

Explanatory Policy Paper accompanying the

CONDUCT OF FINANCIAL INSTITUTIONS BILL

Paper accompanying the first draft of the COFI Bill



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

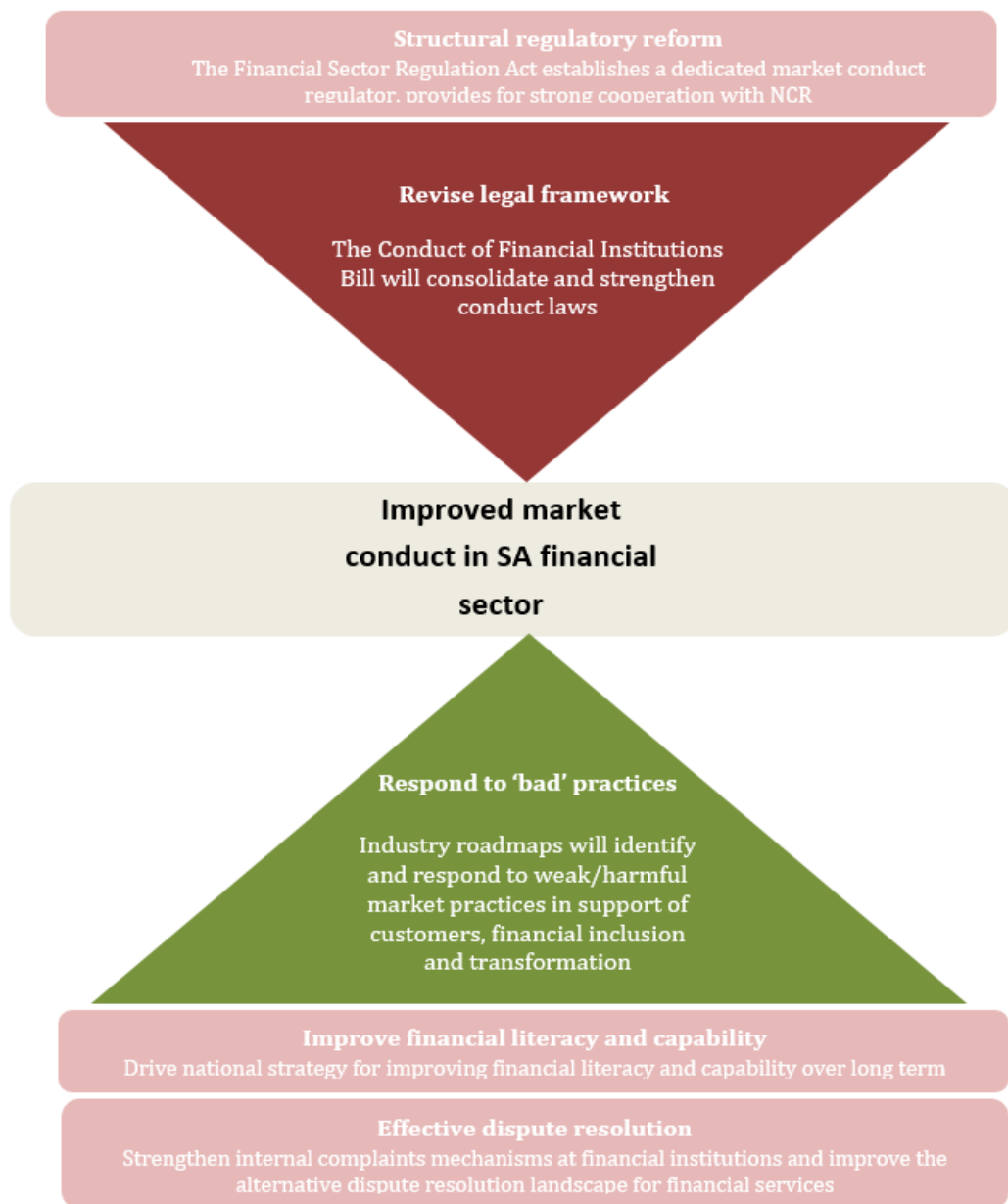


A stronger market conduct policy framework for South Africa

Better regulation, improved financial sector conduct, more financially resilient South Africans

South Africa has renewed and refocused efforts to ensure that our financial sector provides consumers and businesses with good-value products to receive and make payments, save, borrow and insure against daily risks. The National Development Plan highlights the role that an efficient financial sector can play in providing dynamic intermediary services, contributing toward greater economic inclusion – particularly of historically marginalized people – fostering growth and creating employment. Strong market conduct policy is a critical pillar in building a financial sector that delivers these outcomes. It can support and facilitate better competition and participation in the financial sector, including of emerging black-owned financial institutions. Market conduct regulation aims to prevent, and manage when prevention is not successful, the poor outcomes that arise from financial institutions conducting their business in ways that are unfair to customers or undermines the integrity of financial markets and confidence in the financial system.

The figure below outlines the multi-pronged policy approach being taken to strengthen market conduct in South Africa:



The structural regulatory reform is well-progressed, with the Financial Sector Regulation Act signed into law by the President in August 2017. Focus is shifting to the other components of the policy approach. To this end, there will be a series of publications from the National Treasury, setting out in further detail the work being undertaken for each component. These will build on the 2014 discussion document, *"Treating Customers Fairly in the Financial Sector: A Draft Market Conduct Policy Framework for South Africa"*. Documents are available on www.treasury.gov.za/twinpeaks.

The protection of customers in the financial sector, and meaningful financial inclusion in South Africa, are mutually reinforcing objectives. The market conduct policy approach should therefore be seen as a supporting pillar of South Africa's financial inclusion policy – higher standards of customer protection can drive greater inclusion as customers feel more secure in their participation in the financial sector. A Financial Inclusion Policy Paper setting out the South African approach will also be forthcoming.

This document

This document should be seen as addressing the following aspect of the multi-pronged policy approach to improved market conduct in South Africa:

Revise legal framework

The revision of the legal framework aims to significantly streamline the conduct requirements for financial institutions that are presently found in a number of different financial sector laws. The proposed Conduct of Financial Institutions (COFI) Bill will not only replace conduct provisions in existing financial sector laws, but will build a consistent, strong and effective market conduct legislative framework for all institutions performing financial activities.

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1

Developing a market conduct policy framework for South Africa

Regulatory reform in South Africa: towards a Twin Peaks model

The development of a new market conduct policy framework in South Africa forms part of the country's reform of financial sector regulation toward a Twin Peaks model. The decision to shift to a Twin Peaks model was approved by Cabinet in July 2011, and was followed by the publication of a number of policy documents detailing the reform process¹.

Internationally, financial sector reform has become a major focus of attention following the global financial crisis, driven as it was by poor practices in the financial sector coupled with inadequate regulatory oversight. South Africa's reform programme has certainly been given impetus by international developments². However, financial sector regulation was already under scrutiny in South Africa even before the global financial crisis.

There have been a number of high profile cases of poor practices in the financial sector. In 2005 for example, after extensive engagement, a Statement of Intent was signed between the Minister of Finance and the long-term insurance industry, committing to reducing early termination penalty fees on savings policies. This was subsequently entrenched in legislation. In 2006, the Competition Commission began its investigation into the retail banking sector, with its findings being published in 2008, noting a number of poor customer outcomes in the sector. In the investment management sector, the Fidentia and Sharemax scandals, in 2007 and 2010 respectively, highlighted the need for better protection for investors.

The financial sector in South Africa is stable and a significant contributor to the country's GDP. It weathered the storm of the global financial crisis relatively well. However, it is clear that the sector could be producing far better outcomes, particularly for customers. The regulatory framework for the financial sector has not always kept pace with the dynamic nature of the sector. Regulation is largely institutionally based. This means that an institution's legal status (as a bank, insurance company,

¹ All documents available on www.treasury.gov.za/twinpeaks

² Annexure 1 of this document gives an overview of increased international focus on improved market conduct

financial intermediary etc.) determines which regulator is tasked with overseeing its activities from both a financial safety and soundness and a market conduct perspective.

The reform of regulation towards a Twin Peaks model seeks to improve outcomes by placing equal and dedicated focus on managing key risks in the financial sector. It establishes two new authorities – a Prudential Authority to manage prudential risk, and the Financial Sector Conduct Authority to manage market conduct risk. The South African Reserve Bank is also given a mandate for overseeing the stability of the financial sector. The Twin Peaks model is designed to garner the benefits of an integrated model of regulation (including regulatory consistency, jurisdictional clarity and informational efficiency), while better addressing the inherent conflicts between prudential regulation and consumer protection.

An improved legal and regulatory framework can also support broader objectives in the financial sector, including ensuring that the sector grows in a more transformed and inclusive manner. The improved regulatory environment can better support the entry of new institutions into the market, and facilitate the growth and development of existing institutions, in line with government's overall empowerment objectives. This in turn supports the transformative effect of the financial sector in the lives of South African customers, through providing greater access to appropriate and suitable financial products and services to more South Africans.

The first piece of legislation giving effect to the Twin Peaks model is the Financial Sector Regulation Act (FSR Act). The first draft of the Financial Sector Regulation Bill was published in December 2013, and consulted on extensively. A second draft of the Bill was published in December 2014, and a revised version of that Bill was tabled in Parliament in October 2015. After extensive further consultation, the Bill was adopted by Parliament in June 2017 and signed into law by the President in August 2017.

The new regulatory authorities were formally established on 1 April 2018. In the first phase of the reform process, the regulators will operate within the legislative framework set out by the FSR Act, and existing financial sector laws. The FSR Act provides for:

- The Prudential Authority, responsible for the safety and soundness of financial institutions so that these institutions are able to make good on financial commitments to customers.
- The Financial Sector Conduct Authority, responsible for the conduct of financial institutions and the fair treatment of financial customers, financial education and the efficiency and integrity of the financial markets.
- Both regulators having scope of jurisdiction over all financial institutions.
- Powers for the PA and FSCA to effectively fulfil these mandates, including the ability to license, set standards, conduct inspections and investigations, and take enforcement actions.
- The ability for the Minister of Finance to designate new financial products and services which are not captured under existing financial sector laws.

Importantly, the FSR Act is an overlay on existing financial sector laws³. These laws remain in place, allowing the regulators to regulate and supervise the sector both in terms of the FSR Act and existing laws. The FSR Act provides for greater consistency in regulatory operations, but is a first step in the move toward full comprehensive legislative reform.

³ See schedule of financial sector laws in Annexure 2

The next phase of the reform process from a market conduct perspective will be to streamline and harmonise the legal landscape that financial institutions will operate within. This entails a comprehensive review of existing financial sector laws, with the aim of developing a single, holistic legal framework for market conduct regulation in South Africa that is consistently applied to all financial institutions. The draft Conduct of Financial Institutions Bill represents this new legal framework.

An improved market conduct framework for South Africa

The 2014 discussion document, “*Treating Customers Fairly in the financial sector: A Draft Market Conduct Policy Framework for South Africa*” set out the draft policy approach for developing a new market conduct framework in South Africa. It highlighted the poor outcomes being produced in the financial sector, and the weaknesses in the regulatory framework that contributed to this. It set out a number of recommended approaches to reforming the market conduct framework in South Africa, proposing a multi-faceted approach:

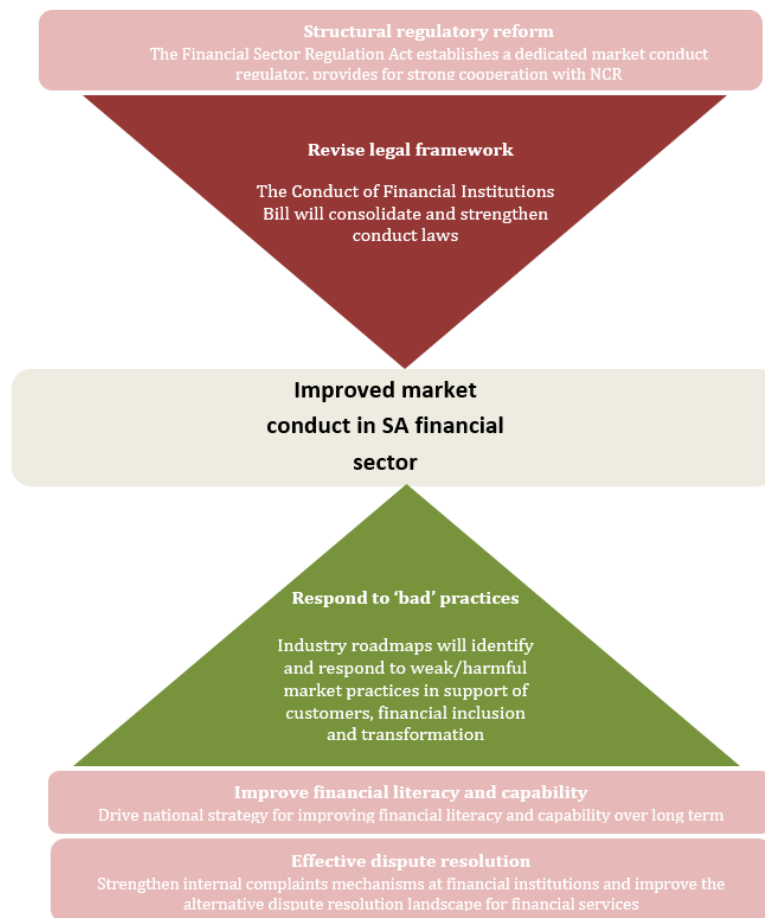


Figure 1: Approach toward an improved market conduct framework

This document and the COFI Bill accompanying it, addresses the component describing a revised legal framework.

Engagement and feedback on 2014 discussion document

The 2014 discussion document setting out the draft market conduct framework formed the basis for engagement with stakeholders on the proposed new market conduct approach.

Public comments were sought on the document, and 14 submissions from different stakeholders were received. This included large industry associations, individual financial institutions of various sizes, international organisations, and a private individual. The document was also engaged on through the National Economic Development and Labour Council (NEDLAC).

In general, the public comments expressed overall support for the intended objective of stronger market conduct and improved customer outcomes.

Some common supportive comments included:

- Support for a regulatory framework focused on improved customer outcomes.
- Support for a review of regulatory weaknesses in the financial sector. Some weaknesses that were flagged include the regulator's perceived inability to respond quickly to issues in the sector, and the current sectoral "silo" approach to regulation.
- Agreed with the need for a more intrusive approach to ensure compliance with market conduct regulation.
- Support for strengthened consumer education initiatives.

Comments also flagged a number of issues that should be carefully considered in strengthening the market conduct framework. Some common concerns raised in relation to the establishment of the FSCA and the development of a new market conduct law, included:

Design of the new framework

- A risk-based approach is required, with sufficient flexibility in rule-making, to allow for differentiation of rules based on the conduct-risk profile of the entity or activity concerned. A one-size-fits-all approach would not be appropriate.
- The manner in which new legislation and regulations are written and enforced should minimise disruption and promote certainty, rather than introduce confusion; unintended consequences should be borne in mind.
- A review of the current legislative framework should be mindful of interlinkages with other laws, such as taxation laws, should changes be proposed.
- The current rules-based approach should not simply be amalgamated with a principles and outcomes-based regime. Concerns were raised that, without careful consideration and engagement, the new approach to market conduct will only be a "FAIS plus" approach – with the principles-based approach of the FAIS Act combined with the more prescriptive approaches in other legislation. There is a fear that principles will serve simply as a "catch-all" for the regulators.
- There is a need for impact assessments to be undertaken for new regulation and legislation.

Licensing

- Clarifying the licensing approach will be important.
- Clarifying the application and differentiation of approach between retail and wholesale customers will be important.

Supervisory and regulatory approach

- A cooperative relationship between the regulator and regulated entities will be an important factor in ensuring the success of the new regulatory approach.
- Effectiveness of coordination and cooperation will be important among all regulators in the sector. This includes with the National Credit Regulator which is also a conduct regulator.

- A principles and outcomes-based approach could create a lack of legal certainty as to how the regulator can and will exercise judgement.
- As a related point, the exercise of judgment by the regulator increases the need for strong accountability measures for the regulator.
- The policymaker should be cautious in avoiding the unintended consequences of overregulation. This could result in a stifling of innovation, and could create barriers to entry in the sector. The FSCA should be supportive of the positive contribution of the financial services sector to the broader economy.
- The regulator will need to have adequate capacity and skills to effectively fulfil its mandate.
- The strategy of the regulator should be regularly reviewed and updated as appropriate.
- Big data collected by the regulator needs to be ‘intelligent’ and consistent, so that the data is effectively used in meeting the regulator’s supervisory and regulatory objectives. The FSCA should consult with industry to ensure that the gathering of information will produce the desired outcome. This will also assist with efficient use of resources both from the perspective of the regulator and that of the industry.

Transition and implementation

- In addition to improved conduct of financial institutions, it is important to ensure that customers’ responsibilities are also well-understood, and the role of financial education in this regard is important.
- International experiences and lessons should be drawn on and can provide guidance, but the South African context must be considered when any legislative and regulatory proposals are made.
- Funding of the new regulator should be clarified.

The NEDLAC Task Team established to consider the draft market conduct framework also expressed broad support for the intended objective of improved market conduct, and the proposed introduction of a new market conduct law. Detailed further actions were identified in 2016 by the NEDLAC Task Team, to be taken forward through various workstreams and projects (see Annexure 3).

Some of the concerns raised through the engagement process on the 2014 discussion document have subsequently been addressed in the course of the Twin Peaks reform process. For example, the concerns about the respective roles of the NCR and FSCA have been clearly explained in the FSR Act. A draft Levies Bill has been published, together with an impact study, setting out the proposed funding model for the new regulatory structure.

This policy document, and the engagement on the COFI Bill itself, will further clarify the approach to the new market conduct framework and responds to some of the proposals and concerns raised.

The policy approach to developing a new market conduct law

In developing the COFI Bill for the FSCA, the following underlying principles, initially proposed in the 2014 discussion document, have been taken into account:

- **Activity-based**

Currently there are some thirteen different financial sector laws applicable to financial institutions. These laws regulate and supervise financial institutions based on their institutional definition. So, for example, institutions defined as banks are regulated in terms of one law, and institutions defined as insurance companies are regulated under a different law. The range of laws are often implemented in a ‘silo’ manner. The new legal framework will shift away from this sectoral approach, and instead provide for an activity-based approach. This means that the COFI Bill will define the *activities* undertaken in the financial sector. Similar activities will be similarly regulated and supervised, regardless of the institution performing the activity, and consistent requirements will be set out in one law. This will close gaps in the current legal framework, where some activities that otherwise should constitute financial services, can escape

regulatory oversight because the entity providing the service doesn't fit into institutional definitions. In doing so it will promote a level regulatory playing field for providers and bring more consumers under the protective regulatory net.

The licensing framework proposed in the COFI Bill (and discussed further in Chapter 3 of this document) implements this activity-based approach.

- Principles-based

A narrow focus on rigid rules and compliance reporting has often led to the letter of the law being followed while the spirit of the law is missed. A principles-based approach seeks to set principles that specify the intention of regulation, rather than set rules detailing requirements of a financial institution.

A focus on principles should see a shift in both industry and the regulator toward ensuring that their actions and processes are geared toward driving the attainment of certain desired outcomes in the financial sector, not only on technical compliance with the law.

However, a principles-based approach does not mean an absence of rules. It is well-recognised that an appropriate mix of principles and rules are required to achieve the correct outcomes. Rules may be required to protect highly vulnerable consumers, where market dynamics create poor incentives for providers (like in the consumer credit insurance market) or to respond to sustained egregious behaviour and practices. The approach is therefore towards a more effective balance between principles-based and rules-based measures to achieve desired outcomes, in contrast to the current framework's heavy reliance on rules.

Principles enable supervisors and enforcers to police the spirit of the rules as well as the letter, avoiding "creative compliance", regulatory arbitrage, and the need for the rules to anticipate every possible situation.⁴ Box 1 discusses the merits of a principles-based approach in more detail.

The COFI Bill entrenches principles in law.

- Outcomes-focused

A strong market conduct policy framework should support the delivery of desired policy outcomes in the financial sector, enable the monitoring of the extent to which those outcomes are being achieved, ensure preventative action is taken to mitigate the risk of poor outcomes, and ensure remedial action is taken when poor outcomes are in fact produced. This is different from the current approach where periodic supervisory assessments check compliance with the letter of the law, and identifying and remedying poor outcomes is a slow and inefficient process.

An outcomes-focused approach therefore requires the following to be tested against the achievement of preferred financial sector outcomes:

- The market conduct of licensed financial institutions;
- the financial sector regulatory framework; and
- the effectiveness of the market conduct regulator.

Where the market conduct of financial institutions is concerned, the supervisory approach must shift from focusing on assessing compliance with prescriptive rules-based requirements, to focusing on whether institutions are conducting themselves in a manner that delivers desired outcomes. Where retail financial customers are concerned, this approach includes particular

⁴ Black J., Hopper M., and Band C., "Making a Success of Principles Based Regulation", Law and Financial Markets Review, 2007, p 191

scrutiny of the extent to which institutions are delivering the customer fairness outcomes targeted by the Treating Customers Fairly initiative.

It is recognised that institutions and their management may be better placed than regulators to determine the processes and actions required within their businesses to achieve necessary outcomes. An outcomes-based approach enables the regulator to focus on the outcomes that they require institutions to achieve, rather than setting unduly prescriptive process requirements. Institutions and their management can find the most efficient way of achieving the outcomes required,⁵ and satisfy the regulator that they have effective governance processes in place to support the delivery of such outcomes. It is noted however that this may work better for some institutions than others – in particular, smaller financial institutions, with limited risk management and compliance resources, would benefit from a more standardised way of demonstrating their compliance with regulatory requirements. The FSCA can provide for such differences by using a combination of conduct standards, interpretation rulings and guidance notices, in support of sector diversification and competition.

