



## **Module 3: Financial Legislation in Banking Learner Resource Guide**

Developed By  
Charlton Scheepers and Nerina de Waal

# Chapter 1

## Banking regulation in South Africa

### Overview

This Banking Regulation guide provides a high level overview of the governance and supervision of banks, including legislation, regulatory bodies and the role of international standards, licensing, the rules on liquidity, foreign investment requirements, liquidation regimes and recent trends in the regulation of banks.

### 1. Legislation and regulatory authorities

#### 1.1 Legislation

South Africa has a well-established banking regulatory framework. The banking capital requirements in the Banks Act, 1990 (Banks Act) and its subordinate legislation, together with the exchange control regulation enforced in South Africa by the national treasury, meant that South African banks were largely shielded from the 2008 global financial crises.

The Financial Sector Regulation Act, 2017 (FSR Act) was signed into law on 21 August 2017, giving effect to the implementation of the "Twin Peaks" model of regulation in the South African financial sector. The Minister of Finance determined that the FSR Act (with the exception of a few transitional periods) would commence on 1 April 2018. As a result of the commencement of the FSR Act, and in particular of section 290, read with Schedule 4, of the FSR Act, the Banks Act has been amended to replace references to the Registrar of Banks at the Bank Supervision Department of the South African Reserve Bank (SARB) with the newly established Prudential Authority (PA). Accordingly, the PA is responsible for supervising the operation of banks in South Africa, and ensuring compliance by banks with the Banks Act.

#### 1.2. Regulatory authorities

##### 1.2.1 Lead bank regulators

The SARB as the central bank of South Africa is primarily responsible for overseeing banks. The PA, as a juristic person operating within the administration of the SARB, supervises the domestic activities of all banks, representative offices and branches of foreign banks, and the foreign activities of South African banks. A key objective of the PA is to promote the soundness of the domestic banking system, through effective and efficient application of international regulatory and supervisory standards and best practice. To keep informed of international regulatory and supervisory developments, the PA participates in, and contributes to, various international forums.

### 1.2.2 Other authorities

The Financial Intelligence Centre monitors and gives guidance to banks as accountable institutions, in relation to their know-your-client duties and compliance with the Financial Intelligence Centre Act, 2001.

The Financial Services Board which was established under the Financial Services Board Act, 1990, has now been replaced with the Financial Sector Conduct Authority (FSCA), as established on 1 April 2018 under the FSR Act. The FSCA is a dedicated market conduct regulator for the financial services sector. The Financial Advisory and Intermediary Services Act, 2002 (FAIS) regulates the provision of financial services in relation to a number of products, including deposits. For banks to market deposits in South Africa, there is a registration requirement under FAIS and compliance is overseen by the FSCA.

The National Credit Regulator (NCR) is established under the National Credit Act, 2005 (NCA) and is responsible for the regulation of the South African credit industry. The NCA requires the NCR to promote the development of an accessible credit market, particularly to address the needs of historically disadvantaged persons, low income persons and remote, isolated or low density communities. It is also tasked with the registration of credit providers, credit bureaux and debt counsellors. To the extent that a bank in South Africa wants to advance credit to natural persons, it must be registered as a credit provider and subject to the oversight of the NCR.

### 1.2.3 Central bank

The SARB is the central bank of South Africa, and its primary objective is the achievement and maintenance of price stability in the interest of sustainable economic growth. The relationship between the SARB and the state is that between banker and client, as ordinarily understood in the law of banking and bills of exchange. The SARB recognises the need to pursue balanced economic development and growth, based on a market system, private and social initiatives, effective competition and social fairness.

The South African Reserve Bank Act, 1989 (SARB Act), together with the Banks Act, the Mutual Banks Act, 1993 and the FSR Act, assigns responsibility for the registration and supervision of banks to the SARB. These Acts provide that the powers for bank registration and supervision are assigned to the PA. Together with the regulations issued under the Banks Act, these Acts provide a comprehensive legal framework for banking supervision in South Africa. Under the Acts, the PA, as a juristic person under the administration of the SARB, is accountable to the Governor of the SARB, and also has a direct reporting line to the Minister.

The Governor or a Deputy Governor can instruct the PA to cause the affairs of an unregistered person suspected of carrying on the business of a bank or mutual bank to be inspected in accordance with the provisions of Part 4 of Chapter 9 of the FSR Act (*section 12, SARB Act*).

### 1.2.4 Others

Banks and controlling companies are only permitted to appoint auditors approved by the PA. Where a bank or controlling company is unable to appoint an auditor which has been approved by the PA, the PA will appoint an auditor for the bank or controlling company (*sections 61 and 62, Banks Act*).

Auditors are required to provide copies of any reports or other particulars submitted to the Independent Regulatory Board for Auditors, in respect of any irregularity or suspected irregularity in the conduct of the affairs of the bank for which that auditor has been appointed, to the PA. In addition, an appointed auditor is required to inform the PA in writing of any matter relating to the affairs of bank:

- Of which the auditor became aware in the performance of such auditor's functions as auditor of that bank.
- Which, in the opinion of that auditor, could:
  - endanger the bank's ability to continue as a going concern;
  - impair the protection of the funds of the bank's depositors;
  - be contrary to principles of sound management (including risk management); or
  - amounts to inadequate maintenance of internal controls.

(*section 63, Banks Act*.)

An appointed auditor can also furnish any information provided to the PA relating to affairs of the bank to the chief executive officer of the bank. Auditors therefore assist the PA with the supervision of banks and controlling companies.

SARB is also a member of and contributor to various international governance bodies such as the G20, the International Monetary Fund (IMF), the Bank for International Settlements (BIS) and the Committee of Central Bank Governors (CCBG) in the Southern African Development Community (SADC). SARB can develop the financial sector, in accordance with member commitments to global regulatory regimes.

In January 2019 the SARB became member of the Global Financial Innovation Network (GFIN) with a view to promoting responsible financial innovation. GFIN acts as an intermediary between financial institutions and regulators to assist them in implementing new ideas between different countries. By joining GFIN, the SARB will receive the benefit of insight from foreign regulators in their bid to enable innovation.

### 1.3 Bank licences

An entity cannot conduct the business of a bank unless it is a public company registered as a bank under the Banks Act (*section 11(1), Banks Act*).

To register:

- Firstly, the relevant entity must apply to the PA for authorisation to establish a bank.
- Secondly, it must apply for registration as a bank.

A bank must also obtain an annual licence.

Once an entity has been registered and licensed as a bank under the Banks Act, it can carry out "the business of a bank" as defined in section 1 of the Banks Act, in particular to conduct deposit taking business in South Africa.

A public company cannot be formed under the Companies Act to conduct the business of a bank without the PA's approval (*section 15(1), Banks Act*). The PA will grant approval if he/she believes that the company will probably be eligible for registration as a bank (*section 15(2)*). The Companies and Intellectual Property Commission (Commission) cannot register a company's memorandum of incorporation unless the application for registration is accompanied by the PA's approval (*section 15(3)*).

A branch of a foreign bank can also register to conduct the business of a bank in South Africa, under section 18A of the Banks Act. The Banks Act and the Regulations relating to Banks (Regulations) apply equally to branches, unless stated otherwise.

The Banks Act provides for the registration of representative offices of foreign banks. Representative offices cannot conduct the business of a bank (*section 34, Banks Act*).

## **1.4 Application**

### **1.4.1 Process**

An application for authorisation to establish a bank must be made in the stipulated manner and form, and contain the information prescribed by the Regulations (*section 12, Banks Act*) and any further information the PA requires.

Provided an applicant's authorisation to establish a bank has not been revoked, it can apply to the PA for registration as a bank during the 12-month period following the date of the authorisation (*section 16(1), Banks Act*). The application for registration must be made in the stipulated manner and form, and contain the information specified in section 16(2) and any further information deemed necessary by the PA.

To obtain authorisation as a branch, the applicant must under section 18A of the Banks Act submit a completed form (as prescribed by the PA) accompanied by the prescribed fee. The PA can request such further information and documentation as he/she may deem necessary.

### **1.4.2 Requirements**

The PA can grant or refuse authorisation to establish a bank, or grant it subject to conditions he/she can determine (*section 13(1), Banks Act*). The PA will only grant an application if the criteria in section 13(2) of the Banks Act have been met. These include that the:

- Establishment of the proposed bank is in the public interest.
- Business the applicant proposes to conduct is that of a bank.
- Applicant will conduct the proposed business of a bank as a public company incorporated and registered under the Companies Act.
- Applicant is able to establish itself successfully as a bank.
- Applicant has the financial means to comply, as a bank, with the Banks Act.

Authorisation can be revoked if the PA believes that either (*section 14, Banks Act*):

- False or misleading information was provided pursuant to an application; or

- A bank has not been formed in accordance with the proposals in the application, within 12 months of the granting of authorisation.

For the PA to grant an application for bank registration, the following must be met (*section 17(1), Banks Act*):

- The business the applicant proposes to conduct is that of a bank;
- The applicant does not propose to adopt undesirable methods of conducting business; and
- The memorandum of incorporation of the institution is consistent with the Banks Act.

The applicant must also provide the PA with proof that it complies with the minimum share capital and unimpaired reserved funds requirements in section 70 of the Banks Act (*section 17(5), Banks Act*). Section 70(2)(a) provides for calculations of minimum share capital and unimpaired reserved funds relating to common equity tier 1 capital, additional tier 1 capital and tier 2 capital relating to the specific business which the bank conducts, for example trading in financial instruments. The calculation formulas required to be implemented by banks differ, depending on the bank's activities. Specifically, section 70 distinguishes between banks which trade solely in financial instruments, banks which trade in financial instruments as part of their business, and banks which do not trade in financial instruments.

### **1.4.3 Foreign applicants**

A foreign applicant wishing to establish a branch in South Africa must comply with the additional requirements set out in the Regulations to the Banks Act (*Regulations Relating to Conditions for the Conducting of the Business of a Bank by a Foreign Institution by means of a Branch in the Republic*) (Conditions):

- The applicant must for the 18 months before the application have held net assets of at least USD1 billion, or if belonging to a banking group, that banking group must have net assets of at least USD1 billion and that branch net assets of at least USD400 million.
- The applicant must have a long-term investment grade debt rating acceptable to the PA.
- The branch capital must at all times be at least the greater of ZAR250 million or 8% (or such higher percentage prescribed by the PA) of the amount of assets and other risk exposures of the branch.
- The branch must maintain a minimum reserve balance in an account with the SARB.
- The value of the unencumbered assets of the applicant cannot be less than the percentage of liabilities stipulated by the PA.
- The PA must be satisfied that the applicant lawfully conducts the business of a bank in a foreign jurisdiction.
- The PA must also be satisfied that the foreign regulator:

- has authorised the establishment of the branch;
- accepts and complies with the proposals and guidelines of the Basel Committee;
- ensures that the members of the board of the bank and the executive management consist of fit and proper persons;
- maintains suitable risk management procedures; and
- is committed to keeping the PA informed of any material information regarding the financial soundness of the applicant.
- 

#### **1.4.4 Timing and basis of decision**

The PA will provisionally register an applicant as a bank and issue it with a certificate of registration, if its application succeeds and it pays the prescribed fee (*section 17(4), Banks Act*). A registration can be made subject to certain conditions.

In practice, registration can generally take between ten to 14 months from the date of the application. The timing varies on a case-to-case basis.

#### **1.4.5 Cost and duration**

A bank, a branch and a representative office must obtain an annual business licence from the PA and pay the prescribed licence fee (*section 35, Banks Act*).

### **1.5 Jurisdiction**

Banks headquartered in other jurisdictions can operate in South Africa through a representative office or a branch of that foreign bank. Each is subject to the Banks Act and the regulatory oversight of the SARB.

A representative office promotes and assists the business of the foreign bank but cannot conduct the business of a bank in South Africa.

A branch of a foreign bank established in South Africa must meet the requirements set out in Section 18A of the Banks Act. This includes prior written approval of the PA.

A branch of a foreign bank must comply with capital adequacy requirements provided in the Banks Act and must register as a company under the Companies Act.

The consent of the PA is required for registration as a representative office or as a branch of a foreign bank. Therefore, a foreign bank cannot operate as a bank in South Africa solely because it holds a foreign banking licence.

Both representative offices and local branches of foreign banks are subject to the same standards of supervision or oversight by the PA as domestic banks. The Bank Supervision Department, a department within the SARB, is responsible for the supervision of banks and provides consolidated supervision of banking groups and their cross-border establishments. The standard of supervision is in line with the minimum standards prescribed by the Basel Committee on Banking Supervision.

In terms of regulation 58 of the Banks Act, the prescribed fee payable in respect of an application to establish a representative office is ZAR6840 (including VAT), while the application fee in respect of a branch ZAR20520 (including VAT). Once authorisation has been granted by SARB to operate as a local branch of a foreign bank, an annual licence fee will also be payable.

## **1.6 Forms of banks**

### **1.6.1 State-owned banks**

There are no state-owned banks in South Africa.

### **1.6.2 Universal banks, commercial and retail banks**

Takeovers and mergers, as well as organic growth fuelled by deregulation, have led to large banks with many interests and services. Labels traditionally given to different banks are becoming increasingly meaningless. However, it is useful to distinguish the typical labels used by different kinds of banks according to their main type of activity.

### **1.6.3 Investment banks**

Investment banks buy and sell corporate and government securities issues, and also advise companies on raising capital, but do not accept deposits or make loans in the traditional sense. The term investment bank is increasingly used by any bank offering a wide range of financial services and advice to corporate clients.

### **1.6.4 Private banks**

This term usually refers to banks which act for high net worth individuals rather than businesses. Private banks are usually owned by commercial or investment banks.

### **1.6.5 Other banks**

**Land Bank.** The Land and Agricultural Development Bank of South Africa (trading as the Land Bank) is a legal person operating under the Land and Agricultural Development Bank Act 2002. The state is the sole shareholder of the Land Bank, and the Minister for Agricultural Land appoints a board of directors to manage its business. One of the objectives of the Land Bank is to increase the ownership of agricultural land by historically disadvantaged persons, by providing financial services. The Land Bank is exempt from other laws specifically governing banks, unless the other law expressly provides for its application to the Land Bank.

**Development Bank of Southern Africa.** This is a legal person under the authority of the Department of Finance. Its function is promoting economic development and growth in the Southern African region in an integrated financial development system, which aims at the efficient deployment of scarce resources. The Minister of Finance can by notice in the Government Gazette apply any provision of the Companies Act, the Banks Act or other law to this bank.

**Mutual banks.** These are governed by the Mutual Banks Act. A mutual bank is defined as a legal person registered as a mutual bank, whose members qualify as such by being shareholders entitled to participate in exercising control in a general meeting. Certain provisions of the Banks Act apply to mutual banks. The regulator for the administration of the Mutual Banks Act is the PA under the Banks Act.

In respect of each form of bank set out in this section, the scope of business which these registered banks are approved to undertake is limited to conducting "the business of a bank", as defined in section 1 of the Banks Act. To provide any other business in South Africa, a registered bank will need to ensure that it is appropriately licensed in respect of those particular activities (for example, a bank wishing to provide financial services needs to be appropriately licensed or exempted under the FAIS).

### **1.6.7 Regulation of systemically important financial institutions (SIFIs)**

Loosely defined, SIFIs are financial institutions that are deemed systemically important to the economy, in that their failure would have significant spill-over effects that could destabilise the financial system. The prevention of the collapse of a SIFI is important, as it is a means of protecting the economy.

The FSR Act provides that the Governor of the Reserve Bank (Governor) can, by written notice to a financial institution, designate the institution as a SIFI. This power cannot be delegated (*section 29, FSR Act*)

In deciding whether to designate a financial institution as a SIFI, the Governor must take into account at least the following:

- Size of the institution.
- Complexity of the financial institution and its business affairs.
- Interconnectedness of the institution with other financial institutions within or outside South Africa.
- Whether there are readily available substitutes for the financial products and financial services that the financial institution provides or, in the case of a market infrastructure, the market infrastructure.
- Recommendations of the Financial Stability Oversight Committee (as defined in the FSR Act).
- Submissions made by or for the financial institution.
- Any other matters that may be prescribed by regulation.

The Governor can also designate a financial institution as a SIFI without complying with section 29(2) and (3) of the FSR Act where the Governor has determined that a systemic event has occurred or is imminent. A systemic event is an event or

circumstance, including one that occurs or arises outside South Africa, that may reasonably be expected to have a substantial adverse effect on the financial system or on economic activity in South Africa, including an event or circumstance that leads to a loss of confidence that operators of, or participants in, payment systems, settlement systems or financial markets, or financial institutions, are able to continue to provide financial products or financial services, or services provided by a market infrastructure (*section 1, FSR Act*).

SIFIs will be regulated by prudential standards made and regulator's directives issued by the PA. These prudential standards and/or regulator's directives can impose requirements applicable to specific SIFIs or to SIFIs generally in relation to solvency measures and capital requirements (which may include requirements in relation to countercyclical capital buffers), leverage ratios, liquidity, organisational structures, risk management arrangements (including guarantee arrangements), sectoral and geographical exposures, required statistical returns, recovery and resolution planning, or any other matter prescribed by regulations made on the recommendation of the Governor (*section 30, FSR Act*).

## **1.7 Organisation of banks**

### **1.7.1 Legal entities**

Only public companies incorporated under the Companies Act can register as banks in South Africa (*section 11(1), Banks Act*). However, to register as a branch of a foreign bank in South Africa, an institution is not required to be a public company under the Companies Act. The institution must be a legal entity established in a country other than South Africa, and lawfully conduct in the other country a business similar to the business of a bank (*section 18A, Banks Act*). The Banks Amendment Bill proposes to amend section 11(1) of the Banks Act to include state-owned entities incorporated under the Companies Act,

### **1.7.8 Corporate governance**

The board of directors and executive officers of a bank must establish and maintain an adequate and effective process of corporate governance (*section 60B(1), Banks Act*) with the objective of achieving the bank's strategic and business objectives efficiently, effectively, ethically and equitably (within acceptable risk parameters) (*section 60B(2), Banks Act*) and ensuring compliance with all applicable laws and realisation of the listed goals (*see section 60B(2)(a)-(i), Banks Act*).

The board of directors is responsible for ensuring that governance includes the maintenance of effective risk management and capital management (*see Regulation 39(1)*). The process must be consistent with the nature, complexity and risk inherent in the bank's on-balance sheet and off-balance sheet activities, and able to respond to changes in the bank's environment and conditions. The board can appoint supporting committees to assist it (*Regulation 39*). Under Regulation 1(4)(d) of the

Conditions, the management of a branch of a foreign institution is responsible for compliance with Regulation 39.

The composition of the board of directors of a bank or controlling company is prescribed by the PA. An employee of a bank or its subsidiary, controlling company or other subsidiary of the controlling company cannot be appointed chairperson of the board of that bank (*Regulation 41(1)*), nor can the chairperson be a member of the audit committee of the bank or its controlling company (*Regulation 41(2)*).

Similar provisions apply to the chairperson of the controlling company. The chairperson must be neither an employee nor a member of the audit committee (*Regulation 41(4)*) of the controlling company, or any bank in respect of which that company is registered as a controlling company.

At least two members of the board must be employees of the bank, unless the PA directs otherwise on application by the bank on the basis of special circumstances (*Regulation 41(5)*).

No person can hold office as an auditor of a bank or a controlling company unless the appointment of that person has been approved by the PA and the person is appointed for the period and on the conditions prescribed by the PA (*section 61, Banks Act*). A bank or controlling company must apply to the PA for approval of the appointed auditor within 30 days of the appointment in accordance with Part C of the Companies Act. The PA has discretion to refuse the application for approval (*section 61(3), Banks Act*). If the application for approval is refused, or an auditor's approval has been withdrawn, the newly appointed auditor must also apply for approval from the PA under section 61(2) of the Banks Act.

The external auditors of the bank must report annually to the PA as to whether they concur with the directors' reports and, if they do not, indicate why they are not in agreement (*Regulation 40(4)(d)*).

Following the commencement of the majority of the provisions of the FSR Act on 1 April 2018, the regulatory structure in South Africa has been reformed from a fragmented structure to a "Twin Peaks" model of regulation. Banks are regulated by the PA, a juristic person under the administration of the SARB, in respect of their prudential activities. The FSCA regulates market conduct in respect of financial services (other than banking activities contemplated in the Banks Act). Banks conducting such financial services will also be regulated by the FSCA. In respect of banking activities, and because the PA supervisor cannot take over the management of a bank, the approach is to conduct the PA's activities in a way that promotes sound risk-management practices by all key players in the risk-management process. The key players include the banks' shareholders and boards of directors, managements,

internal and external auditors, the general public and the supervisor. The approach consists primarily of qualitative assessment and quantitative analysis.

