

The Cost of Financial Advisory Business Compliance in South Africa

Survey conducted by

The Institute of Practice Management and FAnews

Research Sponsors



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Contents

1. Executive Summary	3
2. Introduction by Johann Maree of The Institute of Practice Management	4
3. Key findings	5
4. Participant profiles	6
5. Survey questions and responses	6
6. What we can learn from the survey	26
7. Conclusion	28
8. FAnews comments	27
9. FAnews comments on the role of the FSB	29
10. Other comments	29

Executive Summary

In February 2012 the Institute of Practice Management, FAnews and the Financial Planning Institute undertook a survey amongst the financial adviser fraternity in South Africa with the overall objective of determining what the compliance cost of financial advisory services is.

The study was prompted by growing concerns that the legislative framework as represented by the Financial Advisory and Intermediary Services Act of 2004 (FAIS) is placing a heavy burden on financial advisory practices in terms of time and effort that they need to invest to make their businesses compliant.

The research is one of the first attempts to understand and determine just how much the compliance aspects of the regulatory framework are costing financial advisers. A sample of 62 financial advisers was selected to answer 27 questions via an on-line questionnaire. The sample was constructed to include financial advisers who met the following criteria:

- Business owners, representatives and key individuals in the South African financial services industry
- Any person with a Category 1, II, IIA, or IV licence

For the purposes of the research “compliance cost” is defined as the direct cost to financial advisory businesses of performing the tasks to comply with Government legislation.

The study revealed that the Regulatory Examinations (RE) alone could cost the financial services industry in the region of R1.28bn. A very conservative calculation puts the average cost of compliance per annum to an independent financial advisory business at R188 658.

A typical one year Continuous Professional Development (CPD) cycle for all Representatives and Key Individuals could cost the financial services industry more than R120m per year.

The rising cost of compliance is threatening the livelihood of small, independent financial advisers businesses.

Some of the key findings of the study are:

- Financial advisers have a wealth of industry experience but do not have all the financial planning qualifications
- Financial advisers are not clear on the quantum of their value
- Financial advisers are not ready for charging fees for advice
- Regulatory compliance costs are ‘silent killers’ to independent financial advisers
- The cost of advice is increasing and puts pressure on the affordability of advice
- FSB policies have unintended consequences that may not be beneficial to the consumer
- It is increasingly difficult for the independent financial advisers to put clients’ interests first when profit-margins are shrinking
- Costs will force independent advisers to become employees and move back into the corporate environment
- Losing the “independent” label will impact on “independence of advice” and will not be in the interest of clients

Disclaimer: The results portrayed and discussed in the survey are based on our research

Introduction

The Financial Advisory and Intermediary Services Act of 2004, also known as the FAIS Act and its regulatory compliance thresholds are putting increasing pressures on financial advisory businesses. At its core, these regulations has increased oversight and required financial advisory businesses to implement effective and comprehensive compliance and risk programs.

The growing complexity of regulatory sanctions and the increasing rigor in the enforcement of these requirements has made the task all the more arduous. To coincide with regulatory changes resulting from implementation in new rules the compliance function in advisory businesses has taken on more and more responsibilities to ensure that the necessary implementation and updates are made to all relevant internal policies and procedures. At last count there were more than 20 policies and procedures that advisory businesses were required to document, implement and update regularly.

Creating and updating these policies and procedures generates a stream of other work including staff and client communication and training, the monitoring of plans and the need to maintain an audit trail of changes. Important as the compliance function is, it is only one element of the overall approach to risk management, data recovery and business continuity in financial advisory businesses.

Compliance practitioners around the world are under no illusions that going into the future regulatory information and exchanges will increase. It is perhaps not surprising that there is a strong view that compliance officers and financial services businesses expect to spend more time on regulatory communication and exchanges as well as on the growing intensity of supervision and interaction. The goal here is to ensure that a cost-effective program is installed in advisory businesses so that they ideally create an “inspection and audit ready” state for the business.

Concerns as to the amount of time spent on regulatory compliance by financial advisory businesses raises questions about the cost of compliance to both advisory businesses and financial services providers in South Africa. In terms of this research “compliance costs” may be defined as *the direct costs to financial advisory businesses of performing the various tasks associated with complying with government legislation.*

The study is in all likelihood the first attempt in South Africa to try and understand just how much the Financial Advisory and Intermediary Services Act is costing the financial advisory businesses and what financial advisers can do to mitigate the escalating costs of complying without being forced to either lose their independence or exit the industry.

When conducting research like this one must bear in mind the cost of non-compliance against compliance. A Financial Services Board investigation, prosecution and conviction can have direct costs, collateral costs, costs to on-going business and reputational costs. The direct costs may include a fine or a criminal fine, and defence costs as well as possible collateral costs when parties hurt by these violations enter into lawsuits against the advisory business. The costs to the on-going or future business can include ineligibility for FSP licenses, debarment or suspension from business activities and prison sentences for business-owners or key individuals.

Cutting compliance costs in this environment is not a good idea and will certainly not lead to an overall reduction in costs. We hope that our findings will contribute to the development of a more efficient and FAIS compliant financial advisory business.

We look forward to your feedback and thoughts on the research. This will help us formulate the next questions that we need to ask to continue this important discussion. You can e-mail me on Johann@practice101.net

Johann Maree
The Institute of Practice Management

Key Findings

The results of the Cost of Compliance study support the initial hypothesis that the cost of regulatory compliance is escalating at a rapid rate. While this statement may be intuitively obvious, the real challenge is to understand how financial advisory businesses can move their practices to higher levels of performance so as to entrench business processes and procedures and ensure an overlap of implementation and sustainability.

The following are some of the higher-level findings of the study, all of which are discussed in more detail in this report:

- Financial advisers have a wealth of industry experience but do not have all the financial planning qualifications
- Financial advisers are not clear on the quantum of their value
- Financial advisers are not ready for charging fees for advice
- Regulatory compliance costs are 'silent killers' to independent financial advisers
- The cost of advice will increase and put pressure on the affordability of advice
- FSB policies have unintended consequences that may not be beneficial to the consumer
- It is increasingly difficult for the independent financial advisers to put clients' interests first when profit margins are shrinking
- Costs will force independent advisers to become employees and move back into the corporate environment
- Losing the "independent" label will impact on "independence of advice" and will not be in the interest of clients

Participant Profiles

In February 2012 the Institute of Practice Management, FAnews and The Financial Planning Institute surveyed 562 financial advisers via an on-line questionnaire that contained 26 questions. The sample was constructed to include financial advisers who met the following criteria:

- Business owners, representatives and key individuals in the South African financial services industry
- Any person with a Category 1, II, IIA, or IV licence

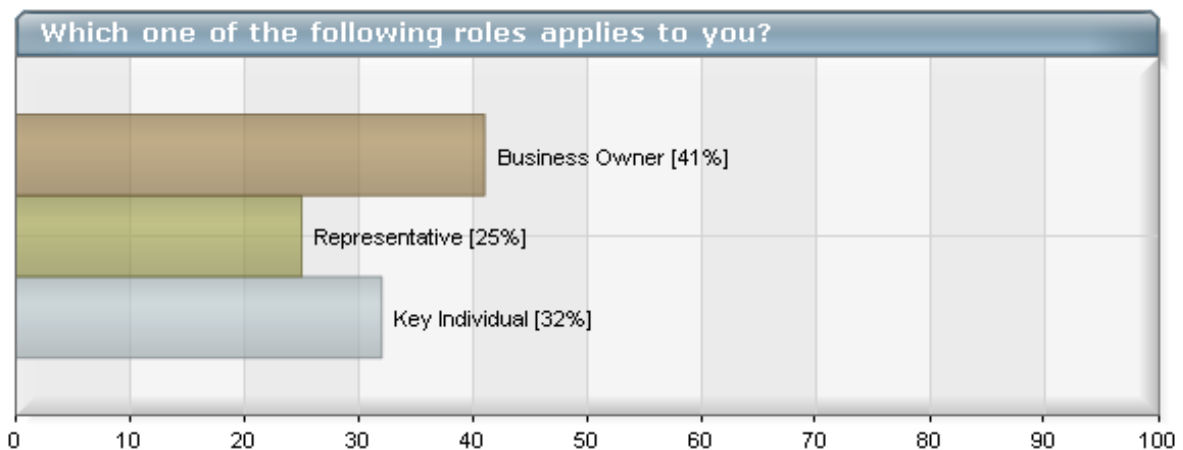
Survey questions and results

1. Which one of the following roles applies to you?

This is how the financial advisers responded to the question:

- 230 regarded themselves as Business Owners (41%)
- 140 regarded themselves Representatives (25%)
- 180 regarded themselves as Key Individuals (32%)

The numbers show us that the majority of business owners do not see themselves as Key Individuals. The legislation is very clear in that a Key Individual is *“any natural person responsible for managing and overseeing, either alone or together with other responsible persons the activities relating to the rendering of any financial service.”*¹ Business owners should therefore include themselves in the definition of key individuals even if they do not give advice.



2. Which one of the following licence categories do you fall under? Select those that apply to you?

The vast majority of respondents have Category I licenses with 22% also falling under a Category II license. This presupposes that most of the respondents offered their clients products in the following areas:

- Life insurance
- Disability Benefits

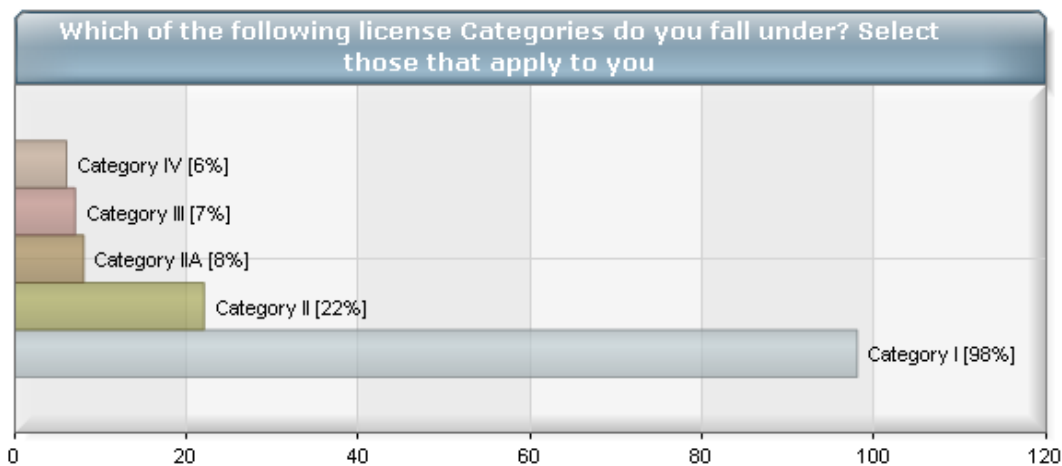
¹ FAIS Act 37 of 2002: Introductory provisions, definitions and applications

- Critical Illness Benefits
- Retirement Funds
- Health Service benefits
- Short-term insurance

Of the 562 respondents, 124 also had a Category II license. Investment planning and asset management are important areas of financial planning for those South African financial advisers who responded to this survey.

