

## LEPPARD LEGISLATION WATCH

**FEBRUARY 2019**

In this issue of Leppard Legislation Watch, we continue to highlight some more of the provisions of the draft Conduct of Financial Institutions Bill. Some of the sections are more applicable to you as a broker than others, but one needs to have a general overview of how one's conduct is going to be regulated going forward.

### Legislation for YOU

#### **Draft Conduct of Financial Institutions Bill**

As we said in the January issue of Leppard Legislation Watch, the Draft Bill presents the next phase of South Africa's reform of financial sector regulation towards a Twin Peaks model approved by Cabinet in 2011. The first phase involved the development, adoption and implementation of the Financial Sector Regulation Act (FSRA).

The current Draft Bill aims to deal with the second of the Twin Peaks by putting in place a single comprehensive law for the regulation of market conduct in the financial sector. It will be administered by the Conduct Authority. In this issue, we'll highlight some of the provisions relating to culture and governance, financial products and the fair treatment of customers.

#### **Culture and governance**

Chapter 3 sets out the general principles and the requirements for fit and proper management, governance and operational matters. Requirements related to transformation and compliance with the Broad-based Black Economic Empowerment Act are included in this chapter.

#### **Governing body responsibility**

Clause 31 of the Bill provides that the governing body of a financial institution has responsibility for the mechanisms within the institution to achieve the Bill's requirements relating to culture and governance.

The governing body has to endorse and be ultimately responsible for the establishment, implementation, subsequent reviews of, and continued internal compliance with governance arrangements within the financial institution to reasonably ensure that the requirements are met.

The governing body also has to ensure that these governance arrangements and the required governance policy, are appropriately embedded in the institution.

### **Principles**

Clause 30(1) requires that a financial institution must at all times conduct its business in a manner that prioritises fair outcomes for financial customers, so that there is confidence that their fair treatment is central to the corporate culture of the institution.

In fulfilling these obligations the institution must at all times:

- (i) Conduct its business with integrity;
- (ii) Conduct its business at all times honestly, fairly, and with due skill, care and diligence, in the best interests of financial customers, and the integrity of the financial sector;
- (iii) Organise and control its affairs responsibly and effectively;
- (iv) Maintain adequate financial and other resources;
- (v) Avoid or, where avoidance is not reasonable, manage, mitigate and disclose conflicts of interest;
- (vi) Deal with the Financial Sector Conduct Authority (Conduct Authority) in an open and co-operative manner;
- (vii) Comply with the requirements or conduct standards issued in terms of this Act relating to market conduct and the conduct of business;
- (viii) Have due regard to the interests and fair treatment of its financial customers, including conducting its activities transparently and with due regard to the information needs of those customers; and
- (ix) ensure that its governing body is accountable for compliance with this Act.

### **Prohibited practice**

Clause 32(1) prohibits a financial institution from requesting or inducing a financial customer to waive any right or benefit under the Act. It is also prohibited for a financial institution to recognise, accept or act on a waiver by a financial customer.

Any waiver of such a right or benefit by a financial customer will be void.

### **Unfair contract terms**

Clause 33 provides for the general requirement that a financial institution that provides financial products or financial services to retail financial customers must ensure that the terms and conditions of a contract or agreement in respect of such product or service are fair, reasonable and transparent.

A term or condition in such a contract will be unfair or unreasonable if:

- (i) It would cause a significant and unreasonable imbalance in the parties' rights and obligations under the contract;
- (ii) The terms of the contract or agreement are so adverse to the retail

customer that they are inequitable;

(iii) It is not reasonably necessary to protect the legitimate interests of the financial institution, who would be advantaged by the term or condition; or

(iv) It would cause undue detriment, whether financial or otherwise, to a retail financial customer if it were applied or relied on.

A term or condition would also be unfair and unreasonable if a retail financial customer is required, on terms that are unfair, unreasonable, or as a condition to entering into a transaction to:

(i) Waive any rights;

(ii) Assume any obligation; or

(iii) Waive any obligation or liability of the financial institution.

Unfair and unreasonable terms or conditions would also apply where a transaction or agreement is subject to a term or condition, or prescribed requirement and:

(i) The term, condition or requirement is unfair, unreasonable, unjust or unconscionable; or

(ii) The fact, nature and effect of that term, condition or requirement was not appropriately disclosed to the retail financial customer in a manner that satisfied the prescribed notice requirements.

A condition or term of a contract or agreement will be transparent if it is:

(i) Expressed in reasonably plain language;

(ii) Legible;

(iii) Presented clearly and unambiguously; and

(iv) Readily available to any party affected by it.

### **Governance policy**

Clause 36 requires a financial institution to adapt, document, implement and monitor the effectiveness of a governance policy that is reasonably expected to ensure adherence to the principles set out in clause 30.

The governance policy must:

(i) Be approved by and subject to the oversight of the governing body;

(ii) Be proportionate to the nature, scale and complexity of the activities and the risks of the institution; and

(iii) Demonstrate how the institution will comply with Chapter 7 and standards issued in terms thereof.

