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MAS Proceeding to Refine Tier Structure Requirements and Impose New Remuneration Restrictions for Financial Advisers

Executive Summary

On 26 July 2024, the Monetary Authority of Singapore ("**MAS**") announced that it will implement the following measures to refine the tier structure requirements, as well as implement remuneration prohibitions relating to volume-based incentives ("**VBI**") for financial advisory ("**FA**") firms.

(a) *Refinements to Tier Structure Requirements* – FA firms that operate tier structures for the provision of any FA service and/or the sale of any investment product must limit the tier structure to a maximum of three tiers, namely, manager (Third Tier), supervisor (Second Tier) and representative (First Tier) ("**tier structure requirements**"). A tier exists when overriding benefits are payable by the FA firms to a representative for the provision of FA services by another representative. MAS will: (i) limit overriding benefits to be paid to a maximum of two supervisors per First Tier representative; and (ii) require supervisors to only accept overriding benefits from the FA firm in which they are a supervisor.

(b) *Exclusions from Tier Structure Requirements* – Breakaway payments, business allowances, vested commissions and joint sales will be excluded from the tier structure requirements, subject to proper governance frameworks and relevant conditions.

(c) *Extension of Tier Structure Requirements to all FA Firms* – The tier structure requirements will be consolidated under the Financial Advisers Act 2001 ("**FAA**") and apply to all financial advisers, save for exempt FA firms serving only accredited, institutional and/or expert investors.

(d) *Remuneration Prohibitions Relating to VBI* – MAS will prohibit direct life insurers ("**DLIs**"), and strongly discourage product manufacturers (such as banks and fund managers), from making direct payment of VBI to representatives and supervisors of the principal FA firms. Instead, only the principal FA firm of these representatives is allowed to pay VBI to the representatives.

(e) *Implementation Timeline* – MAS will provide a transitional period for changes to be made to comply with the proposed tier structure requirements and remuneration prohibitions, and will conduct a consultation on legislative amendments to implement these changes. In the interim

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before the legislative amendments take effect, FA firms are strongly encouraged to implement the tier structure requirements and adjust their remuneration frameworks and practices to be consistent with the finalised requirements.

This development follows from the MAS Consultation Paper titled "Proposals to refine the tier structure requirements and to introduce new requirements relating to remuneration" ("**Consultation Paper**") issued on 12 July 2021 to seek feedback on the above proposals (see our Legal Update on this here). Further engagements and consultations were conducted with some of the respondents to the Consultation Paper. MAS has taken into account all feedback received in formulating its final proposals, which were set out in its "Response to Feedback on Proposals to Refine the Tier Structure Requirements and to Introduce New Requirements Relating to Remuneration" ("**Response**") issued on 26 July 2024.

This Update summarises the key proposals shared in the Response and their implications for FA firms.

Refinements to Tier Structure Requirements

MAS will proceed with the following proposals:

(a) Limit the tier structure in FA firms to three tiers. FA firms that operate tier structures for the provision of any FA service and/or the sale of any investment product are required to ensure that the tier structure has a maximum of three tiers, namely, manager (Third Tier), supervisor (Second Tier) and representative (First Tier) i.e. the tier structure requirements.

(b) Allow overriding benefits to be paid to a maximum of two supervisors (i.e. Second Tier and Third Tier) for each First Tier representative.

(c) Prohibit supervisors from accepting overriding benefits from any person other than the FA firm in which they are a supervisor.

FA firms are required, at the minimum, to incorporate the following guiding principles ("**Guiding Principles**") into their governance frameworks, for which MAS will hold them and their Boards responsible for approving and implementing:

(a) The payments are to align with MAS' policy intent of the tier structure requirements, which restrict the maximum number of tiers to three. Payments of overriding benefits should only be made to the Second Tier and Third Tier who are responsible for supervising the lower tiers in their FA and sales activities.

(b) The FA firm should put in place measures to address market conduct risks specific to these payment arrangements.

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(c) The FA firm should exercise discipline to manage distribution costs to safeguard clients' interests.

Exclusions from Tier Structure Requirements

MAS will proceed to exclude certain types of remuneration practices from the tier structure requirements, subject to proper governance frameworks and relevant conditions.

Breakaway payments

These are payments made by an FA firm to a lower-tier representative who has been promoted to the next tier. In his role as a newly promoted supervisor, he will form a new agency unit with his team of representatives. The FA firm continues to pay overriding benefits to his former supervisor at the previous agency unit based on the sales of the new agency unit.

MAS will exclude breakaway payments from the tier structure requirements, on the following conditions:

(a) They are governed under a remuneration framework that is approved by the FA firm's Board or Board-level Committee (e.g. risk committee, remuneration committee) and consistent with the Guiding Principles ("**Compliant Remuneration Framework**").

(b) Their quantum is computed based only on sales made by the lower-tier representatives who were under the previous supervisor's charge, and excludes sales made by new representatives who joined the new agency unit after the breakaway.

(c) In the case of breakaway payments made by direct insurers, the payments are not charged to any insurance fund.

