



The Retirement Fund Specialist

The Go-Getter! Industry Update

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## Conduct of Financial Institutions Bill, 2018 (“COFI”)

In our budget publication in February 2019, we outlined the objectives of the draft Conduct of Financial Institutions Bill (the “COFI Bill”), which was published by the National Treasury on 11 December 2018. We now provide more detailed information on this Bill, which once enacted, will radically reform the financial services sector.

The COFI Bill is the next phase of the legislative reforms aimed at strengthening the regulation of how the financial services industry treats its customers. The Bill follows the Financial Sector Regulation Act, 2017, which established two new authorities with dedicated mandates. As a reminder, the two new authorities which were established were the Prudential Authority (“PA”) which manages prudential risk (financial health) and the Financial Sector Conduct Authority (“FSCA”) which manages the market conduct risk across all financial institutions. Both regulators became operational on 1 April 2018.

The Financial Sector Regulation Act gives consumers and financial institutions an indication of what to expect of financial sector regulators, while the COFI Bill outlines what customers and industry players can expect of financial institutions.

Once enacted, the COFI Bill will establish a holistic legal framework for market conduct regulation in the South African financial sector. The Bill has far reaching consequences for retirement funds, trustees and service providers alike. Whilst trustees will not need to be licensed, standards will be issued that regulate trustees and sponsors of funds.

### Governance and Regulation Gaps Filled by the COFI Bill

There are several reasons for the COFI Bill, including historical poor practices, inadequate regulatory oversight, regulation which has not kept pace with the changes in the financial sector, as well as gaps and overlaps in the current regulatory landscape.

Furthermore, the Bill aims to legislate the FSCA’s Treating Customers Fairly (TCF) principles, as they currently have little legal backing.

### Principles

The Bill, which intends to replace the conduct requirements in existing financial sector laws, is designed as follows:

- ❑ **Principles-based:** the COFI Bill diverges from other legislation's format, in that it sets out the intention of the regulators, rather than rules which must be complied with. Compliance with the spirit of the law will be required, rather than narrow technical compliance
- ❑ **Outcomes-focused:** outcomes-focused supervision allows the supervisor to test financial institutions on their delivery of prescribed outcomes
- ❑ **Activity-based rather than institutionally driven:** Shifting away from the current institutionally-driven approach, the Bill defines activities undertaken in the financial sector. 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. This will create level playing fields amongst stakeholders
- ❑ **Risk-based and proportionate:** the new framework will enable the regulator to monitor the financial sector, identify areas that pose greatest market conduct risks and use proportionate regulatory capacity to address these risks. Proportionality will affect the regulator's supervisory approach, the standards it sets and the enforcement action it takes. Furthermore, because it will apply to all financial institutions, it is well placed to support the Financial Sector Code issued under the Broad Based Black Economic Empowerment (BBBEE) Act, by requiring financial institutions to comply with that Code.

### **Application for Retirement Funds**

- ❑ Member elected trustees will not be licensed, but the focus will be on their continual skills development through training
- ❑ Professional trustees and independent trustees will be licensed and subject to fit and proper requirements as part of their wider regulatory obligations
- ❑ 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
- ❑ Retirement funds will be required to be licensed under both the Pension Funds Act and COFI Act, and subject to both laws' requirements. However, benefit administrators and other service providers currently regulated under the Pension Funds Act, will be licensed and authorised under the COFI Act only, when the Bill is enacted
- ❑ The FSCA may impose requirements on supervised entities that are involved in retirement fund activities, even where those entities are not licensed under COFI
- ❑ Public sector funds will be included in the Pension Funds Act and subject to its requirements.