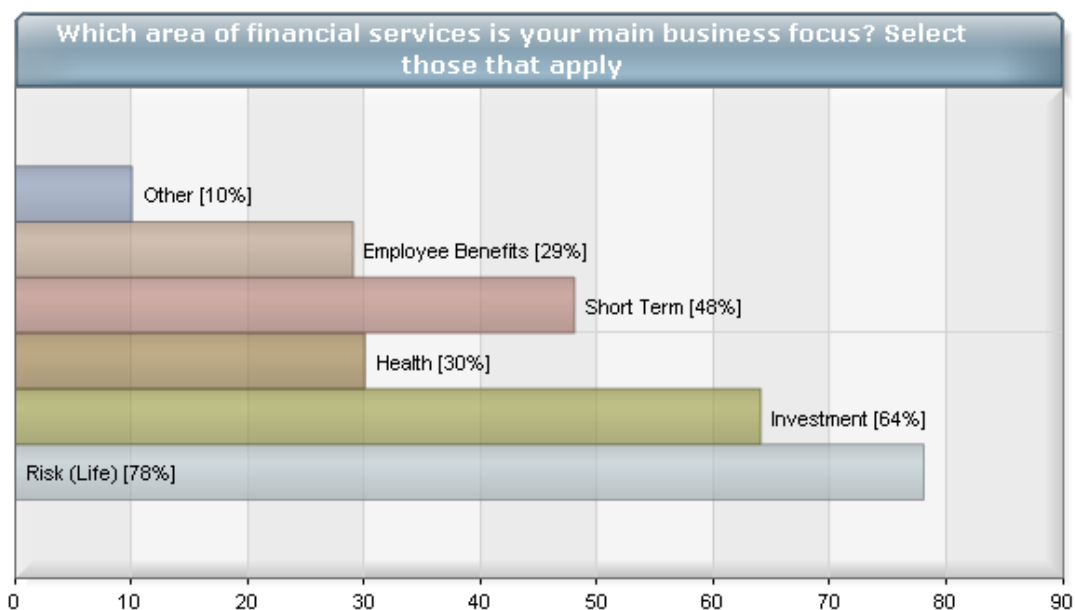
A combination of Category I and Category II licences allows financial advisers to enter the realm of the Wealth Manager – the fastest growing business model internationally. In our dealings with financial advisers we have unfortunately not seen the same trend locally.

However, there many advisers who have adopted the name as they transition to more comprehensive practices geared toward affluent clients.



3. Which area of financial services is your main business focus? Select those that apply:

The main business focus of most of the respondents appears to be risk (life) business and investments.



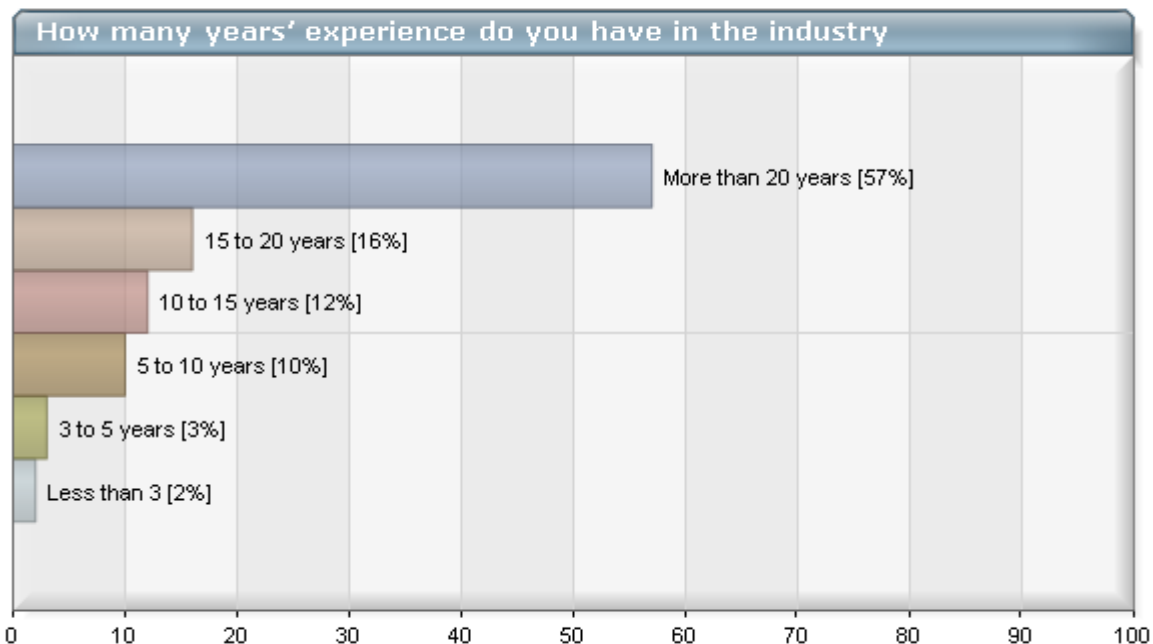
Remuneration from this form of business is generally by way of commission. Financial advisers who earn commission only, have great difficulty in changing their mind-sets and transforming their business into a fee for service model. Advisers must consider this fee transition over the next three years so as to position their businesses for any impending regulatory changes that impact on their ability to earn. This does not mean that commission is 'bad', rather advisers need to define what service the client must receive for the fee or commission that is being paid.

The above graphic illustrates that although wealth management *per se* is not a focus area for many South African advisers they are offering product solutions that as a combination will allow them to convert their businesses into comprehensive wealth management practices.

Wealth Managers are generally 'managers of managers', working with their clients' accountants, attorneys and other consultants on issues ranging from financial planning, taxes, estate planning, risk management, and health. They delve deeper into the issues related to life, health and longer term care. Typically these wealth managers would use a mix of in-house-specialists and external consultants. The expectation of advisers who use this model is that the client relationship will be deeper, longer lasting and hopefully multi-generational. There is no doubt that this 'fee for service' model is the model of the future.

4. How many years of experience do you have in the industry?

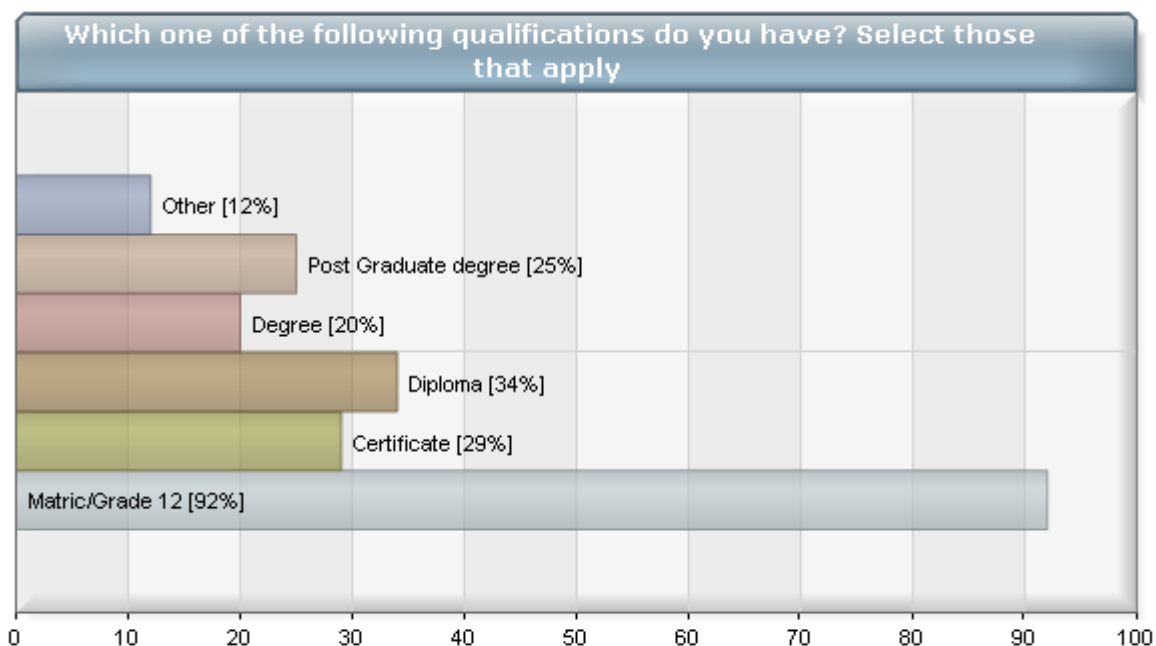
The majority of respondents (57%) indicated that they had been in the industry for more than 20 years. This is hard-earned experience that cannot simply be replaced. The next group (16%) indicated that they had between 15 and 20 years of experience in financial services. This chart shows that the majority of our respondents has been in the industry for a long time and are well-established in their chosen profession. This experience is hard to replace and will undoubtedly put pressure on the industry to replace those advisers who retire from it.



Our on-going research through the www.practice101.net website indicates that the average age of the South African financial adviser is 54. From the information in the chart above we can make an assumption that more than 70% of our advisers are older than 50 years. This means that in the next five to ten years many of the financial advisers in South Africa will be looking forward to retirement. It would appear that there are very few new advisers coming into the industry as financial planners and this will bring pressure on all independent advisers' succession and continuity plans – even though many have indicated in this research that they have plans in place.

5. Which one of the following qualifications do you have?

Alarming many of the experienced financial advisers above do not have post-matric qualifications. In fact 92% of our respondents have not furthered their education in their chosen careers. Not furthering post-school qualifications will make it almost impossible for these advisers to call themselves professionals or enter a new professional era in the South African financial services industry. Passing the Regulatory examinations is not considered a professional qualification and will definitely not make financial advisers professional overnight. Not having a qualification in financial planning will also place pressure on those advisers who wish to transition to a fee-based model.



The late Charles Pillai ² was adamant that for financial planners to be regarded as professional they need to ensure the following:

- That there is a specialised and well-defined body of knowledge
- There must be membership of a professional association
- Members must be devoted to public service
- Members must embrace a code of ethics
- The status of the association is recognised by the community members they serve
- The association is the spokesperson of the profession

From the above we can learn that qualifications and setting standards on how the body of knowledge is applied must occur by way of oral or written examination conducted by members of the profession.

The investment in continuous learning pays off not only for financial advisers, but for their employers and individual investors. For financial professionals, it is about positioning strategically for success. And for financial institutions and their clients, the return on investment is the integrity of the financial markets and the improved industry reputation and consumer trust across the board.

It is submitted that those who do not make inroads to professionalising their total value proposition to their clients will begin feeling the pinch in a fee-for-service environment ³ where knowledge and professionalism will dictate the quantum of fee charged for the work that is done.

