

MOONSTONE
COMPLIANCE AND RISK MANAGEMENT

Understanding the new Fit and Proper Regime (BN194/2017)

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Some important new concepts and definitions

- **“Accredited Provider”** – NB as it relates to class of business training
- **“Assessed”** - strict requirements when activities have an assessment component
- **“Automated Advice”**- advice by electronic medium without direct human involvement
- **“Class of business”** – NEW: 9 classes of business
- **“Class of business training”** – new requirement in respect of classes of business

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Some important new concepts and definitions

- **“Competence”** – skills, knowledge and expertise
- **“CPD and CPD Activities”** – New requirement
- **“CPD Cycle”** – 12 months 1 June 31 May
- **“Particular financial product”** – relates to product specific training
- **“Product specific training”** – training in respect of a particular financial product

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Some important new concepts and definitions

- **“Execution of sales”** – intermediary service on instruction of a client to buy, sell, deal, invest or disinvest in a financial product.
- **“Verifiable”** – NB when it relates to CPD. Must be able to verify identity and completion.

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Some important new concepts and definitions

"limited underwriting" means where the only requirements a prospective policyholder or life insured must comply with in order for a product supplier to accept risk or pay a claim are-

- (a) the furnishing of a health declaration by such policy holder of life insured, structured as answers to no more than eight questions relating to specific medical conditions;
- (b) a requirement that the policyholder of life assured must undergo an HIV test;
- (c) the requirements imposed by the National Credit Act, No. 34 of 2005; or
- (d) a combination of any of the requirements referred to in paragraphs (a), (b) and (c)

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Some important new concepts and definitions

"no underwriting" means there is no requirement by a product supplier for any medical, financial, demographic or lifestyle information to be provided by a prospective policyholder or life insured in order for such product supplier to accept risk or pay a claim.

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New Product Categories

"short-term insurance personal lines A1" means the short-term insurance policies referred to in the definition of 'short-term insurance personal lines', excluding-

- (a) marine policies; and
- (b) engineering policies and guarantee policies as defined in section 1 of the Short-term Insurance Act, and which policies-
 - (i) require no or limited underwriting;
 - (ii) define policy benefits as a sum insured, provide for the replacement of the insured asset or provide for the settlement of outstanding balances due and payable to credit providers;
 - (iii) have contract terms of 24 months or less;
 - (iv) are not subject to the principle of average; and
 - (v) do not provide for any exclusions or conditions from liability of the insurer other than-
 - (aa) exclusions relating to unlawful conduct, provided that such exclusions may only be applied or relied on if there is a direct link between the cause of the loss and the unlawful conduct;
 - (bb) special risks referred to in the Conversion of the SASRIA Act, No. 134 of 1998;
- (c) exclusions relating to the condition of any asset insured at inception of the policy other than exclusions relating to the wear and tear of the asset;
- (dd) exclusions relating to the maintenance and usage of the insured asset under a policy that insures against unforeseen mechanical or electrical component failure;
- (ee) exclusions relating to consequential loss; or
- (ff) any combination of (aa) to (ee);

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New Product Categories

- **"long-term insurance subcategory B1-A"** means those long-term insurance policies referred to in the definition of long-term insurance subcategory B1 which require no or limited underwriting.
- **"long-term insurance subcategory B2-A"** means those long-term insurance policies referred to in the definition of long-term insurance subcategory B2 which provide for the premiums to be invested in an investment portfolio managed by the product supplier with no option by the policyholder to request a change or amendment to that portfolio.

