The struggle for the RDR to find its regulatory footing

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The Twin Peaks regulatory model (Twins Peaks) was implemented in April of 2018, fundamentally changing the South African financial regulatory system into two regulatory streams, primarily the Prudential Authority (PA) and Financial Services Conduct Authority (FSCA). The Prudential Authority will be responsible for oversight of the soundness and financial safety of financial institutions (incl. banks, insurance, and financial services). While the FSCA's mandate be required to protect financial services customers and improve the way providers do business.

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The Treat Customer Fairly (TCF) is a new legislation in the financial services sectors (banking, insurance, investments, etc) supported by six consumer outcomes that ensure fair treatment of customers. It is this TCF approach, which the Retail Distribution Review (RDR) is a prominent example of, focuses on the regulated financial institutions delivery of fair outcomes for financial customers and requires proactive measures by regulators and policymakers for dealing with market conduct failures.

The FSCA published its RDR discussion document in November 2014 where it seeks to improve professional standards in the financial services industry, ensuring that clients are treated fairly when purchasing financial products. It ensures that each financial advisor-client is offered a transparent fee structure, can understand the services the advisor provides and knows that they are being advised by a respected professional.

The RDR is linked to one of the TCF outcomes namely TCF outcome 4 which states that “Where advice is given, it is suitable and takes account of customer circumstance.” In Addition, RDR is designed to increase confidence in customers when purchasing of financial products.

The regulatory body and the RDR

The current regulatory framework, through the FAIS Act, places less accountability on product suppliers. This will change when the review is enacted placing more responsibility on advisers to demonstrate the value of their services. The review will additionally limit the opportunity for regulatory discrepancies by ensuring consistent supervisory measures are in place to identify misconduct, current and emerging risks. The RDR will change the approach to market conduct regulation and supervision, placing more responsibility on suppliers and advisors to provide more comparable products and activities across sectors.

The review will form the basis for adequate supervision on inherent product advice risks. Placing financial customers in a position to better understand the kind of advice or services they are getting. Clients will become aware of the costs along the entire value chain. It will show how much these services will cost and how they will be paid while instilling confidence that their adviser is sufficiently qualified to provide useful advice and is acting in their best interests.

Yet, the RDR doesn't factor in global shocks like Covid-19. The current global pandemic has brought to light economic risks, not only to ensure fair customer outcomes but also to facilitate intermediary sustainability and supervisory effectiveness.

This means that product suppliers may try to give up all risks responsible for mitigating unfair customer treatment by contracted intermediaries. Why? They might see such risk mitigation as being the sole responsibility of the regulator. For example, FAIS licensing, compliance, and dispute resolution frameworks.

What needs to be done?

There need to be clear obligations placed on regulated financial institutions to treat their customers fairly in the context of the RDR. Structural interventions are necessary to change incentives, relationships, and business models where existing regulatory frameworks do not consistently support the delivery of desired outcomes.

This complicates supervision and undermines the regulator's effectiveness in achieving fair customer outcomes. Truth be told, the regulator should not be the first line of defence in ensuring fair outcomes when it comes to advising and distribution models. Product suppliers, who are closer to the intermediary force and have a clear interest in the effective and appropriate distribution of their products, are in a better position than the regulator to monitor advice and distribution outcomes. This should be done while putting reasonable controls in place to promote fair treatment and mitigate mis-selling risks. In doing so, customers who are unwilling or unable to pay direct advice fees up-front are exempted from the risks of commission-led products and adviser bias.

Additionally, we should take into account the Conduct of Financial Institutions Bill, which states that "a financial product provider must ensure that their financial customers are provided with products that perform as that provider has led its customers to expect, through the information, representations and advertising provided by or on behalf of the financial product provider".

Achieving RDR transparency requires that no single regulatory intervention can work in isolation. Similarly, this places obligations on financial advisers to provide appropriate advice should they be torn between the obligations on product suppliers to ensure the distribution models are appropriate for the customers targeted, and the products concerned. The goal that all should be working towards, however, remains quite simple: mutually reinforcing product information to create value for the customer.

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