Should advisors "pay back the money"?

By Richard Rattue

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The phrase "pay back the money" has become deeply ingrained in the South African psyche, having dominated parliament and newspaper headlines for the last year or so. Should the same credo apply to financial advisors?

Should they pay back commission earned on products that subsequently turn out to be a fraudulent scheme or an otherwise bad investment?

This needs to be looked from both a strictly legal position and a principles-based approach.

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Legal approach

Let us first examine the legal position. The main pieces of legislation that cover the activities of financial advisors is the Financial Advisory and Intermediary Services Act, better known by its acronym FAIS, which was enabled in 2002 with a primary aim of regulating the provision of financial advice and ancillary services.

In broad terms, the Act requires anyone who wishes to render financial advice and/or intermediary services to register as such and gain the necessary approval from the Financial Services Board. Once approved, any advice rendered and/or product/investment recommendations made, must only be done once adequate assessment of the client's needs has been

undertaken to ensure that any recommendations made to the client are appropriate for their particular needs and circumstances.

To the best of my knowledge the FAIS legislation does not include any specific provision reflecting a requirement that advisors pay back any commission or fees earned in the event that the client loses out on an investment as a result of guidance given by their financial advisor.

Using the ombud

There is, however, legal recourse through the office of the FAIS ombud, and the aggrieved consumer can lay a complaint (provided the amount is less than R800,000), which is reviewed in terms of the conduct and paperwork supplied by the advisor.

An order can be made that the advisor must repay the amount of the investment in full, together with interest that would have accrued had the investment not been made in the first place. The amount that must be repaid is the full investment, which would therefore include any commission or fees that were deducted by the advisor or product provider before the investment was actually placed.

Applying principles

If you look at a more principles-based approach, then one must apply a principle of fairness to the situation. This could mean that in the event an advisor discharges their legal obligations correctly – did a thorough due diligence of any product structures, and still the product structure disintegrates for reasons beyond reasonable control, should the advisor then share the client's "pain" and refund a portion of their commission?

I would motivate not in such instances, but would be less forgiving if the advisor had not done the necessary homework.

I am aware of at least one instance of a product supplier who shall remain nameless, that undertook to cover costs incurred by their clients as a result of an inherited product structure that they did not directly have control over, yet they made an offer to make good, and indeed lived up to their word.

As I was a client of said firm, I can confirm that this resulted in significant upside in the relationship and resulted in further funds being placed with them. I doubt whether too many companies would follow their lead, however, I could well be wrong and indeed hope I am.

More than ticking boxes

There is no doubt we are moving towards an era where we are going to have to do more than just tick the box, and this will impact a number of areas of financial services.

In the future we may be in a situation where despite clients having signed on the line and having no strict legal claim to refunds of fees, or a portion thereof, we see principles of fairness being applied. Only time will tell.

ABOUT THE AUTHOR

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