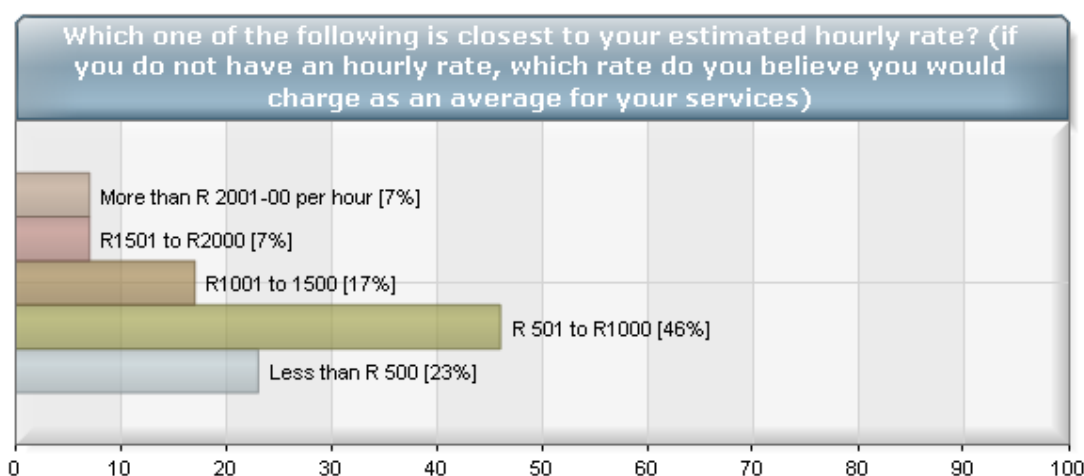
² Past FAIS Ombud speaking at the FPI Convention in Johannesburg 30 May 2007

International research shows that those financial advisers, who have qualifications and more specifically qualifications in financial planning, earn far more than those that do not. What better incentive than to make professional development a life-long challenge!

6. Which one of the following is closest to your hourly rate (If you do not have an hourly rate, which rate do you believe you would charge as an average for your services)

The response to this question shows that 46% of financial advisers believe that their hourly rate is between R501 and R1000 per hour with 17% of respondents indicating that their rate is between R1001 and R1500 per hour. There are a small percentage of advisers who believe that their hourly rate exceeds R 1500 per hour. It will be interesting to see how these advisers determined their rate. No doubt they have spent time looking at what they do for their clients and how much time it takes them to deliver their service.

What is disturbing is the 23% of advisers who do not 'know their value.' This means that they have not moved into a fee-for-service mind-set or calculated what to charge for the services they offer.



Financial advisers must get paid for what they are worth. To determine their value advisers need to put a price to their services by doing the following:

- Decide what their niche-offering will be
- Monitor what gets done in their financial advisory business
- Document the time it takes to complete each task or activity
- Understand who does what in the business
- Get rid of the 'product' mind-set and develop a 'service' mind-set
- Recognise their value; and
- Put a mark-up % on that value

Invariably advisers will find that they are being held back in the fee-for-service space because of their own self-limiting ideas. They are providing a valuable service to clients and have every right to be compensated for it.

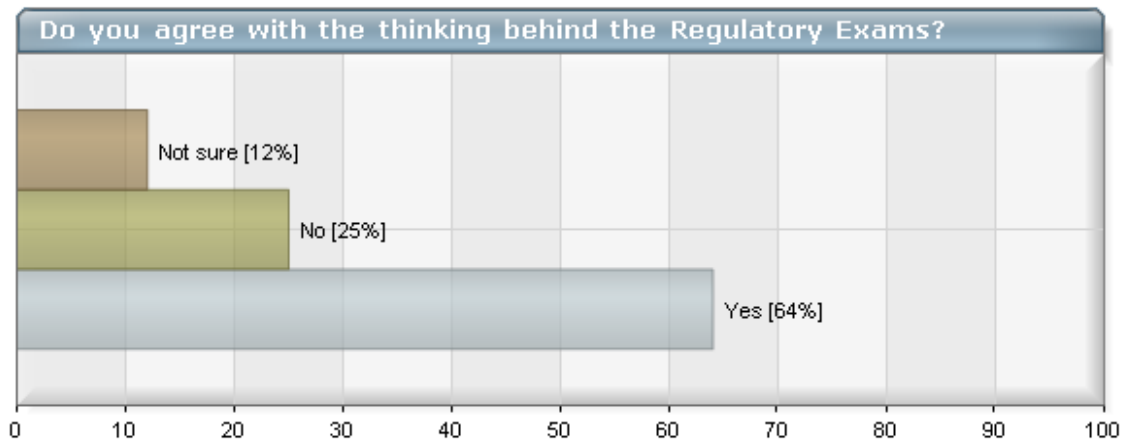
Advisers should also remember that separating their fee from a product or investment ensures that the risk of conflict of interests is significantly reduced. Fee-paying clients attach far greater value to advice they have to pay for.⁴

³ Refer to the Treasury white paper

⁴ Understanding the Fee for Service Model – FaNews November 2011

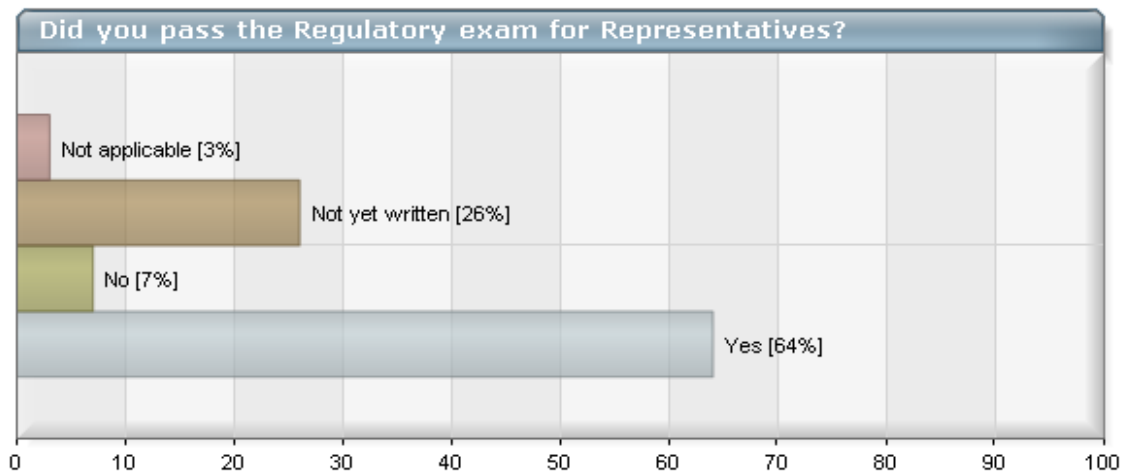
7. Do you agree with the thinking behind the Regulatory Exams?

It would appear that most advisers were happy with the concept behind the Regulatory Exams even though there have been industry rumblings to the contrary.



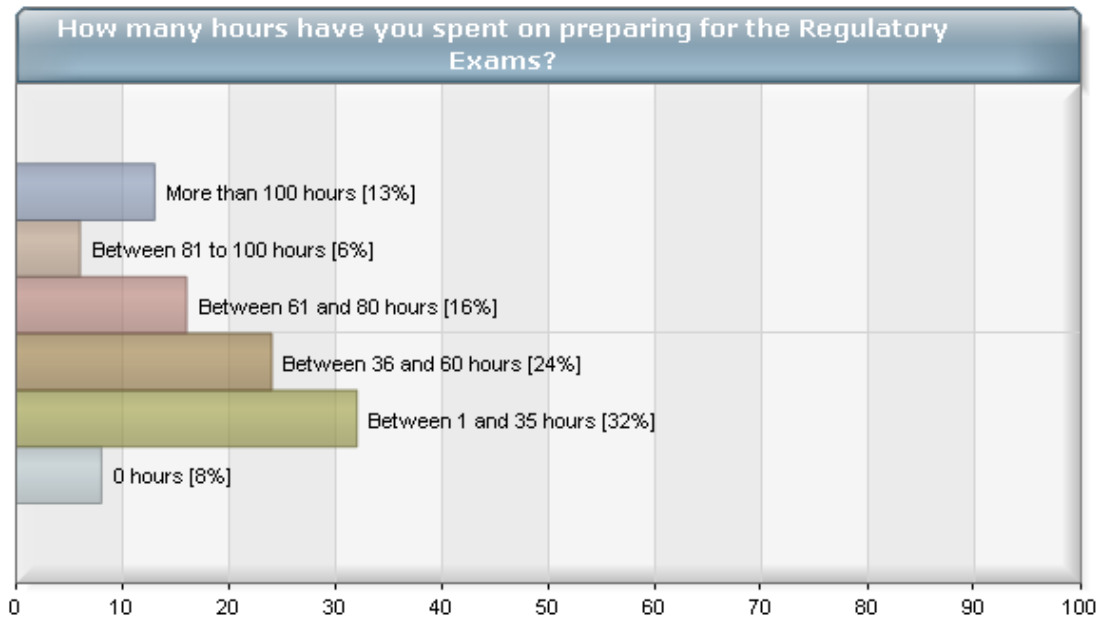
8. Did you pass the Regulatory Exam for Representatives?

The majority of respondents in this survey passed the Representatives exam whilst 26% had not yet written the exam.



9. How many hours did you spend preparing for the Regulatory Exams?

The majority of respondents indicated that they spent between one and 35 hours studying for the Regulatory Exams (RE). On average the respondents spent between three and five days studying for the exams with 13% actually spending more than 12 days on preparing for the RE. It is our experience that those advisers who prepared for the RE passed at better rates than those who did not⁵. But time is money - studying for these exams meant that many advisers could not get to see new or existing clients or deliver services to them. The question is can one put a cost to this time? This is addressed in the next question.



10. How much money have you spent on preparing for the Regulatory Exams?

This was an interesting response and was intended to exclude the R900-00 for the exam fee. The money advisers spent on preparing for the regulatory exams ranged from below R2000-00 to more than R8000-00. We were hoping for more accurate results but the graph show that most advisers do not have a clear understanding of the value of their time. An average amount spent on preparing for the Regulatory Exams appeared to be between 32% below 35 hours and 59% who spent more than 35 hours studying for the exams.⁶ We believe that as a minimum, advisers would have spent 35 hours or more studying for the examinations.

Assuming that there are 107 734 representatives who must write the Regulatory Exams (RE 5)⁷ and 12 645 Key Individuals who must write the RE 1 exams, we can determine that the cost to the industry for the Regulatory Exams only was:

$$107\,734 + 12\,645 = 120\,379 \times R900 = \mathbf{R108\,341\,100}$$

Assuming that at least 30% of these advisers failed the exams on first attempt it would have cost another

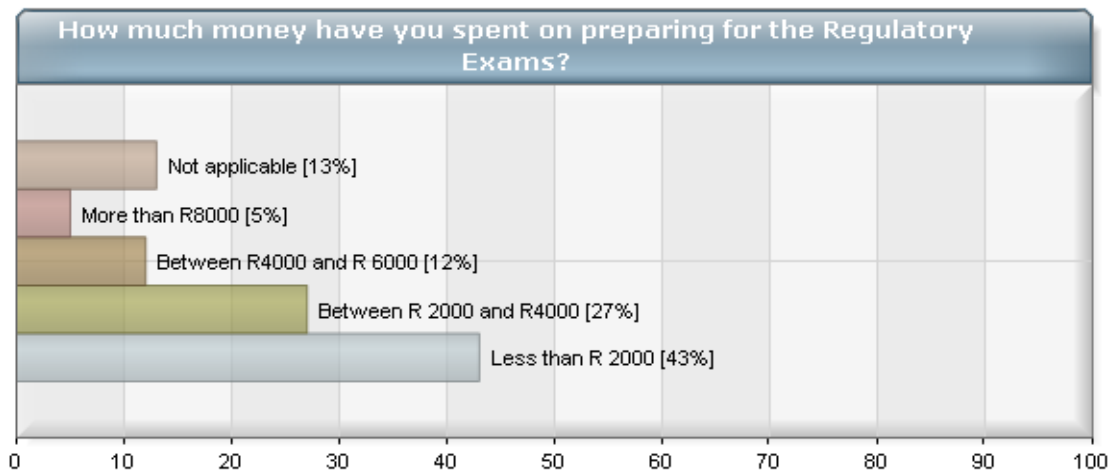
$$32\,320 \times R900 = \mathbf{R29\,088\,188}$$

⁵ See www.practice101.net online Regulatory Learning course.

