

Would you join the dangerous world of financial advice?

The background

The *Financial Advisers Bill* (FAB) refers to an “Executive Chairperson” who is to operate in terms of the *Financial Services Regulatory Act*. Not even the Financial Services Board (FSB) has yet been made privy to the contents of this Act, so for convenience I shall refer to it as the “Fugitive Act”. The term “Executive Chairperson” is an unsavoury mouthful, so again for convenience I shall refer to he, she or it as “Chairman Mao”.

Chairman Mao, in terms of the FAB, Part 6, Section 17(1)(b), should he discover that you, as a financial adviser, have made an “unsolicited call”, meaning that you communicated with your client without his express *prior* consent or invitation, may apply for an order restraining you from continuing to commit such an “offence”.

The dangers

If you fail to comply with this order, Chairman Mao may, in terms of the FAB, Section 17(2), apply for an order requiring you to pay an amount as compensation, a further penalty for punitive purposes of up to 3 times your commission, a further amount for interest thereon and an amount to cover the costs of the suit. Furthermore, you will not pay these amounts to the Court but you will pay them to Chairman Mao, who in the first instance will take 10% off the gross amount in terms of the FAB, Section 17(3)(a)(ii), reimburse himself expenses incurred and, should there be any balance, compensate your client for your dastardly temerity in having made an unsolicited call to him in the first place. Any remaining funds thereafter will accrue to Chairman Mao in his official capacity.

What you *can* do about it

Should you feel aggrieved by this action of Chairman Mao, then you may approach his “Appeal Board” in terms of procedures yet to be laid down in the Fugitive Act.

This applies equally to any other practice which may be deemed by Chairman Mao to be “undesirable” in consultation with an “Advisory Committee” which again is to be appointed in terms of the Fugitive Act. Politicians in South Africa have for too long had very distinct views of what were “undesirable practices” and “in the public interest”. These kinds of terms have no place in a modern democracy.

What they *are* doing about it

This Act involves the creation of an entire new bureaucracy and career system. The FAB is silent on what problem it proposes to address. It tells us nothing about what it intends to achieve, how we will measure the success or failure of those achievements or what it will cost.

Chairman Mao is to be appointed in terms of an amendment to yet another Act: the *Inspection of Financial Institutions Act* No. 80 of 1998, as will be his inspectors and their assistants. Like the Fugitive Act itself, we not seen this proposed amendment.

By edict, euphemistically referred to as “regulation”, Chairman Mao will publish what he considers to be an appropriate Code or Codes of Conduct. These will include reference to such things as academic qualifications, the giving of advice, the keeping of records of that advice, the maintenance of a “Compliance Manual” in every office country-wide, and the twice-yearly communication of these manuals through to his Office. Chairman Mao will by regulation provide a definition of who will be considered “fit and proper” to be a financial adviser. This definition he may change as often as he pleases.

Are we learning from experience?

In 1994, after the UK *Financial Services Act* had been in force for eight years, Actuaries Jardine Arber reported the following:

Sadly, empirical evidence indicates that the regulations in the life assurance sector have yet to have any tangible benefits. This is because:

1. More information is being given but the more vulnerable prospective purchasers are not reading it;
2. policy values have not improved;
3. complaints are not declining as a proportion of sales;
4. overall lapses have not declined; but
5. sales have.

Today, 13 years after the introduction of the UK Act, we read in the latest *British Actuarial Journal*, the record of a discussion by the Society on future financial regulation in the United Kingdom. Mr J Stretton, FFA, said:

The 1986 Act was totally silent about what regulation was expected to achieve – an omission which, I think, was most remiss. It is part of the political job to define what is to be achieved, enabling separation of the executive and legislative functions.

Against what people think it was there for, regulation has not achieved its objectives, and there is a big risk that we will fail again if we put the same sort of woolly-minded objectives up for UK Regulation Mark II.

