FINANCIAL SERVICES BOARD

FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT, 2002

EXPLANATORY MEMORANDUM FOR PROPOSED AMENDMENTS OF FIT AND PROPER REQUIREMENTS FOR FINANCIAL SERVICES PROVIDERS AND REPRESENTATIVES, 2015

1. BACKGROUND

The Registrar of Financial Services Providers, under section 6A of the Financial Advisory and Intermediary Services Act, 2002 (the Act), intends to amend the fit and proper requirements applicable to financial services providers, key individuals and representatives by-

(a) repealing-

  (i) the Determination of Fit and Proper Requirements for Financial Services Providers, 2008; and

  (ii) the Notice on Determination of Qualifying Criteria and Qualifications for Financial Services Providers, Number 1 of 2008; and

(b) determining new fit and proper requirements for financial services providers, key individuals and representatives.

2. PURPOSE OF PROPOSED AMENDMENTS

The proposed amendments are designed to meet the consumer protection objective of the Act and to ensure clarification of the applicable requirements.

The new requirements do not propose any amendment to the current categorisation of financial services providers as it is a matter that will be addressed through the Retail Distribution Review.[1]

It further does not address those aspects of the competency framework that are currently under review by the Registrar of Financial Services Providers (Registrar). Industry consultation on that framework is in progress, and the Registrar will issue a proposal for public consultation by the end of the first half of 2016. The objective of the review is to build

[1] See "A general update on the status of the Retail Distribution Review" published in December 2015.

on the existing competency requirements by establishing an effective and proportionate regulatory framework to ensure financial services providers (FSPs) have the right levels of product related knowledge, meet appropriate standards of professionalism and undergo continuous professional development where necessary.

3. SIGNIFICANT AMENDMENTS

This explanatory memorandum is structured to address those requirements that are significantly different to the current fit and proper requirements rather than to address each and every proposed change. For ease of reference, the changes will be dealt with under the proposed new Chapters.

3.1. Chapter 1 – Definitions

Definitions are proposed for new subcategories of financial products namely: long-term insurance subcategory B1-A, long-term insurance subcategory B2-A and short-term insurance personal lines A1. The proposed definitions are based on the definitions in the exemption published by the Notice on Exemption of Certain Persons from the Level 1 Regulatory Examination Requirements, 2012 (the Exemption). The principles underpinning the Exemption will be incorporated into the fit and proper requirements insofar it relates to the proposed new financial product subcategories.

The Exemption will further be replaced by an exemption that-

(a) will permit a FSP that is currently authorised to render financial services in respect of long-term insurance subcategory B1, long-term insurance subcategory B2 or short-term insurance personal lines to render financial services in respect of the proposed new financial product subcategories provided that the FSP-
   (i) submits within two months after the commencement date of the new fit and proper requirements an application to the Registrar to amend the restrictions on its licence to include the new subcategories of financial products as product categories on its licence;
   (ii) indicates who the key individual is in respect of one or both long-term insurance subcategories B1-A and B2-A and/or short-term insurance personal lines A1;
   (iii) amends the representative register to indicate whether a representative must be recorded for one or both long-term insurance subcategories B1-A and B2-A and/or short-term insurance personal lines A1; and

(b) exempt representatives appointed to render financial services in respect of the proposed new subcategories from having to write the applicable first level regulatory examination until the Registrar has finalised the review of the competency framework referred to in paragraph 2 above.

3.2. Chapter 2 – Personal Character

The requirements relating to personal character qualities have been aligned, where appropriate, with the fit and proper requirements issued by the Registrar of Insurance under the Long-term Insurance Act and Short-term Insurance Act to ensure consistency within the regulatory framework applicable to the financial sector.

In addition, the proposals are aligned with the Insurance Core Principles of the International Association of Insurance Supervisors and the IOSCO objectives and principles of securities regulation.

3.3. Chapter 3 - Competency Requirements

Experience

It is proposed that in order for a person to be approved as a key individual of a Category I FSP he or she must have obtained experience in the management and/or oversight of the rendering of financial services. Currently those key individuals are only required to have experience in the management or oversight of a business irrespective whether or not such business relates to the rendering of financial services.

The Registrar is of the view that a key individual with no experience of the financial services industry would not be able to appropriately and effectively fulfil his or her duties under the Act and that the proposed amendment is necessary to ensure that the key individual is competent to perform his or her functions.

The proposed amendments further clarify the current position that a person's experience lapses when such person has not rendered a particular financial service for a period of five years.

Qualifications

It is proposed that the Registrar, in the interim until finalisation of the review of the enhanced competency framework referred to in paragraph 2 above, continues to recognise qualifications for appropriateness based on the proposed new criteria instead of the current qualifying criteria that forms the bases of the second level of regulatory examinations.