⁶ Courses such as Milne Park Business School, Lexus Nexus-Butterworths, Anton Swanepoel and Practice101 cost between R1000-00 and R2000-00 depending on whether the Representative or Key Individual course was studied

⁷ Information Circular: Registration for Regulatory Examinations, page 6 -22 May 2011–released by FSB

And these costs exclude courses or lost revenue due to studying.



Further assuming that the average adviser’s hourly rate for seeing clients is R250-00 (responses show that the amount was much higher than this) and that client-facing activities account for four hours a day for four days a week; and that the average adviser studied for approximately 35 hours, it may be assumed that the average adviser lost a minimum of R8 750-00 in revenue studying for the exams. Add the approximately R1 000-00 expense on exam preparation such as material or courses, plus the R900-00 exam fee and we can calculate that studying and preparing for the Regulatory Examinations cost in the region of R10 650-00 per adviser (if that Representative or Key Individual passed first time around).

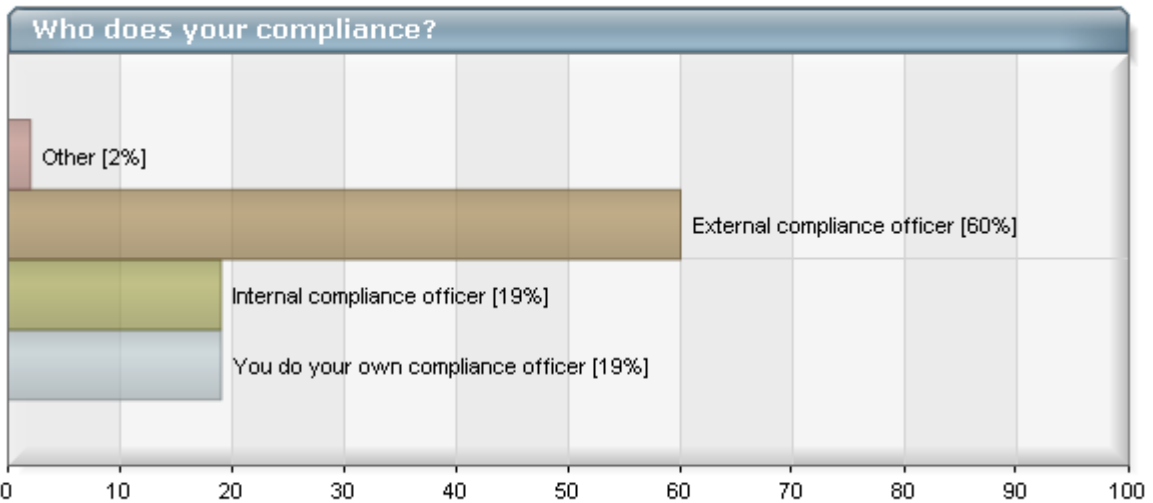
If there are 107 734 Representatives and 12 645 Key Individuals a very conservative cost-estimate of these exams to our financial services industry may be in the region of:

$$R10\ 650 \times 120\ 379 = \mathbf{R1\ 282\ 036\ 350.}$$

Of concern is how much time and money was potentially lost in production, client advice and client service from the financial services’ contribution to the economy during this period?

11. Who does your compliance?

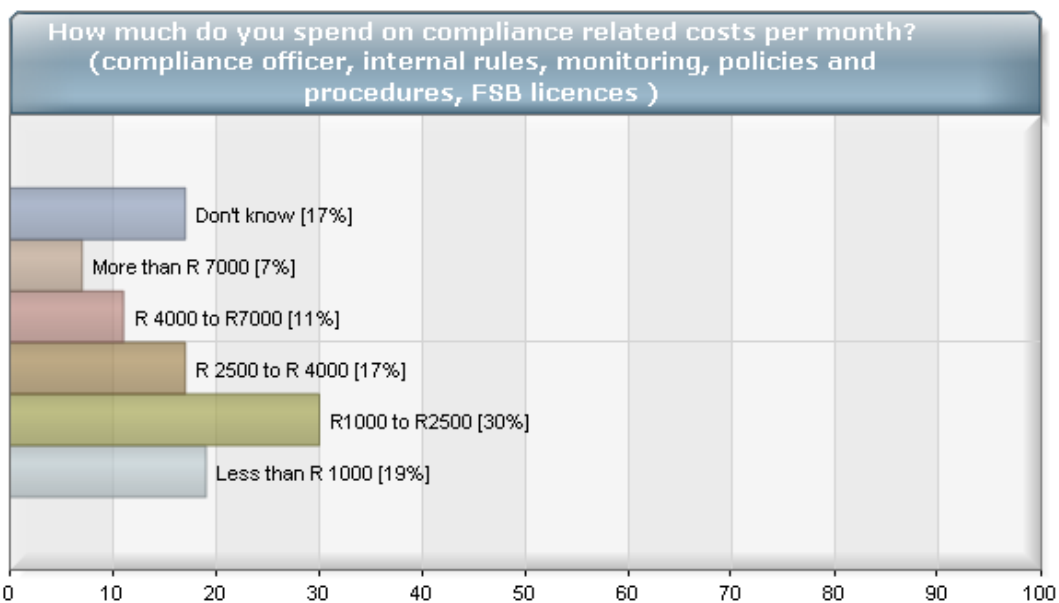
It was pleasing to see that 60% of the respondents used an external compliance officer whilst 38% used an internal compliance officer or acted as their own compliance officer. With regulatory compliance becoming increasingly complex and time-consuming, advisers must consider outsourcing the compliance function to a specialist compliance officer. We believe that taking into account the risks and costs to an adviser it is far better to make use of an external compliance specialist that to go it alone in the hope of cutting costs!



A word of caution to those advisers who act as their own compliance officers: Board Notice 127 sets out very clearly the specific requirements for a compliance officer. It is expected that many of those advisers who have an internal compliance officer will not qualify as compliance practitioners or will find it extremely difficult to pass the Regulatory Exams for compliance practitioners they are now required to write.

12. How much do you spend on compliance related costs per month? (Compliance officer, internal rules, monitoring, policies and procedures, FSB licences)

Interestingly 19% of advisers spent less than R 1000-00 per month on compliance related costs.

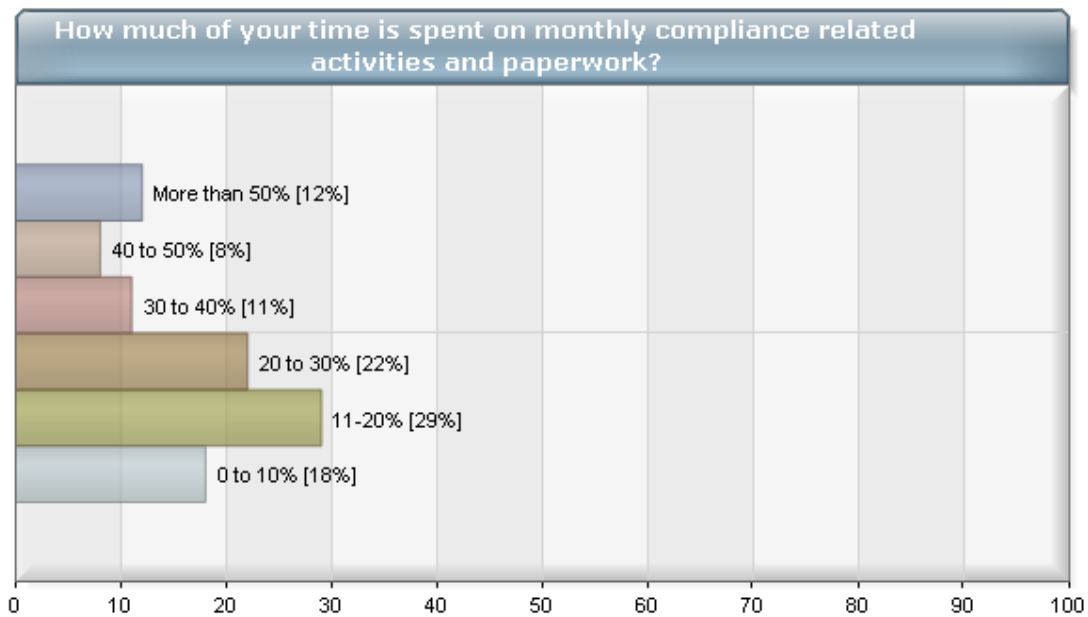


Some respondents (30%) believed that they spend between R1000-00 and R2500-00 per month on compliance related costs and another 35% of advisers believed that they spend more than R2500-00 per month on compliance costs.

Of concern to us was the 17% of advisers who simply did not know what their compliance related costs were – this in a day and age where advisers should know what their monthly business expenses are and how these are derived.

13. How much of your time is spent on monthly compliance related activities and paperwork?

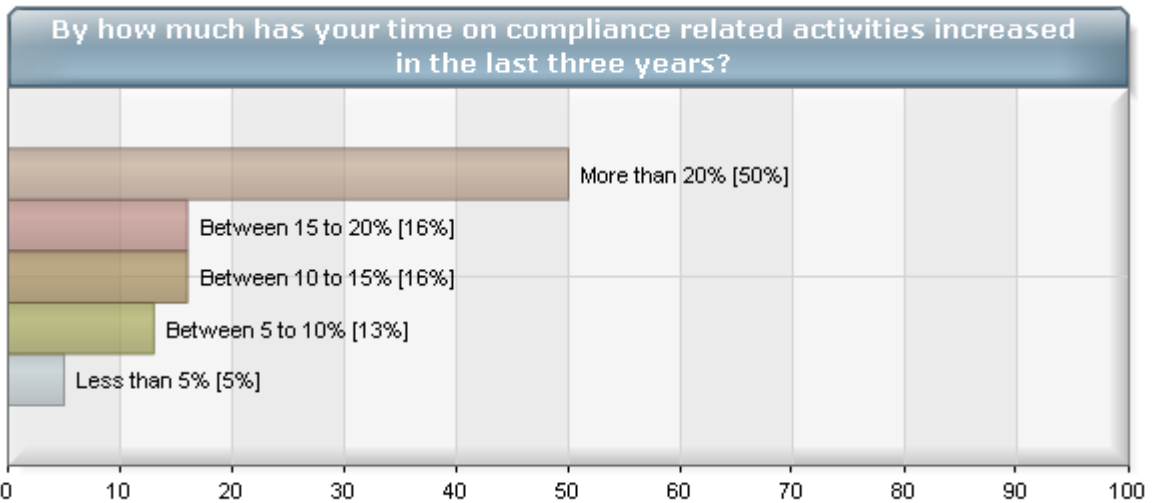
Looking at the charts below we notice that 18% of advisers chose to spend very little time on compliance-related activities. This is either a result of not having a compliance process or believing that as representatives compliance is not their responsibility. Unfortunately compliance is everyone's business - the Financial Advisory and Intermediary Services Act makes it so! The rest of the respondents can be grouped into 29% who spend between 11% and 20% of their monthly time on compliance related activities and the 31% who spend between 20 and 50% of their time on compliance related activities.