An outcomes-focused approach is also a manner in which to hold the regulator accountable for ensuring its supervisory and regulatory approach is effective in producing the outcomes required in the financial sector. The outcomes-focused approach will therefore also require the FSCA to align its supervisory approach to monitoring outcomes, including building the required skill-set and making effective use of information.

- Risk-based and proportionate

A proportional approach is important in ensuring that the outcomes-focused approach is appropriately applied to the different levels of risk arising from different types of activities being supervised.

The new framework must enable the regulator to identify areas that pose greatest market conduct risks, and use proportionate regulatory capacity to address these risks. A risk-based approach will require the regulator to be forward-looking, and to have the skills and resources to identify, collect and analyse market information and trends.

Proportionality should influence the regulator’s supervisory approach, the standards it sets, and the enforcement action it takes in respect of different categories of financial institutions. Chapter 1 (clause 7) of the COFI Bill sets out guidelines for what the FSCA should consider in applying a proportionate approach. Proportionality is important to create a more level playing field for institutions of different sizes that bring different risks to customers and the financial sector. It can therefore be an effective tool for reducing regulatory barriers to entry and supporting transformation of the sector.

Box 1: Principles based regulation⁶

In general terms, principles-based regulation means moving away from reliance on detailed, prescriptive rules and relying more on high-level, broadly stated rules or Principles to set the standards by which regulated firms must conduct business.

⁵ Black J., Hopper M., and Band C., “*Making a Success of Principles Based Regulation*”, Law and Financial Markets Review, 2007, p 192

⁶ Extract from Black J., Hopper M., and Band C., “*Making a Success of Principles Based Regulation*”, Law and Financial Markets Review, 2007

The term “principles” can be used simply to refer to general rules, or also to suggest that these rules are implicitly higher in the implicit or explicit hierarchy of norms than more detailed rules: they express the fundamental obligations that all should observe.

[In the UK] the use of Principles, rather than reliance solely on more detailed and prescriptive rules, has been a feature of the regulatory regime for financial services since 1990.

Principles have a number of characteristics:

- They are drafted at a high level of generality, with the intention that they should be overarching requirements that can be applied flexibly to a rapidly changing industry.
- They contain terms that are qualitative not quantitative: general, usually evaluative terms (“fair”, “reasonable”, “suitable”) as opposed to “bright line” rules (“within two business days”, “turnover of £20m”).
- They are purposive, expressing the reason behind the rule.
- They have very broad application to a diverse range of circumstances.
- The Principles are largely behavioural standards – they are concerned with, for example, the “integrity”, “skill care and diligence” and “reasonable care” with which authorised firms or approved persons conduct and organise their businesses and the fairness with which they treat customers and manage conflicts of interest.
- It follows that breach of a Principle must involve an element of fault.
- Breach of the Principles can be sanctioned through public (but not private) enforcement action.

Benefits of regulation by principles include:

- Principles can engage senior management in the regulatory process, and can require internal compliance divisions to develop a more strategic role.
- Principles focus on the purpose behind the rule rather than just on the detailed provisions.
- Principles offer flexibility for regulated firm and regulator in determining how to comply with the rule, facilitating the development of new business models, products, strategies and internal processes.
- Principles enhance responsiveness of the regulation to market innovation and other developments, increasing the durability of the Principles and reducing the need for constant amendment, thereby “future proofing” the regulatory requirements.
- Principles are hard to manipulate, making creative compliance difficult.
- Principles can lead to a greater degree of substantive compliance with the purpose of the rule, rather than a “box-ticking” approach, as they require firms to think through how to comply; as such they can be directly linked to management-based regulation.

Outcome-based regulation, at least to the extent that it involves a focus on substantive achievement of regulatory objectives, is compatible with using Principles. A focus on senior management responsibilities is an inherent part of Principles-based regulation in that a significant amount of responsibility for interpreting and applying the rules is devolved to the firm itself.

2

The Conduct of Financial Institutions (COFI) Bill

The COFI Bill aims to significantly streamline the legal landscape for conduct regulation in the financial sector, and to give legislative effect to the market conduct policy approach. It will strengthen customer protection by putting in place a single comprehensive market conduct law in the financial sector, resulting in the consistent application of consumer protection principles across the sector.

The new approach will also give more flexibility and better tools to the regulator to support emerging new financial institutions, including black-owned businesses and non-traditional financial institutions (e.g. financial services provided by technology companies through digital innovation). As it will apply to all financial institutions in the sector, the COFI Bill is also best-placed to give legal effect to transformation requirements in support of targets agreed through the Financial Sector Transformation Council⁷ and specified in the Financial Sector Code.

Importantly, the COFI Bill does not adopt a “copy and paste” approach to consolidating existing financial sector laws into a single piece of legislation. While it will draw on elements in existing legislation that may have worked well, it is intended to create a new ‘best of breed’ law that is appropriate to the nature of the financial sector as it operates today. Given the dynamic nature of the financial sector, an important element of this legislation is providing the flexibility to respond to changes in the financial sector. The Bill establishes binding principles that reflect the outcomes that the financial sector will be expected to meet. These outcomes are likely to remain consistent over time, even as new types of financial activities enter the market and optimal methods in which to achieve the outcomes may change. This does not suggest that rules will be done away with entirely, but rather that the optimal balance of principles and rules should be struck.

The COFI Bill is published for public comment. It is anticipated that the Bill will be revised based on public engagement, and tabled in Parliament in 2019.

⁷ This was previously known as the Financial Sector Charter Council

Box 2: Principles versus rules in practise

The FAIS Act requires all Financial Services Providers (FSPs) with more than one representative to appoint a compliance officer. This is a rule. The Act further required that these compliance officers should visit all branches of the FSP a prescribed number of times. This is another rule. These rules can add significant human resource and administrative costs to a business, especially businesses with a large number of branches, and does not take into consideration the technological capabilities of compliance monitoring and risk management.

The rule on prescribed visits also does not necessarily achieve the intended outcome, which is an acceptable level of compliance monitoring and reporting. The requirement can be met by “ticking the box” on the number of visits, even if no meaningful monitoring was done on the visit.

This second rule was therefore replaced by a principle which requires the FSP to implement a monitoring programme appropriate to the size and complexity of the business, to ensure compliance risks and emerging risks are considered. The business will then itself determine the monitoring programme and justify its appropriateness by reference to the risk and complexity of the business.

The COFI Bill drafting process

A COFI Bill Working Group was established by the National Treasury in October 2015. Members of the Working Group include representatives from the National Treasury, the Financial Services Board (now the Financial Sector Conduct Authority) and the South African Reserve Bank (both the bank supervision and payments system departments). The Working Group considered policy matters in the design of the COFI Bill, including issues such as the scope of application, how to capture activity-based, outcomes-focused and proportionality principles in the Bill, and the approach to investment and pension fund regulation. The Working Group also established a drafting team, drawn from the legal support team of the National Treasury and regulatory drafting experts in the FSB, tasked with drafting the Bill itself.

The drafting team followed a phased approach to drafting the COFI Bill, which included the following:

COFI Bill Drafting Phases	
Phase 1	Developing the draft outline of the Bill and the skeleton of each chapter
Phase 2	A scan of international market conduct regulatory approaches undertaken for each chapter of the draft Bill to further enhance the content of the Chapter
Phase 3	Assess draft Bill against existing financial sector laws (including subordinate instruments) to ensure that the draft Bill is comprehensive and does not create regulatory gaps.
Phase 4	Assess draft Bill against the final licensing framework (licensing provisions are explained further in chapter 3)
Phase 5	Assess draft Bill against the requirements related to pension funds (including pending reforms) and assess the extent to which requirements are best accommodated in the COFI Bill versus the Pension Funds Act
Phase 6	Assess whether draft Bill provides for appropriate requirements in relation to retail and non-retail customers

Phase 7	Compare and review draft Bill against existing and future (known) regulatory frameworks to ensure that overlaps are appropriately dealt with
Phase 8	Assessment against the FSCA's market integrity mandate; finalise approach in respect of existing SRO models (both in the financial market infrastructure and payment system environment)
Phase 9	Finalisation of draft Bill for public comment (including considering input from a closed Technical Expert Panel)

A Technical Expert Panel was convened in December 2017 to provide comment and input into an initial draft of the COFI Bill produced by the drafting team. This Panel was comprised of members selected by the National Treasury or nominated by various trade associations, with knowledge and expertise in the area of market conduct policy and regulation. Members served in their personal capacities rather than as representatives of organisations, and on a confidential basis. The process provided valuable insight and assisted the drafting team in identifying areas in the Bill that required further clarification or refinement.

Careful consideration will need to be given in ensuring that subordinate legislation issued under existing financial sector laws, is transitioned to the new legislative environment once the COFI Bill is enacted and the existing laws are amended or repealed.

Structure of the COFI Bill

The COFI Bill aims to be an easily understandable piece of legislation that avoids unnecessary complexities. Where appropriate, chapters and specific Parts of the COFI Bill therefore contain clauses setting out the purpose of the chapter/part. This is intended to provide clarity, in law, on the intended purpose of the legal provisions, making interpretation of the legislation simpler. It is also intended to make it simpler for financial customers themselves to access the law should it be necessary.

The chapters of the COFI Bill are summarised below:

- Chapter 1: Interpretation, objects and application

This chapter sets out the definitions, object and application of the Act. Objectives include protecting and promoting the fair treatment of customers, as well as promoting transformation, financial inclusion and innovation in the sector. The law will apply across the financial sector to ensure a level playing field and reduce the risk of regulatory arbitrage. The FSCA will be able to appropriately accommodate smaller players in the financial sector (for example, burial societies and stokvels) which pose low conduct risk and should not be subject to onerous regulatory compliance costs. Such entities should, within certain thresholds, be exempted or excluded, and the Bill provides for this. The ability to exempt certain financial institutions from provisions, including for developmental, transformation, and inclusion purposes, will allow the regulator to support these outcomes being achieved in the financial sector.

The FSCA will be required to set standards, develop and implement its supervisory approach, and enforce requirements, in a manner that is proportionate to the nature, size, scale and complexity of the risks associated with a type of activity or financial institution, and is proportionate to achieving the purpose of the requirement.

The chapter indicates the application of the Act in relation to financial groups and conglomerates, as well as pension funds.

- Chapter 2: Licensing

Under the FSR Act, licensing requirements for existing types of financial institutions remain as set out in various financial sector laws. The FSR Act set out a licensing process for newly designated financial products or services only. The COFI Bill proposes a new licensing framework for financial institutions, replacing the myriad of different registrations and authorisations in the financial sector with a single market conduct licence from the FSCA, which can have different authorisation categories, depending on the financial activities carried out by the financial institution. Chapter 2 of the COFI Bill sets out licensing requirements and must be read together with the schedule of activities requiring a licence (Schedule 2). It is anticipated that the FSCA will follow a phased process of converting existing registrations held by financial institutions, into licenses under the new framework (proposed provisions to be included in Schedule 4). To reduce regulatory barriers to entry and better support market development and transformation, the licensing approach will allow the regulator to set licensing requirements on new entrants, in support of developmental, inclusion, innovation, and transformation objectives, to permit gradual compliance over time with specified regulatory requirements. The approach to licensing is further explained in Chapter 5 of this document.

- Chapter 3: Culture and governance

Requiring improvements in financial institutions' culture, including ensuring appropriate governance frameworks and that decision-makers are directly and personally held accountable for weak governance and abusive practices by the institution, will be a vital pillar in ensuring that financial institutions better serve South Africans. This chapter sets out the general principles and fit and proper, governance and operational requirements with which financial institutions must comply. It is important to ensure that there is not unnecessary duplication of provisions in this chapter and similar provisions in other legislation, while also ensuring that different requirements relating to governance and operational requirements for different institutions are captured appropriately. This chapter allows the FSCA to set requirements to support the development of appropriate corporate culture that focuses on the fair treatment of customers, improves customer confidence and enhances transparency and discipline in the industry. In the South African context, a good governance framework should include a well-considered approach to transformation and compliance with legal requirements of the BBBEE Act, and requirements related to this are included in this chapter.

- Chapter 4: Financial products

This chapter requires financial institutions to have in place clear processes and procedures regarding the design of financial products marketed and sold. It aims to ensure that products take into account the identified needs of identified financial customers and are targeted accordingly. It also deals with minimum requirements related to product performance.

- Chapter 5: Financial services

As in Chapter 4, this chapter places similar requirements on financial institutions providing financial services. It allows for specific and tailored requirements and conduct standards to be set on the activity of financial service provision, particularly for those instances in which no financial products are provided.

- Chapter 6: Promotion, marketing and disclosure

Informed decision-making by financial customers relies on access to meaningful information at the right time. Chapter 6 of the COFI Bill addresses the provision of adequate, clear information by financial institutions to financial customers before, during and after the point of sale.

- Chapter 7: Distribution, advice and discretionary investment management

In addition to providing adequate and clear information, financial institutions must ensure that their distribution models are appropriate to ensure the delivery of appropriate products and services and, where applicable, provide access to suitable advice. Customers should be able to understand and compare the costs and contractual implications associated with sales and distribution models. Distribution models should enhance standards of professionalism, encourage fair competition, and support sustainable business models for financial institutions. The chapter also deals in detail with the provision of advice, and with discretionary investment management.

- Chapter 8: Post-sale barriers and obligations

Requirements set through this chapter will ensure that customers do not face unreasonable post-sale barriers when wanting to change a financial product or service, switch provider, submit a claim or make a complaint.

- Chapter 9: Safeguarding assets and operational requirements

This chapter deals with institutions that invest, hold, keep in safe custody, control or administer funds of a financial institution, or any trust property. It intends to apply requirements only on institutions not regulated in terms of another Act, to ensure no overlap with prudential requirements. This is to ensure that non-prudentially regulated entities also comply with suitable requirements to ensure that funds are safeguarded and that operational capital is overseen.

- Chapter 10: Reporting

The reporting obligations of financial institutions are set out in this chapter. This includes annual disclosures to the regulator, and gives the regulator the ability to request information from a financial institution.

- Chapter 11: Remedial actions for financial customers

While the FSR Act sets out the primary supervisory powers and tools available to the FSCA, this chapter provides greater detail on specific remedial actions. Consideration will be given on the appropriate placement of requirements in the COFI Bill versus FSR Act.

- Chapter 12: General provisions

This chapter sets out the application of the Bill in relation to other laws, the process for making conduct standards, for recognising equivalence with foreign jurisdictions and vice versa, and details the process for applications and notifications to the regulator. Offences and the reporting of contraventions, are also dealt with in this chapter.

- Chapter 13: Final provisions

This chapter provides savings of existing provisions in terms of specific laws, and transitional arrangements, to ensure the smooth implementation of the COFI Bill once enacted.

3

Application of the COFI Bill to specific subsectors

The COFI Bill is designed to replace the conduct provisions of most existing financial sector laws. This will involve the repeal of provisions in existing Acts, or of the Acts in their entirety (for example, the FAIS Act). Careful consideration is required to ensure that the Bill does not create gaps in the regulatory framework or weaken any existing legislative provisions. The drafting process for the COFI Bill considered this explicitly. Consequential amendments provided for in the COFI Bill indicate the extent to which existing laws are proposed to be repealed and amended.

The Bill and the amendments it proposes to other laws are intended to ensure that all laws are mutually reinforcing, allowing the FSCA to appropriately make use of financial sector legislation to meet its broad market conduct mandate.

Under the Twin Peaks framework, the FSCA has scope of jurisdiction over **all financial institutions** in South Africa. A financial institution is defined, as per the FSR Act, to include a market infrastructure, and any entity that provides a financial product or financial service. In some instances, financial institutions will require a direct conduct licence from the FSCA through the COFI Bill licensing process. In others, the institution may be licensed and supervised through another law, and also subject to requirements set through the COFI Bill. This approach is discussed further below, and is likely to be the subject of considerable further engagement during the consultation process on the Bill.

In addition to institutions, the Bill also sets requirements on **persons** performing critical functions in relation to a financial institution. These include those identified as “key persons” like the CEO, a Director or someone fulfilling a critical governance function like an actuary or compliance officer.

Informal financial sector participants like stokvels will not be subject to requirements set by the Bill. However, the Bill allows for the FSCA to put in place a developmental framework for entities wanting to build financial services capability and formally license with the FSCA, including through allowing exemptions from licensing provisions to allow for gradual compliance.

The COFI Bill addresses all business conduct, for both the **retail and non-retail** markets. The definition of financial customer includes both retail and non-retail customers. Financial institutions

that do not service retail customers will still need to be licensed under the COFI Bill. However, the Bill does not apply a one-size-fits-all approach. A licensed institution will be subject to the COFI Bill requirements on a risk-based and proportional basis, meaning that the institution's relationships with other financial institutions or large corporate customers – which are well resourced and knowledgeable about the markets – will be assessed for different risks than its relationships with typically more vulnerable retail customers.

The interplay between the COFI Bill and specific other pieces of legislation is discussed in more detail below.

The COFI Bill and the Financial Sector Regulation Act

The FSR Act primarily deals with the regulatory architecture of the Twin Peaks model. It establishes the regulatory authorities, and sets requirements for how they must operate. It also sets out the supervisory and enforcement powers of the regulators, and establishes the Financial Services Tribunal as an independent body providing an accountability check for regulators (and other defined decision-makers), as it is empowered to reconsider decisions taken.

The FSR Act is therefore regulator-facing; it also provides the regulators with certain powers in relation to regulated entities, to ensure that current gaps in the legislative framework do not prevent the regulators from meeting their respective mandates (for example, allowing the FSCA to set standards on banks).

The COFI Bill will be primarily regulated entity-facing – setting the requirements that financial institutions under the jurisdiction of the FSCA must meet and the outcomes they are expected to deliver. While the FSR Act gives consumers and financial institutions an indication of what to expect of the *regulators* in the financial sector, the COFI Bill will give customers and industry players an indication of what is expected of *financial institutions*.

Some amendments to the FSR Act may be necessary to align with the introduction of the COFI Bill. For example, while the FSR Act gives the FSCA the general power to set standards, it is considered more appropriate for the COFI Bill to provide the detail on what these industry-facing standards may cover, as has been done in chapters throughout the Bill.

Other changes to the FSR Act may include aligning and refining the definitions of certain regulated financial products and services, in line with the proposed activity-based licensing approach the COFI Bill adopts. Certain proposed amendments to the FSR Act that are required to ensure alignment with COFI Bill provisions, are indicated in the consequential amendments, while further amendments may be identified through the consultation process.

Approach to prudentially regulated financial institutions and Systemically Important Financial Institutions

A key aim of the Twin Peaks model is to minimise regulatory duplications and inefficiencies. The regulators are required to coordinate and develop a cooperative approach to regulation and supervision. Equally, neither regulator should be hindered in fulfilling their respective mandates due to the actions of the other. The FSCA and the PA have entered into a Memorandum of Understanding which details how the authorities will work together, including on operational matters such as licensing, supervision and enforcement⁸.

The COFI Bill recognises the role and operation of the PA alongside the FSCA in the financial sector. Provisions are made where possible to drive efficiencies in the work of these regulators. For example,

⁸ Available on https://www.fsc.co.za/Regulatory%20Liaison/MOU_FSCA%20and%20PA.pdf

an obligation is placed on the regulator to identify areas of duplication in law and work on ways to resolve this with minimal disruption⁹.

The crafting of the Bill is also mindful of not duplicating requirements that may be imposed on prudentially regulated entities. Matters of governance are expected to be a large area of shared focus between the PA and FSCA, and it is likely that joint standards will be issued to mitigate duplication. It is anticipated that the public consultation process will identify areas where provisions in the COFI Bill can be refined or streamlined to limit potential duplications.

The approach to Systemically Important Financial Institutions (SIFIs) is unchanged from that taken in the FSR Act. SIFIs are defined by the SARB through the provisions of the FSR Act, and regulators must obtain the concurrence of the SARB when taking specified actions in relation to SIFIs.

The COFI Bill and the credit sector

Credit regulation under the Twin Peaks model was the subject of careful consideration. The FSR Act provides for both the existing National Credit Regulator (NCR) and the FSCA to play a role in the regulation of credit providers¹⁰. The NCR will continue to regulate credit providers falling within their scope of jurisdiction, for the product they provide – the credit agreement – as per requirements in the National Credit Act (NCA). In keeping with the harmonised, cross-cutting approach that Twin Peaks entrenches, the FSCA will be able to regulate the services provided by credit providers (and other entities) in relation to the provision of credit, in similar ways to its regulation of similar services provided by other financial institutions. The FSCA will therefore be able to regulate credit providers on matters such as marketing and promotion, provision of advice, distribution and disclosure of information relating to credit. As set out in the FSR Act, any new conduct standards set by the FSCA must take into account requirements already in place under the NCA. The intention is to limit duplication in requirements between the NCA and the COFI Bill, and strengthen and harmonise regulatory requirements across all financial institutions.

The outcomes that are sought to be achieved through the COFI Bill are likely to apply to the credit sector on a risk basis – in other words focus will be on categories of credit providers that bring the most conduct risk to the largest numbers of vulnerable customers. Given their size and share of the credit market, banks will be supervised to ensure that their governance arrangements are sound, that their financial services meet customer needs, and that customers don't face undue post-sale barriers.