Business allowances

These are payments made by an FA firm to a representative or supervisor to defray business costs (e.g. office rental) or for the provision of shared services (e.g. administrative support) for representatives in an agency unit or across several agency units within the same FA firm.

MAS will exclude business allowances computed based on sales of the representatives from the tier structure requirements, on the following conditions:

(a) They are governed under a Compliant Remuneration Framework setting out a list of or criteria for eligible expenditures and limits on amounts payable.

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(b) Representatives' and supervisors' statements of accounts on expenses incurred are subject to annual reviews, and the review outcome is reported to senior management. This ensures that there is proper cost management and that payments made are in line with the Compliant Remuneration Framework.

Business allowances administered on a reimbursement basis would not fall within the definition of "overriding benefits" as they are reimbursed based on expenses incurred, and hence are not subject to the tier structure requirements.

To address potential conflicts of interest, for payments by an FA firm to a person other than its representatives or supervisors, the FA firm must ensure that this person is not a connected person of any of its representatives or supervisors.

Vested commissions

These are residual commissions that the FA firm continues to pay to representatives who have left (e.g. retired or joined another FA firm) based on sales they made when they were with the FA firm.

MAS will exclude vested commissions from the tier structure requirements, provided that they are governed under a Compliant Remuneration Framework.

The following payments also fall outside the scope of the tier structure requirements: (i) vested commissions to individuals who are not relevant persons under the FAA, the Financial Advisers (Remuneration) Regulations 2015 and the Insurance (Remuneration) Regulations 2015 (collectively, "**Remuneration Regulations**") (e.g. retired representatives no longer providing FA services or acting as supervisors, or the estate of deceased representatives); and (ii) retirement benefits to such individuals (e.g. pension funds or retirement schemes).

Joint sales

These are sales conducted jointly by two or more representatives of the same FA firm, with commissions and overriding benefits shared among the representatives and their supervisors.

MAS will exclude overriding benefits arising from joint sales from the tier structure requirements, where such payments are in line with the Guiding Principles and subject to proper governance, i.e. (i) approved by senior management; or (ii) governed under a senior management-approved framework setting out clear accountability and responsibilities for representatives and supervisors involved, as well as the senior management's role in performing market conduct oversight of joint sales.

FA firms should institute effective controls to detect and prevent the abuse of joint sales arrangements, including checking to ascertain the identities of the representatives or supervisors present at each FA engagement, and leveraging on data analytics to identify trends, anomalies and cases for investigation.

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Other Clarifications

(a) Introducer fees, which are paid by an FA firm to a person who introduces a prospect or client, and which relate to the provision of FA services, are outside the scope of overriding benefits and not subject to the tier structure requirements. FA firms should ensure that introducers are not involved in providing FA services other than introducing activities.

(b) On 26 July 2024, MAS issued Circular No. FAS 08/2024 titled "Clarification of MAS' Policy Intent in respect of Persons Deemed as "Supervisors"" ("**Circular**") to provide guidance on persons deemed as supervisors under the FAA. As clarified therein, determining whether an individual is a supervisor will depend on the facts and circumstances, based on considerations set out therein. Ordinarily, Chief Executive Officers performing strategic functions and individuals in corporate functions (e.g. compliance, human resources, learning and development) are not considered supervisors, unless they perform roles and responsibilities primarily relating to supervision or management of the conduct and performance of any representative or supervisor.

(c) Corporate staff involved in managing distribution channels (e.g. Head of Distribution, Head of Agency) may receive variable remuneration based on representatives' sales performance and be viewed as a tier even if they are not representatives e.g. where their remuneration includes sales-related key performance indicators ("**KPIs**").

(d) Individuals will be excluded from the tier structure requirements if: (i) they are members of the corporate staff of the FA firm, and not representatives; and (ii) their variable remuneration received is governed by the same remuneration framework as that for other corporate staff of the FA firm and determined based on non-sales related and sales-related KPIs.

(e) An FA firm's Board and senior management should exercise strong oversight over the remuneration framework of corporate staff and not design remuneration frameworks that circumvent the tier structure requirements.

Extension of Tier Structure Requirements to All FA Firms

MAS will proceed to consolidate the tier structure requirements under the FAA and extend them to all financial advisers for consistency across the FA industry.

There should be no impact on: (i) financial advisers such as banks, merchant banks, finance companies, insurance brokers and capital markets services licensees, to the extent that they do not operate tier structures and pay overriding benefits; and (ii) exempt FA firms who serve only accredited, institutional and/or expert investors, as the tier structure requirements will not apply to them.

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Remuneration Prohibitions Relating to VBI

MAS will proceed with proposals to prohibit: (i) persons such as DLIs from determining, communicating and paying VBI directly to representatives and supervisors of the principal FA firms ("**Prohibition on Payment**"); and (ii) representatives and supervisors from receiving VBI for the sale of life business products directly from any person who is not their principal FA firm ("**Prohibition on Receipt**").

Amendments will also be made to the spreading and capping of commissions rules in the Remuneration Regulations to prohibit FA firms from making commission payments for the sale of regular premium life policies to the representatives and supervisors of other FA firms.

While the proposals are applicable to FA firms serving retail clients, all FA firms are encouraged to apply similar principles for effective oversight of representatives, to ensure fair dealing outcomes for clients.