If we assume that most advisers work on average a 48 hour week – this is 192 hours per month of which 20% is spent on compliance- that is 38 hours per month. If this is multiplied by the average of R250 –00 per hour (this is far too low in our opinion) an adviser can charge in that time, then the monthly cost of compliance-related activities per adviser is around R9 500-00 per month.

14. By how much has your time on compliance related activities increased in the last three years?

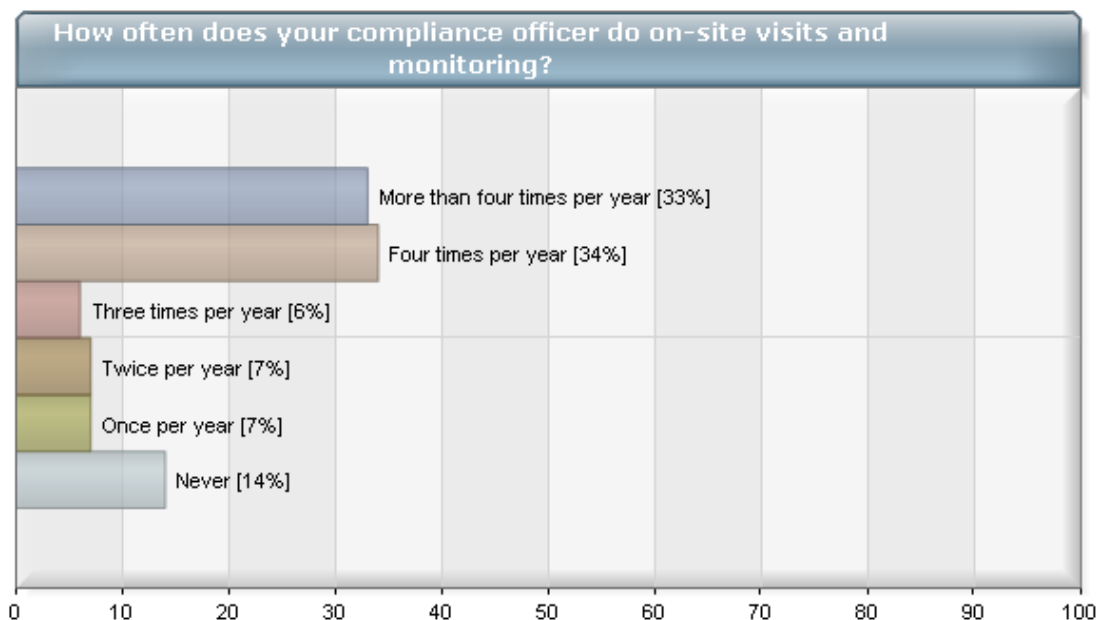
It is apparent from the answers to this question that compliance costs are increasing by more than 10% per annum. Yet there are 50% of respondents who believe that this increase is more than 20% per annum. This is closer to the USA average which has been increasing at a rate closer to 25% per annum over the last four years.



The bad news for South African Advisers is that this increase will continue into the future and need to be factored into budgets and business plans. Bad news for clients is that financial advisers will need to commence recouping their compliance expenses from the client. After all, FAIS is there to protect clients and they will need to pay for the financial services rendered to them in this regard.

15. How often does your compliance officer do on-site visits and monitoring?

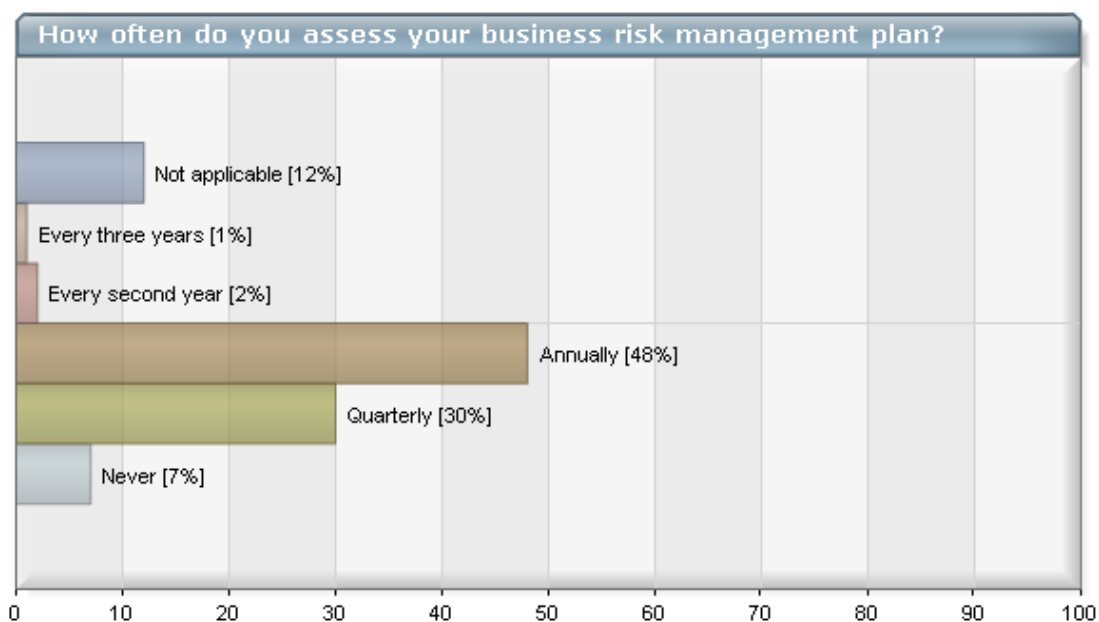
It was really pleasing to see that most respondents were visited four times or more per annum by their compliance officers. What was of great concern was the 14% who have never had a visit from their compliance officer! This is a massive business risk and could lead to potential exposure of non-compliant activities in advisory businesses. Should this happen, debarment or license suspension or withdrawal may be a strong possibility.



16. How often do you assess your business risk management plan?

“A risk may be defined as an uncertain event of condition that, if it occurs, has a positive or negative effect on advisory businesses objectives”. A risk management plan is a business document that is prepared by an advisory business to foresee risks, estimate the effectiveness and to create responses to mitigate them. It also consists of a risk assessment matrix.

The majority of the respondents reviewed their risk management plans on an annual or quarterly basis. This is a particularly pleasing response. We trust that there are well-constructed risk management plans in place and that these are not of a ‘canned’ variety where advisers use another adviser’s or compliance officer’s mass-produced risk management plans.



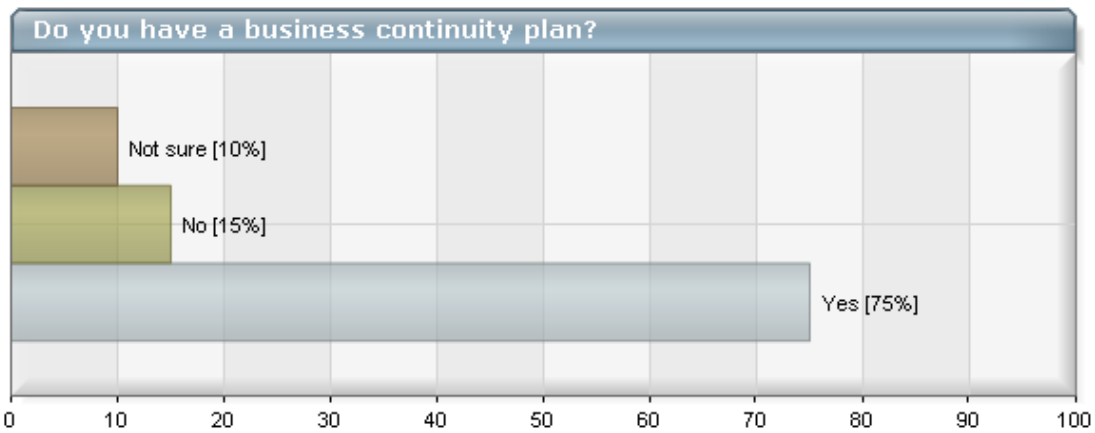
It is imperative that risk management plans are created for each individual advisory business.

17. Do you have a business continuity plan?

Business continuity planning is a proactive process to ensure that the critical advisory businesses services or products are delivered during a disruption. To permit an advisory business to recover its services, data and assets a business continuity plan (BCP) includes the following:

- Plans
- Measures
- Arrangements
- And the identification of necessary resources (including personnel, information, equipment, financial allocations, infrastructure protection and accommodations)

The majority of respondents have business continuity plans in place. This is a commendable response and favours well with international advisers who are not as well-prepared for contingencies. Advisers are warned against having a “canned” BCP version and they are urged to ensure that they spend quality time documenting and implementing a plan that works for their staff and clients.



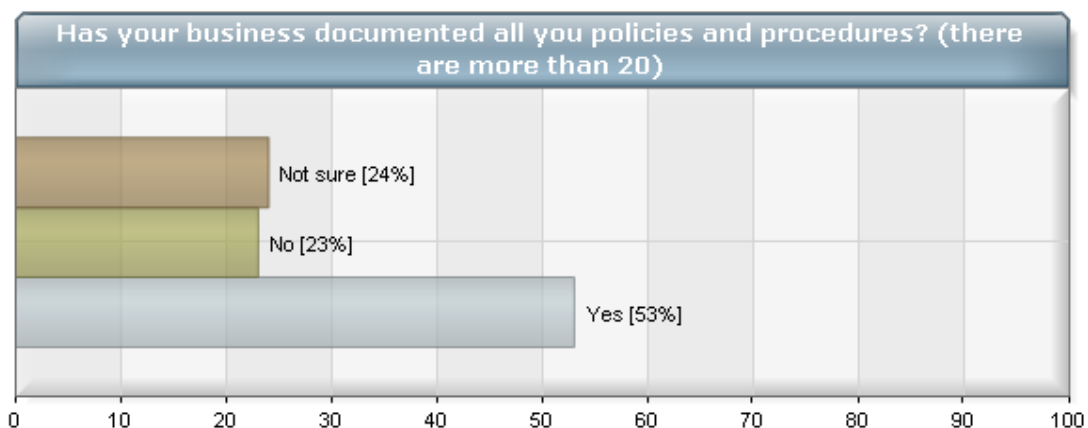
18. Has your business documented all your policies and procedures? (There are more than 20)

A well laid-out policy and procedure manual will help inform employees and also allow the financial advisory business to operate more efficiently and effectively. A policy and procedures manual can:

- Save time and effort
- Assist in recruiting new employees
- Provide detailed job descriptions
- Provide continuity and consistency in decision making
- Set a positive direction for the advisory business
- Provide a way to review existing products and services to ensure the needs are met
- Avoid conflict and the potential for misunderstanding

It is a huge task for an advisory business to create a policy and procedures manual. A well thought-out policy and procedures guide will help the advisory business fulfil its mission and attain its goals.

Over 50% of respondents have documented their policies and procedures as required by the FAIS Act. This is a very positive indicator and bodes well for the on-going professionalization of our industry. What was not positive was the 23% of respondents who said they had not documented policies and procedures and the 24% who were not sure whether this had been done or not.

