ADDITIONAL COMMENTS FROM MEMBERS OF ASISA to the PARLIAMENTARY STANDING COMMITTEE on FINANCE

- **to be read together with comments dated 16 November 2015**

FINANCIAL SECTOR REGULATION BILL, 2015 [b 34-2015]
1 February 2016

CLAUSE	DRAFT CLAUSE WORDING	COMMENT
GENERAL COMMENT	ASISA members thank the Standing Committee on Finance for the opportunity to provide additional comments on the Financial Sector Regulation Bill ("Bill"), which was tabled in Parliament on 27 October 2015. Members' concerns relating to constitutional matters, and other issues were submitted to the Standing Committee on 16 November 2015. The additional comments set out below are kindly to be read in addition to those made earlier.	
30(a) to (i)	**Prudential standards in respect of systemically important financial institutions** **30.** (1) To mitigate the risks that systemic events may occur, the Reserve Bank may, after consulting the Prudential Authority, direct the Prudential Authority to impose, either through directives or prudential standards, requirements applicable to one or more specific systemically important financial institutions or to such institutions generally in relation to any of the following matters: (a) Solvency measures and capital requirements, which may include requirements in relation to counter-cyclical capital buffers; (b) leverage ratios; (c) liquidity; (d) organisational structures; (e) risk management arrangements, including guarantee arrangements; (f) sectoral and geographical exposures; (g) required statistical returns; (h) recovery and resolution planning; and (i) any other matter in respect of which a prudential standard may be made that is prescribed by Regulations made on the recommendation of the Governor.	The Reserve Bank has broad powers to impose additional obligations on systemically important financial institutions and also has a broad discretion to declare a financial institution as a systemically important financial institution. ASISA members suggest that a provision be incorporated that obliges the Reserve Bank to impose the obligations in 30(a) to (i) fairly and consistently between financial institutions.
31	**Winding up and similar steps in respect of systemically important financial institutions** **31.** (1) None of the following steps may be taken in relation to a systemically important financial institution or a systemically important financial institution	It is submitted that disallowing the application of existing legislative rights, remedies and processes to a financial institution simply because that financial institution has been designated as systemically important, is not reasonable. These existing legal rights, remedies and processes are an important part of ensuring stability, certainty and consistency. Given the broad powers granted to the Reserve Bank to address a systemic event, it is also

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	within a financial conglomerate without the approval of the Reserve Bank: (a) Suspending, varying, amending or cancelling a licence issued to that financial institution; (b) adopting a special resolution to wind up the financial institution voluntarily; (c) applying to a court for an order that the financial institution be wound up; (d) appointing an administrator, trustee or curator for the financial institution; (e) placing the financial institution under business rescue or adopting of a business rescue plan for the financial institution; (f) entering into an agreement for amalgamation or merger of the financial institution with a company; and (g) entering into a compromise arrangement with creditors of the financial institution.	submitted that these provisions are not necessary.
45(2)	**Governance and other subcommittees** The Prudential Committee may establish one or more other subcommittees with functions that the Prudential ~~Authority Oversight~~ Committee may determine.	This appears to be a typographical error. **Proposal: Amend as suggested.**
120(g)	**Suspension of licences** **120.** (1) The responsible authority that issued a licence may, by notice to the licensee, suspend the licence if - … (g) fees in respect of the licence, a levy or an administrative penalty payable by the licensee, including any interest, are unpaid and have been unpaid for at least 14 days.	It is submitted that a reasonable period would be 30 days. **Proposal: Amendment of 14 to 30 days.**
283(1)	**Development and implementation of policy frameworks during transitional period** **283.** (1) During the period of three years from the date on which this Part comes	It is unclear why reference is being made to "further policy frameworks". What is the original policy framework?

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	into effect, the National Treasury, in conjunction with the financial sector regulators, must develop principles for further policy frameworks, not inconsistent with this Act, for the regulation and supervision of financial institutions.	
283(2)	**Development and implementation of policy frameworks during transitional period** **283.** (1) During the period of three years from the date on which this Part comes into effect, the National Treasury, in conjunction with the financial sector regulators, must develop principles for further policy frameworks, not inconsistent with this Act, for the regulation and supervision of financial institutions. (2) The Minister may, by notice published in the Register, declare principles developed as contemplated in subsection (1).	The meaning of sub-clause (2) is not at all clear. As it currently reads it doesn't seem to make much sense – there would appear to be a drafting error.
Schedule 4 Page 147 s1(h)	**Schedule 4: Amendments and repeals** Proposed amendment of definition of intermediary services in the Financial Advisory and Intermediary Services Act, 37 of 2002 ("FAIS")	The comments of two large ASISA members are quoted verbatim in the attached Annexure.

