Towards RDR: Perceptions of the South African market on fee-based financial advice

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DECLARATION

I, Riyaad Tar, declare that this research article is my own work except as indicated in the references and acknowledgements. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration in the Graduate School of Business Administration, University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

Riyaad Tar

Signed at Johannesburg

On the 31 day of August 2017

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ABSTRACT

The Retail Distribution Review (RDR) is a reactive response to poor consumer outcomes and market misconduct, despite the significant progress achieved through the Financial Advisory and Intermediary Services (FAIS) Act in raising industry professionalism, improving disclosure to consumers and mitigating certain conflicts of interest. It sets out 55 proposals to be implemented in a phased manner over the next several years in line with the "Twin Peaks" protocol. International implementations of RDR in the United Kingdom (UK) and Australia have indicated important lessons for South Africa. However, given the difference in economic context between these countries and South Africa, it is important to gauge the response of the market. Thus, this study aimed to explore the perceptions of both consumers and Financial Service Providers (FSPs) around fee-based advisory models in preparation for RDR.

This study employed an inductive research methodology where no hypotheses were proposed. This method was selected due to there being little empirical research on this topic in South Africa. Qualitative data was collected through telephonic interviews with two sample population groups; an FSP population to ascertain their readiness for and perceptions of RDR and a consumer population to determine their expectations of services in the financial advisory sector and their willingness to pay for advice.

Results indicated that despite market speculation, many consumers are willing to pay for advice, under the right circumstance and for the right price. However, this does not mean that the market will not see an "advice gap" where many other consumers will resort to self-researching financial advice. FSPs, while expressing concern and unpreparedness for RDR, have been debating over their service adaptations for RDR. A number of fee-based solutions were explored with the most preferable option proposed by the study being an on-going management fee. Additionally, a number of proposals were provided for FSPs to consider when adapting service offerings in line with RDR. While this research has a long way to go in preparing the market for RDR, this study provides a foundation from which banks and FSPs can begin considering gaps

and opportunities in preparation for RDR, and regulatory bodies, such as the FSB, can ensure the RDR is implemented uniquely for the South African market.

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1. INTRODUCTION

The financial services industry in South Africa is highly regulated by the Financial Services Board (FSB), administrating much of the legislative and regulatory framework around financial services and products offered to consumers. The Financial Advisory and Intermediary Services (FAIS) Act is one such regulatory mechanism by which the FSB tries to ensure that the interests of consumers are well-informed and protected, while professionalising the financial services industry. By doing so, South African consumers have the opportunity to strengthen their financial stability and longevity through well-informed purchases of a spectrum of investment and insurance instruments, from or through authorised financial service providers (FSPs).

However, in recent years, the financial industry has come under much scrutiny, citing market misconduct and subsequently demanding market reform (National Treasury of South Africa, 2014). Amongst the most common cited challenges are; vague and complex fee charges, insufficient advice provided by FSPs resulting in poor financial outcomes for consumers, poor disclosure of terms of products, conflicting commission type remunerations and poor governance in the industry (National Treasury of South Africa, 2014). In response to this, the FSB in 2014 introduced the Retail Distribution Review (RDR), employed under the Financial Sector Regulation Act 2017 (Twin Peaks), and in support of Treat Consumers Fairly (TCF) outcomes (FSB, 2014). The main purpose of the RDR is to establish a sustainable environment for the financial services industry.

Specifically, the RDR aims to ensure that as a consumer to an FSP, one is offered sound advice, from a knowledgeable professional who is transparent about the remuneration of his/her service. As such, the RDR outlines 55 regulatory reforms to be implemented in a phased manner. Of particular bearing to consumers and FSPs alike, is proposals II - LL of the RDR, which introduces financial advice as a service, separated from other product charges, to be paid by the consumer (FSB, 2014). This contrasts from traditional practices, where FSPs received most remuneration through commission paid by the product supplier and thus, reduces the conflict of interest that may arise from FSPs favourably promoting investment or insurance instruments that yield higher commissions.

While these proposals are intended to bring about more informed and suitable advice for consumers seeking to purchase investment instruments, the readiness or willingness of consumers to now pay for advice is undetermined. Smith (2016) reveals that South African consumers may be reluctant to adopt a fee-based remuneration model as they perceive advice to be “free” with the sale of investment products. Thus, FSPs fear that that fee-based remuneration models may be perceived as costlier, inspiring consumers to seek alternative means of financial advice (self-research, robo-advisors, etc.) (Lloyd, 2003).

Conversely, the readiness of FSPs to adopt fee-based advisory models are also in question. Kruger (2013) reports that less than half of all registered FSPs are prepared for RDR reforms and withdrawal of commission-based remuneration. Additionally, the article reports that only 12.8% of FSPs have reviewed their business models around financial advisory services and would survive post-RDR implementation (Kruger, 2013). The UK RDR also sheds some insight on this matter; post-RDR implementation, the banking industry experienced a large drop in financial advisors, with many banks halting advisory services and blaming it on the constraints of RDR (Whiteman, 2013).

Considering the above arguments, this study aims to explore the perceptions of both consumers and FSPs around fee-based advisory services in order to provide a benchmark or guideline to help FSPs in the financial services sector and help consumers assess appropriate fee levels and service expectations. These perceptions will be explored through two principal and overarching research questions; How do consumers value financial advice? and How do FSPs value financial advice?

Following this section, section 2 evaluates the literature around this topic and provides a theoretical foundation and section 3 outlines a study design and method to collect data in support of the aim and research questions proposed above.

2. LITERATURE REVIEW

2.1 Introduction

The RDR is a reactive response to poor consumer outcomes and market misconduct, despite the significant progress achieved through the Financial Advisory and Intermediary Services (FAIS) Act in raising industry professionalism, improving disclosure to consumers and mitigating certain conflicts of interest (FSB, 2014). This proposal, released in 2014, regulates two main activities; the provision of advice to consumers and the delivery of intermediary services by a range of FSPs. It also outlines a number of vulnerabilities present in the current environment, including supplier relationships and intermediary remuneration models that contribute to poor outcomes and market conduct challenges in South Africa. The market conduct policy report for South Africa highlights typical challenges across the financial advisory sector (Table 1) with regard to savings and investment services, as well as risk insurance services.

The RDR puts forward 55 proposals, one of which considers the banning of commissions that FSPs typically earn from product suppliers, in order to address market misconduct, such as conflicts of interest; this would enable consumers to understand and evaluate the advice and services that FSPs provide to them. Furthermore, this places greater obligation on product suppliers to ensure the delivery of fair consumer outcomes through their elected distribution channels. The review outlines a more “proactive and interventionist” regulatory approach, proposing a shift towards a set of interventions aimed at changing incentives, relationships and business models in the industry so that it supports the reliable delivery of fair outcomes to consumers (FSB, 2015).

Table 1. Typical market misconduct challenges in South Africa, adapted from National Treasury of South Africa (2014).

Financial Product/ Service Type	Market Conduct Challenges
Savings and Investment	• Opaque, high and sometimes inappropriate investment charges (like rebates), especially in multi-layered products (e.g. a retirement fund backed by an insurance policy invested through a Linked Investment Service Provider into a collective investment scheme) • Product design features may weaken returns (e.g. asset based fees or causal event charges), and competition (e.g. through restricted portability on account of causal event charges, especially in legacy products). • Large gaps in regulatory net allow for structuring of investment vehicles to avoid regulation, especially with regard to the selling of potentially “bad” debt to uninformed purchasers and property syndication • Money market funds – lack of clarity between these funds and money market accounts offered by banks means that investors assume that they are invested in a bank deposit and do not know that they may lose the capital invested (in other words are exposed to market and not just credit risk) • Poor disclosure of risk of securitised assets in the wholesale market
Risk Insurance (asset and life)	• Poor disclosure of product terms, weak understanding by customers of technical policy language • Weak governance in outsourcing arrangements • Conflicted commission-based remuneration structures of intermediaries or service providers (especially upfront commission on life risk, and remuneration for outsourcing asset risk) • Claims handling practices, especially repudiations and non-transparency of exclusions, unreasonable excesses on asset cover, “underwriting at claim stage” • Too much focus on premium price rather than value (where costs to the consumer are displaced to higher excesses), especially on asset (short-term insurance) cover • High incidence of illegal operators in the funeral insurance market

However, key regulatory changes are focused on regulating the provision of financial advice, because it has historically been an area with little regulation or definition, thus preventing consumers from assessing the value of the financial services received (FSB, 2014). Similarly, with little emphasis and ambiguous clarification of "advice" in the current landscape, FSPs who do provide quality advice to consumers may not be fairly remunerated. Hence, the aim of this study is to explore the perceptions of both consumers and FSPs around fee-based advisory services in order to provide a benchmark or guideline to help these parties assess appropriate fee levels and service expectations. These perceptions are explored through two principal and overarching research questions; How do consumers value financial advice? and How do FSPs value financial advice?

In South Africa, implementation of the RDR is said to begin in 2017 in line with the twin peaks implementation, and while the restructuring of advice and remuneration thereof are only planned for phase two's implementation of RDR, it is important to begin discussion around this topic through interviews with the various participants in the market.

Such discussion will aid the banking sector and other FSPs, to restructure their product offerings and fee structures in line with the RDR reform. Additionally, such discussions will inform salary and job descriptions, marketing and operational strategies, as well as customer relationship management. Implementations of RDR type reforms internationally have shown that the banking sector was one of the most impacted industries, as many of the banks withdrew advice offerings to their consumers and placed greater focus on high net worth individuals (Little, 2013). This withdrawal in advisory services to middle and lower income individuals (who form the mass market in the UK) was due to banks being unable to offer cost effective financial advice to those consumer groups (Mitchell, 2015). As a result, the number of financial advisors working in banks and building societies fell from 8658 to 4809 (Mitchel, 2015).

2.2 Overview of the current financial advisory environment

The existing landscape of financial advisory in South Africa is underpinned by three realms; the types of financial services offered, the relationships between FSPs (or intermediaries) and product suppliers and the remuneration models for FSPs (or intermediaries). The type of financial product being distributed and the consumer group amongst whom it is being distributed, will affect the different combinations of these three realms (FSB, 2014).

2.2.1 Types of financial services

2.2.1.1 Financial planning

According to the Financial Planning Institute (FPI), financial planning is defined as

> …the process of structuring and arranging your financial resources to meet your life goals. These can be as short term as saving for a car, to long term planning for retirement. Financial Planning aims to provide financial certainty and clarity on your current and future financial wellbeing…

(FPI, n.d.)

