

Module # 1



Establish and Define a Professional Relationship with the Client

Tasks for this Module

The material provided in this guide is based on the following tasks, as published in Board Notice 105 of 2008 as amended by Board Notice 60 of 2010:

Skills Criteria

1	Establish and define a professional relationship with your client.
2	Gather information in order to conduct a basic needs analysis for a client.
3	Analyse and evaluate the client's financial status as part of a basic needs analysis.
4	Develop and present a financial plan with recommendations and alternatives.
5	Implement the financial plan and recommendations.
6	Monitor the financial plan and recommendations.

Please note that any reference to:

- masculine gender implies also the feminine
- singular indicates also the plural, and vice-versa.

KNOWLEDGE CRITERIA

Describe how the FAIS Code of Conduct is applied when providing financial advice to a client.
Discuss the product disclosures that should be made to clients, both upfront and ongoing.



Purpose

The purpose of this chapter is to highlight the requirements that have to be met when providing advice in respect of CISs. The FAIS requirements do not hold true only when providing advice on CISs but for all financial products.

Glossary of Terms

CIS means a Collective Investment Scheme as defined in Section 1 of CISCA.

CISCA means the Collective Investment Schemes Control Act, Act 45 of 2002.

CIS Portfolio means a portfolio as defined in Section 1 of CISCA.

CIS Manager means a manager as defined in Section 1 of CISCA.

FAIS means the Financial Advisory and Intermediary Services Act, Act 37 of 2002.

General Code means the FAIS General Code of Conduct, Board Notice 80 of 2003.

Registrar means the registrar for CIS established in terms of section 7 of CISCA.

Introduction

The concept of a collective investment scheme ("CIS") may not be as familiar a concept as that of a unit trust fund. For a long time, the South African investor only knew unit trusts as investment vehicles. The Unit Trust Control Act 54 of 1981, and regulations issued thereunder, regulated unit trust investments.

In an effort to align the South African investor landscape to that of global developments, the Collective Investment Schemes Control Act of 2002 ("CISCA") was introduced with effect from 3 March 2002. CISCA recognises and attempts to regulate the much wider concept of collective investments, not only through the well-known vehicle of a trust (from the term "unit trust") but also through other vehicles such as an open-ended investment company (a concept not widely used in South Africa). CISCA also specifically regulates collective investment schemes in security, property and bonds (more about these later in this module).

Today, the collective investment scheme is a highly regulated investment vehicle, and financial services providers ("FSPs") will be well advised to ensure that they understand the obligations of the various role-players, the different types of collective investment schemes and fees associated with them, to name but few. Only then will it be possible to advise and service clients effectively.

Application of FAIS

As we all know (at this stage), the Financial Advisory and Intermediary Services Act 37 of 2002 ("FAIS") governs the rendering of intermediary services and the provision of advice in respect of a financial product. Section 1 of FAIS includes participatory interests in CISs in the definition of a financial product and it is therefore necessary to consider FAIS and subordinate legislation thereto when providing advice or rendering intermediary services in respect of, *inter alia*, participatory interests in CIS.

Section 16 of FAIS prescribes that a code of conduct must be drafted in such a manner as to ensure that the clients who are recipients of the financial service:

1. are in a position to make informed decisions; and
2. that their reasonable financial needs are appropriately and suitably satisfied by the financial product.

As required by section 16, the FAIS General Code of Conduct for authorised Financial Services Providers (FSPs) and Representatives ("General Code") prescribes principles that must be followed by FSPs when providing clients with financial services.

These two principles should form the basis of any attempts at interpretation and practical application of the General Code. The General Code refers to principles rather than steps that need to be complied with. These principles find application in what is commonly known as the six-step financial planning process, and will form the basis of the discussion relating to CISs.