As an important part of the credit product lifecycle, the FSR Act also includes **debt collection** as a financial service, indicating that the FSCA will be able to license and set conduct standards on this activity. Debt collection is intended to be limited to the collection of debt owing on credit agreements as a defined financial product.

The FSCA will work with the NCR to consider setting requirements on credit providers themselves in relation to the collection of debt, whether this is done directly, outsourced, or on-sold. For example, requirements can be imposed on the credit provider to ensure that its loan book may only be on-sold to firms that meet particular criteria.

The NCR and FSCA have entered into a Memorandum of Understanding¹¹, setting out their cooperative regulatory approach to credit regulation. Further engagement, including through proposals made in the COFI Bill, will help develop the regulatory approach to how licensing, supervision and enforcement will be carried out in practice.

⁹ See clause 9(3) of the COFI Bill

¹⁰ It also allows for the Prudential Authority to regulate the safety and soundness of credit providers

¹¹ Available on https://www.fsc.co.za/Regulatory%20Liaison/MoU_%20FSCA%20and%20NCR.pdf

The COFI Bill and the National Payments System

The FSR Act provides for inclusion of **payment services** into the Twin Peaks regulatory model in a way that carefully considers the systemic importance of the national payments system (NPS). The NPS broadly encompasses the total payment process, from payer to beneficiary, and includes all the systems, mechanisms, institutions, agreements, procedures, rules and laws that come into play in the payments universe. It enables transacting parties to efficiently exchange value to conclude financial transactions, which is core to the smooth functioning and growth of the economy. It is therefore crucial for the payments systems to remain stable, safe, efficient and transparent and to ensure that potential risks to the functioning of the payments system are adequately addressed.

Overseeing the safety, efficiency and stability of the NPS is a role performed by the South African Reserve Bank, and this will continue under Twin Peaks. However, it is clear that the payments system also impacts on customer outcomes, and that the conduct of providers in the payments environment should be monitored by the FSCA. Poor customer outcomes include abuses of the debit order system, and complex and opaque charging structures that sometimes impose unfair costs. Payment services are critical to the banking service offering and must be included in the regulatory oversight of banking institutions. In addition, the emergence of new payment service providers warrants an activity-based approach to support well-regulated competition, improved access and inclusion and a level regulatory playing field. The FSR Act therefore includes payment services as a financial service, giving the FSCA the legal authority to set conduct standards on providers of payment services, with the concurrence of the SARB.

The COFI Bill takes steps to more clearly define the payments environment that the FSCA will regulate, and what payments activities should be directly licensed by the FSCA (see schedule of licensed activities). In principle, a conduct licence will be required for payment service providers¹² with a direct relationship with a financial customer, both retail and non-retail, with standards being set accordingly. So for example, the FSCA can set conduct standards in relation to disclosure of fees charged for payment services offered, whether offered by a bank or non-bank provider. This will be done in consultation with the SARB or can be issued as a joint standard between the SARB and FSCA.¹³

However, it is also recognised that there may be interactions that take place within the payments system that, while not directly involving retail customers, can result in customers being ultimately impacted. This is particularly true of system operators in the payment system, like Bankserv, Visa and Mastercard. Recognising that the SARB will continue to oversee the payments system from a stability, integrity and efficiency perspective, the FSCA's conduct mandate will require close cooperation and coordination between the SARB and FSCA to ensure that conduct outcomes are considered across all components of the payments infrastructure.

It is likely that there will be further work done on designating certain payment systems or payment system operators as systemically significant. A similar approach to that taken toward SIFIs would then likely apply – the FSCA will not be able to take specified regulatory actions in relation to a systemically significant payment system or operator without concurrence of the SARB.

It is expected that through further public consultation, the definition of payment services in the COFI Bill can be refined to appropriately provide for the licensing and regulation of the payments environment.

The National Treasury and National Payment System Department of the SARB are currently undertaking a review of the National Payment System Act to assess its adequacy and effectiveness in

¹² The principle of dual licensing will thus also apply in the payments environment, with specified payment service providers requiring a license under the COFI Bill and through NPS Act requirements.

¹³ The COFI Bill proposes consequential amendments to the FSR Act to provide for the FSCA and SARB to issue joint standards on payment service providers, to ensure fair conduct, efficiency and integrity in the payments system.

achieving its stated objectives, in the rapidly evolving financial and payment landscape. The National Treasury, SARB and FSCA are working together to ensure that the NPS Act review and COFI Bill processes are aligned.

The COFI Bill and the Financial Markets Act

The FSCA mandate includes enhancing and supporting the efficiency and integrity of financial markets¹⁴, in addition to its mandate of protecting customers and ensuring their fair treatment. These mandates should be seen as interconnected and mutually supportive. As noted by the International Financial Risk Institute:

“Public regulation of markets [...] looks at issues such as the integrity of price formation (i.e. they accurately reflect the forces of demand and supply), the prevention of manipulative behaviour which deliberately attempts to distort this market price, the provision of a sound legal basis for financial dealings and adequate laws for customer protection (which includes appropriate insolvency law and a code of sales practices.) So any document which is important to understanding *customer protection* is also key to *market integrity*. The dividing line between these key risk concepts is blurred...”¹⁵

The regulation of the financial markets is under review in South Africa, to build efficiency and competition amongst market infrastructure on the one hand, and strengthen the direct regulatory oversight and surveillance of market participants by the FSCA (rather than relying so heavily on the market infrastructure) on the other.

Given that the FSCA already licenses market infrastructure in terms of the Financial Markets Act (FMA), at this stage the COFI Bill does not propose licensing and regulating market infrastructures under the new conduct framework. This is chiefly due to the quasi-regulatory role that market infrastructures perform in the South African markets, creating a specific type of relationship between infrastructures and their members that differs from the typical institution-customer relationship governed by the COFI Bill.

However, it is recognised that further consideration and engagement is needed regarding this approach. Conduct regulation of market infrastructures has become more necessary with the emergence of multiple exchanges (and potentially other market infrastructures) in South Africa, in support of competition. Licensing and regulating such infrastructures will be important to ensure consistent conduct standards are achieved in their operation. The regulatory role of market infrastructures and their licensing will likely be subject to further discussion following the finalisation of the Financial Market Review (FMR) process (explained further below) and subsequent revisions of the FMA.

Consistent conduct standards must also apply to members of market infrastructures, irrespective of the infrastructure through which they operate. The COFI Bill thus provides for the licensing of securities service providers, and for conduct standards to be set regarding their operation. Such standards will not replace the governance and operational risk management requirements set by individual market infrastructure on their members. This means that members will be regulated by the FSCA directly and remain subject to oversight by the market infrastructure of its rules. Rules and requirements set by market infrastructures should align to the conduct requirements set by the FSCA.

In considering what conduct standards should be developed for market participants, the FMR Committee was established to develop recommendations to strengthen conduct standards in wholesale financial markets focusing on:

¹⁴ Note that while the environments are similar, financial markets and payment systems are treated somewhat differently in the Twin Peaks framework

¹⁵ International Financial Risk Institute, “*Overview of market integrity*”, <http://ifci.ch/00013405.htm>

- specific tools to strengthen the implementation and governance of conduct standards by market participants; and
- areas where changes to financial markets legislation and associated subordinate legislation are required to support a new conduct framework for wholesale financial markets.

The findings and recommendations of the FMR will impact on existing legislation such as the FMA, as well as on the drafting of the COFI Bill. A draft report was published in September 2018 for public comment. Specific conduct requirements may be necessary in the markets space as a result of the recommendations of the FMR. Such requirements are likely to be different in nature to those provided in chapters 3 – 7 of the COFI Bill as it stands. One approach is for an additional chapter and dedicated supporting schedules setting specific market conduct requirements for specific financial market activities to be included in the COFI Bill; credit rating services requirements could similarly be captured.

Buying and selling foreign exchange

The activity of buying and selling foreign exchange in the South African market has been identified as an activity requiring improved conduct oversight. Currently the Financial Surveillance Department in the SARB has the responsibility, delegated by the Minister of Finance, for implementing exchange control policy and administering the Exchange Control Regulations. The department is responsible for appointing Authorised Dealers in foreign exchange (these must be banks licensed by the Banking Supervision Department – now the PA) and Authorised Dealers with limited authority (ADLAs - these typically have no other license from a financial sector regulator). The supervision of the entities appointed by the Financial Surveillance Department is generally focused on ensuring that the thresholds of exchange controls imposed on individuals and corporates in South Africa, are not exceeded. There is some conduct oversight of the activities of Authorised Dealers in so far as they perform advisory and intermediary activities regulated by the FAIS Act. However, it has been identified that similar oversight does not apply to ADLAs. These entities – typically bureaux de changes providing money exchange and remittance services – therefore currently operate with little conduct oversight.

The FSR Act includes **services related to the buying and selling of foreign exchange** as a financial service. This is to ensure conduct oversight of such activities when customers are impacted. The application of the COFI Bill to such activities, in a manner that does not impede the work of the Financial Surveillance Department in terms of Exchange Control Regulations, is being considered.

The COFI Bill and Pension Funds Act

Broadly speaking, the retirement fund industry comprises:

- retirement funds which provide a variety of benefits to their members, be they established by an employer, trade union or financial institution, and
- retirement fund benefit administrators.

Other services are also provided to retirement funds like financial advice, investment management, asset consulting, actuarial and auditing services.

The Pension Funds Act (PFA) together with relevant tax laws, aims to encourage retirement savings by South Africans. The PFA contains both prudential and market conduct requirements in respect of retirement funds. The Act also prescribes duties and responsibilities on employers, administrators, trustees, auditors, valuers, monitoring persons and principal officers as they relate to retirement funds.

Asset consultants and investment managers are not subject to the PFA but are currently subject to the FAIS Act, although the FSCA believes relevant requirements should be enhanced. Auditors are regulated by the Independent Regulatory Board for Auditors (IRBA). Valuers of funds (who are in effect specialised pensions actuaries) are primarily regulated by the Actuarial Society of South Africa (some are also registered with the UK actuarial society) but the FSCA does determine whether an actuary has sufficient retirement fund actuarial knowledge to perform the actuarial requirements in respect of a retirement fund.

It is proposed that **retirement funds** will be required to be licensed under both the PFA and COFI Act, and subject to the requirements in both laws to ensure consistency of treatment of members of retirement funds. However, **retirement fund benefit administrators and other service providers** currently regulated under the PFA, will in future be licensed and authorised under the COFI Act only.

The registration of a retirement fund will thus continue in terms of the PFA. This registration process establishes the fund as a juristic person, separate from its members and officers, and includes the approval by the FSCA of the fund's rules. Persons that intend establishing a retirement fund – which may range from an employer, trade union, or financial institution acting as a sponsor – while not separately licensed, will have to satisfy minimum requirements that ensure the retirement fund's compliance with the licensing requirements before a licence is issued.

Boards of retirement funds will remain responsible and accountable for ensuring compliance by a fund with applicable legislation, as part of their broader fiduciary duties. Given this important function, boards should be fit and proper. In the case of member elected trustees the focus will be on continual skills development through training; they will not be licensed. Professional trustees and independent trustees will be licensed and subject to fit and proper requirements as part of their wider regulatory obligations.

There will be a transition period to ensure alignment across the PFA and COFI Act. Initially, retirement funds will be subject to conduct requirements under both the PFA and the COFI Act; the COFI Act will impose high-level, binding principles in respect of retirement funds that will be applicable in addition to the various requirements contained in the PFA. Over time, conduct requirements will be migrated from the PFA to the COFI Act. Various provisions of the PFA will be retained to provide for the separate legal status of the fund and to set prudential requirements. But this migration can only happen following the conclusion of an in-depth mapping of the PFA to determine which requirements are best placed under the COFI Bill framework to be prescribed as conduct standards.

An example of the complexity of this exercise is the requirement for employers participating in a retirement fund to pay contributions in terms of section 13A of the PFA to the retirement fund, which could be considered a conduct requirement but is also specific to retirement funds given their structure and purpose.

The mapping of PFA provisions has begun within the FSCA, and a process will be set up to engage stakeholders on these developments, building on the workshop held in relation to retirement funds in March 2018.

The overall intention is to ensure that members and beneficiaries of retirement funds will have the relevant protection, both through the provisions in COFI and the PFA.

State-owned pension funds

Currently the Government Employees Pension Fund (GEPF) and other state owned pension funds are subject only to their dedicated laws. Given the large number of South Africans contributing to these pension funds, including many lower-income earners, fund members should arguably be subject to the same member protection as those regulated through the PFA, and consideration is being given to ensuring that these funds are over time also regulated under the COFI Act. For this reason, the definition of pension fund includes public sector funds. The scope of application of the Bill in relation

to such pension funds is explained in clause 6 which also intends to provide for a phased period of compliance with the provisions of the COFI Bill.

Fund members in these funds should also be able lay complaints about poor treatment to a financial sector ombud, which they are currently not able to do as ombuds do not have jurisdiction over state owned funds.

The approach being proposed to state-owned funds will be subject to further consultation and engagement.

The COFI Bill and the Collective Investment Schemes Control Act

The COFI Bill is designed to accommodate any investment arrangement that brings together or “pools” contributions from the public, for the purpose of investing those contributions to generate a return for the investors. These investors can be retail, corporate or institutional. This means that providers of traditional products – like collective investment schemes currently housed within the Collective Investment Schemes Control Act (CISCA) – as well as alternative investments like Real Estate Investment Trusts (REIT) and private equity funds, will be licensed under the COFI Bill framework, and subject to regulatory oversight¹⁶.

The CIS category of pooled investments is retained in the COFI Bill, with levels of protection suitable for the average retail customer (although notably these instruments are used by all categories of investors). Any other pooled investment product will fall under the category of alternative investment. This is to ensure proportionate regulatory oversight, taking account of the risks that the different products pose to different types of customers. This should not be interpreted to mean light-touch regulation of the non-retail market – the global financial crisis highlighted the importance of transparency, fairness and good governance across all parts of the financial sector, irrespective the perceived ‘sophistication’ of the investor.

The provision by financial institutions of pooled investments will fall under the COFI Bill licensed activity of providing a financial product. Licensing requirements for providing pooled investments will in turn differentiate between providing products classified as collective investments and providing products classified as alternative investments. With two exceptions, collective investment schemes currently licensed under CISCA will fall into the first-mentioned category (collective investments). The two exceptions relate to qualified hedge funds and participation bonds, which will fall under the second category (alternative investments).

There are certain activities integral to being a provider of a pooled investment, namely investment administration and investment management. This means that a provider of a pooled fund (whether a collective investment or an alternative investment) will need to be authorised not only as a product provider but also for these related activities. Where these activities are outsourced, this can only be done to a financial institution licensed under the COFI Bill framework for that activity, and the product provider remains ultimately responsible.

The COFI Bill thus proposes repealing CISCA, while also covering a potentially wider range of investment product providers than CISCA. It should be noted that the licensing requirements in the COFI Bill include those related to institutional form or legal status. Schedule 3 is intended to provide further detail on this, but this is a matter that requires extensive further consultation. The institutional form for different types of pooled investments will be a particular consideration in this regard.

The FSR Act provides that the FSCA is responsible for prudential oversight of investment schemes for a three-year transitional period, although it is expected that any prudential requirements will be issued in consultation with the PA.

¹⁶ The COFI Bill does also apply to traditional non-pooled investment products

The COFI Bill and the medical schemes sector

Medical schemes operate similarly to insurers in terms of taking premiums in exchange for medical related cover. Consideration is being given to strengthening consumer protection related to services provided by medical schemes. For example, regulatory requirements related to product design, disclosure and claims management should apply.

The FSCA's full powers and duties under the FSR Act apply in respect of medical schemes. However, the Minister of Finance has determined that the Council for Medical Schemes (CMS) must exercise these powers until 31 March 2021, but with the concurrence of the FSCA. The FSCA and the CMS are working together to reach agreement regarding when FSCA concurrence with CMS decisions is required during this transition period, as well as more broadly on how approaches to conduct of business and consumer protection issues in the medical schemes environment can be harmonised.

Medical schemes will therefore not be required to be licensed under the COFI Bill framework during this transitional period, although this may be reviewed over time.

However, medical schemes should be subject to similar conduct requirements to insurers and indeed other financial institutions, where they are performing similar activities. This means that medical schemes administrators should also be licensed under and subject to provisions of the COFI Bill once enacted.

4

Financial sector development: transformation and inclusion imperatives

The Financial Sector Charter came into effect in January 2004 as a result of agreements reached at the National Economic Development and Labour Council (NEDLAC) Financial Sector Summit in August 2002, on a voluntary basis. The Broad-Based Black Economic Empowerment (BBBEE) Amendment Act was introduced in 2013 and provided for Generic Codes as binding requirements on companies. The Act continues to provide for more specific Sector Codes to be Gazetted that provide higher and more tailored requirements per sector than the Generic Codes do; these are equally binding.

The Financial Sector Code, first Gazetted in 2012, commits participants to develop a transformed, vibrant and globally competitive financial sector that reflects the demographics of South Africa. It contributes to the establishment of an equitable society by ensuring active participation by black South Africans in all levels of the sector and directing funds into targeted sectors of the economy. It also increases the focus on financial inclusion, leading to the sector's renewed engagement with lower-income households insofar as providing financial products into these previously un-served or under-served segments. A revised Code was Gazetted in December 2017 and aims to introduce refined and improved transformation targets for the sector, which better aligns to the Generic Codes.

While some progress has been made in transforming the financial sector, much more needs to be done. The FSCA is well placed as a financial sector regulator to promote a sector that is transformed and transformative, as its focus on customers and outcomes can ensure that the sector effectively supports real customer needs and the real economy. Considerations for a transformed financial sector therefore go beyond issues such as representative employment at financial institutions, transformative procurement opportunities, and representative ownership structures; meaningful transformation should also question how the sector supports real economic activity:

- What services are provided to consumers?
- Who owns the firms that manage the assets? How sensitive are they to our country's needs and challenges?
- How are the assets in the system put to use? (procurement, empowerment financing, socio-economic development)

- Who decides how those assets are invested / put to use? (management control, employment equity and skills development)

Parliamentary hearings regarding transformation of the financial sector were held in the first half of 2017. Submissions from the public emphasised amongst others concerns with the heavy concentration of the sector, high barriers to entry for new or emerging entrants, and the need for much stronger support of black industrialists and small to medium enterprises (SMEs). Submissions also noted the prevalence of poor market conduct practices and financial exclusion, compromising the transformative effects of the sector by benefiting relatively few South Africans. Market conduct issues that were raised included:

- South Africans borrow too heavily for consumption at the expense of borrowing for asset and wealth accumulation.
- Too many South Africans remain financially excluded, especially in rural areas; individuals have poor access to insurance and savings products in particular.
- Financial services are too expensive.
- Foreclosure/repossession practices that put consumers in a worse off position than before the foreclosure/repossession.
- Short term insurance sector cancelling policies when a policyholder is retrenched/can't pay and thus the consumer forfeit all premiums paid to date.
- Banks abuse of the court system, chronic corruption within courts in debt collection practices, and the outdated Insolvency Act hurting the indebted.

Improved market conduct and transformation

It is clear that fair and appropriate market conduct is an important component of a transformed financial sector. A strong market conduct framework is key to ensuring that the financial sector has a transformative effects on all South Africans, and supports financial inclusion. This is particularly important for historically disadvantaged and vulnerable members of the population. Inclusion into the financial sector should not facilitate exploitation, as has sometimes been the case – for example, many cases have emerged of newly banked social grant recipients falling prey to unscrupulous financial services providers and entering into unnecessary credit and insurance contracts from which they cannot easily exit.

Government and financial service providers have improved overall financial inclusion from 55 per cent in 2005 to 90 per cent in 2018¹⁷, meaning that most adults in South Africa now have some form of financial product from a regulated financial institution. However, this has not adequately translated into an improvement in the quality of lives of low-income households, nor into viable economic prospects for many SMEs or micro-enterprises. Several products sold to the mass market are not appropriate, and customers are not always treated fairly. Many South Africans with a bank account withdraw their entire salary as soon as it is deposited, and many households are over-indebted. Better treatment of customers can build trust and confidence in the financial sector, supporting broadened participation, the increased use of a wider range of products and services, and in turn stimulating savings and insurance protection against loss. The statutory objective of the FSCA to promote fair treatment of financial customers therefore has an important supporting role to play in transformation and financial inclusion.

¹⁷ Finscope 2018, produced by FinMark Trust

Addressing regulatory barriers

Improved conduct is by no means the only manner in which transformation of the sector is to be achieved. To be supportive of the transformation of the financial sector, laws and regulation in the sector should be designed in a manner that:

- Supports competition and contestability in the sector, allowing for new entrants that offer good value and appropriate financial products and services.
- Does not pose disproportionate barriers to entry, or barriers to existing players to innovate, expand their offering and grow.
- Levels the playing field across providers, irrespective of size, complexity and maturity of the institution.

Additionally, regulators must be able to take a proportionate approach to regulation and supervision. Laws should allow for proportionate application. Historically, financial sector laws have set blunt requirements, applied in a ‘one size fits all’ manner, which could disadvantage new entrants and smaller institutions. It can also create unnecessary compliance burdens for larger institutions.

The Twin Peaks reforms underway aim to improve the legislative framework applicable to the financial sector, simplifying and harmonising requirements, reducing undue barriers and ensuring a proportionate application of law. To achieve this, the FSR Act introduces the objective of transformation, and requires that the regulators, when performing their functions, must “take into account the need for a primarily pre-emptive, outcomes focused and risk-based approach, and prioritise the use of its resources in accordance with the significance of risks to the achievement of its objective”.

