RESPONSE TO FEEDBACK RECEIVED - CONSULTATION PAPER ON DRAFT GUIDELINES ON SWITCHING OF DESIGNATED INVESTMENT PRODUCTS

On 14 June 2004, MAS issued a Consultation Paper inviting comments on the draft Guidelines on Switching of Designated Investment Products (the "Guidelines"). The Guidelines aim to provide guidance on the controls, processes and procedures that MAS expects licensed and exempt financial advisers (FAs) to implement in order to monitor switching and ensure that their representatives do not advise clients to switch from one designated investment product (referred to as "original product") to another designated investment product (referred to as "replacement product") in a manner that would be detrimental to the clients.

The consultation period closed on 21 July 2004. MAS received comments from 19 respondents (listed in the Annex), of which two requested confidentiality. MAS has considered carefully all comments received and incorporated them in the Guidelines, where appropriate.

MAS thanks all respondents for their feedback. We summarise below some of the comments received and our responses to the comments.

1 General Comments

1.1 Some respondents commented that it was not clear what undesirable switching was. They also sought further elaboration on the phrase "(to switch) in a manner that would be detrimental to the client".

<u>MAS' Response</u>

To assess whether a switch is "undesirable" or "detrimental", the FA should consider whether there is a reasonable basis for the recommendation and take into account the following factors (these are listed in FAA-N01 and reiterated in the Guidelines):

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

The FA should also ensure that all appropriate disclosures are made so that the client is fully informed of the costs and implications involved in the switch.

1.2 Some respondents were unclear as to whom the Guidelines are intended and the expected level of compliance with the Guidelines. A few respondents proposed that implementation of the Guidelines be done in phases to allow FAs sufficient time to examine the issue and put in place appropriate monitoring procedures.

<u>MAS' Response</u>

The Guidelines set out minimum standards expected of all licensed and exempt FAs, which include banks, insurers and capital markets services licensees. Each FA is expected to implement the appropriate controls, processes and procedures according to its scale of operation and nature of business as soon as practicable.

2 Definition of a Switch

2.1 Some respondents were of the view that MAS should specify a time frame between the disposal and acquisition of designated investment products so as to assist FAs in the identification of a switch.

<u>MAS' Response</u>

The Guidelines apply to all designated investment products. Given the diverse nature and characteristics of designated investment products, it is not appropriate for MAS to specify a time frame that caters to the entire range of designated investment products offered by FAs. Industry associations are better placed to work with their members to introduce industry guidelines specifying the time frame and other considerations for monitoring switching activities, taking into account the specific circumstances and needs of the industry as well as nature and characteristics of products offered by their members.

2.2 One respondent suggested that the definition of switching be restricted to switching between the same type of designated investment product (i.e. from one life policy to another life policy, or from one collective investment scheme (CIS) to another CIS).

MAS' Response

This runs counter to the purpose of the Guidelines and paragraphs 23 to 25 of FAA-N01, which is to deter undesirable switching activities within the same type as well as across different types of designated investment products.

3 Disclosure Requirements

3.1 Some respondents raised concerns that a representative may not be able to disclose all applicable fees and charges if the original product is purchased from a different FA.

MAS' Response

We will clarify in the Guidelines that the disclosure requirements apply when a representative recommends the switch. As set out in paragraph 23 of FAA-N01, a representative recommending a switch should pay attention to (i) whether the client will suffer any penalty for terminating the original product; (ii) whether the client will incur any transaction cost without gaining real benefit from the switch; and (iii) whether the replacement product confers a lower level of benefit at a higher cost or same cost to the client, or the same level of benefit at a higher cost. In considering the above factors, the representative recommending the switch would need to know the applicable fees and charges paid by the client for the original product.

3.2 Some respondents sought clarification on whether the disclosures have to be made in both the product recommendation and application forms.

MAS' Response

It is not our intention for the requisite disclosures to be made on both forms. As long as the disclosures are made in writing, we will leave it to the FAs to determine the most appropriate form for the requisite disclosures to be made.

3.3 One respondent commented that the Guidelines are unclear as to whether FAs should disclose a client's entitlement to free switches in general or for a particular switching recommendation. The respondent recommended that FAs should disclose all free switching options available to the client so that he is able to make an informed decision.

MAS' Response

We agree that FAs should disclose all free switching options and will clarify this point in the Guidelines.

4 Monitoring of Switching

4.1 Some respondents highlighted that it is not possible, or administratively difficult, to monitor switches between life policies and CIS and across different companies.

MAS' Response

We recognise that FAs may face this problem and have therefore required the following two "front-end" measures in the Guidelines to address this issue - (i) requiring a client to declare whether he has been advised to switch; and (ii) requiring supervisory review for such recommendations. We will make our intention clearer by amending the Guidelines to - (i) state that these are front-end measures; and (ii) require a FA to ensure that the client's declaration (on whether he had been advised to switch) includes the situation where the original product is (a) a different type of designated investment product from the replacement product; and/or (b) purchased from other FAs.

4.2 Several respondents were of the view that there should be different monitoring procedures for life policies and CIS because they are fundamentally different. They also commented that the suggested procedures in the Guidelines such as checking on past transactions and maintaining a register may be too onerous on FAs.

MAS' Response

Procedures such as checking on past transactions and tracking the volume of switches are examples of procedures to monitor and track switching activities. We will clarify in the Guidelines that these are "back-end" procedures. FAs can implement any back-end monitoring procedures they deem appropriate and adequate. Such procedures should commensurate with the FAs' nature of business and risks.

4.3 Two respondents questioned the need for supervisory review of switching transactions. One respondent also asked whether the term "supervisor" refers to a front-line sales manager or a back office post-sales personnel.

MAS' Response

We are of the view that supervisory review, conducted when clients declare that they have been advised by the representatives to switch, is effective in ensuring that each recommended switch is appropriate. Supervisory review also facilitates the competency assessment of representatives. "Supervisor" refers to a person who is responsible for the conduct of a representative and equipped to assess the appropriateness of a switch. For clarity, we have included this definition of "supervisor" as a footnote in the Guidelines.

5 Remuneration

5.1 One respondent sought further guidance on how FAs should structure the remuneration package of representatives to "encourage representatives to be concerned with the well-being of their clients' investments and to provide good quality professional advice".

MAS' Response

Respondents can refer to the draft Information Paper on Good Practices for Licensed FAs and Exempt FAs available on the MAS website for guidance. It encourages FAs to take into account qualitative factors such as the number of complaints received against representatives, persistency ratios for life policy sales and compliance records in structuring the remuneration package of representatives.

MONETARY AUTHORITY OF SINGAPORE
26 October 2004

ANNEX
LIST OF RESPONDENTS TO THE PUBLIC CONSULTATION

ABN Amro Bank N.V. Singapore
Association of Banks
Aviva Ltd
AXA Life Insurance Singapore Pte Ltd
Central Provident Fund Board
Citibank, N.A
Great Eastern Life/ Overseas Assurance Corporation Ltd
HSBC Insurance (Singapore) Pte Ltd
Insurance and Financial Practitioners Association of Singapore
Investment Management Association of Singapore
Life Insurance Association
Manulife Singapore Pte Ltd/John Hancock Life Assurance Co Ltd
NTUC Income Insurance Co-operative Ltd
Professional Investment Advisory Services Pte Ltd
SG Asset Management (Singapore) Ltd
S L Tan & Co: Advocates and Solicitors
UBS AG, Singapore Branch and BDL Banco di Lugano (S) Ltd

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