

CONSULTATION PAPER

P006 - 2018

March 2018

Measures to address the risks posed by the use of sign-on incentives in the recruitment of financial advisory representatives

MAS

Monetary Authority of Singapore

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1 Preface

1.1 Recent episodes involving large-scale movements of financial advisory (“FA”) representatives from one FA firm to another have cast the FA industry in a negative light. MAS recognises that large scale movements of representatives from one FA firm to another could give rise to heightened market conduct risks, potential detriment to consumer interest and disruption to business operations. Such recruitment practice may also drive up costs in the industry as it involves the offer of hefty sign-on incentives to entice FA representatives to join another FA firm. These sign-on incentives, part of which are paid up front, are tied to sales that the FA representatives must generate after they join the new FA firm. If these sales targets are not met, the FA representatives risk having their sign-on incentives clawed back.

1.2 MAS is concerned that such practices would increase the risk of mis-selling and improper switching of insurance policies, in particular life insurance policies and accident and health (“A&H”) policies. There are also concerns that consumers may ultimately end up bearing the cost of the sign-on incentives. To address these risks, MAS has been engaging the Life Insurance Association (“LIA”) to develop rules to safeguard consumers’ interests. MAS has also made it clear to the industry that sign-on incentives offered by an insurer to recruit FA representatives from another firm to join the insurer or its related FA firm cannot be charged to the insurance funds as an expense. If the insurer disburses sign-on incentives, the amount must be borne by the insurer’s shareholders.

1.3 The proposed rules set out in this consultation paper will require all sign-on incentives to be paid out over a minimum period to promote a culture of providing quality advice and good after-sales service. Sales targets that are pegged to the sign-on incentives will have to be set at a reasonable level to mitigate the risk of overly aggressive sales practices by FA representatives seeking to avoid losing their sign-on incentives.

1.4 MAS will also require FA firms that conduct mass recruitment from other FA firms to put in place robust controls to monitor the conduct of their newly recruited representatives. Representatives with persistency ratios for policies transacted at their previous FA firm that are well below industry norms will risk losing part or all of their sign-on incentives.

1.5 MAS invites comments from the financial industry, consumers and other interested parties.

Please note that all submissions received will be published and attributed to the respective respondents unless they expressly request MAS not to do so. As such, if respondents would like (i) their whole submission or part of it, or (ii) their identity, or both, to be kept confidential, please expressly state so in the submission to MAS. In

addition, MAS reserves the right not to publish any submission received where MAS considers it not in the public interest to do so, such as where the submission appears to be libellous or offensive.

1.6 Please submit written comments by 9 April 2018 to –

Capital Markets Intermediaries Department I
Monetary Authority of Singapore
10 Shenton Way, MAS Building
Singapore 079117
Fax: (65) 62203973

Email: CMI_Consult@mas.gov.sg

1.7 We encourage comments to be sent by electronic submission. Please use this [template](#) for your submission to ease our collation efforts.

2 Introduction

2.1 MAS has noted that FA firms usually pay hefty sign-on incentives when they recruit experienced FA representatives from other firms. Based on an industry survey, these sign-on incentives range between 150% and 200% of the representative's annual income in the past one year, while some could go as high as 300%. These sign-on incentives (which could be monetary as well as non-monetary) are also pegged to sales targets that the FA representatives need to meet at the new firm. If these sales targets are not met, the FA representatives risk losing or having their sign-on incentives clawed back.

2.2 Such a practice increases the risks of pressure selling and improper switching of insurance policies. For example, in order to meet their sales targets, FA representatives may encourage their customers from the previous FA firm to surrender their existing policies and buy new ones from the new FA firm. This is known in the industry as a "switch", and may not always be in the best interests of customers. Such customers may forgo policy charges or fees they had already paid during the initial years of their existing policies, or be subject to exclusions for health conditions which they may have developed since the time they purchased their existing policies.

2.3 Under MAS' current rules, FA firms are required to put in place safeguards to guard against improper switching of insurance policies. For example, MAS requires the supervisor of an FA representative to validate that each and every recommended switch is appropriate, taking into account the customer's objectives, financial situation and needs. In the case of vulnerable customers, the supervisor is further required to call these customers to check that they understand the policies they have purchased before the policies are issued. MAS also requires a party independent of the sales process to perform sample post sales transaction checks.