ANNEXURE: MINORITY VIEW - COMMENTS FROM TWO LARGE ASISA MEMBERS

Financial Sector Regulation Bill (FSRB)

Schedule 4: Proposed amendment of definition of intermediary services in the Financial Advisory and Intermediary Services Act, 37 of 2002 ("FAIS")

In Schedule 4 to the FSRB it is proposed to amend, inter alia, certain provisions of FAIS. One of the proposed amendments to FAIS which we are very concerned about is the proposed amendment of the definition of "intermediary services". In their reply to the comments submitted in respect of previous drafts, NT responded as follows:

> "The Act's main objective is the protection of financial customers. All persons who render financial services to consumers must be adequately regulated.
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> The Act, in achieving its objective, has a functional approach, aimed at regulating two types of activities, namely: advice and intermediary services. It is irrelevant in which capacity a person renders the services. For this reason the Act is applicable "in addition" to any other law.
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> The proposed amendment aims to clarify that where a product supplier performs an activity set out under the definition of "intermediary services" through its employees, such product supplier must be licensed under the Act and its employees must be registered as "representatives" unless the exclusion referred to in the proposed amendment to section 45 applies.
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> However, industry increasingly contends that it is not necessary for a product supplier who directly, through its employees, markets and sells its own products to obtain authorisation under the Act as such employees cannot be regarded as being separate from the product supplier.
>
> The effect of the above is that the activities performed by a product supplier that constitute the direct selling of its financial products to clients are seen as being excluded from the definition of intermediary services. The result is that product suppliers, when selling their products to clients, are excluded from the Act, irrespective of whether that activity is regulated by any other law. This defeats the purpose of the Act."

Consumer Protection

Whilst we fully support the protection of financial customers and also fully agree that all persons who render financial services to consumers must be adequately regulated, we do not agree that product suppliers, when selling their products to clients without the intermediation of an FSP, are currently excluded from FAIS.

One of the examples provided by NT in support of their contention that the definition needs to be amended in order to protect consumers, is that of call centers operated by employees of product suppliers who are "hard selling" products. NT stated in their response that these employees presently do not have to comply with the requirements of FAIS, which includes, inter alia, requirements relating to honesty and integrity, competency, conflicts of interest and conduct. It is also stated that clients, when dealing directly with product suppliers, are not afforded the protection of FAIS, as would have been the case if they had interacted through an intermediary. For the reasons set out below we do not agree with these statements.

FAIS provides that "...any recommendation, guidance or proposal of a financial nature furnished , by any means or medium…." constitutes "advice" , which is subject to the provisions of FAIS, irrespective of whether the activity is performed by persons employed or mandated by a product supplier, or by a Financial Services Provider (FSP).

Put differently, if a product supplier elects to market and sell its products directly to customers through call center consultants employed or mandated by it and such selling involves a recommendation, guidance or proposal, it will be regarded as "advice" and the consultant concerned will therefore have to be registered as a "representative" and comply with the fit and proper requirements.

Call center consultants are often employed by product suppliers in order to provide consumers with "factual advice", which is expressly excluded from the ambit of "advice" by subsection 1(3)(a) of FAIS. (Please refer to sub-section 1(3)(a) of FAIS where it is stated that "advice" expressly excludes "factual advice " given in respect of "…the procedure for entering into a transaction ;…description of a financial product;…answer to routine administrative queries…;.objective information about a particular financial product…".)

It is submitted that such "factual advice" clearly does not amount to 'hard selling'. However, rendering the services envisaged in section 1(3), i.e. activities excluded from advice, does by its very nature entail that the person doing so on behalf of the product supplier, will have to provide factually correct information and should the person fail to do so, the consumer concerned will have all the common law remedies available to the victim of a misrepresentation, including the right to resile from any agreement concluded by him/her as a result of such misrepresentation. We respectfully submit that there is therefore no need for any specific fit and proper regulations to be imposed on employees who are simply providing factual information and is not providing advice.

It is furthermore submitted that "hard selling" must by definition involve some recommendation, guidance or proposal with regard to the financial product being marketed and does therefore constitute "advice" as defined in FAIS.

A product supplier which employs or mandates persons in its call center to "hard sell" its products to consumers is therefore presently already subject to FAIS and will have to register such persons as representatives (with all the entailing fit & proper, honesty and integrity, and other requirements that goes with that).

In their response NT refers to the unequal treatment of persons performing the same activity, e.g. an independent intermediary must comply with FAIS and meet competency requirements when selling financial products, while employees of product suppliers performing the same activity do not have to meet such requirements.

