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COFI regulation: Elevating standards in financial advice and market conduct

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The financial services industry has long been governed by regulations aimed at ensuring the stability of the financial system, market integrity and protecting consumers. In recent years, however, the regulatory landscape has undergone significant changes, driven by increasing demand for greater transparency, accountability, and consumer protection. One such regulatory shift is the imminent introduction of the Conduct of Financial Institutions (COFI) Bill in South Africa, designed to change how financial institutions operate and how they interact with their clients to ensure fair consumer outcomes.

The COFI regulations are poised to have a significant effect on many stakeholders across the value chain, including consumers, financial institutions, and particularly financial advisers, as they adjust to this new reality. "

The COFI Bill: Enhancing market conduct and consumer protection

COFI is part of South Africa's broader Twin Peaks regulatory framework restructure, which focuses on market conduct and financial stability. The framework aims to ensure that financial institutions not only maintain financial soundness and stability but also treat customers fairly and operate ethically and with integrity. COFI is primarily concerned with conduct and culture of financial market participants, aiming to reshape how financial institutions serve consumers across financial product lines, whether in banking, insurance, or investment management. With an eye toward changing how financial institutions serve consumers across these product lines, the Act is mostly focused on behaviour and culture.

Fundamentally, COFI aims to enhance ethical market conduct by:

- Encouraging equitable consumer outcomes.
- Encouraging responsible business conduct.
- Developing public confidence in financial institutions.
- Bringing South Africa's financial services industry into line with consumer protection global standards.

By including customer protection ideals into the very fabric of financial institutions regulation, this all-encompassing approach fills in any potential gaps in current practices.

Key effects of COFI on stakeholders

1. Clients

COFI's focus on ethical business practices and fair treatment helps consumers to encounter more transparency through their interactions with financial services providers. Providers will be obliged to ensure their products are suited to the needs and circumstances of their clients, meaning fewer incidents of mis-sold products or opaque contract terms. This higher standard and increased accountability to providers will seek to inspire confidence in the sector and allow for more informed decision-making.

2. Financial institutions

Under COFI, financial institutions will face a significant shift in the way they operate and how they conduct business. The proposed legislation places greater emphasis on governance and culture, requiring institutions to demonstrate that they are embedding a customer-centric culture throughout their product life cycles. This means that institutions must not only comply with technical aspects of the law but also ensure that the interests of customers are at the forefront of their practices, and they act in an ethical manner. As institutions make investments in systems and processes to measure the values COFI seeks to imbed, it is expected that compliance costs will increase.

Over time, however, the advantages of COFI should exceed the initial expense increase. Financial institutions who adopt and embrace the new regulation and enhance their service quality, will most likely benefit through increased customer satisfaction that follows, reduce reputational risks, and set themselves apart from peers.

3. Financial Sector Conduct Authority (FSCA)

COFI gives the FSCA a more robust framework for handling market conduct concerns. It will improve their capacity to identify potential misconduct and act early in cases of possible misconduct, so ensuring that financial institutions maintain and uphold the principles of fairness and transparency. It also allows authorities to have a better understanding of market practices, so reducing risks and supporting a stable financial system.

The impact on financial advisers

Of all stakeholders, financial advisers will feel the effect of COFI the most. With financial advisers linking financial institutions to consumers, thus COFI's customer-centric values will directly influence their interaction with clients.

For financial advisers, there are several main areas of impact:

1. Enhanced standards of advice and customer understanding

COFI places increased emphasis on the quality of financial advice given to consumers. Financial advisers will need to ensure that the advice they provide is not only compliant with regulatory standards but also aligned with the best interests of the client. This will require a deeper understanding of the customer's financial needs, goals, and risk tolerance, and further a deeper understanding of financial products, advising on products that genuinely meet these criteria.

Practically, this could mean more thorough documentation of the advice process, more frequent evaluations of client situations, and continuous education for advisers to remain current with laws. Although this might seem no different to the current regulatory environment, the difference in my mind would be the requirement to have a deeper understanding of each provider's product and the various funds used within a client portfolio to make recommendations.

2. Greater accountability and oversight

Under COFI, financial advisers will need to demonstrate that their conduct aligns with the institution's overall culture of fair treatment and client care. This might involve more frequent audits or compliance checks, especially in high-risk areas like retirement planning, insurance products, or sophisticated investment vehicles.

Advisers will need to ensure they are adequately equipped to handle the potential for additional oversight by maintaining high standards of professional integrity.

Additionally, product providers will be required to closely monitor the activities of advisers distributing their products.

3. Shifting advice practice business models

As institutions adjust to COFI's new requirements, the business models of financial advice practices may shift as well. Advisers who previously operated on commission-based structures might see changes in how they are compensated, as COFI pushes for more transparent fee structures and reduced conflicts of interest. Advisers will likely need to embrace a model that prioritises long-term relationships over quick sales, focusing on building trust through transparent and consistent client service.

4. Client retention and trust

On the upside, the growing trust COFI hopes to inspire in the market should benefit financial advisers. As clients become more confident in the integrity of financial institutions and advisers, the likelihood of positive long-term relationships increases. Advisers who proactively adopt COFI's principles of fairness and transparency will likely stand out from the competition, gaining a reputation for ethical, client-first advice.

By prioritising education, improving communication, and focusing on tailored financial solutions, advisers can strengthen their position as trusted partners in their clients' financial journeys.

Navigating the investment landscape with COFI

COFI represents a significant positive change in South Africa's financial services regulatory environment, and I believe that its impact will be felt across the product value chain. For financial advisers, the transition may bring challenges in terms of increased compliance assessments, changing business models, and a shift towards more client-centric advice. However, those who adapt quickly and embrace the principles behind COFI will be better positioned to build long-term trust with their clients, differentiate themselves in an increasingly competitive marketplace, and ultimately survive into the future, which will result in better client-centric solutions provided.

The regulation should be viewed as an opportunity to align with global best practice and play a key role in driving the progression of the financial services industry towards greater fairness, transparency, inclusion and consumer protection.