2.4 Notwithstanding the rules that are currently in place, MAS recognises the heightened risks faced by consumers when large sign-on incentives pegged to sales targets are offered to FA representatives. Further, the current safeguards may not be adequate when there is a mass movement of representatives from one firm to another.

2.5 To address these risks, MAS has proposed four measures in this consultation paper.

- (i) **Proposal 1:** Setting reasonable sales targets with a cap for the first year
- (ii) **Proposal 2:** Spreading sign-on incentives pegged to sales targets over a minimum period of 6 years with a cap on the amount to be paid in the first year

- (iii) **Proposal 3:** Pegging the sign-on incentives to the persistency of policies serviced by the representative at his previous FA firm
- (iv) **Proposal 4:** Putting in place enhanced transaction monitoring for sales conducted by the migrated representatives for 2 years

2.6 The first two proposals will apply to any FA representative who receives sign-on incentives that are pegged to sales targets. The third and fourth proposals apply only when FA firms engage in mass recruitment¹ exercises to attract representatives of other firms with the offer of sign-on incentives that are pegged to sales targets. These additional safeguards serve to ensure that FA firms have adequate compliance systems and processes to monitor the heightened risks posed by the mass movement of representatives.

2.7 Consistent with our intent set out in the consultation paper on Changes to the Notification Requirements in relation to Representatives serving only Non-Retail Customers², the four proposals are not applicable to representatives serving non-retail customers as such customers are generally better informed or better able to access resources to protect their own interests.

2.8 Details of our proposals are set out in sections 3 to 7.

¹ Mass recruitment is deemed to have occurred when there is a movement of 30 or more representatives from the same FA firm, within a 60-day rolling period.

² <http://www.mas.gov.sg/~media/MAS/News%20and%20Publications/Consultation%20Papers/Consultation%20Paper%20on%20Changes%20to%20the%20Notification%20Requirements%20for%20Representatives.pdf>

3 Proposal 1: Setting reasonable sales targets with a cap for the first year

3.1 Paragraph 3.4 of the Guidelines on Fair Dealing – Board and Senior Management Responsibilities for Delivering Fair Dealing Outcomes to Customers³ highlight the risks that problematic remuneration structures such as those with sales targets may pose. Such remuneration structures heighten the risk of poor market conduct practices such as product pushing and improper switching.

3.2 To minimise such risks, MAS proposes that the first year sales targets that are pegged to the sign-on incentives should not be higher than the average of the representative's annual achieved sales in the preceding 3 years. For example, if a representative's average annual achieved sales in the preceding 3 years (before he joins the new FA firm) is \$40,000, the first year sales targets that are pegged to the representative's sign-on incentives should not be higher than \$40,000. Given that the migrated representative would need to familiarise himself with the operational processes and products offered by the new FA firm as well as time to source for new clients, the sales target in the first year should not be set at a level higher than the representative's past performance.

3.3 In addition, any increase in subsequent years' sales targets (after the first year) should be set at a reasonable level having regard to factors such as the representative's past sales performance, compliance track record, years of financial advisory experience, past persistency ratios and sales targets of the representative's peers. MAS will assess on a supervisory basis whether the sales targets set for subsequent years are reasonable.

MAS proposes that the first year sales target pegged to sign-on incentives should not be higher than the average of the representative's annual achieved sales in the preceding 3 years; and subsequent years' sales targets (after the first year) should be set at a reasonable level having regard to factors such as the representative's past sales performance, compliance track record, years of financial advisory experience, past persistency ratios and sales targets of the representative's peers.

³ Guidelines on Fair Dealing - Board and Senior Management Responsibilities for Delivering Fair Dealing Outcomes to Customers:
<http://www.mas.gov.sg/~media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Financial%20Advisers/Guidelines/Fair%20Dealing%20Guidelines%20%2020%20Feb%202013.pdf>

Question 1. MAS seeks comments on the following:

- (i) Whether the cap on sales target should be extended beyond the first year
- (ii) Whether there are other factors (besides those that are set out in paragraph 3.3) that should be considered when setting sales targets for the second year

4 Proposal 2: Spreading sign-on incentives pegged to sales targets over a minimum period of 6 years with a cap on the amount to be paid in the first year

4.1 Currently, the sign-on incentives that are typically offered to FA representatives require the representatives to remain with the FA firm for about 4 or 5 years. This is a shorter period compared to the requirement for commissions of life insurance policies to be spread over a period of at least 6 years starting from the date the policy is issued⁴.

