CONSULTATION PAPER

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Draft Guidelines on Switching of Designated Investment Products

Monetary Authority of Singapore

INTRODUCTION

FAA-N01 Notice on Recommendations on Investment Products stipulates that a financial adviser shall not advise a client to switch from one designated investment product (i.e. a unit in a collective investment scheme, a life policy, or such other investment product as the Authority may prescribe) to another in a manner that would be detrimental to the client. The financial adviser making the switching recommendation shall also (i) comply with the "Know Your Client", needs analysis, documentation and record-keeping requirements set out in FAA-N01; and (ii) disclose to the client any fees or charges the client would have to bear as a result of the switching transaction.

2 The market has requested MAS to give greater direction on controls, procedures and processes that MAS expects financial advisers to implement to monitor and deter undesirable switching. MAS intends to issue guidelines on these issues. The guidelines will set out the minimum standards expected of all financial advisers.

3 A concerted effort between MAS and industry is needed to deter undesirable switching. We encourage industry associations to work with their members on practical implementation issues and put in place additional industry rules to meet the specific circumstances and needs of their members. MAS notes the recent initiative undertaken by the Life Insurance Association to stem the churning of insurance policies among insurance agents. Financial advisers should take into account applicable industry guidelines in their conduct of financial advisory services.

4 To reduce ambiguity in interpreting what constitutes a switch, MAS intends to amend its definition in FAA-N01 such that switching includes a situation where a client disposes of, or <u>reduces his interest in</u>, all or <u>part of</u> a particular investment product to acquire all or <u>part of</u>, or <u>increase his interest in</u>, another investment product. This seeks to clarify that while there are various methods of divesting an original investment product (such as partial surrender of life policies) to invest in another investment product, these situations are considered as switching.

INVITATION TO COMMENT

5 MAS invites interested parties to forward their comments and suggestions on the draft guidelines on switching of designated investment products and the proposed amendments to the definition of switching under FAA-N01. Please submit your written comments by 14 July 2004 to:

Market and Business Conduct Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117

Email: switching@mas.gov.sg

Fax: (65) 6225 9766

Please note that all submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

DRAFT GUIDELINES ON SWITCHING OF DESIGNATED INVESTMENT PRODUCTS

Purpose of the Guidelines on Switching of Designated Investment Products ["these Guidelines"]

These Guidelines are issued pursuant to section 64 of the Financial Advisers Act (Cap. 110) ["the Act"] to provide guidance on the controls, processes and procedures that the Monetary Authority of Singapore ["the Authority"] expects financial advisers to implement in order to monitor switching and ensure that they and their representatives do not advise clients to switch from one designated investment product [referred to as "original product"] to another designated investment product [referred to as "replacement product"] in a manner that would be detrimental to the clients.

2 These Guidelines are not intended to replace or override any legislative provisions under the Act. They should be read in conjunction with the provisions of the Act, the regulations made under the Act, as well as written directions, notices, codes and other guidelines that the Authority may issue from time to time.

Definitions

3 For the purposes of these Guidelines:

"designated investment product" has the same meaning as in section 25(6) of the Act, which is a unit in a collective investment scheme, a life policy (including a group life policy), or such other investment product as the Authority may prescribe;

"financial adviser" means a licensed financial adviser or a person exempt from holding a financial adviser's licence under section 23(1)(a) to (e) of the Act;

"representative" has the same meaning as in section 2(1) of the Act; and

"switching" has the same meaning as in FAA-N01 Notice on Recommendations on Investment Products.

General Obligations

4 FAA-N01 Notice on Recommendation on Investment Products stipulates that a financial adviser and its representatives shall not advise a client to switch from an original product to a replacement product in a manner that would be detrimental to the client. The financial adviser and its representatives making the switching recommendation shall also (i) comply with the "Know Your Client", needs analysis, and documentation and record-keeping requirements set out in FAA-N01; and (ii) disclose to the client any fee or charge the client would have to bear to switch from the original product to the replacement product.

5 A financial adviser should ensure that its representatives are conversant with their responsibilities and comply with all applicable laws, rules and regulations relevant to switching, including these Guidelines.

Disclosure

6 A financial adviser and its representatives should disclose to a client **<u>in writing</u>** and draw the attention of the client to any fees or charges the client would have to bear if he were to switch from an original product to a replacement product. This is to ensure that the client is able to make an informed decision on the switching recommendation. Fees and charges to be disclosed include any fees associated with the disposal of, or reduction of, interests in the original product, and fees incurred during the purchase of, or increase of, interests in the replacement product.

7 A financial adviser should indicate clearly in the recommendation/product application/any other separate form [referred to as "Form"] the following:

(a) any pecuniary or other disadvantages that the client will or may suffer (temporarily or otherwise) as a result of switching from one designated investment product to another; and

(b) a prominent warning such as:

"Fees and charges may be incurred as a result of (i) disposal of, or reduction of, interests in an existing investment product; and/or (ii) acquisition of, or increase of, interests in another product. Before switching from one product with another, you should find out whether you are entitled to free switches and also consider carefully whether any fees, charges and disadvantages that may arise from a switch would outweigh any potential benefits. Some of the disadvantages associated with switching include:

(i) you may incur transaction costs without any real benefit from a switch;
(ii) the new product may confer a lower level of benefit at a higher cost or same cost, or the same level of benefit at a higher cost;
(iii) you may suffer penalties for terminating the existing designated investment product; and
(iv) the new investment product may be less suitable for you.

You should seek the advice of your financial adviser when in doubt or if you require further clarification."

Monitoring of Switching of Designated Investment Products

8 A financial adviser should institute controls, processes and procedures to effectively monitor and track the switching of designated investment products. Among others, the financial adviser could consider the following:

- To check the past transactions and records of a client for each new purchase made so as to detect undeclared switches;
- To track the volume of switches so as to identify representatives with unusually high volume of switching transactions; and
- To set up a register for the purpose of ensuring that each switch is reviewed by a supervisor to be appropriate and to identify any unusual trends in switching transactions.

9 To facilitate the monitoring of switching that may be detrimental to clients' interests, a financial adviser should include in the Form a section requiring a client to declare whether he had been advised by a representative of the financial adviser to dispose of, or reduce his interest in, all or part of another designated investment product and purchase the new designated investment product. If the answer is yes, the financial adviser should require further declaration to be made in the Form as follows:

(a) by the client, whether the representative had drawn the client's attention to the costs and possible disadvantages associated with switching. The client should also be asked to confirm that he wishes to proceed with the switching transaction notwithstanding that the fees, charges and disadvantages that may arise from a switch could outweigh any potential benefits; and

(b) by the representative, whether the client is entitled to free switches. The representative should also indicate clearly in the Form the basis of the switching recommendation.

10 For all switches where clients declare that the switching recommendations are made by representatives of the financial adviser, the financial adviser should require supervisors to review and indicate for each of the switching transaction, whether they agree that the recommendation is appropriate and if not, what are the actions taken to rectify the situation. In considering the appropriateness of a switch, a number of factors should be taken into account, including:

(a) whether the client suffers any penalty for terminating the original designated investment product;
(b) whether the client will incur any transaction cost without any real benefit from such a switch;
(c) whether the new product confers a lower level of benefit at a higher cost or same cost to the client, or the same level of benefit at a higher cost; and
(d) whether the new product is less suitable for the client.

Remuneration Structure

11 The remuneration of representatives should not be solely based on the sales volume as this may encourage product pushing and switching. A financial adviser should structure its representatives' remuneration package to encourage representatives to be concerned with the well-being of their clients' investments and to provide good quality professional advice.

MAS

Monetary Authority of Singapore