We also do not agree with this statement. It is the activity concerned that dictates whether the fit and proper requirements prescribed by FAIS applies or not.

Should a product supplier employ the services of a third party to render "financial services" on its behalf, such third party will either have to be licensed as a FSP or appointed as a representative and will therefore also be subject to the same provisions of FAIS with regard to representatives.

It is to be noted that whilst the key individual of an external FSP / call center must, inter alia, meet fit and proper requirements, the call center agents will only have to meet the fit and proper requirements if they qualify as representatives of the FSP.

They are therefore in exactly the same position as employees of product suppliers who are not regarded as representatives in terms of the relevant definition. They also do not have to be fit and proper if they are only providing factual information. As such, it is unclear on which basis the allegations are made that external center agents are subject to fit and proper regulation, while their internal product supplier employee counterparts are not.

NT also referred to the situation where complicated derivative instruments are being sold to clients "without the protection of FAIS", as these products are mainly being sold by the issuers of the instruments. They state that the growth and proliferation of the Internet has caused an increase of derivative instruments being offered and sold to retail clients and that issuers increasingly reach potential clients from all walks of life through the internet.

We point out that FAIS does not provide that any person who wish to purchase or invest in a financial product may not do so before he/she/it has obtained "advice". It only stipulates who may provide "advice" in respect of such product and how such "advice" must be furnished.

It is furthermore clear that FAIS does not prohibit product suppliers from advertising their products and from providing "factual information" in respect thereof. In our view, should a product supplier sell derivatives to a customer electing not to obtain advice, the persons employed to provide such a customer with "factual information" about the product in question ought not to be subjected to fit and proper requirements. In addition, it is submitted that the proposed changes under the FSB Retail Distribution Review limiting the type of products which may be sold on an execution only basis should in any event address these concerns.

The proposed amendment is therefore not going to add to the protection currently afforded to consumers in terms of FAIS and it is accordingly not clear how the proposed amendments will be in the interest of clients.

Unintended consequences

In our view the proposed amendment will have a whole number of consequences (several possibly unforeseen), which will have a significant impact on the financial services industry without, for the reasons set out above, a corresponding (or any material) benefit to clients.

1. All product suppliers will have to register as an FSP

   One of the consequences of the proposed amendment is that every product supplier will have to be registered as an FSP under FAIS by virtue of the fact that by performing functions which are inherent or incidental to their business as a product supplier, they will now be seen to be rendering intermediary services (under the new proposed definition).

   According to NT the proposed amendment aims to clarify that where a product supplier performs an activity set out under the definition of "intermediary services" through its employees, such product supplier must be licensed under FAIS and its employees must be registered as "representatives" unless the exclusion referred to in the proposed amendment to section 45 applies (our emphasis).

   It must be noted that it is being proposed that sub-section 1(3)(b) of the FAIS (which provides for the exclusion of certain activities from the definition - more specifically an intermediary service rendered by a product supplier who is authorised under a particular law to conduct business as a financial institution and where the rendering of such service is regulated by such law) be deleted and that section 45 be amended by the insertion of the following subsection after sub-section 1:

   "(1A) The provisions of this Act do not apply to the—
   (a) performing of the activities referred to in paragraph *(b)*(ii) and (iii) of the definition of "intermediary service" by a product supplier—
   (i) who is authorised under a particular law to conduct business as a financial institution; and

(ii) where the rendering of such service is regulated under such law; and

(b) rendering of financial services by a manager as defined in section 1 of the Collective Investment Schemes Control Act, 2002, to the extent that the rendering of financial services is regulated under that Act.

(1B) The exemption referred to in—

(a) subsection (1A)*(a)* does not apply to a person to whom the product supplier has delegated or outsourced the activity, or any part of the activity, contemplated in paragraph *(a)* and where the person is not an employee of the product supplier; and

(b) subsection (1A)*(b)* does not apply to an authorised agent as defined in section 1 of the Collective Investment Schemes Control Act, 2002.''.

This means that the activities in sub-paragraph (b)(i) of the current definition of intermediary services will therefore no longer be excluded. These include:
"(i) buying, selling or otherwise dealing in (whether on a discretionary or nondiscretionary basis), managing, administering, keeping in safe custody, maintaining or servicing a financial product purchased by a client from a product supplier or in which the client has invested;"

The majority of these activities are activities which are incidental to the day to day activities of a product supplier and the proposed amendments will therefore result in a situation that every product supplier will also have to apply to for a FAIS license and will have to appoint a key individual(s) (who will have to meet the fit and proper requirements prescribed in respect of the relevant financial product/s) in order to conduct its business as a product supplier.