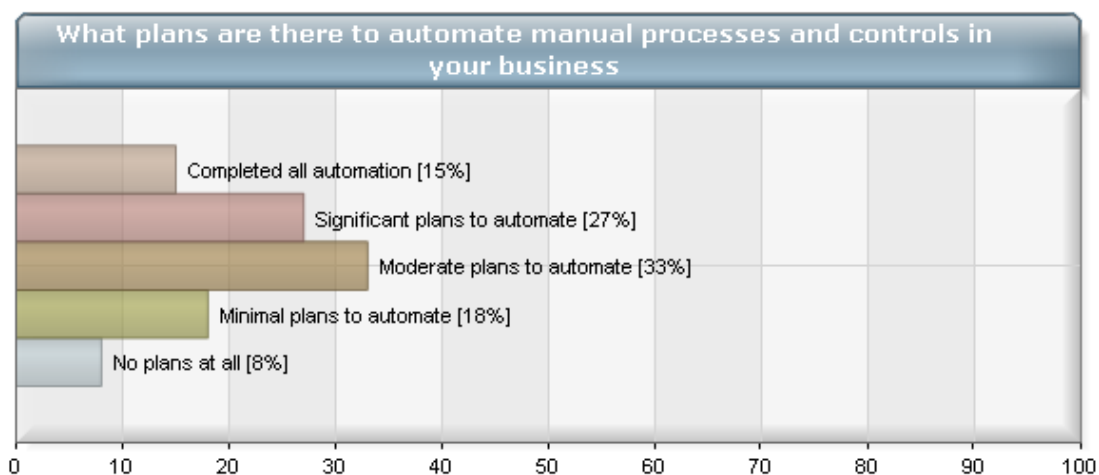


19. What plans are there to automate manual processes and controls in your businesses?

Financial advisory businesses need solutions to help them seize market opportunities, make smart decisions and realise maximum value from their investment in technology. In the hope of switching to higher efficiencies and automation, advisory businesses have turned to new technologies. Unfortunately technology on its own is not the solution. Any discussion about generating new efficiencies in a business should centre on how to empower employees with effective solutions that deliver results. People empowered by the right solutions can act on the right information at the right time.

Automating manual processes must first consist of documenting exactly what the processes are that need to be automated. Thereafter advisers need to find they right software that can automate their business processes. Critical to this is that any software must fit the business. More often than not advisers use a technology solution that does not fit their businesses. Business automation enables:

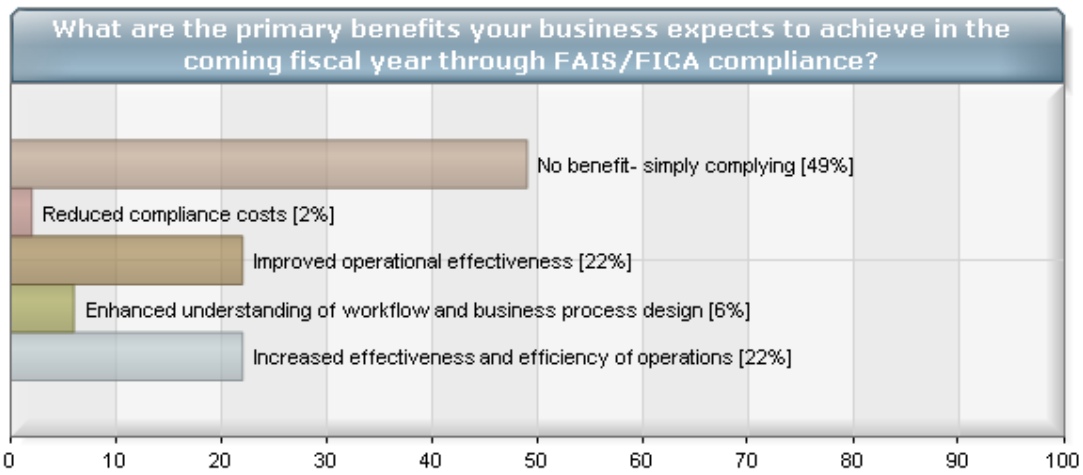
- Increased personal and advisory business productivity
- Better decision making
- Enhanced operational excellence



The survey indicated that 75% of the respondents had made a concerted effort to automate manual processes and controls in their practices. Developing automated business processes increases business efficiencies and decreases compliance costs and risks and adds massive value to the advisory business as a whole.

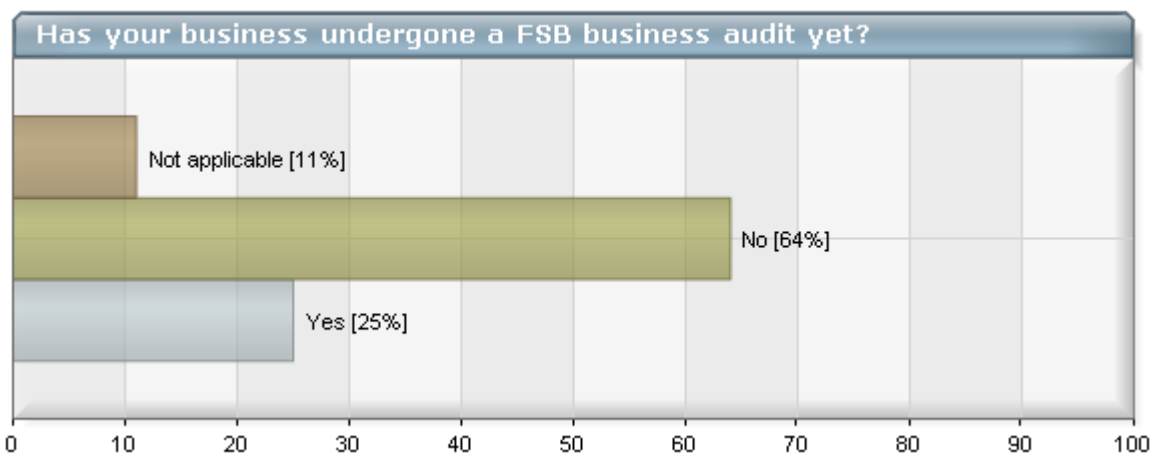
20. What are the primary benefits your business expects to achieve in the coming fiscal year through FAIS/FICA compliance?

A large percentage of respondents (48%) believed that there was no benefit to their business through FAIS and FICA compliance and that there were doing so simply to comply. There is no doubt that FAIS and FICA compliance "forces" financial advisers to improve the effectiveness and efficiencies of their business operations and also give them a better understanding of their workflows and processes.



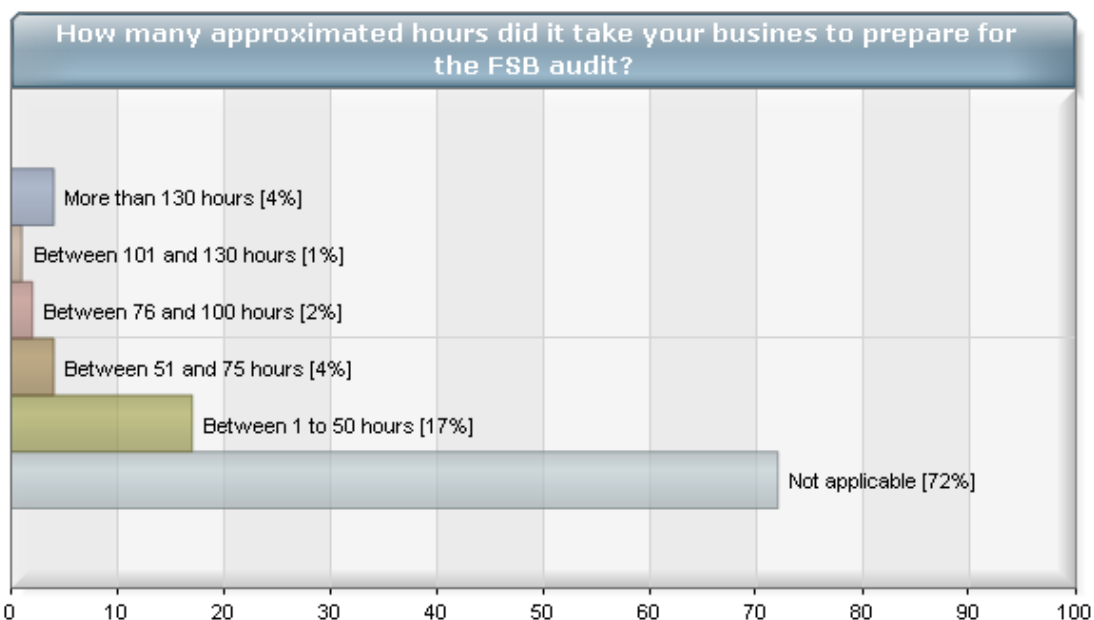
21. Has your business undergone a FSB audit yet?

The majority of advisers and advisory businesses (64%) have not yet undergone a FSB audit. It will be interesting to see how the FSB increase their capacity to ensure that they increase their efficiencies so that more FSPs are audited each year.



22. How many approximated hours did it take your business to prepare for the FSB audit?

Of the businesses that did undergo a FSB audit, 17% believed that it took them between one and fifty hours to prepare for the visit. However, 11% of the advisers believed it took them more than 51 hours of preparation. For a large majority this question was not relevant.



Our personal experience of being involved in these audits and preparing the necessary documentation indicates that such preparation and correspondence can take up over 75 hours of the adviser's time! The average time in the above graphic ranges from 17% of advisers who spent between one and fifty hours preparing for an audit and to 11% who spent more than 50 hours in preparation. It is safe to assume that advisers spent on average 35 hours on preparing for a FSB audit.

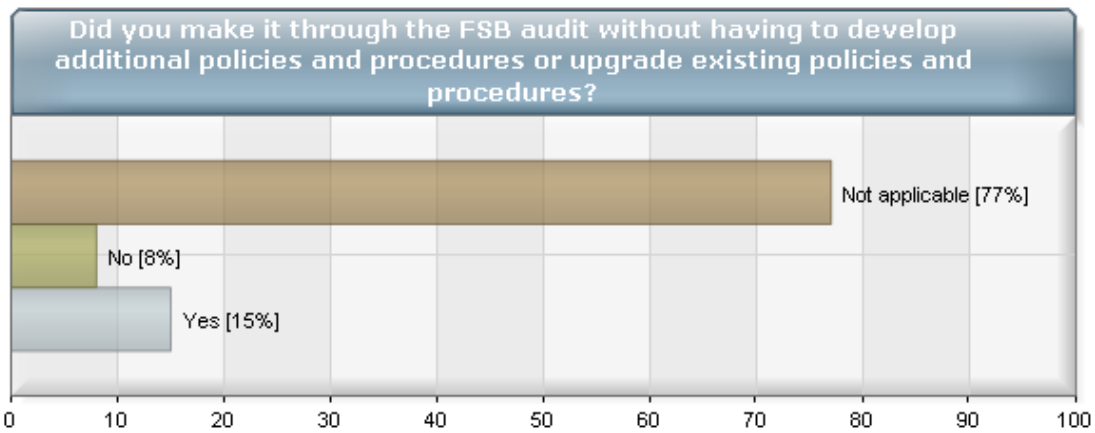
The best time for financial advisory businesses to prepare for a FSB audit is before the audit letter is received. To avoid being caught off-guard advisers should ensure the following:

- **Get organised:** the FSB will ask for an inordinate amount of records and documents within a short time-frame whilst advisers are still trying to conduct business. Being organised ahead of time will take off the pressure.
- **Stay updated:** Take time every quarter to update all the information required for an FSB audit. Ensure all policies and procedures are also updated annually.
- **Develop an audit protocol:** Prepare a document that sets out the FSB audit process to staff. All too often staff members complicate and exacerbate the audit process because they do not understand what to expect or how to handle themselves.
- **Conduct a mock audit annually:** Practice makes perfect and by conducting mock audits through an external compliance practitioner will go a long way to demonstrating to the regulators that the compliance programme is an important focus of the advisory business.