The qualitative aspects of supervisory work are undertaken mainly onsite at the premises of banks, and consist of assessing the corporate governance and internal control systems of a bank. In view of the daily volumes of transactions in the banking system, great reliance is placed on the ability of the system to ensure automatically that good risk-management principles are applied. The PA's onsite work is aimed at forming a high-level opinion about the adequacy of a bank's risk management and controls. The more detailed evaluation of the quality of a bank's systems is formally delegated to the bank's external auditors.

The quantitative analysis is performed offsite at the PA's offices, based on comprehensive statutory data provided by banks on a monthly basis. The data, certified as correct by the external auditors of a bank, is electronically entered into a database and converted into meaningful information by various techniques, such as ratio analysis, time series analysis, peer and sector comparisons, and graphic analysis. Relevant information from other sources, such as published annual financial statements, the media, and rating agencies, is also considered. Any deviation from what is expected is subject to specific discussion at the bank. Apart from frequent informal contacts between analysts and their allocated banks, formal interaction includes a quarterly prudential meeting with the executive management and various risk managers of each bank, a pre-audit planning meeting with the external auditors, annual trilateral discussions with the management and auditors, and annual presentations to the bank's board.

Foreign-owned banks, whether subsidiaries or branches of the foreign parent, are subject to the same standards of licensing and prudential supervision as domestic banks. Branches are not permitted to accept retail deposits, and representative offices cannot accept deposits at all.

Since South African banks also operate in overseas countries, the PA conducts consolidated supervision of banking groups and their cross-border establishments. This is in line with the minimum standards set by the Basel Committee on Banking Supervision. These standards aim to ensure that the cross-border operations of banks can be supervised effectively by the supervisory authorities in the home country and the host country, and that there is an adequate flow of information between them.

Compensation practices at large financial institutions are regarded as one of the factors that contributed to the financial crisis that began in 2007. The Financial Stability Board (FSB) recommended that regulators and supervisors work with market participants to mitigate the risks arising from remuneration policies, and was tasked with a mandate to draft sound practice principles for large financial institutions. In April 2009, the FSB issued Principles for Sound Compensation Practices as part of a call

by the G20 at the Pittsburgh Summit to set global standards as part of pay structure reforms.

During 2008, the Bank Supervision Department of the SARB (now replaced by the PA) included a discussion on the involvement of the board remuneration subcommittee in banks' incentive schemes, in its topics for meetings with banks' boards.

In 2012 the FSB launched the Bilateral Complaint Handling Process (BCHP). The BCHP establishes a mechanism for national supervisors from FSB member jurisdictions to bilaterally report, verify and, if necessary, address specific compensation-related complaints by financial institutions, based on level playing field concerns.

To undertake ongoing monitoring, the FSB has also established a Compensation Monitoring Contact Group (CMCG) comprising national experts from member jurisdictions with regulatory or supervisory responsibility on compensation practices. The CMCG is responsible for monitoring and reporting to the FSB on national implementation of the principles and Standards. The ongoing monitoring exercise is based on the input provided in a survey by CMCG members.

### **Risk Management rules**

It is recognised in the Regulations that the conduct of the business of a bank entails the management of risks (*Regulation 39(3)*). The bank must put in place comprehensive risk-management processes and board-approved policies and procedures to address these risks (*Regulation 39(4) and (5)*).

The bank's management must ensure that the risks are managed appropriately (*Regulation 39(6)(b)(i)*). This requires management to:

- Set capital targets commensurate with the bank's risk profile and control environment (*Regulation 39(6)(b)(ii)*).
- Implement robust and effective risk management and internal control processes (*Regulation 39(6)(b)(iii)*).
- Develop and maintain an appropriate strategy that ensures that the bank maintains adequate capital and an internal capital assessment process that responds to changes in the business cycle (*Regulation 39(6)(b)(iv)(A)*).

Management must also conduct stress tests to identify events or changes in market conditions that may have an adverse impact on the bank (*Regulation 39(6)(b)(vi)*).

Directors of banks must have a basic knowledge and understanding of the conduct of the business of a bank and of the laws and customs that govern the activities of such institutions (*Regulation 40(1)*) and perform their duties with diligence, care and competence (*Regulation 40(2)*). It is their duty to ensure that risks are managed prudently, particularly since banks administer money loaned to them by the public (*Regulation 40(3)*).

South Africa has adopted International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board. The directors of a bank must make

annual reports to the PA (*Regulation 40(4) (a)-(c)*). These reports must address, among other things:

- The integrity of internal controls.
- The maintenance of ethical standards.
- Material malfunctions as defined and documented by the board of directors that have been identified.
- Whether there is reason to believe that the bank will not be a going concern in the year ahead.

The framework for domestic contingency planning has also been strengthened. An example is the Financial Sector Contingency Forum (FSCF). This was created to facilitate cross-sectoral co-operation in identifying threats to the stability of the South African financial sectors, obtaining approval for appropriate mutual plans and structures to mitigate such threats, and co-ordinating responses to resolve crises. The SARB is currently reviewing its contingency planning and crisis management strategies and policies as part of the work of the FSCF.

## **1.9 Liquidity and capital adequacy**

### **1.9.1 Role of international standards**

The Regulations accord with the standards of Basel II, Basel 2.5 and Basel III.

South Africa is considered to be strongly placed to implement the phased-in requirements of the Basel III reforms which commenced in January 2013, as domestic banks are already capitalised above the Basel III required levels. Even though South African bank supervision did not call for capital conservation buffers, domestic banks were capitalised over the buffer requirements, and the current leverage ratio for domestic banks was far more conservative than the Basel III reforms. Consequently, with reference to Basel III, there is no requirement for South African banks to either raise capital or deleverage.

However, domestic banks do not currently meet the new global liquidity standards. Compliance with these standards will require structural change to the financial system, which will allow banks to increase the maturity of their funding and investment managers to increase the horizon of their investments. The first step in this approach has been the amendment to Regulation 28 of the Regulations to the Pension Fund Act 1956 (*Regulation 28*) to allow banks access to more long-term financing. Pension funds will now be allowed to buy long-dated bank debt. Changes to the definition of cash in Regulation 28 will reduce the incentives for pension funds to hold large amounts of short-term operational funds outside the banking system.

To cover any shortfall in liquidity if there is a crisis, the PA (previously the Registrar of Banks) has announced that it will make available to banks a committed liquidity facility, which banks could draw on in time of crisis.

### 1.9.2 Main liquidity/capital adequacy requirements

Section 72 of the Banks Act provides that a bank is to hold liquid assets in South Africa to a value which is at least 20% of its prescribed liabilities. Further, a bank cannot pledge or otherwise encumber any assets which are held by it in compliance with this liquidity requirement, unless the PA has provided an exemption (*section 72(3), Banks Act*).

Under the Basel III framework, SARB introduced a leverage ratio in the Regulations to the Banks Act to serve as a backstop to the risk-based capital requirement, and to prevent build-up of excessive leverage in the financial system. Regulation 38(15) provides that every bank and every controlling company must calculate a leverage ratio in accordance with the relevant requirements specified in that sub-regulation (15), to supplement the bank or controlling company's relevant risk-based capital requirements.

Regulation 38(15)(c) provides the leverage ratio formula, and Regulation 38(15)(d) and (e) set out that this formula must be used and the relevant amounts determined. A bank must calculate its leverage ratio in accordance with the above described formula, provided that:

- The bank must calculate the relevant amount of qualifying capital and reserve funds in accordance with the requirements specified in paragraph (d).
- The bank must calculate the relevant exposure measure in accordance with the requirements specified in paragraph (e).
- In all relevant cases, the requirements specified in subregulation (15) apply on a solo and a consolidated basis.
- Between 1 January 2013 and 31 December 2017 banks, controlling companies and the PA must apply the relevant requirements specified in subregulation (15), to monitor the readiness of relevant institutions to implement and fully comply with these requirements and any subsequent amendments thereto as a minimum standard from 1 January 2018.
- During the monitoring period of 1 January 2013 to 31 December 2017, a bank must manage its business in such a manner that its leverage ratio is at no time less than 4%, that is, the bank's leverage multiple, which is the inverse of the bank's leverage ratio, must at no time exceed 25, or such leverage ratio and multiple as may be determined by the PA in consultation with the Governor of the Reserve Bank, which leverage ratio must in no case be less than 3%.
- On 1 April 2018 the SARB issued Banks Act Directive 1/2018 pursuant to the standard entitled *Pillar 3 disclosure requirements- consolidated and enhanced framework* issued by the Basel Committee on Banking Supervision (BCBS). This directive obliges all banks, controlling companies, and branches of foreign institutions to disclose their capital adequacy and leverage ratios on a quarterly basis as provided by the standard issued by the BCBS.

Section 64A of the Banks Act provides that the board of directors of a bank and its controlling company must appoint at least three of its members (of which at least two must be non-executive directors) to a risk and capital management committee. However, if the committee is appointed in respect of a holding company able to assume these responsibilities for the bank, the PA may exempt the bank from this requirement.

### **1.9.3 Share capital and unimpaired reserve funds**

Chapter 6 of the Banks Act sets out the prudential requirements for a bank. In this regard, the Banks Act differentiates between a bank whose business:

- Does not include the trading of financial instruments (*section 70(2)*).
- Consists solely of the trading of financial instruments (*section 70(2A)*).
- Includes the trading of financial instruments (*section 70(2B)*).

Accordingly, the Banks Act imposes different minimum requirements for the share capital and unimpaired reserve funds of each of the above banks.

In addition, the Banks Act sets certain minimum requirements for the capital and reserve funds of a controlling company. It also provides that any regulated entity included in a banking group and structured under a controlling company must comply with the minimum requirements for its capital and reserve funds set by the relevant regulator (*section 70A, Banks Act*).

### **1.9.4 Concentration risk**

In addition to the above prudential requirements, the Banks Act limits the investments, grant of loans, advance or other credit that a bank, controlling company, branch or branch of bank can undertake (*section 73, Banks Act*). In particular, the Banks Act sets the following limitations:

- An entity cannot make investments with or grant loans, advances or other credit to a person that exceeds 10% of its prescribed capital and reserves without the prior approval of the board of directors or committee specifically appointed (*section 73(1)(a)*).
- If an entity's investments, loans, advances and other credit contemplated above and relating to any private sector non-bank person exceeds 800% of its prescribed capital and reserves, it will be subject to additional capital requirements (*section 73(1)(b)*).
- An entity cannot make investments with or grant loans, advances or other credit to a private sector non-bank person if the transaction, alone or together with previous transactions with the person, results in it being exposed to the person to an amount exceeding 25% of the prescribed amount, without the prior written approval of the PA (*section 73(2)(a)*). If the PA grants this approval, the relevant entity can be subject to additional capital requirements (*section 73(2)(c)*). If an entity enters into such a transaction with any person other than a private sector non-bank person, it must report this to the PA (*section 73(2)(b)*).

- An entity can be subject to additional capital and reserve fund requirements if it is exposed to an industry, sector or geographical area that exceeds the prescribed amount (*section 73(2)(d)*). Accordingly, an entity must report any investment in or loans, advances or other credit exposure to a specific industry, sector or geographical area, which alone or together with any previous such transactions results in it being exposed to that industry, sector or geographical area, in an amount exceeding the prescribed percentage of capital and reserve funds (*section 73(2)(e)*).

However, the PA can exempt an entity from the above with the consent of the Minister of Finance and as he/she can determine (*section 73(4)*).

### **1.9.5 Failure to comply**

If a bank fails to comply or is unable to comply with section 70 (minimum share capital and unimpaired reserve funds) or section 72 (minimum liquid assets), or a controlling company fails to comply or is unable to comply with section 70A (minimum capital reserve funds in respect of banking group), it must report the failure or inability, together with reasons, to the PA (*section 74(1)*).

In addition and despite the power of the PA to impose a penalty under section 91A, the PA can take action against an entity or condone a failure or inability, if he/she deems fit. If the PA condones a failure or inability, he/she can give the entity an opportunity to comply with the relevant provisions within a specified period, and subject to conditions he/she can determine (*section 74(2)*).

The PA can fine an entity, irrespective of whether criminal proceedings have been brought against it (*section 74(3)*).

### **1.9.6 Returns**

A bank must provide the PA with returns, to enable the PA to determine whether it is complying with sections 70 and 72 of the Banks Act and section 10 of the SARB Act, and to determine the extent of its assets, liabilities and contingent liabilities (*section 75(1), Banks Act*). In addition, a bank must provide the PA with returns relating to the extent and management of risk exposures in the conduct of its business (*section 75(3), Banks Act*).

Returns must conform to the financial reporting standards issued under the Companies Act, and must be submitted in the form and at the times prescribed (*section 75(3A) Banks Act*). The returns which most nearly coincide with the financial year end of a bank are to be accompanied by a report by the bank's auditor, stating whether the returns fairly, and in compliance with the reporting standards, present the affairs of the bank (*section 75(5), Banks Act*).

The Banks Act also regulates that in a group of banks the holding company must, in addition to other prescribed returns, provide the PA with a consolidated return in the manner and form prescribed (*section 75(4)(b), Banks Act*).

### **1.9.7 Special requirements for SIFIs**

Not applicable.

## **1.10 Consolidated supervision**

### **1.10.1 Role and requirements**

#### **Role**

Effective governance measures need to be maintained to strike a proper balance between the rights and interests of the public and of banks.

To ensure the soundness of the banking system, efficient and effective supervisory standards have been developed by the Basel Committee. Under the implementation of Basel II and Basel 2.5 in South Africa, the Banks Act and the Regulations were amended to:

- Clarify the responsibilities of banks, banking groups, boards of directors of banks and banking groups.
- Increase the reporting responsibilities and provide comprehensive disclosure requirements for banks and banking groups.
- Facilitate the options available to banks and banking groups in calculating minimum capital requirements for credit risk, market risk and operational risk exposure.
- Strengthen risk coverage of the capital framework.
- Reduce risks from securitisation and off-balance sheet activities.
- Strengthen senior management oversight in banks and banking groups.
- Elaborate on the supervisory review process to, among other things, assess the capital adequacy and control environment of banks and banking groups.

#### **Requirements**

See above, Role.

### **1.10.2 International co-ordination and co-operation**

SARB has entered into a number of memoranda of understanding with key jurisdictions (such as China, Dubai and Australia), in terms of which the information sharing models contemplated under Basel III are established.

## **1.11 Shareholdings/acquisition of control**

Every bank and controlling company of a bank within 90 days of its registration and annually thereafter must, within 30 days of 31 December of each year, provide the PA with a return regarding its shareholdings, as at the date of registration or as at 31 December of that year (*section 59, Banks Act*). In this regard, a specific form (BA 125) must be completed and submitted to the PA.

Section 37 of the Banks Act deals with the acquisition of shares in a bank or controlling company.

No person (other than the bank's controlling company) can acquire shares in a bank or controlling company amounting to more than 15% of the total value or voting rights of the bank's issued shares without having obtained the permission of the PA or the Minister of Finance (Minister). This includes an acquisition which, together with shares already held by that person or an associate of that person, amounts to more than 15% of the total nominal value or total voting rights of the bank's issued shares.

Subject to the permission of the PA or the Minister:

- A person who has for 12 months, or such shorter period as the PA may determine, held 15% of shares or voting rights in respect of issued shares can, with the PA's permission, acquire more than 15% but no more than 24% of the shares or voting rights in a bank or controlling company.
- If that person has for 12 months, or such shorter period as the PA may deem fit, held 24% of shares or voting rights in respect of a bank's issued shares, that person can, with the PA's permission, acquire more than 24% but no more than 49% of those shares or voting rights.
- If that person has for 12 months, or such shorter period as the Minister may deem fit, held 49% of those shares or voting rights in respect of a bank's issued shares, that person can, with the Minister's permission, acquire more than 49% but no more than 74% of those shares or voting rights.
- If that person has for 12 months, or such shorter period as the Minister may deem fit, held 74% of the shares or voting rights in respect of a bank's issued shares, that person can, with the Minister's approval, acquire more than 74% of those shares or voting rights.

Such permission will not be granted unless the PA or Minister is satisfied that the proposed acquisition is not contrary to the public interest, and not contrary to the interest of the bank or its depositors, or of the controlling company.

In light of the provisions above, it is clear that:

- A non-bank can acquire a minority interest in a bank.
- One bank can acquire a minority interest in another bank if it has obtained the approval of the PA or Minister.

Section 42 of the Banks Act provides that, subject to the provisions of section 37, no person other than a bank or an institution which has been approved by the PA and which conducts a business similar to the business of a bank in a country other than South Africa can exercise control over a bank unless such person is a public company and is registered as a controlling company in respect of such bank. Therefore only banks or foreign public companies conducting a business similar to the business of a bank can acquire a controlling interest in a bank.

Banks can invest in non-banks but their ability to do so is regulated and restricted in section 76 of the Banks Act. A bank can invest in shares of any company (excluding preference shares which are not convertible into ordinary shares) on condition that the

sum of the amount invested in those shares does not at any time exceed a prescribed amount. In terms of section 22 of the Regulations, the amount invest in any shares of a company should not at any time exceed a bank's qualifying amount of common equity tier 1 capital and reserve funds, additional tier 1 capital and reserve funds and tier 2 capital and reserve funds relating to risks other than market risk.

The Banks Act does not prohibit foreign investments in banks, and the approval requirements apply where applicable (see Question 4).

Section 38 of the Banks Act requires that any shares held in a bank must be registered in the name of the intended beneficial owner, and prior approval from the PA is required for registration in the name of a nominee.

As discussed in Question 21, section 42 of the Banks Act confirms that a foreign financial institution that conducts a similar business to that of a South African bank in another country may acquire a controlling interest in a South African bank if it is a public company and is registered as a controlling company in respect of such bank.

### **1.12 Liquidation, resolution and transfer**

The Companies Act provides for the liquidation and winding up of companies registered in South Africa. Section 5(4) of the Companies Act must be read with section 51(1) of the Banks Act. This provides that a company registered as a bank or controlling company will continue to be a company in terms of the Companies Act, and the Companies Act will continue to apply to it to the extent it is not inconsistent with the Banks Act.

Section 68 of the Banks Act provides that despite any other provision in the Banks Act and anything to the contrary in the Companies Act:

- The PA has the right to apply to a court for the winding up of a bank under the Companies Act, and to oppose an application by any other persons.
- No person other than a person recommended by the PA can be appointed by a Master of the High Court (Master) as a provisional liquidator or liquidator of a bank.
- The Master will appoint a person designated by the PA (who, in the PA's opinion, has wide experience of and is knowledgeable about the latest developments in the banking industry) to assist the provisional liquidator or liquidator of the bank.

When the winding up of a bank is presented to a court, a copy of the application and every affidavit confirming the facts in it must be lodged with the PA and with the Master. The PA or the Master can report to the court any fact they ascertain which appears to justify the court postponing the hearing or dismissing the application. (*section 68 (2A)(a), Banks Act.*)

In the application of the voluntary winding up of a bank, a copy of every special resolution for the winding up must be provided to the PA (*section 68(3)(b), Banks Act.*)

If in the PA's opinion a bank will be unable to repay when legally obliged to do so deposits made with it, or will be unable to meet any of its other obligations, the Minister

can if he/she deems it desirable in the public interest appoint a curator to the bank (*section 69, Banks Act*).

The management of the bank will then vest in the curator subject to the PA's supervision, any other person vested with management of the bank's affairs will be divested of the management, and the curator will recover and take possession of all the bank's assets.

The curator can then dispose of any of the bank's assets and/or transfer any of its liabilities in the ordinary course of the bank's business, provided that the disposals or transfers are in accordance with section 54 of the Banks Act. In terms of section 69(2C)(c)(i) and (ii), in seeking consent for such a disposal or transfer, the curator must report to the Minister or PA on the expected effect on the bank's creditors, and whether:

- The creditors are treated in an equitable manner.
- A reasonable probability exists that a creditor will not incur greater losses, as at the date of the proposed disposal and/or transfer, than would have been incurred if the bank had been wound up under section 68 of the Banks Act on the date of the proposed disposal and/or transfer.

The Minister or the PA must, in addition to the requirements of section 54, consider the curator's report in making his/her decision in terms of section 54. However, the Minister or PA can consent to the disposal or transfer, even if the above effects are not achieved, if it is reasonably likely to promote the maintenance of either (*section 69(2C), Banks Act*):

- A stable banking sector.
- Public confidence in the banking sector.

The disposal must not be effected unless a reasonable probability exists that the disposal will enable the bank to pay its debts or meet its obligations and become a successful concern.

If at any time the curator believes that there is no reasonable probability that continuation of the curatorship will enable the bank to pay its debts or meet its obligations and become a successful concern, the curator must inform the PA.

While a bank is under curatorship, all actions, legal proceedings, writs, summons and other legal processes against the bank are stayed.