The COFI Bill further embeds this approach.

At a general level, the COFI Bill provides a clear guiding framework for conduct regulation of the sector, allowing the regulator to apply it in a manner that is proportionate to the size, complexity and risk posed by financial institutions, developing regulatory requirements that:

- Do not impose **compliance requirements** that make product and service costs too high to service low income markets; and
- Do not limit diversification, competition and sustainable growth in financial services by imposing unreasonable barriers to the **entry of new players** – particularly emerging small and medium sized businesses.

The new regulatory framework proposed in the COFI Bill is also explicitly supportive of transformation. It includes a definition of transformation of the financial sector, aligned to the BBBEE Act, and makes transformation an objective of the Bill. Dedicated provisions relating to the application of the Act, provisions in the licensing chapter, and governance framework requirements, include transformation as a consideration for regulatory actions undertaken by the FSCA. These are discussed in further detail below.

A developmental framework that supports a transformed, transformative and inclusive financial sector

Meaningful transformation of the sector should look at efforts to explicitly support the formalisation and growth of businesses, both incumbents and new entrants, in line with empowerment and transformation objectives.

Provisions in the COFI Bill enable a more supportive framework for new entrants into the financial sector. It provides the ability to set a more tailored regulatory dispensation that allows for gradual

compliance with certain regulatory requirements over time, rather than needing to be fully compliant before engaging with the regulator. To provide for such an approach, the COFI Bill in clause 8 allows the FSCA to exempt institutions from provisions of the Bill, for developmental, financial inclusion and transformation objectives.

The licensing approach is similarly supportive. Discussed further in chapter 5 of this document, licensing under the COFI Bill shifts towards an activity-based approach. The FSCA is obligated in terms of clause 7 of the Bill to develop a licensing framework that takes into account the object of the Act (including transformation), and that is proportionate to the activities of the financial institution. The FSCA will be able to set specific license requirements on financial institutions, allowing for progressive realisation of requirements, for purposes including providing scope for transformation of the financial sector. This is set out in clause 15. License conditions can similarly be set that allows for the development of a licensee to meet requirements over time, to facilitate transformation. This is set out in clause 19.

Apart from transformation considerations at a licensing stage, the COFI Bill supports a proportionate approach to regulation that allows for regulatory requirements to be better tailored to the nature of financial institutions and the levels of risks they pose, rather than taking a ‘one-size-fits-all’ approach that can hamper growth and development. It supports the achievement of specified outcomes in the sector and shifts away from a tick-box approach to compliance. This shift in approach allows for a regulatory dispensation that does not provide undue barriers to entry or impose undue regulatory burdens.

As briefly discussed in chapter 1 of this document, large institutions generally have the resources and skills required to design suitable regulatory compliance approaches in a principles-based regime. Smaller institutions however may benefit from an instructive approach from the regulator on how to prove compliance with laws. The FSCA will consider how best to support smaller institutions, including through guidance notices, and standardised templates.

The regulator can further support financial inclusion, and the transformative effect of the financial sector on the lives of ordinary South Africans, by promoting inclusive business models of regulated entities.¹⁸

Effective transformation and good governance

Transformation refers to broad-based participation in the financial sector by black South Africans, supporting the sustainable supply of appropriate financial products and services by black-owned and run businesses. An untransformed financial sector is unlikely to deliver products and services that meet the needs of black South Africans, and therefore cannot sustainably support inclusive growth.

¹⁸ Inclusive business models can drive transformation in the financial sector, in terms of increasing consumer access to financial products and services as well as ensuring that this access enables South Africans to use financial products to improve their quality of life. Inclusive business models minimise the barriers that prevent customers from meaningfully using financial products and services. These barriers include:

- affordability;
- physical proximity;
- appropriateness of product/service features for the target market;
- eligibility requirements imposed by financial service providers to access the service; and
- regulatory requirements that influence whether a person can access a product/service or not.

Moreover, a financial institution that fails to transform may compromise its longer-term earnings and growth prospects. Effective transformation is in the public interest and is good governance.

With this in mind, it is proposed that a financial institution be required as part of its governance framework to design, publish and implement a transformation policy that should satisfy the requirements of the BBBEE Act and the Financial Sector Charter.

The Insurance Act, enacted in 2017, took the first step in providing a framework for requirements relating to transformation to be set on insurers. It provides for transformation in:

- The objective of the Act.
- Requirements for conversion of existing registrations and new licences (by requiring an applicant to demonstrate that it has a plan to meet its stated commitments in terms of transformation of the insurance sector, including meeting the targets envisaged by the Financial Sector Code).
- Variation of licensing conditions, exemptions and conversion of registrations under the previous insurance regulatory framework (as with new licenses).

The Insurance Act thus entrenches a regulatory and supervisory approach for the PA in relation to insurers that takes into account developmental, financial inclusion and transformation objectives. To ensure it is consistently applied across the financial sector, provisions in the COFI Bill – which will apply to all financial institutions once enacted – will replace the provisions of the Insurance Act and be applicable to all financial institutions.

Requirements are set out in Chapter 3 of the COFI Bill – clause 38 contains requirements for a transformation policy. The transformation policy is likely to describe:

- What transformation means to the entity.
- How their policy relates to their overall strategic plan.
- Who is responsible for transformation across the entity, at the consolidated level and across the various line departments.
- Approval and oversight processes, including by the Board.
- Goals with timelines and an implementation schedule.

The financial institution will be required to report to the FSCA on how it is achieving its policy, and besides being subject to fines for falling short of its targets, shortcomings may be taken into account in related supervisory decisions, like whether that entity can extend product lines or merge with another entity to grow business.

Consideration should be given to whether these provisions in the COFI Bill are sufficient, or whether more explicit provisions may be needed, including on the role of the regulator once exemptions are granted.

Towards a Financial Sector Summit

South Africa has recognised that concrete steps are necessary to address existing structural imbalances that remain from apartheid, not only in the financial sector but across the economy. The targets identified in the BBBEE framework set these out, and have been included in the Financial Sector Code.

It is acknowledged, and has been highlighted through the Parliamentary engagements on transformation, that the Code has many shortcomings. Questions are being asked about its effectiveness. Questions raised during the Parliamentary proceedings included:

- Are the targets set in FSC the right targets to ensure transformation?
- Is the FSC succeeding in transforming the financial sector or not?
- Are targets ambitious enough?
- What could be refined?

It is envisaged that the BBBEE framework, and the associated Financial Sector Code, should remain the principle channel of directing transformation of the financial sector, to ensure it is aligned to transformation efforts in other industries in South Africa.

However, clearly work must be done to address the shortcomings and weaknesses in the current code and approach to BBBEE targets. Government supports the calls for new Financial Sector Summit to be held to refocus transformation policy, approach and implementation, as agreed in NEDLAC. Market conduct and the role of the FSCA should form an important part of the agenda.

5

Licensing financial institutions

The approach to licensing under the new conduct framework represents a significant shift from the current system. Financial institutions in South Africa today are licensed on an institutional basis – as a bank, an insurer, a collective investment scheme and so on. This institutional approach has been found lacking in the regulation of business conduct. It lends itself to gaps and creates opportunities for arbitrage – even if offering a product or service that looks and “behaves” like a financial product or service, a provider may be able to structure itself to fall outside of the regulatory definitions set out in law to avoid being licensed and regulated under that law. Examples in South Africa include property syndications, certain forex trade-related businesses and certain debt collectors. On the other hand, technology is bringing with it the opportunity for many new types of providers – like technology companies – to compete with traditional brick-and-mortar financial services businesses. The law should sufficiently enable this new competition while adequately protecting consumers against abuse.

The proposed licensing approach is set out in Chapter 2 of the COFI Bill and the accompanying licensing framework in Schedule 2. These provisions should be read alongside licensing powers given to the FSCA under the FSR Act. Provisions in Chapter 2 and in the FSR Act deal with the process that the regulator will follow when licensing institutions, and what license requirements will be. Schedule 2 addresses the activities that institutions can apply to be authorised for in their conduct license. This means a single entity can have one conduct license with different authorisations.

Consequential amendments will be made to the FSR Act to ensure that there is alignment between the definitions of financial products and services, and the activities captured in the licensing schedule.

Box 3: Treatment of existing licenses under a new licensing regime

Once the COFI Bill is enacted, to ensure certainty and expediency, a financial institution that is licensed under existing financial sector laws will have its license converted into the new regime following a mapping process of its activities to the new framework, over a staggered period. This is similar to the approach taken in implementing the 2017 Insurance Act. The mapping process, led by FSCA, will involve ongoing engagement to assist financial institutions understand what they must be authorised for, and what obligations are imposed as a result. To minimise disruption a transitional period will be granted to comply with the requirements of the COFI Bill.

New entrants requiring a license after the COFI Bill is enacted will be subject to the new regime, and provision is made to developmentally support these entities where necessary, including in support of transformation.

The COFI Bill will also assist the FSCA in fulfilling its expanded regulatory and supervisory scope of jurisdiction, as provided for in the FSR Act. This includes its oversight of new areas such as regulation of credit providers and payment service providers, and a refined approach to regulating investment funds, pension funds, and the financial markets. The regulatory and supervisory approach to these areas will shift under the approach proposed by the COFI Bill.

The licensing and supervisory approach provided for in the COFI Bill is explained more fully below.

The COFI Bill licensing framework

The new licensing framework entrenches the activity-based approach of the FSCA. Any financial institution that carries out one or more identified activity will be required to be authorised for each such activity. An institution that carries out multiple activities – as many financial institutions currently do – will therefore obtain a single FSCA licence, but with multiple activity authorisations.

The licensing approach is three-tier: a financial institution will be authorised to carry out an activity, which is linked to a specific financial product/products¹⁹, which is linked to the customers to which the activity applies.

Licenses will be issued in terms of the primary law and will specify the activities a licensed institution is authorised to perform. Schedule 2 of the COFI Bill provides the full list of activities requiring authorisation. Licensing conditions accompanying that license will specify the products and customers to which authorised activities will apply. This implies that should a licensee want to add or remove any of the activities which it is authorised to perform, it will require a change to its primary license. However, should there be amendments to the products or customers that an activity relates to, it would require only a change to licensing conditions.

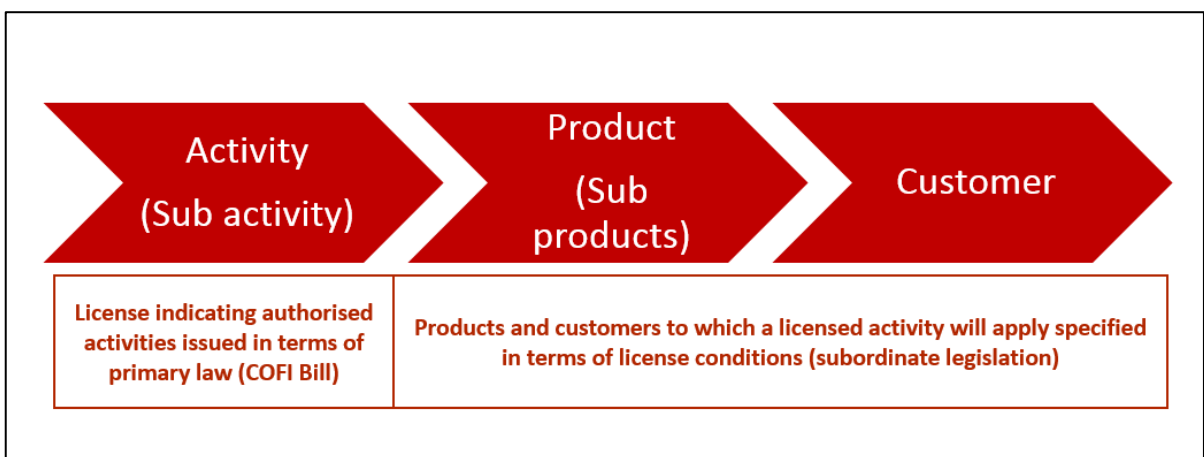


Figure 2: Three tier licensing approach

The schedule of activities is intended to mirror the defined list of financial services in the FSR Act, and consequential amendments will be made where necessary to ensure alignment between the two laws. The FSR Act defines the universe of regulated financial products, and license conditions will

¹⁹ Note however that in some instances, the activity does not relate to a corresponding financial product (for example, a credit rating service is not provided in relation to a product).

be linked to those defined products. The FSR Act allows for the Minister of Finance to designate new financial products and services, and provision will be made to ensure that changes to the list of financial services includes changes to the schedule of activities requiring a license under the COFI Bill.

To assist in better understanding the licensing approach, included as Annexure 4 of this document is an extended licensing schedule which includes the categories of financial products to which an authorised activity could apply.

Dual licensing

Dual licensing is a principle embedded into the Twin Peaks framework, and requires a financial institution to obtain the approval of both authorities – the FSCA and PA – in order to operate.

As an interim step towards achieving “dual key” licensing, for each sectoral law the FSR Act deems either the PA or the FSCA the “responsible authority,” which in effect renders it the regulator responsible for issuing the license. To ensure that both regulators “approve” the financial institution that is applying to operate, the Act builds in a concurrence requirement of the other regulator. So for example, in licensing a new bank, the PA as the responsible authority of the Banks Act can issue a license, but only with the concurrence of the FSCA.

The COFI Bill completes the move to the dual key licensing process, as each regulator is now responsible for its own law. Using the bank example, the bank will be required to be licensed as a bank under the Banks Act by the PA and for the various activities it performs under the COFI Act by the FSCA.

The licensing framework provided for in the COFI Bill therefore only deals with the licensing approach that the FSCA will follow. Memoranda of understanding, as required by the FSR Act, will provide for a process of cooperation and coordination with the PA, ensuring that the dual key licensing approach is well-coordinated between the regulators and is handled efficiently.

Main categories of authorised activities

Schedule 2 of the COFI Bill sets out the categories of financial activities requiring a license. The schedule includes sub-categories as well as descriptions of each of the activities provided for. They are:

1. Providing a financial product or financial instrument
2. Distributing Financial Products
3. Financial Advice
4. Managing and Administering Investments
5. Benefit Administration
6. Professional Fiduciary or Custodian Service
7. Payment Service
8. Financial Markets Activities
9. Providing benchmarks and related services
10. Service related to buying or selling of foreign exchange
11. Credit Rating Service
12. Debt collection service

Approach to outsourced and other activities

The licensing framework provides the activities that require a direct license from the FSCA. It is recognised that there are instances where the performance of a financial activity may be outsourced by a financial institution to another service provider. In some instances, the FSCA may require that specific activities can only be outsourced to entities that themselves are directly licensed to perform that activity. In other instances however, entities performing outsourced activities on behalf of a licensed financial institution may not require a licence. The licensed financial institution will remain ultimately responsible for ensuring that the outsourced activity is performed in line with regulatory requirements. The FSCA will still be empowered to monitor the performance of the activity on an indirect basis, and may set conduct standards for the activity and take enforcement action against the service provider where necessary.

As noted in the previous chapter, there are instances of activities that fall under the scope of jurisdiction of the FSCA but which are not included in the list of activities requiring a license. This can include activities which are licensed by another regulator, such as the NCR, or licensed in terms of another Act, such as the NPS Act. Similarly to the approach taken with outsourced activities, the FSCA will be able to regulate and supervise these entities without a license.

Finally, persons who are not directly providing a financial product or financial service as defined, but provide an activity that is critical to the customer experience, may also be directly subject to regulatory requirements – issued as a conduct standard – even though not requiring a license.

The final list of activities requiring a licence, as well as the definitions of those activities, will be subject to further discussion and consultation. Inputs from stakeholders would be welcome in this regard.

Issues for consideration:

- Are there omissions in the schedule of activities and sub-activities requiring a licence?
- Are there activities in the schedule that may not require a direct licence from the FSCA?
- Are the activities and sub-activities appropriately defined?

Box 4: Consumer protection in the Indonesian financial sector

Indonesia is one of the fastest growing economies in Southeast Asia. Similar to South Africa, it has high levels of inequality in terms of the distribution of wealth, and has a financial sector dominated by financial conglomerates. The Otoritas Jasa Keuangan (OJK – the Financial Services Authority of Indonesia) was established to ensure that the overall activities within the financial services sector are:

- Implemented in an organized, fair, transparent and accountable manner;
- Able to realize the financial system that grows in a sustainable and stable manner; and
- Capable of protecting the interests of consumers and the society.

In 2014, OJK obtained regulatory and supervisory responsibility for the banking sector (including in relation to consumer protection). Indonesia does however have overlapping consumer protection regulators, laws and regulations. Other regulators include the Ministry of Trade and the National Consumer Protection Agency (NCPA) and there is a concern around the lack of

coordination among relevant regulatory bodies.²⁰ It is also noted that while OJK has a strong policy focus on consumer protection, it does not separate its prudential and market conduct supervisory arrangements.

²⁰ World Bank Group, “Indonesia Diagnostic Review of Consumer Protection and Financial Literacy”, <https://openknowledge.worldbank.org/bitstream/handle/10986/25879/111628-WP-P147776-PUBLIC-v2-IndonesiaCPFLDiagReviewVolumeIIFINAL.pdf?sequence=1&isAllowed=y>, December 2014

6

Achieving appropriate market conduct outcomes in the financial sector

Conduct requirements for the South African financial sector are currently spread across 13 different pieces of legislation. Depending on their institutional form, financial institutions comply with different requirements, set in different ways. Some requirements are highly prescriptive in terms of how compliance is to be demonstrated, while others are less so. Some financial institutions are required to comply with more requirements than others, even if the nature of the activity they perform is similar. In some instances, different requirements are set on different financial institutions to try and achieve similar outcomes, or very similar activities are described differently in different provisions. This is particularly problematic for financial institutions that are currently required to be licensed under more than one sectoral Act.

For example, insurers were typically required to be licensed under either the Long-term or Short-term Insurance Act, as well as the FAIS Act. However, definitions of intermediation activities in the Insurance Acts and the FAIS Act differed, as did disclosure and marketing requirements. Further different and sometimes overlapping disclosure requirements apply under the Collective Investments Schemes Control Act and under the Pension Funds Act. Although interim reforms align some of these requirements to a degree, the COFI Bill presents a framework for doing so holistically and consistently.

The COFI Bill significantly streamlines the current legislative framework. The Bill will for the most part replace existing conduct requirements across all existing financial sector laws²¹. It is designed to instead provide a holistic and flexible law that sets consistent high-level minimum requirements on all financial institutions.

²¹ The COFI Bill does not replace provisions in the National Credit Act or the Medical Schemes Act

Principles and proportionality

As discussed in Chapter 1, the Twin Peaks model of financial sector regulation entails a shift away from the traditional prescriptive approach to financial sector legislation and regulation – which has typically led to a tick-box approach to compliance – toward an outcomes-focused approach supported by principles-based legislation, regulation and supervision.

There has been some uncertainty about what such a shift in approach would mean, both for regulated institutions and for the regulator. The COFI Bill aims to introduce the new approach in an appropriate, non-disruptive manner.

Chapter 3 of the Bill provides minimum overarching conduct principles, including specific principles for institutions dealing with retail customers. Chapters 4 to 8 indicate to financial institutions, through the ‘Purpose of chapter/part’ provisions in each chapter, the nature of the outcomes expected in their interactions with their customers.

Including these principles and outcomes in primary law will mean they are binding on financial institutions. A principles and outcomes based approach lends itself to drafted provisions that are widely applicable, so they are as relevant to small institutions as to larger and more complex ones. The drafting of the Bill is therefore not overly reliant on prescriptive requirements.

However, a principles-based approach does not entail an absence of rules or detailed requirements. The legislation does, where appropriate and necessary, include more detailed requirements, and the regulator will also be empowered to set standards through the COFI Bill.

For example, the chapter on governance and culture (Chapter 3), sets the principle requirement that financial institutions must at all times conduct their business with integrity. The chapter also sets more detailed requirements on what an appropriate governance framework should comprise. Importantly, compliance with the *detailed* governance framework requirements will not be the only criteria on which an institution will be supervised; it will have ensure that meeting the detailed requirements in effect fulfils the *principle* requirement of conducting its business with integrity.

Demonstrating that a principle has been met or an outcome has been achieved can be done in various ways, as appropriate for each financial institution. A financial institution, itself most familiar with the operation of its business, is better placed to understand how to demonstrate the outcomes that the institution’s conduct produces. The manner in which a large banking group demonstrates that it operates with integrity, for example, could differ to how a large financial advisory practice demonstrates this. The avoidance of prescriptive requirements in primary law allows for different models of demonstrating compliance, shifting away from the tick-box method.

Box 5: Internal models of compliance

In addition to setting legal requirements, regulators can either prescribe in great detail how compliance to these requirements is demonstrated, or be less prescriptive and allow the entity to develop its own model of compliance. Under Basel II for example, rather than developing a set model for risk-assessment across a variety of entities, the approach encouraged the implementation of credit entities’ own models, known as internal models, for measuring their financial risks²². This is based on the bank’s own estimates of a set of factors.

²² Medina, R., Alfonso, M. and Cueto, M., “*Internal models (IRB) in Basel II: an approach to determining the probability of default*”, Banks and Bank Systems, Volume 5, Issue 2, 2010

Similarly, rather than prescribe what information needs to be provided in order for a financial institution to demonstrate compliance with the COFI Act, the regulator may allow for internal models of compliance to be developed. In this way, large financial groups will be able to distill the information required to demonstrate their understanding of conduct risks in their business, and indicate how they are mitigating these risks. Such an approach is likely to be best suited for large financial institutions, with smaller entities benefitting more from a more prescriptive approach.

