
**MOTIVATION FOR PROPOSED AMENDMENT TO SECTION 1 OF THE FINANCIAL ADVISORY AND
INTERMEDIARY SERVICES ACT, 2002**

INTRODUCTION

1. The FSB proposed amendments to section 1 of the Financial Advisory and Intermediary Services Act, 2002 (Act), with the objective of closing regulatory gaps that are increasingly being exploited by certain sectors in the financial services industry to circumvent regulation under the Act.

2. The proposed amendments are as follows:
Section 1 of the Act is amended by-

2.1. the substitution in subsection (1) for the definition of “intermediary services” of the following definition:

“**intermediary service**” means, subject to subsection (3)(b), any act other than the furnishing of advice, performed by a person **[for or on behalf of a client or product supplier]** -

- (a) the result of which is that a client may enter into, offers to enter into or enters into any transaction in respect of a financial product **[with a product supplier]**; or
- (b) with a view to -
 - (i) buying, selling or otherwise dealing in (whether on a discretionary or non-discretionary basis), managing, administering, keeping in safe custody, maintaining or servicing a financial product **[purchased by a client from a product supplier or in which the client has invested]**;
 - (ii) collecting or accounting for premiums or other moneys payable by the client **[to a product supplier]** in respect of a financial product; or
 - (iii) receiving, submitting or processing the claims of a client in respect of a financial product **[against a product supplier]**;” and

2.2. the deletion of subparagraph (ii) of subsection (3)(b) which provides as follows:

“1(3) For the purposes of this Act-

(b) intermediary service does not include –

(i) ...;

(ii) an intermediary service rendered by a product supplier -

(aa) who is authorised under a particular law to conduct business as a financial institution; and

(bb) where the rendering of such service is regulated by or under such law;”.

3. The primary effect of the amendment to the definition of “intermediary services” is that it removes the requirement that the person performing the activities referred to therein must do so in an agency capacity. It further removes the requirement that the service has to be rendered in a tripartite situation in which a product supplier figures.

4. The amendment to section 1(3)(b)(ii) proposes the removal of the exclusion afforded to product suppliers (issuers of financial products) from the ambit of the Act when rendering intermediary services, and such services are regulated by or under their own governing laws.

5. The proposed amendments effectively bring product suppliers rendering intermediary services within the ambit of the Act. It also clarifies that intermediary services need not be rendered “on behalf” of a client or product supplier, but could be rendered by the product supplier itself acting through its employees or organs.

LEGAL UNCERTAINTY

Definition of 'intermediary service'

6. Product suppliers have increasingly taken the view that they are not subject to the Act when engaging, through their employees, in the direct marketing of their own products to clients. Their view is based, mainly, on the argument that employees cannot be regarded as being separate from the product supplier and, as such, there is no intermediation.
7. In addition, it is argued that a product supplier does not perform the activities on behalf of a client in an agency capacity that requires it to act in the interest of the client, but does so in the furtherance of its own interest.
8. It is correct that the definition of 'intermediary services', as it currently reads, contemplates a person who is interposed between a 'client' on the one hand, and a 'product supplier' on the other hand, representing either.⁴ Product suppliers, based on their contention that their employees do not act separately from the legal *persona* of the product supplier, is relying on the absence of a "go between" to exclude product suppliers from the Act, when selling their products directly to clients.
9. Since inception of the Act it has been the official view of this Office that a product supplier rendering an 'intermediary service' through its employees or so-called tied agents must be licensed under the Act, and its employees must be registered as "representatives" unless such service is regulated by the law under which they are authorised to conduct business as a financial institution.⁵
10. The definition of "intermediary service," if properly analysed, means the following:
 - 10.1. An employee employed by a product supplier acts for or on behalf of a product supplier, and is not the product supplier itself and is also not an organ of the product supplier. An employee is a party acting between the product supplier and the client, although any resulting contract will be between the product supplier and the client. The relationship between the product supplier and its employee who renders the intermediary service, is one of agency, the details of which will be found in the employment contract or some other document.
 - 10.2. AJ Kerr in the Law of Agency states that if there is an obligation on an agent to further his principal's interests it will frequently be found that the contract is one of mandate or of employment. He further quotes from Wille and Millin's Mercantile Law of South Africa that "*A man's ordinary servant or business employees are very often his agents*".⁶
 - 10.3. That agency is, for purposes of FAIS, no different from the type of agency created when the product supplier mandates or appoints an independent intermediary to render an intermediary service for or on its behalf. Only the source of agency is different. Both agents are intermediaries or "brokers".
 - 10.4. Only an organ of a company, for example a director, acts as the company, not as an agent. By contrast, an employee of the company is an agent.⁷ "Legal authority for the proposition that an employee is the employer's agent may be found in *Sizabantu Electrical Construction v Guma and others* [1999] JOL 4503 (LC) and *Banda v Gamegone (Pvt) Ltd & another* [2003] JOL 12298. In the former case employees are aptly described as "internal agents of the employer".
11. The Act further recognises that the definition of 'intermediary service' includes activities that a product supplier

⁴ See *Tristar Investments v The Chemical Industries National Provident Fund* (455/12) [2013] ZASCA 59 (16 May 2013).

⁵ See section 1(3)(b) of the Act.

⁶ For a legal precedent see *Mine Workers Union v Brodrick* 1948 4 SA 959 (A) and see also *Colonial Mutual Life Assurance Society Ltd v Macdoland* 1931 AD 412 at 426.

⁷ Legal authority for the proposition that an employee is the employer's agent may be found in *Sizabantu Electrical Construction v Guma and others* [1999] JOL 4503 (LC) and *Banda v Gamegone (Pvt) Ltd & another* [2003] JOL 12298. In the former case employees are aptly described as "internal agents of the employer".

carries out in its capacity as such, and which may be regulated by the legislation governing product suppliers in that capacity (primary legislation). Therefore, the Act provides for an exclusion to product suppliers under section 1(3)(b)(ii) when rendering intermediary services, and such activity is regulated by their primary legislation.