By incorporating the above process into an advisory business, time and money will be saved, business processes will become more efficient and staff more productive.

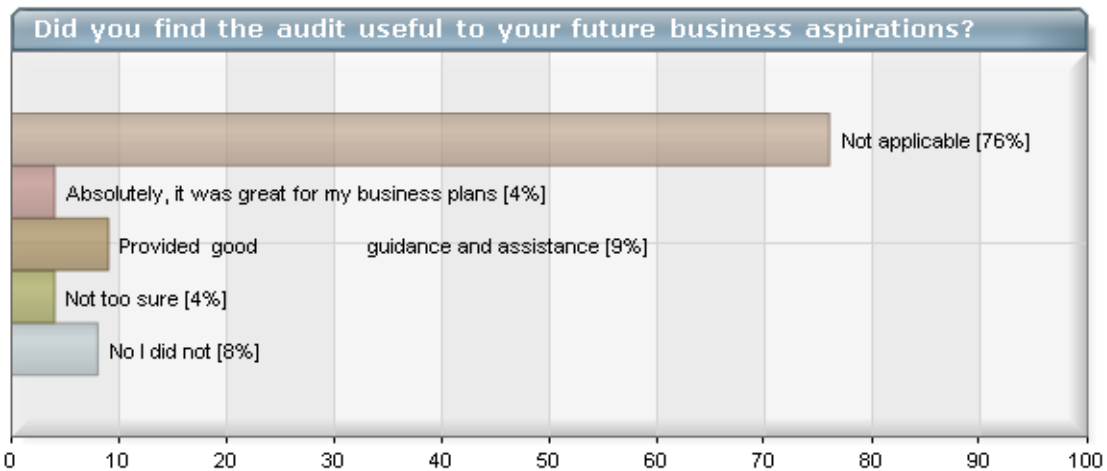
23. Did your business make it through the FSB audit without having to develop additional policies and procedures or upgrade existing policies and procedures?

Surprisingly 15% of those businesses that have had an audit made it through the FSB audit without having to develop additional policies and procedures or upgrading existing policies and procedures. On the other hand we can also infer from this that many advisory businesses still need to be examined by the FSB.



24. Did you find the FSB audit useful to your future business aspirations?

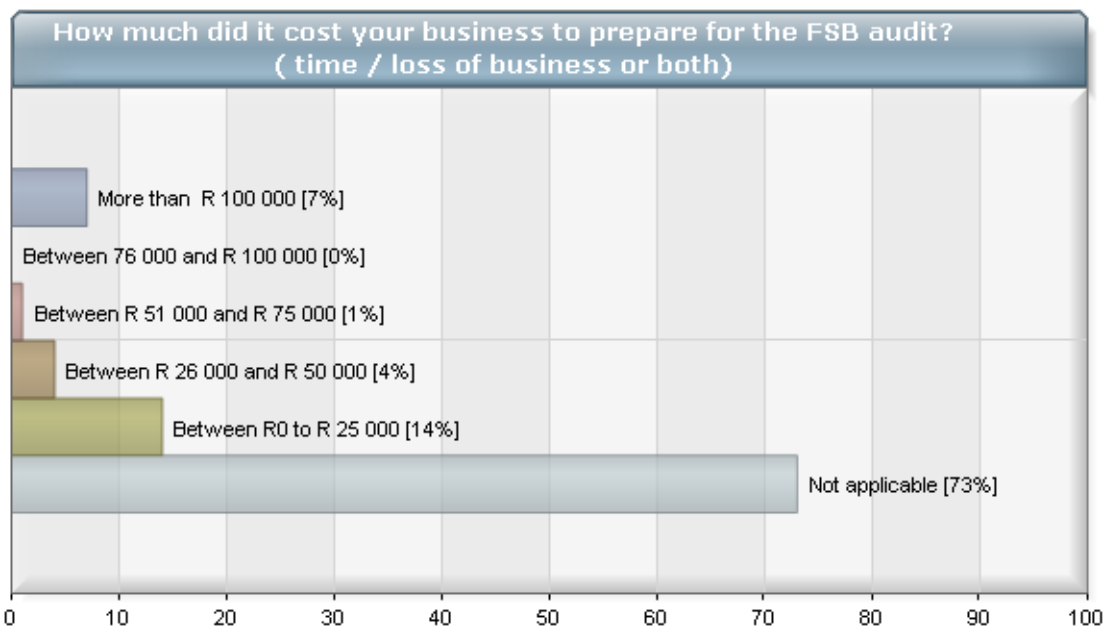
A small percentage of advisers believed that they benefitted from the FSB audit as it provided good guidance and assistance. The balance did not believe this was the case or were not too sure as to whether any benefit was derived from the experience.



Our view is that every FSP and adviser should benefit from the FSB audit. This is one sure-fire way of improving an advisory business and giving advisers the confidence that their business is FAIS and FICA compliant.

25. How much did it cost your business to prepare for the FSB audit? (Time/loss of business or both)

Preparation for the FSB audit was seen by 14% of the advisers as costing them between R0 and R25 000 and 12% indicated that the audit cost them more than R26 000. We can assume then that the FSB audit can cost financial advisory businesses on average R25 000 per audit.



26. Has your business starting preparing for Treating Customers Fairly? (TCF)

All advisory businesses in the United Kingdom who are regulated by their Financial Services Authority must pay due regard to the interests of its customers and treat them fairly.

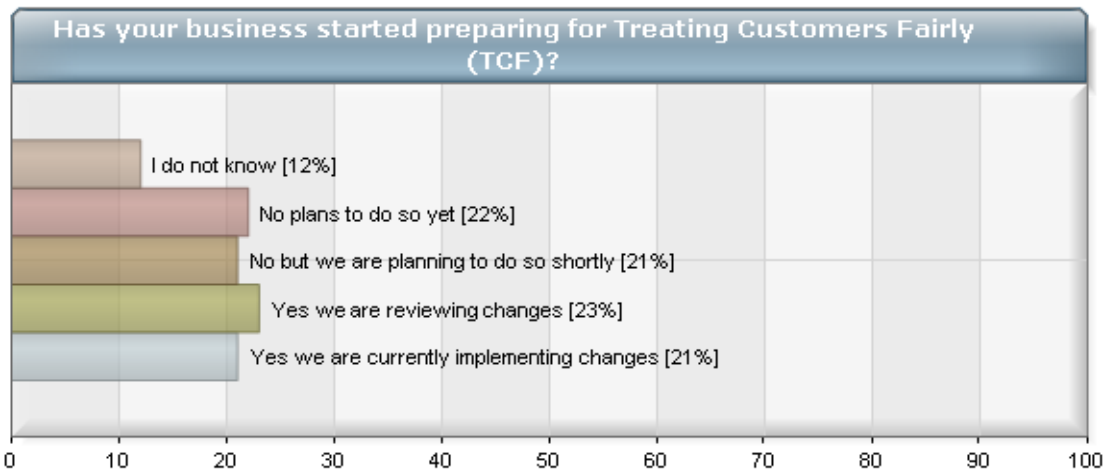
TCF, as it is known, aims to specifically:

- Help customers fully understand the features, benefits, risks and costs of the financial products they buy
- Minimise the sale of unsuitable products by encouraging best practice before, during and after sale

Rather than reinvent the wheel, our Financial Services Board has used the United Kingdom approach in developing the South African TCF. It outlines six core consumer outcomes that it wishes to see implemented by all Financial Services Providers:

- **Outcome 1:** Consumers can be confident that they are dealing with businesses where the fair treatment of customers is central to the corporate culture
- **Outcome 2:** Products and services marketed and sold in the retail market are designed to meet the needs of consumer groups and are targeted accordingly
- **Outcome 3:** Consumers are provided with clear information and kept appropriately informed before, during and after the point of sale
- **Outcome 4:** Where consumers receive advice, the advice is suitable and takes account of their circumstances
- **Outcome 5:** Consumers are provided with products that perform as businesses have led them to expect, and the associated service is of an acceptable standard and as they have been lead to expect
- **Outcome 6:** Consumers do not face unreasonable post-sale barriers imposed by businesses to change product, switch provider, submit a claim or make a complaint.

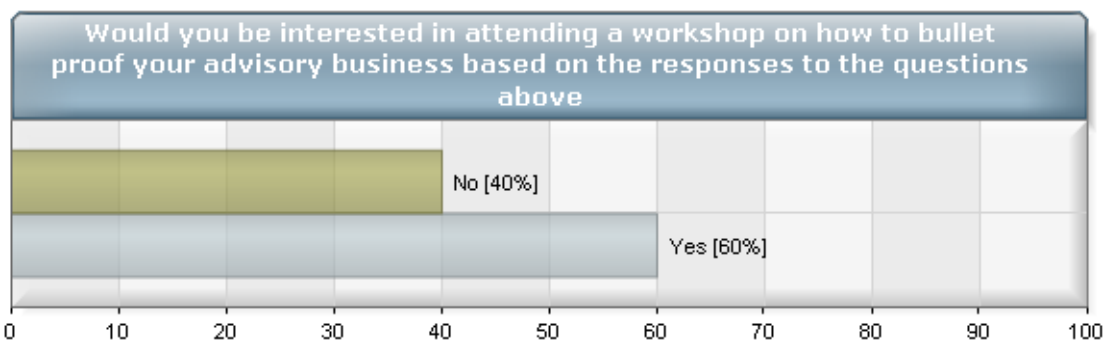
Although the scope of TCF is admirable it will add to the volume of compliance work that financial advisory businesses already have. But then there is the argument that if advisers have been running their practices as businesses and are client-focussed they will not need to do anything more than continue with what they have been doing. TCF will only cost those advisory businesses that are not prepared for the future.



A large percentage of the respondents are looking at Treating Clients Fairly and making preparation for its implementation in their businesses. No doubt the implementation will again increase their spend on compliance-related costs.

27. Would you be interested in attending a workshop on how to bullet proof your advisory business based on the responses to the questions above?

Over 60% of the respondents indicated that they would be interested in such a workshop. This shows that a large number of advisers are willing to learn and implement practices which can help them improve the way they do business.



We are looking forward to discussing the most pressing issues uncovered in this survey. Please watch FAnews for developments in this regard.