Establish and define a professional relationship

Application of the General Code when providing financial advice to clients

General Obligations

The General Code, Sections 3((a) to (f), specifies certain overarching obligations that an FSP has to comply with. These obligations are the following:

- (a) representations made and information provided to a client by the FSP –
 - i. must be factually correct;
 - ii. must be provided in plain language, avoid uncertainty or confusion and not be misleading;
 - iii. must be adequate and appropriate in the circumstances of the particular financial service, taking into account the factually established or reasonably assumed level of knowledge of the client;
 - iv. must be provided timeously so as to afford the client reasonably sufficient time to make an informed decision about the proposed transaction;
 - v. may, subject to the provisions of this Code, be provided orally and, at the client's request, confirmed in writing within a reasonable time after such request;
 - vi. must, where provided in writing or by means of standard forms or format, be in a clear and readable print size, spacing and format;
 - vii. must, as regards all amounts, sums, values, charges, fees, remuneration or monetary obligations mentioned or referred to therein and payable to the product supplier or the provider, be reflected in specific monetary terms: provided that where any such amount, sum, value, charge, fee, remuneration or monetary obligation is not reasonably predeterminable, its basis of calculation must be adequately described; and
 - viii. need not be duplicated or repeated to the same client unless material or significant changes affecting that client occur, or the relevant financial service renders it necessary, in which case a disclosure of the changes to the client must be made without delay;
- (b) the FSP must disclose to the client the existence of any personal interest in the relevant service, or of any circumstance which gives rise to an actual or potential conflict of interest in relation to such service, and take all reasonable steps to ensure fair treatment of the client;
- (c) non-cash incentives offered and/or other indirect consideration payable by another provider, a product supplier or any other person to the provider could be viewed as a potential conflict of interest;
- (d) the service must be rendered in accordance with the contractual relationship and reasonable requests or instructions of the client, which must be executed as soon as reasonably possible and with due regard to the interests of the client which must be accorded appropriate priority over any interests of the provider;
- (e) transactions of a client must be accurately accounted for; and

- (f) the provider involved must not deal in any financial product for own benefit, account or interest where the dealing is based upon advance knowledge of pending transactions for or with clients, or on any nonpublic information the disclosure of which would be expected to affect the prices of such product.

Disclosures

Section 16(2) of FAIS stipulates that this code of conduct (being the General Code) must contain provisions relating to making adequate disclosures of relevant and material information, including disclosures of actual or potential own interests, in relation to dealings with clients.

Section 6 of the General Code prescribes that an FSP, who is not a direct marketer, must at the commencement of any call, contact or visit initiated by the FSP, explain the purpose of the call, contact or visit and provide the information as prescribed in Section 5 of the General Code.

FSP disclosures

Section 5 requires the FSP “at the earliest reasonable opportunity” to disclose to the client:

- a) full business and trade names, registration number (if any), postal and physical addresses, telephone and, where applicable, cellular phone number, and internet and e-mail addresses, in respect of the relevant business carried on, as well as the names and contact details of appropriate contact persons or offices;
- b) concise details of the legal and contractual status of the FSP, including details as regards the relevant product supplier (or, in the case of a representative, as regards the relevant FSP and product supplier), to be provided in a manner which can reasonably be expected to make it clear to the client which entity accepts responsibility for the actions of the FSP or representative in the rendering of the financial service involved and the extent to which the client will have to accept such responsibility;
- c) names and contact details of the relevant compliance department or, in the case of a representative, such detail concerning the provider to which the representative is contracted;
- d) details of the financial services which the FSP is authorised to provide in terms of the relevant licence and of any conditions or restrictions applicable thereto;
- e) whether the FSP holds guarantees or professional indemnity or fidelity insurance cover or not.
- f) whether a representative of an FSP is rendering services under supervision as defined in the Determination of Fit and Proper Requirements; and
- g) the existence of a specific exemption that the Registrar may have granted to the FSP with regard to any matter covered by the Act.

Product Supplier disclosures

In addition to the disclosures detailed above, the FSP must also at the earliest reasonable opportunity, disclose information relating to the product supplier. This information would, in the current context, relate to the CIS manager. This information must contain the following:

- a) Name, physical location, and postal and telephone contact details of the product supplier;
- b) (i) the contractual relationship with the product supplier (if any), and whether the provider has contractual relationships with other product suppliers;
(ii) names and contact details of the relevant compliance and complaints departments of the product supplier;
- a) the existence of any conditions or restrictions imposed by the product supplier with regard to the types of financial products or services that may be provided or rendered by the provider; and
- b) where applicable, the fact that the provider –
 - i. directly or indirectly holds more than 10% of the relevant product supplier's shares, or has any equivalent substantial financial interest in the product supplier;
 - ii. during the preceding 12-month period received more than 30% of total remuneration, including commission, from the product supplier, and the provider must convey any changes thereafter in regard to such information at the earliest opportunity to the client.