The Registrar previously communicated to industry that the FSB does not intend to proceed with the implementation of the second level of regulatory examinations (product examinations) for the reasons provided. That, however, does not mean that a FSP will not be required to have sufficient knowledge of the product in respect of which he or she renders financial services. The objective of the review of the competency framework is to build on the existing requirements by investigating how better to ensure that FSPs have the right level of product related knowledge and, what product suppliers' duties should be in achieving the desired objective where such FSPs are advising clients on their respective products. .

Regulatory examinations

Qualifying criteria are proposed for the new subcategories of financial products that align with the principles of the Exemption referred to in paragraph 1 above and the current qualifying criteria are updated to align with amendments to the legislative framework.

3.4. Chapter 4 – Continuous professional development requirements

The Registrar intends to determine the requirements relating to continuous professional development after finalisation of the review of the enhanced competency framework.

3.5. Chapter 5 – Operational ability

The requirements relating to the operational ability of a FSP have been enhanced to ensure the proper achievement of the objects of the Act. In particular, requirements are proposed relating to the appointment of representatives to mitigate the risks associated with such appointments.

The proposed amendments further seek to address the practice of "rent a key individual" by requiring-

(a) a FSP, on a regular basis, to assess the operational ability of its key individuals to adequately and effectively perform their functions taking into account individual circumstances, the nature, scale, range and complexity of the FSP's financial services related activities and whether the key individuals are approved as key individuals or appointed as representatives of other FSPs; and

(b) a key individual to be able to demonstrate to the Registrar that he or she has the required operational ability to effectively and adequately manage or oversee the financial services related activities of the FSP or juristic representatives for which the key individual was approved or appointed, in particular in cases where the key individual acts as such for multiple FSPs or juristic representatives or where he or she acts as as a key individual and is appointed as a representative of another FSP.

3.6. Chapter 6 - Financial Soundness Requirements

Exclusion of certain FSPs from financial soundness requirements

It is proposed that the financial soundness requirements not be made applicable to FSPs who are also registered insurers or banks provided they comply with the financial soundness requirements prescribed by the Acts in terms of which they are registered as insurers or banks. Requiring those FSPs to comply with the financial soundness requirements will result in an unnecessary duplication of regulation.

Soundness requirements for juristic representatives of Category II, IIA and III FSPs

It is proposed to impose financial soundness requirements on juristic representatives of Category II, IIA and III FSPs, *inter alia*, to mitigate the risk posed to that FSP by such representatives, to mitigate the risk posed to clients of such arrangements and to ensure that FSPs and their representatives have sufficient financial resources to render financial services in compliance with the Act.

Early warning requirements

The proposed early warning requirements are to facilitate the implementation of the recommendations made by the International Monetary Fund after its assessment of South Africa's implementation of the IOSCO principles and objectives. The proposed early warning requirements will allow the Registrar to act more proactively to ensure client protection.

Relaxation of financial soundness requirements

It is proposed that the following requirements relating to financial soundness be amended to avoid any unnecessary burden in maintaining particular levels of soundness:

(a) *the requirements relating to an FSP's liquid assets* - in particular it is proposed that-

   (i) the range of assets that could qualify as "liquid assets", be extended to include, subject to certain limits, investments in collective investment schemes and shares listed on a licensed exchange; and

   (ii) remuneration that is linked to a percentage of the FSP's revenue or a percentage of the revenue generated by an employee, representative or contractor of the FSP and that in the absence of such revenue the FSP has no obligation to pay the remuneration be excluded as an expense for purposes of calculating an FSPs annual expenditure.

(b) t*he requirement that investments with or loans to persons to whom the FSP renders financial services be excluded from the assets of a FSP for purposes of determining* *whether or not the assets of the FSP exceeds the liabilities of the FSP* – it is proposed that the requirement be removed; and

(c) *the liquid asset requirements applicable to a Category IV FSP* - it is proposed that the amount of liquid assets to be maintained by the that FSP be decreased from 8/52 weeks of annual expenditure to 4/52 weeks of annual expenditure.

The Registrar is satisfied that the potential risks associated with the relaxation of the requirements referred to above are mitigated by the implementation of the proposed early warning requirements and the additional reporting requirements.

Reporting requirements on compliance with liquid asset requirements

The proposals regarding the reporting on the FSP's, and where applicable representative's, compliance with the liquidity requirements are aligned with the IOSCO objectives and principles of securities regulation that capital required should be maintained by the FSP and be subject to timely periodic reporting to the regulator.