What we can learn from the survey

So what did compliance cost the average financial advisory business owner in South Africa in 2011 and 2012? Please note that our assumptions are based on the information obtained from this survey and data released by the Financial Services Board⁸, the different levies and on statistics released on the registration for the Regulatory Exams⁹. Please note we have assumed that there are 12 000 Financial Service Providers in South Africa.¹⁰

Average cost of Financial Services Board Levies

Description	Amount	Number	Cost
Levy per FSP	R2960-00	1200 FSP's	R3 552 000
Representatives Levy	R257-00	107 734	R27 687 638
Key Individual Levy	R473-00	12 645	R5 981 085
FAIS Ombud levy/ FSP	R675-00	12 000	R8 100 000

Average cost of Regulatory Exams to Financial Services Industry 2011/2012

Amount	Number	Amount	Cost
Key Individuals	12 645	R900	R11 380 500
Representatives	107 734	R900	R96 960 600
40% KI and Rep Rewrite Exams	48 151	R900	R43 335 900
Attend RE course	107 734 + 12645/2	R1 000	R60 189 500

Time spent on compliance activities

Description	Number	Amount	Total Cost
Representatives	107 734 /2= 53867	R9 500 x 12	R6 140 838 000
Key Individual	12 645/2 =6322	R9 500 x12	R720 708 000

No doubt time spent on compliance-related activities is a difficult cost to calculate. We have been conservative in our calculations by halving our estimated costs.

FSB Audit Preparation

Description	Time	Amount	Total Cost
Key individual	35 hours	R250	R8 750

Continuous Professional Development

Financial advisers will need to complete between 15 and 60 CPD points in three year cycles. We have assumed that advisers will do 10 CPD points per annum and that each CPD session will cost R100 per point.

Description	Number	Amount	Total Cost
Reps and KI	120 379	10 x 100	R120 379 000

⁸ Board Notice 101 of 2012 – Levies on Financial Institutions

⁹ Information Circular : Registration for Regulatory Examinations: 22 May 2012

¹⁰ There are approximately 14 000 FSP's according to FSB presentations: Nov 2011 Roadshow

A one year CPD cycle could for all Representatives and Key Individuals could cost the financial services industry R120 379 000 per annum. *Our prediction: CPD will become a great money spinner for CPD trainers and an on-going annual cost for the industry.*

Assumed Average Cost of Compliance for a Key Individual, Sole Proprietor or Close Corporation in the 2011/2012 financial year

Description	Action	Amount	Total Cost
Regulatory Exams	2 exams	R900	R1 800
Course material	2 courses	R1000	R2 000
Study time	35 hours	R250	R8 750
Compliance-related activities	35 hours	R9500	R114 000
Compliance officer	4 on-site visits plus reports and advice	R1000	R12 000
FSP levies	Average per sole proprietor	R2960+473+675	R4 108
CPD	10 notional hours p.a.	Min R100	R1 000
FSB Audit			R8 750
Accounting	<i>Full financials for FSB</i>	<i>Min R3500 per month</i>	<i>R42 000</i>
Record-keeping and back-ups		<i>R250 per month</i>	<i>R3000</i>

Note: At the time of preparing these results we realised that we did not account specifically for the costs of record-keeping, technology back-ups accounting and PI cover. This would have increased the cost of compliance as we depict it here quite significantly.

A very conservative calculation averages the cost of compliance per annum to an independent financial advisory business at R 188 658.

Conclusion

Financial scandals and the collapse of large financial services institutions have driven calls for increased regulation of financial services businesses and advisers. As a result of this many financial advisers and institutions internationally and in South Africa see compliance as a threat. This is principally through the potential exposure of their weaknesses – reflected in the way South African implement the requirements of the FAIS Code of Conduct and relevant Board Notices.

In both the USA and Europe financial institutions have been fined for everything from not storing files in a proper format, improper reporting to the regulators, to improper reporting with investors on investment fund disclosure. So far in South Africa we have been fortunate in that the FSB has not implemented a similar strategy yet. However, recent presentations by the Board’s Head of Enforcement indicate that the honeymoon period is over in this regard and that heavier penalties will be imposed on those that contravene the FAIS Act.¹¹

Our research shows that whilst some advisers see compliance as a burden others interestingly see it as an opportunity. Those advisers who see compliance as an opportunity plan not only to meet compliance needs of today, but go beyond them and in so doing create genuine competitive advantages for themselves.

¹¹FSB Press release 25 July 2012- Financial Services Board to Deal More harshly with Non-Compliance

Advisers who are past winners of the Practice of the Year and Financial Planner of the Year competitions show clearly how embracing regulatory change can assist in ensuring that a sustainable value-proposition can be offered to clients and still create on-going business growth.

One thing that is certain is that compliance costs will continue to increase and hit the pocket of financial advisory businesses and the independent financial adviser. We believe that in the not too distant future financial advisers will need to pass this cost on to their clients. In the United Kingdom financial advisers and asset management businesses are disclosing the client's contribution to compliance costs in their fee statements in order to ensure their businesses remain sustainable going forward. This has been a direct result of the RDR and adviser charging requirements set out by their Financial Services Authority.

To survive and thrive going forward financial advisory businesses and financial advisers will need to reinvent their business model and then make certain that it evolves with the pace of regulatory changes. Regulators are taking clear steps towards enabling people to accurately assess the value of the financial services they are receiving. Those financial advisers who believe in the value of the services they provide will have nothing to fear from justifying their fees. For those NOT up to the challenges the writing is on the wall – saddle up, sell out or move into the ranks of a tied agency force and the protection it offers.

FAnews Comments

The cost of compliance to the South African Financial services industry is quite extraordinary. In fact if one added the levies for all product providers and CAT II and III collective investment businesses, as well as the salaries of all those people whose function it is to ensure everyone complies, it may well double the numbers stated above.

Does spending all this money on compliance actually make the financial services industry a safer place for the consumer? We believe that the regulatory oversight has unintended consequences that need to be fixed. Below are listed what we believe are the key problem areas:

- Our regulatory system is broken. Each time a new heinous scheme is uncovered we find out after the fact the comedy of errors, ignoring evidence that the problem existed a long time before it collapsed. Regulators need to have better forensic and auditing mechanisms in place to detect schemes long before they go bust.
- Audit and inspection oversight of smaller businesses. The regulators move into the offices of reputable law-abiding advisers looking at many non-essential issues, driving up the costs of doing business for the “good guys” in ways that are visibly ineffective at protecting the public. As this trend continues, compliance costs will threaten the viability of the smaller independent financial advisers.
- One cannot help but notice that the FSB, rather than go after the power houses, instead choose to “show their muscle” by proceeding against the smaller businesses, knowing that these businesses are financially restricted from fighting regulatory actions. Increasing the regulatory reputation of the FSB at the expense of smaller independent financial advisers cannot be good for consumers requiring independent advice. Surely FSB resources should be utilised to bring under control the bigger financial services providers such as product providers and banks as they are the ones ultimately causing far more serious harm to the public and investors.
- Our industry and regulators need to understand the advice model. It would seem hard to believe but the FSB still seems to have little institutional understanding of the business model of the independent financial planner.
- More problematic is the confusion that exists in our Insurance Act and interpretations of the Financial Advisory and Intermediary Services Act where advisers are compensated totally or largely by fees paid

by the consumer. For too long our industry has seen financial advisers remunerated by product sales rather than the expertise and knowledge surrounding advice.

- The traditional focus has been on product regulation, qualification and licensing which has been positioned at an entry-level rather than professional level. Little or no distinction has been made among the activities of those who provide limited advice (financial advisers) and those offering comprehensive financial planning (financial planners).
- FAIS is a piece of legislation driven by controlling product and as long as this situation persists the financial advisory business will never professionalise. Product advice and financial planning advice are two very different things and regulators must recognize financial planning as a distinct professional service and practice.
- It is our concern that without legislation that clearly defines who is appropriately qualified to hold themselves out as financial planners or wealth managers, advisers will be able to avoid the standards of care and professionalism by describing themselves with a title that requires a far lower standard of care. Presently advisers can “self-select their expertise” and call themselves broker, financial adviser, financial consultant, financial counsellor, life planner, wealth manager irrespective of qualification and experience. Unfortunately this position allows consumers to be misled and only adds fuel to the negative perceptions and experiences of the financial services industry.
- Effective disclosure that helps consumers make informed decisions is a good move but not an end in itself. Many providers and advisers believe that giving consumers information so that they take more responsibility is also not a good argument. The nature of the advice that is given is critical to consumers having confidence in the adviser’s professional expertise and qualifications of the person giving that advice. Consumers need to know that advice is unbiased and that the products selected are geared to their individual needs. Many products in our industry are still pushed because of an underlying incentive and reward structure. Our regulators have focussed too much on disclosure from remuneration rather than tackling the root problem of bias.
- There will always be the temptation for advisers to recommend that regulation go away altogether, so that they can eliminate compliance costs. But we would argue that a better regulatory process will actually benefit the honest financial advisers. If there were some confidence that a Fidentia or Supreme Holdings would be nipped in the bud before millions of Rands are lost, consumers would be less hesitant to hire and trust advisers. But at the same time we should pay attention to efficiency and to creating a regulatory system that does not waste the financial adviser’s time or resources.
- The regulatory structure should also help consumers recognise the difference between salespeople and professionals. Perhaps it is time for South Africa to take the stage in the international financial services environment and have two systems: one regulatory system for those who are willing and able to sign a fiduciary oath on behalf of their clients and another separate system for those who are either unwilling or unable to commit to this in writing because of the contractual obligations of their employers. Consumers can then make their choice as to which adviser to go to and pay the ‘fee for service’ price.

FAnews comments on the role of the FSB

- The Financial Services Board (FSB) must get tough on product providers and corporate FSP's
- The FSB must look at product due diligence before marketing is allowed by product providers. Each product should be registered with the FSB and advertised as such. Consumers will be better protected this way
- The FSB should develop a comprehensive compliance kit for independent financial advisers that are implemented through compliance officers. This will improve standards across the industry and ensure that implementation in advisory businesses occurs
- Are the compliance standards sought by FSB applied the same way in every FSP? (FSB audits can range from a 3-hour visit to a two day visit – when processes and procedures are analysed there appears to be differences and inconsistencies in the way these audits are handled)
- Financial advisory business software or CRM packages should also be registered with the FSB. (Many make broad statements about what they do and on closer analysis this does not appear to be so. These necessary business tools cost advisers a lot of money – they need to be protected too.)

Other comments and thoughts

- The draft Continuous Professional Development (CPD) notice will create many new jobs for CPD-providers and increase administrative pressures on the FSB. We think the draft is far from acceptable and needs far more industry consultation and some more serious consideration before it can be finalised and implemented.
- The FSB will need to take a stand on professionalism in our industry - define it and recognise it. Using the words professionalise, professional or professionalism must mean the same thing. Presently the words are being confused with many non-professional meanings sending mixed messages to advisers and to consumers. Mr Pillai's views in this regard clearly reflect what it means to be professional.
- So too, Continuous Professional Development or CPD is the wrong term for people who are not qualified with degrees and experience. Rather it is suggested, why not use Continuous Education (CE) for FAIS and leave CPD to those professional bodies that have professionally recognised qualifications.
- Further, a professional adviser is better qualified and may charge a fee for financial plans and other advice – they should also operate at a prescribed level and format – in fact beyond FAIS – beyond reproach, such should be the level of a professional advisers business and value proposition.
- Transparency is also about saying I am a “non-professional” adviser and I am restricted to provide advice on these products only.
- If compliance is costing advisers in the industry R 1. 5 billion who is picking up the tab for this “loss”? Not the client, yet.
- Should this consumer-driven legislation continue to escalate the cost of advice it will force advisers to charge clients for a portion of their compliance costs. This will make financial advice unaffordable to the average consumer – the very people who need it most.