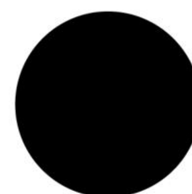
RETAIL DISTRIBUTION REVIEW: SECOND DISCUSSION DOCUMENT ON INVESTMENT RELATED MATTERS

December 2019



FSCA

Financial Sector
Conduct Authority

PART A. Background and purpose

The FSCA's predecessor, the Financial Services Board, published its Retail Distribution Review ("initial RDR paper") in late 2014, marking the start of a multi-year project to reform the regulatory landscape for the distribution of financial services products. Since the publication of the initial RDR paper, the FSB and the FSCA have published a series of status updates on the phased implementation of the RDR proposals. These included a *Discussion Document on Investment Related Matters*, published in June 2018 ("the 2018 Investments Document").

The 2018 Investments Document focused on the impact of certain of the initial RDR paper proposals on the investments sector, inviting feedback on possible regulatory measures to:

- Define the activity of "investment management" and consider the extent to which investment management needs to be demarcated from other forms of discretionary investment mandate;
- Clarify the nature of the legal and business relationships between different types of discretionary investment mandate holders, collective investment scheme management companies and investment advisers, and how best to structure these in the regulatory framework to achieve our RDR objectives; and
- Provide for fee and remuneration arrangements in light of the above, to align with the RDR approach of aligning remuneration with actual activities performed and avoiding unnecessary duplication of costs for the end investor.

Feedback was received on the 2018 Investments Document from commentators representing a wide spectrum of investments sector stakeholders. Twenty-eight entities submitted input. Commentators included six industry associations, and a broad spectrum of financial groups and individual institutions, comprising FAIS Category II FSPs of varying scale and specialisation; investment advisers; asset consultants; CIS management companies; and compliance practices. Understandably, given the broad range of interests represented, views expressed by commentators on most of the regulatory measures proposed in the document diverged significantly.

The FSCA takes this opportunity to thank all of these commentators for their detailed and well-considered contributions to our RDR reform initiative.

Against that background, the purpose of this *Second Investment Matters Discussion Document* is to provide stakeholders with feedback on responses received to the 2018 Investments Document, to share our updated thinking on proposals put forward in that document, and to elicit further stakeholder input on our updated proposals.

In line with the overall structure of the 2018 Investments Document, this document has four key focus areas:

- Section 1: The general investments landscape
- Section 2: Defining and understanding different activities performed under a discretionary investment mandate
- Section 3: Categorising investment advisers within an RDR framework
- Section 4: Implications for remuneration and charging structures.

In each of these areas, the document summarises inputs received on the 2018 Investments Document and then sets out the FSCA's updated position. This document needs to be read together with the 2018 Investments Document. At the start of each Section, for ease of reference, we have therefore set out the applicable questions that were put to stakeholders in the previous document. We also attach the full text of the 2018 Investments Document as *Annexure B* to this document.

Please note that Sections 2 and 3, dealing with defining investment management activities and categorising investment advisers respectively, are the areas where the FSCA's updated position is most advanced. A number of the matters dealt with in Section 4 (remuneration and charging

structures) are to an extent dependent on final proposals in the preceding sections. The FSCA's position on these matters has therefore not yet been significantly updated since the 2018 Investments Document proposals, and our update in Section 4 is therefore relatively more high level than the preceding Sections. Further consultation on these areas will take place in due course.

PART B. Updated thinking based on input received on the 2018 Investments Document

Section 1: The investment landscape

This Section deals with the FSCA's general observation regarding the South African investments landscape, including our observations regarding the complexity of some investment business models and the consequent risks of conflicts of interest and customer confusion. Other key observations related to the potential inadequacy of a broad, "one size fits all" regulatory approach to the activity of investment management; and mismatches between the legal construct of relationships between different entities in the investments value chain and the actual, practical nature of their business relationships.

> ***Question for stakeholder input in the 2018 Investments Document:***
> *Q1. Do you agree with our above observations regarding the investment landscape? If not, where do you disagree? Are there any additional considerations you believe we have overlooked that are necessary to inform our regulatory proposals?*

1.1. Summary of inputs on the 2018 Investments Document

There was general agreement among commentators that the FSCA's description of the investments landscape was accurate, subject to some points of difference on technical details. There was also general acknowledgment that some aspects of current business models and practices give rise to actual and potential conflicts of interest.

However, views diverged widely on the extent to which regulatory intervention is required to address the identified concerns. Opinions varied from arguments that the sector is working well and that no substantive regulatory intervention is required, other than possibly enhanced investor disclosure requirements; to arguments that some business practices are severely compromising fair customer outcomes and require significant regulatory intervention. More "middle ground" views accepted that some level of regulatory intervention would be appropriate, but that this should be proportional to identified risks and not be unnecessarily disruptive. In particular, some inputs highlighted that the business models and practices flagged as potentially conflicted represent only a small proportion of the overall market and that interventions should be appropriately focused to deal with these, without disrupting less problematic models.

1.2. The FSCA's updated position

The FSCA fully agrees that any regulatory intervention we consider should be risk-based and proportional. We do not agree with the position that no structural regulatory intervention at all is required. On the contrary, a number of the detailed descriptions of business models and practices submitted reinforce our view that the regulatory framework needs to provide more clarity regarding the inter-relationships between investors and the different product and service providers in the investments value chain, to reduce regulatory arbitrage and conflict of interest risks.

In particular, the FSCA does not agree that enhanced disclosure requirements are on their own sufficient to address these risks. We do however agree that the quality, consistency and comparability of investor disclosure need improvement in some areas.

We recognise that some of the business models focused on in the 2018 Investment Document (particularly those we described as "model portfolio manager" ("MPP") and 3rd party co-branded models) represent a relatively small proportion of the overall market as compared to more traditional investment management and CIS models. However inputs received, general industry media

coverage, and the FSCA's own supervisory experience show that these types of business models are becoming increasingly prevalent. In particular, the increasing sophistication of technological tools is blurring the lines between investment advice and investment management in the traditional sense. Increased vertical integration of different parts of the investments value chain is also evident. We therefore remain of the view that appropriate regulatory intervention is required to deal with potential conflicts of interest and other conduct risks in these models.

Section 2: Defining and understanding different activities performed under a discretionary investment mandate

This Section covers matters raised under potential Measures 1 to 6 in the 2018 Investments Document, and responses to Questions 2 to 5 of that Document. These questions dealt mainly with identifying and defining different types of discretionary management activity, and the extent to which these should be differentiated in future licensing, fit & proper and / or other aspects of the regulatory framework. The Document discussed four main sub-categories of investment management:

- So-called "traditional" investment management
- Third party co-branded investment management (sometimes referred to as "white label" arrangements
- Model portfolio management (MPPs)
- Mandates held mainly for convenience.

Questions for stakeholder input in the 2018 Investments Document:

Q2. Please let us know whether you agree or disagree with our categorisation of investment management activities into the four broad groupings set out above and our description of each type of activity? If you disagree, where do you disagree and how would you group or describe the activities differently? Suggestions on the appropriate terminology to describe each category of activity will also be welcome.

Q3. Do you agree in principle that the current criteria for a FAIS Category II licence are overly broad and that it is necessary for the regulatory framework to distinguish more clearly between different types of discretionary investment mandate activities? If you disagree, please explain why.

Q4. Please provide your views on the correctness, feasibility and likely effectiveness of each of the possible approaches to discretionary investment mandate categorisation (Measures 1 to 5) set out above. Please let us know if you have any alternative categorisation suggestions.

In particular, please provide your views on –

(i) whether or not different, more rigorous fit and proper standards (including competency financial soundness and operational ability requirements)should apply to investment managers (to be defined) as compared to model portfolio providers (MPPs) and why you hold this view;
(ii) if you agree that different standards should be set for investment managers and MPPs, which standards should apply to providers of a portfolio comprising both existing pooled investments and directly held non-pooled assets?;
(iii) if you agree that different standards should be set for investment managers and MPPs, please provide suggestions on what the key differences between these standards should be; and
(iv) regardless whether you believe that investment managers and MPPs should be subject to different fit and proper standards, whether the current FAIS fit and proper standards for Category II FSP's are adequate and appropriate for investment managers, MPPs, or both or whether you believe any amendments would be required in light of the measures proposed in this paper.

Q5. Do you agree that so-called "mandates for convenience" should continue to be permissible? If not, why not? If yes, please provide your views on the proposed provisos set out under Measure 6. Do you agree that this activity is ancillary to advice provided in relation to the investments concerned?

2.1. Defining "investment management"

2.1.1. Summary of inputs on the 2018 Investments Document

Stakeholders agreed, in the main, that the current scope of activities falling under a FAIS Category II licence is broad, but disagreed sharply on whether this is problematic and hence whether more detailed definitions or categorisation of investment activities are necessary. On the one hand it was argued that a single, broad, holistic definition is appropriate to allow flexibility across different investment management activities; while others felt strongly that the current broad scope allows entities to perform complex investment management activities without adequate expertise.

A point was raised that distinguishing different activities within the overall scope of the investment management activity is only necessary to the extent that different licencing and fit and proper requirements are to be imposed. Some commentators argued that the distinction between advice and investment management is more important than the distinction between different types of IM; and an argument was also made that over and above any distinction between different investment management activities, the regulatory framework should also distinguish between different types of FAIS Category I activities (advice and intermediary services) in the investments space.

2.1.2. The FSCA's updated position

Defining "discretionary investment management"

The FSCA remains of the view that an overarching definition of the activity of "investment management" is required. This is a necessary approach in an activity-based regulatory approach such as that of the RDR as a whole. It is also the approach proposed in the activity-based legislative framework to be introduced by the Conduct of Financial Institutions (COFI) Bill, where "discretionary investment management" is one of the activities that will require a licence from the FSCA under the COFI framework.

