Supporting South Africa's journey to a client-focused and transparent financial advice market

Bravura Solutions produced this report in collaboration with NextWealth and The Collaborative Exchange to provide support to South African financial advisers in light of their experience in the UK financial advice industry during the equivalent RDR reform.

bravura solutions
NEXTWEALTH
THE COLLABORATIVE EXCHANGE

Foreword

Carolyn Erasmus

Country Head (South Africa), Bravura Solutions

This paper serves to pre-arm South African financial advisers with the key points to success in what will be a new era for our industry due to the introduction of the RDR (Retail Distribution Review) regulations.

Pressurised margins, operational efficiencies, vertical integrations, demonstrable client value, transparency of service and speed to market make up an increasing vocabulary where survival is by technology.

Our commitment to the South African financial services market is steadfast. There is no doubt that it is a unique market fired up by passion, new challenges and immense opportunities. The changes that are being brought about by the RDR regulations, however, are not all that new – certainly not for a global company like ours with a significant footprint in the UK. The RDR has been 'live' in the UK since 2012 and although its objectives for improved client outcomes are clear – there are unintended consequences and lessons that we in SA can learn from now to gain second-mover advantage.

Heather Hopkins

Managing Director, NextWealth

Just as in South Africa, the introduction of RDR in the UK was about putting customers' interests first: increasing access to advice, eliminating product bias and raising professional standards.

Most financial advisers have always put their customers' interests first – in the UK and South Africa. While it may seem daunting to shift your business practices in the face of new regulatory rules, these are changes that will benefit your firm in the long-run.

If you were building a financial advice business from scratch today, you would start with a model that fits your clients' needs – professional, transparent, trusted advice – and choose providers and platforms that support your approach. The best future-focused firms are already operating in this way.

Kevin Hinton

Director, The Collaborative Exchange

South Africa's Retail Distribution Review was first published in November 2014 and has 55 constituent reforms - some that are implemented while others are still under consideration. Some seven years later, there are still many key matters that are still unclear. The adviser categorization (tied vs non-tied) has been hotly debated as well as conflicts of interests, where "independent" vertically integrated business models will no doubt come under scrutiny.

Regulatory uncertainty is never ideal, however we do believe that sanity will prevail and sensible regulation will serve all industry participants. South Africa has the benefit of seeing the pitfalls of the UK's RDR, with one of them being the advice gap. South Africa has one of the lowest savings rates in the world and financial advice is a critical component in changing consumer behavior. Good advice is therefore priceless!

Contents

Glossary

CIP - Centralised Investment Proposition (UK)

FCA - Financial Conduct Authority (UK)

FSCS - Financial Services Compensation Scheme (UK)

PII - Professional Indemnity Insurance (UK)

RDR - Retail Distribution Review

Introduction

Wide-reaching changes are ahead for financial advice businesses in South Africa, as the FSCA moves towards a rollout of its Retail Distribution Review.

This new approach to how financial advice will operate is broadly intended to improve transparency in the financial planning industry; bolster the standing of financial advice professionals through higher qualifications, and help consumers access unbiased and clearly priced advice and investments.

Achieving those ambitions requires a set of rules that businesses will need to navigate, covering how advisers will charge for their services, how they evidence their qualifications and ongoing training, and how they declare their status as either fully independent and 'whole of market', or 'tied'- working with a set of products and providers.

Retail Distribution Review (RDR) in a nutshell

The South Africa RDR aims to reform the regulatory framework to ensure delivery of fair customer outcomes.

This reform will structure changes to ensure product suppliers have increased responsibility to deliver fairness whatever their distribution channel, and transparency will be improved around remuneration allowing customers to recognise the cost and value of advice, whilst addressing any conflicts of interest between intermediaries and providers.

The RDR framework will be supported by the Treating Customers Fairly (TCF) frame-work. The RDR reform is being implemented incrementally after stakeholder and public consultation.

South Africa's second-mover advantage

South Africa benefits from a 'second-mover advantage' when preparing for this new regulation. A very similar framework was rolled out in the UK in 2012, and so South African advisers and providers are able to take stock of the impacts and challenges in the UK and design their response accordingly.

As a global technology partner to financial services providers, Bravura Solutions has supported UK businesses in preparing for and adapting to the RDR rules and this paper shares our experiences and key considerations for the adviser market, following the UK's example.

Prior to the UK's implementation of RDR rules, there were voices of concern in the industry that adviser numbers would plummet and consumer access to advice would worsen.

While the UK industry is continuing to work on improving the 'advice gap' and there are lessons to be learnt from the RDR experience, and ultimately it is now difficult to find an adviser who would say it should not have happened.