By this definition, financial planning seems to be an ongoing type of service as the needs of the individual may change over their lifespan.

However, according to FSB (2014), the FAIS Act does recognise financial planning as a distinct service from intermediary services, and FSPs who do not meet the requirements of a financial planner as described by the FPI, may still practice as financial planners. As such, the RDR regulatory framework provides motivation towards better defining this as a distinct service to consumers.

2.2.1.2 *Financial product advice*

Similar to financial planning above, the definitions and consensus of what constitutes “advice” are ambiguous in the legislature. The FAIS act does try to define advice models around the knowledge of a number of financial products and the number of product suppliers that an FSP may have; one product type from one product supplier, one product type from many product suppliers, many product types from one product supplier or many product types from many product suppliers (FSB, 2014). However, there is little clarification on the range of knowledge (of product type and suppliers) that an FSP must have. Through this study some definitions may emerge that may contribute to better defining “advice” during RDR implementation.

2.2.1.3 *Factual information about financial products*

This type of service must be clearly distinguished from “advice”, as many FSPs may incorrectly provide factual information on financial products under the premise of advice (Hawkins, 2003). Factual product information is considered publically available information that any persons may acquire, and is distinguished from advice in that it does not provide any tacit recommendation supported by contextual knowledge of the landscape (FSB, 2014). This form of advice is still very useful for direct selling of financial products (where advice models are omitted) and for addressing consumer queries post-sale of a financial product (Hawkins, 2004).

2.2.1.4 *Sales execution*

This refers to the actual selling of a financial product. This can be carried out through different models; direct sales, or sales through an intermediary or an FSP (Hawkins, 2004). Direct sales are carried out between the product supplier and consumer, usually through the consumer interacting with the product supplier website or call centre; no financial advice is provided here (FSB, 2014; Hawkins, 2004). Sales through an intermediary are carried out between a consumer and a third party (an individual or firm) appointed by the product supplier, through call centres for example; again, no financial advice provided here (only factual product information) (FSB, 2014). Lastly, sales through an

FSP are carried out between a consumer and his/her selected FSP; advice may be provided in this model.

2.2.1.5 Linked investment service providers (LISPs)

A LISP is an investment administration platform that allows one to manage a range of investment and financial schemes from one source (FSB, 2014). It is a type of intermediary service that allows arbitration between a large number of consumers, and a large number of product suppliers. A consumer who subscribes to a LISP service may place orders to buy and sell investment or financial units from a number of product suppliers and will consolidate these units into one portfolio (ASISA, n.d.).

2.2.1.6 Product aggregation and comparison services

These are platforms or services, regarded by the FAIS Act as intermediary services, that provide factual information of many financial products from many product suppliers. The aim is to facilitate consumers in comparing products from product suppliers and to better inform decisions to purchase a product from a particular product supplier (Gupta, 2015). Examples of product aggregator platforms include hippo.co.za that allows one to compare insurance offers and quotes from a range of product suppliers all under one roof.

2.2.2 Types of relationships between FSPs and product suppliers

The various services mentioned above are carried out by FSPs or intermediaries who will have variable types of relationships with the product supplier. In this way, the FSP is the link between product supplier and consumer. FAIS requires FSPs to disclose the type of relationship they have with product suppliers to consumers, so that they are able to make informed decisions on the advice and services they receive from an FSP (FSB, 2014).

The legislature currently does not provide clear definitions for types of advisors, except in the insurance laws where some clarification is provided for types of advisors (FSB, 2014). Hence, there is a proposal in the RDR to clearly define advisor types into two categories; product supplier agents (PSAs) who will be licensed under a financial institution to provide financial services underwritten by these institutions and registered financial advisors (RFAs), who will be licensed in their own right to provide financial services to consumers (FSB, 2016). Regardless, this paper makes use of the insurance laws to explain the types of FSPs in the current landscape. Typically, the FSP type is underpinned by the type and number of product suppliers with which it is associated. Thus, from this, two categories of FSPs immediately arise; an FSP who may be associated with just one product supplier and an FSP who may be associated with more than one product supplier. These are referred to as tied or multi-tied advisors respectively (FSB, 2014). However, in insurance laws, another type of FSP is defined, called the independent financial advisor (IFA). This type of advisor has similar actions as multi-tied advisor, but legislature is unclear on an exact difference between the two. It is suggested that an IFA can be differentiated from a multi-tied advisor by the type of remuneration received; an IFA will rely on service fees from consumers with or without commission from a product supplier, while a multi-tied advisor relies mostly on commission from product suppliers (FSB, 2014).

2.2.2.1 Types of remuneration models

The types of remunerations charged for financial products are determined by the types of services that are offered to consumers and may be paid by either consumers or the product supplier to FSPs. The following section mentions the different types of remuneration that are paid and who are liable to pay this remuneration.

2.2.2.2 Fee type remuneration

This type of fee model is rarely used and mostly adopted amongst high income earners, who purchase investment instruments and are willing to pay for services such a financial advice and planning to the FSP (Smith, 2016). Fees are paid in different ways; as an hourly rate, as a flat rate per service rendered, or as a percentage of the lump-sum investment or even as an ongoing investment (Smith, 2016). These fees are paid by consumers, but may be facilitated by product suppliers under instruction of the consumer (FSB, 2014). It is rare that FSPs will rely solely on fee-based remuneration and will often rely on a combination of fees and commission (or other types of remuneration) (Smith, 2016).

2.2.2.3 Commissions type remuneration

This is the most common type of remuneration, especially in the sale of insurance type of products, however, regulations do not prohibit other product providers from paying commissions (FSB, 2014). Commissions are paid by product suppliers, who may offer variable commission rates for selling their products (FSB, 2014). FSPs who rely solely on commission as remuneration, may be incentivised to promote products where higher commissions are received. Thus, product providers who offer higher commissions may enjoy higher sales (Kolakowski, 2017). Commissions may either be paid upfront or on an as-and-when basis as premiums are paid by consumers over the life-span of the product (FSB, 2014).

2.2.2.4 Salary type remuneration

Salary type remuneration is often applied to tied advisors selling to low-income earners and to persons involved in direct sales, for example, telesales agents, where little to no financial advice is given (FSB, 2014). In this model, an advisor is paid a basic, fixed monthly salary which may or may not be supplemented by other benefits (such as sales commissions, allowances or cash-incentives). Salaries are paid either by a product supplier or an intermediary firm, for example, a brokerage which employs a number of brokers to supply services to consumers (FSB, 2014).

2.2.2.5 Rebates or platform fee type remuneration

The platform fee is a type of administrative fee paid either by the consumer or by the product supplier to a LISP for their administrative, product distribution and marketing services (FSB, 2014). This fee may be payable as a fixed amount or as a percentage of the assets on the platform. When paid by the product supplier, the consumer is charged an inflated management fee from which the product supplier pays for various expenses, including platform services by LISPs (FSB, 2014).

2.2.2.6 Binder type remuneration

A binder agreement is a type of agreement between an insurance product provider and an intermediary or FSP, where the intermediary or FSP is contracted by the insurance product provider to perform certain functions with respect to administration of an insurance product or policy (PWC, 2011). In other words, a binder holder may act as the insurance product provider and administer a policy accordingly and thereafter receive remuneration from the insurance product provider for the sale of a policy (PWC, 2011). A binder holder may also perform other services as an intermediary of FSP for which the insurance product provider is then liable to remunerate appropriately (PWC, 2011). While this type of remuneration is restricted to insurance products and services, it is recognised and addressed in the RDR proposals to ensure fair outcomes and transparency for consumers.

2.3 Overview of RDR

The RDR was first published in November 2014 by the FSB and proposed a number of regulatory reforms to address several issues in the financial services industry; the fair selling of suitable products to consumers supported by comprehensive advice, a competitive financial services market that allows consumers to compare and value the cost of advice, the development of sustainable business models and greater professionalism and trust in the industry.

The 55 RDR proposals are categorised through an activity-based approach (**Figure 1**) that defines services in the financial services industry; services to the consumer, services connecting consumers and product suppliers and services to the product supplier (FSB, 2014). This is expected to provide transparency for consumers around the services they can expect from the industry, by whom they may expect these services to be provided, and quite importantly, how these services are charged and remunerated.

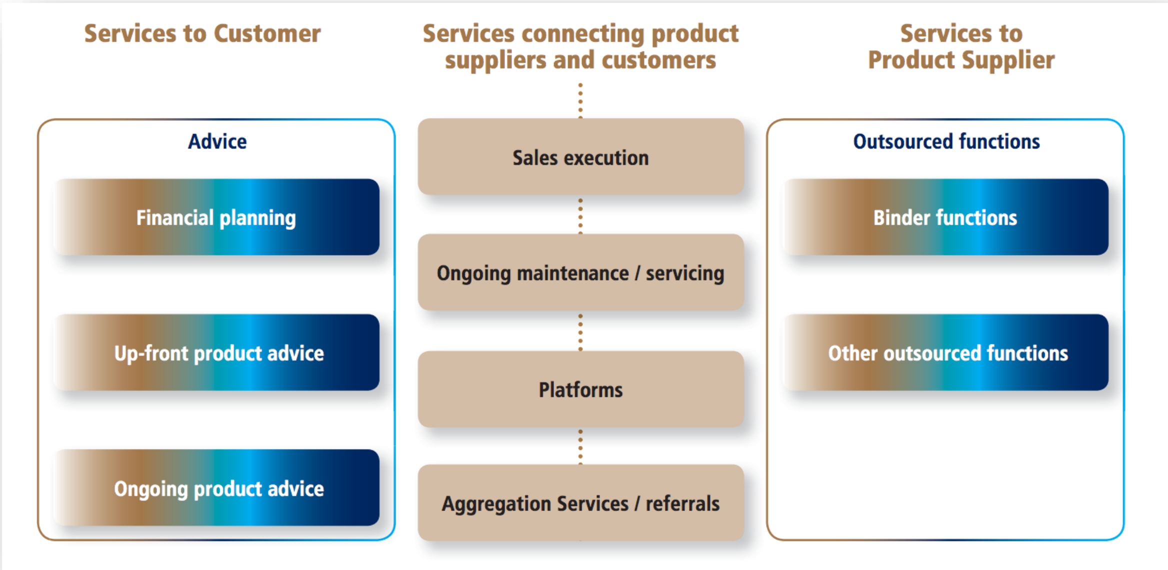

Figure 1. Activity-based approach to defining advice and intermediary services (FSB, 2014).