The FSCA therefore invites suggestions on a possible definition of "discretionary investment management", or on the key elements that such a definition should cover. Our current thinking is that the definition should cover the following[1]:

- Obtaining a mandate from a financial customer to apply an agreed level of decision making, on behalf of the financial customer;
- after establishing and agreeing the financial customer's investment objectives and investment risk appetite;
- identifying, selecting, acquiring or disposing of financial products, financial instruments or other assets (or identifying and selecting other investment managers to perform this activity);
- in accordance with an investment strategy and investment objectives set out in the mandate;
- in accordance with any parameters, limits, thresholds or other instructions set out in the mandate;
- handing any assets acquired over to a custodian or nominee for safekeeping.

It should be noted however that the introduction of a definition of "investment management", and further sub-categorisation of this activity as discussed in Section 2.2 below, does not necessarily need to be deferred until the COFI Act comes into operation. As pointed out in various RDR update publications, in the event of the implementation of the COFI Act being materially later than expected, the FSCA will use existing available regulatory instruments to effect our RDR reforms

[1] Note that some of these elements may be better placed in the "sub-definitions" of proposed sub-activities of investment management. The overarching definition could in turn incorporate these sub-definitions by reference.

where we consider this necessary. Depending on the timing of the COFI legislative process, the FSCA will therefore consider appropriate adjustments to the current FAIS licensing framework to give effect to our proposals regarding invesment management activities. Any such change would of course be subject to our ordinary prescribed consultation processes.

Potential regulatory arbitrage between advice and discretionary investment management – including through "copy trading".

The FSCA agrees in principle that the distinction between advice and investment management should be sufficiently clear to reduce the risk of arbitrage between the regulatory requirements for each activity. Concerns have been raised that a FAIS Category I investment adviser is in effect able to "copy" the services of a Category II investment manager (particularly the services of a multi-manager / MPP), through a process of actively identifying and recommending investments in various combinations of underlying portfolios on an ongoing basis, without needing to meet the more rigorous regulatory requirements for actual investment management. The FSCA's view is that, provided all applicable regulatory requirements for the provision of advice are complied with – including all applicable competency, disclosure and suitability requirements – it is not feasible or desirable to try to impose limits on the extent of these advice activities at present. There is arguably a natural ceiling on the extent to which an adviser could "copy" investment management activities in this way without holding a discretionary mandate, as the need to obtain individual investor instructions and consent for every transaction will become operationally unmanageable across a large investor base.

The FSCA has however been alerted to the potential risks of so-called "copy trading"[2] technology driven models, which enable financial market participants (including less experienced participants) to automatically replicate trading decisions of other investors on trading platforms, thus creating a new type of investment offering. The FSCA plans to undertake further technical work to assess the risks of these models and how best to position the activities concerned within our regulatory frameworks, to ensure they are appropriately regulated. We will also consider the responses of regulators in other jurisdictions to these models.

The FSCA is also mindful of the need to ensure that our proposals regarding "mandates for convenience" (see Section 2.4 below) do not have the unintended effect of increasing the risk of regulatory arbitrage between advice and investment management requirements.

Application of requirement for FAIS Category II FSPs to assess investor suitabilty.

Industry representatives have also requested clarity regarding the application of the current requirement in the FAIS Code of Conduct for Administrative and Discretionary FSPs, requiring investment managers to obtain certain information from customers to identify suitable products, before entering into a discretionary mandate.[3] In particular, clarity has been requested as to whether this requirement needs to be complied with by the Category II FSP concerned where a customer invests in a third party co-branded CIS portfolio managed by that Category II FSP. The concern is that, if the requirement does apply in this scenario, this would be inconsistent with the fact that no such requirement applies where a customer invest in an "ordinary" (not 3rd party co-branded) CIS portfolio. The FSCA takes this opportunity to confirm that this requirement only applies where the investor grants a discretionary mandate to the Category II FSP concerned. Where the transaction concerned is only an investment directly into a CIS portfolio – whether 3rd

[2] Also sometimes referred to as "mirror trading", "coat-tail investing", "social trading" and other terms.

[3] See section 4(b) of FAIS Board Notice 79 of August 2003.

party co-branded or not – no such mandate is granted by the investor to a Category II FSP and the requirement will therefore not apply.

New questions for stakeholder input:

Q1. Please provide your views on the proposed elements to be covered by a definition of "discretionary investment managements". Any suggestions for a draft definition are welcome.

Q2. Do you have any suggestions on how best to mitigate the risk of regulatory arbitrage between advice and discretionary investment management? In particular, do you agree that the practice of "copy trading" presents such a risk and do you have any suggestions as to an appropriate regulatory treatment of this practice?

2.2. Categorising investment management activities

2.2.1. Summary of inputs on the 2018 Investments Document

Most stakeholders agreed that the FSCA's descriptions of the four types of discretionary investment management activities in the document were accurate, but many expressed doubt that these four activity types were an appropriate basis to use for sub-categorising licences and fit and proper requirements. Views on the extent to which sub-categorisation is required at all were aligned with the applicable commentator's view on whether the current broad scope of the FAIS Category II licence criteria is cause for concern (see discussion under Section 2.1.1 above). Some commentators, including a large industry association, argued that no sub-categorisation of investment management activities is necessary, other than carving out "mandates for convenience" from the current scope of investment management.

A compelling case was made that the four investment management sub-categories the FSCA described in the 2018 Investment Document inappropriately conflated differences between activities performed with differences between the legal structures or product "wrappers" used for the resulting investment offering. The view was that, in line with the RDR activity-based approach, any sub-categorisation should depend mainly on the activity concerned. A variation of this argument was a proposal that, in line with an activity based model, a distinction could be made between providers performing actual asset selection (for e.g. "stock picking") and those performing manager selection (i.e. multi-manager / MPP models), rather than a differentiation based on the type of legal construct or business model used to construct the resulting investment portfolios.

Another helpful perspective was that the complexity of investment management activities performed often follows the life of an FSP, with services becoming more complex as the scale and level of sophistication of the business increases. Accordingly, although the commentator was in agreement with a degree of sub-categorisation, they argued that the sub-categorisation should not be too granular, as this would hinder the natural evolution of these businesses. A related argument against overly granular sub-categorisation was to point out that the same investment manager can provide services of different levels of complexity for different customers and for different purposes, and the regulatory framework should therefore be flexible enough to recognise this.

Other noteworthy views included the following:

- It was correctly highlighted that the FSCA's proposed categorisation and activity descriptions did not clearly provide for alternative investment management approaches such as private equity and hedge fund management. It was suggested that these activities may require separate

focus.

- Views differed on whether "traditional" investment management warranted a separate licence and competency category from MPPs, or whether these providers require similar skills.
- A number of commentators argued that no distinction for licensing and competency purposes was required between MPPs and managers of 3rd party co-branded portfolios, as both business models entail the same types of activities and skills, could operate similar portfolio structures, and posed similar risks of conflicts of interest and conduct risk.
- One association proposed that a distinction is required between actual 3rd party co-branding models, as formally provided for in the CIS regulatory framework, and less formally structured MPP offerings put together on a LISP and bearing an adviser's brand, but not structured as a formal CIS portfolio (sometimes referred to as "broker funds"). Some commentators felt that in these models, although the adviser concerned also holds a FAIS Category II licence, no actual investment management is performed.
- Some commentators proposed that it was not necessary to create different licence categories for different types of discretionary investment management, but rather that fit and proper competency requirements should be tailored to the types of underlying products and / or activities performed. Some argued that the current FAIS fit and proper framework already implicitly makes this type of distinction - for example by having different competency requirements for services related to securities (thus applying to "stock pickers") as compared to for services relating to participatory interests in CISs (applying to MPPS who only structure portfolios comprising underlying CISs).

2.2.2. The FSCA's updated position

The FSCA remains of the view that the current "one size fits all" scope of the FAIS Category II licence is too broad to adequately and proportionally deal with the range of investment management services in the market, and that a degree of sub-categorisation of these activities is needed. We believe that this sub-categorisation is required both at actual licensing and at fit and proper requirement level. We also agree in principle with comments that any sub-categorisation should be activity-based, not based on differences in legal construct, product "wrapper" or business model, and that the sub-categorisation should not be so granular as to unduly inhibit flexibility and business development.

The FSCA now proposes that the licensed activity of discretionary investment management be broken down into three sub-activities for licensing purposes:

- Asset management: Discretionary investment management comprising asset selection (including asset class selection);
- Multi-management: Discretionary investment management comprising manager selection (including management style and asset class selection); and
- Alternative investment management: To include hedge fund management, private equity management, and potentially other alternative investment strategies. This category would in effect be an appropriately expanded version of the current FAIS Category IIA licence category.

Each of these sub-activities will need to be clearly defined in the regulatory instruments concerned, and suggestions are invited on appropriate definitions.

The proposed licensing framework would require any entity intending to perform investment management to apply for a licence for discretionary investment management and, as part of that licensing process, to apply for authorisation to perform one or more of the above-mentioned three sub-activities. We confirm that a licensed discretionary investment manager may perform any combination of the three sub-activities, subject to meeting the applicable fit and proper and other licensing requirements for that sub-activity.

New questions for stakeholder input:

Q3. Please provide your views on the proposal to split the activity of discretionary investment management into three sub-activities of asset management, multi-management and alternative investment management.

Q4. Do you have any suggestions for appropriate definitions of each of these sub-activities?

2.3. Fit and proper standards for investment management

2.3.1. Summary of inputs on the 2018 Investments Document

Differences in opinion on the need for differentiated fit and proper requirements for different forms of investment management were aligned with the different views on whether sub-categorisation of investment activities is required. In particular, views differed on whether the current FAIS fit and proper competency requirements for Category II FSPs were adequate or whether they needed strengthening for some or all types of investment management. Some argued that the current requirements are adequate and appropriate, while others felt strongly that the current requirements were too lenient.

Some commentators suggested that any differentiation of fit and proper requirements should focus not only on competence and experience requirements, but also consider differentiated operational requirements.