Put differently, in terms of the proposed amendment any product supplier who contracts with a client, receives money from the client in respect of the relevant financial product (which it has to do in order to give effect to the agreement), manages and administers its own financial product (which it is bound to do in accordance with the various financial sector laws applicable to product suppliers), will now also have to be licensed in terms of FAIS,

Furthermore, as regards the activities listed in sub-paragraphs (ii) and (iii) , there will first have to be a proper analysis of the provisions of the particular law under which a product supplier operates before it can be concluded that the product supplier has been rendering a financial service.

The costs incidental to such a licence as well as those incidental to complying with the relevant provisions of FAIS, will eventually be passed on to the consumer.

We do not believe that it was ever the intention to subject all product suppliers to the provisions of FAIS.

2. Third parties to register as FSP's
   A further concern is that any third party rendering a service on behalf of an FSP, such as the so-called "Independent contractors" who refer clients to the FSP for purposes of obtaining financial advice (e.g. attorneys dealing in Road Accident Fund cases), will now apparently also have to be licenced and comply with the fit and proper requirements. It is our view that such a dispensation, which is bound to lead to a cessation of such referral, can never be in the interest of clients.

   Another potential conundrum is the situation where product suppliers advertise their products in newspapers, magazines, chain stores or on TV and clients who wish to purchase same can either send in the relevant form provided or phone a call center. Whilst such activities will most probably not be regarded as constituting "advice", by virtue of the provisions of sub-section 1(3)(a) of FAIS (activities expressly excluded from the ambit of advice), and will presently also not constitute intermediary service by virtue of the provisions of sub-section 1(3)(b) thereof, the questions *inter alia* posed in terms of the proposed amendments is whether the newspaper, magazine, etc. concerned will now also have to be licensed (as the publishing of such an advertisement may result in a client entering into a transaction in respect of a financial product). This in turn begs the question as to which of the employees of the third party concerned (newspaper, etc.) or the product supplier concerned will have to be registered as a representative (because it can be argued that their action will "lead the client into a specific transaction in respect of a financial product")?

3. Binder holders to be licensed as FSP's
   In view of the wording of sub-paragraphs (b) (i)(ii) and (iii), read with the provisions of section 49A of the LTIA, many "binder holders" will now also have to be licensed as FSP's and appoint a key individual, unless they are a product supplier as defined in FAIS.

4. Services rendered on behalf of discretionary and administrative FSP's
   Persons or institutions rendering any of the services covered under the definition of intermediary services on behalf of a discretionary and administrative FSP's will now also have to be licensed, as the limitation incidental to the words "for or on behalf of a client or product supplier" will no longer have application.

Absurdities

The current definition of "*intermediary services*" in the Act makes it clear that intermediary services are services that are performed by a person other than a "*client*" or a "*product supplier".*

This accords with the definitions of "*client", "product supplier"* and *"financial services provider*" in FAIS and it is clear from the relevant provisions in FAIS (including but not limited to sub-section 1(3)(b)) that the Legislature clearly distinguishes between a "*product supplier*" and a "*financial services provider*".

We would like to refer to the matter of Tristar Investments (Pty) Ltd v The Chemical Industries National Provident Fund (Case number: 455/12) where the Supreme Court of Appeal has held as follow:
(For your convenience we quote part of the judgment here below (the emphasis is ours) and have also highlighted the proposed deletions to the definition in terms of the proposed amendments, in the current definition quoted in the judgement below.)

> *[5] It is not controversial that a substantial portion of the services TriStar undertook to provide constitutes the furnishing of 'advice'. It is also clear from the agreement that some of the services it undertook to provide did not constitute furnishing advice. The court below found that because TriStar was licensed only to 'furnish advice' it was prohibited from rendering those other services, and the agreement was consequently invalid.*
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> *[6] That approach to the matter was not correct. The Act does not prohibit TriStar from performing any service other than 'furnishing advice' (which it is licensed to do). It prohibits it only from providing an 'intermediary service' in the absence of a licence to do so.* ***The correct question, then, is not whether the services in issue*** *constitute something other than 'furnishing advice' (which they are), but instead whether they* ***constitute an 'intermediary service'.***
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> *[7]* ***In ordinary language an 'intermediary' is one who 'acts between others; a go-between' and the word has a corresponding meaning when used as an adjective****.* ***The Act assigns its own meaning to the term that retains that characteristic. The definition contemplates a person who is interposed between a 'client' (or a group of clients), on the one hand, and a 'product supplier' on the other hand.*** *It is as well to have clarity on what is meant by those terms – which are also defined – before turning in more detail to the definition of an 'intermediary service'.*
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> *[8] A 'product supplier' is a person who issues a 'financial product'. The Act contains a comprehensive list of 'financial products', which include shares, debentures, money-market instruments, insurance contracts, investment instruments, and the like. A 'client' means (to paraphrase that definition) a specific person or group of persons to whom a financial service is provided'.*
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> *[9] With those definitions in mind an 'intermediary service' is defined to mean (with a reservation that is not now relevant) 'any act other than the furnishing of advice, performed by a person for or on behalf of a client or product supplier –*
> *a) the result of which is that a client may enter into, offers to enter into or enters into any transaction in respect of a financial product with a product supplier; or*
> *(b) with a view to -*

