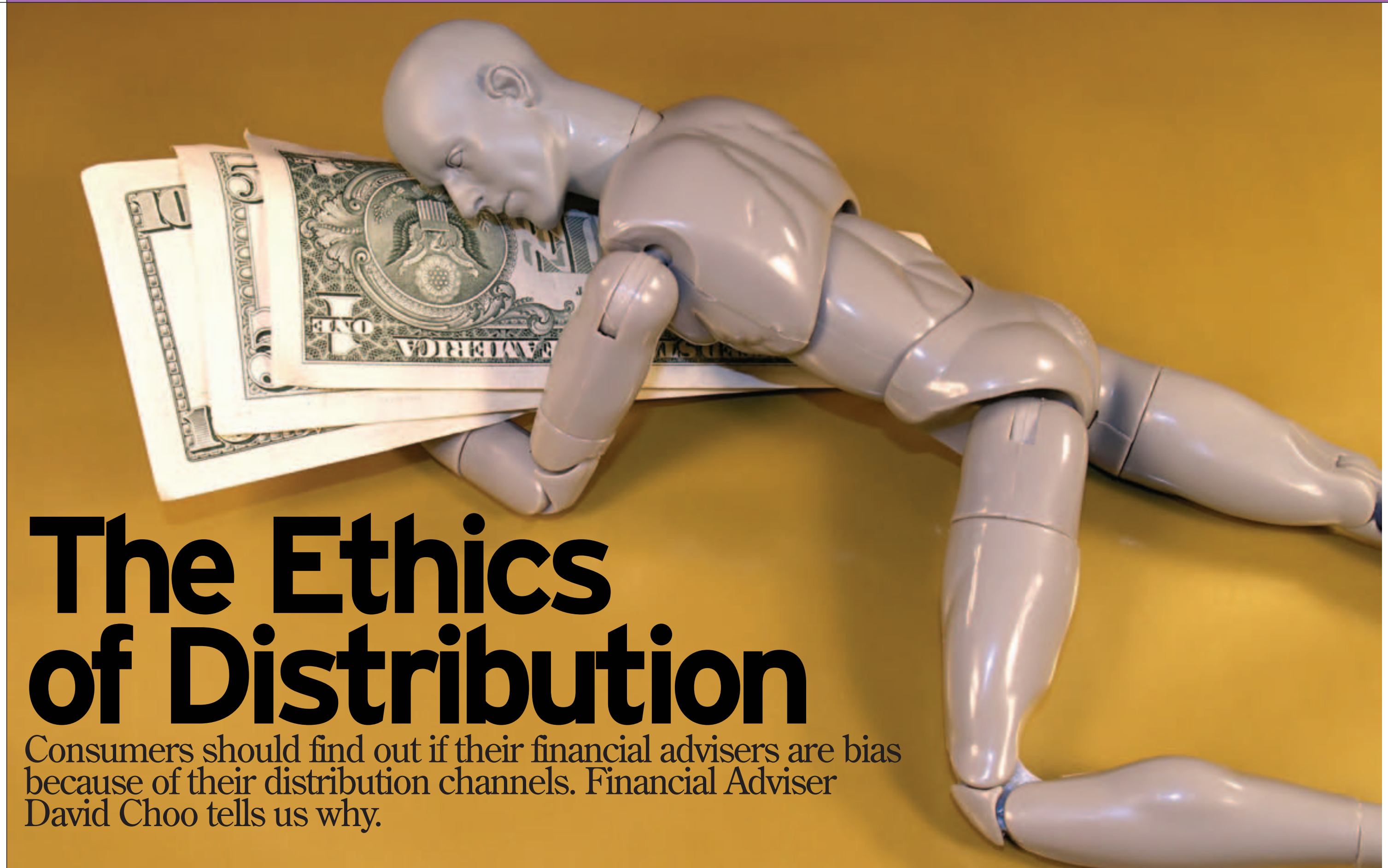

The Ethics of Distribution

Consumers should find out if their financial advisers are bias because of their distribution channels. Financial Adviser David Choo tells us why.

When I decided to join the insurance industry in 1985, one terribly upsetting and unsettling advice I got was: "Be careful, it is a jungle out there and do not let the love of money make you lose your soul". Coming from a Christian background, I knew this was well-intentioned advice from Holy Scriptures: "What shall it profit a man if he gains the world and lose his soul?"

As it turned out, I did meet quite a number who had, in fact, not only traded health for wealth, but traded their souls as well. This was sad, but what was sadder was having to grapple frequently with what I view as "ethical" issues and finding that these were not issues at all to many others. By and large, the word "ethics" has dropped out of currency for many, being replaced by "regulations", "guidelines", "recommended" or "best practices". Interestingly, the Chambers 21st Century Dictionary defines ethics as "a moral system or set of principles particular to a certain person, community or group". It is derived from the Greek ethikos (moral) and ethos (custom or character). It appears lamentably that in modern, secular societies, ethics is up to each person, community or group to set. Reluctantly, I have to accept that my view is shaped by my ethical, moral and religious value system and will likely differ from another's. Nevertheless, a little soul-searching is always good for the soul.

