<u>Change: A Certainty.</u>

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The Financial Services Provider in South Africa finds itself in a very dynamic industry driven by consumer demand, technological advances, global trends and influences, product innovations, to name just a few factors. To top it all, the governance of the industry is just as dynamic and demands greater attention now than ever before.

Benjamin Franklin (1706-90) is said to have coined the phrase: "In this world nothing can be said to be certain, except death and taxes." Around 250 years on, nothing's changed, and everything's changed. Change is inevitable, the pace ever increasing, and to ignore it is to slowly self-destruct.

Is your financial services business poised to embrace change and flexible enough to adapt to the ever evolving legislative environment? Are your business's fundamentals solid and sound? When last did you actually check?

The world is becoming smaller all the time with international trade made so much easier through technological advances; information and intellectual capital exchange is seamless; and there is more corroboration than ever between regulators across jurisdictions and sectors. Regulators are adapting to the changes, and, in many areas, embracing the advances to their benefit. Giving only a cursory acknowledgement to legislation and its regulations, creating tick-box checklists and generic policies and procedure documents, is not how you want to be conducting your business in South Africa in 2014 and beyond.

"Twin Peaks" and "TCF" are not buzzwords to be thrown around lightly and merely added to the tick list. The implementation of both is a current reality that cannot be ignored and both require a core element of ***authenticity*** to be compliant.

The financial services markets across the globe are adapting their legislation to better focus on the conduct of services providers. The **Twin Peaks** model being implemented in South Africa is following global trends in response to the financial crisis which highlighted, amongst others, the need for regulation around conduct.

The Financial Services Board summarises their Twin Peaks model as follows[1]**:**
"A new ***Prudential Authority*** within the Reserve Bank. This Authority will be responsible for the oversight of the safety and soundness of banks, insurers and financial conglomerates.

A new ***Market Conduct Authority*** to protect customers of financial services firms, and to improve the way financial service providers conduct their business. This Authority will also be responsible for ensuring the integrity and efficiency of financial markets, and promoting effective financial consumer education."

Conduct Risk forms the focus of the South African Market Conduct Authority and similar regulators around the world and is a concept that does not have a static meaning – its meaning is largely dictated by your industry and business specifics. Thomson Reuters Accelus conducted a global survey in 2013[2] that provides some insight into how Financial Services Providers should be addressing this concept.

Despite the differences in regulator reference to and the interpretation of Conduct Risk, the global survey draws attention to "fundamental and complex aspects" that are universally incorporated:

- Corporate governance
- Demonstrably fair treatment of customers
- The approach to the design, manufacture and selling of products
- How staff are incentivised, and
- The firm's approach to culture.

The last point seems to be one of the most critical as a firm's culture underpins everything that the business does and how it does it. "Culture" cannot be set out in a nicely worded policy document and filed under Important Documents: culture is lived. The Financial Stability Board[3] has highlighted that Business Conduct Risk as a risk category that requires key focus in order to avert another global financial crisis. Integrity and Trust are fundamental in the assessment of how firms behave and are absorbed into the idea of "culture".

Conduct Risk and Risk Culture are not one dimensional and neither can any of the elements be looked at in isolation.

The Financial Stability Board has identified four parts to a strong risk culture and these could assist businesses in gaging the strength of their Risk Culture[4]:

- **Tone from the top**: directors and senior managers not only set but also behave in terms of the core values and risk culture of the business.
- **Accountability**: all employees understand the risk culture of the firm, accept the risk-related goals and related values, and are held accountable for their actions.
- **Effective challenge**: decision making processes that promote a range of views, allow for testing, and provide for open and constructive engagement.
- **Incentives**: financial and non-financial incentives should support the core values and risk culture, at all levels of the firm.

The focus on Conduct Risk should not be separated from the Treat Customers Fairly (TCF) outcomes based approach that the FSB has fully embraced. As noted on the FSB website, "***Firms are expected to demonstrate that they deliver the following 6 TCF Outcomes*** to their customers throughout the product life cycle, from product design and promotion, through advice and servicing, to complaints and claims handling – and throughout the product value chain:

1. Customers can be confident they are dealing with firms where TCF is central to the corporate *culture*
2. Products & services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly
3. Customers are provided with clear information and kept appropriately informed before, during and after point of sale
4. Where advice is given, it is suitable and takes account of customer circumstances
5. Products perform as firms have led customers to expect, and service is of an acceptable standard and as they have been led to expect
6. Customers do not face unreasonable post-sale barriers imposed by firms to change product, switch providers, submit a claim or make a complaint.

The FSB has been very proactive with this approach and through the TCF Regulatory Framework Steering Committee have made available a TCF Self-Assessment tool[5]. This tool sets out very clearly what the regulator is looking for and (we have already been warned) will be included in assessments done at onsite visits and otherwise. There is no "implementation date" as implementation has already begun. The TCF approach is essentially a means of measuring compliance with Section 2 of the General Code of Conduct, General duty of provider, and which has been in place since the enactment of the FAIS Act:

A Provider must at all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry.

The First TCF Outcome, as it is covered in the self- assessment spreadsheet, looks at the areas listed below and fits perfectly with the focus points of Conduct Risk that we have already covered. The rest of the outcomes look at the detail and will be steered by the results of Outcome One under these headings.

- Leadership
- Strategy
- Decision-making
- Governance and Controls
- Performance Management
- Reward
- Measurement and Management Information

Financial Services Firms in South Africa would be very foolish, to put it blatantly, if they did not use this transitional time of change over to the Twin Peaks Model to conduct a full review (or audit if you wish) of their business with a focus on Conduct Risk, Culture and the 6 Outcomes of TCF. The guidelines are all there in the form of global experience and trends, and locally produced practical assessment tools – there is no excuse.

I conclude this article with the last sentence of the Thomson Reuters Accelus – Conduct Risk Report 2013 as it neatly summarises the advice I would give to Financial Services Providers, small, medium or large, in South Africa:

"Senior individuals who do not engage positively with conduct risk may well find that this is career-limiting, and in extreme cases career-ending, as regulators seek to enforce their expectations on the delivery of good customer outcomes."

If you are looking for assistance with conducting a review of your firm to determine whether your business is poised to embrace this inevitable change and flexible enough to adapt to the ever evolving legislative environment, contact Erica Steeman-Duncan on erica@esdprof.com. For more detail on her consultancy visit www.esdprof.com.

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[1] Twin Peaks Update 13-December-2013.pdf, a letter to the public from the FSB published on the FSB website.

[2] Thomson Reuters Accelus – Conduct Risk Report 2013. For more information about Thomson Reuters and the Governance, Risk & Compliance division please refer to their website: http://accelus.thomsonreuters.com.

[3] The Financial Stability Board (under the aegis of the G20) develops and promulgates global financial services policies designed to minimise the threat of another financial crisis.

[4] These points have been extracted from the Thomson Reuters Accelus – Conduct Risk Report 2013, and not directly from any Financial Stability Board source.

[5] The TCF Self-Assessment Tool can be downloaded from the FSB website by clicking on the TCF block on the home page:.www.fsb.co.za