Where a product supplier that is also an FSP enters into an intermediary contract or similar contractual relationship with another FSP (not being a representative) for the purpose of that other FSP rendering financial services in respect of the product supplier's financial products, that product supplier must within a reasonable time after being requested to do so by the other FSP, provide the other FSP with sufficient particulars to enable the other FSP to comply with the disclosure requirements relating to the furnishing of details of the product supplier and the product in question.

Where these disclosures are made orally, the FSP that is not a direct marketer must confirm them in writing within 30 days.

Product disclosures made to clients (upfront and ongoing)

Section 7 of the General Code goes further to require an FSP that is not a direct marketer to, at the earliest reasonable opportunity, make prescribed product disclosures to the client. Once again where these product disclosures are made verbally, they must be confirmed by the FSP in writing within 30 days.

These product disclosures are:

- a) that the FSP must provide a reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision;
- b) whenever reasonable and appropriate, that the FSP must provide the client with any material contractual information and any material illustrations, projections or forecasts in the possession of the FSP;
- c) at the earliest reasonable opportunity, that the FSP must provide, where applicable, full and appropriate information of the following:
 - i. Name, class or type of financial product concerned;
 - ii. Nature and extent of benefits to be provided, including details of the manner in which such benefits are derived or calculated and the manner in which they will accrue or be paid;
 - iii. Where the financial product is marketed or positioned as an investment or as having an investment component:
 - ca. concise details of the manner in which the value of the investment is determined, including concise details of any underlying assets or other financial instruments;
 - cb. separate disclosure (and not mere disclosure of an all-inclusive fee or charge) of any charges and fees to be levied against the product, including-
 - A. the amount and frequency thereof;
 - B. the identity of the recipient;
 - C. the services or other purpose for which each fee or charge is levied;
 - D. where any charges or fees are to be levied in respect of investment performance, details of the frequency, performance measurement period (including any part of the period prior to the client's particular investment) and performance benchmarks or other criteria applicable to such charges or fees; and
 - E. where the specific structure of the product entails other underlying financial products, disclosure must be made in such a manner as to enable the client to determine the net investment amount ultimately invested for the benefit of the client; and
- cc. on request, information concerning the past investment performance of the product over periods and at intervals which are reasonable with regard to the type of product involved including a warning that past performances are not necessarily indicative of future performances;

- cd. any rebate arrangements and thereafter on a regular basis (but not less frequently than annually): Provided that where the rebate arrangement is initially disclosed in percentage terms, an example using actual monetary amounts must be given and disclosure in specific monetary terms must be made at the earliest reasonable opportunity thereafter: Provided further that for the purposes of this subparagraph, "rebate" means a discount on the administration, management or any other fee that is passed through to the client, whether by reduced fees, the purchase of additional investments or direct payment, and that the term "rebate" must be used in the disclosure concerned, to describe any arrangement complying with this definition, and the disclosure must include an explanation of the arrangement in line with this definition;
- ce. any platform fee arrangements, which may be disclosed by informing the client that a platform fee of up to a stated percentage may be paid by the product supplier to the administrative FSP concerned, rather than disclosing the actual monetary amount: provided that for the purposes of this sub-paragraph, "platform fee" means a payment by a product supplier to an administrative FSP for the administration and/or distribution and/or marketing cost savings represented by the distribution opportunity presented by the administrative platform, and may be structured as a stipulated monetary amount or a volume-based percentage of assets held on the platform, and that the term "platform fee" must be used in the disclosure concerned, to describe any arrangement complying with this definition, and the disclosure must include an explanation of the arrangement in line with this definition.
- iv. the nature and extent of monetary obligations assumed by the client, directly or indirectly, in favour of the product supplier, including the manner of payment or discharge thereof, the frequency thereof, the consequences of non-compliance and, subject to subparagraph (xiv), any anticipated or contractual escalations, increases or additions;
- v. the nature and extent of monetary obligations assumed by the client, directly or indirectly, in favour of the FSP, including the manner of payment or discharge thereof, the frequency thereof, and the consequences of non-compliance;