4.2 MAS also notes that the sign-on incentives are typically heavily front-loaded, with about 30% to 40% of the total sign-on incentives paid upfront at the point the representative joins the FA firm, and more than 50% of the total sign-on incentives could be paid within the first year. Such a payout structure could result in representatives engaging in aggressive sales, even before they have familiarised themselves with the new FA firm's product offerings, in order to receive the large sign-on incentives promised in the first year.

4.3 Taking into account the above considerations, MAS proposes to require the sign-on incentives tied to sales targets to be paid out over a minimum period of six years, similar to MAS' current rule on spreading of commissions. We also propose to cap the total amount of sign-on incentives payable during the first year to 50% of a representative's average annual remuneration received for the sale of products that the representative was authorised to sell at his previous FA firm(s) in the last three years⁵, with the remaining sign-on incentives to be paid evenly over the next five years or more. We have proposed a cap of 50% in the first year, given that this is the average amount of renewal commissions⁶ which a typical representative would have been entitled to if he had remained with his previous FA firm. It would minimise any cash flow impact on representatives moving from one FA firm to another.

⁴ Under the Financial Advisers (Remuneration) (Amendment) Regulations 2017, the Spreading and Capping of Commission Rules require FA firms to spread the payment of commissions of a relevant life policy for a minimum period of 6 years or the premium payment period, whichever is shorter.

⁵ 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. In this proposal, the annual remuneration should exclude any payment made by the 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).

⁶ Renewal commissions are commissions paid to the representative in the subsequent years after the first policy year.

4.4 The longer payout period coupled with the requirement to spread sign-on incentives more evenly, aims to incentivise FA representatives to provide quality after-sales services. The following diagram illustrates the proposed payout structure:

Illustration of the payout structure of a representative whose sign-on incentives are set at 150% of the representative's average annual remuneration paid by his previous FA firm in the past 3 years

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

MAS proposes that the sign-on incentives tied to sales targets be paid out over a minimum period of six years. We also propose to cap the total amount of sign-on incentives for the first year at 50% of a representative's average annual remuneration in the last three years, and the remaining sign-on incentives to be spread evenly over the next five years or more.

Question 2. MAS seeks comments on the following:

- (i) Whether the sign-on incentives that are tied to sales targets, should be paid out over at least 6 years
- (ii) Whether the first year payout should be capped at 50% of a representative's average annual remuneration in the past 3 years, with the remaining sign-on incentives spread evenly over the remaining 5 or more years

5 Additional measures to be imposed on FA firms which conduct mass recruitment exercises

5.1 MAS recognises that there are heightened risks to consumers when there is a large scale movement of representatives among FA firms, accompanied by large sign-on packages paid to migrating representatives. In this regard, Proposals 1 and 2 on their own may not be sufficient to mitigate these risks and additional safeguards are required so that FA firms have adequate compliance systems and processes to monitor the heightened risks.

5.2 To ensure that FA firms which conduct mass recruitment exercises can manage the risks well, MAS proposes that such FA firms put in place additional safeguards (i.e. Proposals 3 and 4) when they recruit 30 or more representatives from the same FA firm within a 60-day period (to be tracked on a 60-day rolling basis). MAS has proposed setting the threshold at 30 given that under the Life Insurance Association's framework on span of control, one agency unit generally comprises about 15 representatives. Accordingly, a movement of two or more agency units would constitute mass recruitment and trigger the additional safeguards set out below (see Proposals 3 and 4).

MAS proposes to define mass recruitment as the movement of 30 or more representatives from the same FA firm within a 60-day rolling period. FA firms which conduct mass recruitment are required to put in place additional safeguards

Question 3. MAS seeks comments on whether setting the threshold of a mass recruitment exercise at 30 or more representatives within a 60-day rolling period is reasonable.

6 Proposal 3: Pegging the sign-on incentives to the persistency of policies serviced by the representative at his previous FA firm

6.1 In the insurance industry, persistency ratio refers to the percentage of insurance policies that remain in force without lapsing or being replaced by another policy. Currently, FA firms monitor the persistency ratio of insurance policies sold by their representatives over different periods. Persistency ratio is an important metric as a low persistency ratio could be indicative of customers being dissatisfied with their policies or the quality of after-sales services provided by their representatives.