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New Product Categories

- **"structured deposit"** means a -
 - (a) combination of a short-term deposit or a long-term deposit and another Tier 1 financial product; or
 - (b) a short-term deposit or long-term deposit where the return or value is dependent on the performance of or is derived from the return or value of one or more underlying financial product, asset, rate or index, on a measure of economic value or on a default event.
- **"Collective Investment Scheme in Hedge Funds"**

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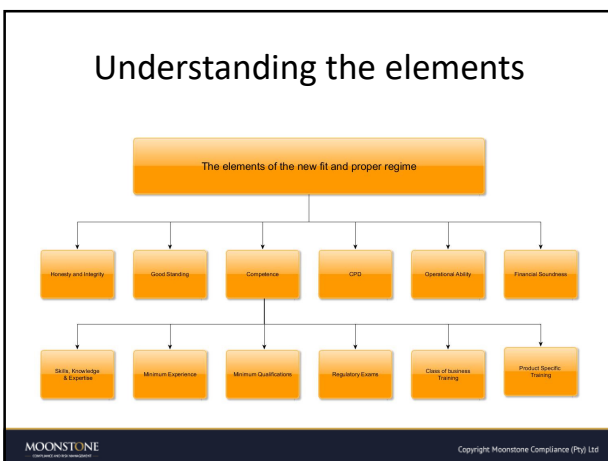
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Product Tiers

| FINANCIAL PRODUCTS | |
|--|--|
| Tier 1 Financial Products | Tier 2 Financial Products |
| Structured Deposits | Short-term Insurance Personal Lines A1 |
| Short-term Insurance Personal Lines | Long-term Insurance subcategory A |
| Short-term Insurance Commercial Lines | Long-term Insurance subcategory B1-A |
| Long-term Insurance subcategory B1 | Long-term Insurance subcategory B2-A |
| Long-term Insurance subcategory B2 | Friendly Society Benefits |
| Long-term Insurance subcategory C | Short-term Deposits |
| Retail Pension Benefits | Long-term Deposits |
| Pension Fund Benefits | |
| Participatory interest in a collective investment scheme | |
| Participatory interest in a CIS hedge fund | |
| Forex Investment | |
| Health Service Benefits | |
| Shares | |
| Money market instruments | |
| Debentures and securitised debt | |
| Warrants, certificates and other instruments | |
| Bonds | |
| Derivative instruments | |
| Securities and instruments | |

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- ### Applying the Board Notice
- 90% of understanding the BN is dependent on understanding how to read it!
 - The BN consists of Chapters, Parts and Sections.
 - At the beginning of each Chapter or Part the BN very clearly indicates who the Chapter or Part applies to.
 - If a definition is included in a part, then it only applies to that part, unless otherwise indicated.
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Honesty, Integrity and Good Standing

- Applies to all FSPs, KIs and Representatives
- A person must be:
 - Honest
 - Have integrity
 - Be of good standing
- Expanded list of *prima facie* disqualifiers
 - (Note that questions are asked as part of approval and there is no longer a timeframe relating to offences)

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Honesty, Integrity and Good Standing

- Juristic persons have to demonstrate compliance through corporate behaviour and the behaviour of its governing body, directors, partners and KIs etc.
- When assessing compliance the registrar **must** consider:
 - Seriousness
 - Relevance
 - Passage of time
- Requirement to disclose fully on own initiative to Registrar (In case of a rep, disclosure to FSP)

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Competence Requirements

- Part 1 : General Requirements
 - Applies to all FSPs, KIs and Representatives
 - FSPs, KIs and Representatives must:
 - Have appropriate, adequate & relevant skills, knowledge & expertise i.r.o. financial products and financial services
 - Comply with minimum requirements of Parts 2,3,4 &5
 - Maintain competence
 - FSP must ensure that it has policies and systems in place to ensure KIs and representatives comply, properly discharge their duties, are trained, undertake CPD and are competent to offer clients the particular financial services or products for which they are authorised.