These reforms are planned to be effected in three phases, aligned with the legislative schedule to implement the "Twin Peaks" model. Proposals were then published for public commentary and review, with the most updated version being published in December 2016 (FSB, 2016). The major areas commented on by various key stakeholders included; advisor categories, product supplier obligations and accountability, remuneration for services including restrictions on commission-based remuneration (Discovery Financial Planning Summit, 2015)

2.4 RDR regulations for services to the customer

The 55 proposals put forth in the RDR use the activity–based approach above to then clarify the regulatory reforms it hopes to achieve. This is broken down into three sections, the first section defining each of the services that are outlined in the activity based approach diagram, the second section defining the different types of advisors (or intermediaries) that act between the consumer and the product supplier and lastly, defining types and limits for remuneration to advisors and other intermediaries mentioned in section two's proposals. Since this paper only explores the perceptions around remuneration for advice type of services, this next section only focuses on those proposals, II-LL (Appendix A), that refer to remuneration regulations for services to the consumer, i.e. remuneration for advisory services.

The aim of the remuneration regulations under the RDR proposals are to ensure that remuneration for services are reasonable and proportionate to the services rendered, but also to reduce any conflict of interest between the FSP (or intermediary) and the product supplier. Conflict of interest here refers to the preferential suggestion of a product from a particular product supplier to a consumer due to favourable commission fees that may be earned by the FSP. Thus, it infers that the presence of commission on certain financial products may encourage an FSP to suggest products that are ill-suited to a consumer. As a result, the RDR proposals advocate the removal of commission from certain financial products (where there may be conflicts of interest, such as investment products) and the introduction of a fee for financial advice, to be agreed upon and paid by consumers for all financial products.

Proposals II-LL in the RDR define the minimum standards for advisory fees around the three types of advice (financial planning advice, up-front advice and on-going advice), as well as the role of product suppliers in facilitating advice fees on behalf of the consumer. However, these proposals have not yet proposed a fee range or guide for FSPs to price the advice they give to consumers on financial products. The most recent updated RDR review from December 2016 indicates that the FSB will continue to work on developing such pricing guidelines for FSPs and has invited commentary on this subject (FSB, 2016). Thus, this study may provide some insight to pricing guidelines for the RDR.

2.5 Lessons from international RDR implementations

2.5.1 The Australian Retail Distribution Review

In Australia, the RDR was called the Future of Financial Advice (FoFA) and focuses on improving the quality of financial advice (particularly product recommendations) and expanding the availability of more affordable forms of advice. The reforms aim to improve consumer protection and instil confidence in the financial advice industry, much like the RDR in South Africa does.

The FoFA, like the RDR, bans commissions. This means FSPs will not be allowed to give or receive payments or other benefits if it could influence financial product recommendations or advice provided to consumers. This reform means that more FSPs fees will be paid directly by the consumer than indirectly through product commissions, making them more fair and transparent and acting in the best interests of consumers (The Australian Government Treasury, n.d).

The fee-based remuneration model requires FSPs to gather relevant information from the consumer and prepare a list of suitable products for this consumer after careful investigation of their needs and circumstances. This ensures that consumers receive the most suitable advice and recommendations for their needs, but also safeguards the FSP from undue criticism from consumers who claim ill-advice from an FSP (van Breda, 2013).

This fee-based remuneration model is carried out through an opt-in service, or renewed advice agreements every two years if consumers are paying for on-going services. In addition, an annual statement outlining the fees charged and services provided must be given to consumers paying on-going fees on an annual basis. This means that FSPs must be in regular contact with their consumers and will need to demonstrate the value of the services they are providing to their consumers (van Breda, 2013).

2.5.2 The UK Retail Distribution Review

The RDR aims of the UK are similar in nature to those of South Africa and Australia, ensuring consumers are offered a transparent and fair charging system for the advice they receive. A substantial change implemented by the UK RDR is that product providers are no longer able to pay any form of commission on new products. Instead, advisors will need to set their own charges in close agreement with their consumers. Also, post RDR implementation, FSPs may only charge on-going fees if on-going services can be verified. Similar to the proposals in the South African RDR, product providers may offer facilities for the FSP charge to be deducted from the investment (Faurie, 2015).

Following the implementation of RDR in the UK, there was a 25% reduction in independent financial advisors and retail bank employed advisors (Faurie, 2015). FSPs no longer engage in building portfolios, but rather on customising, evaluating, fulfilling and servicing their consumers' financial needs (Lombard, 2014). Thus, the business model of financial advisory has shifted in favour of value creation for the customer, as fees charged need to be justified to the consumer. While receiving much backlash from consumers after its initial implementation, the RDR has led to an increase in investments and greater knowledge of financial products amongst consumers (Lombard, 2014; Faurie, 2015).

2.6 Impact of RDR on FSPs and consumers

A common misperception amongst consumers is that FSPs provide their services for free (Gerson, 2014). Most consumers are unaware of the hidden costs they pay when an FSP receives commission on investment products sold to them. This has been the traditional practice of FSPs in the financial advisory industry (Van Breda, 2013). One can almost say that FSPs act as sales people rather than advisors, and are thus likely to promote investment instruments that deliver a higher commission to them (FSB, 2014). That also disadvantaged the consumer from receiving a comprehensive range of product advice because it made it difficult for some FSPs to recommend non-commission products in the fear that they would not receive remuneration in that month (Gerson, 2014; Smith, 2016). It also meant FSPs normally needed to recommend a product to get paid (incorrectly reinforcing the notion of FSPs as sales people), when in fact, no product may have been suitable for the consumer (FSB, 2014). Regulators believe this could have led to some conflict of interest, in cases where a product provider offered higher commission rates than others for the same investment product (FSB, 2014).

A survey conducted by CoreData revealed that around 9 775 out of 11 500 FSPs in South Africa currently cost consumers through a commission–based remuneration model (Kruger, 2013). Additionally, the survey revealed that only about 2 300 have already, or were planning to change their fee models in line with RDR reforms (Kruger, 2013).

The fee-only type of compensation provides consumers with the opportunity to get more service out of the money they spend on professional advice (Smith, 2016). This provides an opportunity for FSPs to adapt their model from sales-oriented to service-oriented, such as the fee-based systems adopted in the UK and Australia (Gerson, 2014).

All financial advisors will have to outline and agree fees for their advice in advance (FSB, 2014). Consumers are then responsible for meeting these fees and product providers may no longer pay a commission in any form. For many consumers, this is the first time they have had to pay a fee directly for advice. Other models have shown that this may not be taken well, unless the consumer can perceive tangible value (Gerson, 2014). The idea is that this makes the process more transparent as it should be easier for consumers to work out what the FSP is charging, what they are doing in return for that charge and then to compare this proposition with that of other FSPs. This then begs the question of whether South African consumers would be willing to pay for advice and if not, what would motivate them to pay for advice (Kruger, 2013).

The RDR proposes two ways in which a fee-based remuneration model could be set up; the first way is through up-front payments after an amount has been agreed upon by both consumer and FSP; and the second method would allow consumers to instruct the product supplier to deduct the advice fee from earnings on their investment products (FSB, 2015). Consumers who are less persuaded to pay up-front fees for advice may opt for the second option.

The method for both FSPs and consumers to approach the seemingly onerous costs of fee-based remuneration systems, is to clearly define the value proposition (Gerson, 2014). In this way, the consumer can off-set costs with perceived value. It is worth realising that the consumer has the power position in a fee-based remuneration model, as it is up to the FSP to provide evidence of value. Should the consumer not be satisfied with the value proposition of the FSP, they may seek other FSPs, until they are able to find one who can justify a fee for advice (Smith, 2016).

For consumers, this is an advantage as they will have greater transparency on the fees they are charged and can hold FSPs accountable for undue charges; FSPs, without the conflict of interest provided by commission can offer a wider, more suitable range of financial products to consumers; and consumers benefit from better investments (FSB, 2014).

However, the larger problem does not lie in transforming the business model from commission-based to fee-based, but in pricing advice fees (Smith, 2016). There are currently little or no regulated frameworks for pricing advice, as this has previously not been clearly defined as a service in the legislature (FSB, 2014). Without a framework to price advice services, consumers may see a wide range of prices in the market (Smith, 2016). This needs more clarification from the FSB for future success of fee-based systems.

2.7 Impact of RDR on the banking sector

Drawing on the experiences of the UK, it is important to consider the effect that RDR will have on the banking sector. According to a report by Fundscape (2014), financial advice is largely undervalued by mass-market consumers (low to middle income earners), thus a threat of many banking consumers snubbing fee-based advisory models. However, this provides an opportunity for South

African banks to innovate and educate their consumers about the value of financial advice. The challenge in this will be for banks to be able to restructure their advice models so that it is cost-effective for consumers, while also being profitable for the bank. This was said to be one of the greatest challenges for banks in the UK, resulting in many banks limiting their advisory services to only high net worth individuals (Mitchell, 2015).

Post-RDR effects in the UK led to a favourable market for non-advice sales models (Fundscape, 2014). Proposal D of the South African RDR refers to non-advice sales execution, where the sale of financial products will be carried out through carefully scripted dialogue as opposed to customised advice (FSB, 2016). For banks opting to employ this model in lieu of advisory services, where advice models are not productively efficient, scripts will need to be carefully prepared and sales persons well trained so as not to result in unfair outcomes for the consumer. However, the proposal has yet to define which financial products or instruments may be executed under a non-advice model and the sales process to be followed.

International trends have also shown a growth in the use of robo-advisors, online product comparison sites, and automated financial planning services by consumers who are unwilling or unable to pay for advice fees (Baker & Dellaert, 2017). This may be an opportunity that South African banks could invest in to prevent losing consumers in the low to middle income groups. However, such platforms require a large initial investment and may take some time to develop, in which time organisations may lose some of their consumers (Baker & Dellaert, 2017). Standards for product aggregation platforms and other online instruments have been mentioned in the South African RDR and will still be developed, based on international trends (FSB, 2016).

The greatest consequence for South African banks to avoid is the “advice gap” that was the downfall of UK banks. Banks will need to conduct careful impact studies on their financial product offerings and craft careful solutions to overcome negative impacts and exploit new revenue opportunities in line with the RDR reform. This study worked closely with ABSA to identify the impact of non-commission sales and through telephonic interviews with both advisors and consumers investigated concerns around fee-based models and how it can be structured to benefit both the consumer and the bank equally.