6.2 FA firms may subject their representatives with poor persistency ratios to penalties such as a reduction in incentives payable. However, such monitoring and disincentives for representatives with poor persistency ratios usually end when the representative leaves the firm.

6.3 Under the Guidelines on Switching of Designated Investment Products⁷, FA firms are required to put in place systems and processes to identify any unusual trends in switching transactions. In addition, supervisors must review the switches and indicate in writing whether they agree with the recommendations made by the representatives under their supervision. However, the effectiveness of the Guidelines may be limited if improper switching occurs across FA firms as the new FA firm may not be aware that a client had lapsed his policy at the previous FA firm unless this was declared by the client. Errant representatives may also mislead their clients into not declaring the policy switches, resulting in the transactions not being subject to additional checks. To mitigate this risk, MAS proposes that the amount of sign-on incentives that a representative is allowed to retain should be pegged to the persistency of the whole block of regular premium life policies and A&H policies serviced by the representative at his previous FA firm (“ring-fenced policies”⁸). This persistency ratio should be calculated 2 years after the representative had left his previous FA firm.

6.4 Under this proposal, when an FA firm recruits 30 or more representatives from another FA firm within a 60-day rolling period, the hiring firm is required to provide the previous FA firm with the names of the representatives that the hiring firm has recruited.

⁷ Guidelines on Switching of Designated Investment Products: http://www.mas.gov.sg/~media/resource/legislation_guidelines/fin_advisers/fin_advisers_act/guidelines/switching.pdf

⁸ Regular premium life and A&H policies are being ring-fenced as there is greater harm to customers in the event of a wrongful switch. For the avoidance of doubt, ring-fenced policies exclude the policies bought by the representatives or policies that are no longer in force because they have matured or claims have been made.

The previous FA firm is required to track the persistency of the ring-fenced policies serviced by their former representatives for the next 2 years. At the end of the 2 year period, the previous FA firm should share the persistency ratio of the ring-fenced policies with the hiring FA firm. For example, if a representative leaves Firm A for Firm B in March 2018 and there are 1,000 regular premium life and A&H policies serviced by him before he left Firm A, the 1,000 policies would be ring-fenced and tracked by Firm A. In March 2020, Firm A would share with Firm B the persistency ratio of its former representatives' ring-fenced policies. If 800 out of 1,000 ring-fenced policies remain in force, then the persistency ratio of the representative's ring-fenced policies is 80%.

6.5 MAS recognises that policy lapses may not be the result of any improper conduct by the representative after he has left his previous FA firm. For example, clients may be unhappy with the services provided by the new representative that has been assigned to handle their policies when the previous representative left. Clients may also be friends or family members of the representative and wish to become clients of the representative's new FA firm. To ensure that representatives are not unduly penalised by our proposal, MAS had requested persistency data and inputs from the industry in formulating a fair and appropriate framework. Based on data provided by the insurers, the persistency ratio in the industry ranges from 75% to 85%, 2 years after a representative had left his previous FA firm.

6.6 Upon receipt of the persistency ratio, the hiring FA firm is required to adjust its representatives' entitlement to sign-on incentives or claw back the incentives already paid out when the persistency ratio falls below a particular threshold ("X"). We seek comments on an appropriate figure for X, within the range of 75% to 85%. Table 1 below provides an illustration of how such claw backs can be effected.

Table 1: Representatives' Entitlement to Sign-on Incentives

Persistency ratio of ring-fenced policies at the end of the 2 year period	Entitlement to sign-on incentives
X% to 100%	100%
50% to less than X%	50% to less than X% (Note: The entitlement is proportionate to the persistency ratio. For example, a 70% persistency ratio corresponds to 70% entitlement to the sign-on incentives.)
0% to less than 50%	0%

6.7 MAS will also require the FA firm conducting the mass recruitment exercise to engage an independent external party to verify and report to MAS that the FA firm has complied with the requirements set out in paragraphs 6.4 and 6.6 at the end of the 2 year period.