It is important to note that from a prudential regulation perspective, the approach taken in Basel II is being reviewed for two reasons²³:

- Internal models have become increasingly complex since they were initially introduced under Basel II. This has made it more and more difficult for banks and supervisors to understand them and to assess whether risks are being mapped correctly and consistently.
- A number of benchmarking studies have highlighted inconsistencies as well as high variability in the capital requirements calculated by different banks' internal models.

The suitability of internal models for conduct compliance is considered to still be suitable to the South African context, but there will be careful consideration of changes that may be undertaken in the field of financial regulation going forward.

The shift in regulatory and supervisory approach is also intended to better support the proportionate application of regulation. It is recognised that smaller institutions may benefit more from a prescriptive approach, rather than designing their own internal models of compliance. Small, less complex operations present less risk of transgressing outcomes while meeting prescriptive requirements, and it would be to the benefit of both the regulator and such entities to set guiding frameworks for compliance. The COFI Bill allows for this to be done through tools such as guidance notes and standards tailored to institutions performing certain activities, providing specific products or addressing specific target markets.

Proportionality better supports competition and a level playing field in the financial sector. It means that small or new institutions are not expected to comply with regulation in the same manner as larger established institutions, creating a friendlier environment is for the entry of new small players, and better supporting smaller incumbent businesses to grow over time.

Focusing on outcomes in the financial sector

The principles-based drafting of the COFI Bill supports a shift in supervisory approach. Rather than checking whether “boxes have been ticked”, the FSCA can focus on monitoring the demonstrable achievement of outcomes in the financial sector, pre-emptively identifying emerging trends and risks. Importantly, the regulator will be able to hold institutions to account based on evident transgressions of a principle or failure to deliver a required outcome.

Internationally, it is noted that generally financial sector regulators have begun to “move... away from a reactive to a pre-emptive and judgement based approach, and now seek to address the underlying causes of misconduct rather than simply dealing with the symptoms. And most importantly, they are moving from an approach focused only on compliance with rules to one that

²³ European Central Bank, “*What is the targeted review of internal models?*”, 2017

encourages firms to do the right thing with respect to the customers they serve and the markets they operate in.”²⁴

The Institute of Chartered Accountants in England and Wales have developed Principles for Good Financial Regulators which notes that “regulatory activity is not an end in itself, only final outcomes matter.”²⁵

An outcomes-based approach allows both financial institutions and their regulators to be held accountable for ensuring the correct outcomes are being met in the financial sector.

Box 6: Evaluating the effectiveness of regulation through outcomes²⁶

The Monetary Authority of Singapore has developed the following list of questions for evaluating the effectiveness of a regulatory system with multiple objectives. These are useful to consider in evaluating the **outcomes** that a regulatory system is producing:

- Is the financial system as a whole stable even in the instance of the failure of one or more financial institutions?
- Is the financial system serving the needs of customers and the economy efficiently?
- Are regulatory standards of a high quality, consistent with international standards and best practice, yet appropriate to the local context?
- Is there shared ownership of the desired outcomes of regulation among stakeholders?
- Does the balance of benefits and costs weigh in favour of regulation?
- Are market incentives alone likely to deliver a desired outcome?
- Are the obligations imposed by regulation on regulated entities clear?
- Does regulation take into proper account market practices and legitimate commercial considerations?
- Does regulation provide regulated entities with legal certainty and predictability where it is needed and, where appropriate, flexibility to apply their own practices to meet regulatory objectives?
- Does the regulation provide a level playing field for potentially competing activities and institutions?
- Does regulation recognise that some institutions may have lower risk profiles and stronger governance and controls? Does it provide differentiated treatment where appropriate and can it adjust in a timely fashion if the risk profile changes?
- Is the regulatory framework able to adapt to fast-changing practices and products as well as to new risks in the financial services industry so that it can continue to be effective in respect of its intended regulatory objective and impose obligations that remain appropriate?

²⁴ Oliver Wynman, “*Conduct Risk Management in the Asia Pacific Region*”, 2014, p.6

²⁵ The Institute of Chartered Accountants in England and Wales, “*Principles for Good Financial Regulators*”, <http://www.icaew.com/en/technical/financial-services/inspiring-confidence-in-financial-services/principles-for-good-financial-regulators>

²⁶ Monetary Authority of Singapore, “*Tenets of Effective Regulation*”, June 2010

Chapters 3 to 8 of the COFI Bill set requirements on licensed financial activities, starting with overarching culture and governance requirements in Chapter 3, with Chapters 4 to 8 structured to broadly align with the typical lifecycle of financial product and service provision.

The lifecycle structure that these chapters follow aligns with the design of the TCF outcomes-based framework, which is similarly structured to require stated outcomes at different stages of a typical customer's interaction with a financial institution. However, it is important to note that the outcomes entrenched in the COFI Bill are broader than the TCF outcomes. The TCF outcomes are aimed mainly at retail customers (including retail-end customers), whereas the COFI Bill is intended to have scope of jurisdiction across the financial sector, and is not limited to the retail environment. Chapters 3 to 8 are therefore drafted to be appropriately applied to all interactions taking place in the financial sector – from those involving individual, retail customers to those involving institutional or corporate customers. The chapters set requirements for financial institutions generally; where appropriate, there are also more specific requirements for institutions that serve retail customers.

The chapters are summarised below, with specific issues for further consideration flagged per chapter.

Overall issue for consideration for chapters 3 to 8:

- Are there instances where provisions in these chapters may be too detailed for primary legislation, or would be better placed as standards?

Culture and governance – Chapter 3

Chapter 3 aims to foster cultural and governance practices within financial institutions which support the correct conduct outcomes being achieved, including ensuring due regard to the interests of customers. The chapter sets a number of general principles that financial institutions will be required to uphold when operating in South Africa. This chapter is a key component of the drive toward improved overall market conduct in the financial sector.

General principles specified in this chapter include that a financial institution must at all times:

- conduct its business with integrity;
- conduct its business with due skill, care and diligence;
- organise and control its affairs responsibly and effectively;
- maintain adequate financial and other resources;
- observe proper standards of market conduct and of conduct of business;
- pay due regard to the interests of its financial customers and treat them fairly;
- pay due regard to the information needs of its financial customers, and communicate information to them in a way which is clear, fair and not misleading;
- manage conflicts of interest fairly;
- take reasonable care to ensure the suitability of its advice and discretionary decisions for any financial customer who is entitled to rely upon its judgment;
- arrange adequate protection for financial customers' assets when it is responsible for them; and
- deal with the Financial Sector Conduct Authority in an open and cooperative way.

The chapter sets requirements for governance frameworks within financial institutions, including corporate governance, risk management and internal control requirements. There is a close relationship between the governance of a financial institution and its ability to properly meet its other regulatory requirements. Thus, governance requirements include that a financial institution have in place policies that support the achievement of outcomes specified in later chapters of the

COFI Bill – for example, that there are policies in place to support clear oversight and governance of products and services.

An element of good governance for all companies operating in the South African economy is the commitment to the government objective of empowerment and transformation of the economy. For this reason, and consistent with the objectives and provisions of the BBBEE Act as amended, the COFI Bill requires that governance frameworks for financial institutions include a transformation policy, as discussed in Chapter 4 of this document.

Persons in control of a financial institution can influence the governance and risk-management behaviour of the institution. For this reason, Chapter 3 of the Bill also sets requirements for significant owners of financial institutions. Fit and proper requirements for significant owners as well as key persons are specified.

Compensation and remuneration practises in the financial sector are receiving increasing attention both domestically and in the international arena. Part 5 places specific requirements on financial institutions regarding their conflicts of interest policy. Part 6 sets principle requirements for remuneration practises within financial institutions. Remuneration practices are closely linked to the risk incentives, and thus carry both conduct and prudential risks.

In many instances, requirements related to governance of an institution address both prudential and market conduct risks, and both the PA and the FSCA therefore have an interest in governance arrangements. For this reason, regulatory requirements for governance frameworks are likely to be developed by both the PA and FSCA and issued through joint standards.

The chapter provides for standards to be set with further detail of how some of the requirements may be met. Standards can specify requirements that may be particular to a specific activity (e.g. providing risk products versus providing deposits), particular to a specific institutional structure (e.g. a public company versus a sole proprietor), or particular to specific customer interactions (e.g. institutions involved in the retail market versus institutions dealing with other institutions).

Issues for consideration:

- Do the proposed requirements in this chapter dovetail appropriately with similar requirements that may be found in other relevant legislation, in particular, prudential requirements and requirements in the Companies Act?
- Are the requirements sensible for all types of licensed financial institutions?

Box 7: The rights and responsibilities of financial customers

Financial market conduct regulation sets clear obligations on financial institutions regarding their interactions with customers. Such regulation aims to address traditional imbalances in power and information between institutions and their customers, and ensure customer protection.

However, customers too have obligations toward the institutions they interact with in the financial sector and indeed the economy more broadly. Improved outcomes in the financial sector benefits from appropriate conduct by both financial institutions and financial customers.

Some jurisdictions impose obligations on, or publish recommended behavior of, financial customers in their interactions with financial institutions. In a few instances, these are set

in terms of law, while in most others, it is provided in terms of regulatory or industry guidance. A summary is provided below:

In **Uganda**, the Uganda Bankers Association, an industry association, sets the following obligations on financial customers:

- To provide correct information to assess whether they qualify for a given service or product.
- To maintain a consistent specimen signature or request for a change of signature when a variation is noticed.
- To advise financial service providers of changes of contact details (address, e-mail or telephone number).
- To fulfill the terms and conditions of the services as indicated in the contract documents signed.
- To keep safely documents that can cause risk of loss to the bank e.g. cheque books.
- To keep safely / secretly private codes or pin numbers.

In **Canada**, the Insurance Bureau of Canada (IBC), an industry association representing Canada's private home, auto and business insurers, has published a Code of Consumer Rights and Responsibilities, which requires customers to:

- Understand their needs.
- Provide accurate information.
- Update their information.
- Report the facts (in relation to a claim).

In the **Netherlands**, the Authority for Financial Markets (the Dutch market conduct regulator) advises that consumers should do the following when seeking financial advice:

- Ask as many questions as possible and only purchase financial products that they understand.
- Ask for a financial information leaflet if they are thinking of purchasing a complex financial product.
- Contact the AFM if the correct information is not being provided to them.

In the **United Kingdom**, the Financial Conduct Authority similarly sets out recommended actions for consumers when interacting with financial institutions, including:

- Know the deposit protection limits on your bank account.
- Check the FCA's register of firms and advisors to avoid.
- Beware of upfront fees.
- Check whether a firm is permitted to offer loans and credit.
- Protect their personal information.
- Notify their bank in case of a card lost or stolen.

In Saudi Arabia, the Saudi Arabian Monetary Agency (SAMA), in its binding Finance Companies' Consumer Protection Principles, sets mutual obligations on financial institutions and customers. Customer obligations include:

- Providing honest information.
- Ensuring they understand the information provided by their service provider.
- Asking questions where they don't understand.
- Knowing how to complain.
- Using the product in line with terms and conditions stated.
- Avoiding risks that threaten their financial situation.
- Applying for products or services that meet their needs.
- Reporting any unauthorised transactions to their bank.
- Not disclosing their banking information to another person.
- Talking to their bank when facing financial difficulties.
- Providing an updated information and correct email address.

Financial products – Chapter 4

The design and performance of financial products can be directly linked to the outcomes that financial customers experience. Financial products should be developed to meet a clearly identified and legitimate customer need. Chapter 4 sets principle requirements to ensure that financial products are designed to meet customer needs, are targeted appropriately, and perform as expected. Financial institutions are expected to have a written product oversight and governance policy in place.

The FSCA will not require institutions to get product preapproval from the regulator before going to market²⁷. Institutions and their leadership are the first line of defence in ensuring that products taken to the market are designed appropriately. Senior management is therefore required to sign off on new products. Product pre-approval by the regulator has the potential to carry a moral hazard risk, raising questions about who is responsible in the case of the product not living up to customer expectations. It also carries the risk of delaying business processes at financial institutions.

It is anticipated that the FSCA will be able to prescribe certain product features where this is considered appropriate for specified target markets (such as micro-insurance products), or to prohibit the inclusion of potentially harmful product features, either in their entirety or when products are designed for specific target markets. The FSCA will have intervention powers where it becomes apparent that products or services issued are not delivering appropriate outcomes.

The chapter sets out a number of issues where standards can be set, including product performance requirements, on-going product monitoring requirements, charging structures, and the identification of suitable target markets.

Issues for consideration:

- This chapter is intended to apply to all financial institutions that provide financial products. All financial institutions should be cognisant of the needs of their customers when designing products or services. Are the requirements in the chapter suitable for application to financial institutions dealing with non-retail customers?

²⁷ For certain categories of financial products, financial institutions may be required to notify the FSCA prior to launching the product

Box 8: Product standards for products sold to vulnerable customers

The poor treatment of social grant beneficiaries by financial service providers came under the spotlight recently in South Africa. Social grant beneficiaries, comprising some of the most vulnerable members of society, found themselves exposed to unscrupulous institutions who sold them unnecessary or expensive financial products and services, including loans and insurance policies. In many instances, these were collected on through debit orders imposed on their bank accounts, which in some instances left them with no grant money after deductions were made.

As South Africa considers how best to distribute social grants in a safe, affordable manner, that does not leave the beneficiaries vulnerable to predatory behaviour, consideration is being given to product standards for simple financial products which are used by particularly vulnerable customers.

In the case of social grant beneficiaries, such product standards could apply to the provision of simple bank accounts, which carry low costs, and allow only a certain number of transactions to be performed against such accounts. So for example, it could permit only a single debit order, or allow debit orders only of a limited value. National Treasury commissioned a diagnostic study into market conduct practises in the South African retail banking sector, with the final report published in September 2018²⁸. As part of taking recommendations of that report forward, the FSCA will commission further research into customer needs in relation to transactional banking, which can inform the setting of product standards including for products aimed at vulnerable customers.

Simple financial products could be considered in for other financial products, including insurance and savings policies, to ensure that the needs of vulnerable customers are met while limiting the opportunity to exploit their participation in the financial sector.

Financial services – Chapter 5

Similar to financial products, the manner in which financial services are designed and provided to customers can impact on customer outcomes. Chapter 5 contains similar provisions to chapter 4 in requiring a financial institution to consider the needs, circumstances and expectations of targeted financial customers, when providing financial services. It also required institutions and representatives to remain aware of the impacts of financial services on customers indirectly impacted through another financial institution.

The chapter allows for specific requirements to be set on financial services offered to retail financial customers. This chapter will allow for specific conduct standards to be set on financial services for matters such as investment administration, services provided to another financial institution, payment services, and benchmark determination. This is in recognition of the range of financial services that may be offered that are not always linked to a financial product, and so require distinct and specific conduct oversight of that activity in itself.

Promotion, marketing and disclosure – Chapter 6

Financial institutions should promote, market and disclose information about their products and services in a way that promotes informed and confident decision-making by customers. This chapter requires financial institutions to have documented processes and procures in place for signing off promotional and marketing materials by a person of appropriate seniority. Certain requirements for the presentation of promotional and marketing material are specified, and prohibited marketing practises are specified. The chapter also ensures that lines of accountability remain clear, in that

²⁸ The full report is available on <http://www.treasury.gov.za/publications/other/SA%20Retail%20Banking%20Diagnostic%20Report.pdf>

financial product or service providers remain ultimately responsible for their products and services, even if these are promoted or marketed by other entities.

Chapter 6 also provides for more consistent disclosure requirements to be set across the financial sector. Consistent standards of disclosure can better empower customers by ensuring that they receive similar *types* of information, regardless of the financial product or service they purchase, which enables more informed decision making. Disclosures are necessary at various points of the product life cycle, and requirements are set for initial, point-of-sale disclosures as well as those required on an ongoing basis.

Under this chapter, the FSCA will be empowered to set standards on matters such as inducements and competitions, endorsements, direct and bait marketing and negative marketing. The FSCA will be able to set standards specifying details on things like Key Information Documents that institutions may be required to have in place, white labelling, and plain and simple language requirements.

Issues for consideration

- Is the application of this chapter appropriate across the financial sector? Are there specific sectors or products for which requirements may need more nuancing?

Box 9: Bounded rationality and the importance of a culture of fair treatment and integrity

Bounded rationality is a concept proposed by Herbert Simon that challenges the notion of human rationality as implied by the concept of *homo economicus*. Rationality is bounded because there are limits to our thinking capacity, available information, and time (Simon, 1982).

In decision-making, it means that the rationality of individuals is limited by the information they have, the cognitive limitations of their minds, and the finite amount of time they have to make a decision. This means that in addition to disclosure requirements, financial institutions should also have a duty of care toward their customers, who may not always act in their own best interests. This should not imply a paternalistic approach to customers, but rather providing confidence that financial institutions do not seek to exploit the bounded rationality of customers to further their own interests at the expense of the customer. Disclosure is necessary but not sufficient.

Distribution, advice and discretionary investment management – Chapter 7

The manner in which financial products are sold and distributed can create poor customer outcomes, particularly when incentives drive behaviour that is not in the customer's best interests. This chapter sets requirements for financial institutions to apply when choosing channels or developing models to distribute their products and services. It addresses sales practises that rely on intermediated distribution models and those that involve direct selling.

Requirements aim to, among others, ensure suitability of the distribution model for the products and services concerned, enable informed decision making by customers in relation to the different distribution models available, and enhance standards of professionalism in sale and distribution. Since distribution of products can happen on an advised and non-advised basis, this chapter sets specific obligations on those providing financial advice to financial customers. The FSCA will be able to set a range of conduct standards, including on matters such as product aggregation and comparison services, investment platform administration, referrals and lead generators, and remuneration arrangements.

The chapter also sets requirements on discretionary investment management as a specific financial activity.

Issues for consideration

- Does the chapter adequately cover all distribution and advice activities in the financial sector? Are there any gaps in terms of these services?
- Is the application of the chapter in relation to discretionary investment management understood?

Post-sale barriers and obligations – Chapter 8

Chapter 8 aims to introduce consistent approaches and practices amongst financial institutions once a customer has purchased a product or entered into a contract with a financial institution. The practises of financial institutions should not lead to unreasonable barriers to customers switching products, or exiting when necessary. There are clear requirements for claims handling processes where applicable. Conduct requirements are provided for practises related to the renewal of contracts. The chapter also entrenches requirements for the complaints management processes within financial institutions, including interactions between a financial institution and the relevant financial sector ombud, and requirements for how the information generated through complaints are used within an organisation.

Issues for consideration

- How would or should these requirements apply in the nonretail sector?

7

Other considerations

Developing an approach to Fintech regulation

The Financial Stability Board has defined fintech as technologically-enabled financial innovation that can result in new business models, applications, processes, products, or services with an associated material effect on financial markets and institutions, and the provision of financial services. Fintech can be applied to a wide range of areas including electronic payments, automated advice, delivery channels, cyber security and peer-to-peer lending. It does not only refer to start-ups or new entrants, but can include scale ups, maturing companies, and even non-financial services companies, such as telecommunication providers and e-retailers.

These innovations present a challenge to policymakers and regulators, who need to understand how to approach fintech so that the innovations do not create unlevel playing fields, or negatively affect competition. Importantly, consideration needs to be given to how customers themselves understand and interact with innovative financial products and platforms, and what customer protection principles do and should apply in these circumstances.

Fintech can deliver benefits for consumers through improved access to financial products, greater flexibility, speed of delivery and service and competitive prices²⁹. Regulators therefore need to carefully balance the risks and benefits that innovations can bring. When regulation is not sufficiently adaptable to technological change, as it can also hinder innovation.

As has been noted:

“The goal for policy makers and regulators is to facilitate innovation where it has the most potential and to provide improved outcomes for consumers, to strengthen household economic resilience, while ensuring that risks are anticipated, understood and managed³⁰.”

Innovations can also affect regulators directly, including improving the manner in which regulators and regulated entities interact with each other to achieve regulatory objectives. This is sometimes referred to as Regtech and Suptech.

²⁹ OECD/G20 Task Force on Financial Consumer Protection, “*Fintech Roundtable Discussion Note*”, 2016

³⁰ OECD/G20 Task Force on Financial Consumer Protection, “*Fintech Roundtable Discussion Note*”, 2016

Many countries, and international standard-setting bodies, are carefully considering their approach to fintech. The World Economic Forum has developed key insights into innovation in financial services, including that “innovation in financial services is deliberate and predictable; incumbent players are most likely to be attacked where the greatest sources of customer friction meet the largest profit pools.”³¹ Understanding this provides a point of reference both to financial institutions and to regulators on where innovation is likely to stem from. Given that this is a new area of regulatory focus, international developments must be mindful of minimising duplications and overlaps in the development of international standards.

The UK has established Project Innovate, a regulatory hub within the Financial Conduct Authority, aimed at encouraging innovation in the financial sector that carries a clear consumer benefit. The hub helps the regulator keep pace with market developments and identify consumer benefits and risks. Through Project Innovate, the FCA provides a ‘one stop’ regulatory interface for fintech firms. It also considers applications from firms wanting to enter the financial markets and allows them to operate in a ‘sandbox’ environment. Finally, it also considers Regtech in terms of technological innovations that can improve the FCA’s own regulatory and supervisory processes. The FCA is also currently considering how to encourage fintech innovation in particular areas. For example, the introduction of the Retail Distribution Review in the UK had resulted in a drop-off in the use of financial advisors among some middle-income customers. Consideration is now being given to how robo-advice can be developed to fill this gap.