- vi. the nature, extent and frequency of any incentive, remuneration, consideration, commission, fee or brokerages ("valuable consideration"), which will or may become payable to the FSP, directly or indirectly, by any product supplier or any person other than the client, or for which the FSP may become eligible, as a result of rendering of the financial service, as well as the identity of the product supplier or other person providing or offering the valuable consideration: Provided that where the maximum amount or rate of such valuable consideration is prescribed by any law, the FSP may (subject to Clause 3(1)(a)(vii)) elect to disclose either the actual amount applicable or such prescribed maximum amount or rate;
 - vii. concise details of any special terms or conditions, exclusions of liability, waiting periods, loadings, penalties, excesses, restrictions or circumstances in which benefits will not be provided;
 - viii. any guaranteed minimum benefits or other guarantees;
 - ix. to what extent the product is readily realisable or the funds concerned are accessible;
 - x. any restrictions on or penalties for early termination of or withdrawal from the product, or other effects, if any, of such termination or withdrawal;
 - xi. material tax considerations;
 - xii. whether cooling off rights are offered and, if so, procedures for the exercise of such rights;
 - xiii. any material investment or other risks associated with the product; and
 - xiv. in the case of an insurance product in respect of which provision is made for increase of premiums, the amount of the increased premium for the first five (5) years and thereafter on a five-year (5-year) basis but not exceeding twenty (20) years;
- d) fully inform a client in regard to the completion or submission of any transaction requirement–
- i. that all material facts must be accurately and properly disclosed, and that the accuracy and completeness of all answers, statements or other information provided by or on behalf of the client, are the client's own responsibility;
 - ii. that if the FSP completes or submits any transaction requirement on behalf of the client, the client should be satisfied as to the accuracy and completeness of the details;
 - iii. of the possible consequences of the misrepresentation or nondisclosure of a material fact or the inclusion of incorrect information; and
 - iv. that the client must on request be supplied with a copy or written or printed record of any transaction requirement within a reasonable time.

Furthermore, an FSP who has provided advice or is rendering ongoing financial services to the client in respect of one (1) or more financial products, must on a regular basis (but not less frequently than annually) provide the client with a written statement identifying such products that are still in existence, and provide brief current details (where applicable), of –

- a) any ongoing monetary obligations of the client in respect of such products;
- b) the main benefits provided by the products;
- c) where any product was marketed or positioned as an investment or as having an investment component, the value of the investment and the amount of such value which is accessible to the client; and
- d) any ongoing incentives, consideration, commission, fee or brokerage payable to the FSP in respect of such products;

provided that such a statement need not be provided where the client is aware, or ought reasonably to be aware, that the FSP concerned does not render or has ceased rendering ongoing financial services in respect of the client or the products concerned.

Conclusion

It is evident from the content of disclosures listed above that the intention of the legislature is for the client contemplating an investment or investing in a financial product to be as informed as possible in order for that client or potential client to make an informed decision when investing or transacting on the client's investment(s).

Unfortunately these disclosures are voluminous and complicated for the layperson. In practice these disclosures are made in, *inter alia*, the Letter of Introduction, the Quote and the Application Form. Clients often do not read these documents as they are, for example, of the opinion that the "fine print" is too much, they are not able to read for various reasons, or the concepts are too complicated. Often these clients do not adequately appreciate the consequences of entering into the contract with the manager.

In order to address this issue, the Consumer Protection Act 68 of 2008 was promulgated and has introduced the concept of plain and simple language. The aim of these provisions is to make "consumer" documents (such as the documents listed above) plain and simple for the layperson to read and understand. A potential negative implication of the plain and simple language provisions is that it often results in a lengthier document(s) for the client to read. Despite all the attempts at full disclosure and plain and simple language, the obligation still rests on the FSP and representatives to ensure that their clients understand what they are investing in and the key terms and conditions that govern the investment.

Summary

In this chapter, we considered the requirements specified in the General Code which govern the establishment of a professional relationship that an FSP must have with the FSP's clients.

In essence, the General Code sets general rules of conduct (section 3) and prescribes mandatory disclosures that have to be made by the FSP to the client relating to the product supplier, the FSP itself (being the provider – section 5), the nature of the financial service being provided, and the financial product(s) being considered (section 7).

These disclosures are directed at ensuring that the client can make an informed decision as to whether the client should purchase the financial product based on the identity of the FSP, the product supplier, the specific product rules and the costs associated with making the investment.