The PA is currently drafting a statutory framework for bank resolution.

During May 2017, the SARB's Financial Stability Department released a discussion document containing proposals for the resolution framework and a deposit insurance scheme (DIS) for South Africa. As a member of the G20, South Africa has agreed to adopt the Financial Stability Board's *Key Attributes of Effective Resolution Regimes for Financial Institutions*, one of which requires jurisdictions to have a privately-funded depositor protection and/or a resolution fund in place. The paper advocates the need for an explicit, privately-funded DIS for South Africa, the main objective being the protection of less financially sophisticated depositors in the event of a bank failure. The paper also refers to the discussion paper titled *Strengthening South Africa's*

*Resolution Framework for Financial Institutions*, published by National Treasury on 13 August 2015. The May 2017 discussion paper was open to public comment until 31 August 2017, however, no further communication regarding next steps has been made.

The proposed resolution framework, incorporating the DIS, is expected to form the comprehensive regulatory architecture for reducing the social and economic cost of failing financial institutions. In January 2018, a draft resolution framework was released to the financial services industry for initial review, following which it will be released to the public for general comment. This draft framework sets out the broad principles for the resolution of banks, systemically important non-bank financial institutions and holding companies of banks, and highlights the various legislative amendments required to ensure the framework is enforceable and that the actual and potential impacts of a failure of a branch or a systematically important financial institution on financial stability are managed appropriately. Detailed definitions of key elements of the resolution framework are subject to finalisation, and directives or addendums to this framework will be published once finalised.

The resolution framework will allow the PA to prepare for an event for which the institution's recovery actions have failed or are deemed likely to fail. Bank resolution plans will be owned and maintained by the Resolution Authority (a proposed new unit in SARB), but will require a significant amount of bilateral engagement and input from individual banks to enable the PA to develop a customised plan that is most appropriate to each bank.

The Financial Sector Laws Amendment Bill, 2018 (FSLAB) has incorporated the proposals made in the discussion documents by making provision for the establishment of a Resolution Authority and a deposit insurance scheme (DIS).

The FSLAB has been published for public comment and remains in draft form. Once finalised, the FSLAB will establish the resolution framework and DIS system applicable to:

- Designated institutions currently defined to include all banks.
- Systemically important financial institutions.
- Payment system operators and participants of systemically important payment systems.
- Holding companies of the above and members of a financial conglomerate where one of the members is a bank or a systemically important financial institution.

There is no specific bank bail-out regime in South Africa. Further, there is no precedent in South Africa of any government bail-out of a bank, as has been seen for foreign banks after the 2008 financial crisis. It is expected that the statutory framework for bank resolution will deal with a bail-in regime rather than a bail-out regime.

### **Obligations to prepare recovery plans**

These will be determined once the FSLAB is finalised and signed into law.

## **Powers of the regulator**

The powers of the Resolution Authority (SARB) will be determined once the FSLAB is finalised and signed into law.

## **Transfers of business**

The ability to transfer business in connection with a resolution regime will be determined once the FSLAB is finalised and signed into law.

### **1.13 Regulatory developments and recent trends**

South Africa is currently phasing in Basel III. Transitional arrangements for the implementation of Basel III were phased in until 1 January 2019. After the implementation of Basel III in South Africa the BCBS issued revised requirements in respect of the following:

- Capital disclosure requirements.
- Revision of liquidity coverage ratio.
- Liquidity disclosure requirements.
- Requirements related to intraday liquidity management.
- Public disclosure requirements related to leverage ratio.

As discussed in *Question 24*, in September 2018 the FSLAB was published for public comment. The FSLAB proposes to introduce a framework for the orderly resolution of designated institutions (including banks as well as non-banks which are systemically important financial institutions) and establish a DIS.

The Twin Peaks model for financial sector reform came into effect from 1 April 2018 (except for a couple transitional periods) by virtue of the FSR Act.

In December 2018, the draft Conduct of Financial Institutions Bill (CoFI) was published for public comment. CoFI proposes to establish a consolidated, comprehensive and consistent regulatory framework for the conduct of financial institutions. CoFI therefore supplements a series of legislative reforms aimed at strengthening the regulation of the financial institutions and more specifically the way customers are treated in the course of providing financial services. CoFI, once finalised, will replace provisions dealing with conduct requirements in existing financial sector legislation.

In August 2019 the National Credit Amendment Act, 2019 (NCAA) came into force. The NCAA amends the National Credit Act, 2005 (NCA) to introduce, among other things, the concept of "debt intervention". Under section 86A of the NCA, an applicant can now apply to the National Credit Regulator for debt intervention and over-indebtedness is set as the requirement for this debt intervention.

The Minister is now also empowered to "prescribe a debt intervention measure". The purpose of this provision is to help provide relief to groups of people experiencing debt and economic difficulties. This provision allows for debt intervention where consumers are over indebted and allows debts to be suspended in whole or in part for a prescribed

period or even be extinguished entirely (*section 88, NCA*). The NCAA also introduces amendments to section 87 of the NCA and empowers the magistrates' court to prescribe maximum interest rates, fees and charges in respect of credit agreements. A new bill proposing to amend the Banks Act (Banks Amendment Bill) was first published on 15 May 2019 and is currently under consultation. The Banks Amendment Bill, if promulgated, will make it possible for state-owned companies to (among others):

- Register as a bank and conduct the business of a bank in terms of the Banks Act.
- Exercise control over a bank.
- Be eligible to apply for registration as a controlling company.

## Chapter 2

### The Banks Act and other Regulations

#### 2.1 Summaries of the primary statutes and regulations that govern the banking industry.

##### 2.2.1 Regulation and supervision of the South African banking sector

The legal framework for the regulation and supervision of the banking sector in South Africa consists of (i) the Banks Act, 1990 (Banks Act), (ii) the Co-operative Banks Act, 2007 (CBA) and (iii) the Mutual Banks Act, 1993 (MBA) together with the regulations, directives, circulars and guidance notes relating to each of the Banks Act, CBA and MBA:

- The Banks Act regulates the business of public companies taking deposits from the public and related matters.
- The CBA regulates deposit-taking financial services cooperatives that are capitalised by their members and qualify as cooperative banks.
- The MBA regulates the operations of informal financial structures such as credit unions, building societies and stokvels (general savings, burial or investment societies) that qualify as mutual banks.
- The National Payment Systems Act, 1998 regulates the management, administration, operation, regulation and supervision of payment, clearing and settlement systems in South Africa.
- The Companies Act, 2008 (Companies Act) regulates the organisation and management of companies generally.
- Legislation concerning the oversight of the banking industry includes the following:
  - The South African Reserve Bank Act, 1989 regulates the SARB and the monetary system in general.
  - The FSR Act regulates financial stability by providing for prudential standards applicable to, and the supervision of, financial institutions, including banks.
  - The Currency and Exchanges Act, 1933 regulates legal tender, currency, exchanges and banking. The Regulations made under the Currency and Exchanges Act, 1933 and published on 1 December 1961 limit the extent to which South African residents and companies may transfer funds abroad. The exchange control rules are also set out in the

Currency and Exchange Manuals and related client guideline documents implemented with effect from 1 August 2016.

- The Financial Institutions (Protection of Funds) Act, 2001 sets out and consolidates the laws relating to, the investment, safe custody and administration of funds and trust property by financial institutions.
- The Promotion of Administrative Justice Act, 2000 gives effect to the right to administrative action that is lawful, reasonable and procedurally fair and applies to any administrative action taken by a financial sector regulator in terms of the FSR Act or any specific financial sector law.

### **2.1.2 Stability and soundness of financial institutions**

- The FSR Act has the objective of achieving a stable financial system that works in the interests of financial customers and that supports balanced and sustainable economic growth in South Africa.
- The Financial Markets Act, 2012 regulates financial markets, prohibits insider trading and other market abuses and regulates and controls securities trading.

### **2.1.3 Consumer protection and market conduct**

- The National Credit Act, 2005 (NCA) aims to promote a fair and non-discriminatory marketplace for access to consumer credit and to prohibit certain unfair credit and credit-marketing practices as well as reckless credit granting.
- The Consumer Protection Act, 2008 (CPA) promotes a fair, accessible and sustainable marketplace for consumer products and services (including banking services) and seeks, among others, to establish national norms and standards relating to consumer protection and to prohibit certain unfair marketing and business practices.
- The Financial Advisory and Intermediary Services Act, 2002 (FAIS Act) regulates the rendering of certain financial advisory and intermediary services to clients.
- The Competition Act, 1998 applies to the investigation, control and evaluation of restrictive practices, abuse of dominant position, and mergers.
- The Promotion of Access to Information Act, 2000 gives effect to the constitutional right of access to any information held by another person and required for the exercise or protection of any rights.
- The Protection of Personal Information Act, 2013, among others, establishes minimum requirements for the processing of personal information by public and private bodies; provides for the rights of persons regarding unsolicited

electronic communications and automated decision making and regulates the flow of personal information across the borders of South Africa.

#### **2.2.4 Expanding access to financial services through financial inclusion**

- The Broad-Based Black Economic Empowerment Act, 2003 establishes a legislative framework for the promotion of black economic empowerment. The Code published in terms of this legislation commits financial institutions to promoting transformation in the financial services sector.
- The South African Postbank Limited Act, 2010 establishes the Postbank Division of the Post Office to, among others, conduct the business of a bank that will encourage and attract savings among South Africans.

#### **2.2.5 Financial integrity and combatting financial crime**

The Financial Intelligence Centre Act, 2001 (FICA) seeks to combat money laundering activities and the financing of terrorist and related activities by, among others, imposing certain duties on institutions to identify, and conduct due diligence in respect of, the clients with whom they have business relationships.

- The Prevention of Organised Crime Act, 1998 criminalises money laundering.
- The Protection of Constitutional Democracy Against Terrorism and Related Activities Act, 2004 criminalises terror financing.

*The Financial Intelligence Centre Act is discussed in more detail in Chapter 3*

### **2.3 Regulatory authorities**

Banks are regulated by the following entities.

- The SARB is responsible for, among others, supervising the banking sector and ensuring the effective functioning of the national payment system. The oversight of the soundness of the domestic banking system and financial stability has been delegated to the Bank Supervision Department (BSD) within the SARB. The BSD is accountable to the Minister of Finance and is required to submit an annual report on its activities.
- FICA establishes the Financial Intelligence Centre, which is required to supervise and enforce compliance with this legislation or any directive made in terms of this Act by accountable institutions, including banks, for purposes of

27

its objective. The Financial Intelligence Centre is accountable to the Minister of Finance.

- The National Credit Regulator is established in terms of the NCA to promote and support the development, where the need exists, of a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry to serve the needs of (i) historically disadvantaged persons, (ii) low income persons and communities and (iii) remote, isolated or low density populations and communities. The National Credit Regulator is responsible for regulating the consumer credit industry by, among others, registering, and suspending or cancelling the registration of, credit providers, including banks. The National Credit Regulator is accountable to the Minister of Trade and Industry as the Minister currently responsible for consumer credit matters.

The FSR Act establishes the Prudential Authority within the administration of the SARB, which is tasked with:

- promoting and enhancing the safety and soundness of financial institutions (which includes banks) that provide financial products and securities services;
- promoting and enhancing the safety and soundness of market infrastructures;
- protecting financial customers against the risk of financial institutions failing to meet their obligations; and
- assisting in maintaining financial stability.

The FSR Act also establishes the Financial Sector Conduct Authority, which is replacing the Financial Services Board (FSB). The FSB was established in terms of the Financial Services Board Act, 1990 to supervise compliance with laws regulating (without affecting the operation of a bank's business as a bank) (i) financial institutions, including banks, that deal with trust property as a regular feature of their business and (ii) the provision of financial services. Accordingly, the FSB Act regulates South Africa's non-banking financial services industry. The Financial Sector Conduct Authority is, subject to the concurrence of the SARB, responsible for making standards (i) that impose requirements on providers of payment services or (ii) aimed at assisting in maintaining financial stability. The FSB Act will be entirely repealed once the FSR Act is fully implemented. The Financial Sector Conduct Authority is responsible for enforcing the provisions of the FAIS Act.

Upon implementation of the FSR Act, the Prudential Authority, the Financial Sector Conduct Authority, the National Credit Regulator and the Financial Intelligence Centre will be subject to the directives of the Governor of the SARB in the event that the Governor determines that a specified event or circumstance is a systemic event that

may reasonably be expected to have a substantial adverse effect on the financial system or on economic activity in South Africa.

#### **2.4 Government deposit insurance**

The CBA requires the establishment of the Cooperative Banks Deposit Insurance Fund for purposes of compensating members of cooperative banks (that paid contributions to the fund) for deposits lost as a result of a cooperative bank having been unable to repay the deposits from its members, up to a percentage or amount determined by the Minister of Finance. The Minister of Finance must also prescribe the deposit insurance contributions that are payable by cooperative banks. At the time of writing this note, the Minister of Finance has not prescribed the applicable amounts of contributions payable to, and compensation payable from, the Cooperative Banks Deposit Insurance Fund.

The SARB has published a discussion paper dated May 2017 titled 'Designing a deposit insurance scheme for South Africa'. The paper motivates the need for an explicit, privately funded deposit insurance scheme for South Africa and presents for public discussion proposals on the key design features of such a deposit insurance scheme. There is currently no deposit insurance mechanism employed in the banking sector in South Africa.

The government of South Africa does not own any interest in the banking sector.

#### **2.5 Transactions between affiliates**

In terms of the Banks Act, a bank must manage its business in such a manner that the aggregate amount of

(i) its investments in debentures or preference shares of any of its associates (other than subsidiaries of which the main object is the acquisition and holding or development of immovable property), a bank or mutual bank, which debentures or preference shares are not convertible into ordinary shares plus

(ii) its advances to any such associates plus

(iii) its guarantees or other instrument relating to the liabilities or contingent liabilities of such associates less

(iv) the excess amount of qualifying primary and secondary capital and reserve funds, does not at any time exceed 10 per cent of the bank's aggregate amount of deposits, current accounts and other creditors.

For the purposes of this provision an 'associate' in relation to a bank refers to

- (i) any subsidiary or holding company of that bank, any other subsidiary of that holding company and any other company of which that holding company is a subsidiary, or
- (ii) any juristic person of which the board of directors is accustomed to act in accordance with the directions or instructions of that bank and includes any trust controlled or administered by that bank. The terms 'holding company', 'subsidiary' and 'control' have the meanings given to them in the Companies Act.

The Prudential Authority must approve any transaction by a bank or its associate to:

- establish or acquire a subsidiary within or outside South Africa or enter into an agreement having the effect that any company becomes its subsidiary within or outside South Africa;
- invest in a joint venture within or outside South Africa if the investment, or the investment together with one or more investments already made by the bank in that joint venture, results in the bank being exposed to an amount representing more than five per cent of its capital and reserves and to make any further investment for so long as the bank is exposed. A joint venture means a contractual arrangement between two or more persons, one or more of whom is a bank or a controlling company, in terms whereof the parties undertake an economic activity that is subject to their joint control;
- open or acquire a branch office outside South Africa;
- acquire an interest in any undertaking having its registered office or principal place of business outside South Africa
- create or acquire a trust of which the bank is a major beneficiary outside South Africa;
- establish or acquire any financial or other business undertaking under its direct or indirect control outside South Africa;
- establish or acquire a representative office outside South Africa; or
- create or acquire a division within or outside South Africa by means of an arrangement or agreement with any person having the effect that such person conducts his or her business through or by means of such a division.

A bank or its controlling company must disclose to the Prudential Authority details of:

- any subsidiary it has established or acquired;
- any joint venture it has invested in;

- an undertaking it has acquired an interest in; or
- any trust or financial or other business undertaking it has established or acquired.

The Banks Act prohibits a bank from:

- holding shares in any company of which such bank is a subsidiary;
- lending money to any person against security of its own shares or of shares of that bank's controlling company;
- before provision has been made out of profits for any amount representing the cost of organisation or extension or the purchase of a business or a loss (including a loss originating from the sale of an asset) or bad debts, (i) opening any branch or agency or any further branch or agency or (ii) paying out dividends on its shares;
- concluding a repurchase agreement in respect of a fictitious asset or an asset created by means of a simulated transaction;
- purporting to have concluded a repurchase agreement without (i) such agreement being substantiated by a written document signed by the other party thereto and (ii) the details of such agreement being recorded in the accounts of the bank as well as in the accounts, if any, kept by the bank in the name of such other party; or
- without the prior written approval of the Prudential Authority and notwithstanding anything to the contrary contained in any law, paying out dividends from its share capital without the prior written approval of the Prudential Authority.

A bank must hold all its assets in its own name, excluding any asset (i) held pursuant to a bona fide hypothec to secure an actual or potential liability, (ii) that is held in the name of another person with the written approval of the Prudential Authority has, on application of the bank concerned, approved in writing that such asset may be held in the name of another person or (iii) falling within a category of assets designated by the Prudential Authority as a category of assets that may be held in the name of another person.

## **2.6 Regulatory challenges**

The FSR Act aims to coordinate the SARB and other organs of state to ensure financial stability. Differences in interpretation of the new regulatory requirements pursuant to the FSR Act and related legislation may cause disputes. For instance, the FSR Act

grants the Prudential Authority broad powers to require a bank to take action to avoid risks arising from, among others, conducting its business in an improper or financially unsound way or the likelihood of the bank (i) contravening a financial sector law, (ii) being involved in a financial crime or (iii) causing or contributing to instability in the financial system. The implementation of such provisions of the FSR Act may require banks to implement new internal processes and procedures or otherwise restrict their powers and actions and banks may wish to challenge such restrictions.

## **2.7 Consumer protection**

Other than the provisions of the NCA, the CPA and the FAIS Act set out in question 2, banks are subject to scrutiny by competition authorities of their compliance with the provisions of Competition Act, 1998 (Competition Act) regulating restrictive market practices. The Competition Act prohibits, among others, an agreement between, or concerted practice by, firms directly or indirectly fixing a purchase or selling price or any other trading condition. On 15 February 2017, the Competition Commission filed a complaint referral initiating proceedings against certain banks at the Competition Tribunal alleging that the banks entered into an agreement or engaged in a concerted practice to fix bids, offers and bid-offer spreads and to allocate customers and suppliers in respect of trade in United States dollars and the rand currency pair. At the time of writing this note, the matter has not been heard before the Competition Tribunal.

## **2.8 Future changes**

A notice recently published by the National Treasury schedules the remainder of the FSR Act to come into force by April 2019. This will include new provisions regulating, among others, 'significant owners' and 'financial conglomerates', as well as further changes to financial sector regulation. The 2018 Budget Review contemplates that a Conduct of Financial Institutions Bill will be tabled in Parliament in 2018. According to the 2018 Budget Review, in 2017 the National Treasury, in partnership with the World Bank, assessed the conduct of retail banks and how well they treat their customers. The recommendations pursuant to this review are expected to be published in 2018 and will inform the emerging regulatory requirements.

## **2.9 Supervision**

### **2.9.1 Extent of oversight**

The BSD of the SARB is responsible for the supervision of the activities of all banks. In terms of the Banks Act, the Prudential Authority is entitled to undertake the following:

- conduct (i) an onsite examination, inspection or review of a bank or controlling company and its respective branches, subsidiaries, joint ventures or related entities, within or outside South Africa or (ii) an offsite review of a bank or controlling company and its respective branches, subsidiaries, joint ventures or related entities, within or outside South Africa;
- hold discussions, from time to time, (i) with the chief executive officer of any bank, or with any executive officer or employee, designated by such chief executive officer or (ii) with a member of the board of directors or a member of a board-appointed committee of a bank or controlling company;
- review (i) the work done by an external auditor of a bank or controlling company or (ii) reports submitted in terms of the Banks Act by a bank, controlling company or banking group; and
- require a bank to furnish (i) any information at intervals specified in the notice or (ii) a report by a public accountant.

In terms of the FSR Act, the financial sector regulators (ie, the Prudential Authority or the Financial Sector Conduct Authority) may conduct information gathering, supervisory on-site inspections and investigations of financial institutions. The supervisory on-site inspections may be conducted for purposes of (i) checking compliance by the entity with an applicable financial sector law, a directive issued by the relevant financial sector regulator or an enforceable undertaking accepted by the financial sector regulator, (ii) determining the extent of the risk posed by the entity of contraventions of an applicable financial sector law and (iii) assisting the financial sector regulator to supervise the relevant financial institution. A financial sector regulator may appoint an investigator to conduct an investigation if the financial sector regulator (i) reasonably suspects that a person may have contravened, may be contravening or may be about to contravene, an applicable financial sector law or (ii) reasonably believes that an investigation is necessary to, among others, coordinate and harmonise the reporting and other obligations of financial institutions, exchange information, coordinate supervisory activities and regulate and enforce any laws with certain authorities (including authorities in whose countries a subsidiary or holding company of a financial institution is incorporated or a branch is situated) in terms of a bilateral or multilateral agreement or memorandum of understanding.