(i) buying, selling or otherwise dealing in (whether on a discretionary or nondiscretionary basis), managing, administering, keeping in safe custody, maintaining or servicing a financial product purchased by a client from a product supplier or in which the client has invested;
(ii) collecting or accounting for premiums or other moneys payable by the client to a product supplier in respect of a financial product; or
(iii) receiving, submitting or processing the claims of a client against a product supplier in respect of a financial product……"

[13] Sub-clause (a) of the definition of an intermediary service, properly construed, contemplates acts that directly result in the consequences referred to. ***To construe it as including any act that indirectly has that result would lead to absurdities****. It contemplates a person who stands with a client (or clients) on the one side, and a supplier of financial products on the other side, acting as the 'go-between' to effect the relevant transactions. Quintessentially, that person is the asset manager, who is mandated to act on behalf of the Fund. As for sub-clause (b), it contemplates a person who manages or administers the relevant financial products.*

[14] None of the services TriStar undertook to provide falls foul of those provisions. Initially they were to compile and convey the appropriate mandates and instructions to the asset managers, and thereafter to take steps to ensure compliance with their mandates. It was not to bring about the relevant transactions – those would be brought about by the asset managers – nor was it to manage or administer the financial products. So far as it was to manage or administer anything at all, it was to manage and administer no more than the mandates of the asset managers.

[15] In my view none of those constitutes 'intermediary services' on the ordinary meaning of the language of the definition. I can also see no reason – and none could be suggested – why the legislature would have thought it necessary for services of that kind to be regulated. In those circumstances TriStar was not required to be licensed to provide them, and the objection raised by the Fund ought to have been dismissed.

The proposed amendment seeks to remove the words "…for or on behalf of a client or a product supplier…" in the introductory part of the definition, as well as the references to "product supplier" in paragraphs (a) and (b) thereof. This runs counter to the ordinary meaning of 'intermediary', as recorded in the Tristar matter. NT responded to this comment by stating that "the amendment changes the normal meaning of "intermediate". That, however, is not problematic as the Act assigns specific meaning to the terminology."

In our view this approach will lead to absurdities. As pointed out by the SCA in the TriStar matter the current definition accords with the ordinary meaning of "intermediary" and was intended to regulate activities performed in respect of a financial product by someone who stands between the product supplier and the client, acting on either's behalf, and whose actions directly result in the consequences referred to in the definition. As pointed out by the Court an interpretation that it includes

any action which may indirectly result in such consequences will lead to absurdities. Take for example, the situation where a taxi driver who regularly drives potential customers to the offices of a product supplier. In terms of the current definition such a person will not be rendering "intermediary services" because such a person is not interposing between the product supplier and the customer with regard to a financial product and the taxi driver's action will not directly result in the consequences envisaged. In terms of the proposed amendment, such person may well be regarded as rendering "intermediary services", as his/her "act" of driving the client to the offices of the product supplier may result in a situation that the client "may enter into, offers to enter into or enters into any transaction in respect of a financial product…".

We also wish to point out that neither a client nor a product supplier can render intermediary services on behalf of itself. When a product supplier contracts with clients, it acts in its capacity as product supplier and is therefore not rendering intermediary services on its own behalf. As such it cannot be regarded as rendering intermediary services on behalf of itself nor on behalf of the client, because the client is the counterparty. To illustrate, if a customer purchases goods from the retailer, a transaction is concluded between the retailer and the customer. The retailer is acting as itself and not on behalf of itself. It is also not acting on behalf of the customer, because the customer is acting in its own capacity. Upon our reading of the proposed amendment of the definition it is intended that the retailer must be regarded as rendering intermediary services on behalf of itself when it contracts with clients, which is, with respect, absurd.

It is submitted that it was never the intention of FAIS to regulate product suppliers when acting in its capacity as product suppliers.