As noted in paragraph 2.2.1, an argument was made that the current FAIS fit and proper framework already implicitly differentiates between different types of investment management by imposing different competency requirements for different underlying product classes[4]. A specific concern was raised in relation to the current requirements for Category IIA FSPs, highlighting the risk of regulatory arbitrage between the Category II and Category IIA competency requirements.

A number of commentators also urged the FSCA to extend equivalent fit and proper requirements to those for investment managers to authorised users in the financial markets space (stockbrokers), arguing that their activities pose similar risks to investors.

2.3.2. The FSCA's updated position

It follows from the updated proposal that the licensing framework for investment managers should distinguish between asset management, multi-management and alternative investment management, that the fit and proper requirements will need to align to these sub-categories.

The FSCA's current thinking is that the experience and "class of business" training requirements, in particular, will need to be tailored to the three proposed sub-activities. We also invite input on the extent to which all other elements of the current fit and proper framework for Category II FSPs – including operational, qualification, product specific training and CPD requirements – may need to differentiate between the sub-activities[5].

---

[4] See for example the different subcategories under the "class of business" training requirements for the Investments class.

[5] See specific questions in the attached Stakeholder Feedback Template.

The FSCA recognises that there will inevitably be a degree of overlap between the competency requirements for each sub-activity and that the skills and knowledge bases for the three sub-activities are by no means mutually exclusive. We therefore envisage a competency framework comprising a set of “core” requirements that will need to be met by all discretionary investment managers, complemented by additional sets of more focused requirements for each selected sub-activity – viz. asset management, multi-management and alternative investment management – designed to address skills and other requirements specific to that sub-activity.

Suggestions on how to reduce the risk of any current regulatory arbitrage between requirements for different licence categories are also welcome. In this regard, the FSCA will consider a requirement that an investment manager may not adopt investment strategies (such as gearing) that are typical of alternative investments, unless they are licensed for the alternative investment strategy sub-activity.

Note that the question of “levelling the regulatory playing field” between investment managers and investment advisers on the one hand, and authorised users of exchanges providing comparable services to investors on the other, is under review as part of broader policy discussions around the extent to which various provision of the future COFI Act should apply to such users.

New questions for stakeholder input:

Q5. Please provide your views on appropriate fit and proper requirements for each of the proposed sub-activities (asset management; multi-management; alternative investment management) in relation to:
(a) Operational requirements
(b) Minimum qualifications
(c) Minimum experience
(d) Class of business training
(e) Product specific training
(f) Continuous professional development.
Please indicate in what respects (if at all) the above requirements should differ for each sub-activity and to what extent they should differ from the existing competency requirements for FAIS Category II or IIA FSPs.

Q6. Which competency requirements, if any, do you believe should apply equally to all three sub-activities?

Q7. Do you believe there is currently scope for arbitrage between the fit and proper requirements for different licence categories in the investments sector and, if so, do you have any suggestions on how this could be resolved?

2.4. “Mandates for convenience”

2.4.1. Summary of inputs on the 2018 Investments Document

The 2018 Investments Document proposals regarding “mandates for convenience” enjoyed the greatest degree of support from commentators, with a significant majority agreeing that holders of these types of mandates should not be required to hold a discretionary investment management licence, and should be subject to a less rigorous regulatory framework than the current FAIS Category II requirements. Most commentators agreed that this would help to reduce the number of Category II licences that are held by or applied for by entities not performing true discretionary investment management. Some were of the view that current holders of Category II licences would

retain them, but that a more lenient dispensation for "mandates for convenience" would reduce the number of new Category II applicants. Others believed that a number of current Category II licence holders would in fact relinquish their licences to reduce compliance costs if they no longer required the licence.

Views differed somewhat on whether the current FAIS Category I fit and proper competency requirements were sufficient for these types of mandates, or whether additional competency requirements were required. Most stakeholders agreed that, regardless of whether these mandates require specific competency requirements, it would be important to ensure adequate governance and controls.

Most commentators who supported this dispensation agreed that this type of mandate was incidental to the provision of investment advice and that no separate fee should therefore be payable over and above the advice fee concerned. A limited number argued that operating such a mandate was an additional service to investors and should warrant an additional fee. Those opposed to an additional fee argued that this mechanism is in fact a cost saving to the adviser, not an additional service to the investor.

It was highlighted that it would be essential to clearly and carefully define the scope of activities that could be performed under these "mandates for convenience" to ensure that a less rigorous dispensation does not allow for regulatory arbitrage by allowing Category I advisers to perform *de facto* investment management without having to meet Category II requirements.

A suggestions was received that this dispensation should also permit switching between CIS portfolios operated by different investment managers, provided the portfolios concerned have similar mandates or fall under the same CIS fund category.

2.4.2. The FSCA's updated position

The FSCA proposes to create and define a specific regulated activity for what the 2018 Investments Document described as operating a "mandates held mainly for convenience".

General criteria

We remain of the view that this dispensation should be subject to the following criteria as set out in the 2018 Investments Document:

- Intermediaries holding these mandates are not regarded as exercising investment discretion but rather as holding a more limited authority to perform specified services under a written "standing authorisation" from a customer, without having to obtain the customer's separate written instruction on each such occasion;
- The intermediary is not regarded and may not describe itself as an investment manager (unless they also in fact hold an investment management licence).

In addition, in order to limit the scope and potential risks of this service, the dispensation will be limited to mandates granted **by retail investors**. Portfolio rebalancing and similar activities for non-retail customers, which are a potentially complex exercise, will therefore continue to require a full discretionary investment management licence. The FSCA recognise that this will require a definition of "retail investor". Our proposal is that this dispensation should initially apply in respect of investors who are natural persons only and, assuming that the COFI Act will in due course include a broader definition of "retail customer" that includes small businesses, the scope of this dispensation can be correspondingly expanded when that Act comes into operation.

Terminology

The FSCA invites suggestions on an appropriate naming convention for this type of mandate. Options we have considered include “standing portfolio adjustment authorisation”; “limited investment administration mandate”; “defined investment execution mandate” – or combinations of this terminology – but other suggestions are welcome.

Scope of the mandate

The FSCA fully agrees that a clear definition for the types of services that may be provided under this type of mandate / authorisation, that clearly sets out its limitations, is essential. It is important to avoid the risk of regulatory arbitrage whereby a Category I adviser purports to use this dispensation to de facto perform discretionary activities (see the discussion under paragraph 2.1.2 regarding potential regulatory arbitrage between advice and discretionary investment management).

In the 2018 Investments Document we stated that “transactions to be executed under such an authorisation would be limited to those required to rebalance the client’s portfolio - at certain pre-agreed periods of time - back to the percentage fund exposures and / or asset allocation (in the existing selected portfolios / underlying assets) that the client originally agreed to, or to place additional investments into the same portfolios that the client originally agreed to”. This remains the FSCA’s position, and we now invite specific input as to how such a mandate should be expressed.

We are considering the feasibility of prescribing a standard mandate template – possibly with a short “menu” of pre-defined types of transactions that the customer could elect to authorise - to mitigate the risk of “scope creep” for these mandates.

The FSCA has also considered the suggestion that this dispensation should be extended to permit switching between CIS portfolios operated by different investment managers, provided the portfolios concerned have similar mandates or fall under the same CIS fund category. Our concern with this proposal is that it does entail the exercise of actual discretion by the Category I adviser as to the selection of investment managers, as opposed to mere ongoing alignment with a previously agreed investment solution, and should therefore fall within the regulatory framework proposed for the discretionary activity of “multi-management”. We are also concerned that expanding the mandate in this way increases the risk of conflict of interests, where switches between funds could be influenced by the adviser’s relationship with the CIS management company and / or investment managers concerned, rather than solely motivated by the investor’s needs. The ability to make such switch decisions without prior customer consent could also increase the risk that the investor does not receive the level of advice that would otherwise be expected from a Category I FSP before recommending such a change. The FSCA is therefore not in favour of extending the “convenience” mandate to such switches. .

Fit and proper requirements and other conduct standards

The FSCA’s current thinking is that we will not require additional fit and proper requirements for holders of “mandates for convenience” over and above the requirements that the holder will in any event need to meet in their capacity as a Category I adviser in relation to the types of investments subject to the mandate. Note that this means that a “mandate for convenience” may only be held by an FSP that is licensed under Category I for the provision of advice in relation to the investment products concerned. It also follows that any individual representative of the FSP that will be implementing the mandate must meet all applicable fit and proper competency requirements.

Aside from fit and proper requirements, these mandate holders will be subject to specific governance requirements and other conduct standards relating to oversight by management and key individuals, mandate control, customer communication and disclosure, record keeping, and regulatory reporting.

We will also consider imposing appropriate oversight obligations, where applicable, on CIS management companies and / or LISP platforms acting on the instructions of these mandate holders – for example requiring them to verify that the mandate is in fact in place before effecting the transactions concerned.

Remuneration

The FSCA remains of the view that the Category I adviser concerned may not receive a fee for this service over and above an advice fee negotiated with and agreed to by the customer. This is in line with our view that actions taken under a "mandate for convenience" are ancillary to the investment advice provided.

Licensing and authorisation approach

Holding and acting on a "mandate for convenience" will not require a separate licence category or authorisation by the FSCA. Any FSP licensed under the FAIS Act as a Category I FSP (for advice in relation to the applicable product categories) will be permitted to perform this activity. They will however be required to notify the FSCA that they intend to perform this activity, in order to enable the FSCA to identify FSPs performing this activity so that we can supervise compliance with relevant requirements[6]. Note that the FSCA, using its normal enforcement powers, will be able to direct an FSP or representative to cease these activities, or impose appropriate sanctions, in the event of contravention of standards regarding these mandates.

Where the Category I FSP concerned does in fact also hold a discretionary investment management licence (currently a Category II or IIA licence), separate notification to the FSCA of the intended performance of this activity is not required. The performance of the types of services envisaged under this mandate will in that case be a function of the applicable discretionary mandate already in existence.

[6] This notification approach will therefore be similar to the approach currently in place for Category I advice FSPs that provide "automated advice".

