Technology & TCF in uncertain times. Top 5 trends during the Covid-19 pandemic

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The Covid-19 pandemic has had far-reaching and irrevocable consequences for countless industries in South Africa. The financial services sector - and the way it is regulated - is no exception. The need to adapt and respond rapidly has become non-negotiable. The best way to do this is to identify the trends that will continue to shift the way the sector does business, and how it needs to be regulated to keep up with the pace of change, whilst ensuring that customers are treated fairly.

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Overall, the pandemic has highlighted that as an authority, we are regulating in line with our counterparts in other countries. The operational resilience of the global financial sector was put to the test during Covid-19, and the sector responded impressively. This period has also emphasised the importance of coordination in regulatory responses. The Twin Peaks approach in South Africa stood us in good stead for ensuring this coordination happens among financial sector regulators.

Some of the observations we made across the sector during this time include the following:

1. **The shift to digital financial services means that regulation in banking and payments needs to focus on financial inclusion and consumer protection:** even though the shift to digital banking and financial services preceded Covid-19, the pandemic forced banks to close some of their branches – temporarily or permanently – consequently, encouraging customers to utilise their digital platforms.

This presented challenges around consumer protection and financial inclusion in terms of accessibility, affordability, trust and digital literacy. Consumers were placed in the position where they had to adapt to using digital platforms without proper knowledge, which has made them vulnerable to fraud which potentially also makes them vulnerable to exclusion if they are unable to use digital platforms.

While banks continue to invest in technology directed at improving client experiences, it has become quite clear that financial regulation needs to keep pace to ensure that consumer outcomes are being protected, particularly in a digital environment.

2. **Artificial intelligence (AI) and fintech innovation hold the key to financial inclusion – but regulators need to keep up with the pace of change to avoid being left behind:** With the adoption of emerging technologies such as AI and the entry of upstart fintech firms and new financial service providers helping deploy digitised services to customers, digital disruption is a given.

   New upstart fintech firms won't necessarily wait for regulations to catch up, and regulators are at risk of being left behind as innovation outpaces the rate of regulatory change. This has made it necessary for regulators to evolve their engagement model to ensure they keep pace with the times.

   To this end, we have partnered with other key South African financial services regulators under the Intergovernmental Fintech Working Group (IFWG) umbrella and jointly with the South African Reserve Bank (Sarb) the Financial Sector Conduct Authority (FSCA) led the establishment of the Innovation Hub to ensure that fintech activity in South Africa is regulated effectively.

   The Innovation Hub provides a space for safe experimentation, collaboration, and for market innovators to resolve specific questions regarding the policy landscape and regulatory requirements.

3. **Digital disruption is forcing specialist financial services functions and support to become more vigilant and agile:** New business models in fintech and other disruptive businesses require us to be constantly learning, adapting and questioning regulation as well as identifying loop holes that exist to maintain a healthy financial system.

   Much thought needs to be placed on how to regulate the changing landscape. Covid-19 in itself will not affect the nature of supervision – that is driven by the Financial Sector Regulation Act (FSRA) and mandate requirements. How we do it may well change, in that there may be less face-to-face and travelling, for example and greater use of data and analytics in an effort to proactively identify and respond to market trends.

   This will require the FSCA to be vigilant when observing the markets and responding to changes, especially with ongoing rapid technological advancements. The advertising of financial products has largely shifted towards digital platforms, for example, which has led to an increase in scams targeting consumers who are becoming financially vulnerable because of the constrained economic environment.

   We have seen a rise in the promotion of pyramid and get-rich-quick schemes where members of the public are promised huge returns in a short space of time and get scammed of their hard-earned cash without possibilities of recourse.

   The industry, and the FSCA, have responded with concerted efforts to issue public warnings – as well as raising awareness and educating customers to not only help them spot these scams but also to better understand financial products and services. This extended to using digital platforms and technology to reach consumers in the absence of face-to-face consumer education activities – including the launch of the FSCA's MyMoney Learning Series.

4. **The nature of financial advice will change – the focus is going to be simple language, simpler products, and meaningful disclosure:** Advice is going to be about helping customers, in simple language, to understand complex products. It will, however, also be about putting pressure on product providers to simplify products that are impossible

to explain.

Advisors will no longer be expected to advise customers on the most suitable product based on their needs, but rather to do so in such a way that customers truly understand how it will perform.

Advisors are going to have to be more honest about the bad news, making it clear to customers how and when the product in question will respond. If this impacts sales, they will then have a duty to engage the product supplier about how customers are responding and why they believe certain terms are unfair.

This is going to become particularly relevant in the reinsurance space. Reinsurers all around the world are mitigating their exposure to catastrophes that could result in economic losses – like pandemics.

Wording will be changed to make it clear that certain risks are not covered, such as economic losses, or that if they are deliberately covered, they will be priced appropriately. This will help manage customer expectations, but on the flip side could also lead to a protection gap with certain covers no longer being available or affordable.

5. **Financial distress is on the rise amongst South African employers, and contributions are declining so South African retirement funds need to embrace innovation and change to protect customers:** A recent survey by the FSCA shows that in nearly 40% of active retirement funds, the employer was in some form of financial distress because either the employer or employee, or both, had approached the fund to ask for a temporary suspension or reduction of retirement contributions. However, this financial distress should not necessarily be interpreted as financial unsoundness, given the nature of retirement funds and that most are Defined Contribution funds.

   The risk to the employer's future impacts its employees, not only regarding current income, but also in relation to future retirement savings and security. The overall economic impact will still be felt for a long time and will be difficult to recover from.

   Larger employers managed, for the most part, to stave off the effects of the pandemic and continue with the payment of salaries and honouring of their commitments to preserving retirement fund benefits. This was helped by temporary short-term compromises made on the regulatory side. To support long-term savings over a period where customers are likely to need access to savings, the FSCA has provided exemptions to legislative requirements that apply to pension funds.

   These, however, should not create long-term shifts in the way funds are supervised. So far, government have not permitted accessing retirement savings immediately, this will protect the assets that people have already saved if the employee remains in employment. This will make the recovery to previous long-term expected income levels easier, as individuals do not have to start saving again from scratch.

   Emerging trends that can also help retirement funds recover in the long-term include sustainable investing, which covers green financing, climate financing and the integration of Environmental, Social and Governance (ESG) considerations into investment activities. There is also a growing focus on alternative assets like private equity and infrastructure to diversify risk and enable better returns.

   A project to benchmark costs and fees in the retirement industry is also underway as fees, if left unchecked, can erode a significant amount of retirement savings by reducing returns. However, the question of fees must not be asked in isolation; it is important for funds to assess and understand the value they are getting from the fees they are charged because not everything that is 'cheap' offers value.

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