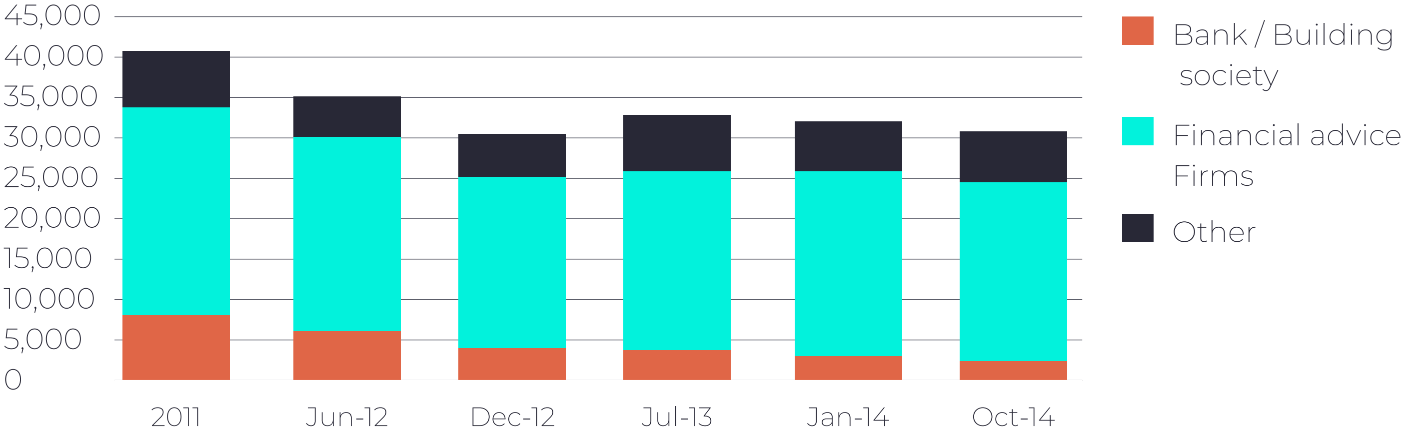
An overview of the UK advice market pre and post-RDR

1. Number of advisers pre and post-RDR

RDR in the UK was implemented on 31 December 2012. A year prior to the RDR deadline, **25 616** advisers (both independent and 'tied') were registered in the UK. This number fell 20% to **20 453** advisers after RDR.

The big shift was away from advisers based in banks and building societies. The number of bank staff authorised by the FCA to sell investment products dropped from 41 760 to 35 130* between March 2011 and March 2015. Pressure on banks to move away from rewarding staff based on the volume of financial products they sold led many banks to either stop providing financial advice on investment products or scale back their advice models to only higher income consumers.

Decline in adviser numbers 2011 - 14



Source: RS Consulting (2011) and FCA (2012 onwards)

Highest qualification held by financial adviser

Adviser numbers are now up on 2011 figures, currently, at 27 501 registered advisers, approximately 80% of whom are independent.**

Only 37% of financial advisers stopped at acquiring the minimum of a level 4 qualification. 59% hold a level 6 or level 7 qualification.

37%	Level 4, e.g. CII diploma in financial planning; CII certificate in paraplanning
45%	Level 6, e.g. CII advanced diploma in financial planning; CISI certificate in advanced financial planning
14%	Level 7, e.g. CISI diploma in advanced financial planning
4%	Not applicable / none of the above

*Source: Bovills, regulatory consultant analysis 2015
** Source: NextWealth Financial Advice Business Benchmarks October 2021

2. Number of consumers accessing advice pre and post-RDR

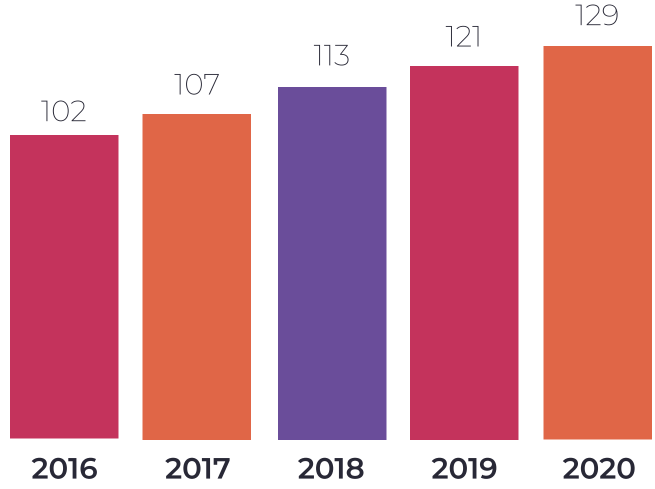
As at December 2020, approximately 4.1 million UK adults have received financial advice, an increase of 2% since 2017. Across all adults in the UK population, it was reported that 42% had confidence in the UK financial services industry. This proportion has increased since 2017 from 38%*.

Financial advisers report a steady and sustained increase in their number of active clients since 2019.

While these are encouraging signs, there is no doubt an advice gap persists in the UK. There is much discussion about a potential guidance framework to allow providers to nudge consumers to take decisions that are in their financial best interest (i.e. investing cash, increasing deferral rates into pension plans).

*Source: FCA Financial Lives Survey

Average number of clients per adviser



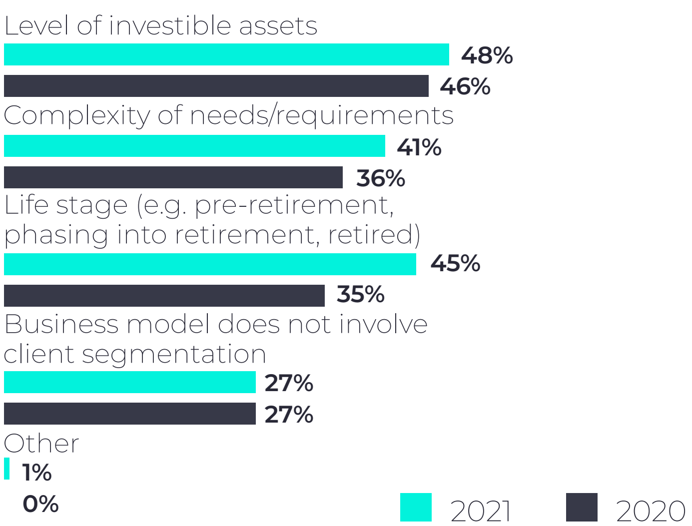
Note: The above figures are aggregate, there will be variance depending on the size of firm.