3. DATA COLLECTION AND ANALYSIS

3.1 Study Design

This study employed an inductive research methodology where no hypotheses were proposed. This method was selected due to there being little empirical research on this topic in South Africa. Qualitative data was collected through telephonic interviews with two sample population groups; an FSP population to ascertain their readiness for and perceptions of RDR, and a consumer population to determine their expectations of services in the financial advisory sector and determine their willingness to pay for advice.

A qualitative research method was chosen as it better allows for the understanding and sharing of tacit knowledge (Luton, 2010) and it also allows for deep exploration of the research questions (Ritchie, Lewis, McNaughton Nicholls & Ormston, 2013), while also providing comprehensiveness of perspective (Rubin & Babbie, 2009).

3.2 Study Population and Sampling Method

This study focuses on two population samples; a consumer population and an FSP population. The consumer population consisted of middle to high income earners, of both genders, between the ages of 23-65. This age range was selected as most financial products are purchased before a consumer reaches retirement age. Low income earners (households with an income of less than R86 000 per annum (Hunter, 2016)) were excluded for this study as the RDR proposals may be applied uniquely for this group. For the convenience of this study, participants were recruited from the Wits Business School (WBS) alumni and student populations. The FSP population sample was recruited from ABSA bank as the researcher is able to access a sizeable number of participants from this organisation. ABSA bank is also the sponsor of the researcher's study programme and may benefit from data of this research. FSPs of all age groups and genders were included in the study and there was no discrimination against number of years practising in the industry. FSPs must have had to be selling two of the following product types to be included in the study; An investment product, an insurance product and/ or estate planning. These are all products that would include advice and where commission would be removed when RDR would be implemented.

3.3 Data collection tool

Structured telephonic interviews were used to collect data for this study. The focus of the interviews was to explore the perceptions of both consumers and FSPs around fee-based advisory services in order to provide a benchmark or guideline to help ABSA and consumers to assess appropriate fee levels and service expectations. These perceptions were explored through two principal and overarching research questions; How do consumers value financial advice? and How do FSPs value financial advice? The full list of questions that were asked is included in Appendix B.

The interview was divided into two sections; section 1 collected demographic data of the participant and section 2 explored their perceptions of the participant around fee-based advisory services. Demographical data collected included the age, gender, occupations, income level, and ownership of a financial product.

3.4 Data Collection Method

After receiving the relevant permissions to conduct the study from the Wits Business School (WBS), data collection began in July 2017. Participants were recruited with the help of the WBS. An email containing information about the study and an invitation to partake in the study was sent out. The invitation contained a link to a SurveyMonkey form. This SurveyMonkey form asked participants to confirm their interest in taking part in the study and then asked them to provide a contact number, including a convenient date and time to be contacted for the telephonic interview. This email was sent out twice to ensure as many participants as possible. Additionally, the participant received permission to use five minutes before classes began to inform students about the study and invite them to participate.

For the FSP population, ABSA had provided consent to interview several FSPs. An email containing details of the study was sent out to the FSPs inviting them to partake in the study. Similarly, the emailed contained a link to the SurveyMonkey form to gain consent to participate and details of a convenient time to call for an interview.

Interviews were carried out at the ABSA call centre by a designated call centre agent. These interviews were audio-recorded with consent from the participant. Upon contacting a participant, the agent would introduce himself and provide an overview of the purpose of the call. He would then re-confirm the participant consent to partake in the interview. The telephonic interview lasted around 15-20 minutes per participant and before ending the call, the agent would again confirm consent to use the interview recording in the study.

The interview process took place over two weeks. Once interviews were completed, all recordings were transcribed and then passed onto a statistician for data analysis.

3.5 Data Analysis and Presentation

All transcribed interviews were then entered into an Excel worksheet for data analysis. Descriptive statistics were used to describe the population demographics. Charmaz (2000) explains that grounded theory is useful for analysing data in exploratory studies and relies on inductively generating concepts from the data gathered on the ground. Thus, grounded analysis was one of the main analytical methods used to interpret the perceptions of participants. It fitted well with the aims of the study which were to explore the perceptions of both FSPs and consumers on fee-based advisory models for the financial services sector. Grounded analysis was selected over content analysis because the study did not propose any hypotheses, and thus grounded analysis provided for valuable themes to emerge from the interviews without prejudice. Due to the range of possible perceptions owing to the fact that this topic is under-researched, grounded analysis was thought to be the most appropriate analysis. The process consisted of inductively identifying themes and sub-themes from common wording identified in the interview transcripts of participants. Analysis of concepts involved open coding to find themes amongst participant perceptions and axial coding to find links between the categories. Theoretical sensitivity of the data analysis was ensured through literature searches and analytical processes.

The themes were then uploaded into SPSS' statistical package for inferential analysis of concepts. Multiple analysis of variance tests was performed to observe any effect of participants' demographic factor on their perceptions around the financial advisory sector.

3.6 Ethical Considerations

Research carried out with participants, through interviews, was done in accordance with research ethics standards. Participation was voluntary and could have been withdrawn at any point without consequence to the participant. No identifiable characteristics such as participant names, ID numbers, staff/student numbers or emails were collected during the study, thereby ensuring anonymity and safeguarding participants from any undue bias or discrimination.

4. RESULTS

The results of the study have been divided into two sections; section 1 reports on the responses of the consumer sample population and their perceptions of fees in the financial advisory sector and section 2 reports on the responses of the FSP sample population and their perceptions of the RDR regulation around the removal of commission on certain financial products.

4.1 Consumer perceptions of advisory services

4.1.1 Sample population demographics

The study collected 30 responses from the consumer population sample; 40%(12) were female and 60%(18) were male participants. The ages of the participants ranged from 21 - 62 years old, with the average age of a participant being 34 years old. All participants were employed in many different industries, and held either a skilled labour (23.3%) or management position (76.7%). High income earners were considered to be those earning above R700 000 per annum; within the study population 53.3%(16) of participants were middle income earners and 46.7%(14) were high income earners.

4.1.2 Consumer perceptions of "advice" in the financial advisory sector

From here on, the results are divided into middle and high income earners, as RDR will affect these market segments in different ways, based on their earning capacity. Amongst middle income earners, only 69%(11) currently possessed an investment or insurance product, compared to 92,9%(13) of high income earners, at the time of data collection. From those owning financial products, only 21,4% of high income earners and 25% of middle incomes earners claimed to have known about the fees paid on these financial products; from knowing their premium amount and amount of commission paid out to a few having a more detailed understanding of the fees paid.

When asked if they would pay for financial advice, 85.7% of high income earners and 68.7% of middle income earners responded with a yes. However, this was conditional on the advisor providing full disclosure of the fees charged to them and the services that would be provided. Participants who were not willing to pay for advice, indicated that they would self-research financial information on the internet. The interview also asked participants how they would pay for this advice; 43.5% said they would pay per hour, 8.7% said they would prefer to pay per product type, 30.4% said they would rather pay a percentage of their investment value and 17.4% were unsure how they would pay. Amongst the high income earners, the preference for paying for advice seemed to have been between a per hour rate or a percentage of their investment value, but amongst the middle income earners, most were “unsure”. Those who indicated that they would pay per hour, quoted paying anything between R50-R800, depending on the quality of the advice and the ability to negotiate.

Next, participants were asked to rate their confidence, on a scale of 1-5, in the advice received from seven sources; an FSP working for the bank, a robo-advisor, a call centre, an independent FSP, advice from family, advice from mathematical software and advice from the internet. All source responses were normally distributed, except for the category of advice from a robo-advisor, which was positively skewed. FSPs working in the bank, call centres, family members and friends, mathematical software and internet research received a ranking of 3. Independent FSPs received a higher ranking of 4 and advice from a robo-advisor received a mixed response with most participants ranking it a 1.

A three-way mixed MANOVA was performed to test for any effect of three independent variables; participants’ earning potential (middle or high income), their current status of possessing a financial product and their willingness to pay for advice on their ranking of advice from the seven sources mentioned above. The results were insignificant ($p>0.05$), showing no effect of the three independent variables on the seven dependant variables.

In order to help FSPs prepare for the RDR transition, the interview then explored the consumer perceptions of “how would you define advice?”, “what services are expected from an FSP?", "What qualities do you value in an FSP" and "what value proposition would attract you to seek their services?". Thematic content analysis was applied to the responses to these open-ended questions.

When asked to define what advice means or entails for them, consumers identified seven themes (**Figure 2**); Conducting a needs analysis, providing product information, information around the quality of the investment, developing customised guided solutions, using layman terminology, working within the consumer budget and after-sale support.

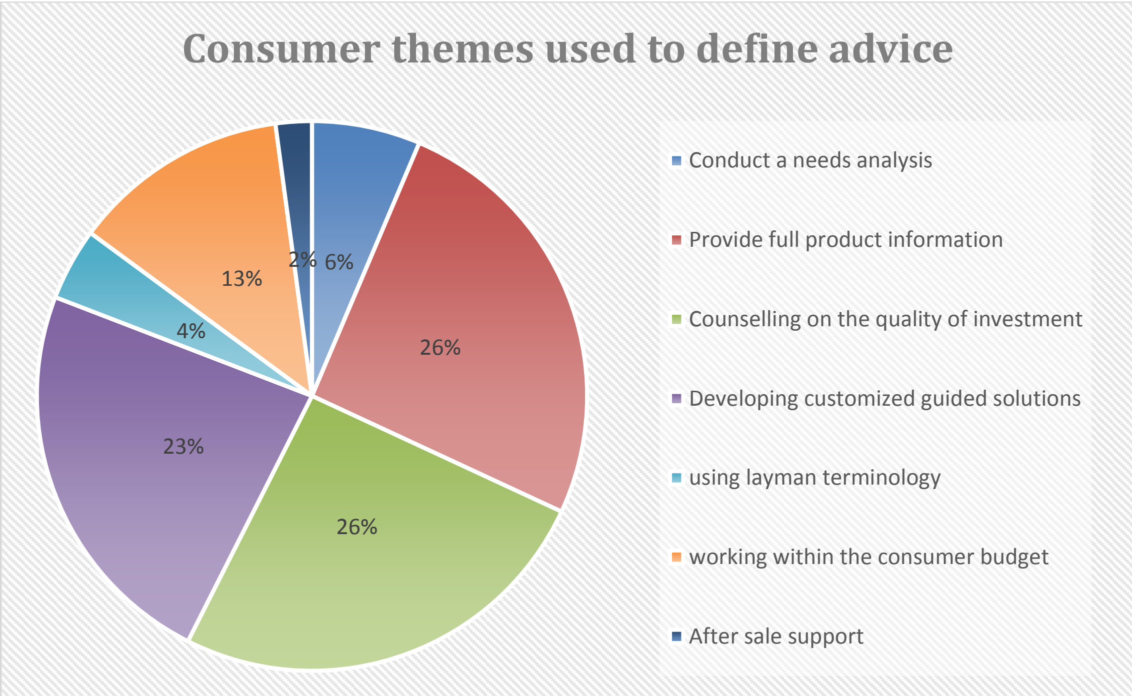

Figure 2. Consumer perceptions of what constitutes "advice"

Next, consumers were asked what kind of services they expected from an FSP. Here, consumers identified five themes (**Figure 3**); fee disclosure, full product disclosure, financial projections, personalised product advisement and regular portfolio updates. Responses around full product disclosure involved the FSP providing information on the types of products available, what these products entail, the risk profile of these products and the product clauses. Responses regarding financial projects involved understanding the long and short term outcomes of products, the benefit that consumers will gain and how this fares with inflation.

