Legal Services

FINANCIAL SERVICES

ON THE SCALES 3 OF 2019

Conduct of Financial Institutions Bill

The draft Conduct of Financial Institutions Bill (“COFI Bill’) was published by the National Treasury on 11 December 2018.

This Bill is very important for funds and many of their service providers (collectively called financial institutions). The Bill tells financial institutions what they need to do to treat their customers fairly.

Summary

- COFI Bill provides a holistic legal framework for market conduct regulation in the South African financial sector.
- Regulates how financial institutions treat their customers, in line with the Treating Customers Fairly principles.
- The Bill sets out the specific intention of the law, rather than setting rules for compliance.
- The Financial Sector Conduct Authority (‘FSCA’) can issue conduct standards with details on how the principles must be attained. The standards are binding.
- Regulators will test institutions on the delivery of the outcomes, but the institutions can decide what processes and actions are required to meet the outcomes.
- Decision-makers of an institution are accountable for compliance with the Bill and can be held personally liable for weak governance.

On the Scales is produced by Alexander Forbes Legal Services department to provide clients with information on employee benefits. The issues need to be carefully considered taking into account the specific circumstances of each of our clients.

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What is the COFI Bill?

The COFI Bill will put in place a single holistic legal framework for market conduct regulation in the South African financial sector.

It gives customers certainty about what they can expect from financial institutions.

Why do we need the COFI Bill?

There are several reasons for this Bill, namely historical poor practices, inadequate regulatory oversight, regulation has not kept pace with the dynamic nature of the financial sector, as well as gaps and overlaps in the current regulatory landscape.

Objectives of the COFI Bill

- Regulate how financial institutions treat their customers, in line with the Treating Customers Fairly principles
- Streamline the existing range of laws applicable to the financial sector
- Promote:
  - innovation,
  - competition,
  - financial inclusion,
  - transformation
- Support fair and efficient financial markets
- Improve financial literacy
- Effective dispute resolution

Design of the COFI Bill

The Bill is very different from what we are used to seeing legislation look like.

Principles-based

The Bill sets out the specific intention of the law, rather than setting rules for compliance. Compliance with the spirit of the law, rather than narrow technical compliance will be important.

The FSCA can issue conduct standards with details on how the principles must be attained. The standards are binding and we shall explain below the standards that will be issued under each principle.

Outcomes-focused

Regulators will test institutions on the delivery of the outcomes, but the institutions can decide what processes and actions are required to meet the outcomes.

Activity-based

Instead of institutions being registered under a sectoral law, the focus will be on the activities being performed and the same law will apply per activity, rather than per institution.

Risk-based and proportionate

The FSCA will identify high risk areas and use their capacity proportionately to address the risks.

Transformation

Institutions will have to comply with the Financial Sector Code.

The FSCA will put in place supportive requirements to allow for new entrants into the financial sector and exemptions from the Bill can be applied for based on developmental, financial inclusion and transformation objectives.

The FSCA will tailor the regulatory requirements to the nature of the institution and risks they pose.

Institutions will have to design, publish and implement a transformation policy and then report to the regulator on how they are meeting the targets that have been set.

The provisions of the Bill

Definitions, objectives and application

Many definitions cross refer to the Financial Sector Regulation Act, so one has to read both pieces of legislation together.

The Bill applies to retirement funds and, whilst trustees do not need to be licensed, standards may be issued that regulate trustees and sponsors of funds.

The FSCA may impose requirements on supervised entities that are involved in pension fund activities, even where those entities are not licensed under the Bill.

Comment: we have yet to see what this could entail, for example auditors, tracing agents or participating employers.

Exemptions may be granted by the FSCA, to ensure the proportional application of the Bill, after taking into account various factors, including: the risks and complexity of the activities being undertaken by the institution; practicalities of compliance; to provide for innovation; other laws which exist and the purpose of the provision for which exemption is required.

Licensing

There will be a phased approach to convert existing registrations into licences under the Bill.

Institutions will hold one licence, with authorisation for the various activities they are permitted to perform.