Box 10: What is a regulatory sandbox³²?

A regulatory sandbox is a framework set up by a financial sector regulator to allow small scale, live testing of innovations by private firms in a controlled environment (operating under a special exemption, allowance, or other limited, time-bound exception) under the regulator’s supervision. The concept, which was developed in a time of rapid technological innovation in financial markets, is an attempt to address the frictions between regulators’ desire to encourage and enable innovation and the emphasis on regulation following the financial crisis of 2007–2008.

The importance of fintech in South Africa has been recognised by industry, government and Parliament. In their joint hearings on transformation in the financial sector for example, the Standing Committee on Finance and Parliamentary Committee on Trade and Industry noted that government and regulators must actively monitor and evaluate the fintech space, and look to develop flexible, risk-based regulatory approaches to fintech activities, especially in areas which may potentially promote the entry of smaller players and ensure access to affordable financial services.

An Inter-governmental Fintech Working Group (IFWG) was formed at the end of 2016 and comprises representatives from the National Treasury, South African Reserve Bank, Financial Services Board (now the Financial Sector Conduct Authority), and Financial Intelligence Centre. It aims to allow policymakers and regulators to understand, regulate and foster fintech with the objective to ensure the continued efficient functioning of financial markets, financial stability and that the interest of customers and investors are safeguarded. The IFWG hosted its inaugural workshop in April 2018,

³¹ “The Future of Financial Services”, 2014, <https://www2.deloitte.com/au/en/pages/financial-services/articles/future-financial-services.html>

³² Jenik, Ivo, and Kate Lauer. 2017. “Regulatory Sandboxes and Financial Inclusion.” Working Paper. Washington, D.C.: CGAP

which covered topics including cryptocurrency regulation, fintech and financial inclusion, and approaches to innovation³³.

Box 11: Supporting financial sector innovation in Malaysia

Malaysia in 2016 launched the Financial Technology Enabler Group³⁴ established by the Bank Negara Malaysia (BNM) – the country’s central bank – and staffed by bank employees. It is responsible for formulating and enhancing regulatory policies to facilitate the adoption of technological innovations in the Malaysian financial services industry. The entity’s key regulatory objectives³⁵ are to ensure safety and soundness of financial system through promoting:

- market conduct objectives:
 - Promoting fair and equitable market practices
 - Promoting financial capabilities of consumers
- prudential objectives:
 - Able to withstand adverse economic condition and maintain customer confidence
 - Address moral hazards by mitigating excessive risk taking behavior
 - Protection of depositors and policyholders by preventing mismanagement of funds
- technology risk objectives:
 - Security and consumer’s privacy
 - Ensure business continuity if technology fails
- anti-money laundering objectives:
 - Effective management of money laundering or terrorist financing risks through appropriate mitigation measures
 - Prevent the infiltration and abuse by criminals to the reporting institutions

The group provides a ‘sandbox’ approach for new fintech entrants into the sector. Sandboxing involves a two stage approval process. The first is a determination of a firm’s eligibility criteria which includes assessing:

- Product feature and purpose
- Product testing by the applicant to identify risk
- Adequate resources to mitigate risk emanating from the product ,service or solution offered
- A viable business model to offer the product/service after sandboxing
- Provision of the product
- Credibility of the applicant.

The second phase is the actual sandbox test which entails:

- The details of testing parameters
- Measures in determining failure or success
- Reports submitted during the test and
- Exit strategy when the test has failed/discontinued

Six companies are currently undergoing the sandboxing assessment. It is expected that the assessment will be concluded within 12 months.

It has been noted that the Central Bank of Malaysia’s and Bahrain’s regulatory sandboxes are the only ones that explicitly list financial inclusion among key objectives³⁶.

³³ The post workshop report can be found on <http://www.treasury.gov.za/publications/other/IFWG%20Report%20April%202018.pdf>

³⁴ <https://www.myfteg.com/>

³⁵ <https://www.myfteg.com/key-guiding-principles>

³⁶ Jenik, Ivo, and Kate Lauer. 2017. “Regulatory Sandboxes and Financial Inclusion.” Working Paper. Washington, D.C.: CGAP

The COFI Bill and fintech

The COFI Bill is designed to be flexible in the manner it applies to different institutions. This includes the ability to appropriately apply regulation to new entrants to the financial sector. In addition to the requirements in Chapter 1 requiring the FSCA to take a proportionate approach to regulation and supervision, clause 8 in that chapter also allows the FSCA to consider exempting certain participants in the financial sector from the application of the Act for specifically to provide scope for innovation and the development and investment innovative technologies, processes and practices. Chapter 2 provides for licensing of new entrants in a manner that supports the entry of innovative new firms into the financial sector. Specifically, the FSCA will be able to set licensing conditions, as per clause 19, that similarly provide scope for innovation and the development of and investment in innovative technologies, processes, and practices. The chapter also allows the FSCA to vary certain licensing conditions, to similarly promote innovation and investments in innovative technologies.

These provisions would allow the FSCA to develop a supportive approach to fintech entrants into the financial sector while still ensuring that the objective of fair customer treatment is overseen. Through the ability to flexibly license new entrants for the purposes of supporting innovation, the FSCA could provide for regulatory ‘sandboxes’, similar to those established in other jurisdictions.

In its recent working paper on regulatory sandboxes³⁷, CGAP noted that while there are some differences in approach in different jurisdictions, many regulatory sandboxes seem to follow the FCA’s ‘blueprint’, designed along the following considerations:

- Objectives of the sandbox.
- Eligibility to apply to the sandbox.
- Criteria (specified in the application) regarding risks, safeguards, and other restrictions.
- Timing for applicants and sandbox entities tests.
- Costs to the regulator and the sandbox entities.
- Regulator’s actions following sandbox test(s).

Through a sandbox, the FSCA will be able to maintain oversight over fintech companies as they participate in the financial sector, and evaluate how best regulatory requirements could be applied to meet regulatory objectives while also supporting innovation. The design must be carefully considered so it responds to real demands, instead of becoming ‘a solution looking for a problem’.

Consumer redress

The FSR Act provides a range of enforcement tools to both regulators. This includes both corrective and punitive tools. The FSCA can undertake enforceable undertakings, issue directives, and then impose penalties or fines if offences are committed.

Further tools are proposed in chapter 11 of the COFI Bill in the form of remedial actions. This includes providing the FSCA with the ability to issue directives requiring that institutions undertake consumer redress where appropriate. This would be in instances where a financial institution has put the customer in a worse off situation financially, either through breaking the law or acting without the best interests of the customer in mind.

³⁷ Jenik, Ivo, and Kate Lauer. 2017. “Regulatory Sandboxes and Financial Inclusion.” Working Paper. Washington, D.C.: CGAP

The provisions of Chapter 11 expand on provisions in the FSR Act that allow the FSCA to issue directives to a financial institution with the aim of remedying the effects that a contravention of a financial sector law has had – including the impacts on customers. The COFI Bill has a more explicit provision allowing the FSCA to direct a financial institution to provide appropriate redress to financial customers if they have been found to contravene a requirement of the Act.

In the UK, a white paper by the Financial Services Compensation Scheme found high levels of mistrust amongst consumers related to receiving compensation for losses incurred because of poor financial advice. Many consumers do not think that financial services firms are willing or able to compensate them, and were unaware of the presence of the Financial Services Compensation Scheme in this regard³⁸. The ability of the FSCA to direct financial institutions to provide redress to customers can help build greater levels of confidence in the financial sector.

Redress is a complex area, and opens up many questions relating to the powers of the regulator vis a vis the courts, for example in regard to ordering compensation, re-opening or changing contracts and bringing actions on behalf of consumers in a class action. Careful consideration must also be given to redress measures in instances where financial institutions are no longer prudentially sound – the interplay between a deposit insurance scheme and consumer redress measures in this context are likely to differ. The compensation scheme in the UK is specifically for instances where the firm is in default or failing, and not for general compensation.

Further inputs on the provisions in the COFI Bill regarding redress and other remedial actions, would be welcome.

Managing exits in the market

An important aspect of regulation by the FSCA is powers related to promoting the recovery of financial institutions where there is non-compliance with the COFI Bill or other financial sector laws, where the financial soundness of the financial institution is of increasing concern, or where there is mismanagement or maladministration. The powers of statutory management, curatorship, and business rescue are mechanisms that are currently provided for in legislation, including the Financial Institution (Protection of Funds) Act, and the Companies Act. It is envisaged that the Financial Institution (Protection of Funds) Act will be repealed by the COFI Bill, and it is necessary to retain some of the important processes provided for in that Act. It is also necessary to appropriately provide for the operation of business rescue in relation to financial institutions.

As part of the overall Twin Peaks reform process, consideration is already being given to how Systemically Important Financial Institutions (SIFIs) should be resolved in the event of financial difficulties. This is important to ensure an orderly and consistent resolution process, which will better manage the effects that the resolution could have on other institutions and the economy broadly, better maintaining financial stability. A discussion document, “Strengthening South Africa’s Resolution Framework for Financial Institutions” was published in 2015 outlining some of the policy considerations in this regard. Based on feedback from this document, the Financial Sector Laws Amendment Bill, containing draft resolution provisions for SIFIs, was published for public comment in 2018. It is anticipated that the Bill will be tabled in Parliament in 2019.

It is recognised that a consistent resolution framework will be needed across all financial institutions, those that are SIFIs and those that are not. Consideration is therefore being given to providing for a holistic resolution framework that would deal with the powers and actions of both the Resolution Authority and the FSCA in the financial sector. New resolutions provisions, catering for repealed provisions in existing laws and dealing with the resolution of non-SIFI entities, could be included as

³⁸ Mind the Gap: Restoring Consumer Trust in Financial Services, FSCS, November 2015

a new chapter in the FSR Act also through consequential amendment (as has been the approach taken for resolution of systemic entities). Included as Annexure 5 of this policy paper is draft provisions for such a resolution chapter.

8

Way forward

The COFI Bill will be consulted on for a three-month period, with comments due on 1 April 2019. Stakeholder workshops will be scheduled both before and after the comment period to support further engagement on the Bill. Following consultation, the Bill will be revised with the intention of tabling it to Parliament in 2019.

Comments are welcome on the Bill, as well as on the ‘issues for consideration’ flagged throughout this document.

Comments can be sent to marketconduct@treasury.gov.za

Annexure 1: International focus on strengthened market conduct

At a high-level, the global financial crisis resulted in two main outcomes in financial regulation³⁹:

- greater scrutiny of whether firms have sufficient capital and can be wound-down in an orderly manner
- greater scrutiny of how and why transactions are undertaken and their impact on customers and wider financial markets.

Prior to the financial crisis, there tended to be greater regulatory emphasis on capital adequacy requirements in the financial sector (rather than customer impact issues). Even so, the crisis highlighted inefficiencies in regulatory approaches, particularly the light-touch approach taken in many instances. Ultimately this resulted in public funds being used in many jurisdictions to bail out large financial institutions. Significant work has gone into ensuring that prudential regulation is strengthened, particularly for systemically important financial institutions.

In addition to improved approaches to prudential regulation and resolution since the crisis, the global financial regulatory environment has also seen a strong shift towards the second outcome, focusing on greater understanding by regulators of the transactions between financial institutions and customers, and the end-impact on customers and the markets.

In 2017⁴⁰ the World Bank issued a report on the Global Financial Inclusion and Consumer Protection Survey. The report presented main findings from a questionnaire developed by the World Bank for completion by financial sector authorities. Responses were received from 124 jurisdictions, represented by 141 economies. Some key findings of the report include:

- In 124 out of 141 economies, a legal framework for financial consumer protection is in place. The results indicate that many jurisdictions have adopted varied approaches, resulting in some instances of overlap, conflicts and incomplete frameworks. Reforms to rationalize and streamline legislation is still ongoing in many jurisdictions. (See Figure 3 below).
- In 70 percent of jurisdictions, consumer protection provisions are entrenched within regulations relating to the financial sector.
- In 76 percent of jurisdictions, regulators are involved in multiple financial consumer protection laws, and 21 percent of jurisdictions have a standalone financial consumer protection framework (mostly from high-middle income group countries).

³⁹ Norton Rose Fulbright, “*Beyond law: understanding the scope of conduct regulation*”, 2014

⁴⁰ World Bank, *Global Financial Inclusion and Consumer Protection Survey: 2017 Report*, 2017

- Financial regulators have increased efforts to prioritise financial consumer protection from 89 percent in 2013 to 98 percent in 2017.
- In more than half of jurisdictions (52 per cent), the financial consumer protection function is established in a unit separate from prudential supervision.

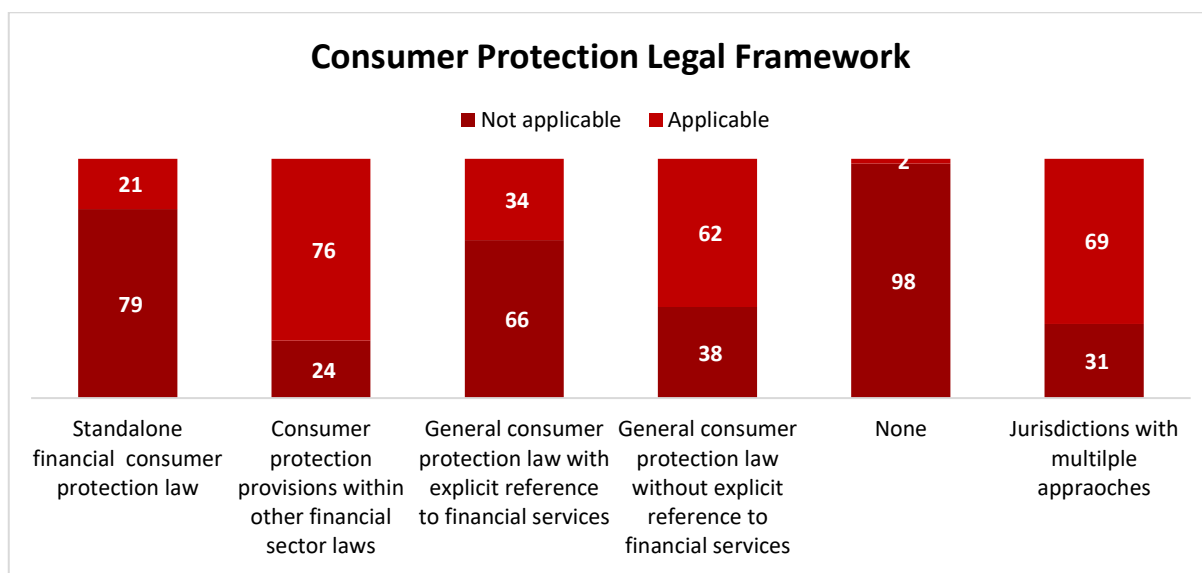


Figure 3: Reproduced from World Bank Survey. Indicates where financial protection provision are found in law. Based on responses from 124 jurisdictions in 2017.

Institutional Arrangements for Financial Consumer Protection

In 121 out of 141 jurisdictions, institutional arrangements for financial consumer protection are in place. Principle 2 of the G-20 High Level Principles on Financial Consumer Protection states that there should be oversight bodies explicitly responsible for financial consumer protection. The responding jurisdictions classified their institutional arrangements for financial consumer protection into five broad categories:

- Integrated Sectoral Financial Sector Authority, where multiple financial sector authorities are each responsible for the supervision of consumer protection aspect.
- Integrated Single Sector Authority, when the supervision of consumer protection is solely placed under a single financial sector authority.
- A Dedicated Financial Consumer Protection Authority is responsible for consumer protection.
- Shared Financial Sector and General Protection, with multiple financial sector authorities and general consumer protection authorities sharing the supervision and responsibilities of financial consumer protection.
- General Consumer Protection Authority, where the financial consumer supervision responsibilities fall under one or more authorities responsible for general consumer protection supervision within the jurisdiction, including nonfinancial activities.

The Integrated Sectoral Financial Sector Authority approach has been adopted by most jurisdictions followed by Integrated Single Sector Authority (See Figure 4 below).

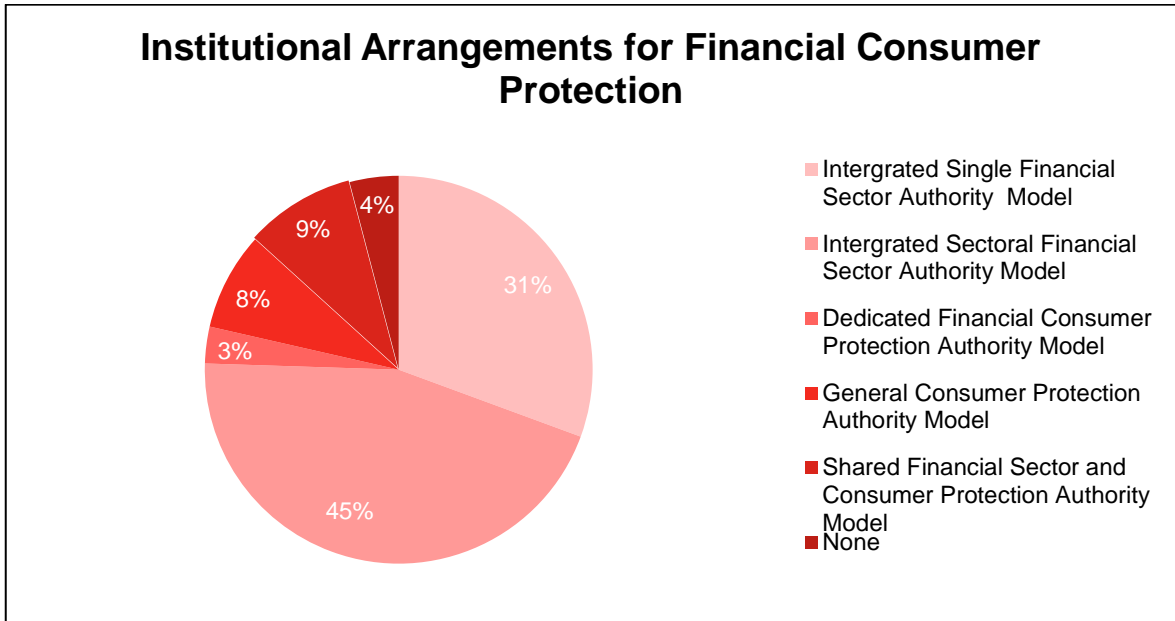


Figure 4: Reproduced from the World Bank survey. Indicates a variation of approaches adopted by jurisdictions for their Institutional Arrangements for financial consumer protection regulation and supervision. Based on responses from 121 jurisdiction in 2017.

The strengthening and reform of market conduct regulation in South Africa is thus consistent with reforms being undertaken internationally as the issue of consumer protection is increasingly placed into focus. In developing the legal framework and institutional structure, South Africa has drawn on learnings and best practices internationally, while also ensuring that the reform programme is suited to the South African context.