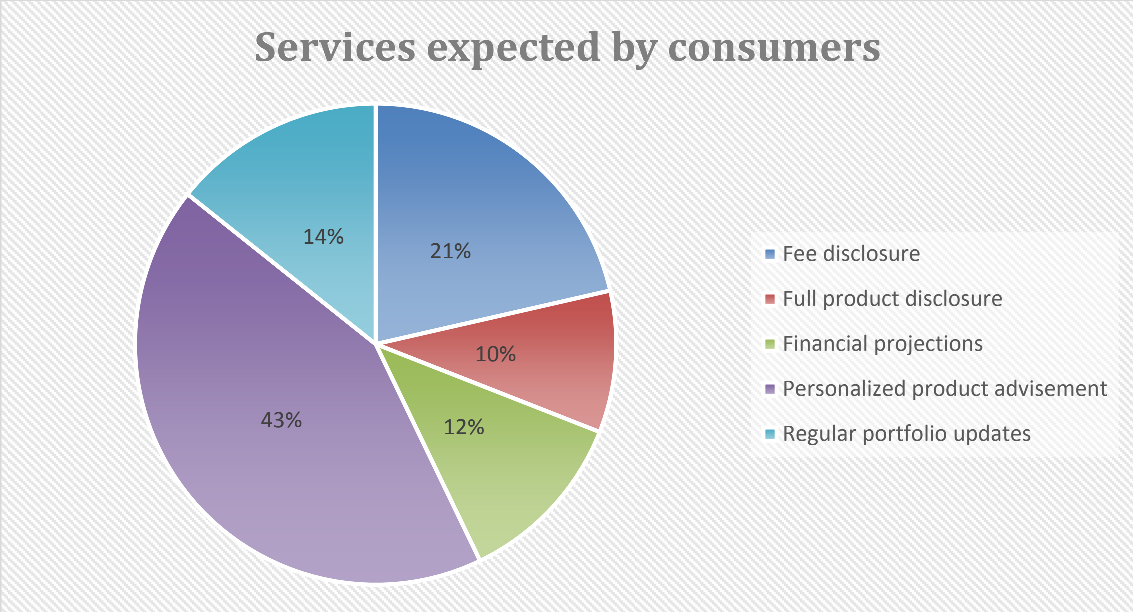

Figure 3. Consumer expectations of services offered

Then, participants were asked to identify qualities they desired in FSPs. Participants identified five themes here (**Figure 4**); an FSP who is well informed, has a proven track record, possesses honesty and integrity; considers the consumers' best interest and communicates regularly. Participants described "well informed" as having both a breadth and depth of knowledge around financial products. Proving of track records included indicating the number of years practising in the industry and showcasing how value has been created for other clients. There was a strong opinion of FSPs considering the best interests of the consumer rather than "selling products to earn the greatest commission".

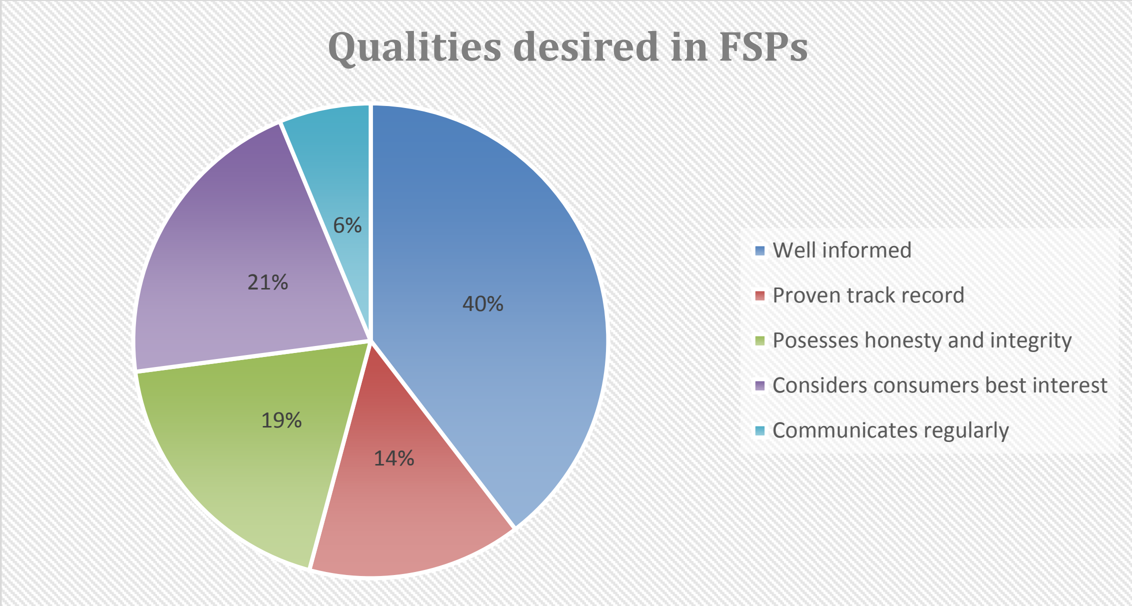

Figure 4. Qualities consumers desire in FSPs

Lastly, consumers were asked to comment on the value proposition of an FSP that would attract them to use his/her services. A proven track record seemed to be a dominant theme here, with good customer relations following as the second dominant theme. Good customer relations skills incorporated a number of smaller themes around long-term relationship building, caring attitudes, non-coercive guidance and communication skills.

4.1 FSP perceptions around the removal of commission in preparation for RDR.

4.1.1 <u>FSP participant demographics</u>

There were 25 participants in the FSP sample population; 32%(8) were female and 68%(17) were male participants. The ages of FSP participants raged from 30 to 66 and was positively skewed. The average participant age was 46 with most participants at age 40. Only 24% of participants have been practising in the industry for less than 10 years, with the longest practising participant having 36 years of experience in the financial services sector. All participants interviewed provided services for investment, insurance products as well as estate planning and reported seeing clients between 1 – 6 hours a day. Most

FSPs interviewed admitted only spending about an hour a day interacting with clients. Other time was spent on paper work and administration.

4.2.2 FSPs perceptions of RDR regulation and the removal of commission on certain products

When asked how the products they sell created value for a consumer, four prominent themes emerged; providing information about these product types to consumers who are unaware of them, conducting a needs analysis of the consumer, long-term financial planning to avoid future risk and creating wealth for the consumer.

Like the consumer sample participants, FSP participants were asked to provide a definition of “advice”. Three prominent themes immediately emerged in this participant group; providing product information, conducting a needs analysis and recommending a number of products to cover financial risks.

The interview then shifted its focus to report on the readiness and preparedness of FSPs for the RDR. All participants were asked if they would leave the industry if they could no longer earn commission. 56% reported that they would not leave the industry; some commenting that they would need to carefully consider how to restructure their services and others commenting that a change of industry would not pan out any better for them. 8% were unsure what they would do and commented that they would wait to see what impact the RDR will have. And 36% said they would rather leave the industry, because a fixed salary or fee-based remuneration would not be a viable option for them.

When asked how they would charge for services in the absence of commission structures, participants fell into four categories; charging a per hour rate for services, charging a percentage of the product value, charging a monthly fee with ongoing advice provided and a sub-group that felt unsure about an appropriate pricing model.

Following this, the interview asked if FSPs thought they would lose consumers with the new RDR regulation imposing advice fees on the consumer. 72% of participants reported that they felt they would lose clients for several reasons; “consumers are not use to paying for advice and will wonder why they have to pay for it now” and “many of my low income clients will not be able to afford an advice fee”. 24% felt they would not lose clients because they service mostly affluent, high income earners or because some had already moved to a fee-based system and their clients were already paying for advice and financial planning services, and 4% were unsure of how their clients would respond to a fee-based system.

Asking participants to comment on their perceptions of where consumers will seek information should they not be willing to pay for advice fees, revealed that FSPs anticipate consumers will seek advice and/or information from one of three sources (Figure 5); self-research on the internet, call centres with generic product information, and robo-advisors.