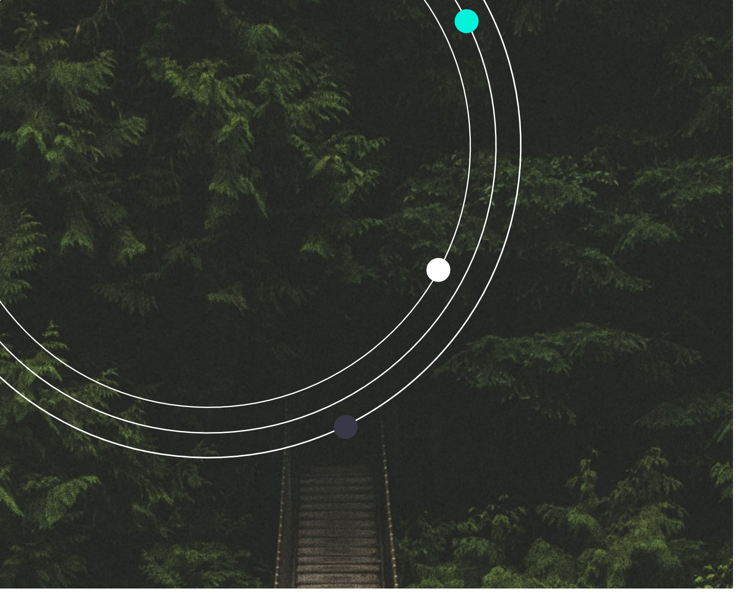
3. Service propositions

The UK regulator's view is that not all clients need the same level of service and so should not all be charged at the same level. In the FCA's Financial Advice Market Review, the idea of gold, silver and bronze segments was proposed – three tiers based on needs.

Client segmentation models based on needs rather than the value of assets have been slow to get going in the UK, however, data from 2020 show this approach is now gaining pace.

Segmentation criteria

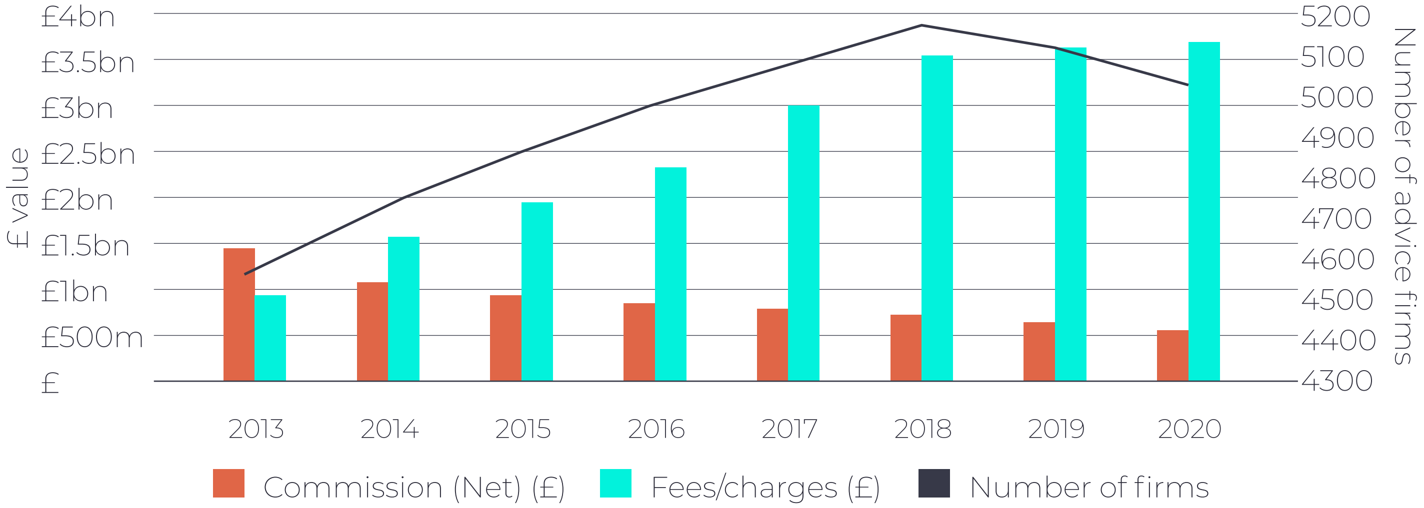




4. Adviser revenue models

The UK RDR rules stipulated that all advisers would no longer be able to receive commissions from fund companies for funds sold to clients from 2013. The chart (below) shows the decline in commission income and an almost four-fold increase in fee income received by advice firms. [Note that in the UK advisers continue to receive 'trail' commission on investment funds where the advice was given before RDR, and on financial protection products. Additional rules now require the commission on protection products to be clearly set out to clients.]

