BY EMAIL ONLY

Members' Undertaking No. 72
17 September 2019

To: All Ordinary and Associate Members

MU 72/19 (17 SEP 2019) - LIA GUIDELINES ON THE USE OF INCENTIVES IN THE RECRUITMENT OF FINANCIAL ADVISORY REPRESENTATIVES

ACTION:

1. **MEMBERS' UNDERTAKING NO. 72 OF 13 JUNE 2019 IS REPLACED BY THIS MU.**

2. **FOR COMPLIANCE OF ORDINARY MEMBERS WITH TIED AGENTS AND/OR RELATED FINANCIAL ADVISER FIRMS WITH IMMEDIATE EFFECT.**

3. **TRANSITION PERIOD OF THREE MONTHS (13 MARCH TO 12 JUNE 2019)**

   Candidates who were offered sign-on incentives/ incentive schemes, based on the previous measures, during the transition period prior to the issuance of MU 72/19 dated 13 June 2019, i.e. 13 March to 12 June, are allowed to accept the incentives as offered, if they have not done so, by **31 October 2019**.

   Affected members and affected related FA firms should maintain adequate documentation to show that the candidates were indeed offered such incentives/ schemes during the transition period.

4. **FOR OTHER MEMBERS' INFORMATION.**

LIA promotes self-regulation and the recruitment activities undertaken by members should comply with the principles and measures set out in this Members' Undertaking.

LIA SECRETARIAT

MU 72/19 - LIA GUIDELINES ON THE USE OF INCENTIVES IN THE RECRUITMENT OF FINANCIAL ADVISORY REPRESENTATIVES

COMMITMENT TO UPHOLD PROFESSIONALISM OF THE LIFE INSURANCE INDUSTRY AND SAFEGUARD CUSTOMER INTERESTS

1. LIA recognises that some insurers or their related FA firms may offer migration packages to recruit FA representatives. When such migration packages are offered, they must be done in a reasonable manner that does not undermine the professionalism of the industry, and most importantly, does not adversely affect the interests of consumers.

2. To achieve this, LIA members commit to abide by the following principles:

   a) We are committed to adopting ethical, professional and responsible recruitment practices.

   b) We encourage growth in the number and quality of representatives in the industry while continuing to maintain high standards.

   c) We strive to attract new entrants with the right ethics, motivation, aptitude and attitude.

   d) We acknowledge the individual's right to move between companies. However, such movements should not adversely affect the interests of consumers. They should be protected from, for instance, any resulting increase in the cost of insurance, unethical conduct such as improper switching and aggressive sales practices.

   e) We commit to adopt the measures set out in these guidelines, as well as any further measures required by MAS.

3. Should the insurer or its related FA firm intend to engage in mass recruitment (as defined in paragraph 8), it is to notify MAS early of its plans prior to the mass recruitment.

FUNDING OF COSTS

4. In line with section 17 of the Insurance Act, all costs, direct or indirect, that pertain to such acquisition of FA representatives should not be borne by the insurance fund. An example of direct costs would be compensation packages paid to migrating representatives. Examples of indirect costs would be additional compliance costs incurred in employing additional resources to perform more intensive checks on migrated representatives' sales transactions, as well as management expenses relating to the acquisition initiative. Accordingly, these costs should not be factored in members' pricing of products, as doing so would transfer the costs borne by the shareholders' fund to the insurance fund.

SCOPE OF MEASURES TO SAFEGUARD CUSTOMER INTERESTS

5. There are four measures to be followed.

6. Measures 1 and 2 apply to all representatives who are offered sign-on incentives (with upfront payment) or any incentive schemes tied to sales targets with a clawback mechanism (termed as "incentive schemes").

7. Measures 3 and 4 will apply when the insurer or its related FA firm conducts mass recruitment.

Definition of mass recruitment

8. Mass recruitment is defined as the recruitment of 30 or more representatives from the same insurer or FA firm within a 60 day period (to be tracked on a rolling basis). ("Threshold")

9. Besides sign-on incentives, any incentive schemes offered to representatives that are pegged to sales target requirements with a clawback mechanism should be included as part of the Threshold. When in doubt, the insurer or its related FA firm should seek clarification from MAS.

10. Unless exempted as set out in paragraph 11, Measures 3 and 4 will apply to the above group of migrating representatives for at least 2 years.

Exemption for groups of individuals that are recruited with incentive schemes (other than sign-on incentives)[1]

11. The 4 measures set out in these guidelines do not apply to:

    a) Individuals who have less than 2 years of cumulative FA experience[2]; and
    b) Former FA representatives who have left the FA sector for 2 or more years and subsequently re-join an FA firm.

MEASURE 1: SALES TARGETS TO BE SET AT A REASONABLE LEVEL

Rationale

12. This measure seeks to mitigate the risk of representatives engaging in improper conduct such as mis-selling or improper switching in order to meet sales targets.

13. Sales targets set for Year 1 should not be higher than the representative's average of his annual achieved sales in the preceding 3 years.

14. Year 1 sales targets should be based on First Year Commission (FYC) or its equivalent.[3]

15. If the insurer or related FA firm is unable to verify a representative's past achieved sales based on documentary evidence, incentives can still be offered but it must not set a sales target for Year 1. Sales targets can be set for subsequent years, based on the achieved sales of the representative in his first year.