In terms of the Regulations relating to banks published pursuant to the Banks Act on 12 December 2012, as amended (Banks Act Regulations), the directors of a bank are required to report the following information annually to the Prudential Authority:

- whether or not the bank's internal controls provide reasonable assurance as to the integrity and reliability of the financial statements and safeguard, verify and maintain accountability of the bank's assets;

- whether or not the internal controls are based on established policies and procedures and are implemented by trained, skilled personnel, whose duties have been appropriately segregated;
- whether or not adherence to the implemented internal controls is continuously monitored by the bank;
- whether or not all bank employees are required to maintain high ethical standards, thereby ensuring that the bank's business practices are conducted in a manner that is above reproach;
- whether or not anything has come to the directors' attention to indicate that any material malfunction, as defined and documented by the board of directors, which definition has to be submitted to the Prudential Authority of banks, in the functioning of the aforementioned controls, procedures and systems has occurred during the period under review;
- that there is no reason to believe that the bank will not be a going concern in the year ahead, and should there be reason to believe so, such reason shall be disclosed and explained; and
- reports on the internal controls and going-concerns aspect of a bank, which is required to be delivered to the Prudential Authority within 120 days after the financial year of the bank.

The external auditors of a bank shall annually report to the Prudential Authority whether or not they concur with the reports of the directors and the reasons if they do not concur with such reports.

### **2.9.2 Enforcement**

The Banks Act requires the Prudential Authority's approval of an auditor's appointment by a bank or controlling company. The Prudential Authority may refuse an application for approval of an auditor's appointment or withdraw any approval previously granted if an auditor:

- (i) has been convicted of an offence of which dishonesty is an element;
- (ii) is found to be incompetent or unfit to perform the functions of an auditor;
- (iii) is under investigation by the Independent Regulatory Board for Auditors; or
- (iv) fails to disclose any direct or indirect interests that may constitute a conflict of interest in respect of such auditor's duties.

Under the Banks Act, the Prudential Authority may by notice in writing to the institution concerned, cancel or suspend on such conditions as the Prudential Authority may

deem fit, the registration of a bank if, among others, the institution concerned has failed to comply with a prescribed condition or a further condition for registration determined by the Prudential Authority, to which its registration is subject. The Prudential Authority may also institute court proceedings for an order cancelling or suspending the registration of a bank if there exist other grounds in the opinion of the Prudential Authority to justify such cancellation or suspension.

The FSR Act prohibits a bank from providing a financial product or financial services otherwise than in accordance with the licence issued to it in terms of the Banks Act or other applicable law. The bank, as licensee, is required to report any material contraventions of law or other applicable provisions specified in the FSR Act to the Prudential Authority. The Prudential Authority is entitled to suspend or revoke a bank's licence in the instances specified in the FSR Act.

The FSR Act also requires the auditor of a licensed financial institution or a holding company of a financial conglomerate to submit a detailed report to, among others, the Prudential Authority about any matter that the auditor considers:

- (aa) is causing or is likely to cause the financial institution to be financially unsound;
- (bb) is contravening or may contravene a financial sector law; or
- (cc) may result in an audit not being completed or may result in a qualified or adverse opinion on accounts.

It is an offence for a financial institution to fail to comply with a regulator's directive issued to it, for which the financial institution would be liable on conviction to a fine not exceeding 15 million rand or imprisonment for a period not exceeding 10 years. Under the FSR Act, the Prudential Authority is also entitled to commence court proceedings against any person in order to ensure compliance with any financial sector law.

The CBA makes it an offence for a cooperative bank to contravene or to fail to comply with certain provisions of the CBA or a directive under the CBA or to make an untrue or misleading statement. Such offences are subject to a fine or to imprisonment. The MBA contains similar provisions.

In terms of FICA, administrative sanctions may be imposed on banks for, among others, failing to comply with (i) a provision of FICA or determination or directive made in terms of FICA or (ii) a condition of a licence, registration, approval or authorisation issued in terms of FICA. The following administrative sanction may be imposed by the Financial Intelligence Centre or a supervisory body, including the SARB:

- (a) a caution not to repeat the conduct that led to the non-compliance;
- (b) a reprimand;
- (c) a directive to take remedial action or to make specific arrangements;

- (d) the restriction or suspension of certain specified business activities; or
- (e) a financial penalty not exceeding 10 million rand in respect of natural persons and 50 million rand in respect of any legal person.

Most recently, administrative sanctions were imposed by the SARB on banks in terms of the provisions of FICA, including financial penalties, a reprimand and a directive to take remedial action to address certain deficiencies such as in relation to:

- identifying and verifying customers' details;
- training of employees to enable them to comply with the provisions of FICA and the bank's internal rules; and
- failing to implement adequate processes and working methods in relation to the sanctions screening of customers to ensure that the bank complies with its reporting duties.

## **2.10 Resolution**

### **2.10.1 Government takeovers**

There are no circumstances in which banks may be taken over by the government or regulatory authorities. However, the SARB has appointed a curator in respect of a bank in order to facilitate the orderly management of the bank in instances where such bank has not complied with its prudential requirements. As more fully set out in question 19, the Minister of Finance may appoint a curator to the bank in terms of the Banks Act if the Prudential Authority believes the bank will probably be unable to meet its obligations in general.

### **2.10.2 Bank failures**

South Africa is a member of the Financial Stability Board, which has issued international standards for resolution planning titled 'Key attributes of effective resolution regimes for financial institutions' in 2011 and additional guidance in 2014. In terms of the 2015 SARB Directive, South Africa is required to comply with these international standards, which include recovery and resolution planning.

The prevention of bank failure is not regulated by the banking laws currently in force. However, the SARB has issued a directive on 4 February 2015 (2015 SARB Directive)

setting out certain minimum requirements for the recovery plans of banks, controlling companies and branches of foreign institutions. The directive requires the recovery plan to identify interdependencies among group entities, including material intra-group exposures and funding relationships, shared services, capital mobility within the group as well as intra-group guarantees applicable ordinarily and in times of crisis. The recovery plan should also provide the details on the criteria used to identify significant legal entities within the group. The criteria should be based on an assessment of the legal entity's possible impact on the overall banking group as measured by, among others, size, profitability, strategic importance, systems and other discrepancies. The recovery plan must also identify key executives, managers and members of the bank that would be involved in the implementation of each recovery option. Details of the governance process to be followed in the implementation of the recovery options should be included, including internal and external stakeholder communication teams and processes, the escalation process and the decision-making process.

In 2015, the National Treasury published a paper setting out the principles and policy proposals for a strengthened framework for the resolution of designated financial institutions. The paper proposes the drafting of a 'special resolution bill', which would designate the SARB as the resolution authority.

The FSR Act introduces requirements applicable to, among others, banks that are designated as systemically important financial institutions in order to mitigate the risk of occurrence of systemic events (ie, event or circumstances that may reasonably be expected to have a substantial adverse effect on the financial system or on economic activity in South Africa). The requirements will include prudential standards or directives to be made in terms of the FSR Act and imposed on systemically important financial institutions in relation to, among others, recovery and resolution planning.

The Companies Act establishes the personal liability of directors in certain circumstances, including for the following actions or omissions:

- Representing or purporting to bind the company despite knowing that he or she lacked authority.
- Allowing the company to carry on its business while knowing that the business is being carried on recklessly, with gross negligence or with the intent to defraud any person.
- Being a party to an act or omission by the company despite knowing that it was calculated to defraud a creditor, employee or shareholder of the company, or had another fraudulent purpose.
- Having signed or consented to (i) the publication of a financial statement that was false or misleading in a material respect or (ii) the publication of a

prospectus that contained an 'untrue statement' or with reckless disregard as to whether, the statement was false, misleading or untrue.

- Taking part in a meeting and failing to vote against a resolution in respect of (i) the issuing of unauthorised shares or options on those shares, despite knowing that those shares had not been authorised, (ii) the issuing of any authorised securities without shareholder approval, (iii) the provision of financial assistance to any person for the acquisition of securities of the company or to a director while knowing that the financial assistance is in contravention of the Companies Act or the company's constitutional documents, (iv) approving a distribution, despite knowing that the distribution was contrary to the Companies Act, (v) the acquisition by the company of any of its shares, or the shares of its holding company, despite knowing that the acquisition was contrary to the Companies Act and (vi) an allotment by the company despite knowing that the allotment was contrary to the Companies Act.

In terms of the FSR Act, if a financial institution commits an offence in terms of a financial sector law (including the Banks Act, MBA, CBA or the FAIS Act) and a member of the governing body of the financial institution failed to take all reasonably practicable steps to prevent the commission of the offence, the member of the governing body would be guilty of the same offence and, on conviction, liable to a penalty not exceeding the penalty that may be imposed on the financial institution for the offence.

### **2.10.3 Planning exercises**

The 2015 SARB Directive specifies the minimum requirements to be met by a recovery plan that is adopted by a bank, which includes the following:

- Banking groups that have been classified as systemically important within the South African banking sector are required to have group-wide recovery plans in place (including in respect of foreign branches and subsidiaries).
- The development, maintenance, approval and annual review of the recovery plan should be subject to an appropriate governance process with clearly assigned roles and responsibilities for operational staff, senior management and the board of directors (or committee of similar standing of a locally registered branch of a foreign bank).
- The recovery plan must include details the bank's strategy, business model, core business lines (ie, the business lines that a bank would seek to protect through the implementation of its recovery options in order to ensure the

sustainability of the bank after the implementation of one or more recovery options) and main activities as well as the bank's legal and operational structures, organisational structure and business units.

- The recovery plan should identify any interdependencies among group entities in a banking group, including material intra-group exposures and funding relationships, shared services, capital mobility within the group as well as intra-group guarantees that would apply in both business-as-usual and crisis times.
- Banking groups should identify significant legal entities within the group and specify the criteria used to determine this based on an assessment of the legal entity's possible impact on the overall banking group measured by, among others, size, profitability, strategic importance, systems and any other interdependencies.
- Any branches that are considered systemically significant in the country of operation should also be included in the banking group's recovery plan.
- Each bank should develop triggers that would activate the recovery plan for capital, liquidity and operational purposes.
- The recovery plan must identify and provide a quantitative and qualitative description of the point of failure (where the bank's recovery options' cumulative capital or liquidity benefit would not be able to meet the capital or liquidity required for the bank's operations to remain sustainable) through the use of reverse stress testing. The stress scenarios should cover at least one systemic stress scenario and at least one idiosyncratic stress scenario resulting in a liquidity, capital and operational disruption of such a severe nature that it could lead to the bank's failure.
- Each recovery option should include details of (i) the expected amount of the benefit it could provide during a stressed period, (ii) the impact on capital and/or liquidity as a result of the implementation, (iii) the time frame for execution and/or implementation during stressed periods, (iv) the process to be followed, (v) the approvals required, (vi) the identification of potential buyers, (vii) valuations, (viii) costs, (ix) human resources; (x) legal and structural considerations, (xi) the key executives and/or managers and/or members of the bank that would be involved in the implementation of each recovery option and (xii) possible barriers to implementation and actions to overcome these.
- The recovery plan should identify:
- the bank's critical functions, which are the functions performed by a bank for third parties where failure would lead to a disruption of the services that are vital for the sustained functioning of the real economy and for the financial stability

in the country where the bank is present, including deposits and withdrawals, payments, clearing and the settlement of transactions);

- the bank's critical shared services, which are activities performed by a bank or outsourced to a third party where failure would lead to the inability to perform critical functions; and
- the bank's core shared services, which are activities performed by a bank or outsourced to a third party where failure would impair the bank's ability to continue its core business lines.

## **2.11 Capital requirements**

### ***2.11.1 Capital adequacy***

For purposes of setting capital adequacy requirements, section 70 of the Banks Act distinguishes between (i) banks of which the business does not include trading in financial instruments, (ii) banks of which the business consists solely of trading in financial instruments and (iii) banks of which the business includes trading in financial instruments. A bank is required to manage their affairs to maintain a prescribed minimum sum of share capital and unimpaired reserve funds (comprising the bank's common equity tier 1 capital, additional tier 1 capital and tier 2 capital, and its common equity tier 1 unimpaired reserve funds, additional tier 1 unimpaired reserve funds and tier 2 unimpaired reserve funds). For most banks, the prescribed amount of such funds may not fall below the greater of 250 million rand and a prescribed percentage (minimum percentage) of the sum of amounts relating to the different categories of assets and other risk exposures (namely, credit risk, counterparty credit risk, market risk, operational risk) and calculated in such a manner as may be prescribed. Regulation 38 of the Banks Act Regulations sets out directives and interpretations concerning capital adequacy and leverage for banks as contemplated in the Banks Act and presently sets the applicable Minimum Percentage of assets and other risk exposures required to be maintained by a bank at 8 per cent.

Currently, under the Banks Act Regulations, banks are also required to maintain, among others, the following current minimum capital and reserve funds:

- the common equity tier 1 capital adequacy ratio (ie, the ratio of qualifying common equity tier 1 capital and reserve funds to risk-weighted exposure) must at all times be a minimum of 6.5 per cent;
- the tier 1 capital adequacy ratio (ie, the ratio of qualifying common equity tier 1 capital and reserve funds and additional tier 1 capital and reserve funds to risk-weighted exposure) must at all times be a minimum of 8 per cent;
- the total capital adequacy ratio (ie, the ratio of qualifying common equity tier 1 capital and reserve funds and additional tier 1 capital and reserve funds and

tier 2 capital and reserve funds to risk-weighted exposure) must at all times be a minimum of 10 per cent;

- the minimum required percentage of capital and reserve funds specified from time to time for systemic risk must be maintained;
- the minimum required percentage of capital and reserve funds specified from time to time for idiosyncratic risk must be maintained;
- a capital conservation buffer must be maintained, ranging between zero and 2.5 per cent of a bank's relevant amount of risk-weighted exposure;
- a countercyclical capital buffer must be maintained, ranging between zero and 2.5 per cent of a bank's relevant amount of risk-weighted exposure;
- the additional minimum required percentage specified by the Prudential Authority from time to time must be maintained by systemically important banks or controlling companies;
- from 1 January 2016, capital constraints, including capital distribution constraints, must be imposed on a bank if its capital adequacy ratios are reduced owing to write-offs against the capital conservation buffer until the bank's conservation buffer is restored;
- after 1 January 2015 no amount obtained from the issue of any hybrid-debt instrument may form part of the total amount of qualifying common equity tier 1 capital and reserve funds and additional tier 1 capital and reserve funds of the bank.

In terms of the Banks Act, banks are also required to hold level one high-quality liquid assets to a value not less than the sum of amounts calculated as percentages not exceeding 20 per cent of different categories of its liabilities. A bank is not entitled to pledge or encumber such liquid assets.

Banks are not required to make contingent capital arrangements.

The FSR Act allows the SARB to direct the Prudential Authority to impose (through appropriate standards or directives) requirements that would apply generally or specifically to systemically important financial institutions concerning any of the following matters:

- (a) solvency measures and capital requirements, which may include requirements in relation to countercyclical capital buffers;
- (b) leverage ratios;
- (c) liquidity;
- (d) organisational structures;

44

- (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 or regulator's directive may be made that is prescribed by Regulations made for this section on the recommendation of the Governor.

Failure to comply with the prudential requirements set out in the Banks Act constitutes an offence that is punishable by a fine or imprisonment for a period not exceeding five years. Regardless of pending or contemplated criminal proceedings, the Prudential Authority is entitled to impose a fine upon the relevant bank or controlling company limited to (i) one-tenth of 1 per cent of the amount of the shortfall for each day on which the failure or inability to comply with the minimum capital and reserve funds requirements continues or (ii) 3 per cent of the amount of the shortfall arising from the failure or inability to comply with the minimum liquid assets requirements. A bank's failure to pay such fine may be enforced by civil court proceedings.

### **2.11.3 Undercapitalisation**

If a bank, its controlling company or its branch fails or is unable to comply with the prudential requirements under the Banks Act and the Banks Act Regulations concerning the minimum capital and reserve funds and minimum liquid assets to be maintained, such institution must report its failure or inability to comply with reasons to the Prudential Authority. The Prudential Authority may choose to immediately take enforcement action against such institution or set any conditions and afford it the opportunity to comply within a specified period.

### **2.11.4 Insolvency**

Under the Banks Act, the Minister of Finance may place a bank under curatorship if (i) the Prudential Authority is of the opinion that the bank will be unable to repay deposits made with it when legally obliged to do so or will probably be unable to meet any other of its obligations and (ii) the Minister of Finance deems it desirable in the public interest. The Minister of Finance must notify the chief executive officer or the chairperson of the board of directors of the bank in writing of the appointment of the curator. The Prudential Authority may appoint an assistant to the curator who, in the opinion of the Prudential Authority, has wide experience of and is knowledgeable

about the specific field of activities in which the bank under curatorship is predominantly engaged.

The Minister of Finance must, in the curator's letter of appointment, direct, among others, the curator's management of the bank under curatorship and incidental matters, including in respect of raising money by that bank, as the Minister of Finance may deem necessary. Once appointed, the curator is responsible for managing the bank with the supervision of the Prudential Authority and in the manner that the Prudential Authority deems to best promote (i) the interests of the creditors of the bank, (ii) the interests of the banking sector as a whole and (iii) the rights of employees in accordance with relevant labour legislation. The bank's management shall be divested of such power. The curator must recover and take possession of all the bank's assets. The curator's appointment and powers must be announced in the Government Gazette.

The curator is also required to, among others:

- keep the required accounting records and prepare the required annual financial statements, interim reports and provisional annual financial statements in respect of the bank;
- convene the meetings of the members of the bank and comply with the company laws applicable to directors; and
- apply any money of the bank towards (i) paying the costs of the curatorship, (ii) conducting the bank's business in accordance with the requirements of the curatorship and (iii) as far as the circumstances permit, paying the claims of creditors that arose before the date of the curatorship.

The curator is entitled to:

- exercise the power to bring or defend legal proceedings on behalf of the bank; and
- dispose of any of the bank's assets or transfer any of its liabilities in the ordinary course of the bank's business or by following the procedure for amalgamations, mergers and arrangements set out in the Banks Act.

The provisions of the Insolvency Act, 1936 concerning circumstances in which dispositions of property may be set aside are applicable to a bank under curatorship. All legal proceedings and legal process against a bank while it is under curatorship are stayed unless the court grants leave to continue with such processes.

The curator must inform the Prudential Authority if it is in the opinion that there is no reasonable probability that the continuation of the curatorship will enable the bank to pay its debts or meet its obligations and become a successful concern. The Prudential

Authority may apply to a court for the winding-up of any bank in accordance with the Companies Act. Pursuant to the Companies Act, the previous Companies Act, 1973 continues to apply with respect to the winding-up of insolvent companies, which requires, among others, that:

- In the winding-up of a company unable to pay its debts the provisions of the Insolvency Act, 1936 must, in so far as they are applicable, be applied, with the necessary changes, in respect of any matter not specially provided for by the Companies Act, 1973.
- A company is deemed to be unable to pay its debts if (i) a creditor, by cession or otherwise, to whom the company is indebted in a sum not less than 100 rand then due has served on the company a demand requiring the company to pay the sum so due and the company has for three weeks thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor, (ii) any process issued on a judgment of any court in favour of a creditor of the company is returned by the sheriff or the messenger with an endorsement that he has not found sufficient disposable property to satisfy the judgment or that any disposable property found did not upon sale satisfy such process or (iii) it is proved to the satisfaction of the court that the company is unable to pay its debts.
- Every disposition of property made by a company of its property that, if made by an individual, could, for any reason, be set aside in the event of the individual's insolvency, may, if made by a company, be set aside in the event of the company being wound up and unable to pay all its debts, and the provisions of the law relating to insolvency shall be applied to such disposition.
- Every disposition of property (including rights of action) made after the commencement of winding-up proceedings by a company that is unable to pay its debts, shall be void unless the court otherwise orders.

In terms of the Banks Act, the following additional requirements apply to the winding up of a bank:

- The Master of the High Court may only appoint a liquidator who is recommended by the Prudential Authority and an assistant to the liquidator who, in the opinion of the Prudential Authority, has wide experience of, and is knowledgeable about the latest developments in, the banking industry.
- The Master and the Prudential Authority must receive (i) copy of any resolution or application for winding up, and (ii) the accompanying documentation including every affidavit confirming the facts stated in the application.

- A copy of every special resolution for the voluntary winding-up of a bank and of every court order amending or setting aside the proceedings in relation to the winding-up must be delivered to the liquidator, Master and Prudential Authority by the bank within 14 days after registration of the resolutions with the Companies and Intellectual Property Commission or the making of an order.