Annexure 2: Schedule of financial sector laws

Pension Funds Act, 1956 (Act No. 24 of 1956)

Friendly Societies Act, 1956 (Act No. 25 of 1956)

Banks Act, 1990 (Act No. 94 of 1990)

Financial Services Board Act, 1990 (Act No. 97 of 1990)

Financial Supervision of the Road Accident Fund Act, 1993 (Act No. 8 of 1993)

Mutual Banks Act, 1993 (Act No. 124 of 1993)

Long-term Insurance Act, 1998 (Act No. 52 of 1998)

Short-term Insurance Act, 1998 (Act No. 53 of 1998)

Financial Institutions (Protection of Funds) Act, 2001 (Act No. 28 of 2001)

Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002)

Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002)

Co-operative Banks Act, 2007 (Act No. 40 of 2007)

Financial Markets Act, 2012 (Act No. 19 of 2012)

Credit Rating Services Act, 2012 (Act No. 24 of 2012)

Annexure 3: Action points emanating from the NEDLAC Task Team⁴¹

Action point	Next steps
Market Conduct Policy Approach	
<p>Constituencies raised a number of issues that should feed into the final policy approach for market conduct. In addition to the matters highlighted by government in the discussion document, other issues include:</p> <ul style="list-style-type: none"> • The approach should encourage empowering customers to protect themselves. • Financial inclusion should balance financial sector and financial customer accountability. • Effective enforcement must be a focus • Regulators must have sufficient technical industry knowledge of the financial sector. • Regulatory supervision should take a risk-based, proportionate approach, rather than a “tick-box” approach. This will require a culture change in financial institutions and supervisors. • To ensure that the policy and regulatory framework do not over-correct for issues that are 	<p>Government to take issues into account in outlining clear policy approach and in designing the Conduct of Financial Institutions Act</p> <p>Government can submit final policy approach and draft Bill to Task Team representatives</p>

⁴¹ This matrix reflects the agreed upon action points and next steps concluded through the NEDLAC engagement process on the draft market conduct framework (“Treating Customers Fairly in the Financial Sector: A Draft Market Conduct Policy Framework for South Africa”) in 2016. Various projects and workstreams underway since then may have impacted on the next steps being taken. This includes the Parliamentary hearings on transformation in the financial sector and the establishment of the FSCA

<p>already being addressed, the impact of regulatory changes already underway should be properly understood. For example, what lessons were learnt from the FAIS implementation?</p> <ul style="list-style-type: none"> • Regulatory red-tape should be minimised. • Co-operation between the various financial regulators is imperative. It would be ideal if cooperation could extend to a similar approach to supervision as well as the areas of supervision (risk-based and in line with FSCA regulatory strategy). • The plethora of regulations the industry faces could become a systemic risk, and the FSCA strategy should be mindful of the full landscape of regulations • The regulatory approaches around the globe particularly in South America, Europe (Spain), North America (Canada) which have allowed the proliferation of inclusive institutions such as Credit Unions and Co-operative Banks is worth noting. International lessons should always remain cognisant of local circumstances. 	
<p>The legislative approach for the new market conduct framework</p>	
<ul style="list-style-type: none"> • Approach taken in Competition Law may be useful for the financial sector and a basis for designing the market conduct framework. This law is highly principles based, with a few important rules, and credible deterrents to breaches. • Treasury should eliminate and avoid duplication of legislative requirements and also ensure consistency in application across the sector • Must address issues of scope-creep and lack of certainty over the jurisdictional authority of the 	<p>The Conduct of Financial Institutions Bill being drafted will address issues such as the jurisdiction of the regulator. Government can submit final policy approach and draft Bill to Task Team representatives</p>

<p>National Consumer Commissioner (CPA) in relation to financial services</p> <ul style="list-style-type: none"> • Drawing from international best practise and legislation in other countries must be done in such a way that legislation is still appropriate and designed for the South African market • Careful consideration needed in drawing right balance between rules and principles • Must be able to capture new products brought into the market 	
<p>The new Financial Sector Conduct Authority</p>	
<p>The FSCA should take the following issues into account:</p> <ul style="list-style-type: none"> • Should be community friendly and economically fair • Should implement programmes in a manner where all levels of society will be involved • Should place strong focus on vulnerable consumers • Should be proactive and preventative • Both the culture of firms and of the regulator needs to change. The new FSCA needs to work with the sector to build mutual trust, reflected in information sharing and transparency. • Financial literacy should be one of the core focus areas 	<p>The regulatory strategy of the FSCA should ensure it caters for the issues raised. The FSCA will have to publish its regulatory strategy within six months of its establishment. Can consider submitting the regulatory strategy to NEDLAC constituencies</p>
<p>Conduct issues – banking sector</p>	
<p>Problems flagged for attention:</p> <ul style="list-style-type: none"> • Abusive debit order practices, including the costs incurred by the customer in resolving these • Fraudulent debit orders are simply stopped and a few debit orders reversed with no follow up on 	<p>Propose diagnostic on the retail banking sector, to explain the sector, its customers and products; acknowledge developments since the Competition Commission</p>

<p>the unlawful recipient of the money, no explanation is required from the fraudster and the fraudster resurfaces again and again with impunity. Crime must be treated as crime.</p> <ul style="list-style-type: none"> • Other payment system issues – e.g. accountability of PASA • Rewards programmes with monthly fees – similar risk to club fees which accumulate on your account even when the account is dormant or you want it closed. Such programmes must have clear disclosures and be appropriate for customer needs • Penalty fees on investment accounts should not disincentive savings. • The determination of penalty fees should be transparent, a down sliding scale fee that is inversely proportional to the age of investment be applied. • Interest accumulating on dormant accounts • Challenges faced by the consumers who are not employed permanently or doing piece jobs in relation to the requirement for bank accounts before they get employment 	<p>Enquiry in 2008; identify ways to get better value products for customers. Scope of diagnostic should include the payment system and payment services, and credit where this overlaps (e.g. disclosure of bank products with credit component).</p> <p>National Treasury can coordinate this through the Banking Sector Conduct Working Group it has already established</p>
<p>Housing and evictions</p> <ul style="list-style-type: none"> • Fraud involving banks, courts, auctioneers • Shortfall payment requirement in relation to houses and other movable assets sold in execution or repossessed. • An option for an evictee to apply for voluntary liquidation of estate subject to five year rehabilitation period should be available to the debtor. 	<p>Propose that a Working Group is established between Government, banks, community. Consider research to map out the problems linked to specific role players and laws, which will be used to propose necessary interventions, taking into account reform processes already underway.</p>
<p>Conduct issues – short term insurance sector</p>	

<p>Problems flagged for attention:</p> <ul style="list-style-type: none"> • Insurers should have to give clear reasons why a claim is repudiated • Insurers are levying premiums from the community but none of this going back into the community – should investigate things like approved motor repair service providers, authorized sellers of parts etc • More professional supervision on funeral products needed, many consumers use them, even those who aren't employed 	<p>Claims processes: NT to engage FSB on setting minimum standards and the implementation thereof.</p> <p>Small business development supporting BEE: NT to engage South African Insurance Association on this</p> <p>Funeral products: to evaluate the impact of existing proposals including: regulating microinsurance as proposed in (prudential) Insurance Bill, the application of proposed CoFI Bill to funeral parlours, role of Cooperative Banks Development Agency in supporting formalisation of emerging insurers.</p>
<p>Conduct issues – investment sector (including long term insurance and pensions)</p>	
<p>Problems flagged for attention:</p> <ul style="list-style-type: none"> • Causal event charges on certain policies still an issue. How will legacy problems be addressed? • How are unclaimed pension benefits being managed? • The GEPF should face similar conduct requirements as other pension funds, particularly from a customer perspective – customers should get clear information and have easy complaints processes 	<p>Penalty fees on causal events: NT and FSB to engage industry on how to reduce these to zero.</p> <p>Unclaimed benefits: NT to engage stakeholders on conduct issues around the unclaimed benefit challenge, and support stakeholder coordination in this regard.</p> <p>GEPF and related matters: NT/FSB to engage GEPF and relevant entities on the proposal</p>

	to include the fund under the jurisdiction of the FSCA (in later implementation phases, e.g. under the CoFI Bill) and the Pension Fund Adjudicator (possibly through FSRB).
Conduct issues – credit sector	
<p>Problems flagged for attention:</p> <ul style="list-style-type: none"> • Retail store cards and micro-lenders contribute significantly to over-indebtedness, and expanding the regulatory net to include these operators is vital. • The need for a centralised database on credit information is pressing. Must ensure information is not misused • Can municipal and other debt (e.g. Eskom) be addressed? Significant contributor to over-indebtedness and customer vulnerability generally. The correctness of the municipal billing system is questionable sometimes. It would be useful to consider municipal and Eskom debt in the broader view of over-indebtedness, especially how debt review treats these debts, as well as the role these debts play when a debt goes to the sales in execution process (see later point on treatment of secured vs unsecured lending). • Regulation of debt collectors very important issue to address. Unscrupulous practises prevalent • Abusive judicial practices • Inadequate disclosure and understanding of total credit costs. • The regulatory treatment of secured vs unsecured lending 	<p>Level playing field for all providers: agreed; steps being made through amendments to NCA and coverage of FSRB. – Suggest also a NT, DTI, DoJ, industry working group to review the regulatory landscape for secured vs unsecured debt.</p> <p>Centralised database: Government to take stock of its response to over-indebtedness and consider gaps, like whether a central database is necessary/possible.</p> <p>Drivers of debt accumulation like Eskom: government concerned these issues lie beyond the scope of financial sector policy, but will raise issues internally.</p> <p>Debt collectors: Debt collectors will be brought under FSR Bill; also propose to combine this issue with Evictions WG (see above)</p>

	<p>Judicial practices: Note steps already taken to address abuse related to Emolument Attachment Orders. Propose combine issue of other poor judicial practices with proposed Evictions WG (see above)</p> <p>Disclosure: Government to consider enhancing disclosure requirements for credit providers to develop total cost of credit Key Information Document, to align with NCA requirements. (Note that this is standardizing the way in which information is disclosed, and should not be confused with imposing a limit on the total cost of credit). NT to publish policy paper on interventions proposed to comprehensively deal with consumer credit insurance abuses.</p>
Disclosure	
<ul style="list-style-type: none"> • Disclosure requirements should focus on ensuring effective disclosure rather than more information. • Request for broad engagement on final Key Information Document (KID) templates, not just with industry • Would like to see disclosure extended to many products. Propose developing standard cost disclosure templates for each sector – e.g. cost of credit, cost of banking, insurance premiums vs excess 	<p>Government to prioritise disclosure framework, and support FSB/FSCA in developing standardised point of sale documents (KIDs), to include standardised disclosure of total cost (this refers to the way total cost is calculated and disclosed, it should not be confused with cost caps).</p>

<ul style="list-style-type: none"> • On certain products, should make clear who insurance is underwritten by. Assists with complaints processes. • Certain clauses that treat a movable property as a fixed property should be removed to avoid easy repudiation of claims. • Consequences in the contract should equally apply to both parties in the contract – not unfairly on customer only. • The necessity of gap cover flags the overpricing of products, especially vehicles, as well as underinsurance. The other issue is mismatch between financing and value of product. 	<p>Government will circulate updated versions of KIDs as they are finalised.</p>
<p>Complaints management</p>	
<ul style="list-style-type: none"> • Complaints mechanisms within financial institutions – while at sales interfaces many languages are available to interact with customers, this not the case as the complaints get escalated 	<p>FSB to finalise requirements relating to complaints processes; NT to engage the FSB on implementation.</p>
<p>Ombuds system</p>	
<p>Considerations for reforming the ombuds system should include:</p> <ul style="list-style-type: none"> • Lack of visibility of ombuds offices must be addressed • Access to ombuds system is difficult. A proposal that can be investigated is to make use of municipal government offices as representation points • Efficiency of ombuds office must be addressed – sentiment that issues do not get resolved. Appeal processes can also draw things out. 	<p>Government to continue reform through the FSR Bill and CoFI Bill; a policy note to be released with the FSR Bill when Standing Committee on Finance resumed deliberations on the Bill in August. Note will identify the need for further research in this area.</p>

<ul style="list-style-type: none"> • Findings of ombuds must be better communicated. How to ensure that the findings in one case will also apply to other customers who may be in the same situation? • Findings and trends should be fed upwards, so that can direct consumer education programmes. Can also feed into disclosures made by financial institutions • Ombud for debt collectors – flagged as not being useful . • Debt collectors impose themselves as lawyers to debtors therefore they should be subjected to law society . • Why do different prescription terms apply to different complaints? • International practices should only be considered if they are suitable to South Africa circumstances 	
Financial Education	
<p>More effective approach to financial education necessary. Some considerations:</p> <ul style="list-style-type: none"> • Financial institutions should have clear literacy strategy, which must be consistent with the NCFE strategy. It should deal with Point of Sale education explicitly, but not only there. “Preventative” measures are also required as education at point of sale only may be too late. • Better connectivity needed between the literacy strategy and implementation. Should be performance contracts for meeting targets to hold people accountable • Should be focus on early interventions for financial literacy – in schools. Consider making 	<p>Government to release a policy paper that explains how it will progress the financial education agenda.</p>

<p>this a NEDLAC proposal for the FSB to take forward</p> <ul style="list-style-type: none">• Financial institutions should sponsor community outreach looking at financial literacy• Financial education strategy of the FSB in particular should get more input from community constituency, perhaps through NEDLAC, to assess whether programmes are effective and inclusive	
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Annexure 4: Extended licensing framework

The tables below illustrates the manner in which an FSCA authorisation to perform one or more of the activities and sub-activities (as set out and defined in Schedule 2 of the draft COFI Bill) will be linked to one or more financial product categories and sub-categories in the COFI licensing framework.

Note that this is provided for illustrative purposes only. The final linkages between authorised activities and financial products will be informed by the final definitions of the authorised activities to be prescribed in Schedule 2 of the COFI Bill.

TABLE 1: PROVIDING A FINANCIAL PRODUCT OR INSTRUMENT

Authorised Activity: <i>Providing a financial product or instrument [and sub-activities]</i>	Financial Product Category		Notes / discussion points
	Main Product Category	Product Sub-categories	
Providing a financial instrument	Financial Instrument	Derivative instrument	The activity of “providing a financial instrument” is defined as the structuring of an instrument for the purpose of making it available to financial customers to purchase or transact in as an investment. As such, the activity is at this stage proposed to apply to derivative instruments only. Should other forms of financial instrument be identified that meet the purpose of this definition, they will be added as product sub-categories for this activity.
Providing a financial product	Life insurance policy (other than micro-insurance policy)	Product sub-categories as per the Insurance Act	
	Non-life	Product sub-categories	

Authorised Activity: <i>Providing a financial product or instrument</i> [and sub-activities]	Financial Product Category		Notes / discussion points
	Main Product Category	Product Sub-categories	
	insurance policy (other than micro-insurance policy)	as per the Insurance Act	
	Micro-insurance policy	Categories of policies that will fall within micro-insurance standards.	
	Pension benefit	Benefits provide by: <ul style="list-style-type: none"> • RA Fund • Pension preservation fund • Provident preservation fund • Beneficiary fund • Unclaimed benefit fund • Commercial umbrella occupational fund – pension fund • Commercial umbrella occupational fund – provident fund • Non-commercial umbrella fund (e.g. bargaining council funds, union funds, sectoral determination funds, funds for specific occupations) – pension fund • Non-commercial umbrella fund (e.g. bargaining council funds, union funds, sectoral determination funds, funds for specific occupations) – provident fund • Stand-alone occupational funds – pension fund 	

Authorised Activity: Providing a financial product or instrument [and sub-activities]	Financial Product Category		Notes / discussion points
	Main Product Category	Product Sub-categories	
		<ul style="list-style-type: none"> Stand-alone occupational funds – provident fund 	
	Deposit	<ul style="list-style-type: none"> Basic deposits (including transactional accounts) Other deposits 	Definitions of these product sub-categories to be developed.
	Health service benefit	N/A	The extent to which the FSCA will be involved in the authorisation and supervision of medical schemes is subject to the transitional provisions of the Financial Sector Regulation Act (FSR Act) and determinations by the Minister of Finance in this regard.
	Credit	<ul style="list-style-type: none"> Credit agreements supervised by the NCR Other credit agreements 	<p>The role of the FSCA in relation to authorising and supervising activities in relation to credit will be informed by MoU agreements with the NCR.</p> <p>Current thinking is that, although the actual licensing decision (in respect of the credit provider itself) will lie primarily with the NCR, the FSCA may still need to issue a licence – appropriately co-ordinated with the NCR - in order to ensure that it can exercise its governance oversight powers per the FSR Act.</p>
	Credit support arrangement	Need for sub-categories to be confirmed.	Credit support arrangements are explicitly included in the FSR Act definition of <i>financial service</i> . Further discussion is needed to confirm the scope of such arrangements and whether they warrant separate categorisation in the licensing framework.
	Participatory interest in a pooled investment	<ul style="list-style-type: none"> Participatory interest in a CIS 	The product sub-categorisation for various types of pooled investments distinguishes between CISs and “alternative investments”.

Authorised Activity: <i>Providing a financial product or instrument</i> [and sub-activities]	Financial Product Category		Notes / discussion points
	Main Product Category	Product Sub-categories	
		<ul style="list-style-type: none"> - CIS in securities - CIS in Property - ETFs • Participatory interest in an alternative investment: <ul style="list-style-type: none"> - hedge fund - private equity fund - REIT (listed) - REIT (unlisted) - other property fund - other pooled investment 	

TABLE 2: DISTRIBUTING FINANCIAL PRODUCTS

Authorised Activity: <i>Distributing Financial Products</i> [and Sub-activities]	Financial Product Category		Notes / discussion points
	Main Product Category	Product Sub-categories	
Distributing Financial Products: Sales and Execution	See Notes / discussion points column.	See Notes / discussion points column.	This <i>Sales and Execution</i> sub-activity could in principle apply to any type of financial product or financial instrument.
Distributing Financial Products: Product comparison and aggregation services	See Notes / discussion points column.	See Notes / discussion points column.	For <i>the Product comparison or aggregation services</i> sub-activity, this could again theoretically apply to any type of financial product or financial instrument. However, further work on conduct standards for this activity is in progress through the FSCA's Retail Distribution Review initiative, which may result in restricting this

Authorised Activity: <i>Distributing Financial Products</i> [and Sub-activities]	Financial Product Category		Notes / discussion points
	Main Product Category	Product Sub-categories	
			activity to certain types of products only.

TABLE 3: FINANCIAL ADVICE

Authorised Activity: <i>Financial Advice</i>	Financial Product Category		Notes / discussion points
	Main Product Category	Product Sub-categories	
Financial advice	Financial instrument	<ul style="list-style-type: none"> • Share • Derivative instrument • Other financial instrument 	
	Participatory interest in a pooled investment	<ul style="list-style-type: none"> • CIS • Alternative pooled investment 	The degree of sub-categorisation of products for <i>Financial advice</i> need not be as granular as it is for other activities such <i>Managing and Administering</i> the products concerned. For example, an adviser could be authorised to provide <i>Financial advice</i> in respect of participatory interests in a CIS, without this authorisation having to be further broken down into advice on CISs in securities, property, etc. The CIS product provider (current CIS management company) itself on the other hand would need to be authorised at this more granular level.
	Life insurance policy (other than micro-insurance policy)	<ul style="list-style-type: none"> • Risk policy • Investment policy 	
	Non-life insurance policy (other than micro-insurance policy)	<ul style="list-style-type: none"> • Personal lines and small commercial policies • Commercial lines 	
	Micro-insurance policy	Categories of policies that will fall within micro-insurance standards, if this level of granularity is considered necessary for	

Authorised Activity: <i>Financial Advice</i>	Financial Product Category		Notes / discussion points
	Main Product Category	Product Sub-categories	
		providing financial advice on these products.	
	Reinsurance policy	No sub-categories	
	Pension benefit	<ul style="list-style-type: none"> • RA fund or Preservation fund • Umbrella and occupational funds (includes all other types of funds listed under the <i>Issuing a financial product</i> activity in relation to issuing of pension benefits (See Table 1). 	
	Deposits	<ul style="list-style-type: none"> • Basic deposits (including transactional accounts) • Other deposits 	Definitions of these product sub-categories to be developed.
	Health service benefit	N/A	
	Credit	<ul style="list-style-type: none"> • Credit agreements supervised by the NCR • Other credit agreements 	The role of the FSCA in relation to authorising and supervising activities in relation to credit will be informed by MoU agreements with the NCR. Note that the FSR Act specifically excludes the activities of debt counselors from the jurisdiction of the FSCA.
	Credit support arrangement	Need for sub-categories to be confirmed.	Credit support arrangements are explicitly included in the FSR Act definition of <i>financial service</i> . Further discussion is needed to confirm the scope of such arrangements and whether they warrant separate categorisation in the licensing framework.

TABLE 4: MANAGING AND ADMINISTERING INVESTMENTS

Authorised Activity: <i>Managing and Administering Investments [and Sub-activities]</i>	Financial product category		Notes / discussion points
	Main Product Category	Product Sub-categories	
Managing and Administering Investments: Discretionary investment management 42	Participatory interest in a pooled investment	<ul style="list-style-type: none"> • Participatory interest in a CIS <ul style="list-style-type: none"> - CIS in securities - CIS in property - ETFs • Participatory interest in an alternative investment <ul style="list-style-type: none"> - hedge fund - private equity fund - REIT (listed) - REIT (unlisted) - other property fund - other pooled investment 	
	Financial Instrument	<ul style="list-style-type: none"> • Share • Money market security • Depositary receipt • Debt instrument • Derivative instrument • Warrant, certificate, securitisation, instrument, etc. 	
Managing and Administering Investments: Administering a pooled investment	Participatory interest in a pooled investment	<ul style="list-style-type: none"> • Participatory interest in a CIS <ul style="list-style-type: none"> - CIS in securities - CIS in property - ETFs • Participatory interest in an alternative investment <ul style="list-style-type: none"> - hedge fund - private equity fund - REIT (listed) - REIT (unlisted) - other property fund 	

⁴² The FSCA, through its Retail Distribution Review (RDR) process, is in the process of consulting stakeholders on a definition of this activity. The FSCA has identified a need to define the activity in a way that distinguishes it more clearly from the broader situation (contemplated in the current FAIS Cat II license criteria) of simply holding a customer mandate to make decisions regarding the purchase of or investment in financial products.

		- other pooled investment	
Managing and administering investments: Operating an investment platform	N/A	N/A	At this stage, the scope of the sub-activity <i>Operating an investment platform</i> relates to the current FAIS Administrative FSP (LISP) activity, where the defining feature is the activity of “bulking” as defined in FAIS. Accordingly a link to specific product categories is not necessary. If the scope of this sub-activity extends beyond the current FAIS Administrative FSP role, this may need to be reconsidered.

TABLE 5: BENEFIT ADMINISTRATION

Authorised Activity: Benefit Administration [and Sub-activities]	Financial product category		Notes / discussion points
	Main Product Category	Product Sub-categories	
Benefit administration service: Pension fund benefit administration	Pension benefit		
Benefit administration service: Medical scheme administration	Health service benefit		The extent to which the FSCA will be involved in the authorisation and supervision of medical scheme administrators is subject to the transitional provisions of the FSR Act determinations by the Minister of Finance in this regard.
Benefit administration service: Funeral administration	Life insurance policy	Funeral policy	The intention is to deal with entities that administer funeral policy benefits across multiple funeral parlours, rather than to seek to regulate the ordinary business operations of individual parlours.