A licence will be granted on three levels: activity being performed, product involved and targeted customer.

The Bill sets out general requirements for licensing including: meeting fit and proper requirements, having operational capability, being able to comply with relevant laws and standards, having a business plan in place and the licensing must not be contrary to public interest.

The FSCA will also prescribe specific licensing requirements based on the institutions and activities involved.

Culture and governance

The governing body of an institution is accountable for compliance with the Bill and can be held personally liable for weak governance.

Institutions must implement a governance policy dealing with: roles & responsibilities, remuneration, record-keeping, management procedures, compliance procedures, transformation, conflicts of interest and marketing.

Key persons must at all times comply with fit and proper requirements.

Institutions must at all time conduct their business with integrity, due skill, care and diligence, avoid or manage conflicts of interest and act in the best interest of customers– and will have to demonstrate how they achieve this.

The FSCA can order an independent review of an institution’s governance framework, which review will be paid for by the institution.

Institutions cannot induce customers to waive any rights or benefits they have under the Bill. Institutions must comply with Protection of Personal Information Act when dealing with personal or confidential information.

Standards to be issued - governing bodies, risk management, compliance, internal controls, outsourcing arrangements, record-keeping and issues to be included in the governance policy.

Financial products and financial services

Institutions must promote the supply of <u>products</u> that are appropriate to identified customer needs, circumstances and expectations while facilitating efficiency, flexibility and innovation and are targeted accordingly.

Institutions must promote the supply of <u>services</u> that support the fair treatment of customers, taking into account customer needs.

Written processes and procedures must be in place regarding the design of financial products and services to ensure oversight in line with the Bill's requirements.

Senior management will have to sign off on new products and services.

Standards to be issued – performance requirements, ongoing monitoring of products and services, charging structures, remedial action in case of poor customer outcomes, benchmark methodologies and reporting to customers.

Promotion, marketing and disclosure

This section aims to promote informed and confident decision-making by customers by providing adequate & clear information before, during and after the sale of a product or service.

Senior management must sign off on promotional and marketing material.

Standards to be issued - inducements, competitions, endorsements, direct and bait marketing, negative marketing and key information disclosures.

Distribution, advice and intermediation

There are requirements for institutions to apply when choosing channels or developing models to sell and distribute products, including direct and intermediated models.

Standards to be issued – disclosures, distribution models, investment platform administration, product aggregation, comparison services, referrals and lead generators, remuneration arrangements, provision of advice and advice process, fees, low income market distribution, financial advisers and planners, terms and conditions for contracts.

Post sale obligations

The principles in this section cover: no unreasonable barriers to switching or exiting a product, claims handling processes, renewal of contracts and making a complaint.

The support for products and services must be fair, reliable, transparent and consistent with the reasonable expectations that have been created.

Reporting

The FSCA will prescribe the content, regularity, medium, form and manner of information to be disclosed to it by institutions.

The FSCA will prescribe the information that institutions must publicly disclose 6 months after the institution's year end.

Remedial action and offences

The FSCA can implement corrective and punitive action against institutions. A contravention of different sections of the Bill will carry different levels of fine or terms of imprisonment, which are yet to be determined.

Transitional arrangements

Different sections of the Bill will become effective at different dates, and different dates will apply to the amendment or repeal of other legislation.

The COFI Bill will introduce amendments to the Pension Funds Act, Financial Sector Regulation Act and the Insurance Act.

The following legislation will be repealed over time - FAIS Act, Collective Investment Schemes Act, Long-term Insurance Act, Short-term Insurance Act and Financial Institutions (Protection of Funds) Act.

Pension Funds

The Pension Funds Act will govern the structure and prudential requirements of retirement funds. The COFI Bill will govern the market conduct of retirement funds. A change in the COFI Bill to the Pension Funds Act is the inclusion of 'public sector pension fund' in the Pension Funds Act. That includes funds to which the State or a public entity or municipality contributes. In time a professional trustee system may be considered by Government, but that is not contained in the COFI Bill.

Comments are due on the COFI Bill by 1 April 2019.

If you need more information, please contact your consultant.