The approval of the SARB is required under the FSR Act in order to take any of the following steps in relation to a systemically important financial institution or a systemically important financial institution within a financial conglomerate:

- (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 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.

### **2.11.5 Recent and future changes**

The Banks Act Regulations have been amended over recent years to include the requirements developed by the Basel Committee on Banking Supervision to strengthen the regulation, supervision and risk management of the banking sector, including most recently the requirements of the Basel III framework and revisions to such requirements, including in respect of:

- capital disclosure requirements;
- revisions to the liquidity coverage ratio;
- requirements related to a restricted committed liquidity facility;
- liquidity disclosure requirements;
- requirements related to intraday liquidity management; and
- public disclosure requirements related to the leverage ratio.

The FSR Act allows the Prudential Authority to make prudential standards for or in respect of, among others, a bank and key persons of such financial institutions, including concerning requirements relating to financial soundness such as capital adequacy,

minimum liquidity and minimum asset quality.

## **2.12 Ownership restrictions and implications**

### ***2.12.1 Controlling interest***

A bank may only be controlled by (i) a public company and is registered as a controlling company in respect of a bank; (ii) another bank or (iii) an institution that has been approved by the Prudential Authority and that conducts business similar to the business of a bank in a foreign country.

A person is deemed to exercise control over a bank if:

- the bank is a subsidiary of the controlling company;
- the controlling company alone or together with his or her associates holds shares in the bank of which the total nominal value represents more than 50 per cent of the nominal value of all the issued shares of the bank and entitles the controlling company to decisively influence the outcome of the voting at a general meeting of the bank;
- the controlling company alone or together with his or her associates is entitled to exercise more than 50 per cent of the voting rights in respect of the issued shares of the bank; or
- the controlling company alone or together with his or her associates is entitled or has the power to determine the appointment of the majority of the directors of the bank, including the power to appoint or remove, without the concurrence of any other person, all or the majority of the directors or to prevent the appointment of a director without his or her consent.

### ***2.12.2 Foreign ownership***

The acquisition of shares in a bank or its controlling company requires the written permission of the Prudential Authority if the acquisition results in the purchaser, alone or together with any associates, (i) holding shares amounting to more than 15 per cent of the total nominal value of the issued share capital of the bank or controlling company or (ii) being entitled to exercise more than 15 per cent of the total voting rights in respect of the issued shares of the bank or controlling company. The Prudential

46

Authority's permission must be obtained for each subsequent acquisition of the relevant bank's shares or voting rights exceeding 15 per cent and 24 per cent of the bank's total shares or voting rights if the acquirer has held 15 per cent or 24 per cent, as the case may be, of such shares or voting rights for a period of 12 months (or a shorter period determined by the Prudential Authority).

The permission of the Minister of Finance, through the Prudential Authority, is required to hold more than 49 per cent of the shares or voting rights in a bank or controlling company. The Prudential Authority or Minister of Finance, as the case may be, may only grant permission for the acquisition of shares in a bank if satisfied that the acquisition will not be contrary to the public interest and the interests of the relevant bank or its depositors or of the relevant controlling company. The permission of the Minister of Finance must be obtained for each acquisition of a bank's shares or voting rights exceeding 49 per cent and 74 per cent of that bank's total shares or voting rights if the acquirer has held 49 per cent or 74 per cent, as the case may be, of such shares or voting rights for a period of 12 months (or a shorter period determined by the Minister).

While approval from the SARB pursuant to the Exchange Control Regulations, 1961 promulgated in terms of the Currency and Exchanges Act, 1933 (Exchange Control Regulations) will not be required for the purchase of shares in a resident by a non-resident, control measures require securities held by non-residents to be endorsed by authorised dealers as 'non-resident'. The 'Currency and Exchanges guidelines for business entities' issued by the SARB on 21 February 2018 provide a general understanding of the exchange control system in South Africa and explain the requirement as follows:

The principal objective in controlling non-resident owned securities is to ensure that residents requiring funds outside [South Africa] do not obtain such funds by purchasing securities in [South Africa] and selling them abroad without accounting for the proceeds in foreign currency or Rand from a [n]on-resident Rand account. In addition, since all income due to non-residents on their securities is freely transferable, the aim is to ensure that non-residents do not purchase securities from residents other than through approved channels at a fair market price. Since exchange controls on non-residents have been abolished, the onus rests on the South African buyer or seller of securities to prove that the transaction was concluded on an arm's length basis at a fair and market related price. ... The control over the acquisition or disposal of non-resident securities is exercised by an Authorised Dealer placing the endorsement 'non-resident' on securities owned by non-residents or in which non-residents have an interest. The effect of this endorsement is to ensure that in the event of a disposal by the non-resident of its interest, the payment may be transferred abroad or credited to a Non-resident Rand account.

### **2.12.3 Implications and responsibilities**

The Banks Act establishes, among others, the following requirements in respect of controlling companies, in addition to those listed in question 24:

- Controlling companies must be registered in terms of the Banks Act.
- Controlling companies are subject to the supervisory review process and inspection required to be implemented and maintained by the Prudential Authority.
- The Prudential Authority may issue a non-financial sanction or a directive requiring, among others, a controlling company to:

(i) cease or refrain from engaging in any act, omission or course of conduct or to perform such acts necessary to remedy the situation;

(ii) perform such acts necessary to comply with the directive or to effect the changes required to give effect to the directive; or

(iii) provide the [Prudential Authority] with such information and documents relating to the matter specified in the directive.

- The Prudential Authority may require controlling companies to furnish information or prepare a report at its own expense.
- The Prudential Authority must approve a controlling company's (i) establishment or acquisition of a subsidiary or entry into an agreement having the effect that any company becomes its subsidiary within or outside South Africa, (ii) acquisition of an interest in any undertaking having its registered office or principal place of business outside South Africa, (iii) to creation or acquisition of a trust outside South Africa of which the bank is a major beneficiary or (iv) establishment or acquisition of any financial or other business undertaking under its direct or indirect control outside South Africa.
- The Prudential Authority must approve the acquisition of shares in a controlling company in certain instances.
- The Prudential Authority's approval is required for the reconstruction of companies within a group of which a controlling company is a member.
- The Prudential Authority's approval is required for the alteration of a controlling company's constitutional documents.

- The Prudential Authority's approval is required for a controlling company to convert its shares to, or to issue, preference shares, hybrid debt instruments or debt instruments.
- The Prudential Authority may impose a penalty on a controlling company that has contravened or failed to comply with the Banks Act.

The Banks Act also requires a bank to disclose the name of any individual shareholder who holds more than 25 per cent of that bank's issued shares if the bank's exposure to the shareholder (through loans or other advances) exceeds the nominal value of the shares.

In terms of the FSR Act, the Prudential Authority is entitled to regulate the conduct of holding companies of financial institutions. In particular, the Prudential Authority is entitled to make prudential standards that must be complied with by, and issue written directives requiring the holding company to take specified actions to, the holding company of a financial conglomerate.

The FSR Act allows prudential standards to regulate:

- (a) financial or other exposures of companies within financial conglomerates;
- (b) the governance and management arrangements for holding companies of financial conglomerates;
- (c) reporting of information about companies within financial conglomerates that are not financial institutions; and
- (d) reducing or managing risks to the safety and soundness of an eligible financial institution arising from the other members of the financial conglomerate.

The FSR Act prohibits a holding company from acquiring or disposing of a material asset (which is required to be identified in a prudential standard) without the approval of the Prudential Authority.

In terms of the FSR Act, a directive may be issued in circumstances where the holding company or another company in the financial conglomerate:

- (a) is conducting its business in an improper or financially unsound way and, as a result, there is a risk that an eligible financial institution in the conglomerate will not be able to comply with its obligations under a financial sector law or in relation to a financial product or financial service that it provides or offers to provide;
- (b) has not complied with an enforceable undertaking accepted by the Prudential Authority;
- (c) has contravened or is likely to contravene a financial sector law;
- (d) is involved or is likely to be involved in financial crime; or

(e) is causing or contributing to instability in the financial system, or is likely to do so.

The Banks Act imposes, among others, the following responsibilities on controlling companies.

- A controlling company must disclose details of its interest in subsidiaries, joint ventures, certain undertakings and certain trusts.
- The amount of investments made by a controlling company (i) in undertakings other than banks or institutions that conduct business similar to the business of a bank outside South Africa, controlling companies or companies of which the main object is the holding or development of property for the purpose of conducting the business of a bank or(ii) in fixed property that is not used or intended to be used mainly for the purpose of conducting the business of a bank, may not exceed a prescribed percentage of a prescribed amount of the share capital and reserve funds of the controlling company.
- The amount of loans and advances provided by a controlling company (i) to undertakings other than banks or institutions that conduct business similar to the business of a bank outside South Africa, controlling companies or companies of which the main object is the holding or development of property for the purpose of conducting the business of a bank or(ii) in relation to fixed property that is not used or intended to be used mainly for the purpose of conducting the business of a bank, may not exceed a prescribed percentage of a prescribed amount of the share capital and reserve funds of the controlling company.
- The Banks Act imposes certain duties and standards of conduct on the directors of controlling companies in addition to those required by the Companies Act.
- Controlling companies must comply with the corporate governance requirements set out in the Banks Act.
- Controlling companies must comply with prudential requirements to maintain certain minimum capital and reserve funds and are liable to receiving a fine for their failure or inability to comply.

In terms of the Banks Act, the chief executive officer of a bank (in the case of the appointment of the chief executive officer, a director designated by the board) must, at least 30 days prior to the proposed date of appointment, give the Prudential Authority written notice of the nomination of any person for appointment as chief executive officer, director or executive officer. The Prudential Authority may object (and must provide the grounds for the objection) to the proposed appointment within 20 working days of receipt of the notice. Each director, chief executive officer and

50

executive officer of a bank owes towards the bank the duties set out in the Banks Act and the Companies Act. The Prudential Authority may object to the appointment or continued employment of a chief executive officer, director or executive officer of a bank if the Prudential Authority reasonably believes that such individual is not, or is no longer, a fit and proper person to hold that appointment or if it's not in the public interest for that individual to hold or continue to hold the appointment.

The majority of directors of a bank must not be employees of that bank, its subsidiary or controlling company and the majority of the employees of a bank's controlling company must not be employees of that company or of any bank in respect of which that company is registered as a controlling company. Those directors who are employees must not together be entitled to exercise a vote in excess of 49 per cent of the total vote on the board of the bank or controlling company, as the case may be.

In the event that a bank is placed under curatorship, the curator may be empowered by the Minister of Finance to make and carry out any decision in respect of the bank that would have required an ordinary resolution or a special resolution of shareholders of the bank or its controlling company in terms of the Banks Act, the Companies Act, the bank's memorandum of incorporation or the rules of any securities exchange on which any securities of the bank or its controlling company are listed.

While a bank is under curatorship, the Prudential Authority is entitled under the Banks Act to appoint a commissioner and assistants to the commissioner to investigate the business, trade, dealings, affairs or assets and liabilities of that bank or of any of its associates. The commissioner would have the powers and duties corresponding to the powers and duties conferred or imposed on a financial sector regulator, and each assistant to the commissioner would have the powers and duties corresponding to those of an investigator under Part 4 of Chapter 9 of the FSR Act, including the power to question or require the production of a document by any person who the investigator reasonably believes is able to provide information relevant to the investigation.

## **2.13 Changes in control**

### ***2.13.1 Required approvals***

A person is deemed to exercise control over a bank if:

- the bank is a subsidiary of the controlling company;
- the controlling company alone or together with his or her associates holds shares in the bank of which the total nominal value represents more than 50 per cent of the nominal value of all the issued shares of the bank and entitles

the controlling company to decisively influence the outcome of the voting at a general meeting of the bank;

- the controlling company alone or together with his or her associates is entitled to exercise more than 50 per cent of the voting rights in respect of the issued shares of the bank; or
- the controlling company alone or together with his or her associates is entitled or has the power to determine the appointment of the majority of the directors of the bank, including the power to appoint or remove, without the concurrence of any other person, all or the majority of the directors or to prevent the appointment of a director without its consent.

A public company may apply to the Prudential Authority as a controlling company if (i) it intends to exercise control over the bank or (ii) it is a holding company in respect of the company that has applied for registration as a bank. Acquisition of control of a registered bank also requires the permission of the Minister of Finance, through the Prudential Authority. Such permission is required for a person to hold more than 49 per cent of the shares or voting rights in a bank or controlling company.

### **2.13.2 Foreign acquirers**

Control of a South African bank may be acquired by an institution that has been approved by the Prudential Authority and that conducts business similar to the business of a bank in a foreign country.

Foreign acquirers of securities will require the same approval from the Prudential Authority or the Minister of Finance, as the case may be, as South African acquirers. Also see question 22 regarding the acquisition of securities by non-residents.

### **2.13.3 Factors considered by authorities**

Pursuant to the Banks Act, the Prudential Authority must be satisfied of the following requirements before it may grant the application of the bank's controlling company:

- (a) that the registration of the applicant as a controlling company will not be contrary to the public interest;
- (b) that, in the case of [a public company applying for registration where it that intends to exercise control over any bank], the applicant will be able to establish control ... over the bank concerned;
- (c) no provision of the memorandum of incorporation of the applicant is inconsistent with a provision of [the Banks Act] or is undesirable in so far as it concerns banks;

(d) that every director or executive officer of the applicant is, as far as can reasonably be ascertained, a fit and proper person to hold the office of such director or executive officer, and that every such executive officer has sufficient knowledge and experience to manage the affairs of the applicant in its capacity of a controlling company;

(e) that the applicant is in a financially sound condition;

(f) that no interest which any person has in the applicant is inconsistent with a provision of [the Banks Act]; and

(g) that the application complies with the requirements of [the Banks Act].

The Minister of Finance may only grant permission for the acquisition of shares in a registered bank if the Minister of Finance is satisfied that the acquisition will not be contrary to the public interest and the interests of the relevant bank or its depositors or of the relevant controlling company.

#### **2.13.4 Filing requirements**

In terms of the Banks Act Regulations, the application for registration as a controlling company must be accompanied by the following documents:

- the constitutional documents of the applicant;
- the registered office and postal address in respect of the applicant; a statement containing the name and address and the curriculum vitae of the chairperson, every director and every executive officer of the applicant;
- full particulars of the business that the applicant conducts or proposes to conduct, of the manner in which such business is or is to be conducted and of the extent of each type of business conducted or to be conducted;
- the applicant's latest audited group and company financial statements or, in the case of an applicant whose first financial year has not yet expired, of an audited balance sheet or a pro forma balance sheet of the applicant, as at a date not more than 30 days prior to the date of application; a return concerning shareholders of a bank or controlling company duly completed in respect of the applicant;
- a statement furnishing, as at a date not more than 30 days prior to the date of the application (i) the amount of the issued share capital and reserves of the applicant, (ii) the amounts of the applicant's investments in fixed property used mainly for the purpose of conducting the business of a bank and fixed property not used mainly for the purpose of conducting the business of a bank and (iii) the name of the undertaking concerned and the amount invested or proposed

to be invested, set out separately under the headings Shares and Loans, in banks, controlling companies, property companies of which the property is used mainly for the purpose of conducting the business of a bank, property companies of which the property is not used mainly

- for the purpose of conducting the business of a bank and other undertakings (to be specified in the statement);
- a diagrammatic representation of the structure of the group of companies consisting of associates of the applicant, showing also the percentage shareholding of members of that group in the other members; and
- a return concerning shareholders of a bank or controlling company duly completed in respect of every bank in respect of which the applicant is, or is to be, registered as a controlling company.

A controlling company must enclose with the application, a registration fee in the amount of 6,000 rand, excluding VAT

## Chapter 3

### 3.1 The Financial Intelligence Centre Act (FICA)

The Financial Intelligence Centre Act (38 of 2001) (the FIC Act) came into effect on the 1st of July 2003. The FIC Act was introduced to fight financial crime, such as money laundering, tax evasion, and terrorist financing activities.

The FIC Act brings South Africa in line with similar legislation in other countries designed to reveal the movement of monies derived from unlawful activities and thereby curbing money laundering and other criminal activities.

### 3.2 Background

The G7 summit meeting in 1989 established an inter-governmental body known as the Financial Action Task Force (FATF). FATF was set up to evaluate the effectiveness of local and international money laundering control structures. In addition, the Financial Action Task Force was commissioned with setting standards and promoting effective implementation of legal, regulatory and operational measures to combat money laundering, terrorist financing and other related threats to the integrity of the international financial system.

Pressure from the FATF and the international environment to implement effective money laundering control legislation led to the development of the Financial Intelligence Centre Act. South Africa's commitment to the implementation of TATF recommendations codified in FICA meant South Africa became the first African country to become a fully-fledged member of FATF. South Africa was accepted as a member of the FATF in June 2003 after it was evaluated and found to have developed a comprehensive legal structure to combat money laundering activities

In 2008, the Financial Intelligence Centre Amendment Act made several changes to the original Act. The Amendment Act defines or further defines certain words and expressions; clarifies the application of the Act in relation to other laws; extends the objectives and functions of the Centre; changes the name of the Money Laundering Advisory Council to the Counter-Money Laundering Advisory Council; clarifies certain provisions; updates references to legislation; provides for the sharing of information by the Centre and supervisory bodies; provides for the issuance of directives by the Centre and supervisory bodies; provides for the registration of accountable and reporting institutions to clarify the roles and responsibilities of supervisory bodies ; provides for written arrangements relating to the respective roles and responsibilities of the Centre and supervisory bodies; authorises the Centre and supervisory bodies to conduct inspections; regulates certain applications to court; provides for administrative sanctions that may be imposed by the Centre and supervisory bodies; establishes an appeal board to hear appeals against decisions of the Centre or supervisory bodies; makes further provision for offences; and provides for matters connected therewith.

### **3.3 Purpose**

The Purpose of the Financial Intelligence Centre Act is to: assist in the identification of the proceeds of unlawful activities; combat money laundering; and combat the financing of terrorist and related activities.

The Act does this by creating a legal framework for effective identification and verification of client identities; recordkeeping; reporting processes; staff training; compliance requirements and the establishment of the Financial Intelligence Centre and Counter-Money Laundering Advisory Council.

### **3.4 Money Laundering**

Money Laundering is the process used by criminals to hide, conceal or disguise the nature, source, location, disposition or movement of the proceeds of unlawful activities or any interest which anyone has in such proceeds. The act of conducting or causing to conduct two or more transactions with the intention of avoiding the duty to report such transactions is a recognised offence in terms of section 64 of the FIC Act.

A Money Laundering Offence has Three Core Elements:

- The act of money laundering.
- The presence (benefit) of proceeds of crime.
- Knowledge of the fact that a money laundering transaction is happening or has taken place.

### 3.4 Affect

The term “accountable institution” is defined as a person or organisation referred to in Schedule 1 of the FIC Act that carries out business of any entity listed.

Accountable Institutions Include the Following Organisations:

- A practitioner who practices as defined in section 1 of the Attorneys Act (53 of 1979).
- A board of executors or a trust company or any other person that invests, keeps in safe custody, controls or administers trust property within the meaning of the Trust Property Control Act (57 of 1988).
- An estate agent as defined in the Estate Agency Affairs Act (112 of 1976).
- An authorised user of an exchange as defined in the Securities Service Act (36 of 2004).
- A manager registered in terms of the Collective Investment Schemes Control Act (45 of 2002), but excludes managers who only conduct business in Part VI of the Collective Investment Schemes Control Act (45 of 2002).
- A person who carries on the ‘business of a bank’ as defined in the Banks Act (94 of 1990).
- A mutual bank as defined in the Mutual Banks Act (124 of 1993).
- A person who carries on a ‘long-term insurance business’ as defined in the Long-Term Insurance Act (52 of 1998).
- A person who carries on the business of making available a gambling activity as contemplated in section 3 of the National Gambling Act (7 of 2004) in respect of which a license is required to be issued by the National Gambling Board or a provincial licensing authority.
- A person who carries on the business of dealing in foreign exchange.
- A person who carries on the business of lending money against the security of securities.
- A person who carries on the business of a financial services provider requiring authorisation in terms of the Financial Advisory and Intermediary Services Act (37 of 2002), to provide advice and intermediary services in respect of the

investment of any financial product (but excluding a short term insurance contract or policy referred to in the Short-term Insurance Act (53 of 1998) and a health service benefit provided by a medical scheme as defined in section 1(1) of the Medical Schemes Act (131 of 1998).

- A person who issues, sells or redeems travellers' cheques, money orders or similar instruments.
- The Postbank referred to in section 51 of the Postal Services Act (124 of 1998).
- The Ithala Development Finance Corporation Limited.
- A person who carries on the business of a money remitter.