TABLE 6: PROFESSIONAL FIDUCIARY OR CUSTODIAN SERVICE

Authorised Activity: Professional Fiduciary or Custodian Service [and Sub-activities]	Financial product category		Notes / discussion points
	Main Product Category	Product Sub-categories	
Professional Fiduciary or Custodian Service: Professional custodian service	Participatory interest in a pooled investment	<ul style="list-style-type: none"> Participatory interest in a CIS Participatory interest in an alternative investment. 	
Professional Fiduciary or Custodian Service: Professional nominee company service	N/A	N/A	
Professional Fiduciary or Custodian Service: Professional Pension Fund Trustee Service	Pension Benefit		
Professional Fiduciary or Custodian Service: Independent Pension Fund Trustee Service	Pension Benefit		

TABLE 7: PAYMENT SERVICE

Authorised Activity: Payment Service [and Sub-activities]	Financial product category		Notes / discussion points
	Main Product Category	Product Sub-categories	
	N/A	N/A	The scope of the FSCA in relation to authorisation of payment services, and any necessary sub-categories, is under consideration.

TABLE 8: FINANCIAL MARKETS ACTIVITIES⁴³

Authorised Activity: Financial Market Activities [and Sub-activities]	Financial product category		Notes / discussion points
	Main Product Category	Product Sub-categories	
Financial markets activities: Underwriting a public offering	Financial instrument	<ul style="list-style-type: none"> • Share • Money market security • Depositary receipt • Debt instrument • Derivative instrument • Warrant, certificate, securitisation, instrument, etc. 	The product sub-categories noted here are taken from the FSR Act definition of <i>financial instrument</i> . Discussion is required on whether the licensing framework for the sub-activity of <i>Underwriting a public offering</i> of a financial instrument needs to be this granular.
	Participatory interest in a pooled investment	<ul style="list-style-type: none"> • CIS • Other pooled investment 	
Financial markets activities: Trading	Financial instrument	<ul style="list-style-type: none"> • Share • Money market security • Depositary receipt • Debt instrument • Derivative instrument • Warrant, certificate, securitisation, instrument, etc. 	
Financial markets activities: Making a market	Financial instrument	<ul style="list-style-type: none"> • Share • Money market security • Depositary receipt • Debt instrument • Derivative instrument • Warrant, certificate, securitisation, instrument, etc. 	Discussion is required on whether the licensing framework for the sub-activity of <i>Making a market</i> in financial instruments needs to be this granular in distinguishing between sub-categories of financial instruments.
Financial markets	N/A	N/A	

⁴³ See the various discussion points in Schedule 2 of the draft COFI Bill in relation to the need to clarify the definitions and scope of a number of these activities.

activities: Clearing service			
Financial markets activities: Settlement service	N/A	N/A	
Financial markets activities: Custody service	N/A	N/A	

TABLE 9: PROVIDING BENCHMARKS AND RELATED SERVICES

Authorised Activity: Providing benchmarks and related services [and Sub-activities]	Financial product category		Notes / discussion points
	Main Product Category	Product Sub-categories	
Providing benchmarks and related services: Providing a benchmark	N/A	N/A	
Providing benchmarks and related services: Providing an index	N/A	N/A	
Providing benchmarks and related services: Administering a benchmark or an index	N/A	N/A	

TABLE 10: SERVICE RELATED TO THE BUYING OR SELLING OF FOREIGN EXCHANGE

Authorised Activity: Services related to buying and selling foreign exchange [and Sub-activities]	Financial product category		Notes / discussion points
	Main Product Category	Product Sub-categories	
	N/A	N/A	The scope of the FSCA in relation to authorisation of services related to the buying and selling of foreign exchange, and any necessary sub-categories, is under consideration.

TABLE 11: CREDIT RATING SERVICE

Authorised Activity: Credit Rating Service [and Sub-activities]	Financial product category		Notes / discussion points
	Main Product Category	Product Sub-categories	
	N/A	N/A	

TABLE 12: DEBT COLLECTION SERVICE

Authorised Activity: Debt collection service]	Financial product category		Notes / discussion points
	Main Product Category	Product Sub-categories	
	Credit	<ul style="list-style-type: none"> Credit agreements supervised by the NCR 	The FSR Act specifically includes a debt collection service as a form of service “related to the provision of credit” (as part of the definition of a “financial service”). The intention is to deal with the collection of debts under credit agreements that fall within the scope of the regulatory provisions of the National Credit Act, including where such debts may subsequently be ceded by the credit provider to a third party for collection.

Annexure 5: Recovery and exit from the market – draft provisions

1. Purpose and application of Chapter

- (1) The purpose of this Chapter is to provide the Authority with additional remedies in the event that a financial institution's non-compliance with this Act requires any measure provided for in this Chapter to be exercised.
- (2) A measure provided for in this Chapter may only be exercised by the Authority—
 - (a) in the case of a financial institution that is regulated by the Prudential Authority, after consultation with the latter;
 - (b) in the case of a systemically important financial institution, with the concurrence of the South African Reserve Bank;
 - (c) in the case of a financial institution that is a payment system participant as contemplated in the National Payment System Act, 1998 (Act No. 78 of 1998), with the concurrence of the South African Reserve Bank.

PART 1: STATUTORY MANAGEMENT

1. Appointment of statutory manager

- (1) Despite any other law, the Authority may, by agreement with a financial institution and without the intervention of a court, appoint a statutory manager for that financial institution, if it appears that—
 - (a) the financial institution—
 - (i) has in a material respect failed to comply with a law;
 - (ii) is likely to be in an unsound financial position; or
 - (iii) is maladministered; and
 - (b) it is advisable to appoint a statutory manager in order to protect—
 - (i) the interests of the financial customers of the financial institution;
 - (ii) the safety and soundness of financial institutions in general; or
 - (iii) the stability, fairness, efficiency and orderliness of the financial system.
- (2) An appointment under subsection (1) takes effect immediately, but the Authority must, as soon as practicable after the appointment, and in any event within 30 days after the appointment, apply to the High Court for an order confirming the appointment.
- (3) On hearing the application in terms of subsection (2), the court must confirm the appointment, unless satisfied that the grounds for making the appointment no longer exist.
- (4) The statutory manager of a financial institution—
 - (a) must be allowed full access to the accounting records, financial statements and other information relating to the affairs of the financial institution;
 - (b) must participate in the management of the affairs of the financial institution with its executive directors or managers;
 - (c) has the final decision, in the event of a disagreement between the statutory manager and the executive directors or managers of the financial institution; and

- (d) is entitled to receive remuneration from the institution that the Court may order.
- (5) (a) The statutory manager of a financial institution and the financial institution must manage the affairs of the institution with the greatest economy possible compatible with efficiency and, as soon as practicable, report to the Authority and indicate what steps should be taken to ensure that the financial institution—
- (i) complies with the law;
 - (ii) becomes financially sound; and
 - (iii) is properly administered.
- (b) If the statutory manager considers that it is not practicable to take steps in terms of paragraph (a), the statutory manager must report to the Authority and must indicate—
- (i) whether steps should be taken to transfer the financial services business or a part of the business of the financial institution to an appropriate financial institution, and if so, on what terms; or
 - (ii) whether the financial institution should be wound up or placed under curatorship.
- (6) The statutory manager of a financial institution and the financial institution must comply with directives issued by the Authority from time to time in relation to the statutory manager's functions, and report to the Authority should the statutory manager be hindered in giving effect to any directives.
- (7) The statutory manager of a financial institution and the financial institution may, after giving notice to the Authority, at any time apply to the court for directions.
- (8) The Authority may at any time apply to the court to—
- (a) terminate the statutory management; or
 - (b) remove a statutory manager from office and, subject to subsection (2), to confirm the appointment of a replacement.
- (9) The statutory manager of a financial institution is not liable for loss suffered by the financial institution, unless it is established that the loss was caused by the statutory manager's fraud, dishonesty or wilful failure to comply with the law.
- (10) The provisions of this section must not be construed as limiting any of the powers of the Authority provided for elsewhere in this Act or the Financial Sector Regulation Act.
- (11) If a statutory manager is appointed under this section, no business rescue or winding-up proceedings may be commenced in respect of a financial institution until the appointment of the statutory manager is terminated.

PART 2: CURATORSHIP

3. Appointment of curator

- (1) The Authority may, on an *ex parte* basis, apply to a division of the High Court having jurisdiction for the appointment of a curator to take control of, and to manage the whole or any part of, the business of a financial institution.
- (2) Upon an application in terms of subsection (1) the court may—
- (a) on good cause shown, provisionally appoint a curator to take control of, and to manage the whole or any part of, the business of the institution, on the conditions, and for the period, that the court deems fit; and
 - (b) simultaneously grant a *rule nisi* calling upon the financial institution and other interested parties to show cause on a day mentioned in the rule why the appointment of the curator should not be confirmed.
- (3) On application by the Authority or the financial institution, the court may anticipate the return day, if not less than 48 hours' notice of the application has been given to the other party.
- (4) If, at the hearing pursuant to the *rule nisi*, the court is satisfied that it is desirable to do so, it may confirm the appointment of the curator.
- (5) The court may, for the purposes of a provisional appointment in terms of subsection (2)(a) or a final appointment in terms of subsection (4), make an order regarding—
- (a) the suspension of legal or foreclosure proceedings against the financial institution for the duration of the curatorship;
 - (b) the authority of the curator to investigate the affairs of the financial institution or any related, inter-related or associated entity;
 - (c) in addition to subsection (11), the powers and duties of the curator;

- (d) the remuneration of the curator;
- (e) the costs relating to any application made by the Authority;
- (f) the costs incurred by the Authority in respect of any supervisory on-site inspection or investigation conducted in terms of the Financial Sector Regulation Act;
- (g) the method of service or publication of the order; or
- (h) any other matter which the court deems necessary.

(6) (a) Any person, on good cause shown, may make application to the court to set aside or alter any decision made, or any action taken, by the curator or the Authority regarding any matter arising out of, or in connection with, the control and management of the business of a financial institution which has been placed under curatorship.

(b) A person who makes application contemplated in paragraph (a) must give notice of not less than 48 hours of the application to the Authority or the curator, as the case may be, and the Authority or curator is entitled to be heard at the application.

(c) The court may, on good cause shown, cancel the appointment of the curator at any time.

(7) (a) Despite subsections (1) to (6), the Authority may on good cause shown, by agreement with an institution, and without the intervention of the court, appoint a curator for the purpose set out in subsection (1).

(b) The terms of the appointment contemplated in paragraph (a) must be set out in a letter of appointment issued by the Authority to the curator and—

- (i) must include—
 - (aa) the powers and duties of the curator;
 - (bb) the remuneration of the curator; and
- (ii) may include any other matter agreed upon between the Authority and the financial institution.

(c) The rights of any creditor or client of the institution are not affected by the appointment of a curator in terms of paragraph (a).

(8) An appointment in terms of subsection (7) lapses—

- (a) if the Authority, after consultation with the curator, withdraws the letter of appointment;
- or
- (b) by order obtained at the instance of the financial institution in terms of subsection (6)(c).

(9) The curator acts under the control of the Authority, and in accordance with guidelines made by the Authority, and the curator may apply to the Authority for instructions regarding any matter arising out of, or in connection with, the control and management of the business of the financial institution.

(10) The curator must furnish the Authority with the reports or information concerning the affairs of the institution that the Authority may require.

(11) In addition to any powers or functions that may be afforded by a court to a curator on appointment under subsection (1), a curator on appointment—

- (a) is vested with the power to take and implement any decision in respect of the financial institution that would have required an ordinary resolution or a special resolution of shareholders or members of the financial institution in terms of the provisions of the—
 - (i) Companies Act;
 - (ii) Co-operatives Act;
 - (iii) Memorandum of Incorporation, or the equivalent constitution, deed or founding instrument of a financial institution that is not a company; or
 - (iv) rules of any securities exchange registered under the Financial Markets Act on which any securities of the financial institution are listed;
- (b) is vested with all executive powers which would ordinarily be vested in, and exercised by, the key persons (other than an auditor or the head of a control function) of the financial institution, whether by law or in terms of its Memorandum of Incorporation, or the equivalent constitution, deed or founding instrument of a financial institution that is not a company, and the present key persons must be divested of all powers in relation to the business;
- (c) must take immediate control of, manage and investigate the business and operations of and concerning the financial institution, together with all assets, interests and liabilities relating to the business, subject to the control of the Authority in accordance with

- subsection (9), and with all the rights and obligations that relate to the management of the business and operations of the financial institution;
- (d) must at all times consider the best interests of the financial customers of the financial institution;
 - (e) must exercise the powers vested in the curator with a view to conserving the business and, with the prior approval of the Authority, may—
 - (i) alienate or dispose of any of the property or transfer any of the liabilities or business of the financial institution;
 - (ii) cancel any guarantee issued by the financial institution prior to the financial institution being placed under curatorship, excluding a guarantee which the financial institution is required to make good within a period of 30 days from the date of the appointment of the curator; and
 - (iii) raise funding on behalf of the financial institution, despite any contractual obligations of the financial institution, to provide security over the assets of the financial institution in respect of the funding;
 - (f) must continue to conduct the business for which the financial institution is licensed, but may not enter into new contracts for the provision of financial products or financial services without the approval of the Authority;
 - (g) must take custody of the cash, cash investments, shares, other securities or investments held or administered by the financial institution, and of other property (movable or immovable) or effects belonging to, or held by or on instructions of, the financial institution, or any entity directly or indirectly controlled by, affiliated to or associated with the financial institution;
 - (h) must notify the Authority should the curator deem it necessary or expedient that an application be made to the court—
 - (i) for the extension of the curator’s powers to any other company (including any holding company or subsidiary) or other related or inter-related person or person associated with the financial institution;
 - (ii) for the winding-up of the financial institution; or
 - (iii) for any relief as envisaged in the Financial Sector Regulation Act against the financial institution or any of its key persons;
 - (i) may, in the curator’s discretion, and depending on available resources, make full or part payments to financial customers in identified circumstances, after the prior approval of the Authority has been obtained;
 - (j) may conduct any investigation with a view to locating the assets belonging to, administered or controlled by the financial institution, including assets held by way of securities, in cash or liquid form;
 - (k) may incur reasonable expenses and costs that may be necessary or expedient for the curatorship and control of the financial institution and operations of the financial institution, and to pay expenses and costs from the assets held, administered or under the control of the financial institution;
 - (l) may engage, after consultation with the Authority, assistance of a legal, accounting, administrative, or other professional or technical nature, that the curator may reasonably deem necessary for the performance of the curator’s duties, and the curator may defray reasonable charges and expenses incurred from the assets held or under control of the financial institution;
 - (m) may institute or prosecute any legal proceedings on behalf of the financial institution, and defend any litigation against the financial institution;
 - (n) may invest funds that are not required for the immediate purposes of the business, with a bank registered under the Banks Act, 1990 (Act No. 94 of 1990), or other liquid instrument approved by the Authority;
 - (o) may take control of and operate or freeze existing banking accounts of the financial institution and of its subsidiaries or related persons, and of any director of the financial institution, insofar as any money belonging to the financial institution has been deposited into that banking account;
 - (p) may open and operate any new banking accounts for the purposes of the curatorship; and

(q) may claim all costs, charges and other expenditure reasonably incurred by the curator in the execution of duties in terms of this section, including the curator's own remuneration, as administration costs, in the event of the winding-up of the financial institution ensuing.

(12) A curator, when acting in accordance with subsection (11), must consider the expected effect on the creditors of the financial institution and whether—

- (a) creditors are treated in an equitable manner; and
- (b) when acting under subsection (11)(e)(i), a reasonable probability exists that a creditor will not incur greater losses, as at the date of the proposed disposal, transfer, or disposal and transfer, than would have been incurred if the financial institution had been wound-up on the date of the proposed disposal, transfer, or disposal and transfer.

(13) A claim for damages in respect of any loss sustained by, or damage caused to, any person as a result of the cancellation of a guarantee referred to in subsection (11)(e)(ii), other than a guarantee that constitutes an insurance obligation under a life insurance policy as defined in the Insurance Act, or provision of security, may be instituted against the financial institution after the expiration of a period of 6 months from the date of the cancellation.

(14) A financial institution may not begin or enter business rescue or be wound-up while under curatorship, unless the curator applies for the business rescue or winding-up.

PART 3 : BUSINESS RESCUE

4. Application of Companies Act to business rescue of financial institutions

(1) Despite any other law under which a financial institution is established or incorporated, Chapter 6 of the Companies Act applies, subject to this section, and with the necessary changes, in relation to a financial institution, to the exclusion of any similar provisions under the Co-operatives Act, or any other law under which a financial institution is established or incorporated, and in an application for business rescue, the Authority must be deemed to be an affected person.

(2) In the application of Chapter 6 of the Companies Act—

- (a) a reference to the Commission must be construed as a reference also to the Authority;
- (b) the reference to creditors must be construed as a reference also to the financial customers of the financial institution;
- (c) a reference relating to the inability of a financial institution to pay all its debts, must be construed as relating also to its inability to comply with the financial soundness requirements of this Act; and
- (d) in addition to any question relating to the business of a financial institution, it must be considered if any proposed action is in the interests of the financial customers of a financial institution.

5. Business rescue applications and resolutions

(1) The Authority may make an application under section 131 of the Companies Act in respect of a financial institution, if the Authority reasonably believes that it is in the interests of the financial institution's financial customers.

(2) (a) If an application to a court for an order relating to the business rescue of a financial institution is made by an affected person other than the Authority, —

- (i) the application may not be heard, unless copies of the notice of motion and of all accompanying affidavits and other documents filed in support of the application have been lodged with the Authority at least 14 days before the application is set down for hearing;
- (ii) the Authority may, if the Authority reasonably believes that the application is not in the interests of financial customers of the financial institution, join the application as a party and file affidavits and other documents in opposition to the application.

(b) Any order granted by the court in circumstances where paragraph (a)(i) has not been complied with is void.

(3) (a) Any resolution of a financial institution to begin business rescue proceedings is subject to the approval of the Authority.

(b) A financial institution may file a resolution under section 129 of the Companies Act only after the Authority has approved the resolution.

(c) Any resolution of a financial institution that is not approved by the Authority under paragraphs (a) or (b), is void.

(4) Despite the provisions of the Companies Act, the following acts are subject to the approval of the Authority:

- (a) The appointment of a business rescue practitioner; and
- (b) the adoption of a business rescue plan.

(5) Despite the provisions of the Companies Act, if the Authority does not approve a resolution referred to in subsection (3)(a) or (b), or the appointment or plan referred to in subsection (4)(a) or (b), the Authority must apply to court—

- (a) for the winding-up of the financial institution under this Act; or
- (b) to place the financial institution under curatorship under this Act.

(6) As from the date on which a business rescue practitioner is appointed, the business rescue practitioner of a financial institution may not enter into any new contracts for the provision of financial products or financial services, unless the practitioner has been granted prior approval to do so by the Authority.

PART 4: WINDING-UP

6. Application of Companies Act to winding-up of financial institutions

(1) (a) Despite any other law under which a financial institution is incorporated, sections 79 to 81 of, and item 9 of Schedule 5 to, the Companies Act applies, subject to this section, and with the necessary changes, in relation to the winding-up of a financial institution, and to the exclusion of any similar provisions under the Co-operatives Act, or any other law under which a financial institution is established or incorporated.

(b) In an application for the winding-up of a financial institution, the Authority is deemed to be a person authorised under the Companies Act to make an application to the court for the winding-up of the financial institution.

(2) In the application of sections 79 to 81 of, and item 9 of Schedule 5 to, the Companies Act, as provided by subsection (1)—

- (a) a reference which relates to the inability of a financial institution to pay its debts must be construed as relating also to its inability to comply with the financial soundness requirements of this Act;
- (b) a reference to a financial institution in this section must, for the purposes of the application of sections 79, 80 and 81 of the Companies Act, be construed as a reference to a financially sound financial institution;
- (c) in addition to any question whether it is just and equitable that a financial institution should be wound-up, there must also be considered the question whether it is in the interest of the financial customers of a financial institution that it should be wound-up;
- (d) the references to the Commissioner, Commission, Master or Panel must be construed as a reference also to the Authority; and
- (e) the requirement to give security does not apply where the Authority makes the application to court.

7. Winding-up applications and resolutions

(1) The Authority may make an application under the Companies Act for the winding-up of a financial institution, if the Authority reasonably believes that it is in the interests of the financial customers of that financial institution to do so.

(2) (a) If an application to the court for, or in respect of, the winding-up of a financial institution is made by any person other than the Authority—

- (i) the application may not be heard, unless copies of the notice of motion and of all accompanying affidavits and other documents filed in support of the application are lodged with the Authority at least 14 days, or a shorter period that the court may allow on good cause shown, before the application is set down for hearing; and
- (ii) the Authority may, if the Authority reasonably believes that the application is contrary to the interests of the financial customers of the financial institution, join

the application as a party and file affidavits and other documents in opposition to the application.

(b) Any order granted by the court in circumstances where paragraph (a)(i) has not been complied with is void.

(3) (a) Any resolution of a financial institution to begin winding-up proceedings is subject to the approval of the Authority.

(b) A financial institution may file a resolution under section 80 of the Companies Act only after the Authority has approved the resolution.

(c) Any resolution of a financial institution that is not approved by the Authority under paragraph (a) or (b) is void.

(4) Despite the provisions of the Companies Act, the appointment of a trustee or a liquidator is subject to the approval of the Authority.

(5) Despite the provisions of the Companies Act, if the Authority does not approve a resolution referred to in subsection (3)(a) or (b), or the appointment referred to in subsection (4), the Authority may apply to court to place that person under curatorship in terms of the section 3.

8. Preferred claims of retail financial customers⁴⁴

⁴⁴ This is an aspect that will be a subject of consideration, engagement and discussion, taking into consideration international approaches.