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Competence Requirements

- Category 1 FSPs that employ representatives to perform "execution of sales" must ensure compliance with S 22(b)(ii).
- FSPs must demonstrate and record evaluation at regular and appropriate intervals of KIs and representatives competence and the appropriateness of CPD activities.
- The evaluation must take the following into account:
 - Technical knowledge and application
 - Skills and expertise
 - Changes to markets, products, services and legislation

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Competence Requirements

- FSPs must establish, maintain, update and submit a competence register to the FSCA in the format to be determined by the FSCA.
- FSPs must notify FSCA immediately if aware that KI no longer meets any requirements.
- NB: The requirements in Parts 2,3,4 & 5 are minimum requirements and do not mean a person complies with the general competence requirements.

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Minimum Experience

- Applies to all FSPs, KIs and Reps
- General experience requirement that FSPs and representatives have adequate and appropriate experience in rendering a particular financial service i.r.o. a particular financial product and particular category of FSP.
- KI must have adequate and appropriate experience to manage and oversee the rendering of a particular financial service of a particular category of FSP.
- Experience lapses after 5 years of inactivity.

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Minimum Experience per Category of FSP

| Type | Experience |
|------------------|--|
| CAT I FSP/Reps | Refer table 1 |
| CAT I KI | 1 Year management + oversight of CAT I |
| CAT II FSP/Reps | Refer table 2 |
| CAT II KI | 1 Year management + oversight of CAT II |
| CAT IIA FSP/Reps | 3 Years experience CAT IIA |
| CAT IIA KI | 1 Year management + oversight of CAT IIA |
| CAT III FSP/Reps | 3 Years experience CAT III |
| CAT III KI | 1 Year management + oversight of CAT III |
| CAT IV FSP/Reps | 1 Year experience in CAT IV |
| CAT IV KI | 1 Year management + oversight of CAT IV |

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Minimum Qualification

- Applies to all FSPs, KIs and Representatives except:
 - CAT I FSPs, KIs and Reps authorised for Long Term A and Friendly Society only
 - Representative of CAT I FSP appointed to perform execution of sales only, provided that the rules in S22(b)(ii) are met!

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Section 22(b)(ii) (The rules for execution of sales)

- Rep has at least Grade 12 or equivalent
- Execution of sales is performed:
 - In accordance with approved script
 - Under direct oversight of KI
- If by telephone, all calls are recorded
- FSP has adequate controls to ensure that:
 - Clients are not furnished with advice
 - No unfair sales techniques/misleading
- FSP on a regular basis:
 - Reviews recordings and checks for deviation
 - Reviews adequacy of controls
 - Reviews script

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Regulatory Exams

- Applies to all FSPs, KIs and Reps except:
 - CAT I FSPs, KIs and Reps authorised for Long Term A and Friendly Society only.
 - Representative of CAT I FSP appointed to perform execution of sales only, provided that the rules in S22(b)(ii) are met; and/or
 - Representative of CAT I FSP appointed to render financial services in respect of Tier 2 products only.
- Refer to Table A for list of exams

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Class of business training and product specific training

- Applies to all FSPs, KIs and Reps except **Class of business training** does not apply to:
 - CAT I FSPs, KIs and Reps authorised for Long Term A and Friendly Society only.
 - Representative of CAT I FSP appointed to perform execution of sales only, provided that the rules in S22(b)(ii) are met; and/or
 - Representative of CAT I FSP appointed to render financial services in respect of Tier 2 products only.
- **Product specific training** does not apply to:
 - CAT II, IIA & III FSPs or its reps (NB does apply if they are CAT I also)
 - KIs of all categories of FSP (NB does apply if KI is Rep also)
 - Provided they comply with Section 12

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Class of business training and product specific training

- FSPs or their reps must complete class of business and product specific training **prior** to rendering financial services.
- KIs must complete class of business training **prior** to managing and overseeing.
- FSP has duty to ensure Reps and KIs are proficient, have adequate understanding and have completed adequate and appropriate training.

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Class of business training and product specific training

- NB: There are very specific requirements regarding class of business training and product specific training. Please refer to Section 29 (4) and (5).
- Class of business training can only be provided by an accredited provider or education provider and must be assessed.
- Class of business training may form part of product specific training or qualification.
- Training must be recorded in competence register within 15 days.