In addition to the accountable institutions, the Financial Intelligence Centre Act affects all clients/consumers entering into either a single transaction or a business relationship with an accountable institution.

Clients/Consumers include:

- Natural Persons
- Natural person acting on behalf of another, or
- Foreign national
- Close corporation
- South African company
- Foreign company
- Legal Persons
- Partnerships
- Trusts

### **3.5 Consumer Responsibilities**

An accountable institution reserves the right to deny or terminate business relationships or transactions if the FIC Act requirements are not met. General consumer responsibilities include:

- The consumer must authorise staff and/or consultant to collect, view, collate, process and store FICA documents.
- The consumer must authorise the storage of FICA documents in the FICA database as is required by law.
- The consumer must acknowledge and accept the current privacy policy.
- The consumer must not falsely state, impersonate, or otherwise misrepresent his/her identity and/or proof of residence and/or any other information provided.

- The consumer must guarantee the accuracy, truthfulness, correctness, and validity of his/her personal information. The consumer must indemnify and hold harmless the staff, the consultant and the accountable institution against any loss, damage, or injury arising by his/her failure to comply with the FIC Act requirements.
- The customer must provide permission, when required, and authorise staff or consultants to disclose or receive his/her FICA documents to or from: any accountable institution seeking to establish a business relationship or conclude a single transaction with the customer; any legitimate third party (such as SARS, deeds office, credit bureaux, municipalities) for verifying or comparing personal information in the FIC Act Database, and; any accountable institution or competent authority for investigation or prevention of any criminal activity and auditing of the Database.
- The consumer must ensure the FIC Act documents are kept up-to-date, notifying staff or consultants of applicable accountable institutions timeously for inclusion in the FIC Act Database.

### **3.7 Responsibilities of accountable institutions**

ACCOUNTABLE INSTITUTIONS HAVE THE RESPONSIBILITY TO:

- Identify and verify new and existing clients;
- Keep records of identities of clients and transactions entered into with clients;
- The following records shall be obtained and retained in instances of concluding a single transaction, concluding transactions as part of a business relationship or establishment of a business relationship:
  - If the client acts on behalf of a third party, the identity of the third party as well as a copy of the mandate between the client and the third party;
  - If a third party acts on behalf of a client, the identity of the third party as well as a copy of the mandate between the client and the third party;
  - The method of identification and verification of particulars;
  - The exact nature of the transaction or business relationship;
  - The parties to a transaction as well as the monetary value thereof;
  - The particulars of the employee or representative that obtained the information;
  - The information, documentation or forms furnished by the client to verify the information.

In Addition, to Keeping Records:

- No person shall destroy any record, except if the destruction of such record was authorised by the responsible person.
- No person shall amend any record kept in terms of the Act.
- Report certain large or suspicious transactions to the Financial Intelligence Centre established by the FIC Act;
- Formulate and implement internal rules consistent with FICA obligations;
- -offer compulsory FIC Act training to employees; and
- Appoint a responsible person as a compliance officer to monitor compliance.

### 3.8 Key Points

#### 3.8.1 **FINANCIAL INTELLIGENCE CENTRE**

The FIC was established in terms of Section 2 of the Financial Intelligence Centre Act (38 of 2001). The purpose of the FIC is to establish and maintain an effective policy and compliance framework and operational capacity to identify and combat crime, money laundering and terror financing in order for South Africa to protect the financial system, develop the economy and be a responsible global citizen.

The FIC collects, processes and analyses information disclosed or obtained in terms of the Act: to inform, advise and cooperate with investigating authorities, supervisory bodies, the South African Revenue Services and intelligence services to facilitate the administration and enforcement of the laws of South Africa; to exchange information with similar financial intelligence units in other countries regarding money laundering activities; to monitor and provide guidance to accountable institutions, supervisory bodies and other persons regarding the performance of their duties in relation to their respective compliance; and to retain the aforementioned information in the manner required.

#### 3.8.2 **THE COUNTER MONEY LAUNDERING ADVISORY COUNCIL**

Renamed the Counter-Money Laundering Advisory Council in 2008, the organ was established to advise the Minister of Finance on best policies and practices for the identification of proceeds of unlawful activities and to combat money laundering. In addition, the Counter-Money Laundering Advisory Council will advise the FIC about the performance of its functions and act as a forum in which parties can consult one another.

Consisting of various government, accountable institutions and supervisory body representatives, the Counter-Money Laundering Advisory Council must be consulted before the Minister of Finance may create, change or repeal FICA regulations, amend the accountable institution list, supervisory bodies or reporting institutions or exempt anyone from FICA compliance.

### **3.8.3 IDENTIFICATION AND VERIFICATION**

For the money laundering control procedures to be effective, the FIC Act prescribes that accountable institutions must know who they do business with. As prerequisites for the establishment of business relationships or for the conclusion of transactions, the Act requires the identification and verification of each person or entity with which a transaction is concluded.

Identification and verification extends to new and existing clients according to prescribed procedures based on 4 categories namely natural persons, legal persons, partnerships and trusts. In Addition, in certain instances, members are exempt from compliance.

### **3.8.4. RECORDS**

Accountable institutions are required to keep records of all character identification and verification documents and/or copies obtained before establishing a business relationship, as well as the nature of the business relationship or transaction and the parties to the transaction. Information on clients shall be updated if additional products are purchased by clients or amendments are made to existing products. Records may be kept physically or in electronic form and must be kept for a minimum of 5 years from the date on which the transaction is concluded or relationship is terminated. The accountable institution may appoint a third party to keep records on their behalf if free and easy access to the records is available. However, the accountable institution remains liable for failure of specified record storage.

Authorised Centre representatives, only by virtue of a warrant issued in chambers by a magistrate or regional magistrate or judge of an area of jurisdiction within which the records or any of them are kept, or within which the accountable institution conducts business, have access to records to examine, make extracts or copies of, any such records. These records or part thereof are admissible in court as evidence.

### **3.8.5 REPORTING**

In terms of the FIC Act, all accountable institutions are obliged to report certain financial transactions of a specific threshold or frequency of occurrence. Several exceptions relating to long-term insurance such as life, disability or medical policies and investment in unit trusts or on the stock exchange such as pension funds, retirement annuities or provident funds are exempt from reporting.

In addition, accountable institutions are to report any suspicious or unusual transactions to the Centre. These include business receiving, transferring or laundering money or the proceeds from unlawful activities or property connected to financing of terrorist and related activities, has no apparent business or lawful purpose;

is conducted for the purpose of avoiding the FIC Act requirement. Other reporting includes the evasion or attempted evasion of a responsibility to pay any tax, duty or levy imposed by the Commissioner for the South African Revenue Service.

### **3.8.6 INTERNAL RULES AND TRAINING**

Accountable institutions must formulate and implement internal rules to identify and verify identity, develop record management and storage systems, methods of identifying reportable transactions and other prescribe matters. In addition, accountable institutions must provide training to their employees and appoint a Compliance Officer to ensure compliance with the provisions of the FIC Act. Failure to comply is an offence that may result in penalties.

### **3.8.7 OFFENCES AND PENALTIES**

Accountable institutions are guilty of an offence if they fail to identify persons and keep records; destroy or tamper with records; fail to give assistance to representatives of the Centre; fail to advise Centre representatives of client history when requested; fail to report cash transactions above prescribed limits; fail to report suspicious or unusual transactions; discloses information contained or to be contained in a report to the Centre; fail to report conveyance of cash in or out of the Republic; fail to send a report to the Centre; fail to report electronic transfers; fail to comply with a request by the Centre or investigating authority; fail to comply with a monitoring order; misuses, discloses, tampers with or destroys confidential information; fail to formulate and implement internal rules; fail to provide training or appoint a Compliance Officer; obstructs an official in the performance of their duties; conducts transactions to avoid reporting duties; or; wilfully accesses or modifies an application, data or computer system under the control of the Centre.

Certain offences carry imprisonment up to 15 years or fines up to R100 million.

## **3.9 Mechanisms of the Act**

According to the FIC Act, a supervisory body is an entity or functionary which performs supervisory or regulatory functions in relation to any category of accountable institutions. The supervisory bodies are responsible for the monitoring of compliance, guidance and onsite visits of accountable institutions.

Supervisory Bodies Include:

- The Financial Services Board established by the Financial Services Board Act (97 of 1990).

- The South African Reserve Bank as defined in the South African Reserve Bank Act (90 of 1989).
- The Estate Agency Affairs Board established in terms of the Estate Agents Act (112 of 1976).
- The Independent Regulatory Board for Auditors established in terms of the Auditing Professions Act (26 of 2005).
- The National Gambling Board established in terms of the National Gambling Act and retained in terms of the National Gambling Act (7 of 2004.).
- A Law Society as contemplated in section 56 of the Attorneys Act (53 of 1979).
- A provincial licensing authority as defined in the National Gambling Act (7 of 2004).

The Financial Intelligence Centre is responsible for strengthening measures to combat money laundering, and the financing of terrorism through policy development, implementation of effective compliance standards, and the production of quality financial intelligence in collaboration with the private sector and public agencies. An important outcome of compliance is accountable institutions' submission of cash threshold reports (CTRs) and suspicious transaction reports (STRs). The FIC collects, processes and analyses data to generate and distribute financial intelligence products to domestic investigating agencies, intelligence services and SARS for investigation or action.

# Chapter 4

## Insurance Regulation

### Overview

**Insurance in South Africa** describes a mechanism in that country for the reduction or minimization of loss, owing to the constant exposure of people and assets to risks (be they natural or financial or personal). The kinds of loss which arise if such risks eventuate may be either patrimonial or non-patrimonial.

A general definition of insurance is supplied in the case of *Lake v Reinsurance Corporation Ltd*,<sup>[1]</sup> which describes it as a contract between an insurer and an insured, in terms of which the insurer undertakes to render to the insured a sum of money, or its equivalent, on the occurrence of a specified uncertain event in which the insured has some interest, in return for the payment of a premium.

According to *LAWSA*,

Insurance is the result of man's efforts to create financial security in the face of dangers to his life, person and estate. A typical desire of a man is to form and develop his estate [...] The object of forming and developing an estate may, however, be thwarted by dangers to which his present and future position is exposed: if these materialise they may bring about undesirable consequences which may affect his estate immediately or in the future. Even while a danger is still remote it creates an element of uncertainty, whether in relation to its actual occurrence, the exact time of its occurrence, or the extent of its undesirable consequences. This element of uncertainty creates insecurity. Accordingly, it may be said that man's need for security arises from the tension between his desire to form and develop his estate, on the one hand, and the dangers threatening to thwart that desire, on the other. The most effective and obvious way of achieving security is to take direct precautionary measures against imminent or potential harm [...] One of the most satisfactory general methods of creating financial security against risks therefore seems to be that of spreading the risk among a number of persons all exposed to the same risk and all prepared to make a relatively negligible contribution towards neutralising the detrimental effects of this risk which may materialise for any one or more of their number. This is known as insurance.

### 4.1 Insurance Regulation

#### 1 The regulator

Short-term insurance is regulated by the Financial Services Board (registrar of insurance) (FSB) under the Short-term Insurance Act, 1998 (STIA) for indemnity

insurance. Long-term insurance is regulated through the Long-term Insurance Act, 1998 (LTIA) for life and investment products. Any person carrying on insurance business must be licensed to do so. Financial advisers and brokers must be authorised to provide financial advisory and intermediary services.

## **2 Subsidiary/branch**

An insurer must be a registered South African public company or a Lloyd's underwriter. Branches of foreign insurers are not permitted. An insurer/reinsurer may be a wholly-owned subsidiary of a foreign company. Intermediaries may either incorporate a company in South Africa or operate through a branch, but must have a financial services provider licence.

## **3 FDI restrictions**

Foreign ownership of insurers and intermediaries is not restricted. The FSB welcomes foreign investment in the Republic.

## **4 Control approvals**

Any sale or transfer of 25% of the shares in a local insurer or reinsurer or its holding entity requires regulatory approval. The FSB evaluates whether the transaction is in the best interests of the public.

Directors must be approved as fit and proper. Foreign directors are allowed. The head office and public officer must be South African residents.

Insurance/reinsurance may be placed with foreign insurers to the extent the regulator accepts that the South African market has insufficient capacity or no will to cover the risks.

## **5 Minimum capital**

The current minimum capital requirements are ZAR10 million for a long-term insurer/reinsurer and ZAR5 million for short-term insurer/reinsurer. But see 6 below.

The capital requirements may increase depending on the five year projections of the insurer.

Intermediaries require capital that renders the company solvent and liquid.

## **6 Risk based capital**

Insurers are required to have assets in South Africa which in the aggregate value are not less than the aggregate value on that day of its liabilities plus the regulated capital adequacy requirements.

The Solvency Assessment and Management Project (SAM) will from January 2014 introduce a risk-based solvency regime for insurers based on Solvency II.

## **7 Group supervision**

Save for the requirement in 4.1 above, there is no group supervision but SAM encompasses supervision of solvency at insurance group level. The FSB has been developing an approach to the supervision of groups by requiring more regular and extensive reporting.

## **8 Policyholder protection**

South Africa has progressive policyholder protection provisions. The LTIA, STIA and the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act) protect policyholder rights. The FAIS Act requires disclosure of intermediary remuneration and mitigates conflicts of interests.

Policyholder Protection Rules are in place. Treating Customers Fairly policies are being developed by the FSB based on the UK version.

The insurance industry also sets its own standards and has established a long-term and a short-term insurance ombud to settle personal claims equitably.

## **9 Portfolio transfers**

Under the STIA and LTIA insurers must obtain the consent or mandate from policyholders for portfolio transfers.

In the case of long-term insurance policies, the High Court must approve the transfer of the business from one insurer to another. Short-term insurance business transfers require approval of the FSB.

## **10 Outsourcing**

Outsourcing of insurance functions that insurers would otherwise need to perform themselves is only permitted in terms of an outsource policy and a formal agreement with the service provider.

*The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.*

*“Authors: Donald Dinnie, Patrick Bracher and Christine Rodrigues”*

## 4.2 The Rules About Short-Term Insurance

The **Short-term Insurance Act 1998** provides for the registration of short-term insurers, and for the control of their activities and those intermediaries who work for them. It falls under the authority of the Minister of Finance, but for all intents and purposes is administered by the Registrar of Short-term Insurance, who is the Executive Officer of the Financial Services Board.<sup>4</sup>

### Rules

#### A. Powers of the Registrar

1. The Registrar can direct a short-term insurer to furnish him, within a specified period, with certain information or documents. If the insurer fails to comply with such a directive, it is guilty of an offence.
2. The Registrar can also issue a directive, which can apply generally, or to a particular person or class of persons, in order to ensure compliance with the Act, and it is an offence to contravene or fail to comply with the directive.
3. If any person is conducting short-term insurance business and is unregistered, or is (registered but is) not authorised to carry on that particular kind of business, the Registrar can issue a directive to that person to make necessary changes and arrangements so that he does not contravene those obligations. It is an offence to fail to comply with such a notice.
4. The Registrar can, if an insurer has contravened any provision of the Act (or a condition of registration, etc.) notify that insurer of his intention to prohibit it from carrying on business, from a specified date. If he does issue such a prohibition, the insurer commits an offence if he fails to comply therewith.
5. An insurer must furnish the Registrar with returns as prescribed by him and is guilty of an offence if it fails to do so.
6. The Registrar can call for further information and or documentation concerning a return, if he is satisfied that it is incomplete or incorrect. It is an offence to fail to comply with such a directive.

7. The Registrar can make rules aimed at policyholder protection. These get published in the Gazette, and can stipulate any contravention.

## **B. Registration and prohibited activities**

1. It is a criminal offence to carry on any kind of short-term insurance business unless you are:
  - registered as an insurer;<sup>14</sup> and
  - authorised to carry on the particular kind of business.
2. The Registrar may impose conditions for the registration of a short-term insurer. It is an offence to contravene any such conditions.
3. It is a crime to use any name or description in relation to your business which includes the words 'insure', 'assure' or 'underwrite' (or derivations of these words) unless you are a registered insurer or a member of Lloyds.
4. No person may perform any act which indicates that he carries on the business of short-term insurance, or is authorised to do so, unless he is registered, and is in fact authorised, or is a member of Lloyds. It is an offence to contravene this prohibition.
5. It is a crime to furnish false information in respect of an application for registration as a short-term insurer.
6. It is a crime to furnish false information in relation to any application for approval from the Minister for any purposes in terms of the Act.
7. If an insurer has stopped entering into policy contracts, or has notified the Registrar of its intention to do so, or the Registrar considers it appropriate to do so, he must direct that insurer not to enter into any more policies, and discharge its obligations under existing policies. (When the Registrar is satisfied that this has happened, he must cancel the insurer's registration). If the insurer fails to comply with these directives, it commits an offence.
8. It is an offence to carry on business (other than the short-term insurance business authorised by the Registrar) as the Registrar may have prohibited, specifically or in general.
9. It is, moreover, an offence so to carry on business otherwise than in accordance with any conditions or limitations which the Registrar may have determined, for a particular insurer, or for insurers in general.
10. It is forbidden for an insurer to undertake to provide survival benefits.
11. It is an offence for a short-term insurer to conduct business as a long-term insurer, except under certain circumstances.

## **C. Intermediaries**

The Act does not define ‘intermediary’. In essence, it is someone who acts between two parties – an insurance broker, for example.

1. It is an offence to render services as an intermediary, in relation to a policy for short-term insurance, unless a registered short-term insurer is the only underwriter for the policy;<sup>26</sup> or, collectively, short-term insurers and Lloyds underwriters.
2. If the intermediary is an agent for a Lloyds broker or Lloyds underwriter (i.e. he is a ‘Lloyds correspondent’) he commits an offence if his intermediary services are not in respect of a policy where Lloyds is the only underwriter.
3. At all times the intermediary must be approved by the Registrar, and it is an offence if he renders services without being approved.
4. It is an offence to offer, provide or accept any remuneration in respect of an intermediary’s services other than as contemplated by the regulations.

## **D. Auditors, actuaries and officers**

1. A short-term insurer which fails to have, at all times, an auditor (appointed in accordance with the provisions of the Companies Act particularly applicable to a public company) is guilty of an offence.
2. Insurers must also have an actuary in their employ. This actuary is obliged to report to the board, without delay, any matter relating to the insurer’s business which in his opinion contravenes any provision of the Act relating to his duties, or affects his ability to comply therewith. He commits a criminal offence if he fails to make such a report.
3. The Registrar can notify an insurer to terminate the appointment of any director, managing executive, public officer, auditor or statutory actuary who is not fit and proper to hold the office. Upon such notice, the insurer shall comply and the person (or firm) concerned must cease the functions concerned, and commits an offence if it fails to do so.
4. The board of directors of an insurer must appoint an audit committee. The insurer commits an offence if they fail to do this.
5. The insurer also commits an offence if the audit committee has a majority of members, including its chairperson, who are its employees.

## **E. Shareholding**

1. An insurer commits a crime if it issues shares to, or registers shares in the name of, or registers transfer of any of its shares to a person other than the beneficial shareholder.

2. No person shall (directly or indirectly) hold any interest in an insurer which results in him exercising control over it, without the approval of the Registrar, and it is an offence to do otherwise.
3. It is a crime (directly or indirectly) to acquire or hold shares in a short-term insurer, without the approval of the Registrar, if the total value of the shares would be equal to or exceed 25% of the total value of all issued shares. It is an offence to do otherwise.
4. So that the insurer knows to, or for whom it may be issuing or registering shares, it can require existing or likely shareholders to furnish certain information. The person in question is guilty of an offence if he fails to comply with a request in this regard.
5. When required to do so, an insurer must furnish to the Registrar a return containing such information as he determines in respect of its shareholders and other persons with controlling power. The insurer is guilty of an offence if it fails to comply with this obligation.
6. An insurer commits an offence if, without the approval of the Registrar, it:
  - issues any securities;
  - changes the capital structure of the company;
  - reduces its share capital;
  - allows a subsidiary to acquire shares in it;
  - provides financial assistance for the subscription of securities.
7. It is an offence to cast a vote attached to a share issued to a person, or registered in his name, in conflict with the provisions of the Act.
8. It is an offence to receive a dividend in respect of such a share.

## **F. Financial health**

1. An insurer commits an offence if, at any time, it conducts the business in a financially unsound condition by not having assets, or by not providing for its liabilities and capital adequacy requirement, or by the general conduct of its business, so that is unable to meet its liabilities and capital adequacy requirement.
2. If at any time an insurer is unable to meet those obligations, it also commits an offence by failing to notify the Registrar immediately, and furnishing the reasons.
3. Upon such notification the Registrar may authorise the insurer to adopt a specified course of action (or he may initiate business rescue or winding up proceedings). The insurer commits an offence if it fails to comply with that authorisation.
4. An insurer is guilty of a criminal offence if, while it is in a financially unsound position as contemplated in F.1 (or is likely to be) it either declares, or pays out a dividend to its shareholders.
5. An offence is also committed if, as a result of declaring or paying out a dividend, the insurer would enter (or be likely to enter) into that financially unsound position.