FSCA
Financial Sector Conduct Authority

New questions for stakeholder input:

Q8.Do you agree that the dispensation for "mandates for convenience" should be restricted to retail investors? If you believe it should not be so restricted, please provide examples of where such a mandate would be appropriate in the non-retail space.

Q9. Please provide suggestions on an appropriate term to denote a "mandate for convenience".

Q10. Please describe the specific types of transactions you believe are appropriate to be authorised under a "mandate for convenience", recognising the need to avoid inappropriate arbitrage between these mandates and discretionary investment management mandates.

Q11. Do you support the proposal for a prescribed standard template with a "menu" of pre-defined permissible transactions for these "mandates for convenience"?

Q12. Do you foresee any unintended consequences of the FSCA's view that "mandates for convenience" should not be extended to include switches between similar CIS portfolios?

Q13. Do you foresee any unintended consequences of imposing no additional fit and proper competency requirements for holding a "mandate for convenience" over and above the applicable requirements for a FAIS Category I (advice) licence?

Q14. Please provide suggestions for appropriate governance, record keeping, disclosure and / or regulatory reporting requirements to be imposed on the holder of a "mandate for convenience".

Q15. Do you agree that CIS management companies and LISP platforms should be required to verify that a "mandate for convenience" is in place before acting on the instruction of such a mandate holder? If not, why not?

Section 3: Categorising investment advisers within an RDR framework

As explained in previous RDR communications, the adviser categorisation model to be adopted under the RDR framework distinguishes between:

- Product supplier agents (PSAs), who operate on the licence of a product supplier and may provide advice on the products of that product supplier (and other product suppliers in its group) only; and
- Registered financial advisers (RFAs), who will be separately licensed in their own right to provide advice on whatever products their licence permits, and are not limited to offering the products of any particular product supplier/s.

This two-tier adviser categorisation model also means that the same entity will not be permitted to operate as both a PSA and an RFA. A clear choice between the two categories of adviser will be required.

The 2018 Investments Document asked a number of questions regarding the implications of this adviser categorisation approach for the investments sector, dealt with in potential Measures 7 to 14 and questions 6 to 13 in the 2018 document. This Section summarises the responses received and provides an update on the FSCA's thinking in this regard.

This Section should be read together with the FSCA's paper titled *RDR: Discussion Document on Categorisation of Financial Advisers and Related Matters*, also published in December 2019.

Questions for stakeholder input in the 2018 Investments Document:

Q6. Which of option (a) or (b) under Measure 7 above do you believe would be most appropriate to provide for the possibility of an investment adviser acting as the PSA of an investment manager or LISP? If you do not believe that either option is appropriate or necessary, please explain why and let us know if you have any alternative suggestions. In particular, please indicate whether or not you believe it is necessary to provide for the situation where an investment adviser could act as the PSA of a LISP and why you hold this view.

Q7. Would your answer to Question 5 above in relation to allowing an investment manager to appoint a PSA be the same in relation to allowing an MPP to appoint a PSA as discussed under Measure 8? If not, why not?

Q8. Do you agree that all of the distribution model options described in Measure 9 should be available to all investment managers and MPPs and do you agree with the descriptions of each model? If not, why not?

Q9. Please provide your views on the correctness, feasibility and likely effectiveness of each of the possible provisions set out under Measure 10 to regulate CIS white label arrangements. Please let us know if you have any alternative suggestions.

Q10. Do you agree that a CIS management company should be able to appoint a PSA to provide advice on its portfolios? If not, why not? If yes, do you agree with the above description of the implications of such an arrangement?

Q11. Which of options (a) to (c) under Measure 12 above do you believe would be most appropriate to deal with the implications for PSAs of using a LISP platform outside their group? If you do not believe that any of these options is appropriate, please explain why and let us know if you have any alternative suggestions.

Q12. Do you agree that the details under Measure 13 correctly describe the adviser categorisation implications of acting as a third party co-branding investment manager as well as holding another type of discretionary mandate? If not, why not? Are there any additional implications we have not identified that might influence the adviser categorisation in these business models?

Q13. Do you agree that an appropriate due diligence review should be required in all of the scenarios set out under Measure 14? Are there additional arrangements requiring due diligence that we have not mentioned? Do you have any suggestions as to what such due diligence requirements should comprise?

3.1. Is there a need for a “tied” advice / product supplier agent (PSA) model in the investments sector and how would it work?

3.1.1. Summary of inputs on the 2018 Investments Document

Commentator views were divided on whether there is a demand for “tied” advice models in the investment space, and whether strict application of the two-tier PSA / RFA categorisation is feasible for investment advice.

Some commentators felt that, particularly in light of the "open architecture" nature of investment offerings and the need for flexibility in tailoring investment solutions to customer needs, there would be very little demand for an advice model which limited advice to the offerings of a single supplier or group. The opposite view was that, where an investment manager has developed its own "in house" investment solutions and has confidence that these meet an adequate spread of customer needs, an advice model restricted to recommending such solutions should be available. It was also pointed out that "tied" advice models already exist in a number of financial groups, where for example the tied advisers of an insurer in the group also offered the investment products of CIS management companies and / or LISP platforms in the group.

Some argued that it should be open to financial groups to include both tied and non-tied distribution channels (i.e. both PSA and RFA models) in the same group through separate legal entities, while others argued that the PSA / RFA split at entity level would not be feasible and that the same entity should be permitted to offer tied advice for some products / solution types and non-tied advice for others. Some took this further, arguing that different individual advisers in the same entity should be able to be tied and others non-tied.

It was generally recognised that the tied advice model would be most likely to be adopted in so-called "vertically integrated" models, although some commentators felt that these models made up a relatively small proportion of the investments industry and it was therefore not necessary to introduce the complexity of a tied advice framework for these models.

Most stakeholders who supported the need for a tied investment advice model highlighted that this should nevertheless allow adequate flexibility in relation to the use of "open architecture" investment platforms and portfolio construction.

Clarity was requested on whether, where the advisers in a group predominantly recommend their in-house solutions, but are not contractually precluded from also recommending external solutions, this would mean that the advisers have to be categorised as PSAs.

3.1.2. The FSCA's updated position

The FSCA believes that there is, on balance, a need to provide for a tied / PSA advice model in the investments sector, where industry players can if they so wish establish distribution models that limit advisers to recommending "in-house" or "in-group" investment offerings. This will however require careful delineation of what constitutes such a group offering, with due regard to the "open architecture" flexibility of investment structures. (See section 3.2 below).

The establishment of a tied advice model will entail an explicit contractual limitation on the advisers concerned, disallowing them from providing advice on any products or services external to the group. Absent such a contractual limitation, the advice channel will be categorised as an RFA.

The fact that a particular RFA adviser or advice channel primarily recommends the offerings of a particular product or service provider, including in-group offerings, will therefore not automatically preclude it from being categorised as an RFA, nor will it necessarily trigger "re-classification" as a PSA channel. The RFA will however need to be able to satisfy the FSCA that there are no incentives in place that create the risk of biased or conflicted advice. For group structures, we will require appropriate controls to be in place to ensure that advisers are indeed free to recommend external offerings where the in-group offerings are not appropriate to an investor's needs. The FSCA will also monitor the spread of products or services recommended by RFAs, and require the RFA itself to monitor the recommendations of its individual advisers, to mitigate the risks of such conflicts. This scrutiny will be proportionally closer in vertically integrated group structures, given the increased risk of conflicts of interest in such models. If the FSCA observes that an RFA channel in a group is in practice exclusively or nearly exclusively recommending in-group offerings only, we are likely to interrogate management as to whether the channel is appropriately structured as an RFA or

whether a PSA structure would be more appropriate.

We also confirm the following:[7]

- It will be permissible for the same group of companies[8] to operate both tied and non-tied (PSA and RFA) advice channels, provided these are operated through separate legal entities. Group level governance controls will need to be in place to mitigate the risk of conflicts of interest arising in such business models.
- It will not be permissible for the same entity to offer tied advice for some products / solution types and non-tied advice for others; nor for different individual advisers in the same entity to provide tied advice and others to provide non-tied advice. This does not preclude an RFA firm from allowing some advisers to offer advice on a broader range of products and services than others, depending for example on their competence and experience levels or the customer groups they serve, provided that such restrictions do not limit the adviser to in-group offerings only.

3.2. Defining "group" products and services for determining the scope of advice for a tied (PSA) investment adviser

3.2.1. Summary of inputs on the 2018 Investments Document

In the RDR framework, the concept of a PSA entails an adviser acting as the agent of a product supplier, where that product supplier itself is licensed to provide advice and the PSA therefore operates through the product supplier's advice licence. In the current FAIS framework, the product supplier would be required to hold a FAIS Category I FSP licence for advice, and the individual PSAs would be representatives of that product supplier FSP. In the investments sector, although CIS management companies are regarded as product suppliers, discretionary investment managers and LISP platforms (administrative FSPs) are regarded as performing specialised intermediary services, under FAIS Category II / IIA and Category III licences respectively.

The 2018 Investments Document therefore noted that in order to provide for a tied advice model in relation to investment management services and / or LISP platform services, it would be necessary to deviate from the base RDR model in one of two ways: Either (a) by providing that a PSA could act as an agent of either a product supplier or a service provider; or (b) by regarding investment managers and / or LISPs as "product suppliers". The significant majority of stakeholders preferred option (a), viewing it as less disruptive to the current FAIS framework, with very limited support for option (b).

Most commentators agreed that it should be possible for an adviser to be appointed as the PSA of a CIS management company, and that this was already legally possible as a CIS management company is clearly a product supplier. There were however opposing views, arguing either that it should not be possible for a PSA to act for a CIS management company, or that there would be little demand for this, as CIS management companies are typically not equipped to oversee advice models and do not regard advice as part of their value proposition. In response to whether it would be necessary to provide for PSAs to be appointed by LISP platforms, the majority (but not unanimous) view was that this would not be appropriate as these platforms perform a purely administrative function in relation to the investments managed on their platforms, and that it is these investments that are the subject of advice rather than the administrative services of the LISP itself.