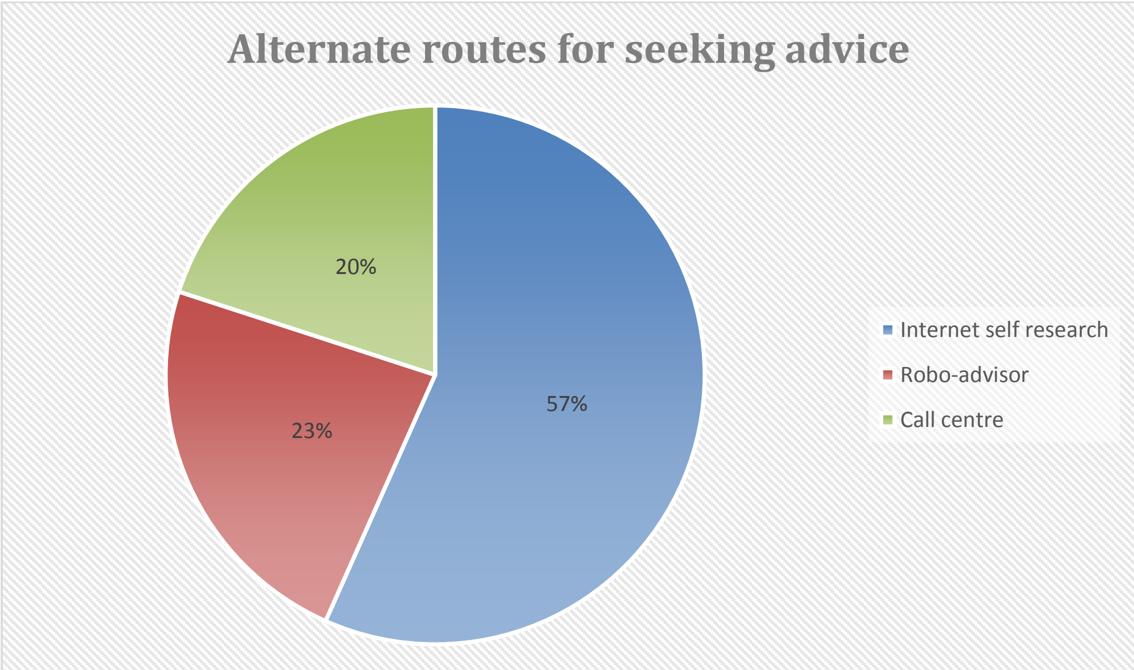

Figure 5. FSP perceptions of consumer alternative for seeking advice

Several ideas were proposed when FSPs were asked to comment on how they would adapt their service offering for RDR, however 40% of participants were still unsure of how they would prepare for an RDR reform. Some explained that they would adjust their fee structure accordingly; either by starting to charge a per hour rate or monthly ongoing fees, and others commented on how they would adjust their business proposition by creating a strong value proposition, segmenting their consumer market and tailoring services accordingly, explaining to consumers about the new regulations and being more transparent and negotiable with their fees.

Lastly, FSPs were asked to comment on how banks could restructure the financial services divisions in preparation for RDR. While the majority, 52% of participants, were not sure how this could be done, 32% were convinced that banks would need to start using a fee-based system to provide basic salaries to their FSPs. 16% went on to comment that these fees should vary depending on the package the consumer wants (thus, avail a number of structured packages) and also differ depending on the years of experience of the FSP, in addition to incentivising annual sales by banking FSPs.

ABSA also provided information on annual salary and commissions earned from FSPs who consented to disclosing this information anonymously. Only 17 FSPs were willing to provide this information (Appendix E). The percentage range of commissions earned from FSP's annual salaries ranged from 55% - 80%, with the average of 68% of the annual salary being composed from commissions. Since this information was provided anonymously from Absa Insurance and Financial Advisors (AIFA), this study was unable to investigate if the amount of commission earned had any significant effects on the FSP responses asked in the telephonic interview.

5. DISCUSSION

This study investigated the perceptions of both consumers and FSPs around fee based advisory models in anticipation of the upcoming RDR implementation. The goal of the study was to understand consumer needs and FSPs service offerings to identify gaps where opportunities may be taken advantage off. The interviews of participants highlighted many themes that offer valuable insight for FSPs and the financial services sector in preparing themselves for the RDR. It also emphasised knowledge gaps in consumers that need to be addressed in order to build a financially savvy population that is able to secure a firm financial standing for their futures.

A very important observation from the study is the lack of financial literacy amongst consumers. This seemed to be apparent in both middle and high income earners who claimed to have not known or understood the fees paid for financial services and products. Atkinson and Messy (2012) argue that financial literacy is an essential skill for consumers to have, because a lack in financial knowledge may lead to poor financial choices, resulting in undesirable financial consequences to the consumer. Thus, for RDR to enable consumers to negotiate fees and services with FSPs after future implementation, the FSB would need to make sure consumers first understand financial fee structures and services that may be charged for. Also, financial literacy has been shown to be a great determinant of a savings culture (Atkinson & Messy, 2012), and developing individuals' savings culture may emphasise the importance of financial advisory services amongst consumers, thus lowering the resistance to paying for advice services.

Many consumer participants indicated that they would refer to the internet for advice should they be unwilling or unable to pay for advice, thus providing more financial information on the internet, through banking sites, for example would be a suitable vehicle to deliver this financial knowledge to consumers. Some banks, like Standard Bank also offer investment workshops to help their consumers become more aware of investment opportunities and how they work. This is a smart service offering in that it is beneficial to consumers (increases their investment knowledge) and beneficial to the bank, as it may result in the sale of a financial product. The manner in which these workshops are offered are also productively efficient as they are run by one facilitator and reach a number of consumers. A potential weakness of this service offering, however, may be when these workshops are offered, as many middle and low income earners may not be able to take leave to attend such workshops.

Following the market assumptions, the study demonstrated that high income earners are more financially prepared for the long term than middle income earners, as more high income earners possess financial products to secure their long-term future than middle income earners. However, the number of middle income earners have seen increases with the introduction of tax-free investments, according to an article in Money Marketing (Roberts, 2017). While this may be true, RDR may impede this growth if consumers are expected to pay for advice fees. This is supported by participant responses that indicated an unwillingness to pay for advice. The middle income sector may see a 1/5th reduction in financial product purchases with the introduction of advice fees. According to FSPs, more than 1/5th may cease seeking financial services from FSPs with the introduction of advice fees. This is a major problem because decreasing savings culture in South Africa households may result in an increasing dependence on foreign capital inflows, which normally attract inflated interest rates (Aron & Meullbauer, 2000).

Not only will the economy see a decrease in the number of consumers purchasing financial products, but a dramatic decrease in the number of FSPs. Reponses from participants indicated just over a 1/3rd of FSPs would leave the industry. This is consistent with the UK trend post RDR implementation. The cost to FSPs to comply with RDR's regulatory framework became too high to be overcome with a fee based system, resulting in many advisors in the UK exiting the industry due to margin losses (Childs, 2012).

It was not possible to determine if the amount of commission earned had any bearing on the decision of an FSP to leave the industry. However, it is important to note that more than half of an FSPs annual earnings is made up by commissions. Replacing these commissions with advice fees may not yield the same returns. This was also observed in the UK RDR, where advisors experienced a marginal loss of annual income after implementing fee-based advisory models in the absence of commissions (Fundscape, 2014). This marginal loss could have been due to the “advice gap”, where middle and low income earners forfeited advice services due to the inability to pay for them. However, as the UK population became more financially literate post RDR implementation, FSPs did see an increase of consumers seeking advice two years after the implementation (Mitchell, 2015). Thus, if FSPs develop strong value propositions and deep customer relations, coupled with an appropriate service fee model, the loss of income may not be as devastating over the long haul. Furthermore, these commissions fluctuate annually depending on the number of products sold per year and may create anxiety about earning enough when not many products are sold. However, this may be stabilised where an FSP can restructure services to provide ongoing services to the customer base and reduce anxiety around annual earnings.

Many FSPs indicated that a majority of their consumer population just do not have the disposable income to pay upfront fees for advice. Both consumers and FSPs indicated that in the event of not being able or willing to pay for advice fees, they will self-research information about financial products and make decisions based on that, thus creating a knowledge gap, as done in the UK. This could lead to two scenarios; one where a population of consumers who make ill-informed decisions emerge, or one where consumers start becoming more aware of financial information and are able to compare and contrast to make better decisions. For the latter to occur there would need to be an expansion and growth of layman financial information on the internet.

A major concern of FSPs is that consumers would be unwilling to pay for financial advice, because it has historically not been seen as a service that is charged for. This is largely underpinned by a misconception about advice and what it constitutes by both FSPs and consumers. While both participant groups were able to identify elements of advice they, however, failed to describe advice as a comprehensive service. Furthermore, only two descriptors amongst FSPs and consumers matched when defining advice; table 2 illustrates these descriptors. FSPs also provided less descriptors than consumers and provided vague narratives for “planning for financial risk”. This illustrates a general lack of understanding of the concept of “advice” amongst FSPs. The FSB would need to be clear in defining the concept of “advice”, what it is and what it is not, before embarking on any reforms that that propose fee-based advisory models.

Table 2. Consumer and FSP descriptors used to define advice.

Consumer descriptors used to define advice	FSP descriptors used to define advice
• *Provide product information* • *Conduct needs analysis* • Counsel on the quality of the investment/insurance product • Develop customised, guided solutions • Make use of layman terminology • Suitable to an individual's budget • After-sale service	• *Provide product information* • *Conduct needs analysis* • Planning for financial risk • Wealth creation

In piecing together the themes described by consumers for "what does advice mean to you", the study was able to derive the following definition for advice as a comprehensive service offering;

> "Financial advice is a service provided by a qualified FSP, who conducts a comprehensive needs analysis of the gaps and areas of financial risk that the consumer is exposed to, then provides a number of product options and fully discloses all information using layman terms that are understandable to the consumer, including product risk and value, in order to provide a *customised*, guided solution for the consumer, that is budget conscious and supported by after sale services that will consider the changing needs of the consumer, while also alerting the consumer to the health of their investment over time".

While this definition provides a better understanding of “advice” as a service, it still requires further investigation into what constitutes a “comprehensive needs analysis”, i.e. what tools are appropriate in conducting a needs a analysis. Very important to note in this definition of “advice” as a service, is the word “customized”. This was a very important theme identified by consumers and a generally lacking component in financial advisory. Customized services may very well become a compulsory value proposition for fee based advisory models.

The study produced several suggestions from both participants and FSPs in how services could be charged for in the absence of commission. The most popular suggestion from both sample populations was to pay for services per hour. There are several drawbacks to this suggestion. Some financial planners in the sample population indicated already employing this with success, but only amongst their high income clients. Additionally, this would be a workable solution for those who spend more hours on client interaction per day. However, as indicated by most FSPs, only about 1-2 hours are spent on client interaction per day. Thus, in order to match what would have been made in commissions per month, the hourly rate would need to be extremely high, and unfortunately, participants in the middle income bracket were not willing to pay higher than R500 per hour.

The second most common popular suggestion, was for consumers to pay a percentage of the investment value. For example, if a consumer purchased an investment product for R50 000, the FSP would take 2% as an advice fee. This was suggested to work better in middle to low income earners as they would not need to pay an upfront advice fee and may be more likely to agree. However, this implies a once off charge and does not take into consideration ongoing services. This also means that the FSP may not be equitably remunerated for advice offered, as the advice fee will depend on the value of the investment regardless of the quality of the advice provided.

A third option was to pay for advice based on the product type. Again, with this suggestion the quality of advice is not taken into consideration. Thus, if there is a fixed fee for each product type, for example, R500 for life cover, and the quality of advice varies amongst FSPs, the consumer may receive a raw deal or an experienced FSP may be under-valued. Additionally, this infers a once-off payment, which may not be a profitable model for the FSP.