### **Financial products**

The provisions in chapter 4 require institutions to have clear procedures and procedures in place regarding the design of financial products they market and sell. Minimum requirements related to product performance are also dealt with.

### **Financial services**

Chapter 5 provides for requirements on the provision of financial services. It allows for specific and tailored requirements and conduct standards to be set

on the activity of financial services provision, particularly in those cases where no financial products are provided.

The purpose of these provisions is to promote the provision of financial services that promote the fair treatment of financial customers.

### **Principles**

When providing financial services, a financial service provider or a representative must:

- (i) Take into account the needs, circumstances and expectations of financial customers that are targeted, impacted, or likely to be impacted by the service, including those customers that are impacted indirectly through another financial institution;
- (ii) Reasonably ensure that services are suitable and perform as the provider has led the financial customer to expect, through information and representations provided; and
- (iii) Enable financial customers to understand and compare the nature, value and cost of financial services.

If a financial institution identifies, during the lifetime of a financial service, circumstances which are related to the service that give rise to the risk of poor or unfair outcomes to financial customers or that it is no longer suitable, the institution must take appropriate action to mitigate the situation and prevent the reoccurrence of poor or unfair outcomes for financial customers.

A financial institution that provides a financial service must:

- (i) Where possible, enter into a written contract of engagement with the financial customer; and
- (ii) Always act within the mandate given by the financial customer in terms of the contract between the financial institution and the financial customer.

### **Oversight**

A financial service provider must establish and implement, on an on-going basis, oversight arrangements relating to the provision of financial services.

These oversight arrangements must:

- (i) Support the achievement of the purpose and principles set out above;
- (ii) Ensure proper disclosure and management of conflicts of interest, and ensure that the objectives, interests and characteristics of targeted financial customers are duly taken into account;
- (iii) Be appropriate to identify and disclose risks that financial customers or groups of financial customers for a financial service is exposed to;
- (iv) Allocate clear roles and responsibilities for persons in the financial institution responsible for, or partly responsible for, establishing and implementing the oversight arrangements;
- (v) Incorporate effective assessment by the risk and compliance functions of the extent to which the purpose and principles are being achieved; and
- (vi) Include appropriate measures and procedures to ensure compliance.

The oversight arrangements may vary depending on the financial service in accordance with the principle of proportionality, taking into consideration the nature, scale and complexity of the relevant business and the business model of the financial institution.

A financial service provider that is not a small enterprise must set out the service oversight arrangements as part of the governance policy and make it available to relevant persons.

The service oversight arrangements must be reviewed regularly to ensure that they remain valid and up to date, and the governance policy must be amended where applicable and appropriate.

A new financial service must be signed off by the governing body of a financial institution before that institution markets, offers or enters into contracts to provide that service. That sign-off must be accompanied by a confirmation that the service reasonably complies with the oversight arrangements.

### **Retail financial customers**

When providing financial services to retail financial customers a financial institution must conduct a thorough assessment of the main characteristics of the financial service, and related disclosure documents.

The object of the assessment must be to ensure that the service and disclosure documents:

- (i) Are consistent with the business model of the financial institution and its risk management approach as well as applicable conduct standards; and
- (ii) Entails steps to mitigate risks resulting or that may result from the service that could harm retail financial customers.

In addition, the financial institution must, on an on-going basis take into account changes in customer needs, circumstances or expectations, or external factors such as economic conditions, that could affect how the financial service impacts on financial customers.

Sufficient flexibility must be allowed in the way in which the service is provided to meet these changes without harm or prejudice to the customer.

### **Conduct standards**

The Financial Sector Conduct Authority is empowered to prescribe conduct standards that provide for additional requirements, limitations and prohibitions.

Such conduct standards may address, amongst others:

- (i) Investment platform administration;
- (ii) Financial services provided to another financial institution;
- (iii) Charging structures for financial services;
- (iv) The terms and conditions of financial services contracts, including unfair terms and fair, just and reasonable terms and conditions;
- (v) On-going monitoring requirements relating to the suitability of a financial

- service;
- (vi) The identification of a suitable target market of a financial service;
  - (vii) The identification of a target market for whom a financial service would likely be unsuitable;
  - (viii) The offering of a financial service to a suitable target market;
  - (ix) The assessment of whether it is appropriate to offer a financial service to a particular customer, and in particular where the financial customer would gain access to complex financial products;
  - (x) Appropriate remedial action in respect of a financial service in the event of poor customer outcomes;
  - (xi) Transparency of financial services;
  - (xii) Frequency and nature of reporting to financial customers;
  - (xiii) Prohibited financial services;
  - (xiv) The prohibition or restriction of the offering of services to particular categories, subcategories or types of customer;
  - (xv) Payment services; and
  - (xvi) The methodologies in determining a benchmark.

## Legislation for YOU and YOUR CLIENT

### Prescribed Rate of Interest Act

The prescribed rate of interest is 10,25% from 1 January 2019 (it was previously 10%).

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