FAIS calls advisors back to basics

By Anton Swanepoel, Senior Financial Planner at Alexander Forbes Financial Planning Consultants and author of "Invest like a Pro".

The financial services industry is entering a new era with the implementation of the FAIS Bill, as this legislation is aimed at protecting the consumer and enhancing the integrity of South African financial services.

Advisors are faced with fresh challenges as the new legislation makes it clear that they are responsible for enabling their clients to make informed decisions.

The Bill makes provision for the drafting of a code of conduct that places the following obligations on advisors:

* Act honestly and fairly, with due skill and diligence;
* Act in the interest of clients and the integrity of the financial services industry.

In a selling environment the focus is on the product. In many cases this approach does not serve the interests of the client, as it may not be the appropriate solution relative to the need. Giving professional financial and investment advice in the best interest of the client is something completely different. Creating a professional environment within the industry starts with changing the approach of the advisor, as he/she is the person who has to do the job – the one that has first contact with the client.

To comply with the new regulations, advisors will have to go back to the drawing board. Hopefully the product factories will supply part of the board and some of the chalk, as they have an enormous responsibility towards the people who bring in their business and ultimately they have the same responsibility to the consumer.

Five keys to compliance

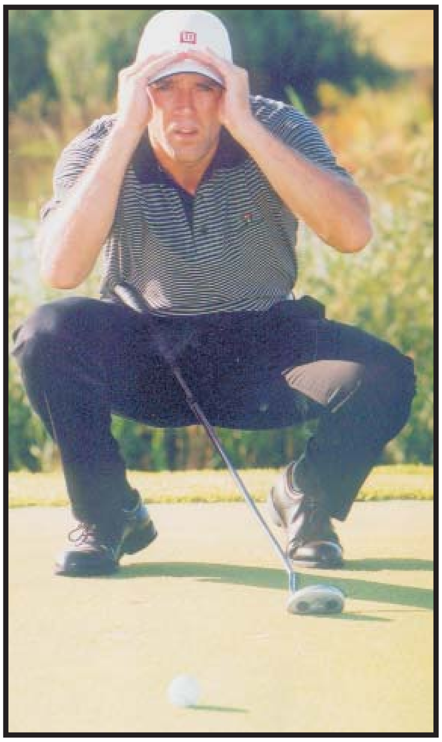
This article aims to give practical guidelines to advisors to assist their clients in making well-informed decisions.

There are five basic elements that just must be confirmed in writing:

1. Identifying the objective/goal/ target

The code requires that advisors seek appropriate and available information from clients regarding their financial situation, financial product experience and objectives in connection with the financial service required.

To illustrate the importance of this fundamental principle, readers are reminded of South African golfer



Ernie Els' final putt in the 2002 British Open Championship. That last five-foot putt required important homework. Els had to investigate the line of the put and did not just go up to the ball hitting it in a general direction. He knew exactly where his target was - and that was the single most important principle of his winning putt.

However, it did not happen automatically. He made every effort to find the right line, first doing the necessary 'homework'.

Marcus Aurelius said: 'Without a purpose, nothing should be done.' Don Harold explains why many clients complain from time to time: 'Unhappiness is not knowing what we want and killing ourselves to get it.' An investor who does not know where he/she is going, does not know what he/she wants.

Over the years I have seen that every complaint in financial services originates from the target and as in golf, once the target is identified, everything else should follow in that direction. That is why I agree with the quote from Horace: 'The beginning is the most important part of the work.'

It is important that advisor and client understand the target and work together towards the same goal. If the goal/mandate is not in writing it opens numerous opportunities for speculation, and this is where happiness or unhappiness is born.

Whenever a change is made to an existing product or portfolio, it is important to reconfirm the goal. Only then will it be possible to explain the reason for the change, as the product must always complement the goal. It should also be in writing as it puts the advisor in a position to avoid uncertainty and to give substantial meaning to everything that follows.

2. Specifying the benchmark in order to measure performance

A benchmark gives the advisor and client an objective guideline to keep them focused on the target. If the right benchmark is explained to the client and confirmed in writing, there can never be any dispute about the target, nor about how performance will be measured.