### **COFI's Application**

- ❑ The FSCA will be empowered to issue binding conduct standards with details on how the principles must be attained
- ❑ Regulators will test institutions on the delivery of the outcomes. However, institutions will be able to establish their own processes and actions to meet the outcomes
- ❑ Transformation: institutions will have to design, publish and implement a transformation policy and report to the regulator on meeting targets that have been set
- ❑ The FSCA will put supportive requirements in place to allow for new entrants into the financial sector
- ❑ The FSCA will tailor regulatory requirements to the nature of the institution and risks they pose
- ❑ Institutional decision-makers will be held accountable for compliance with the COFI Bill and will be held personally liable for weak governance
- ❑ 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, provision for innovation, other laws which exist and the purpose of the provision for which exemption is required.

## Transitional Arrangements

- ❑ The Bill will introduce amendments to the Pension Funds Act, Financial Sector Regulation Act and the Insurance Act
- ❑ The COFI Bill will impose high-level, binding principles on retirement funds that will be applicable in addition to the various requirements contained in the Pension Funds Act
- ❑ Initially, retirement funds will be subject to both the PFA and COFI
- ❑ Over time, conduct requirements will be migrated from the Pension Funds Act to COFI
- ❑ Various provisions of the Pension Funds Act will be retained to provide for the separate legal status of the fund and to set prudential requirements. However this migration will only take place after an in-depth mapping of the Pension Funds Act, to determine which requirements are best placed under the COFI framework, to be prescribed as conduct standards
- ❑ Different sections of the Bill will become effective at different dates
- ❑ Various dates will apply to the amendment or repeal of other legislation
- ❑ 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.

## Licensing

- ❑ There will be a phased approach to convert existing registrations into licences under COFI
- ❑ Institutions will have one licence, with authorisation for the activities they are permitted to perform
- ❑ A licence will be granted on three levels: activity being performed, product involved and targeted customer
- ❑ COFI sets out general requirements for licensing, such as: meeting fit and proper requirements, operational capability, ability to comply with relevant laws and standards and having a business plan in place. Furthermore, the granting of the licence must not be contrary to public interest
- ❑ The FSCA will also prescribe specific licensing requirements based on the institutions and activities involved.

## Culture & Governance

- ❑ The governing body of an institution will be accountable for compliance with the Bill and can be held personally liable for weak governance
- ❑ Institutions must implement a governance policy dealing with roles and responsibilities, remuneration, record-keeping, management procedures, compliance procedures, transformation, conflicts of interest and marketing
- ❑ Standards to be issued: governing bodies, risk management, compliance, internal controls, outsourcing arrangements and record-keeping are to be included in the governance policy
- ❑ Key persons must comply with fit and proper requirements, at all times
- ❑ Institutions must at all times conduct their business with integrity, due skill, care and diligence, avoid or manage conflicts of interest and act in the best interest of customers. Furthermore, institutions will have to demonstrate how they achieve this
- ❑ The FSCA can order an independent review of an institution's governance framework, which review must be paid for by the institution
- ❑ Institutions cannot induce customers to waive any rights or benefits they have under COFI
- ❑ Institutions must comply with the Protection of Personal Information Act when dealing with personal or confidential information.

## **Financial Products & Financial Services**

- ☐ Institutions must promote the supply of products 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 services that support the fair treatment of customers, whilst considering customer needs
- ☐ Written processes and procedures must be in place in respect of 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 include: 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 & Disclosure**

- ☐ This section aims to promote informed and confident decision-making by customers, by providing adequate and clear information before, during and after the sale of a product or service
- ☐ Senior management will have to sign off on promotional and marketing material
- ☐ Standards to be issued include: inducements, competitions, endorsements, direct and bait marketing, negative marketing and key information disclosures.

## **Distribution, Advice & Intermediation**

- ☐ There are requirements for institutions to apply when selecting channels or developing models to sell and distribute products, including direct and intermediated models
- ☐ Standards to be issued include: 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 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, six months after the institution's year end.

## **Remedial Action & Offences**

The FSCA can implement corrective and punitive action against institutions. Contravention of the various sections of COFI will carry respective fines or terms of imprisonment, which are yet to be determined.