---

[7] Please also see the *RDR Discussion Document on Categorisation of Financial Advisers and Related Matters*, also published in December 2019, which provides further detail on a number of the matters discussed in this section.

[8] The *RDR Discussion Document on Categorisation of Financial Advisers and Related Matters* proposes a definition of "group of companies" aligned to the corresponding definition in the Companies Act.

The point was made that although the choice of LISP can have service delivery and efficiency implications for customers, it does not in itself have significant impact on investment returns and that the focus of RDR should therefore be on the selection of investment portfolios and / or investment managers, rather than the selection of a LISP platform.

The majority of stakeholders felt that, if tied advice relationships were to be established in the investments space, these would most likely be between advisers and discretionary investment managers in their groups, rather than between advisers and CIS management companies or between advisers and LISPs.

One of the most contentious issues raised in the 2018 Investments Document was the question of whether, and to what extent, a PSA within a financial services group should be permitted to provide advice on investment offerings administered on a LISP platform outside of the group. The FSCA had requested views on three options: (a) Disallow the PSA channel from advising on offerings on any LISP outside the home group. This would also mean that PSA channels in a group that did not have its own LISP platform in the group, would not be able to offer LISP based portfolios at all; (b) Allow the PSA channel to advise on offerings on an external LISP, but only where the LISP does not have its own LISP platform and where the investment offerings on the external LISP are structured by an investment manager in the home group; Or (c), the same option as option (b), but with the further limitation that use of an external LISP will only be permitted in groups below a certain size and scale.

Views on all three of these options diverged widely. The majority of commentators viewed option (a) as unnecessarily restrictive and unfair to groups that did not have their own LISPs, and objected to option (c) as unduly interfering in business model choices by seeking to “force” larger groups to establish LISPs if they wish to run tied advice models. Option (b) enjoyed the greatest level of general support, although a number of concerns were raised regarding some or all of the conditions attached to this option.

The argument was put forward that, because a LISP platform is purely an administrator (see above), limitations on the use of external LISPs are unnecessary. Although a number of commentators supported limiting PSA advice to products on the in-group LISP for groups that do have a LISP, others argued that even in this case PSAs should be permitted to offer products on external LISPs too. A valid point was also raised that it would be inconsistent to allow a PSA in a group that does have a LISP to recommend investments managed by non-group investment managers if these are administered on the in-group LISP, but then to limit PSAs of groups that do not have a LISP only to investments on an external LISP that are structured by an in-group investment manager.

The important point was raised that any change in the adviser categorisation model would need to clarify how existing investments and contractual relationships between advisers, customers and other entities in the value chain (so-called “legacy” arrangements) would be impacted.

3.2.2. The FSCA’s updated position

Allowing investment managers to appoint “tied” advisers

The FSCA believes that the regulatory framework should allow a discretionary investment manager – in any of the three sub-categories of investment management proposed in this document – to appoint “tied” / PSA advisers if it so wishes. We agree with the view of the majority of stakeholders that the most appropriate way to provide for this will be to extend the scope of the PSA model to allow tied advisers to be appointed by either product suppliers or service providers (specifically, discretionary investment managers). This would also require a change to the current RDR term of

"product supplier agent", which would not be an accurate description of this relationship.[9]

It follows that a tied adviser / PSA will therefore, in addition to being permitted to recommend financial products offered by a product supplier in its home group (such as a bank, insurer or CIS management company), also be permitted to recommend the entering into of a discretionary investment mandate with a discretionary investment manager that is also a member of that group. Note that the focus here is on the entity *in whose favour the actual discretionary mandate is signed* by the customer concerned – it is that entity which needs to be a member of the group concerned in order for the recommendation concerned to fall within the scope of tied / PSA advice. Note that, where the investment is directly into a CIS portfolio, the customer concerned does not sign a discretionary investment mandate. Accordingly, in the case of CIS portfolios, the PSA will be permitted to recommend any CIS portfolio offered by a CIS management company within the group, regardless of whether the underlying investment manager/s of the CIS portfolio is also a member of the group.

Where an adviser acts as the tied adviser / PSA of a discretionary investment manager, that investment manager will therefore be fully accountable for the advice provided and for ensuring compliance with all applicable legislative requirements related to that advice.

PSAs of CIS management companies

The FSCA confirms that it will also be permissible for a CIS management company to appoint "tied" / PSA advisers if it so wishes. As CIS management companies are already product suppliers for FAIS purposes, this will not require any structural change to the FAIS licensing framework. As pointed out in the 2018 Investments Document, this it will however be necessary to amend the current FAIS exemption of CIS management companies, to confirm that the management company and the adviser will indeed be subject to relevant FAIS obligations relating to the provision of advice in such cases. It will also be necessary to amend CIS legislation to remove "advice" from being included as part of the scope of the CIS management company's ordinary administrative activities.

Use of LISPs by tied advisers

The FSCA agrees in principle with stakeholders who argued that the services of a LISP platform (Administrative / Category III FSP) are purely administrative in nature, and that the identity of the LISP should therefore not be a material factor in determining which investment products or investment management services a PSA may recommend. We therefore now propose that, *where there is no LISP platform inside a group*, PSAs will be permitted to recommend the following types of investment offerings:

- Investments directly into CIS portfolios offered by a CIS management company that is a member of the group;
- Other investment products issued by other product suppliers in the group – such as bank deposits or insurance policy "wrapped" products of a bank or insurer in the group, regardless whether any investments underlying such a products are administered by an investment manager inside the group or not;
- Investments directly into 3rd party co-branded CIS portfolios managed by an investment manager that is a member of the group, regardless whether the CIS management company is a member of the group or not;
- Offerings administered on a LISP but not in the form of investment directly in a "product wrapper" such as an insurance policy or a CIS portfolio, where the investor signs a discretionary investment mandate with a discretionary investment manager that is a member of the group, regardless of which LISP or LISPs the offering/s may be administered on. In the case of a multi-managed investment, provided the discretionary investment manager with whom the

[9] See proposals regarding terminology to describe different categories of advisers in the *RDR Discussion Document on Adviser Categorisation and Related Matters*, also published in December 2019.

mandate is signed is a member of the group, it will not be necessary for any underlying investment managers to also be members of the group;
- Other investments (for example segregated portfolios) entailing the signature of a discretionary investment mandate with an investment manager that is a member of the group.

In view of the divergent feedback received on the extent to which PSAs should be able to recommend products administered on LISPs outside the group in cases *where there is a LISP platform inside the group*, we invite feedback on which of the following approaches is preferable in relation to LISP administered investments:

- *Option1*: Group PSAs to have the same product range as set out above for PSAs of groups that do not have a LISP; or
- *Option 2:* As for Option 1, except that offerings administered on a LISP but not in the form of investment directly in a "product wrapper", where the investor signs a discretionary investment mandate with a discretionary investment manager that is a member of the group, must be administered on the in-group LISP. As for groups without a LISP, in the case of a multi-managed investment, provided the discretionary investment manager with whom the mandate is signed is a member of the group; it will not be necessary for any underlying investment managers to also be members of the group.

Importantly, the approach that the choice of LISP is not a key factor in adviser categorisation, presupposes that the role of LISPs in the investments value chain is indeed purely administrative, and does not stray into influencing actual investment management decisions and investment advice. Our proposals regarding choice of LISP platforms therefore need to be complemented by our other RDR proposals regarding "clean pricing" of LISP services and removal of rebates[10] and more broadly mitigating conflicts of interest in the investments value chain. These proposals will be consulted on in more detail in due course.

PSAs of LISPs

If, as discussed above, if it is accepted that a LISP's role is purely administrative, the FSCA believes it follows that there should be no need for a LISP platform to be able to appoint its own PSAs to provide advice on its behalf – i.e. to recommend the use of the LISP's administrative services. We invite comment however on whether there are in practice business models where it would be appropriate for a LISP to appoint its own PSAs. (Note that this would imply that the LISP itself would need an advice licence in addition to its platform administration licence – i.e. both a Category I FSP licence and a Category III FSP licence.)

General

In summary: The combined effect of the FSCA's above thinking regarding the scope of "group" products and services for purposes of PSA limitations, is that a PSA will be limited to advising on either "product wrappers" offered by product suppliers in the group or, where the offering is not in the form of such a product wrapper, recommending the granting of a discretionary investment mandate to an investment manager in the group. Other than possibly limiting PSAs that have a LISP platform in their group to using such platform for non-"wrapper" offerings, the choice of LISP platform on which such offerings may be administered will not be restricted.

Note however that in all cases the use of LISP platforms and investment managers outside the PSA group will be subject to applicable due diligence processes, as discussed in the 2018 Investments Document.

[10] See Proposal YY in the initial RDR paper.

New questions for stakeholder input:

Q16. Please provide your views on the FSCA's proposed approach to allowing investment managers to appoint "tied" advisers.

Q17. Please provide your views on the FSCA's proposed approach to PSA's of CIS management companies.

Q18. Please provide your views on the FSCA's proposed approach to the use of LISPs by tied advisers where there is no LISP platform in the group.

Q19. Please let us know whether you prefer option (1) or (2) above in respect of the use of LISPs by tied advisers where there is a LISP platform in the group. Please explain why you prefer this option.

Q20. Please describe any business models you are aware of where a LISP platform's role goes beyond purely administrative functions and could potentially influence investment management decisions or investment advice.

Q21. Please describe any business models you are aware of where it would be necessary or appropriate for a LISP platform to be able to appoint its own tied advisers.

3.3. Third party co-branded CIS models

3.3.1. Summary of inputs on the 2018 Investments Document

The 2018 Investments Document proposed various measures to clarify the relationships between CIS management companies and discretionary investment managers in relation to third party co-branded CIS portfolios.