Mr A Neill, FFA, FIA, Past President of the Society, said:

Do the public know that the current regulatory system costs them as much each year as Robert Maxwell did in a lifetime?

Mr GM Murray, CBE, FFA, and Chairman of Irish Life said:

It seems to me that individual registration has the potential for bureaucracy running wild. We have seen what happens with unfair dismissal legislation. Individual registration will mean that we will soon get bogged down in a morass of on-going civil actions.

The Australians introduced their financial adviser regulations in 1993. By the end of 1996 LIMRA of Australia reported the following:

1. The number of career life agents has fallen from $\pm 20\,000$ to less than 4 500.
2. Total annual recurring premiums fell from A\$2.8 billion to A\$1.9 billion.
3. Almost no company, general agents, life brokers or Independent Field Advisers are recruiting new advisers.
4. Traditional field force management skills are all but lost as companies have shed internal field forces and no longer employ traditional agency skills in-house.

In South Africa, of all complaints received by the Life Assurance Ombudsman last year, only 8.8% were found in favour of complainants in regard to allegations of intermediary mis-selling. The rest were all to do with disallowed claims, life office administration failures, unsatisfactory withdrawal benefits and the like. Yet we persist in the belief that it is the intermediaries who are the blackguards.

Where do we go from here?

Before this matter can be taken any further, the representatives of the Financial Services Board must convey the following to their political masters:

1. The FAB is to be part of a suite of no less than 5 new Acts and amendments, each of which will interact with the other and none of which can be contemplated in isolation. Attempting to deal with these Acts piecemeal as we are here, will inevitably lead to confusion.
2. *Objectively* defined Codes of Conduct must be agreed *prior* to promulgation and before we face the same shambles as prevails abroad. The proposals calling for client advice and complaints records are simply not practicable in by far the majority of life office branches in this country, particularly those in rural areas.
3. We must fix an *objective* definition of “fit and proper”. This is not a matter for bureaucratic regulation.
4. The FAB must make a clear statement of what it wishes to achieve, what the measurements for achievement will be and over what period. A comprehensive study of the overseas experience must be undertaken, together with an “environmental impact” report showing a full cost/benefit analysis.
5. An agreement must be reached on the procedures to be adopted for “execution only” *non-advice* sales. These include orders for products through the internet, direct mail, telesales or other direct methods.
6. Very particular steps must be taken to avoid the civil actions which will follow any attempt to deny a financial adviser his bread and butter.
7. Minimum qualifications and experience required for the appointment of Chairman Mao must be defined in the Act. We cannot leave such an important aspect of the success of this new bureaucracy to chance.
8. We must eliminate the term “unsolicited calls” from this legislation. They are the very lifeblood of our industry.
9. We must eradicate all terms which can be only subjectively interpreted such as: “undesirable practices”; “fit and proper”; “in the public interest”.
10. The power of Chairman Mao to apply for the sequestration of a solvent financial adviser is entirely unacceptable and probably unconstitutional.
11. We must ensure that this legislation does not raise barriers to entry to the developing segments of our population and we must prevent the “rental” of such licences to unlicensed persons.
12. We must eliminate as far as possible the ability of bureaucrats to make NEW law by regulation. The discipline inherent in making changes to an Act go through Parliament produces healthy benefits which far outweigh any advantage which may be claimed to arise from the more speedy procedures of “regulation by inclination”.

13. Before we once again become the laughing stock of the world, let us drop the term “Executive Chairperson” in favour of the more widely used and wholly adequate “Executive Officer”.

Lest we tread carefully, we may cause the future to be considerably less perfect than the present!

Further reading

Simpson, D (1996) *Regulating Pensions: Too Many Rules, Too Little Competition*, Hobart Paper 131, Institute of Economic Affairs, London.

This Briefing Paper was delivered originally as a lecture on 18 May 1999 by Dr Brian Benfield in the Dorothy Suskind Lecture Theatre at the University of the Witwatersrand.

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