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## TCF vs CoFI:

### Findings show SA businesses coincide well with standards of good conduct

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Following in-depth discussions with 25 of South Africa's top financial firms, and the Royal Commission of Inquiry's report on misconduct in the financial industry, it is encouraging to see that initial findings point to a financial services industry that comports well with standards of good conduct. However, gaps remain that need to be overcome.

As part of an assessment of the commitment to conduct standards in the sector, DB & Associates has had over 100 meetings with the executive leadership of the top 25 firms in South Africa's financial sector over the past 18 months. This culminated in a Royal Commission of Inquiry into misconduct in the financial industry, which delivered its final report earlier this year. The Commission's findings were, to say the least, sobering. Initially, the assumption was made that, because South Africa is a developing country with high levels of corruption in government, as bad as things were in Australia, they would be worse in South Africa. This prediction could not have been more wrong.

#### Learnings from Australia's mistakes

Forming part of the discussions with leading financial institutions were Dr Andy Schmulow, Senior Advisor at DB & Associates, who has in-depth experience in Australia's financial industry. His extensive knowledge about the Australian landscape is relevant for two reasons: the financial system regulatory reforms currently underway in South Africa are modelled on Australia's *Twin Peaks* regime; and secondly, because Australia's financial regulation is in crisis – the product of system-wide failure to enforce anything approaching good conduct, pervasively evident for over a decade, with misconduct, and at times serious criminality, perpetrated on an industrial scale.

What was encountered is a financial services industry which, while not perfect by any means, nonetheless comports well with standards of good conduct. The reasons are many and varied. They include a far deeper awareness that the financial industry must serve the community in which it operates, not the other way around. An understanding of the need to contribute to redressing economic inequality embedded by decades of discrimination, for both social justice reasons, and to create the kind of economic prosperity that firms themselves need, in order to grow. But doubtless also the *treating customers fairly* (TCF) regime has played an important role in readying financial firms for the forthcoming introduction of new conduct legislation: the *Conduct of Financial Institutions Act* (CoFI).

#### From process-driven to values-driven

However, gaps remain. These relate chiefly to requirements to transform culture and governance, and the disjuncture between TCF and CoFI. With regards to the former, CoFI will require a shift in corporate governance from *what*, to *how and why*. This shifts culture and governance from being process-driven to becoming values-driven. TCF compliance similarly requires shifts to plug gaps. For example: the six TCF pillars do not map exactly to the nine pillars of CoFI.

The three pillars that will be new under CoFI present significant challenges. In the case of product or service distribution, a regulated entity will be responsible for misconduct committed by brokers, including brokers wholly independent. This will be tricky. How should a firm enforce its obligations on an independent broker – especially a highly successful one – without the risk of that broker ending its relationship with the firm, and henceforth, selling only its competitor's products? How will a firm impose, if need be, close



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scrutiny of a broker's activities, especially one located remotely? There are answers to these questions, but they are imperfect.

### **Three pillars, three challenges**

*1. These differences relate primarily to CoFI requirements for distribution, culture and governance, and licensing.*

In respect of culture and governance, CoFI will require a whole of entity regeneration of culture; an exercise that will go far deeper than anything encouraged by TCF. The consequences of failure are real: Momentum has recently been slapped with a R100 million fine by the FSCA for governance failures in one of their unit trusts. So, whereas in the past governance issues, like conflicts of interest, could be ticked off on the basis that the firm 'has a policy' addressing the issue, this will no longer suffice. Now the enquiry will relate to both the efficacy of the policy itself, and the strength of its implementation.

*2. TCF compliance is ascertained by the firm itself. CoFI compliance will be independently judged by the newly established Financial Sector Conduct Authority (FSCA).*

To date, TCF compliance has been a matter for the firm to judge, but self-assessment is a complacency trap writ large. For one thing, self-assessment will never be as searching or as critical as an independent review. Unavoidable cognitive biases, with which we are all afflicted, guarantee that. The only credible form of assessment is arms-length (which must preclude, for example, being undertaken by a firm's auditors; such assessments merely embed leveraged conflicts of interest). Reviews must be grounded in methodologically rigorous, credible, and critical recursive reviews, conducted independently. As such, current TCF assessments present the risk of being a complacency and self-affirming trap.

*3. TCF compliance is more superficial in nature and is often addressed as an afterthought, whereas CoFI requires a deeper and more profound treatment, addressed as a forethought.*

TCF's pillars lack the cascading sets of sub-principles included in CoFI's pillars. As such, TCF is by nature more superficial, more malleable, and easier to demonstrate. As a result, it tends to default to a tick-box approach, in which TCF adherence is demonstrated through the use of leading questions, posed by the firm, to deliver the affirmations the firm seeks. As a result, even under a TCF framework, several firms have acknowledged that they are still product-focused, not client-focused. A failure to reform such a *product-flogging* emphasis will serve them poorly under the new regime. CoFI, by contrast, will require compliance as a forethought to product and service design and construction, whereas under TCF, a number of firms continue to check compliance as the product rolls off the production line. Put differently; compliance must be an active participant from conception, not a theatre assistant at birth. Therefore, CoFI requires demonstrable success in promoting financial literacy and financial inclusion and affords protection to sophisticated as well as retail customers.

### **A journey of change towards compliance**

Set against all of this is a conduct authority – the FSCA – whose remit and powers – especially as compared to its progenitor, the Australian Securities and Investments Commission – make it fully weaponised. It can punish, and can do so severely (and has already), whereas the recipients of FSCA sanctions are severely limited in their avenues for appeal. This enables the FSCA to move swiftly, and come down hard. In the process, firms that incur its wrath, even if they mount successful appeals, will be tarnished, and their reputations damaged.



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A better and more prudent approach would be to leverage existing TCF adherence, not in a vein of complacency, but rather as a good start to a real and much deeper change journey. A journey in which compliance is reconceptualised, firm values are implemented (not simply articulated), and corporate culture is strengthened and enhanced towards customer centricity, at every level of the organisation.

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#### About DB & Associates

DB & Associates is a management consulting firm operating out of South Africa and Australia. With over 40 consulting professionals working across industries, we are one of South Africa's fastest-growing advisory firms. Our strength lies in our ability to bring together powerful analysis, drive transformational change and leverage technology to help our clients achieve sustainable results. Fast.

DB & Associates' Senior Advisor (and internationally recognised authority on financial regulatory architecture and Twin Peaks), Dr Andy Schmulow, is leading the team by informing firms on how best to adapt to the financial system regulatory reforms currently underway in South Africa.

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