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Continuous Professional Development ("CPD")

- Applies to all FSPs, KIs and Reps except:
 - CAT I FSPs, KIs and Reps authorised for Long Term A and Friendly Society only.
 - Representative of CAT I FSP appointed to render financial services in respect of Tier 2 products only; and/or
 - Representative of CAT I FSP appointed to render intermediary services in respect of Tier 1 products only. (*Remember execution of sales is an intermediary service*).

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Continuous Professional Development ("CPD")

- CPD general requirements:
 - FSP, KIs and Reps must:
 - Maintain competence register
 - Complete minimum CPD requirements
 - Ensure CPD activities are relevant, contributes to skill, addresses training gaps etc.
 - FSP must establish and maintain CPD policies and procedures.
 - FSP must within 30 days after cycle, record activities in competence register and reconcile.

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Continuous Professional Development ("CPD")

| Minimum CPD Hours | |
|--|----------|
| Single subclass of business within a single class of business | 6 hours |
| More than one subclass of business within a single class of business | 12 hours |
| More than one class of business | 18 hours |

A person appointed for a period of less than 12 months must utilise the formula in Sec 33 (4) to apportion CPD points.

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Continuous Professional Development ("CPD")

- Important to note re CPD Activities
 - They **have to** be accredited by a professional body
 - They **do not** include product specific training and activities performed towards a qualification
 - They **must** be verifiable

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Operational Ability – Some important highlights

- FSPs must have
 - Operational ability
 - Governance Framework
 - Adequate KIs to effectively oversee activities
 - At least one KI per class of business
- The Governance Framework must include:
 - A business plan
 - Risk management policies
 - Accounting policies
 - Remuneration policy
 - Business continuity plan
 - Disaster recovery plan
 - Review processes

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Operational Ability – Some important highlights

- Additional requirements when providing automated advice:
 - Adequate and appropriate human resources that have the technical ability to understand the system, algorithms, assumptions and methodology
 - Establish and maintain adequate policies and procedures to test and review the system
 - Have adequate resources to store, retrieve and protect customer information
- Please refer to Section 38

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Operational Ability – Some important highlights

- Section 39 sets strict requirements for outsourcing
- FSPs may not appoint a representative which has been declared insolvent or provisionally insolvent, has been placed under liquidation or is subject to pending proceedings regarding the above.
- Every representative must at all times have at least one KI overseeing that representative.
- KIs that are responsible for more than one FSP or JR will have to demonstrate their ability to oversee those FSPs or JRs.

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Financial Soundness

- The assets of a CAT I FSP and the JR of a CAT I FSP must at all times exceed the liabilities. (NB please note no exclusions from the definitions of assets and liabilities – assets to include goodwill and liabilities to include subordinated loans)

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Financial Soundness

- General Solvency Requirement for assets (as defined) to exceed liabilities (as defined) applies to:
 - CAT I FSPs who hold client funds or collect premiums
 - CAT II, IIA, III & IV FSPs and their JRs
- New definition of liquid assets which allows for inclusion of listed securities and CIS investments up to certain percentages.
- New obligation to submit Form A to the FSCA every 6 months or annually.
- JRs of CAT II, IIA, III and IV FSPs have to submit Form A to the host FSP on a bi-annual basis.