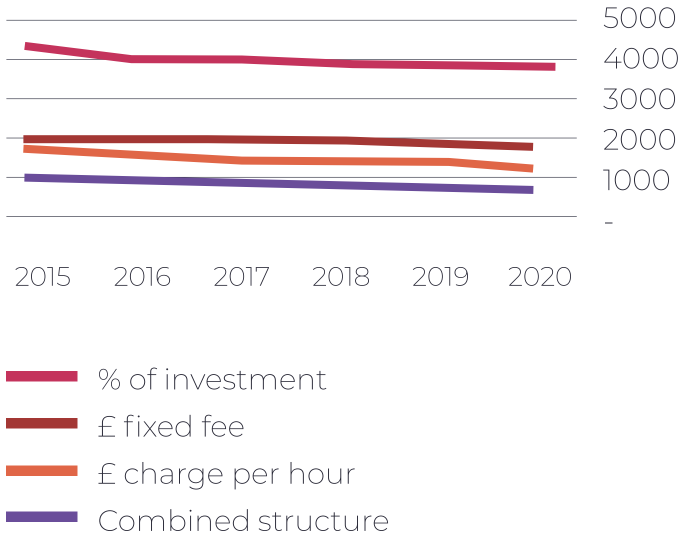
UK adviser review models & number of advice firms



Advisers in the UK mostly favour charging a percentage of assets invested. A smaller number charge flat fees for project work or an hourly rate.

The FCA says advisers charge an average of 2.4% of the amount invested for initial advice and 0.8% a year for ongoing advice (1.9% p.a. with the underlying product and portfolio charges factored in).

Typical charging structure, number of firms



5. Amplification of TCF

As in the new South African regulatory framework, TCF in the UK is the Treating Customers Fairly legislation and the current regulation (which is due to be replaced by a new Consumer Duty in 2022) means that financial services firms must pay due regard to the interests of their customers and treat them fairly. TCF is at the core of the UK regulator's principles-based approach.

RDR in the UK supported the regulator's aim to deliver improved outcomes for retail customers by:

Reducing conflicts of interest in the distribution of investment products, ensuring that customers can be more confident and their interests are being considered.

Improving the suitability of advice – UK advisers are now more professional and better qualified, supporting the FCA's objective that where consumers receive advice, that advice is suitable and takes account of their circumstances.

Upfront fees led to a greater focus on delivering value for advised clients and better client outcomes.

6. Disclosure of adviser firm status

Independent firms in the UK can consider and recommend a wide range of retail investment products that can meet their client's needs and objectives.

Independent firms are not required to assess every relevant product available on the market, however, they must be able to ensure that their client's investment objectives can be suitably met. A firm providing independent advice should be in a position to advise on all types of relevant products within the scope of the market on which it provides advice. For UK retail clients, that means being in a position to advise on all types of financial instruments, structured deposits and other retail investment products.

Those firms must therefore define and implement a selection process to assess and compare a sufficient range of products. The number of products must be considered representative of the products available on the market, as well as being assessed for risk, costs and complexity as well as client suitability.

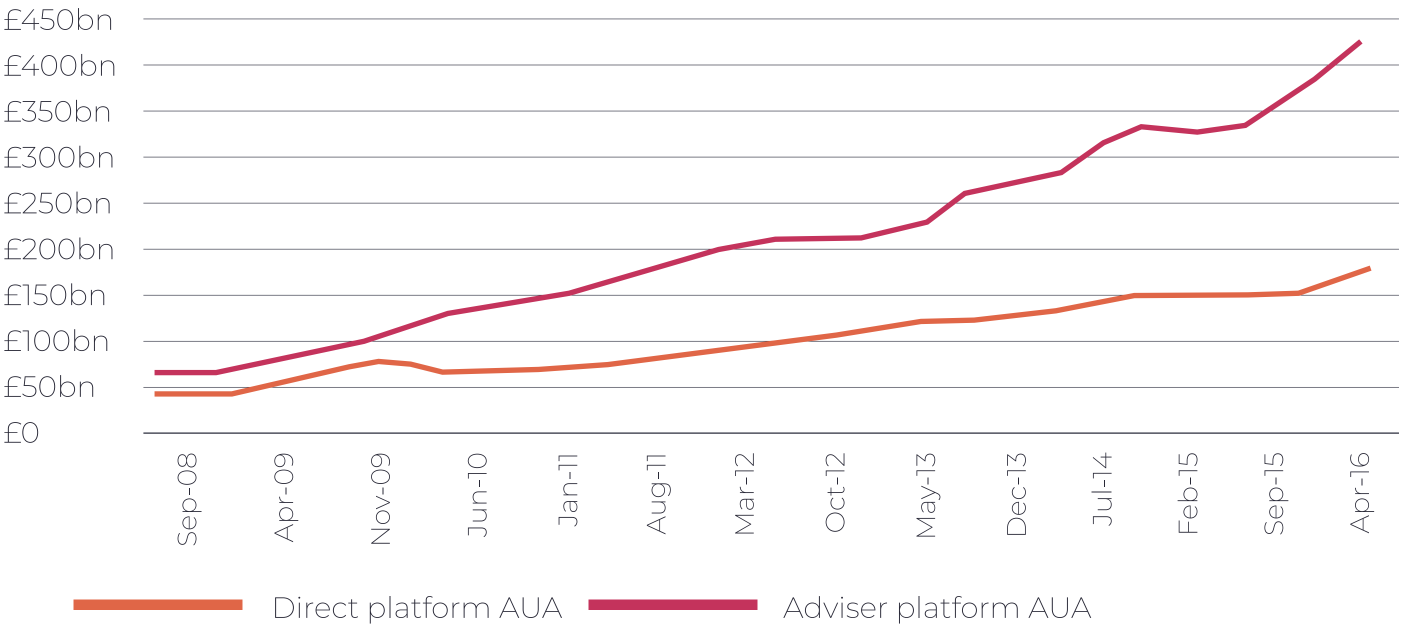
Restricted firms or advisers can only recommend certain products, product providers, or both.