Although most stakeholders agreed that the CIS management company should be responsible for the investment management activities of the 3rd party investment manager, there were some dissenting views. Some commentators argued that CIS management companies operating 3rd party co-branding models typically specialise in investment administration, but do not have the skills and capacity to be accountable for the actual investment management activities (asset and manager selection). Accordingly, these commentators felt that although the CIS management company should be accountable for overseeing the administrative and governance related compliance of the 3rd party investment manager, it should not be accountable for the actual investment decisions, portfolio construction activities and resulting investment performance of the 3rd party. A few commentators took this argument further, raising a concern that if the CIS management company were to be held fully accountable for the actual investment decisions of the 3rd party, this would compromise the value proposition of the 3rd party investment managers using this business model, and could result in the CIS management company "second guessing" the 3rd party investment manager's strategies. It was also argued that the FSCA's approach would result in greater levels of vertical integration and lack of competition in the investments sector, adding additional fee layers and driving up costs to investors.

Among those who supported holding the CIS manager accountable for the 3rd party's investment management activities, some made the additional point that this should not allow the 3rd party itself to abdicate its own regulatory responsibilities as an investment manager.
There was general support for the proposal that, notwithstanding its accountability for the 3rd party's investment manager activities, the CIS management company should not be accountable for the

advice provided by the 3rd party investment manager or its associates (unless these also happen to be PSAs of the CIS management company or its group).

Views were divided on whether any advice provided by a 3rd party investment manager operating a co-branded CIS portfolio (where the 3rd party also holds an advice licence) may describe itself as "independent".

Views were also sharply divergent on the extent to which the CIS management company in these business models should take responsibility for the services provided by a LISP, where the co-branded portfolio concerned is offered through one or more LISP platforms. Some commentators agreed with the FSCA proposal that the CIS management company should have the same responsibility in relation to the LISP in these models as for any other (non co-branded) CIS portfolio it manages. Others felt that the FSCA's proposal was not consistent with the practicalities of LISP services. It was flagged that, although some degree of due diligence in relation to a LISP may be appropriate (see section 3.4 below), the LISP does not act as the agent of the CIS management company whose portfolios are placed on its platform, and the CIS management company's responsibility for the LISP's services should therefore not be overstated. It was pointed out by some that the CIS management company will often not have access to data regarding LISP administered investments at adviser level – for e.g. the CIS management company will not know which investment advisers support its portfolios through the LISP – and that this reality must be recognised in setting expectations for oversight of LISPs.

An additional concern was raised regarding business models that are not formally structured as 3rd party co-branded CIS portfolios, but are structured as less formal "co-named broker funds", where CIS management companies allow financial advisers to co-brand portfolios without performing actual investment management activities in relation to the offerings concerned.

3.3.2. The FSCA's updated position

CIS management company oversight of the 3rd party's investment management activities

The FSCA remains strongly of the view that a CIS management company that enters into third party co-branding arrangements retains full accountability for the third party's outsourced investment management activities. In addition to the views set out in the 2018 Investments Document, the FSCA's rationale for this approach is illustrated by and expanded on in the reasons provided in our recent administrative penalty decision against MET Collective Investments (Pty) Ltd.[11]

The FSCA is therefore not persuaded by the concerns raised regarding the CIS management company unduly "second guessing" the 3rd party investment manager or undermining its role. We are not aware in our supervisory experience of any actual examples of such "second guessing", over and above compliance and risk management oversight by the CIS management company, actually taking place. Our expectation would be that the CIS management company's oversight should be of a similar level to that over investment managers managing non co-branded CIS portfolios.

Robust CIS management company oversight is a necessary precondition for outsourced 3rd party co-branded portfolios and the MET Collective Investments case vividly illustrates the risks of an oversight failure. Where an entity wishes to manage an approved CIS portfolio but is not comfortable with the level of CIS management company oversight required in the 3rd party co-branded model, the entity has no alternative but to apply for its own licence as a CIS management company.

---

[11] See FSCA Case number 11/2019.

The FSCA will however consider issuing regulatory guidance to clarify our expectations on the respective responsibilities of the CIS management company and the 3rd party investment manager in these models, should it become apparent that there is confusion in this regard.

Independence of advice in 3rd party co-branded arrangements

On the question whether advice provided by the 3rd party investment manager (where it is also licensed for advice) or members of its group may describe its advice as "independent", we confirm that the same prerequisites for this designation as set out in pending changes to the FAIS General Code of Conduct and in the *RDR Discussion Document on Adviser Categorisation and Related Matters*, will apply where the adviser operates as an RFA. The mere existence of the 3rd party co-branding arrangement will therefore not preclude the RFA adviser from describing itself as "independent", provided the other criteria for that designation apply. Note however that an adviser appointed as a PSA of the 3rd party investment manager or as a PSA in its group, will never be able to use the designation "independent".

Responsibility for use of LISPs in 3rd party co-branded models

Concerning the CIS management company's responsibility for the activities of a LISP on whose platform the 3rd party co-branded portfolio is administered, the FSCA remains of the view that the management company should have the same responsibilities as would apply where non co-branded CIS portfolios are offered through a LISP platform. We believe that the concern raised that the CIS management company may not have access to adviser level data is misplaced. Our proposal does not require oversight of the LISP's activities at adviser level, but rather oversight at portfolio level. A CIS management should always be aware of the fact that its portfolios, including 3rd party co-branded portfolios, are being administered on a LISP platform.

Further potential risks

Lastly, the FSCA will do further fact finding regarding the concern raised around so-called "co-named broker funds" that are not operated through formal 3rd party co-branding arrangements, to understand the nature, prevalence and potential conduct risks posed by any such practices. One potential option we are considering is to require a LISP to ensure that no such branding is allowed on its platform unless it has verified that the entity concerned is licensed as an investment manager (typically this would be as a "multi-manager") and does in fact hold and act on discretionary mandates in relation to the branded solution. A LISP would therefore be disallowed from permitting such branding by any entity that holds only a Category I licence, including where it holds a "mandate for convenience".

New questions for stakeholder input:

Q22. Please provide your views on the FSCA's proposed approach to when advice in relation to 3rd party co-branded portfolios may be described as "independent".

Q23. Please provide your views on the nature, prevalence and potential conduct risks of so-called "co-named broker funds" that are not operated as formal 3rd party co-branded CIS portfolios.

Q24. Do you agree that a LISP platform should be required to ensure that no branded portfolio is allowed on its platform unless it has verified that the entity concerned is licensed as an investment manager and does in fact hold and act on discretionary mandates in relation to the branded solution? If not, why not?

3.4. Due diligence responsibilities

3.4.1. Summary of inputs on the 2018 Investments Document

All commentators broadly agreed that an appropriate level of due diligence should be performed by players in the investment value chain before entering into relationships with one another or recommending their products and services to financial customers. Further clarity was however requested regarding the FSCA's expectations around the extent and outcomes of such due diligence investigations. A number of commentators argued that the same level of due diligence would not be appropriate as between all the types of entities involved and that a proportional approach should be applied, taking into account the capacity of the entity required to perform a due diligence. For example, a small financial advisory business should not be expected to perform the same level of due diligence on a large CIS investment manager, as a CIS management would be expected to perform on a LISP platform.

Other key points raised were:

- Prescribed due diligence requirements should be principles-based and flexible.
- The FSCA should consider alignment with other due diligence requirements in other regulatory frameworks, such as those for insurers.
- Entities required to perform a due diligence should be entitled to place reasonable reliance on the fact that the entity to be reviewed has been licensed by the FSCA.
- Entities should not be required to perform an additional due diligence where this has already been performed by another entity in its group.
- Concern was raised that the term "due diligence" implies that an extensive financial and operational reviews such as that used in large corporate finance transactions is required, and an alternative term should be considered.
- The scope of the required due diligence should be limited to factors relevant to the particular products and services to be used / recommended by the entity performing the due diligence.
- One commentator suggested that an entity required to perform a due diligence should be permitted to outsource the task to an appropriate expert, particularly where the first-mentioned entity may not have sufficient expertise in the other entity's activities. This was expanded to suggest that such expert reviews could, subject to agreed industry level criteria, then be made available to prospective customers more broadly – an approach analogous to a "roadworthy certificate".

3.4.2. The FSCA's updated position

The FSCA acknowledges that further clarity is required regarding expected levels of due diligence in different situations and will consult on more detailed proposals in due course, taking the above inputs into account. We agree with the view that due diligence requirements should be flexible and proportional. Although we agree that an entity required to perform a due diligence exercise should be able to place reasonable reliance on the fact that an entity has been licensed by the FSCA, we emphasise that due diligence cannot be reduced to a mere licence check.

New question for stakeholder input:

Q25. Pending further consultation, do you have any specific views you wish to share with the FSCA at this stage regarding appropriate levels of due diligence between different entities in the investments value chain?

Section 4: Implications for remuneration and charging structures

This Section deals with matters raised under potential Measures 15 to 21 in the 2018 Investments Document, and responses to Questions 14 to 20 of that Document. As noted in Part A above, final proposals on a number of the matters dealt with in this Section 4 are to an extent dependent on the outcomes of our consultation on Sections 2 and 3. This Section therefore provides feedback at a more summarised level than the preceding Sections, and in the main indicates areas of further stakeholder engagement.

Questions for stakeholder input in the 2018 Investments Document:

Q14. Do you support the use of ASISA's EAC cost disclosure mechanism as proposed and do you have any suggestions as to how it could be applied or adapted to support the desired RDR outcomes regarding cost transparency in the investments sector?

Q15. Please provide your views on the questions raised under Measure 16 in relation to mitigating the risks of duplication of charges. Are there any other risks of inappropriate duplication of fees and charges in the investments sector that we should be considering?

Q16. Please provide your views on each of the possible regulatory responses noted under Measure 17 in relation to mitigating the risks of conflicted advice. Are there any other risks of conflicted advice in the investment sector that we should be considering?

Q17. Please provide your views on the correctness, feasibility and likely effectiveness of each of the possible provisions set out under Measure 18 in relation to facilitation and monitoring of fees and charges. In particular, do you agree that the provisions should extend beyond advice fees, and if so in what circumstances? Please let us know if you have any alternative suggestions.