If there is no benchmark, how will performance be evaluated? It often happens that clients hear of other products or better performing investments, and they compare those products with the ones they have. This normally leads to a debate with the advisor and demands for an explanation.

Clients often forget what they have been told and they lose focus. In most cases, these products that the client heard of are aimed at achieving goals different to those of the client.

An improper benchmark aims in the wrong direction and leads to implementation of inappropriate products and inappropriate measurement of performance.

An objective benchmark is the only one that can be measured realistically as it removes most of the emotion and elements that do not apply to the goal that was agreed to.

For instance, if an investor's goal is wealth preservation, the appropriate benchmark is inflation because if an investment does not beat inflation, the investor will lose money in real terms. If the benchmark is aligned with the goal, there can be no question about results. Investors are often keen to use other benchmarks like the Dow-Jones index or the ALSI 40 to measure performance. The problem is that they use indicators or benchmarks that are irrelevant to their target. Their initial target was wealth preservation and not 'let's just invest in US and/or SA equities'.

Tiger Woods says: 'The grip is the cornerstone of the swing. Everything else (in the swing) revolves around it.' That is why advisors and clients need to get a grip on the right benchmark. Being the cornerstone of the investment process, everything else should revolve around it when performance is measured.

If the appropriate benchmark relative to the goal is explained and confirmed in writing, it will take care of selective memories and protect advisors from unreasonable and unrealistic client expectations.

3. A summary of the plan aimed at achieving the objective

The late Harvey Penick was a legendary golfing coach. His most important lesson, apart from loving a good grip, was: 'Take dead aim.'

If we analyse Els' last putt in the British Open, it is clear that he was desperately seeking victory in this special event. He was extremely focused on the target and made very sure that he 'took dead aim' to the hole. Knowing where to go and aiming at the target were vital elements to Els' eventual success in the British Open.

The same principle applies to consumers, but FAIS places an obligation on advisors to take responsibility for this process. Therefore advisors will have to be able to prove that they took the necessary steps to inform their clients of what the product is designed to do.

If advisors can give clients an executive summary of the contents of the products they are advising them to buy or invest in, it should be relatively easy to give a client peace of mind that the suggested products are aimed in the right direction.

For instance, a summary of risk benefits pertaining to an insurance product is a practical way to explain the big picture. The Policyholder Protection Rules should take care of the rest. As people tend to remember the big picture, it should be presented in a very practical way - easy to understand and easy to remember.

Advisors should consider giving clients a practical illustration of how investment risk is diversified. An executive summary of the asset allocation to confirm the nature of the portfolio should suffice. The big picture must be clear as it will be better understood and remembered.

To inform achieves nothing if it is not understood.

4. Confirming the advisor's service model

After the first three principles have been confirmed, advisors should explain to clients how their service model will assist the client in achieving his/her objectives. Before any final decision can be made, the consumer needs to be satisfied with the advisor's service model.

As advisors may lose their registration with the FSB if they do not honour their commitments to their clients,

