill levels through a set of common examinations.

Some representatives have questioned why they need to pass these new exams when all they sell are simple products. MAS takes the view that a good financial adviser should be able to explain the advantages and disadvantages and the risks of competing products – both simple and complex.

The reality is that consumers today are faced with a wide range of choices. For example, a consumer wishing to invest and buy insurance protection has a few options. He may consider a participating policy or a regular premium investment-linked policy or simply purchase an insurance term policy and invest separately. He could build a portfolio of just plain vanilla stocks and bonds or include ETFs and futures or simply buy unit trusts. Each option has its own set of risk-return and cost considerations. The increasingly educated consumer will expect his representative to help him make sense of the complexity of the products and their suitability, even if he eventually settles on simple life insurance and investment products.

Some other FA representatives feel that their academic qualifications are sufficient and should allow them an exemption from the exams. But consumers should have some assurance that the qualifications of the FA representatives meet a common standard. The examinations are industry-certified, and set a common standard and benchmark for FA representatives.

It is important that all representatives, even those who have been in the industry for many years, stay abreast of latest market developments and products. Only then can they provide holistic advice and comprehensive recommendations on what to buy, and – more importantly – what not to buy.

But we understand the concerns that some representatives have raised. MAS is prepared to adjust its requirements subject to the companies putting in place proper controls to ensure that only simple products are sold by the selected FA representatives who do not take the new examinations.

Entry requirements for FA representatives

Next, as part of FAIR, MAS will review the minimum level of qualifications that we expect of our FA representatives, to ensure they stay relevant to the needs and expectations of consumers.

The current entry requirement for FA representatives is four GCE “O” level passes. It is clearly not in keeping with Singapore’s rising educational levels, the increasing complexity of products, and higher expectations from a more literate and sophisticated public.

- One out of two Singaporeans has above GCE “O” level qualifications, compared to one out of three, ten years ago.
- One out of four Singaporeans has a degree; this is double the proportion ten years ago.

Our current requirements do not stack up well against major jurisdictions. They have been raising the quality and professionalism of their financial advisers.

- In the UK, the minimum requirement for representatives serving retail customers will be raised by end 2012 to tertiary level qualification, defined as at least a Diploma.
- In Australia, the current educational entry level is a Diploma-equivalent.

Let us not short-change the consumers of life insurance and investment products in Singapore. I am heartened to note that some insurers are already consciously recruiting better qualified individuals who can provide value-added advice to their customers. These agents are better able to explain the intricacies of financial planning, and recommend solutions to meet the financial needs of busy professionals or less savvy customers. But we must level the playing field and make this the industry norm.

Raising the quality of financial advisory firms

Management expertise and financial resources of financial advisory firms

The second thrust of our approach is to raise the quality of financial advisory firms. While banks and insurers are generally well resourced, financial advisory firms vary in size. Some firms are so small that shareholders or directors double up as representatives, CEO, CFO, and compliance personnel. Under FAIR, we will review the management expertise and financial resources of financial advisory firms, to ensure they are well managed and financially sound. We will take this review into consideration when admitting new financial advisory firms.

Making financial advice a dedicated service

Besides raising the quality of FA representatives and financial advisory firms, we must make financial advice a dedicated and professional vocation. Customers looking for financial advice deserve to be served by representatives whose primary focus is to provide quality advice on regulated financial products.

Unregulated activities of FA representatives

We want an industry where providing financial advisory services is the primary focus of FA representatives.

But of late, we have noticed a worrying trend of FA representatives conducting or wanting to conduct other activities alongside providing financial advice. Let me give a few examples.

- We have received queries from insurance agents who also want to be real estate agents. They want to be allowed to market and earn commissions from property transactions, often to the same customers they provide financial advice to.
- Some FA representatives have even applied to the Casino Regulatory Authority for a junket promoter license!
- MAS has received complaints against FA representatives who used their regulatory status to market questionable schemes in gold bullion. Some of these activities are clearly in conflict with FA activities. They risk undermining the interests of consumers.

