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Reflections on three decades of financial regulations

Key take-aways

- South Africa has made significant strides in safeguarding individual investor welfare through legislation and regulation involving worker representation on pension fund boards, client reporting standards, detecting financial crime, data protection, needs-based selling, etc... that many individuals may be unaware of.
- Our investment industry is world-class, but more needs to be done in terms of investor education, pro-active investigation of criminal financial transactions, differing interpretations of standards, and closer surveillance of insider trading and market manipulation, among others.
- Information verification has proved to be cumbersome and an additional barrier to investing,

In a few months, I will be taking a break from financial services so that I can follow an old dream of going back to full-time study for several years. I am doing this in consultation with M&G's leadership, and we have spent the last few months making sure that I fully hand over my responsibilities in a steady and structured way. In truth, the compliance team I have been working with for the last decade and more has been doing the "heavy lifting" for some time now, and my move is a natural progression. As soon as we have the necessary regulatory approvals, we will introduce them and their new roles.

With the decision made to follow a new path and the practical considerations in my function taken care of, I find myself reflecting on a career of 30 years in financial services. And because change and reflection of this nature makes most of us (or maybe it's just me?) quite self-involved, I find myself wanting to share some of these reflections.

Better trustee training, but what about fund members?

When I first started, the industry was engaged with significant proposed changes to the Pension Funds Act – specifically the requirement to include member-elected representatives on the management boards. I like thinking about this time because it reminds me how significant it felt then and how natural and obvious it feels now: of course members should have representation on their retirement funds. Of course the pension fund is exclusively theirs, and one of the most crucial building blocks in saving for old age and emergencies.

As a result, in these early days we were extremely busy with trustee training programmes and a cottage industry quickly followed. And right there, a side benefit of the regulatory change appeared – knowledge sharing and empowerment. Would it not be fabulous if the same could be said for investor education programmes? Why are there still exceptionally smart, engaged, curious investors running their lives, their businesses and their careers who still glaze over when the topic turns to financial products? Why is investing still a grudge purchase? Why are our investors still intimidated by our products and how they actually work? After all, if I can understand derivatives, anyone can.

Financial crime detection still falling short, despite the paperwork

The next big regulatory change introduced from the late '90s was the suite of financial crime legislation starting with regulating organised crime and ending with codifying the obligations to prevent money laundering. This has been a significant change in our industry and is, to my mind, a constant source of friction. At a theoretical level, the rationale for this legislation is obvious. Why would we want our financial services industry to become a haven for criminals and crime and a global pariah? At a practical level, oh my goodness, if financial products are already a grudge purchase, the process of proving we are who we say we are, and that our hard-earned money is actually legitimate, is overwhelming. From my perspective as both the functionary implementing the legislation and as a financial services client, I feel this tension all the time.

As far as we have come in adapting to this anti-money laundering regime, I do believe that we have not yet climbed this mountain. It still feels like our efforts are merely responsive and not pro-active detective work – as sharply evidenced during the days of state capture. My perspective is clearly from the outside of the state's detective and enforcement agencies, however, and I claim no special expertise or knowledge on this subject.

Some murky areas remain within FAIS

Around the same time as the financial crimes legislation (because waves never arrive on their own), we saw the omnibus FAIS (Financial Advisory and Intermediary Services) legislation that tried to regulate market conduct regardless of the type of

company performing financial services. This legislation, from my perspective, aims to put our clients at the centre of what we do. It has pushed consumer protection, data protection, needs-based selling, honesty, integrity and clarity in our marketing and selling, among other best practices. We in the business probably all thought we were already doing this, so perhaps it's better to say that the legislation defines how we should evidence this practice.

I wasn't intimidated by the legislation. Much of it was extremely familiar and almost borrowed wholesale from existing asset management legislation. What has been a struggle are the few round pegs squeezing into square holes. This has mostly been in the area of advice-giving, where the institutional client and retail client processes don't easily align in terms of what clients need versus what is required. And, of course, the areas of managing conflicts of interest in asset management (trading processes; deal allocations; personal account trading; etc.) and sales practices (what is allowable for client entertainment; conferencing; charity events; etc.) remain frustratingly debatable given the widely different interpretations across the industry.

Self-regulation prevails, but market still vulnerable to abuses

I have one final regulatory reflection. When I started in asset management, I was picking the brain of one of the "grey hairs" I have always sought out – their stories are the best and their egos are not or no longer inflamed. He related that when he started as a young analyst, he and his colleagues were lobbying for salary reviews. His leadership responded with: you're in possession of all the information you need to make your own salary. What

leadership was talking about was access to market analyses and data as well as client trade and investment data. Oh, the “wild west” of investing indeed. That was when, as another grey hair described it, insider trading was a national sport.

Not terribly much has changed regarding insider trading and market manipulation legislation since the early 2000's, but my experience is that much has evolved in our practices. While the threat of prosecution is indeed scary, the reputational risk in our tiny industry is, to my mind, the biggest deterrent. What I find heartening is that the industry embraced the challenge collectively. Asset management is a value chain from stockbroker research to investment analysis and decision to trade and back to stockbroker execution and settlement. By its very nature, this value chain requires collusion between parties if anyone in that chain is intending to trade in inside information or manipulate the market. It is my view that this separation of function has meant that, in recent years, incidents of insider trading and market manipulation on a mass scale have been hard to find. And because asset management is a competitive game, watch the hackles go up if we suspect someone else of trying to cheat the system! Talk about self-regulation. From my perspective, and it's a humble one, there are gaps in the legislation – some pretty big ones. Market manipulation is notoriously difficult to regulate. Its success is a collective effort.

What I take from this brief review of the big changes in our legislative landscape is that there have been great strides in keeping investors and our broader financial system safe and strong amid rapid globalisation, expanding product choice and

technological progress. Our financial system remains among the strongest in the world. I'm proud to have played a part in this and to have seen many more South Africans brought into the world of investing. In a country with an extremely fragile social security net, an investment culture and practice are absolutely critical to individual work-life standards of living and, crucially, to post-work-life dignity and security.

However, we have seen, especially in the last ten years, what the limitations of legislation are when there is a concerted and coordinated effort to undermine the rule of law. Lurching over the horizon is a new wave of financial services legislation but, as this has been a retrospective, I will leave the future of our legislation to others. I'm confident that my fellow compliance colleagues and successors are well-equipped to meet this. □

Kerry joined M&G Investments in 2010 as Head of Risk and Compliance. She is responsible for governance, which includes: regulatory compliance; operational risk management; the legal function; control insurance and responsible investment. She is a member of M&G Investments' Executive Committee and Investment Risk Management Committee as well as a permanent attendee for all Board meetings and Board Subcommittee meetings. Prior to joining M&G Investments, Kerry served as Head of Compliance at Old Mutual Investment Group. With 24 years' investment experience, Kerry has worked for various financial services providers in a range of compliance and risk management roles. Kerry's qualifications include: BA, University of KwaZulu-Natal; LLB, University of Kwa-Zulu-Natal; LLM (Distinction), University of Cape Town.