6. A short-term insurer shall not:
  - encumber its assets;
  - allow its assets to be held by another person on its behalf;
  - directly or indirectly borrow any asset;
  - by means of suretyship (or any other personal security) give security in relation to obligations between other persons;
  - include in its assets, shares directly or indirectly held in its holding company,
  - without the approval of the Registrar, and commits an offence if it does.
7. The insurer also commits an offence if it breaches any of the conditions upon which the Registrar may have granted such approval.

### **G. Policy holder protection**

1. If a person is required to make a short-term policy (or its benefits) available and use it for security in respect of a contract for the loan of money (or the leasing of goods, or where credit is granted) the person so requiring that security is guilty of an offence if:
  - he does not give the other person the free choice as to whether to enter into a new policy for that purpose; and
  - he does not give prior written notification of the free choice.
2. It is a crime to provide (or offer to provide) directly or indirectly, any valuable consideration as an inducement to a person to enter into, continue, vary or cancel a short-term policy.
3. No independent intermediary may receive, hold or deal with premiums unless authorised by the insurer concerned, and then in accordance with regulations. He is guilty of an offence if he does otherwise.
4. The short-term insurer is guilty of an offence if it permits an independent intermediary to receive, hold or deal with premiums other than as it has authorised, in accordance with the regulations.
5. The insurer and/or intermediary commits an offence if it/he does not issue a receipt (stating the name, address, policy number and insurer) when premiums are paid to it/him in cash.
6. The insurer must provide a policy holder with a copy of the policy within 30 days, if the insurance is personal (home, or car insurance, for example) as opposed to commercial, and otherwise upon request. The insurer commits an offence if it fails to do so.

### **H. General**

1. A short-term insurer commits an offence if:

- it does not have its head office in the Republic;
  - it fails to appoint a natural person who is permanently resident in the Republic as its public officer;
  - it does not notify the Registrar of the address of that head office and of the name of that public officer; and
  - the address of that head office changes, or if that public officer or the name of that public officer changes, it does not notify the Registrar thereof within 30 days.
2. The public officer is guilty of an offence if he fails to ensure that the short-term insurer complies with the Act.
  3. A short-term insurer commits an offence if it changes:
    - its financial year; or
    - its name (or a translation, shortened form or derivative thereof), without the approval of the Registrar.
  4. A short-term insurer must notify the Registrar in respect of every director or managing executive appointed by it, or whose appointment has been terminated by it, or who has resigned, within 30 days, together with the reasons. It is a crime not to do so.
  5. Any such director or managing executive who resigns or whose appointment has been terminated, must inform the Registrar (if requested) of any matter relating to the affairs of that insurer of which he became aware in the performance of his duties and which may prejudice its ability to comply with the Act. Any such person who is requested to do so, and fails to inform the Registrar accordingly, is guilty of an offence.
  6. It is an offence for an insurer to allow another person to perform certain functions, other than by way of an agreement in writing and in accordance with any requirements, limitations or prohibitions prescribed by regulations

### 4.3 The Long-Term Insurance Act

To provide for a legal framework for the regulation of conduct of business supervision of long-term insurers in the Republic, that is consistent, to the extent practicable, with international standards for insurance regulation and supervision; for the control of certain activities of long-term insurers and intermediaries; and for matters connected therewith.

To view regulations: go to <https://www.gov.za/documents/long-term-insurance-act>

## Long term insurance

Long term insurance refers to a range of insurance products that provide you either with an income in the long term – usually when you retire – or a lump sum of money should you become permanently disabled or pass away.

In general, long term insurance usually refers to products such as life insurance, personal accident insurance, retirement annuities and endowment policies. So, which of these types of insurance do you need?

## Types of Long-term Insurance

### Life Insurance

When you pass away, life insurance pays out a lump sum of money to your nominated beneficiary, which is the person or entity you choose to receive the money. Life cover is a good idea if you're the **main breadwinner** and have **dependents** who rely on you for financial support. Should you pass away, you'll know that your loved ones will be left **financially secure** and that any financial obligations such as a home loan will also be covered.

### Personal Accident Insurance

If you're fit and healthy, you may not be able to imagine a time when you're not able to work and provide an income. The reality, however, is that if you become disabled, you may not be able to work and earn money as you did before - if at all. If this happens, you'll still need to cover your monthly living expenses.

Also known as accident and disability cover, personal accident insurance **pays you out a lump sum** should you be permanently disabled as a result of an accident. The overall aim with this type of long term insurance is to keep your standard of living the same as before you were injured.

### Retirement Annuities

A retirement annuity is a savings plan that provides you with an income once you've retired. These annuities work by you paying a monthly contribution in exchange for money back when you retire, either monthly, quarterly, annually or in one lump sum. Retirement annuities are ideal if you don't already have an active pension or provident fund, or even if you just want to have more money available when you're not working anymore.

As far as long term insurance goes, retirement annuities have good tax benefits in that you can deduct a portion of the money you pay towards the annuity each month from being taxed. They're also a good way to save because you can't access the money until you retire.

## Endowments

An endowment policy is a type of long term insurance policy that pays out a lump sum at a **defined future date**, or earlier, should you die before that date. In this way, you can think of an endowment policy as a **mix between a retirement annuity and life insurance cover**.

The main benefit of an endowment policy is that if you live longer than you think you will, you'll have a lump sum to use in your retirement to supplement a retirement annuity. But, should you pass away prematurely, you'll know that your loved ones will be financially secure.

### 4.4 Medical Schemes Act (No. 131 of 1998)

provide for the establishment of the Council for Medical Schemes as a juristic person; to provide for the appointment of the Registrar of Medical Schemes; to make provision for the registration and control of certain activities of medical schemes; to protect the interests of members of medical schemes; to provide for measures for the co-ordination of medical schemes; and to provide for incidental matters.

#### 4.4.1 Industry Overview

There are 82 medical schemes in South Africa with approximately 8.88 million members. 21 of these medical schemes are open to the public and 59 are restricted medical schemes, mostly offered by big companies exclusively for the benefit of their employees (Council for Medical Schemes Annual Report 2017-2018).

#### 4.4.2 Regulation

##### The Department of Health

The Department of Health is the executive department of the South African government that is assigned to health matters. It is the overall governing body for the healthcare industry in South Africa.

##### Council for Medical Schemes

The Council for Medical Schemes is a statutory body established by government to supervise private health financing by medical schemes and to interpret the laws drawn up by the Department of Health.

Medical schemes are governed by the Medical Schemes Act 131 of 1998, which supplements the National Health Act.

#### **4.4.3 Other Governing Bodies / Associations**

Besides the Department of Health and the Council for Medical Schemes, the following representations and regulatory bodies govern the industry:

##### **The Board of Healthcare Funders of Southern African (BHF)**

BHF is a representative organisation for medical schemes in South Africa, Namibia, Zimbabwe, Botswana as well as Lesotho. This is an organisation that provides relevant, up-to-date information; engages with government on behalf of medical schemes and provides services to the industry.

##### **Health Funders Association**

Established in 2015, the Health Funders Association (HFA) is a non-profit organisation representing stakeholders involved in the funding of private healthcare in South Africa.

The HFA represents some of the country's most prominent medical schemes, representing approximately 73% of open schemes and 50% of the total memberships. Through its membership of three of the largest medical scheme administrators HFA represents 3.8 million people and 17 medical schemes.

##### **Health Professions Council of South Africa**

The Health Professions Council of South Africa is a statutory health professional council. It was established in terms of the Health Professions Act 56 of 1974.

The purpose of the Council is to provide for control over the training, registration and practices of healthcare practitioners and to provide for matters incidental thereto.

##### **South African Pharmacy Council**

The South African Pharmacy Council is a statutory health professional council. It was established in terms of the Pharmacy Act 53 of 1974.

The purpose of the Council is to ensure the provision of quality pharmaceutical services in South Africa by developing, enhancing and upholding universally

acceptable standards, professional ethics and conduct, ongoing competence and pharmaceutical care.

### **South African Nursing Council**

The South African Nursing Council is a statutory health professional council. It was established in terms of the Nursing Act 33 of 2005.

The purpose of the Council is to control and exercise authority in respect of the education, training and manner of practices pursued by registered nurses, midwives, enrolled nurses and enrolled nursing auxiliaries.

- South African Medical Research Council
- Medicines Control Council
- Allied Health Professions Council of South Africa
- South African Dental Association

National Health Insurance

National Health Insurance (NHI) and South Africa's journey to Universal Healthcare (UHC) is not a topic one can summarise easily.

### **4.5 Understanding the Occupational Health and Safety Act - OHS Act**

This guide was written in the interest of the health and safety of workers in South Africa. It is not intended as a substitute for the Occupational Health and Safety Act, 1993. It is intended to explain the Act in simple, non-legal terms to all the role players in the South African occupational health and safety field.

The Occupational Health and Safety Act, 1993, requires the employer to bring about and maintain, as far as reasonably practicable, a work environment that is safe and without risk to the health of the workers.

This means that the employer must ensure that the workplace is free of hazardous substances, such as benzene, chlorine and micro organisms, articles, equipment, processes, etc. that may cause injury, damage or disease. Where this is not possible, the employer must inform workers of these dangers, how they may be prevented, and how to work safely, and provide other protective measures for a safe workplace.

### **Employee involvement**

The Act is based on the principle that dangers in the workplace must be addressed by communication and cooperation between the workers and the employer. The workers and the employer must share the responsibility for health and safety in the workplace. Both parties must pro-actively identify dangers and develop control measures to make the workplace safe.

In this way, the employer and the workers are involved in a system where health and safety representatives may inspect the workplace regularly and then report to a health and safety committee, who in turn may submit recommendations to the employer.

### **Safety Inspection**

Inspections are usually planned on the basis of accident statistics, the presence of hazardous substances, such as the use of benzene in laundries, or the use of dangerous machinery in the workplace.

Unplanned inspections, on the other hand, usually arise from requests or complaints by workers, employers, or members of the public. These complaints or requests are treated confidentially.

### **Safety Inspectors**

If an inspector finds dangerous or adverse conditions at the workplace, they may issue the employer with a prohibition notice (prohibit a particular action, process, or the use of a machine or equipment), a contravention notice (immediate prosecution, but in the case of a contravention of a regulation, the employer may be given the opportunity to correct the contravention within a time limit specified in the notice which is usually 60 days), or an improvement notice (require the employer to bring about more effective measures).

The inspector may also enter any workplace or premises where machinery or hazardous substances are being used and question or serve a summons on persons to appear before them. The inspector may request that any documents be submitted, investigate and make copies of the documents, and demand an explanation about any entries in such documents. The inspector may also inspect any condition or article and take samples of it, and seize any article that may serve as evidence.

### **Work Environment**

The employer must provide and maintain all the equipment that is necessary to do the work, and all the systems according to which work must be done, in a condition that will not affect the health and safety of workers.

Before personal protective equipment may be used, the employer must first try to remove or reduce any danger to the health and safety of his workers. Only when this is not practicable, should personal protective equipment be used. The employer must take measures to protect his or her workers' health and safety against hazards that may result from the production, processing, use, handling, storage or transportation of articles or substances, in other words, anything that workers may come into contact with at work.

**To ensure that these duties are complied with, the employer must:**

- Identify potential hazards.
- Establish the precautionary measures.
  
- Provide the necessary information, instructions, training and supervision
- Not permit anyone to carry on with any task unless the necessary precautionary measures have been taken.
- Take steps to ensure that every person under his or her control complies with the requirements of the Act.
- Enforce the necessary control measures in the interest of health and safety.
- See to it that the work being done and the equipment used, is under the general supervision of a worker who has been trained to understand the hazards associated with the work.
  
- Such a worker must ensure that the precautionary measures are implemented and maintained.

## Article 1

### Banking Law Developments

*South Africa has a sophisticated banking system that aims to ensure economic stability, consumer protection and institutional safety. Numerous new laws are in the process of being implemented that will address how the financial system is regulated in future.*

April 30, 2019 Author: Rui Lopes and Farah Sheik

South Africa has a sophisticated banking system that aims to ensure economic stability, consumer protection and institutional safety. Numerous new laws are in the process of being implemented that will address how the financial system is regulated in future. The South African financial regulatory structure is currently regarded as being “fragmented” because various pieces of legislation operate in tandem, sometimes in harmony and sometimes not, in order to regulate the banking sector of South Africa.

The Financial Service Board (**FSB**), until its repeal, supervised financial institutions other than banks, while banks and mutual banks fell under the supervision of the Registrar of Banks as part of the South African Reserve Bank (**SARB**). Additionally, the National Credit Act is responsible for regulating the provision of credit to individuals within South Africa.

Since the implementation of the Financial Sector Regulation Act (**FSRA**), which was signed into law on 21 August 2017, this framework has begun to change. Different sections of the FSRA will come into force on different dates, and will essentially commence the implementation of the so-called “Twin Peaks” model of financial sector regulation for South Africa, thus aiming to de-fragment and consolidate legislation in the sector.

The Twin Peaks model of financial regulation seeks to promote and maintain financial stability as its core objective. Two regulators have been established in terms of the FSRA namely, the Prudential Authority (housed within the SARB) and the Financial Sector Conduct Authority (FSCA), which replaced the FSB. The Prudential Authority is tasked with overseeing the system-wide safety and soundness of financial institutions and the FSCA is tasked with overseeing system-wide efficiency and integrity of financial markets, whilst affording greater financial consumer protection. Additionally, the FSRA empowers these new regulators to issue new standards under industry-specific legislation until the Conduct of Financial Institutions Act is enacted,

which is expected to be during the course of 2019. The mandates of the Prudential Authority and the FSCA are much broader than those of their predecessors, which will benefit a sector that has recently been the subject of much attention, particularly after allegations of misappropriation in the VBS Mutual Bank saga.

The Twin Peaks model of financial regulation seeks to promote and maintain financial stability as its core objective. Two regulators have been established in terms of the FSRA namely, the Prudential Authority (housed within the SARB) and the Financial Sector Conduct Authority (**FSCA**), which replaced the FSB. The Prudential Authority is tasked with overseeing the system-wide safety and soundness of financial institutions and the FSCA is tasked with overseeing system-wide efficiency and integrity of financial markets, whilst affording greater financial consumer protection. Additionally, the FSRA empowers these new regulators to issue new standards under industry-specific legislation until the Conduct of Financial Institutions Act is enacted, which is expected to be during the course of 2019. The mandates of the Prudential Authority and the FSCA are much broader than those of their predecessors, which will benefit a sector that has recently been the subject of much attention, particularly after allegations of misappropriation in the VBS Mutual Bank saga.

Further, to demonstrate the extent of the fragmented nature of the banking sector, there are numerous other key pieces of legislation that are applicable to banks in South Africa, including but not limited to:

- the Banks Act 94 of 1990 and regulations published in terms thereof, providing for the regulation and supervision of the taking of deposits from the public;
- the Mutual Banks Act 124 of 1993, which provides for the regulation and supervision of the activities of mutual banks;
- the Co-operative Banks Act 40 of 2007, which provides for the regulation and supervision of cooperative banks and acknowledges member-based financial services cooperatives as a different tier of the official banking sector;
- the South African Reserve Bank Act 90 of 1989, which regulates the SARB and the monetary system;
- the National Payment Systems Act 78 of 1998, which provides for the regulation and supervision of payment, clearing and settlement systems in South Africa;
- the Inspection of Financial Institutions Act 80 of 1993, providing for the inspection of the affairs of financial institutions (such as banks) and for the inspection of the affairs of unregistered entities conducting the business of financial institutions;

- the Currency and Exchanges Act 9 of 1933, which regulates legal tender, currency exchanges and banking. Exchange Control Regulations issued in terms of that Act impose exchange controls that restrict the export of capital from South Africa;
- the Financial Intelligence Centre Act 38 of 2001, which regulates the combat of money-laundering activities and the financing of terrorist activities;
- the Financial Advisory and Intermediary Services Act 37 of 2002, which regulates the rendering of certain financial advisory and intermediary services to clients;
- the National Credit Act 34 of 2005 (NCA), which regulates consumer credit, prohibits certain unfair credit and credit-marketing practices as well as reckless credit-granting;
- the Consumer Protection Act 68 of 2008 (CPA), which regulates the provision of goods and services (including financial services) to consumers, unless exempted;
- the Financial Markets Act 19 of 2012, which provides, inter alia, the regulation of financial markets, the custody and administration of securities and insider trading; and
- the Protection of Personal Information Act 4 of 2013 (POPIA) which, once fully effective, will regulate the manner in which personal information may be processed by establishing the conditions, in harmony with international standards, that prescribe the minimum threshold requirements for its lawful processing.

### **Recent changes/amendments**

There are also a number of amendments to industry-specific financial sector legislation, which have either been enacted or proposed to assist with the establishment and transition of the two new regulators. These include:

- the introduction of a new Insurance Act, the repeal of certain sections of the Short Term Insurance Act and Long Term Insurance Act and amendments to Insurance Regulations;
- proposed amendments to the Banks Act, Mutual Banks Act, Insolvency Act, Financial Markets Act and Financial Sector Regulation Act dealing with the resolution of certain designated financial institutions;

- proposed amendments to the Financial Sector Regulation Act introducing the concept of “Deposit Insurance” and a policy paper from the Treasury regarding the proposed deposit insurance scheme for South Africa;
- the restructuring of the Ombuds system for various financial subsectors; and
- amendments to the Financial Markets Act dealing with, among other things, the regulation of trade in certain over the counter derivatives.

## Future changes

Although fintech is yet to be properly regulated in South Africa, the SARB has recently established the Fintech Programme, designed to assess the emergence of fintech in a structured and organised manner, in order to determine its regulatory implications. The main focus of the programme is to analyse fintech developments to assist policymakers in creating the necessary framework in response to emerging innovations. Currently, however, there remains a lacuna on the treatment of fintech before the law in South Africa

## Article 2

### New regulation allows you to insure with confidence

By Gareth Stokes      Aug 27, 2019

**This article was initially published in the 2nd-quarter 2019 edition of Personal Finance magazine.**

It is a tough ask to discuss financial services regulation in a consumer magazine, but the protections offered by South Africa’s world class regulatory framework are worth exploring. Thanks to concerted efforts from National Treasury, the South African Reserve Bank (SARB) and the Financial Sector Conduct Authority (FSCA) – collectively referred to as regulators – you can buy financial products secure in the knowledge that every possible safeguard is in place. Each of these regulators has a clearly defined role.

National Treasury is responsible for developing the overarching regulatory framework. Its long term plan for the financial services sector is outlined in a policy document titled “A safer financial sector to serve South Africa better”, published in 2011. Treasury has made significant changes to achieve the desired framework in the eight years since. Each change – whether achieved by tweaking an existing law or introducing a new

one – takes the country closer to its vision of sustained economic growth underpinned by financial stability, consumer protection and financial inclusion. An important milestone was reached following the recent enactment of the Financial Sector Regulation Bill to create a ‘twin peaks’ model for financial sector regulation. From April 2018 South Africa has a Prudential Authority housed in the SARB (the first peak) and a Market Conduct Authority (the second peak) to oversee the behaviour of financial institutions. The market conduct function is performed by the FSCA, previously the Financial Services Board.

The need for comprehensive financial sector regulation is starkly exposed by the tongue-in-cheek urban dictionary definition of insurance: “Business that involves selling people promises to pay later that are never fulfilled.” This negative perception has been formed by decades of poor conduct by financial institutions, some of which was profit driven and some purely criminal. Add to this a media that often focuses on negative insurance outcomes without due consideration of the underlying circumstances and you have all the ingredients for widespread consumer mistrust.

For these reasons our regulators have placed consumer protection at the heart of their law making. This led to the adoption and incorporation of the principles of treating customers fairly (TCF) throughout the financial services sector. “The TCF principles are not new to the insurance and advisory market and were introduced by the South African regulators in 2011,” says Samantha Williams, the head of legal and regulatory affairs at the Financial Intermediaries Association (FIA). “The key intention behind these principles is to ensure fair outcomes for customers throughout the customer journey – from ensuring that the appropriate culture is embedded within organisations, to the product design, sales and disclosure process; and the claims and complaints experience.”

There are six principles (see “The TCF principles”, below) that have been embedded in most regulatory interventions since their adoption.