We will review the activities that FA representatives can conduct outside their advisory role, to ensure that representatives continue to put their customers first. Specifically, we will work with the industry on a list of activities that FA representatives should not engage in. To my mind, the activities with clear conflicts include:

- money lending;
- promoting junkets for casinos;
- selling real estate; and
- marketing investment products which do not accord safeguards to customers under the Financial Advisers Act.

We will also review other activities that FA representatives engage in that are not in conflict but which may distract representatives from their professional focus. Several insurers and FA firms recognise the risks of associating with representatives who may be distracted by other commitments and remuneration opportunities outside the realm of financial advisory services. These companies accept only representatives who are fully dedicated and committed to providing quality financial advice to their customers. This is how it should be. But practices vary across financial institutions, and it may not be practical to ban representatives from undertaking other activities that earn an income. MAS will work with the industry to push for a consistent industry-wide approach to representatives who engage in multiple activities.

Role of introducers

FAIR will also review the current practice of FA firms and their representatives making use of “introducers” to reach out to customers. An introducer may be another representative, but may also be any man-on-the-street. Introducers are typically paid a fee to refer customers to financial advisers, or they get a cut of the commissions generated from sales to the customers. The use of introducers means customers risk dealing with individuals whose credentials have not been vouched for by any financial institution. It also means that customers may not receive proper advice when introducers go beyond introducing and pressure customers to buy products.

Financial advisory activities in insurance broking firms

Making sure that the financial advisory role is the primary focus of FA representatives is only one side of the coin. The other aspect to ensure, is that firms whose primary activity is not financial advisory services, are fully capable of managing this part of their business.

In this regard, FAIR will review the scope of financial advisory activities currently carried out in insurance brokers. Some insurance brokers advise on group term life insurance to complement the suite of general insurance products offered to their corporate customers. However, over the years, we have noticed that for some insurance brokers, FA activities and revenue from the advisory business have eclipsed that of their core insurance broking business. MAS is concerned that insurance brokers may not have sufficient management expertise and compliance capability to oversee and manage the FA portion of their business.

Lowering distribution costs

Our fourth key thrust is to lower the cost of distribution, so that we can keep the overall cost of life insurance products affordable for Singaporeans.

Direct sales of simple products

The online channel is one of the ways in which we can lower distribution costs. We have seen the use of direct sales via the internet for the distribution of general insurance products such as travel insurance and motor insurance. Why not life insurance? The industry could explore the use of the internet as an alternative distribution channel to offer life insurance to consumers at competitive prices.

Online distribution will also mean that products will have to be simplified. Simple term life insurance via the internet could be a good way to help lower cost and make affordable insurance protection more readily available to a wider population. And simple term life insurance is sometimes all that a person needs to protect against risk. MAS would like to see the sale of simple term life insurance products through the internet.

Commission-based remuneration and distribution structure

But customised financial advice is still required for the more complicated insurance plans, tailored to suit individual and family needs and circumstances, and for those who want to supplement their term life insurance. To lower costs for such products, we must address some of the underlying inefficiencies in our remuneration and distribution structure. FAIR will fundamentally review the commission-based remuneration and distribution structure.

In Singapore, insurance products are distributed through insurance agencies, banks, and financial advisory firms. The premiums for these insurance products include charges that cover mortality risk, as well as various expenses incurred by the insurer, such as distribution and management expenses. A substantial proportion of the premium in the earlier years goes to paying for distribution expenses. Over the life of a policy, this cost can account for as much as 8% of the total premiums paid. A key driver of this cost is the multi-tier distribution structure that is common in Singapore's insurance companies and large FA firms.

The commission-based, multi-tier distribution structure involves representatives in the upper tiers having a share of the commissions earned by lower-tier representatives who provide insurance and financial advice to the consumer.