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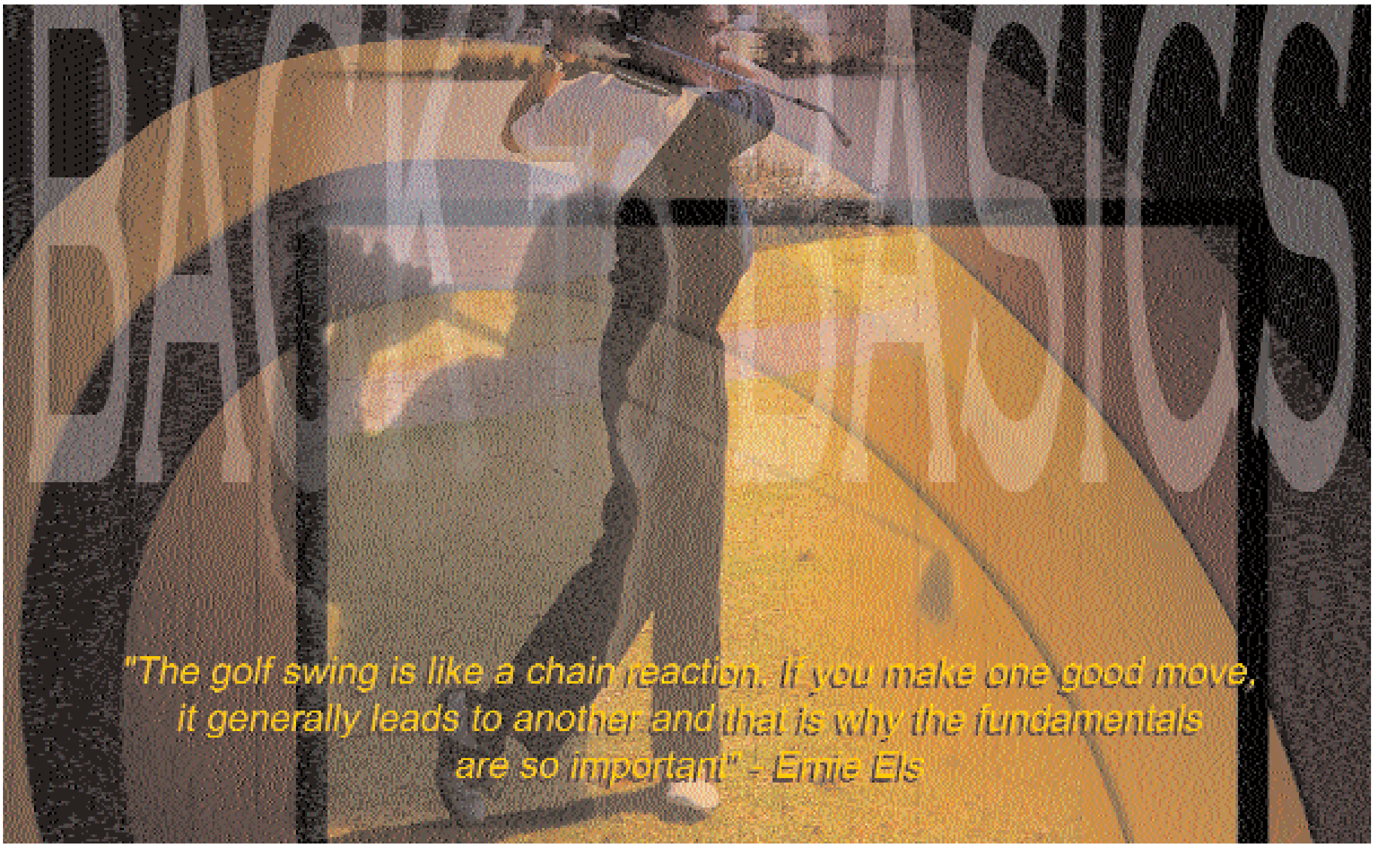

it is important that advisors do not over-commit and under-deliver in this area. It is vital to offer a realistic service model that can take care of the client after implementation of the plan. Putting it in writing is equally important as it serves as a sound source of reference for both parties.

Ideally the advisor's interests and actions must be aligned with the client's goal(s). Confirming this in writing after taking care of the previous fundamentals should give clients peace of mind about the advisor's advice and ongoing service model.

5. Fees

Explaining and confirming in writing how much everything is going to cost is the last element, but obviously not the least.

Without the five above elements it will be impossible for any consumer to make a well-informed, balanced decision. In the absence of written documentation, advisors will have a difficult time to convince anyone that they complied with the code.

Investing is not an event – it is a process. One good move normally leads to another. This article focused on how to assist clients in making a decision. Comprehensive compliance in terms of FAIS starts with a deep understanding of all the basic elements of the full process.

'The golf swing is like a chain reaction. If you make one good move, it generally leads to another and that is why the fundamentals are so important' – Ernie Els.

Come back to basics and compliance will be like playing golf – always better when things are done correctly!