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Financial Soundness

| Table B | | | |
|---|--|--|--|
| Category of FSP and juristic representative | Additional Asset Requirement | Working Capital Requirement | Liquidity Requirement |
| Category I | N/A | Current assets must exceed current liabilities | Liquid assets equal to or greater than 4/52 weeks of annual expenditure |
| Category II | N/A | Current assets must exceed current liabilities | Liquid assets equal to or greater than 8/52 weeks of annual expenditure |
| Category IIA | Assets of the FSP must exceed the FSP's liabilities by at least R3 million | Current assets must exceed current liabilities | Liquid assets equal to or greater than 13/52 weeks of annual expenditure |
| Category III | Assets of the FSP must exceed the FSP's liabilities by at least R3 million | Current assets must exceed current liabilities | Liquid assets equal to or greater than 13/52 weeks of annual expenditure |
| Category IV | N/A | Current assets must exceed current liabilities | Liquid assets equal to or greater than 4/52 weeks of annual expenditure |

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Financial Soundness

- **Early warning requirements:**
 - CAT I (who holds client funds or collects premiums), II, IIA, III and IV FSPs must immediately and in writing notify the FSCA if:
 - (a) the assets of the FSP or that of its juristic representative exceed the liabilities by less than 10%;
 - (b) the current assets of the FSP or that of its juristic representative exceeds the current liabilities by less than 10%;
 - (c) in respect of a Category IIA and III FSP and juristic representatives of those FSPs, the additional assets of the FSP or that of its juristic representative exceed the minimum requirement by less than 10%;
 - (d) the FSP or its juristic representative does not meet any of the requirements in this Chapter; or
 - (e) the FSP becomes aware of an event or situation that may or will result in the effect contemplated in paragraphs (a), (b) and (c).

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Transitional provisions

- **Qualifications**
 - Qualifications obtained prior to 1 Jan 2010 are deemed to meet requirement – only for those they were originally approved.
 - Qualifications recognised by BN 106 are deemed appropriate.
- **Experience**
 - Experience of FSPs, KIs and reps (excluding reps under supervision) is deemed to meet minimum experience requirements – only for products/services currently approved.

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Transitional provisions

- **Product Specific Training:**
 - FSPs and reps (excluding reps under supervision) approved prior to 1 April are deemed to have completed training for products for which they were authorised.
 - Still required to complete product specific training on amendments to products.
 - Reps under supervision have 3 months from 1 May 2018 to complete training.
 - Persons appointed between 1 April and 1 May have 3 months to complete training.

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Transitional provisions

- **Class of Business Training:**
 - FSPs and reps (excluding reps under supervision) and KIs other than the KI of a CAT I FSP, approved prior to 1 April are deemed to have completed training for products for which they were authorised.
 - KIs of CAT I FSP appointed before 1 April are deemed to have completed the training i.r.o the products the KI was approved for or the products for which the FSP was approved for.
 - Reps under supervision have 12 months from 1 August 2018 to complete training.
 - Persons appointed between 1 April and 1 August have 12 months to complete training.

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Licensing Changes

Table C: Products will be amended automatically. FSP must update rep register within 3 months

Table D: FSP needs to apply within 3 months to have products added.

| TABLE C | | TABLE D | |
|-------------------------------------|---|--|--|
| Column A | Column B | Column A | Column B |
| Short-term Insurance Personal Lines | Short-term Insurance Personal Lines A-1 | Participatory interest in a collective investment scheme | Participatory interest in a CIS hedge fund |
| Long-term Insurance subcategory 01 | Long-term Insurance subcategory 01-A | Short-term deposit | Structured deposit |
| Long-term Insurance subcategory 02 | Long-term Insurance subcategory 02-A | Long-term deposit | Structured deposit |

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Implementation Dates

| Section in Notice | Deals with | Effective Date |
|--|--|----------------|
| Section 13(3) and (5) | Evaluation of competence and competence register | 1 May 2018 |
| Section 29(1)(a) | Class of business training | 1 August 2018 |
| Section 29(1)(b) | Product specific training | 1 May 2018 |
| Sections 31-34 | CPD | 1 June 2018 |
| Section 38 | Automated advice requirements | 1 May 2018 |
| Sections 44(1)&(2); 45;48 and 49 but only insofar as it relates to JRs | Financial Soundness and early warning requirements | 1 March 2019 |

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Questions?

Thank you!

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