- Take for example a whole life insurance policy. An FA representative could earn a basic commission of 50% of the policy's annual premium in the first year, and another 40% of the annual premium during the following five years.
- His supervisor would in turn earn overriding commissions throughout the first six years. There is typically a third tier comprising the agency managers who also get overrides.
- Total overrides during the first six years can amount to 70% of the policy's annual premium.
- Together, the total commissions and overrides earned by the representative and his supervisors would be equivalent to about 160% of the policy's annual premium.

FAIR will examine whether this commission structure aligns the interest of representatives with the long term interest of consumers, whether these representatives have the adverse incentive to sell products that pay them higher commissions, and whether the tier structure provides value for the customer or merely adds cost.

Most major jurisdictions have long moved away from the tiered structure. The United Kingdom and Australia are moving towards a fee-based model. They have, in fact, banned commission payments from product manufacturers to financial institutions except in the case of pure-protection products.

Enhance transparency of distribution and other costs

A third way in which we can lower distribution and related costs is to enhance the transparency of these costs. Presently, benefit illustrations show the total distribution costs but hide the direct payout to a representative. Customers should know what they are paying for. With greater transparency, a customer can decide if he is getting his money's worth for the service and advice provided by his FA representative.

Benefit illustrations also do not include a detailed breakdown of the split between the protection and investment components in an investment-linked insurance product. Customers often assume that the insurance policy they bought covers only insurance to their dependants, when in fact the product may contain a substantial savings element. Insurers should strive to provide greater disclosure on how the premium is split between protection and investment on bundled insurance products to enable customers to better understand what they are buying.

Promoting a culture of fair dealing

The fifth thrust in our approach to instilling customer trust in life insurance and financial advisory services is through promoting a culture of fair dealing by financial institutions.

Dealing fairly with customers goes beyond mere compliance with regulatory requirements. It is an attitude that springs from the ethos and values of the institution. It is about a culture that places the consumer first, that is focused on doing what is right for the consumer, and that places a premium on integrity.

It is the responsibility of the Board and Senior Management to forge this culture of fair dealing throughout the organisation. The Board and Senior Management must set a clear strategy to achieve the fair dealing outcomes, monitor its implementation, and train their staff and representatives to treat customers fairly. Most of all, they must – by word and deed – make clear to their staff that meeting revenue targets must never be at the expense of treating their customers with fairness and honesty.

Enhance transparency of products

A key aspect of fair dealing is to make insurance and investment products more transparent. MAS has enhanced safeguards for consumers who buy investment and insurance products that are complex. For example, for consumers investing into unit trusts via their investment-linked life insurance policies, we now require insurers to provide a Product Highlights Sheet or “PHS” on the underlying funds. The PHS should be written in plain language, in a “Question & Answer” format prescribed by the MAS. It describes the profile of customers the fund is suitable for, what the fund invests in, and what the risk areas are that could cause a customer to incur a loss.

We also require FA representatives to conduct a Customer Knowledge Assessment to assess whether a customer has the relevant knowledge or experience to understand the risks of products which are more complex or have innovative features which customers might not understand.

FAIR – the next steps

MAS recognises that FAIR will have a significant impact on the industry and on the public. We will take a consultative approach and engage all stakeholders. A review panel will be formed, with representation from industry associations, the investment community, academia, media and consumer bodies, to review and propose recommendations on the five areas I have outlined. MAS will shortly announce the members of the panel. We will solicit feedback from the public before the panel begins its deliberations and after it has made its recommendations.

I appreciate that some of the proposals will impact businesses and representatives. I urge the industry to take a long term view from the customer’s perspective. The aim of FAIR is to bring about a higher quality of financial advisory services and better outcomes for customers, and by enhancing customer trust, promote sustained growth of the financial advisory industry. MAS will work to ease the transition for those most affected by the changes.

Conclusion

Since its inception in 1962, LIA’s key objectives have always been to promote high standards and best practices in the life insurance industry, ensuring quality financial advisory services and raising public awareness and understanding of life insurance. We see LIA as a key partner in facilitating the FAIR process and developing the insurance industry.

I congratulate LIA on your golden anniversary and wish you many more fruitful years ahead. Thank you.