In addition to DLIs, MAS will also extend the Prohibition on Receipt, by prohibiting representatives from receiving VBI for the sale of investment products directly from product manufacturers (such as banks and fund managers) who are not their principal FA firm. MAS will not legislate the Prohibition on Payment on product manufacturers given that they generally do not offer or directly pay VBI to representatives and supervisors of other FA firms, and they are strongly discouraged from doing so.

Principal FA firms should have appropriate controls to ensure that their arrangements with representatives and product manufacturers do not contravene these prohibitions.

For outsourcing arrangements where: (i) the distribution support function of an FA firm is outsourced to its parent firm; (ii) the principal FA firm remains fully responsible to determine its representatives' remuneration; and (iii) the related firm only performs an operational role, the direct payment of remuneration by the related firm to the principal FA firm's representatives is not prohibited.

Implementation Timeline

MAS will provide a transitional period for changes to be made to comply with the proposed tier structure requirements and remuneration prohibitions, and seek feedback on its length in the subsequent consultation on legislative amendments.

In the interim before the legislative amendments take effect, MAS strongly encourages FA firms to implement the tier structure requirements and adjust their remuneration frameworks and practices to be consistent with the finalised requirements.

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Concluding Words

The Response reflects MAS' commitment to regulate the remuneration practices of the FA industry, protect the interests of consumers and enhance the professionalism and reputation of the industry.

FA firms should review their current remuneration structures and practices, prepare for the changes that will be introduced via legislative amendments, and comply with both the letter and spirit of the rules. Some of the key action steps that FA firms should take note of include the following:

(a) FA firms should incorporate the Guiding Principles into their governance frameworks for compliance with the tier structure requirements.

(b) Principal FA firms should establish appropriate controls to ensure that their arrangements with representatives and product manufacturers do not contravene the remuneration prohibitions.

If you have any queries on the above or require advice on the implications and implementation of the changes, please feel free to contact our team members below who will be happy to assist.

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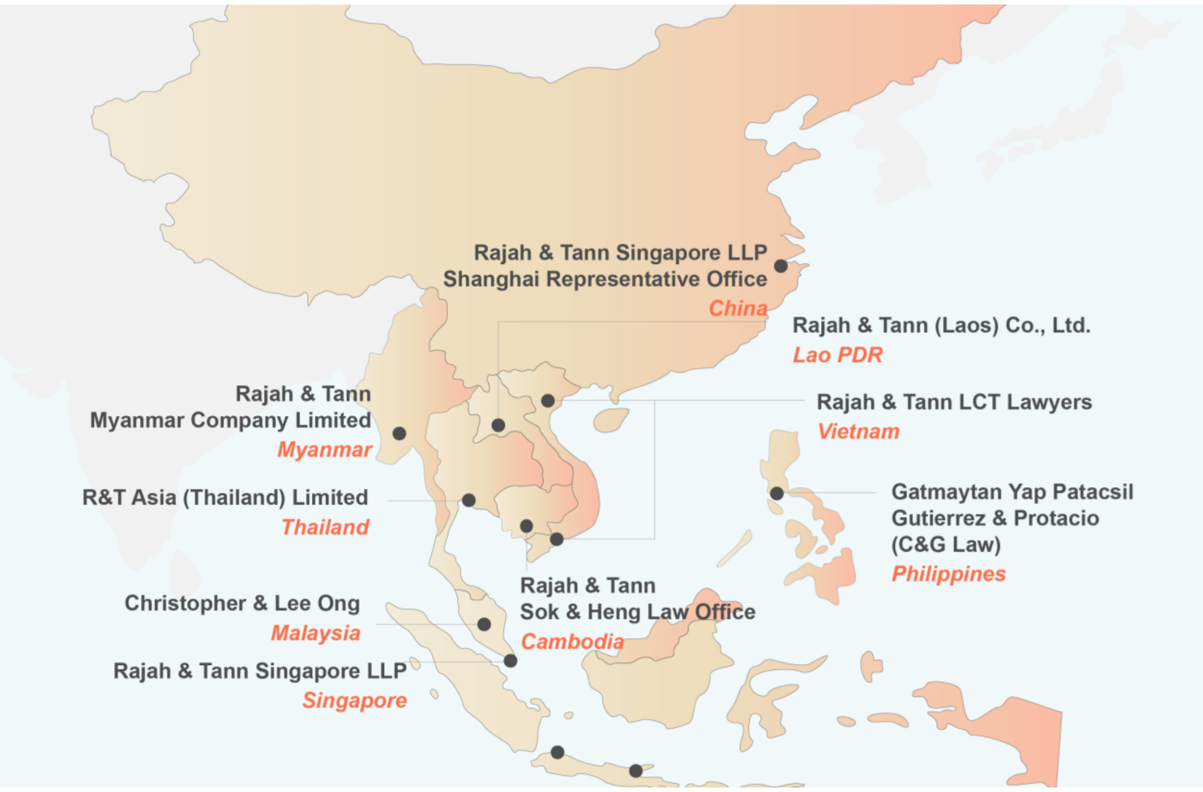

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