Q18. Please provide your views on the appropriate remuneration model for automated advice services.

Q19. Please provide your views on the appropriate remuneration model for non-advised investment product sales. Inputs on the current extent and structure of such models will be appreciated.

Q20. Please provide your views on how best to mitigate the risk of conflicted exercise of discretion in the situation discussed under Measure 21. Inputs on the current extent of such models – i.e. where investment management fees are charged by both the model portfolio provider and the underlying investment manager/s - will be appreciated.

4.1. Cost disclosure

4.1.1. Summary of inputs on the 2018 Investments Document

Almost all commentators indicated in-principle support for using a cost disclosure model based on ASISA's Effective Annual Cost (EAC) disclosure mechanism for a broader range of investment offerings. It was pointed out however that the EAC mechanism was designed for specific purposes and would require some technical adjustment to be effectively applied to a broader range of products and business models.

Commentators highlighted that it would be important to ensure that the disclosure mechanism enabled visibility of the costs of all “layers” of entities and services in the applicable investment value chain and catered for all business models. It was argued that this will enable investors to make informed decisions and comparisons and to assess the “value add” of the different services charged for. The need for both simplicity and flexibility of the model was also flagged, with some concerns raised that the current EAC model is complex and difficult for ordinary customers to understand.

One commentator, who did not support the use of the EAC model, argued that it places undue emphasis on the cost element of an investment and disregards the actual quality of investment outcomes.

A number of suggestions were also made that a disclosure document similar to the prescribed Minimum Disclosure Documents required for CIS portfolios should apply to offerings outside of the formal CIS framework, such as model portfolios.

4.1.2. The FSCA’s updated position

Based on feedback received, the FSCA will engage with ASISA and other stakeholders to understand the extent to which the EAC model could be adapted as a broader investment cost disclosure mechanism, and the associated technical challenges. We fully agree that the disclosure model needs to enable investors to understand and compare the costs associated with every entity in the value chain, what services are being provided for that cost, who the recipient of any remuneration is, and what the impact of each item of cost will be on their investment return.

The FSCA also agrees that investment managers offering model portfolios and other non-CIS solutions should be required to provide disclosure documents similar to - and comparable with - CIS Minimum Disclosure Documents, and will consult further on how best to achieve this.

Also note the new requirement in the amended s.3A of the FAIS General Code of Conduct[12] requiring written customer consent to the amount, frequency, payment method and recipient of any fees (other than regulated commission and certain other regulated fees) including consent to the details of the services that are to be provided in exchange for the fees.

New question for stakeholder input:

Q26. Pending further consultation, do you have any specific views you wish to share with the FSCA at this stage regarding our updated position on cost disclosure?

[12] These amendments have been finalised after consultation and have been submitted to the National Treasury for onward submission to Parliament.

4.2. Mitigating the risk of duplication of charges

4.2.1. Summary of inputs on the 2018 Investments Document

Almost all commentators argued that the improved disclosure of all charges for all activities and players in the value chain was - in whole or in part - the most effective mitigation of duplicated fees and charges.

Additional risk mitigation measures suggested or highlighted by some commentators included:

- Implementation of RDR Proposal YY, in effect requiring “clean pricing” for LISP platform services and disallowing rebates.
- Implementation of the FSCA’s proposal to extent the ASISA EAC cost disclosure mechanism to a broader range of offerings, covering all applicable costs and entities.
- Prescription of the types of fees that may be charged (including some suggestions that the level of fees should be capped) and associated disclosure obligations.
- Placing responsibility on the financial adviser concerned to ensure disclosure of all fees associated with all services and entities.
- A proposal to impose an investor “opt-in” every three years for the continuation of any ongoing fees, with the opt-in notification to be accompanied by full disclosure of the impact of each type of fees to date.
- Principle-based requirements that no fee should be chargeable without an actual demonstrable service provided; and that fees should be commensurate with the services provided (although some concerns were raised regarding the difficulty in determining what constitutes a “commensurate” fee).
- A requirement to provide a detailed fee comparison, including a comparison of the impact of fees, when investments are switched – including switches between business models (for example switches from existing CIS portfolios to model portfolios or 3rd party co-branded solutions).
- A requirement for CIS management companies and LISPs to approve, take responsibility for and benchmark investment management fees charged on offerings using their funds or platforms.
- A suggestion to clearly separate advice fees from other product or service fees, so that changes in other fees do not impact on the advice fee, thus reducing the risk of conflicted advice and increasing the likelihood of the adviser negotiating lower product and service fees.
- The FSCA to adopt an “exception management” supervision approach to charging practices.

A point was made that, provided all disclosure and conflict of interest management requirements were complied with, the FSCA should not interfere in commercial arrangements regarding allocation of costs across the investments value chain. Some commentators argued that competitive market forces, coupled with disclosure, are already imposing some constraints on charges. Others pointed out however that market forces are only effective in this regard if fee arrangements are entered into on an arms’ length basis, which is not always the case.

4.2.2. The FSCA’s updated position

Although the FSCA is in full agreement that enhanced disclosure is a significant mitigating factor in reducing the risk of inappropriate cost duplication, it cannot be relied on as the sole solution to conflicted and unjustified charging practices. Strengthened disclosure standards therefore need to be complemented by broader interventions aimed at reducing these risks, as discussed elsewhere in our RDR proposals. In this regard, we believe that all of the above stakeholder suggestions to mitigate the risk of inappropriate cost duplication are worth exploring. We will consult further on

these potential measures, together with our broader conflict of interest management frameworks.

We also point out the pending general remuneration principles being introduced through amendments to section 3A of the FAIS General Code of Conduct[13]. These principles are in summary that an FSP may only earn financial interests (other than regulated commissions) where the interest is reasonably commensurate with the service being rendered; it does not result in the provider being paid more than once for a similar service; any actual or potential conflicts of interest are effectively managed; and delivery of fair customer outcomes is not impeded.

New question for stakeholder input:

Q27. Pending further consultation, do you have any specific views you wish to share with the FSCA at this stage regarding our updated position on mitigating the risk of duplication of charges?

4.3. Mitigating the risk of conflicted advice in vertically integrated models

4.3.1. Summary of inputs on the 2018 Investments Document

Measure 17 of the 2018 Investments Document invited comment on various possible measures to address the risk of conflicted advice in certain vertically integrated business models. These included proposals regarding: Ensuring the relevant relationships are clear through common branding, marketing and advertising material; requiring advice and investment management activities in groups to be provided through separate legal entities; if advice and investment management are permitted through the same licensed entity, disallow the charging of separate fees for these services; if multiple fees are chargeable by different group entities, require explicit customer consent to all layers of fees; and / or disallow any sharing or splitting of fees between a group's advice operations and its investment management operations.

Stakeholder views on most of these proposals were mixed. Some indicated disagreement with all of these proposals collectively, while others indicated agreement with all of them. More nuanced views were as follows:

- *Common branding proposal:* The majority of (but not all) commentators supported this proposal, with some, including one large industry association, expressing strong support. Although all commentators supported clear disclosure (and customer acknowledgment) of the status of the advice provided and of the relationship between the adviser and applicable investment managers or product suppliers within groups, not all were persuaded that co-branding is necessary to achieve this. Some suggested that "co-branding" of advice and investment services would be more appropriate than requiring use of the same common brand. Practical challenges were raised regarding the use of a single common brand in groups with multiple brands. The point was made that disclosure should highlight not only the relationship between group entities but also the impact of such relationships on the status of the advice provided.

- *Requiring separate licences and separate legal entities for advice and investment management services in groups:* Views on this proposal were divided. Those opposed to it argued that it would simply create more complex group structures without addressing any underlying conflicts that may exist. The point was made that the same conflict risks can arise regardless of whether

[13] These amendments have been finalised after consultation and have been submitted to the National Treasury for onward submission to Parliament.

the respective activities are offered by the same entity or separate entities in a group. Those in support felt that it would enable clearer governance accountabilities and simplify regulatory oversight. Clarity was requested on whether the same group would be able to operate both RFA and PSA advice models.

- *Disallowing the charging of both advice fees and investment management fees by the same entity:* Although a few stakeholders agreed with this proposal, the majority were opposed to it on the grounds that it is inconsistent with the general activity-based approach of the RDR framework – namely that where separate activities are indeed performed they can and should be separately remunerated. One commentator felt that this issue would not arise because investment managers do not provide advice at all.

- *Requiring explicit customer consent for all fees charged by all group entities:* This proposal enjoyed almost universal support. One dissenting view was that consent to separate fees should not be required as consent to the overall fee structure is sufficient.

- *Disallowing fee sharing or fee splitting between advice and investment management operations:* Opinions on this proposal were varied, although a number of commentators expressed strong support. Commentators not in support of the proposal argued that broader proposals regarding disclosure, remuneration and conflict prevention were sufficient and specific intervention in internal fee arrangements was not necessary.

4.3.2. The FSCA's updated position

The FSCA remains of the view that branding is a useful tool to highlight intra-group relationships between advisers, investment managers and product suppliers, over and above more substantive disclosure around these relationships and the status of the advice provided. We are however open to the use of co-branding rather than a single common brand, provided the display of the respective brands is sufficiently prominent to highlight the relationships concerned. We also recognise the potential complexity of common or co-branding requirements in groups with multiple brands and are open to how best to accommodate these models without compromising customer understanding of intra-group relationships in these models.

On the question of whether advice and investment management services can be provided through the same or separate legal entities, stakeholders should refer to our proposals in the *RDR Discussion Document on Adviser Categorisation and Related Matters* (the Adviser Categorisation paper), also published in December 2019, as well as the FSCA's updated thinking regarding investment adviser categorisation in Section 3 of this document. (Also see our updated thinking on adviser categorisation set out in section 3.1.2 and 3.2.2 above.)