Although you seldom think about financial sector regulation, there are multiple laws in force to protect you from financial market upheaval or unscrupulous market conduct. The Insurance Act, 2017 sets out the licensing requirements, operating structures and prudential standards for insurers, insurance groups, microinsurers and reinsurers, whether they operate in the life or short-term markets. The Act ensures both the appropriate capitalisation of these firms and the long-term sustainability of the sector. It gives you peace of mind that the insurer you deal with will not go “belly up”. The law governing insurers’ conduct is presently under review and will eventually be enacted as the Conduct of Financial Institutions Act (COFI). But there are plenty of other conduct regulations currently in effect to govern how your insurer treats you. Principle among these is the Policyholder Protection Rules (PPRs).

## Policyholder Protection Rules

The PPRs are issued in terms of the in-force insurance legislation and give specific instructions on how an insurer should treat its policyholders. They were first introduced decades ago under the Short-Term Insurance and Long-Term Insurance Acts (these Acts will eventually be replaced by the new Insurance Act and COFI) to see that “insurance policies are entered into, executed and enforced in accordance with sound insurance principles and practices in the interests of the parties and in the public interest generally”. The PPRs are updated from time to time with the two most recent amendments published in December 2017 and September 2018.

“The latest PPR revisions are all pro-consumer,” says Rhett Finch, financial director and managing director of broker business at King Price. “Top of the list must be the requirements for all insurers to now disclose how benefits and ‘bonuses’ are calculated – consumers are realising that these benefits are not ‘free’ and making more considered insurance choices as a result, forcing top insurers to rethink their business models.” The PPRs also introduced stricter governance of advertising and marketing practices. “Statistics and accolades must now be referenced and dated while advertisements that rely on comparisons (whether of price or benefits) may now only compare like policies with like,” Finch says.

The PPRs are extremely prescriptive in detailing how insurers must treat you. “They detail requirements in relation to product design, advertising and disclosure, intermediation and distribution, product performance and acceptable service, and no unreasonable post-sale barriers,” Williams says. “These rules set out how your insurer should interact with you, in line with the overarching TCF principles”.

Under these rules your insurer must instil a TCF culture; design products to meet your needs; keep you appropriately informed before, during and after the time of purchasing your policy; ensure that any advice given is suitable and takes account of your circumstances; ensure that products perform as you have been led to believe they will; and eliminate any unreasonable post-sale barriers should you wish to change or replace a policy, submit a claim or make a complaint.

The removal of post-sales barriers is an important win for consumers. Andrew Coutts, head of intermediated distribution at Santam, says: “We have a dedicated client care team that registers every complaint lodged with Santam and ensures a timely and robust complaints monitoring and management process. The head of this department reports on the complaints volume, key complaint causes and mitigating actions to our quarterly ‘Conduct of Business’ committee”. Santam also proactively monitors keywords on social media and makes use of sentiment analysis technology to

measure and respond to customer “mood” on its key customer engagement email addresses.

“From a regulatory point of view, transparency on the part of insurers is an imperative and plain language a requirement,” says Finch. “The PPRs are about fairness and transparency – they prevent insurers from hiding behind fine print and require that consumers be provided with all relevant information around premium calculations, benefits and pay-outs.” He says the enforcement of the PPRs has assisted in the TCF principles becoming entrenched in every aspect of business and market conduct.

The PPRs impact on your adviser or broker too. “These rules place an onus on the insurer to ensure that intermediaries are fit and proper and appropriately licensed to sell their products; meet the Financial Advisory and Intermediary Services (FAIS) Act product knowledge competency requirements in respect of the policies offered by the insurer; as well as ensuring the suitable intermediary agreements are in place that detail the terms and conditions of their appointment,” says Williams. There are clear rules on the flow of insurance premium and commission between brokers, insurers and policyholder with the aim to enhance the level of industry-wide professionalism and to ensure that customers are treated fairly throughout the customer journey.

Rule 12.2 clearly sets out the oversight responsibilities of an insurer over its brokers. “At the onboarding of any broker we need to confirm that the broker is licensed as a financial services provider (FSP) and is authorised to render financial services in respect of the types of policies offered,” says Coutts. The insurer must ensure that all persons performing intermediary services on the broker’s behalf meet the FAIS product knowledge competency requirements. There are also strict rules governing how an insurer may facilitate the deduction or charging of any fee payable by you to your broker. “After concluding an agreement with the broker, we remain accountable to monitor whether the broker’s FSP license is still active and if it is still authorised for the product categories and financial services as agreed on,” he says.

“Rule 12 is all about-insurer-intermediary relationships,” adds Finch. “We support our brokers by helping them with the administrative requirements of changing legislation; we prepare communications for them to send to their clients to assist with getting broker fees approved; we have changed some of our processes to help make signing up new clients faster and less onerous; and we underwrite our brokers’ clients directly, which relieves a huge broker pain-point and enables us to ensure fair treatment in that part of the client journey.”

What other pro-consumer business practices have resulted from the implementation of PPRs? “We’ve gone to great pains to write our policy documents, and all other communication, in easy-to-understand English so that our clients know exactly what

they're signing up for – there is no fine print and no hiding behind confusing legalese,” says Finch. “We are also busy translating our ‘get a quote’ process into five vernacular languages, which, we hope, will make entering the insurance ambit more comfortable for a larger segment of the local consumer market.”

Santam has a dedicated communications team to assist its various business units in ensuring that plain language is used in all customer documentation and marketing material and that the type of communication is appropriate for the relevant customer group. “Some of the specific initiatives introduced to ensure the fair treatment of customers include embedding ‘good and proper’ in every aspect of our business; including TCF outcomes in performance contracts and staff incentive schemes; the active measurement of customer satisfaction with learning circles to drive ongoing improvement initiatives; a strong TCF governance structure ensuring that all projects consider TCF and customer impacts; and mandatory TCF training for all new staff,” says Coutts.

It is common practice for insurers to develop scripts for staff members who deal directly with customers: these scripts are vetted by both communications and compliance resources to ensure that all the correct disclosures are included in engagements with customers. The quality assurance function assesses staff members based on their interactions with customers and the lessons learnt are fed back via the necessary channels. Coutts adds that the disclosure documentation sent to customers is regularly reviewed in order to ensure that customers are aware of where to lodge their claim, how to complain and how to engage with either the industry regulator or ombudsman scheme.

The value of financial advice was acknowledged at the beginning of our regulatory evolution. South Africa’s financial intermediaries – including employee benefit consultants, financial advisers, healthcare brokers and short-term insurance brokers – have been subject to the FAIS Act since 2004. “Since its introduction, the FAIS Act has had the effect of ensuring a more structured and intrusive set of disciplines for those offering services to the buyers of insurance products with offerings being more appropriate to customer needs,” says Williams. The FAIS Act is enforced by the FSCA which has broad powers to issue any sub-regulations it deems necessary to ensure that the advice, products and services offered to you by intermediaries meet your needs. It is currently working on new legislation – the COFI Act – to govern the market conduct of all financial institutions in the sector.

### **Fit-and-proper regulations for advisers**

For a recent example of consumer protection in action we turn to the updated fit-and-proper regulations, issued by the FSCA under the FAIS Act. “The fit-and-proper

regulations require intermediaries to fully understand all the details in respect of the products which they are authorised to sell and ensure that they are kept up to date so that they may provide the most appropriate products to the clients they service,” says Williams.

“Insurers are obligated to ensure that your broker – and any persons rendering services as an intermediary on its behalf, meet the product knowledge competency requirements in respect of the policies offered by the insurer,” says Coutts. “This means that the insurer is not allowed to let your broker market its products without ensuring that he or she has undergone the necessary training on the insurer’s products and completed an assessment as proof that he or she understands the product section, criteria, excesses, additional cover and other nuances”.

There is a requirement for ongoing monitoring and evaluation of this product training. Santam notes that whenever there are product changes your broker and its representative must undergo training on the amendments to the product before being allowed to market it. This enables your broker to provide detailed and adequate advice to you, building on professionalism in the insurance market.

Another welcome development under the fit-and-proper regulations is the finalisation of continuous professional development (CPD) requirements for intermediaries. “The existing fit-and-proper legislation requires that CPD activities must be recorded – this ensures that the insurer and broker remain up to date on developments related to the financial services and products that he or she is authorised for, to provide excellent financial services to customers,” says Coutts.

The overarching objective of CPD is to maintain the required level of competency and professionalism required by intermediaries to render financial services. All FSPs are required to track the various competency requirements, including CPD, in a competency register as proof of compliance. “The CPD requirements ensure that brokers are kept up to date with industry development, which should give them a more holistic view of the market in which they operate – better informed advisers will ultimately be able to better sell to their customers,” adds Williams.

Stakeholders across the financial services sector are cognisant of the trade-offs between regulation-backed pro-consumer outcomes and costs. While acknowledging that recent amendments will result in positives for consumers, Finch observes that compliance with new regulation will lead to higher costs. “The industry will have to work together to minimise the impact of compliance-linked costs on policyholders,” he says.

The FIA – which represents approximately 2000 FSPs active in the healthcare, long-term insurance, short-term insurance, employee benefits and investment advice disciplines – is supportive of the new operational ability requirements introduced for FSPs, key individuals and representatives under the latest fit-and-proper regulations. “The current changes to the fit-and-proper requirements, which apply to all brokers, will further entrench the principles of TCF and create shareholder value throughout the financial services sector,” says Williams. “What still needs to be considered is that ongoing changes to regulation are balanced and do not create barriers to entry for brokers, in particular as we enter a stage where financial inclusion and the emergence of new broker practices become essential.”

## **THE TCF PRINCIPLES**

Treating Customers Fairly (TCF) is an outcomes-based regulatory and supervisory approach designed to ensure that regulated financial institutions deliver specific, clearly set out fairness outcomes for financial customers. Regulated entities are expected to demonstrate that they deliver the following six TCF outcomes to their customers throughout the product life cycle, from product design and promotion; through advice and servicing; to complaints and claims handling:

8. Customers can be confident they are dealing with firms where TCF is central to the corporate culture;
9. Products and services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly;
10. Customers are provided with clear information and kept appropriately informed before, during and after point of sale;
11. Where advice is given, it is suitable and takes account of customer circumstance;
12. Products perform as firms have led customers to expect, service is of an acceptable standard and as they have been led to expect; and
13. Customers do not face unreasonable post-sale barriers imposed by firms to change product, switch providers, submit a claim or make a complaint.

## **MICROINSURANCE IN THE SPOTLIGHT**

Consumers in low-income groups can breathe a sigh of relief following the widespread inclusion of microinsurance in new insurance regulation. Recent changes are aimed at protecting the most vulnerable consumers – those who typically buy credit life insurance, funeral policies and other low-premium products.

“The adoption of microinsurance within the regulatory framework aims to improve financial inclusion and enhance insurance penetration rates,” says King Price’s Rhett Finch. “Low-income earners will benefit from a paradigm shift in which insurance competitors will have to innovate and improve their product offering with an emphasis on simplicity and accessibility.” He says that a regulatory framework for microinsurance introduces protections for both low-income earners and financially illiterate consumers.

The operational and governance standards for microinsurance are outlined in the new Insurance Act and backed up by the introduction of product standards for credit life and consumer credit insurance in the latest amendments to the Policyholder Protection Rules. “The addition of microinsurance regulation will play a major role in opening up of markets previously unavailable to a large section of the consumer market and will support principles of financial inclusion,” says Samantha Williams at the FIA.

There is still much to be done to ensure comprehensive protection for consumers in the microinsurance sector. The formal recognition of this type of insurance is a welcome first step in achieving National Treasury’s objective of extending access to valued formal insurance products that meet the needs of low income households. “An enhanced, formal and regulated environment will deliver superior consumer protection and enhanced trust,” concludes Finch. “This trust will allow brands, both big and small, to begin unlocking value in and engaging with the low-income market”

### ARTICLE 3

FAIS FIT AND PROPER REQUIREMENTS INFLUENCE A FINANCE AND INSURANCE AGENT (F&I) IN THE MOTOR DEALER INDUSTRY?

21

JUN, 2018

By Elmarie Aberdein

**How will the new FAIS Fit and Proper requirements that was introduced in Board Notice 194 of 2017, influence me as a Finance and Insurance agent (F&I) in the motor dealer industry?**

The long awaited new Fit and Proper Requirements for Financial Services Providers, key individuals and representatives, as described in Board Notice 194 of 2017, became operational on 1 April 2018.

Current and prospective representatives in the financial services industry must comply with these changes.

In previous blog posts we discussed how the changes to the FAIS Fit and Proper Requirements would influence representatives and key individuals in the financial services industry. In this post, we will focus specifically on how the changes will influence F&I's, in their role as representatives in the financial services industry.

**Let's first consider what the role of the F&I in the financial services industry is.**

An F&I has two major functions. The "F" stands for finance (which means dealing with the major banks to negotiate credit for customers), while the "I" stands for insurance (selling insurance to customers).

There are two laws that an F&I must comply with. Firstly, they have to write the NCA (National Credit Act) examination and get a NCA card. This they must do for the "finance" part of the job.

For the "insurance" part, they are seen as representatives in the financial services industry, and therefore must comply with the "fit and proper" according to Board Notice 194 of 2017.

The FAIS Fit and Proper Requirements applicable to Representatives are as follows:

1. Honesty, Integrity and Good Standing
2. Competency Requirements
  - Experience
  - Qualification
  - Class of business Training
  - Product Specific Training
3. CPD requirements

**Honesty, Integrity and Good Standing**

All representatives must comply with the fit and proper requirements relating to honesty, integrity and good standing, and must disclose to the FSP promptly and on its own initiative, fully and accurately, all information in relation to matters which may be relevant in determining whether a person complies or continues to comply with the requirements.

**Competency Requirements**

Representatives must have adequate, appropriate and relevant skills, knowledge and expertise in respect of the financial services, products and functions that it performs, and must maintain their competence.

The competency requirements for representatives are:

## 1. Minimum experience

Representatives (including F&I's) must comply with the experience requirements in relation to the Financial products for which they are appointed, as set out in Column A of Table 1 (see below). The F&I must ensure that they know for which financial products they are appointed, so that they can comply with the experience requirements.

## 2. Minimum qualifications

Qualification requirements do not apply to representatives who are appointed only to perform the execution of sales according to a script, but do apply to all other representatives, therefore the F&I will have to complete a qualification that is approved by the FSCA.

## 3. Regulatory examination requirements

Regulatory examination requirements do not apply to Category I representatives that are appointed only to perform the execution of sales according to a script, and/or render financial services in respect of Tier 2 financial products. If the F&I is only appointed to render financial services in respect of Tier 2 financial products, they will be exempted from the Regulatory Examination requirements.

## 4. Class of business training requirements

Class of business training does not apply to representatives in Category 1 who performs the execution of sales according to a script, as well as Category I representatives who renders financial services in respect of Tier 2 financial products.

## 5. Product Specific training requirements

All representatives must do product specific training.

## 6. CPD requirements

CPD requirements do not apply to representatives who render financial services in respect of a Tier 2 financial product, and/or representatives who renders an intermediary service only, in respect of a Tier 1 financial product.

New product subcategories

Long-term insurance subcategory B1-A	Long-term insurance policies referred to in the definition of long-term insurance subcategory B1 which requires no or limited underwriting
Short-term insurance personal lines A1	Short-term insurance personal lines policies with no or limited underwriting, with a contract term of less than 24

	months, which are not subject to the principle of average and which meet certain conditions relating to policy benefits and exclusions
--	--

FSP's who were already licensed at 1 April 2018 for Long-term insurance B1, will automatically be granted approval for Long-term Insurance B1-A, and FSP's already licensed at 1 April 2018 for Short-term Insurance Personal Lines, will automatically be granted approval for Short-term Insurance Personal Lines A1

If automatic approval was granted to an FSP, it will be deemed to have been authorised for the new product category on the same date as the associated existing subcategory. FSP's must update the central representative register within three months from the date of the automatic amendment.

How will the new FAIS Fit and Proper requirements influence me as a Finance and Insurance agent (F&I) in the motor dealer industry?

To answer the question how the new Fit and proper Requirements will influence me as a Finance and Insurance agent (F&I) in the motor dealer industry, the F&I must establish from their FSP in which product sub-categories they are appointed, in order to decide which fit and proper requirements will be applicable to them, as F&I's in certain product categories have been exempted from certain of these requirements.

Let's summarise the Fit and Proper requirements specifically applicable to F&I's:

- F&I's who renders advice in Tier 1 product categories will have to comply will all the requirements as it applies to representatives in the financial services industry.
- F&I's who renders financial services in Tier 2 product categories will have to comply will the experience, qualification and product specific requirements, but are exempted from regulatory examination, class of business training and CPD (Continuous Professional Development) requirements.
- F&I's who renders intermediary services only in Tier 1 product categories will have to comply will the experience, qualification, regulatory examination, class of business and product specific requirements, but are exempted from CPD (Continuous Professional Development) requirements.

However, if you consider advancing in your career as an F&I, or you might consider a career change in future, we recommended that you still comply with all the requirements as stipulated in Board Notice 194 of 2017, as this might just be the boost you need to advance to the next step in your career.

<b>ANNEXURE ONE TABLE 1: EXPERIENCE REQUIREMENTS FOR AND IN RELATION TO CATEGORY I FSP's</b>				<b>ANNEXURE THREE TIER ONE AND TIER TWO FINANCIAL PRODUCTS</b>	
Subcategory	Column A: Financial Products	Column B: Advice – Minimum experience	Column C: Intermediary Services – Minimum experience	Column A: Tier 1 Financial Products	Column B: Tier 2 Financial Products
1.1	Long-term Insurance sub-category A	6 months	2 months	.	Tier 2
1.2	Short-term Insurance Personal Lines	1 year	6 months	Tier 1	.
1.3	Long-term Insurance sub-category B1	1 year	6 months	Tier 1	.
1.4	Long-term Insurance sub-category C	1 year	6 months	Tier 1	.
1.5	Retail Pension Benefits	1 year	6 months	Tier 1	.
1.6	Short-term Insurance Commercial Lines	1 year	6 months	Tier 1	.
1.7	Pension Fund Benefits	1 year	6 months	Tier 1	.
1.8	Shares	2 years	1 year	Tier 1	.
1.9	Money-market Instruments	2 years	1 year	Tier 1	.
1.10	Debentures and securitised debt	2 years	1 year	Tier 1	.
1.11	Warrants, certificates or other instruments	2 years	1 year	Tier 1	.
1.12	Bonds	2 years	1 year	Tier 1	.

1.13	Derivative instruments	2 years	1 year	Tier 1	.
1.14	Participatory interest in a Collective Investment Scheme	1 year	1 year	Tier 1	.
1.15	Forex Investments	2 years	1 year	Tier 1	.
1.16	Health Service Benefits	2 years	2 years	Tier 1	.
1.17	Long-term Deposits	6 months	3 months	.	Tier 2
1.18	Short-term deposits	6 months	3 months	.	Tier 2
1.19	Friendly Society Benefits	6 months	2 months	.	Tier 2
1.20	Long-term Insurance sub-category B2	1 year	6 months	Tier 1	.
1.21	Long-term Insurance sub-category B2-A	1 year	6 months	.	Tier 2
1.22	Long-term Insurance sub-category B1-A	1 year	6 months	.	Tier 2
1.23	Short-term Insurance Personal Lines A1	1 year	6 months	.	Tier 2
1.24	Structured Deposits	2 years	1 year	Tier 1	.
1.25	Securities and instruments	2 years	1 year	Tier 1	.
1.26	Participatory interest in a CIS hedge fund	2 years	1 year	Tier 1	.

**References:**

<https://www.banking.org.za/consumer-information/consumer-information-legislation/financial-intelligence-centre-act/>

[https://uk.practicallaw.thomsonreuters.com/w-007-](https://uk.practicallaw.thomsonreuters.com/w-007-6934?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1)

[6934?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/w-007-6934?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1)

<https://www.skillsportal.co.za/content/understanding-occupational-health-and-safety-act-ohs-act>

<https://www.realpeopleassurance.co.za/difference-between-long-term-and-short-term-insurance/>

<https://www.iol.co.za/personal-finance/new-regulation-allows-you-to-insure-with-confidence-31159515>

<http://www.fwdconsult.co.za/how-will-the-new-fais-fit-and-proper-requirements-influence-a-finance-and-insurance-agent-fi-in-the-motor-dealer-industry/>

[https://en.wikipedia.org/wiki/South\\_African\\_insurance\\_law#History](https://en.wikipedia.org/wiki/South_African_insurance_law#History)

<https://lawfulliving.co.za/book/text/financial-services--short-term-insurance.html>

<https://www.iol.co.za/personal-finance/financial-planning/10-things-your-financial-adviser-should-do-995676>

<https://www.angloms.co.za/portal/ams/industry-overview>

**Note:** This guide was written in the interest of explaining the Acts applicable to Banks in a more user-friendly way to all students. It is not intended as a substitute for the Acts referred to in this module. Copies of the Acts; as published by the South African Government, can be downloaded from : <http://www.treasury.gov.za/twinpeaks/>