ETHICAL DILEMMA - CONSCIENCE OR COMMISSIONS

The first ethical issue I was confronted with surfaced even before I joined the industry. I had come across the noble sounding phrase "clients' interest first" and tried to analyse what it should be in practice. I reckoned it should mean that clients are given good and timely advice, choice of "best of class" products and good continuing service. Taking this tack, brokerage was the only option for me as the agency model does not provide choice of products. This was more important to me than which distribution model gave better remuneration and which path was easier. But I found that many agents, while agreeing that offering choice is good, could not go with their conscience because they stood to lose thousands in future commissions. The commission system for traditional products, whereby commissions are payable for up to seven or even ten years for sales made now, became like a bond and tied down agents to remain with their firms. The longer they remained and the more they sold, the thicker the financial chain around their neck. For the thousands who joined as agents in the 1980s and 1990s, there was not much of a choice because life insurance brokerage was still fairly new and there were only two life insurance brokerages up to 1995. New entrants today have more than 30 FA firms to choose from besides joining tied agencies in the life insurance companies. Interestingly, FA firms are willing to offer their representatives rights to the future commissions, while the insurance companies still retain the deferred compensation scheme primarily, I believe, as a retention strategy.

A few other ethical issues surfaced early, too.

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While all but one of the life insurance companies were willing to distribute through brokers in the 1980s and 1990s, the largest one was strongly against it. I remember debating the ethical nuances of insurance companies not willing to offer their individual products to customers through brokers, while allowing it for group products. Clearly the decision was business driven as the tied agents have no choice but to sell their products (there being no others), while the brokers (now FAs) have a choice to promote what they deem is best for the clients. Instead of going forward, in the late 1990s and early 2000s, two large insurance companies changed course and withdrew their products from being distributed by most FAs, ostensibly to stem the growing tide of their agents leaving to join FAs or set up their own.

While the issue of choosing the channel of distribution is ultimately a business decision, what should not be lost on consumers is that they do not have easy recourse to product comparison of all the life insurance companies because of the defensive and restrictive strategies of the three larger life insurance companies in Singapore. It would do Singapore a lot of good if one day all life insurance companies are willing to distribute their products through FAs, thereby subjecting their products to closer scrutiny and competition, like the general insurance and unit trust markets.

> "ALLOWING NON-TIED ADVISERS TO BE NON-INDEPENDENT HAS BLURRED THE DISTINCTION THAT SHOULD EXIST BETWEEN TIED ADVISERS AND INDEPENDENT ADVISERS."

EASIER ACCESS TO PRODUCT COMPARISON

I have, no doubt, that Singapore consumers will enjoy premium savings and better products when the life insurance market is totally open as has been the case for general insurance and unit trust. Money that goes largely into advertising and marketing to build brand awareness and loyalty will be saved, and competition will be more on lowering premiums (cost) and increasing benefits (cash values, maturity values and protection sums insured). The tied agency system is an expensive distribution model to maintain and insurance companies will achieve significant savings as well. The nation will gain, too, economically as buying life insurance and investment products becomes more cost efficient. The prospect needs to see only one adviser to access the whole market. There will be savings in manpower (fewer people involved in distribution) and man-hours as the prospect need not see so many different agents to ascertain that he gets a good buy. The entire life insurance industry will also become more and more efficient as every company's products will be scrutinized and compared and the firms that cannot compete will have to shape up or ship out.

The alternative distribution favoured by the life insurance companies is bancassurance, which has gone up in market share to a substantial 29 per cent in 2004. What the banks have in their favour are their branch system that brings customers into their premises, and access to valuable financial data of clients. However, what must not be forgotten is that, so far, most banks have chosen to distribute the products of selected life insurance companies exclusively, thus, not offering choices to their customers. This means that customers still do not know whether the products marketed by the banks are the best for their needs.

From a business and ethical viewpoint, the distribution channel that arguably best meets clients' interest is the independent financial advisers (IFA) model. But to date, the Singapore consumers are still not too aware of this and there is need for the regulators and the licensed Financial Advisers to better publicise this channel.

FINANCIAL ADVISORY FIRMS SHOULD CLEARLY STATE IF THEY ARE INDEPENDENT

After three years of market regime under the Financial Advisers Act passed in October 2002, the general public is, by and large, still confused about who licensed Financial Advisers and exempt Financial Advisers are, and what real differences they make to clients. The public is also uncertain about what is the difference between independent Financial Advisers and those who are not, since many firms do not state their status clearly. Perhaps, it is time to go back to the simple distinction between tied advisers representatives to describe tied insurance agents and advisers of any institution or firm which are tied to a life insurance company, and independent advisers representatives to refer to those from firms (whether licensed or exempt) who are not tied to any life insurance company. The key question is whether the representatives are free to recommend the products of product providers, like life insurance and fund managers, without any obligation to a particular firm or firms. The MAS' definition of independence is clear enough, so this could be the standard set for all who are not tied advisers. Allowing non-tied advisers to be non-independent has blurred the distinction that should exist between tied advisers and independent advisers.

I do not know how the distribution matrix in Singapore will pan out. FA business, now estimated to be 6 to 7 per cent of market share from almost zero ten years ago, is increasing at a faster pace than the other channels. Tied agency has, in fact, lost ground, from almost 100 per cent to slightly more than 50 per cent today, while bancassurance is showing signs of plateauing. What I like to see is consumers taking more care over their insurance and investment matters and demanding comparisons and substantiated recommendations. I believe that, while the regulators are right in allowing different channels of distribution and letting the market decide who is to grow and who is to go, our consumers are still more led, and sometimes misled, rather than holding product providers and distributors to their credo of "clients' interest first". **SI**

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