7. Platforms and adviser facilitation vs commission/product sales

Pre-RDR, **platforms were paid by product providers to list their products**. These 'fund supermarkets' were paid to put products on the shelf and facilitated adviser commission payments. Post-RDR, platforms rapidly morphed to become wrap platforms, centred around the tax wrappers available. Rather than a place to buy or sell funds, they became a way to manage tax wrappers and client investment holdings.

The following chart from the FCA's 2017 Platform Market Study illustrates the rapid rise of assets on adviser and D2C platforms.

Adviser and direct platform AUA over time



Today, investment platforms offer rich functionality and client tools and calculators. Their main functions can be summarised as follows:

- Provide the mechanism for advisers to buy, sell and hold their clients' investments
- Have largely taken the place of life offices (although some platforms are part of insurance companies) as providers of pension, life assurance bonds and ISAs
- Are the main way advisers report on investment performance to their clients and provide them with a continuing picture of the whole of their invested wealth
- Provide the means by which advisers typically charge their clients for their services post-RDR

The RDR rules in the UK and South Africa

The proposed RDR rules in South Africa follow a very similar framework to the UK:

In the UK, advice firms under RDR have to:

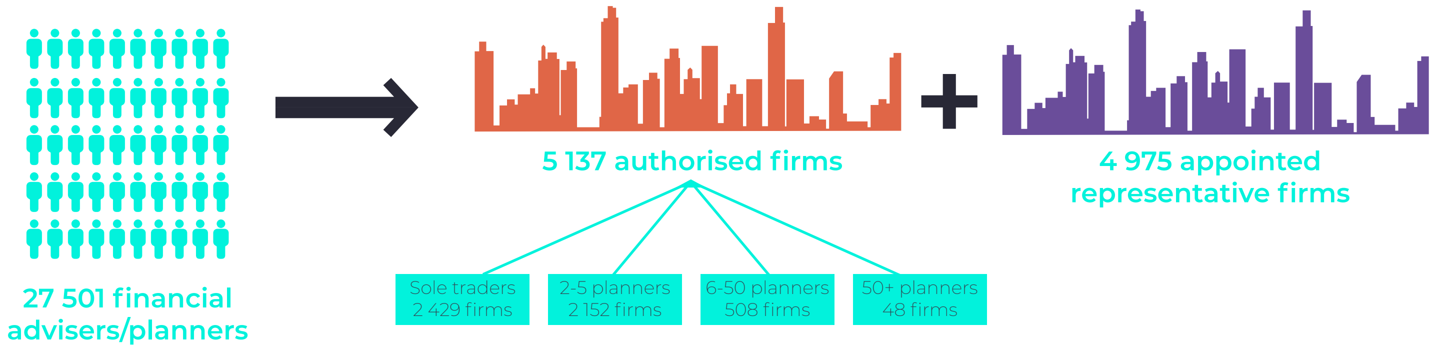
- Declare themselves as either independent or restricted advisers. Independent advisers need to consider all different kinds of investment products from the whole of the market. Restriced advisers can choose areas of specialisation rather than advising on all investment products and may work with a list of providers rather than research all available products.
- Achieve a minimum level of professional qualification, and evidence a required number of Continuing Professional Development hours of ongoing learning.
- Charge an upfront negotiated fee for their advice services, rather than receive a commission from providers.

In South Africa, advice firms under RDR will:

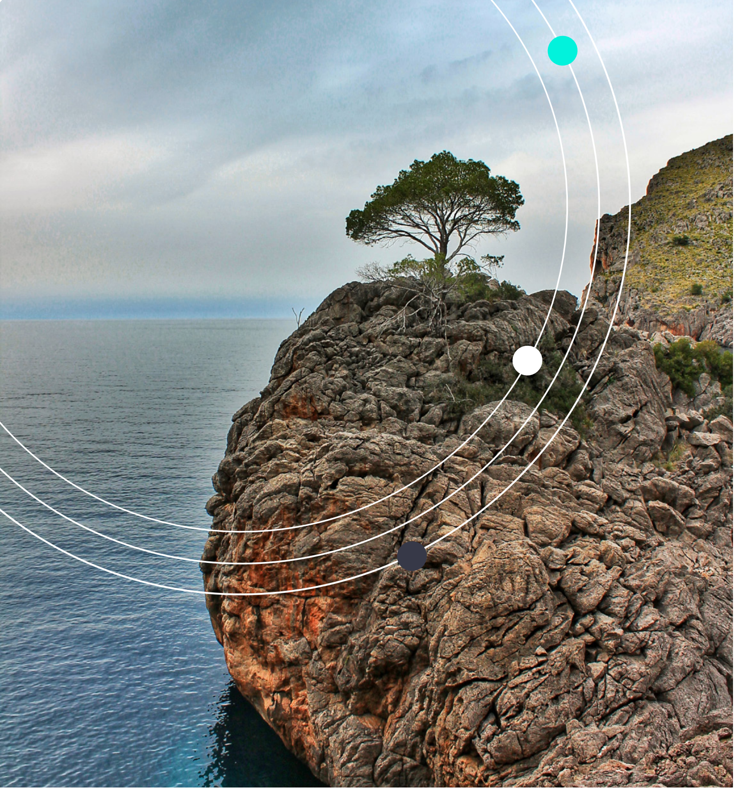
- Choose between being a Registered Financial Adviser (RFA), and providing independent whole of market advice to clients, and a Product Supplier Agent (PSA) who may specialise in certain product areas or sell products from only certain providers.
- Pass category and product exams to demonstrate that their knowledge is up to date, and demonstrate ongoing training through Continuing Professional Development points.
- Charge an upfront negotiated fee for their advice services, rather than receive a commission from providers.