- As advised in earlier sections, a group of companies may operate both PSA and RFA advice models, but these must be operated through separate legal entities. The same legal entity cannot act as both an RFA and a PSA.
- An investment manager may appoint a tied adviser (PSA) to provide advice on its behalf. This would require the investment manager to be licensed for advice in addition to its investment management licence, and the PSA would then provide advice through that licence.
- However, in light of the discussion in section 3.2.2 above, note that it will be possible for a PSA appointed by another group entity (for e.g. a product supplier in the group) to also recommend the investment management services (i.e. the entering into of a discretionary mandate) with an investment manager in the group. In such a model, the investment manager will not itself require an advice licence, but governance arrangements must be in place in the group to ensure that the investment manager bears an appropriate level of responsibility for such recommendations.
- We also confirm that an investment manager will not be disallowed from holding an advice licence as an RFA, where it wishes to provide both advice and investment management

services. However, investment managers adopting such a model will need to take care to ensure that appropriate controls are in place to ensure that the advice so provided is objective and not biased in favour of the investment managers or its group's own products or services (in other words to ensure that it is indeed acting as an RFA and would not be better positioned as a PSA).

The FSCA agrees with the view that disallowing the same entity from charging both advice and investment management fees, where both such licences are held, is inconsistent with the RDR activity-based approach. We will therefore not proceed with this proposal. However, stakeholders are reminded of our broader proposals regarding enhanced cost disclosure, general remuneration principles including not charging more than once for the same service, and the need for appropriate management of conflicts of interest, as discussed elsewhere in this document and in our other RDR communications.

On the requirement for explicit customer consent to all fees charged by group entities, the majority view in favour of this proposal is in line with the FSCA's broader proposals regarding enhanced disclosure and with recent amendments to the FAIS General Code, discussed elsewhere in this document. It will however be important to ensure that the disclosure framework ensures transparency of the impact of each separate type of cost on investments, as well as the combined effect of all costs.

We will consider further whether any explicit prohibitions of intra-group fee sharing or splitting arrangements in the investment sector are necessary, over and above the various other conflict of interest mitigation measures proposed through our broader RDR proposals.

New question for stakeholder input:

Q28. Pending further consultation, do you have any specific views you wish to share with the FSCA at this stage regarding our updated position on mitigating the risk of duplication of charges?

4.4. Facilitating and monitoring advice and other fees

4.4.1. Summary of inputs on the 2018 Investments Document

Views on the proposals for product suppliers, LISP platforms and investment managers to facilitate, monitor and report on advice fees and certain other fees were sharply divided across all aspects of the proposal. Some commentators were full in support of all measures proposed, while others had more nuanced views on different elements of the proposal.

Most commentators had no objection to our proposal requiring fee facilitation, provided that the measures proposed would be practical to implement. Arguments against compulsory fee facilitation were that it should be left up to industry participants to decide whether and to what extent they should facilitate fee deduction and market forces would drive the consequences of such decisions. An argument was made that fee facilitation should be required, but that the type of fee facilitation offered should not be prescribed but left to market forces. A contrary view was that, if fee facilitation is required, it should be limited to the specific options set out in the document. Some stakeholders pointed out that some providers currently set their own maximum fee limits that they are willing to facilitate and argued that this option should remain available.

Views regarding fee monitoring and reporting were even more mixed, with those in favour agreeing that this would provide useful insights for the regulator, although noting that careful data analysis

would be required to ensure correct conclusions are drawn. Some inputs were in favour of fee monitoring, but opposed to reporting of fees, or opposed in particular to reporting of "unusually high" fees. Objections to the latter proposal were mainly that the entity deducting the fee would not have knowledge of the arrangements between the investor and the fee earner and the services provided, and therefore would not be able to make a fair judgment on what is an unusually high fee.

4.4.2. The FSCA's updated position

The FSCA is still considering the divergent views expressed regarding fee facilitation and monitoring and will share our updated thinking in due course. We are also considering whether an information gathering exercise on current fee facilitation practices would assist us in finalising our position.

New question for stakeholder input:

Q29. Pending further consultation, do you have any specific views you wish to share with the FSCA at this stage regarding facilitation and monitoring of fees?

4.5. Remuneration for automated advice

4.5.1. Summary of inputs on the 2018 Investments Document

Almost all commentators agreed that no special remuneration standards are required for automated advice and that this service should be subject to all other RDR proposals and other regulatory requirements for the provision of more traditional types of advice. A few commentators did however suggest that where a product supplier in relation to its own products provides automated advice on a "tied" basis, the costs of the automated advice tool will typically already be covered by other product charges and a separate advice fee should not be charged.

The following additional noteworthy points were made:

- As technology evolves, combinations of automated and traditional advice models are likely to emerge. Developments in artificial intelligence will also increase the sophistication of the automated advice tools available. Remuneration models should therefore be flexible enough to accommodate these developments.
- In line with the principle of remuneration being reasonably commensurate with the service provided, remuneration for automated advice should take into account the extent of the service provided, such as the degree of customisation and the robustness of the advice provided.
- Automated advice models are not necessarily cheaper to operate than more traditional models.
- Automated advice models potentially entail the same levels of conflicts of interest as for other advice models. In particular, automated advice tools are often provided in vertically integrated business models, thus presenting the same conflict risks as other vertically integrated scenarios.
- Customers must be informed that automated advice is being provided and any fees for such advice must be disclosed to enable informed decisions around opting to use automated advice, no advice or more traditional advice models.
- Both additional and ongoing advice fees should be permissible for automated advice, provided evidence of ongoing advice can in fact be provided (although there was a minority view that automated advice should only attract a once-off fee).

4.5.2. The FSCA's updated position

The FSCA agrees that no separate remuneration dispensation is required for automated advice and that equivalent standards and principles should apply to all advice models. We also agree with the various additional points summarised above. Regarding the view that an additional fee should not be charged where the costs of automated advice are covered by other product charges in "tied" models, we believe that this is addressed by the general remuneration principle that fees should not be charged more than once for the same service and our other proposals regarding avoiding intra-group conflicts of interest.

New question for stakeholder input:

Q30. Pending further consultation, do you have any specific views you wish to share with the FSCA at this stage regarding our updated position on remuneration for automated advice?

4.6. Remuneration for non-advice distribution

4.6.1. Summary of inputs on the 2018 Investments Document

Commentators flagged that an appropriate remuneration model for non-advice distribution models requires broader consideration of the different types of non-advice distribution models in the market, including distribution models beyond the investments sector alone. It was pointed out that different business models and remuneration / charging practices currently apply, for example, for non-advice call centre scripted sales; non-advice services offered by entities that also provide advice; and non-advice on-line sales. Useful inputs were provided on current practices in each of these models.

There was a general view that providers of non-advice execution services should be able to charge a fair and reasonably commensurate fee for their service, although views differed on the extent to which elements of such a fee should be prescribed. (There was however a contrary argument made that no separate "execution" fee should be charged in non-advice models as execution costs should be covered by the investment management fee). In particular, a few commentators questioned the appropriateness of charging a fee linked to the value of the investment for such non-advice services. On the other hand, other commentators pointed out that a fixed fee might not be sustainable for smaller entities.

There was full agreement on the need for clear disclosure of any such fee and its impact on the investment, and customer consent. There was also agreement that it should be clear that no advice fee could be charged in these cases.

4.6.2. The FSCA's updated position

The FSCA will further consider whether any explicit remuneration standards are required for non-advice distribution models, taking the above inputs into account, as part of our development of broader RDR proposals regarding these models (see in particular RDR proposals D, EE and WW).

New question for stakeholder input:

Q31. Pending further consultation, do you have any specific views you wish to share with the FSCA at this stage regarding remuneration for non-advice distribution?

4.7. Mitigating the risk of conflicted exercise of discretionary mandates

4.7.1. Summary of inputs on the 2018 Investments Document

There was general recognition that models where an investment manager uses a discretionary mandate to place investments in portfolios managed by the investment manager itself or its associates, do present material conflict of interest risks – particular in business models where investment management fees are charged both by a "model portfolio manager" and an underlying investment manager in the same group[14]. A number of commentators felt that these risks were mitigated by other proposals regarding disclosure, avoidance of intra-group conflicts of interest, general RDR remuneration principles and common law fiduciary obligations of holding a discretionary mandate. A number of commentators highlighted that applying the so-called "double dipping" principles set out in Collective Investment Schemes Act Board Notice 90 to these models, would also assist.

There was also broad agreement that where different fees are charged these should be for demonstrably separate services. This would entail the model portfolio manager (multi-manager) being able to justify a separate value adding service from that of the underlying investment manager (asset manager). This would in turn require clear disclosure of the difference in the services provided by each of these entities.

On the other hand, opposing arguments were made that business models entailing multiple layers of investment managers and other providers in the value chain have led to significant increases in the overall cost of investing and compromised investment returns. One commentator proposed that the total of all fees outside of the investment management fee (i.e. platform fees; multi-manager / model portfolio fees; and advice fees) should be capped a stated percentage of the underlying investment management fee (asset manager fee).

4.7.2. The FSCA's updated position

The FSCA will take the inputs regarding conflicted exercise of discretion into account as we develop more concrete regulatory frameworks for the proposals set out in Sections 2 and 3 of this document. Feedback on this document will also inform our thinking.

New question for stakeholder input: *Q32. Pending further consultation, do you have any specific views you wish to share with the FSCA at this stage regarding mitigating the risk of conflicted exercise of discretionary mandates?*

PART C. Stakeholder input and next steps

Investments sector stakeholders are invited to provide input on the FSCA's updated thinking as set

[14] Using the investment management categorisation proposed in Section 2 of this document, this would refer to both multi-management and asset management activities bring performed by different investment managers in the same group.

FSCA
Financial Sector Conduct Authority

out in this document, using the Feedback Template attached as *Annexure A.* Feedback received will inform further informal consultation or the development of draft formal regulatory instruments – which will in turn be subject to our ordinary prescribed consultation processes.

Please submit feedback to FSCA.rdrfeedback@fsco.co.za by **no later than 31 March 2020**.