12. The Act aims to regulate the furnishing of advice and rendering of intermediary services in respect of financial products, in the furtherance of consumer protection. The exclusion of product suppliers and their employees from the Act, to the extent they are not regulated elsewhere, could never have been intended, as such an interpretation would defeat the purpose and objective of the Act. It will further create an imbalance in the application of the law to persons performing the same regulated activity.
13. The Act, in achieving its objective, has a functional approach, aimed at regulating two types of activities, namely: advice and intermediary services (financial services)⁸. It is irrelevant in which capacity a person renders the services. For this reason the Act is applicable “in addition” to any other law.⁹ In fact, it is even applicable to the State and public entities.¹⁰
14. Although product suppliers are exempted from the Act when rendering intermediary services subject to meeting certain requirements, they are not exempted when furnishing advice. But for the exemption, product suppliers must apply and comply with the Act.¹¹
15. In addition, the Act provides that authorisation granted to a product supplier is supplementary to, but separate from, the supplier’s authorisation under a particular law as a financial institution.¹²
16. The purpose of the proposed amendment to the definition of ‘intermediary service’ *inter alia*, will bring about legal certainty.
17. The effect of the industry’s interpretation of the definition of ‘intermediary service’, is that the direct marketing by a product supplier of its own financial products is not regarded as the rendering of an intermediary service and therefore not subject to the Act. It then follows that section 1(3)(b)(ii) of the Act is also not applicable.
18. Therefore, product suppliers (when selling their products) do not have to comply with the Act, irrespective of whether or not their activities are regulated by any other law. Clearly, this could not have been the intention.
19. Below are some further difficulties arising from industry’s interpretation:
 - 19.1. Call centres operated by employees of product suppliers “hard selling” products do not have to comply with the requirements of the Act. This, *inter alia*, include requirements relating to honesty and integrity, competency, conflicts of interest and proper conduct. Clients, when dealing directly with product suppliers, are not afforded the protection of the Act, as would have been the case if they had interacted through an intermediary.
 - 19.2. Complicated derivative instruments¹³ are being sold to clients without the protection of the Act, as these products are mainly being sold by the issuers of the instruments. The growth and proliferation of the Internet has caused an increase of derivative instruments being offered and sold to retail clients. Issuers increasingly reaching potential clients from all walks of life through the internet.
 - 19.3. Unequal treatment of persons performing the same activity eg, an independent intermediary must comply

⁸ See definition of ‘financial service’ in section 1(1) of the Act.

⁹ See section 1(6) of the Act.

¹⁰ See section 1(5) of the Act.

¹¹ The Act, in terms of section 12(1), provides for the granting of exemptions to product suppliers that must be authorised under the Act from having to submit some or all of the information required from an applicant for a licence.

¹² See section 11(2) of the Act.

¹³ Eg. Contracts for differences (CFDs), a margined, over the counter derivative instrument with an equity, index, commodities, currency or bond as its underlying asset, where the holder participates in market movements of the underlying asset. The risk of loss arising from trading in CFDs can be substantial. Market movements, in a relatively short time can result in the holder of the CFD sustaining more than the total loss of funds by way of the margin deposit.

with the Act and meet competency requirements when selling financial products, whilst employees of product suppliers performing the same activity do not have to meet such requirements.

20. In addition, the definition requires that for a service to qualify as an 'intermediary service', it has to be rendered in a tripartite situation. (The service must result in a transaction in respect of a financial product being concluded with a product supplier.) The effect is that financial services rendered in respect of financial products in the second-hand market,¹⁴ is excluded from the Act. No transaction is concluded with a product supplier, although the product involved is a financial product as defined in the Act.
21. The Act's main objective is the protection of consumers of financial services. It is an important objective in all financial services markets but particularly in South Africa where the policy, legal and regulatory environments are being changed in an effort to improve access to financial services. As access increases, less literate, more vulnerable consumers are likely to enter the market. Therefore, it is of paramount importance that all persons who render financial services to consumers are adequately regulated.

Deletion of exclusion of product suppliers in terms of section 1(3)(b)(ii)

22. The deletion of the exclusion of product suppliers from the Act in section 1(3)(b)(ii) is to avoid regulatory arbitrage, improve consistency and to ensure equal treatment of persons performing the same activity, and by doing so, creating level playing fields.
23. Currently there are inconsistencies and lacunae in the sector specific legislation relating to the regulation of market conduct. These gaps create the possibility of regulatory arbitrage.
24. The suspensive conditions under section 1(3)(b)(ii) only require that intermediary service must be regulated by the law governing the product supplier. It is not a requirement for the services to be regulated to the same extent or at the same level as the Act. This results in the exclusion of product suppliers and their employees from the ambit of the Act when marketing their products to clients. In these instances they only have to comply with lesser market conduct requirements.
25. No other financial sector specific legislation provides for the regulation of intermediary services and more specifically the direct marketing by product suppliers of their own products to the extent that the Act does eg. the Act requires providers of financial services to adhere to onerous conflict of interest provisions, and to comply with specific fit and proper requirements, including honesty, integrity, experience, qualifications, regulatory examinations and continuous professional development.
26. It may be necessary to amendment subordinate legislation passed under other financial sector laws that also, possibly not to the same extent as in the Act, regulate the market conduct of product suppliers in order to avoid any potential conflicts between the Act and the other financial sector laws, such as the Policyholder Protection Rules made under the Long- and Short-term Insurance Acts.

¹⁴ Eg. the trade in second-hand endowment policies and the on-selling of shares.