The advice market in the UK and South Africa

The current starting position for the South African advice market is broadly similar to the UK's current position, reflecting the similarities between the two territories. The UK has 27 500 financial advisers, as at October 2021.



Source: NextWealth analysis based on FCA RMAR data, FCA directory, proprietary survey research and company reports



The impact of RDR in the UK

The RDR has been overwhelmingly positive for financial advice businesses. It has contributed to higher standards and professionalism in financial advice businesses, greater levels of transparency and higher levels of consumer trust. Financial advice businesses have been transformed, developing recurring revenue models that have allowed business owners to realise unprecedented value in their businesses.

In 2021, nearly a full decade after the implementation of RDR in the UK, advice firms of all sizes are largely bullish about the future of advice in the UK, both in terms of the growth of their firms and the number of clients they will service.

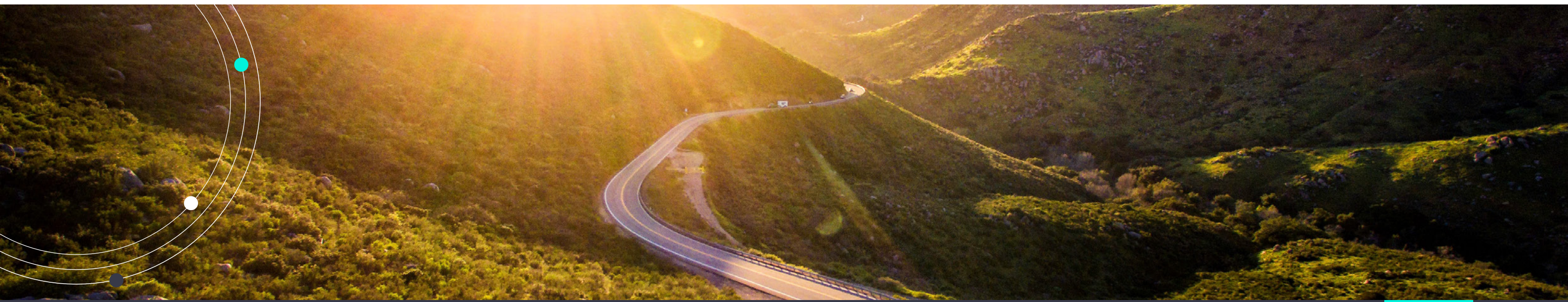
Further measures needed to tackle the 'advice gap'

However, even the UK regulator admits that the changes from RDR alone were insufficient to get more of the population accessing advice on their money. A follow-up review of the retail market in 2015, the Financial Advice Markets Review, aimed to address this 'advice gap' and alongside it a 'guidance gap', in other words, the opportunity for UK adults to receive at least a level of personalised guidance as an option between no help and full regulated advice. Its measures included clearer guidance on streamlined advice and tax breaks for employer-arranged advice, both of which were welcomed by the advice community but with limited impact so far on the take-up of advice.

In the UK, the regulator is expected to clarify rules for advice and guidance in the coming months to allow, in particular, workplace savings providers to nudge clients to support better decision making.

Automated advice propositions are another potential solution under consideration. As at August 2021, only 10% of financial advisers in the UK say they offer or refer clients to a digital advice proposition, this has however doubled in the past two years. Despite low initial adoption rates, many expect this growth in digital advice to continue. Demand for advice is strong but trust in financial advisers is low among the general public and it is perceived as too costly for many. Regulators are keen to see lower-cost solutions come to market as more consumers take control of managing their own wealth in retirement.

Vanguard recently announced that it is rolling out a personal financial planning service in the UK, offering low-cost restricted advice to retirees. Vanguard's Personal Adviser Service (PAS) has been hugely successful in the US.



Five key changes in the UK market that can be traced back to RDR:

1. Growth of centralised investment propositions

In preparation for RDR in the UK, many advice firms began to change their business models to offer a Centralised Investment Proposition ("CIP") or standardised approach to providing investment advice. In 2020, at least 80% of advice firms in the UK work to a CIP.

CIPs were first introduced to the UK market in the run-up to RDR and have been rapidly adopted by advice firms as a way to free up their advisers' time from product picking and due diligence on multiple providers to focus on client facing activities. The investment selection process is managed centrally and helps ensure consistency across the business. If a client sees different advisers within an advice firm, all working to the same CIP, they will receive the same outcome.

Clients can therefore benefit from a more structured and clearly defined firm-wide approach to their investments and advice firms can benefit from efficiencies in the streamlining of the investment process and easier management of the risk associated with investment selection.

In working to a CIP, firms need to ensure that their client's best interests are fully considered and that the typical needs and objectives of their target clients are researched and evidenced. Many firms conduct detailed client segmentation exercises to offer a range of CIP services to different client segments.

