

## **Revised PPR: A further compliance burden for the Insurance Industry**

The introduction of the Policy Holder Protection Rules in July 2001 was intended to reinforce ethical market conduct by Long and Short-term insurers and their intermediaries. From the 1<sup>st</sup> of October 2004, The General Code of Conduct of the Financial Advisory and Intermediary Services Act (FAIS) will assume this responsibility and more.

FAIS, though, is silent on the relationship between product suppliers and the Financial Services Providers (FSP) that distribute their products and one can assume that at present there is nothing prohibiting product suppliers engaging with unlicensed intermediaries. An insight into where this issue may be heading can be gleaned from Gerry Anderson, Deputy Executive Officer of the Financial Services Board, who was quoted recently as saying that he *expects* insurance companies and providers of financial services will not deal with unlicensed independent financial advisers after the 30<sup>th</sup> of September.

The recently redrafted Policyholder Protection Rules (PPR) appear to effectively seal this gap in the FAIS Act, for the insurance industry.

The revised draft PPRs state that an insurer may only contract with an intermediary that is a licensed FSP, or representative of a licensed FSP; and that any existing intermediary sales contract will lapse if that intermediary is not a licensed FSP on the effective date of the new PPR, or that intermediary was licensed as an FSP but that license has been provisionally, or finally suspended or the contract is between the insurance company and representative of a licensed FSP, and that representative has been debarred

One would presume that, in any event, most insurers are currently building systems and processes to flag unlicensed FSPs in order to ensure that they

would not enter into, or continue sales agreements with unlicensed FSPs, after September 30<sup>th</sup> for reputational reasons

Having said this, the draft PPRs introduce onerous implications for insurers. The proposed revisions to PPR make it a legal prerequisite for FSPs to be licensed before an insurer may enter into agreements with them. This exposes insurers to additional compliance risks should they not meet the deadline by when they have to identify which of their intermediaries are licensed or not.

Once insurers clear this hurdle, they will have to amend existing agreements with licensed FSPs to include suitable provisions triggering termination of the agreement should the FSPs license be suspended or withdrawn.

Obviously, insurers will have to continuously monitor which of their FSP's licenses have become inoperative, and implement a system to immediately flag and prevent the receipt of new business proposals from that FSP. In effect insurers will become FAIS enforcement agencies assuming both liability and additional cost implications. This would seem to partially defeat the purpose of FAIS, where responsibility for compliance vests with the entity rendering the financial service.

The insistence on a FAIS licence also creates difficulties in the case of existing intermediary contracts where the intermediary has ceased to render financial services. Currently it is not necessary for an independent intermediary to obtain a FAIS licence in respect of payment of contractually due commissions, unless the intermediary is providing advice or rendering intermediary services (as defined in FAIS). The proposed wording of this section of the revised PPR however suggests that even in these circumstances the insurer would be obliged to terminate the intermediary contract, notwithstanding vested contractual rights.

The PPR applies only to the Long and Short term industry and as such there is at present nothing prohibiting product suppliers in other sectors from engaging with unlicensed FSPs thus potentially leading to an untenable situation of arbitrage by intermediaries, impacting on the competitiveness of the insurance sector, and the appropriateness of advice rendered.

(The Draft PPRs are still under review and open for comment till 23 August 2004, all information in this article was correct at time of writing)