MAS proposes that for firms which conduct mass recruitment exercises, the amount of sign-on incentives that a representative is allowed to retain be pegged to the persistency of the regular premium life and A&H policies serviced by the representative at his previous FA firm. This persistency ratio should be calculated 2 years after the representative had left his previous FA firm. The FA firm conducting the mass recruitment exercise will also be required to engage an independent external party at the end of the 2-year period to verify that the FA firm has complied with this measure

Question 4. MAS seeks comments on the following:

- (i) Whether the sign-on incentives should be adjusted depending on the persistency of regular premium life and A&H policies serviced by the representative at his previous FA firm, 2 years after the representative has left his previous FA firm
- (ii) Whether the entitlement to the amount of sign-on incentives based on the persistency ratio of ring-fenced policies in Table 1 is appropriate
- (iii) What would be an appropriate value for X within the range of 75% to 85%

7 Proposal 4: Putting in place enhanced transaction monitoring for sales conducted by the migrated representatives for 2 years

7.1 Currently, as part of the Balanced Scorecard (“BSC”) framework under FAIR, supervisors are required to conduct pre-transaction call-backs to selected clients⁹ shortly after the advisory process to assess the quality of FA services provided by their representatives. FA firms are also required to have an independent sales audit unit to perform post-transaction documentation checks and client surveys on a sampling basis. For transactions closed by selected representatives¹⁰, a larger sampling size of 10% is required instead of 5% for other representatives.

Full-scale Pre-transaction surveys

7.2 For representatives that receive sign-on incentives pegged to sales target, MAS proposes that pre-transaction surveys be conducted for all sales of investment products and A&H policies. To ensure effectiveness of the surveys, at least 50% of the pre-transaction surveys must be conducted via call-backs. Similar to the arrangements under the BSC framework, for cases where the FA firm is unable to complete the pre-transaction checks before the transactions are effected, the FA firm should complete the pre-transaction checks within the free-look or cancellation period of the product. Further, where recommendation is made for an investment product which is time sensitive, the FA firm should complete the pre-transaction checks within 5 business days from the date the transaction is effected.

7.3 Due to the heightened market conduct risks posed by the mass recruitment of representatives with sign-on incentives pegged to sales targets, MAS proposes that the pre-transaction surveys be conducted by an independent external party. The independent external party will be required to submit a quarterly report to MAS and the Board of the FA firm on the work done. The FA firm will be required to engage MAS on the suitability of the proposed entity and the work scope to be carried out.

⁹ A selected client in relation to a financial adviser, means any client of the financial adviser who meets any two of the following criteria –

(a) is 62 years of age or older;

(b) is not proficient in spoken or written English;

(c) has below GCE ‘O’ level or ‘N’ level certifications, or equivalent academic qualifications, other than a client who meets any two of the criteria and has been assessed by the financial adviser (such assessment to be documented in writing) to possess adequate investment experience and knowledge to transact in the investment product recommended.

¹⁰ A selected representative refers to a representative who has been assigned a Balanced Scorecard grade B or worse under the Balanced Scorecard framework consecutively for two calendar quarters immediately preceding the measurement quarter.

10% Post-transaction documentation checks

7.4 To supplement the call-backs conducted by an independent external party, the FA firm's independent sales audit unit will be required to conduct post-transaction documentation checks on the sales of the representatives, based on a sampling size of 10%.

7.5 The above two measures should be implemented for at least 2 years after any mass recruitment exercise.

MAS proposes that for an FA firm which has conducted mass recruitment exercises, pre-transaction surveys be conducted for all transactions closed by representatives that receive sign-on incentives pegged to sales targets. To ensure effectiveness of the surveys, at least 50% of the pre-transaction surveys must be conducted via call-backs. The pre-transaction surveys should be conducted by an independent external party. To supplement these call-backs, the FA firm's independent sales audit unit will be required to conduct post-transaction documentation checks on the sales of the representatives, based on a sampling size of 10%.

Question 5. MAS seeks comments on:

- (i) The requirement to engage an independent external party to conduct 100% pre-transaction surveys, of which minimally 50% to be conducted via call-backs (paragraph 7.2 and 7.3)
- (ii) The requirement for the hiring firm's independent sales audit unit to conduct 10% post-transaction documentation review (paragraph 7.4)
- (iii) Whether there are other safeguards FA firms engaging in mass recruitment exercises should put in place to mitigate the heightened risks

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