2. Increased cost of compliance

The cost of compliance has risen significantly since the introduction of RDR in the UK and continues to rise. Businesses are having to allocate time and resources to comply with regulatory change and this impacts the cost of advice.

Regulatory disruption is a constant business risk and has been the biggest disruptive force on the UK retail financial industry in recent times. Professional indemnity insurance (PII) fees are a particular challenge for smaller firms in the UK that have been hit hard by recent increases.

NextWealth analysis of FCA data below shows that firms with regulated revenue in 2020 of £101k-£500k have seen their PII premiums increase 40% in the past two years.

	PII premium as % of regulated revenue			
Financial adviser	**2020**	**2019**	**2018**	**2017**
Up to £100k revenue	5.00%	4.40%	4.00%	4.20%
£101k to £500k revenue	3.10%	2.80%	2.20%	1.90%
£501k to £10m revenue	3.20%	3.30%	2.90%	2.70%
Over £10m revenue	1.40%	1.40%	1.20%	1.20%
All firms	**2.40%**	**2.30%**	**2.00%**	**1.90%**

While most advisers have seen their overall income unaffected by the shift to fee-charging, increased regulatory costs have placed pressure on firms to focus on streamlining processes and increasing efficiencies to reduce costs elsewhere in the business.

3. Shift from advice to planning propositions

The UK market has seen a shift from traditional product-based advice, from advisers focused on selling products, to many offering a more holistic financial planning service and defining themselves as financial planners.

The removal of commission-based advice in the UK required advisers to give more consideration to how they articulate the value of advice services to their clients, as part of a much more upfront discussion on advice fees.

In separating out the value added by the financial plan, rather than the product, many UK professionals have sought to distance themselves from the previous notion of transactional product-based advice to a more advanced exploration of the client's needs and goals in terms of their family, work and leisure and how their financial life is best organised to achieve these goals.

4. Growth of financial planning technology

The pressure to improve efficiency and productivity to protect profit margins, coupled with an expanding range of services and tools to meet the demands of modern financial planning clients has led to a growth in uptake of financial planning technology by advice businesses in the UK.

Financial advice technology has become more central to the advice proposition over recent years. The switch to fee-charging both increased the need for firms to streamline the way they operate to keep fees at a palatable level for their clients and maintain their margins, and increased the demand for specific financial planning tools such as cash flow modelling to add to the client proposition.

80%* of UK financial advice businesses now use cashflow modelling tools, and 70% use client portals to communicate securely and share documents and reports with clients, as part of the digitalisation of processes.

*Source: NextWealth Financial Advice Business Benchmarks October 2021

5. Consolidation and vertical integration

RDR prompted a trend towards consolidation of advice businesses and, more recently, larger providers buying or launching advice departments.

Figures from the UK regulator show the number of retail investment firms is on a slow decline. It is also worth noting that the decline was sharpest among mid-sized firms, with 6 to 50 advisers, that tend to be of highest interest to consolidators. Firms with between 6 and 50 advisers decreased 5.2% in number from 2018 to 2021.

Large firms have the scale to command preferential pricing from fund managers and platforms, bring functions inhouse such as compliance and research, and dedicate resources to non-core specialisms such as marketing and, increasingly, IT.

Adviser band	# of firms 2018	# of firms 2019	# of firms 2020
1 adviser	2466	2448	2429
2-5 advisers	2210	2207	2152
6-50 advisers	528	536	508
Over 50 advisers	42	45	48
Total:	**5246**	**5236**	**5137**

Source: The retail intermediary market 2020, FCA

In an interesting reversal of the trend seen immediately after RDR, where larger financial institutions pulled back from offering advice, the UK market is seeing an increase in provider companies buying or launching advice departments, and this trend of vertical integration is expected to continue as companies move to become closer to the end client.

Six points to success for advice firms in South Africa

Success favours the bold

Integrated tech reduces costs

Work with platforms that support a future-focused business model

Examine your client base to define your new proposition

Model the impact of fees on your business

Centralized Investment Proposition

1. Success favours the bold

As in the UK ahead of RDR, advice firms in South Africa have already begun shifting business models and practices towards fee-charging, financial planning and a higher level of qualification. These firms in the UK pre-RDR were known as ‘new model advisers’ and they had both an eye on the coming regulation as well as a sense that these changes were good business practices and made for a more client-centric proposition which would benefit them in the long run.

Research post-RDR in the UK shows that those firms who were initially negative about RDR fared worse on retaining clients after the switch from commission to fees, not least because of the manner in which the change was presented to clients.

2. Integrated tech reduces costs

Research in the UK shows that advice firms with more integrated technology solutions across the business (i.e.technology solutions that can transfer data to one another, reducing rekeying and increasing the streamline of process) can reduce costs. Advisers with client portals save an average of £28 per client meeting*.

Those advice firms who invest the time and resource in joining up their tech as much as possible save on client processing time, re-keying of data (with its associated risk of error) and report generating.

3. Work with platforms that support a future-focused business

The UK’s RDR led to a rapid rise in platform providers partnering with specialised technology firms for their underlying platform technology. These platforms recognised that sharing costs to meet changing rules was critical to future success. It helps keep costs down and ensures rapid compliance with rules. Choosing a platform with a strong operational capability and an expert technology partner is important to reduce disruption in adviser businesses.