The last option suggested, took into consideration advice as an ongoing service offering, and proposed that FSPs could charge a monthly management fee, that could be offered as a range of service packages. This would also address the affordability of the client and allow clients a certain amount of control over the services they would like to buy from the FSP. This monthly management fee would also then impose regular contact between the client and the FSP, creating a stronger value proposition for the FSP and fostering a better long-term relationship in which to build trust and loyalty with the consumer. This option would be the most sustainable model for FSPs to adopt. This would also be a suitable model for banks to adopt. Additionally, banks could structure this ongoing management fee according to their market segments by structuring service offerings variably according to factors such as FSP track record and product type, to make this offering useful for the consumer while being productively efficient and financially sustainable for the bank.

While there were several suggestions on how FSPs could adapt their service offering in preparation for RDR, there were few ideas around how banks could restructure their financial services for RDR. This will need great consideration, especially considering that many banks in the UK closed down their financial service divisions or limited them to high income earners, after being unable to sustainably provide profitable adaptations for themselves and consumers (Mitchell, 2015). What was certain from the interviews was that banks would need to start providing their FSPs with basic salary packages and find some mechanisms to boost this through incentives or other means. One participant suggested adding advisory services as an account fee, where consumers would then be able to access financial advisory services at will. Thus, those who make use of the service less often will subsidise those who need and would use the advice services more often; thereby allowing low income earners to also benefit from the same quality advice services.

A second powerful observation from the study uncovered the great distrust that consumers have in the financial services sector. One of the sought after qualities consumers wanted to see in FSPs was integrity and honesty, as many consumers felt that FSPs sell financial products for commission gains rather than for the consumer need. This is a view shared by the FSB and is a great motivator to implement RDR; by removing commission, it is hoped that FSPs will focus on the consumer need for a product as well as recommend products more suited to the individual. In the UK, the RDR implementers who adopted ongoing advisory services, managed to overcome this perception and build stronger relationships with their consumers (Fundscape, 2014). Thus, demonstrating how RDR may restore professionalism and trust in the financial services industry.

Closely related to the second observation is that consumers felt FSPs did not tailor solutions or recommend products that were suited to their individual needs. This criticism was prominent despite FSPs reporting that a consumer's needs analysis is part of their value creation and service offering. This also ties in very closely with the desired quality of "considers consumer's best interest" amongst FSPs. The study believes that this could be due to a number of reasons. First, the FSP could have little product knowledge and therefore be unable to provide suitable product recommendations despite performing a needs analysis. Second, FSPs who are tied to a product provider cannot provide a breadth of product options and may recommend a generic product where a consumer need cannot be matched. Lastly, FSPs who have a breadth of product knowledge may not be able to provide a depth of information about these products and thus cannot accurately match a product to a consumer need.

To remedy this, it will become important during RDR implementation for product providers to ensure that FSPs selling their products are well informed about the product. There also needs to be some regulation and standards around the breadth and depth of knowledge of financial products. Perhaps introducing a system which benchmarks the FSPs' knowledge of products for different needs would be helpful, not only to the consumer, but for the FSB to construct ranges for advice fees that FSPs may charge. This will require a new approach by most FSPs who must be able to identify what financial services they do or can offer to their customers across the different product types.

Two other highly sought after qualities of FSPs were “a well-informed advisor with a reputable track record”. Over half the consumer participants expressed that this would influence their selection of an FSP. Generally, it is assumed that the number of years an advisor has spent practising in the industry will indicate their level of knowledge and experience. However, consumers expressed the need for explicit proof of financial knowledge and a good track record. One participant even commented that they would like to see the wealth that the advisor has created for his customers as proof of his abilities. This may be a challenge for new FSPs entering the industry as they will not have a track record or any way to prove their product literacy to the consumer.

Perhaps having clients provide a testimony of their experience with an advisor could be used to demonstrate the quality of services that can be expected from that advisor. To ensure advisors are well informed about financial products (especially in the case of new FSPs), product providers must be able to provide detailed and fully disclosed product information to FSPs and the FSB could require annual FSP knowledge testing (at different levels to accommodate FSPs from entry level all the way to established FSPs) to ensure professionalism and quality in the industry.

Thus, the answer to the overarching research questions proposed in the beginning of this paper; how do consumers value financial advice? and how do FSPs value financial advice? are simply that, consumers seek a variety of needs to be satisfied by advice services and are generally willing to pay for this advice through various means, and FSPs require a more structured framework to define advice services and guidance from the FSB on how these services can be remunerated fairly for both FSP and consumer.

Drawing on the experiences and lessons from international implementations of the RDR will be a useful exercise for the FSB before initiating RDR reforms in South Africa. However, it would be short-sighted to assume that South Africa will undergo the same losses and gains with RDR implementation, because the economic context of South Africa differs from that of the UK and Australia. If one considers the Gini coefficient, which is a statistical measure of the economic inequality and income distribution in a country or region (Investopedia, n.d.), the higher the Gini index in a region, the less equality there is in income or wealth distribution amongst the people. According to the CIA's (n.d.) World Fact Book, South Africa has the second highest Gini index of 62.5 (last measured in 2013) in the world, the UK is 110th on the list with a Gini index of 32.4 (last measured in 2012), and Australia is ranked 123rd with a Gini index of 30.3 (last measured in 2008). This indicates that South Africa has a much larger lower income and middle income population than the UK and Australia, meaning the effect of RDR may differ greatly from these countries.

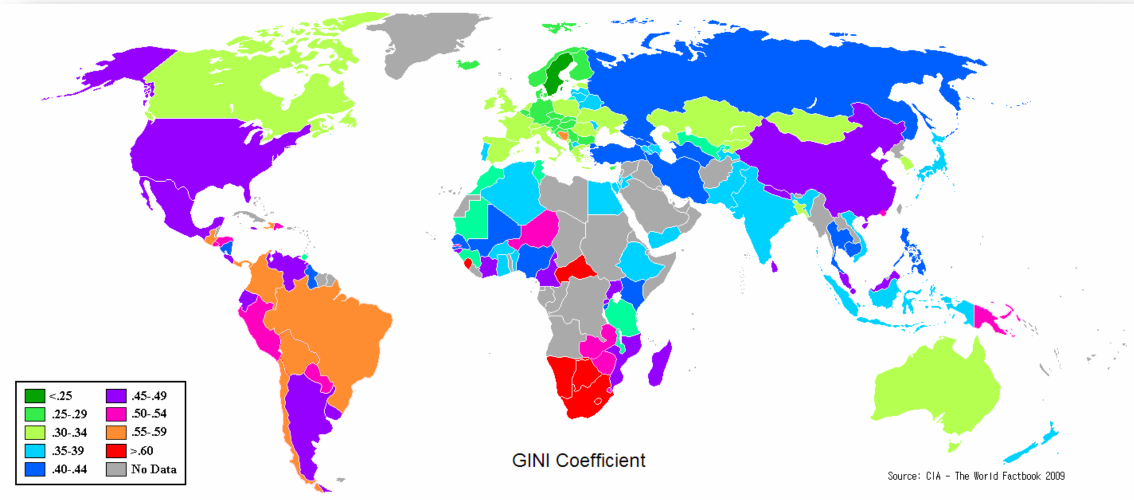

Figure 6. Country comparisons of Gini index (CIA, n.d.)

5.1 Limitations and future opportunities

This study was the first of its kind to explore perceptions of the market in preparation for the RDR reform in South Africa and is not without its limitations. The study chose to only include middle to high income earners in light of RDR regulations for low income earners being omitted. However, understanding the perception of the low income earners would be a vital investigation for FSPs and banks to understand how their service offering may be affected and/or need to be adapted for RDR. Additionally, the low income segment is a relatively large segment in South Africa and the effect on this segment must be considered before any RDR implementations.

Only bank associated FSPs were interviewed for the FSP sample population, thus the views of independent FSPs may have been omitted in this study. The RDR in the UK and Australia saw a drop in both independent FSPs and bank FSPs. It is important to consider the readiness of independent FSPs and even explore how they could collaborate with banks to mutually benefit from RDR.

The methodology of the structured interviews in this study prevented the researcher from exploring certain themes in depth and exposing concerns and perceptions outside of the questions asked in the interview. While this provides a benchmark for future studies, deeper explorations of both FSP and consumer populations should be explored to fully realise a successful implementation of RDR in South Africa.

Future studies around this topic would do well to compare the economic context of South Africa, the UK and Australia to understand where international RDR implementations will not be applicable to South Africa. Other studies could look at evaluating fee-based implementations from the UK, Australia and even those who have already implemented it in South Africa, to explore viable options for FSPs and banks, for as much as this RDR benefits the consumer, it must also benefit the FSPs in the industry.

6. CONCLUSION

The RDR is the beginning of a new era for the financial services industry. With high expectations to increase consumer benefits through fair and equitable outcomes and practices, the FSB needs to also be aware of over-regulating the sector and marginalising FSP services and earnings. This study endeavoured to explore two principal and overarching research questions; how do consumers value financial advice? and how do FSPs value financial advice? The findings reveal important lessons for businesses, regulatory bodies and individuals participating in the financial services sector. An unavoidable reality of the RDR will be that the FSP population will see a marked decline, along with a “knowledge gap” of consumers who are unwilling or unable to pay for advice. This study did, however, highlight that there are a great number of consumers who are willing to pay for advice, under the right circumstances and for the right fee. Additionally, it also revealed the general unpreparedness of FSPs for the RDR. Several options for fee-based models were discussed, with a monthly management fee for ongoing services appearing to be the most sustainable option, especially for the banks. These fees will need to replace the portion of income made up by commissions (more than 50%), but may well not be in the range of commissions currently earned by FSPs. The study also did well to highlight important qualities and value propositions for FSPs to consider going forward, in order to develop long-term, loyal consumer relationships. More importantly, the study was able to formulate a definition for “advice”, taking both the FSP and consumer opinions into consideration. While this research has a long way to go in preparing the South African market for RDR, this study provides a foundation from which banks and FSPs can begin considering gaps and opportunities in preparation for RDR; and regulatory bodies such as the FSB can ensure the RDR is implemented uniquely for the South African market. It may be important to be aware of both the successes and failures of international implementations of RDR, but also consider that the economic context of South Africa may be different from Australia and the UK. More studies like this will pave the way forward to realise tangible solutions.