16. Any increase in subsequent years' sales targets (after Year 1) should be set at a reasonable level having regard to factors including, but not limited to, the following:

    a) Representative's past sales performance
    b) Representative's compliance track record, e.g. BSC grades
    c) Representative's years of financial advisory experience
    d) Representative's past persistency ratios
    e) Sales targets of representative's peers

[1] For the start/end dates to account for the number of years of financial advisory experience that a representative has, the insurer should use the dates indicated under the Representative Notification Framework.
[2] This would include fresh hires with no FA experience.
[3] The insurer or its related FA firm is expected to demonstrate that any equivalent measure used corresponds to an amount that is not higher than the average of the representative's past 3 years of annual achieved sales.

MEASURE 2: PAYMENT OF INCENTIVES TO BE SPREAD

Rationale

17. This measure seeks to incentivise representatives to stay on and service their customers for a longer period of time.

18. Payment of incentives is to be spread over a minimum period of 6 years, with a cap in the first year, and the rest to be spread evenly over the next 5 years or more.

19. The first year payment is capped at 50% of the representative's average annual remuneration in the last 3 years[4], and the remaining payments are based on a level percentage.

20. Non-monetary incentives should be spread over a minimum period of 6 years if it is practicable to do so, by including the value of non-monetary incentives into the total package of the scheme and spreading the pay-out accordingly.

21. For non-monetary incentives that cannot be quantified or spread, the insurer or its related FA firm should only pay the non-monetary incentives at the end of 6 years.

<u>Illustration for a rep whose sign-on incentives are set at 150% of the average annual remuneration[1] paid by the previous FA firm in the past 3 years</u>

Sign-on incentives are spread over a minimum period of 6 years

Total sign-on package offered	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
150% of average annual remuneration in past 3 years	50% (max)	20%	20%	20%	20%	20%

First year payment is capped at 50% of the average of the representative's annual remuneration in the past 3 years

The remaining payment to be evenly spread out over the next five years or more

Assuming that a rep's average annual remuneration in the past 3 years is $100,000, the sign-on incentives payable each year would be spread as follows:						
$150,000	$50,000	$20,000	$20,000	$20,000	$20,000	$20,000

[1] Remuneration is defined as - a) any monetary commission, incentive, benefit or reward; b) any non-monetary incentive, benefit or reward.

MEASURE 3: PEGGING THE INCENTIVES TO THE PERSISTENCY OF POLICIES SERVICED BY THE REPRESENTATIVE AT THE PREVIOUS FIRM

Rationale

22. This measure seeks to deter representatives from giving inappropriate advice to former customers to replace their existing policies with new policies from the hiring insurer or related FA firm.

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[4] Under Section 38 (10) of the Financial Advisers Act, remuneration is defined as - a) any monetary commission, incentive, benefit or reward; and b) any non-monetary incentive, benefit or reward. The annual remuneration should exclude any payment made by the insurer or its related FA firm to the FA representatives to compensate for any remuneration that is not incidental to the rep's financial advisory activities at the previous firm (e.g. payment to compensate for the representative's sign-on incentives received from his past employers).

23. When mass recruitment (as defined in paragraph 8) has occurred, the hiring insurer or related FA firm will furnish a listing of the migrated representatives to the previous FA firm to track the block of regular premium life policies and accident and health policies ("ring-fenced policies") serviced by the representative at his/her previous firm for a 2 year period.

24. The tracking of the ring-fenced policies will start on the date of each representative's departure from the previous FA firm.

25. At the end of the 2 year period, the hiring insurer or related FA firm will compute the persistency of the ring-fenced policies upon receipt of the information from the previous FA firm. The persistency will be calculated on a case-count basis.

26. Depending on the persistency of the ring-fenced policies, the hiring insurer or related FA firm is required to adjust the representative's entitlement to incentives according to Table 1 below:

Table 1: Representatives' entitlement to incentives

Persistency ratio of ring-fenced policies at the end of the two-year period	**Entitlement to Incentives**
85% to 100%	100%
75% to less than 85%	90% to less than 100% i.e. a reduction of 1% entitlement for each percentage drop in persistency ratio below 85%. For example, • 84% corresponds to 99% entitlement • 80% corresponds to 95% entitlement • 75% corresponds to 90% entitlement
50% to less than 75%	50% to less than 75% i.e. entitlement is proportionate to the persistency ratio. For example, • 74% corresponds to 74% entitlement • 60% corresponds to 60% entitlement • 50% corresponds to 50% entitlement
0% to less than 50%	0%

27. The hiring insurer or related FA firm is required to appoint an independent external party to verify and report to MAS that it has complied with Measure 3 at the end of the 2 year period.

28. To ensure effectiveness of this measure, LIA members undertake to share information regarding persistency ratio of insurance products when asked by other FA firms.

MEASURE 4: ENHANCED MONITORING OF REPRESENTATIVES FOR AT LEAST 2 YEARS

Rationale

29. This measure seeks to encourage quality advice from representatives.

30. When mass recruitment (as defined in paragraph 8) has occurred, the hiring insurer or related FA firm is to engage an independent external party to conduct a pre-transaction survey of <u>all</u> (100%) transactions involving representatives that receive incentives.

31. The hiring insurer/FA firm will be required to engage MAS on the suitability of the proposed entity and the work scope to be carried out by this entity should be discussed with MAS.

32. Minimally, 50% of the surveys are to be conducted through a call-back. The remaining customers may be surveyed through other means. The pre-transaction surveys may be completed within the free-look or cancellation period of the product. Where the recommendation is made for an investment product which is time sensitive, the firm should complete the pre-transaction checks within 5 business days from the effective date of the transaction.

33. The work done by the independent external party is to be reported to the hiring insurer's/ FA firm's Board and MAS on a quarterly basis.

34. In addition, the representatives are to be subjected to the requirements that are imposed on "Selected Representative" under the BSC framework, i.e. subject to the higher sampling size of 10% for post-transaction documentation review.

** End **