4. Examine your client base to define your new proposition

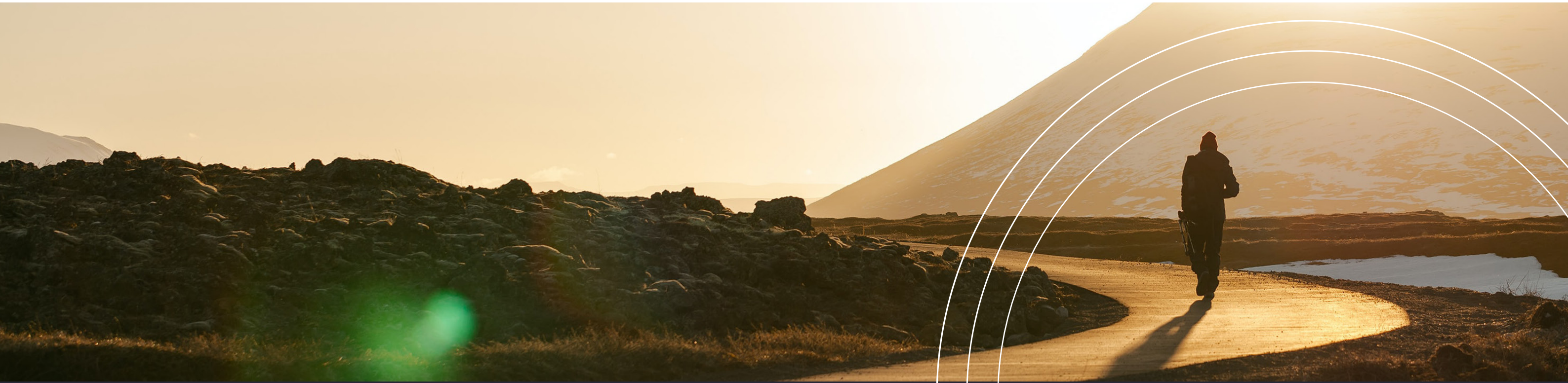
The RDR is about putting the client’s interests first. Financial advice businesses in the UK found that a customer segmentation exercise helped to define service propositions and pricing models suitable to different segments. Even in advance of any new rules, it is worth undergoing a segmentation exercise to refine your own customer proposition.

5. Model the impact of fees on your business

The experience of the UK is that the overall cost to the customer has declined since the introduction of the RDR. Fees paid to financial advisers have settled on around 80bps on average for ongoing advice. It is important to ensure the financial health and strength of your business and so it is worth modelling the impact of a fee change on your firm's income. UK financial advisers found little impact on income but have found that a significant amount of risk has shifted to their businesses and also costs are higher, in particular regulatory costs (FSCS levy and PII premiums).

6. Define your Centralised Investment Proposition

Segment your client base and define your firm's investment proposition for each segment. This will likely include partnering with Discretionary Fund Managers who will allow you to focus on financial planning while portfolios are managed by professionals. Competition is rife in this area and prices continue to decline making it a potentially good value solution.



If you would like to talk to us about this paper, please get in touch:

Carolyn Erasmus
Country Head, South Africa
E: cerasmus@bravurasolutions.com
T +27 (0)10 593 0625
M +27 (0)83 982 6003

Michael Mulder
Principal Consultant
E: mmulder@bravurasolutions.com
T +27 (0)10 593 0625
M +27 (0)83 408 4810

Rory Taylor
Head of Client Services
E: rtaylor@bravurasolutions.com
T +27 (0)10 593 0625
M +27 (0)83 337 6077

Get in Touch

Website: www.bravurasolutions.com/southafrica
LinkedIn: https://www.linkedin.com/company/bravura-solutions
Twitter: https://twitter.com/BravuraFinTech
Address: Katherine & West, 114 West Street | Sandton JHB, Gauteng 2196, South Africa

Bravura Solutions is a leading provider of software solutions for the wealth management, life insurance, and funds administration industries. Our solutions are underpinned by functionally rich technology that enables modernisation, consolidation, and simplification. Our software solutions enable our clients to increase speed to market, provide a seamless digital experience and address ongoing changes in financial services regulation. Backed by over 30 years of experience, our on-premise, managed, hosted and cloud solutions are used by many of the world's leading financial institutions, who entrust trillions of dollars in assets held in accounts to our systems. We support our clients with a team of more than 1,400 people in 17 offices across Africa, Australia, New Zealand, United Kingdom, Europe, and Asia.

NextWealth is a research, data and events business in the UK helping firms to adapt and thrive amid disruption. NextWealth focusses on retail investing and in particular the financial advice market, investment propositions and adviser technology. The future is bright for firms that have the capacity and courage to adapt to these disruptions. At NextWealth we help firms understand what's next in wealth – not to simply accept the future but to exploit the trends for competitive advantage.

The Collaborative Exchange was founded and launched in September 2018 by the founder and sole director – Kevin Hinton.

The business offers independent strategic advisory and retail implementation strategies for asset managers, investment platforms and wealth managers within the South African retail landscape. Through our specialist skills in all aspects of the investment value chain, we help companies plan and execute strategies to penetrate key retail market segments.

The company owns the intellectual property rights for five of South Africa's leading investment conferences for asset managers and financial advisers (The Investment Forum, Meet the Managers, The Financial Planning Summit, The Alternative Investments Forum and The Investment Think-Tank).

The business has arguably the largest database of financial adviser information in South Africa. It has also published a number of leading research papers on South African Platforms (Linked Investment Product Suppliers) and Discretionary Fund Managers.