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APPENDICES

Appendix A – Proposal II-LL of RDR

Proposal II: Standards for financial planning / risk planning fees
Conduct standards will be set in relation to:
- The requirement to obtain explicit customer consent to a planning fee before any financial or risk planning is carried out, where consent must relate to the quantum of the fee, the fee calculation basis, the manner of payment and the scope of planning service to be rendered, including in relation to any ongoing financial planning services.
- Regulatory reporting obligations in relation to fees earned.
- Related disclosure obligations.
- Product supplier obligations to monitor planning fees charged by tied advisers and the scope and quality of the planning services provided by tied advisers.

In addition, the regulator may publish benchmark guidelines in relation to planning fees, together with requirements to monitor and / or report on adherence or deviations from such guidelines and enable comparability of such fees.

Proposal JJ: Standards for up-front and ongoing product advice fees
Conduct standards will be set in relation to:
- The requirement to obtain explicit customer consent to an advice fee before any such fee may be charged and (in the case of up-front product advice) before any product transaction is entered into – where consent must relate to the quantum of the fee, the fee calculation basis, the manner of payment, and the type of advice to which the fee relates.
- Regulatory reporting obligations by advisers in relation to advice fees earned.
- Related disclosure obligations.
- Product supplier obligations to monitor and report to the regulator on advice fees charged by tied advisers and the scope and quality of the planning services provided by tied advisers.
- Product supplier obligations to monitor advice fees charged by multi-tied advisers and IFA's, where the product supplier facilitates the fee collection.
- Limitations on the extent to which advice fees charged may vary between product types.
- The principle that advice charges should be reasonable and commensurate to the service being provided, and not allow for cross-subsidisation by product charges.

In addition, the regulator may publish benchmark guidelines in relation to advice fees – in the form of a "safe harbour" benchmark or tariff guideline – together with requirements to monitor and / or report on adherence or deviations from such guidelines and enable comparability of such fees.

Proposal KK: Additional standards for ongoing advice fees
The standards referred to in proposal JJ above will apply to both up-front and ongoing advice fees. The following additional standards will however be set in relation to ongoing advice fees:
- Ongoing advice fees may not be charged unless the customer has agreed in advance to receive ongoing advice and to the fee concerned, and such ongoing advice is in fact provided.
- Where there is a periodic fee paid for ongoing advice, the customer should be able to "opt out" if no ongoing advice is provided.
- Where a customer agrees to pay a periodic fee for ongoing advice, and such advice is provided, the adviser may stop providing the ongoing advice if the customer does not pay or stops paying the agreed fee.

Proposal LL: Product suppliers to facilitate advice fees
For investment products, product suppliers will be obliged to offer a facility for customers to instruct the product supplier to deduct up-front advice fees (in a single payment or in instalments) or periodic ongoing advice fees, and pay these across to their appointed adviser. Standards will be set providing for:
- The requirement to provide, at the customer's election, for deductions from either the amount of any investment contribution paid by the customer, or from the value of the investment product from time to time, or both.
- The type of customer instruction that the product supplier must receive before making any fee deduction.
- The product supplier's obligations to cease or amend any such deductions at the customer's request.
- A requirement that the product supplier offer the same advice fee facilitation services for all types of adviser – IFAs, multi-tied or tied.
- The product supplier's obligation to disclose to customers any advice fees that it facilitates, in a manner that clearly distinguishes them from any product charges.

For risk products or other products where deduction from the product value is not applicable, the product supplier will also be required to offer a facility to deduct advice fees as additional amounts over and above the contribution or premium payable for the product concerned (for example a separate debit order amount). Product suppliers will be obliged to offer the same facility for all types of adviser – IFAs, multi-tied or tied.

Comment is specifically invited on the range of fee deduction options which product suppliers should be required to facilitate.

Appendix B – Interview Questions for FSP sample population

Questions for Advisers

Dear Name and Surname,

I am Nonku / Simphiwe, calling on behalf of Riyaad Tar. Thank you for responding to my email about the study on the perceptions of advisers on financial advisory fee-based models (in the absence of commission) should the South African Financial industry migrate to a fee-based model. You have provided this contact number and indicated this time on the SurveyMonkey form as suitable to answer some questions by telephonic interview. We will start by collecting some demographic information about yourself and then proceed to the research specific questions. Please confirm that you have at least 10 min to conduct this telephonic interview before we proceed;

Please confirm the following for demographic purposes:

- What is your gender?
- What is your age?
- How long have you been an adviser?

With regards to the research study, please answer the following;

- Can I confirm what types of financial services do you offer by indicating a Yes or a No to the following:
    - Investment advice? Yes / No
    - Life Insurance advice? Yes / No
    - Estate Planning advice? (Wills & Trusts) Yes / No
- How do each of these services create value for the consumer?
- Should the south African Financial services industry move to a fee-based model over-time, would you leave the industry if you could not earn commission? If so, what would you do?
- What percentage of your time is spent in actual client interaction providing advice?
- What constitutes this advice?

- Hypothetically speaking, what pricing model would you use for each of your advice services in the absence of commission and how much would you charge for each in this pricing model?
- Hypothetically speaking, what percentage of your customers do you think you would lose if advice fee-based models were implemented? Why do you think you would lose these customers?
- How would you adapt your service offering in the absence of a commission based model? How would you convince these customers to pay for advice?
- If not from you, where do you think customers will start seeking advice on financial products if they did not want to pay advisory fees?
- How would you suggest the banks restructure remuneration to advisers where commission-type remuneration is removed?

Appendix C – Interview Questions for Consumer sample population

<u>Questions for consumers</u>

Dear Potential participant,

I am Nonku / Simphiwe, calling on behalf of Riyaad Tar. Thank you for responding to my email about my study on the perceptions of consumers on a financial advisory fee-based models (in the absence of commission) under the FSB RDR review. You have provided this contact number and indicated this time on the SurveyMonkey form as suitable to answer some questions by telephonic interview. We will start by collecting some demographic information about yourself and then proceed to the research specific questions. Please confirm that you have at least 10 min to conduct this telephonic interview before we proceed;

Please confirm the following for demographic purposes:

- What is your gender?
- What is your age?
- What industry do you work in?
- What is your job title?
- Do you earn above or below R700,000 per annum?
- Do you currently pay for an investment or long-term insurance type of product?
- Are you aware of the fees you pay for these products? Please tell us about these fees?

  With regards to the research study, please answer the following;

- What services do you expect a financial service provider to provide when you are purchasing an investment or insurance product?
- How would you define ‘advice’ (guidance around purchasing a financial product) when purchasing an investment or insurance product?
- What qualities would you expect to see in an FSP providing advice to you?
- What value proposition would attract you to seek service from this FSP?

In the current financial services structure, you as a consumer pay an administrative fee to the product supplier. This administrative fee is a percentage of the premium you pay towards your investment or insurance product. Depending on the type of financial product you purchase this administrative fee could be between 7-20%. This means on a premium of 1500 per month, you pay between R105-300 in fees. Under the RDR reform, these administrative fees may be reduced AND you will have to pay for “advice” separately to the financial advisor selling the product to you.

- Would you pay for financial advice?
- Please rate how much you trust advice about recommending the purchase of financial products from the following sources from 1-5 (1- I don’t trust it at all, 5 – I trust this source of advice 100%)
    - Advice from your bank
        - Through an FSP
        - Through a Robo-advisor
        - Through a call centre
    - Advice from an independent/ outside advisor
    - Advice from friends and family
    - Advice from mathematical software designed to recommend financial products
    - Advice from the internet

Appendix D – Email content sent out to participants

Dear Wits Alumni / Student / FSP

My name is Riyaad Tar. I am a final year MBA student, conducting a research study on the perceptions of consumers and financial service providers (FSPs) on a fee-based remuneration model for financial advice provided before a decision is made to purchase financial instruments, such as investment or insurance schemes. This research is in fulfilment of the research requirement for the WBS MBA program.

Introduction:

I am doing research on the perception of consumers and FSPs on fee-based advisory models. What I want to investigate is how consumers would value advice and what it constitutes vs how FSPs would value advice and what it constitutes, to develop a pricing and service benchmark for the financial industries preparing for the Retail Distribution Review (RDR) reform. The RDR reform is a regulatory framework that has been proposed by the Financial Services Board (FSB) in South Africa and will become implemented in three phases starting this year 2017. This regulatory reform hopes to provide more transparency and fair outcomes for consumers interacting with FSPs and financial product suppliers, while also uplifting professionalism in the financial services industry. This reform will affect both consumers and FSPs as one of the key regulatory reforms is to introduce financial advice as a formal and distinguished service offering, paid for by the consumer, as well as to remove commission based remuneration for FSPs so that they are able to provide unbiased product information to consumers without conflicting interests from product suppliers who offer higher commissions for products sold.

Invitation to participate: I would like to invite you, as a participant in the financial services market to participate in this study.

What is involved in the study: This study will collect information about the perceptions of consumers and FSPs on fee-based advice models through telephonic interviews. This means that, as a participant you will be asked a pre-set list of questions. It is anticipated that an interview will take up to 10 minutes of your time as a participant. Interviews will be telephonically, at a time that is most convenient to you. Your participation is voluntary and you may withdraw or refuse to answer any of the questions during the interview. Interviews will be recorded and transcribed thereafter so that they may be analysed for the research report. Personal and identifiable information will not be recorded during the interview process.

Benefits: this study may help you with a better understanding of new regulatory frameworks that will come into effect in the near future and what your role and rights are as a consumer in the financial industry.

If you are an FSP, this study may help you better understand the new regulatory reforms of RDR and how you can better prepare for the changes that will take effect soon.

The participant will be given pertinent information on the study while involved in the project and after the results are available. Participation is voluntary and a refusal to participate will involve no penalty or consequence. A participant may also discontinue participation at any time without penalty or consequence.

Contact details of researcher/s: Should you have further queries on the study or would like a copy of the proposal, please feel free to contact me on; riyaadt07@gmail.com or 076 242 7711

If you are interested in taking part in this study, please provide us with your contact details and a suitable time for us to call you by following this link. I would like to thank you in advance for your participation in my research

Appendix E – FSP annual salaries and commissions from AIFA

Advisor Study No	Yearly earnings	What percentage of monthly earnings is commission
1	2 069 705	80%
2	1 819 533	71%
3	1 441 413	63%
4	1 247 645	64%
5	1 480 711	78%
6	1 144 342	64%
7	1 108 284	67%
8	950 718	64%
9	1 066 201	77%
10	981 886	79%
11	946 462	77%
12	649 466	56%
13	766 871	67%
14	666 920	60%
15	539 956	55%
16	492 514	75%
17	374 090	59%