SUMMARY OF FEEDBACK RECEIVED ON THE DRAFT FSCA STRATEGY FOR PROMOTING FINANCIAL SECTOR TRANSFORMATION

FSCA

Financial Sector
Conduct Authority

Contents

1 Introduction

In February 2022, the Financial Sector Conduct Authority (FSCA) published for public comment its draft strategy for promoting transformation of the financial sector, setting out a two-phase approach. Under phase one, the strategy outlines the FSCA's approach to promoting financial sector transformation within the existing policy framework i.e. the Financial Sector Conduct Act (FSR Act), Broad-based Black Economic Empowerment Act (B-BBEE Act), and Financial Sector Code (FS Code). In phase two, the strategy outlines how the FSCA intends to give effect to key proposals relevant to transformation in the Conduct of Financial Institutions Bill (COFI Bill).

The FSCA received comments on the draft strategy from the 26 stakeholders listed below:

Table 1 – List of commentators

No.	Organization
1	Actuarial Society of South Africa
2	Associated Compliance Pty Ltd (AC)
3	Association for Savings and Investments South Africa (ASISA)
4	Banking Association of South Africa (BASA)
5	Batseta Council of Retirement Funds for South Africa
6	Black Management Forum
7	Capitec Bank Limited
8	Financial Intermediaries Association (FIA)
9	Financial Planning Institute of Southern Africa (FPI)
10	Free Market Foundation
11	Institute of Retirement Funds Africa
12	Masthead
13	Micro Finance South Africa (MFSA)
14	Morningstar Investment Management South Africa (Pty) Ltd
15	Motswedi Emerging Manager Strategists
16	Multisure Corporation (Pty)
17	Munich Reinsurance Company of Africa Limited (MROA)
18	Outsurance
19	Portfolio Analytics Consulting (Pty) Limited
20	PSG Konsult
21	The Southern African Venture Capital and Private Equity Association (SAVCA)
22	Sentinel Retirement Fund
23	South African Institute of Stockbrokers (SAIS)
24	South African Insurance Association (SAIA)
25	The Unlimited Group (Pty) Limited
26	Ujasiri Consulting

The comments received broadly supported the FSCA's objective of improving the transformation of the financial sector. Concerns and questions raised related in most instances to providing clarity on how the FSCA's intended approach would be implemented. Some suggestions for improvements to the strategy were also made.

All comments have been carefully considered. Key changes made to the strategy as a result of the comments submitted include the following:

- The legislative frameworks that guided the development of the strategy were clarified;
- The FSCA has reconsidered its proposal to introduce a minimum B-BBEE Level 4 requirement;
- Further clarity has been provided as to how the FSCA can ensure its application of the strategy remains proportional; and
- The impact of transformation requirements on new institutions entering the market and licenced institutions has been clarified.

The approach of the FSCA in terms of phase 2 of its transformation strategy relies on the enactment of the COFI Bill. As such, further detail on transformation requirements can be expected from the FSCA as the Act is implemented; this may include guidance notes and the issuance of draft conduct standards for comment.

This document sets out a summary of common and significant issues raised by stakeholders during the comment period, as well as the FSCA's responses to these.

2 FEEDBACK ON SECTION 2 OF THE DRAFT STRATEGY - THE CURRENT POLICY AND LEGISLATIVE FRAMEWORK FOR TRANSFORMATION

2.1 Stakeholder feedback: The legislative framework outlined in the strategy is too narrow and does not take into account the entire transformation value chain.

The draft strategy identified the B-BBEE Act and the FS Code as the primary legislative instruments for promoting the transformation of the financial sector. In this regard, some commentators felt that the FSCA did not consider the entire transformation value chain that impacts the financial sector, and that the strategy should also include the following legislation which are pertinent to the overall policy framework:

- Companies Act No. 71 of 2008
- Employment Equity Act No. 55 of 1998
- Skills Development Act No. 97 of 1998
- Competition Act No. 89 of 1998

The Employment Equity Amendment Bill (EEA Bill) was highlighted as a particular source of concern due to its considerable impact on the sector. The Bill empowers the Minister of Labour and Employment to set 5-year employment equity sectorial targets. Institutions will be required to submit a plan to the Department of Employment and Labour (DoEL) setting out their annual targets toward achieving the 5-year sectorial targets. Failure to meet the annual targets without providing justifiable reasons may result in the imposition of penalties.

It was proposed that the FSCA should consider EEA Bill[1] and its potential implications for the sector when developing its approach to transformation. The potential implications highlighted included capital adequacy risks as a result of the imposition of penalties for noncompliance. Clarity was sought on how the EEA Bill's requirements would align with the proposals set out in the strategy.

[1] The Employment Equity Amendment Bill, 2020 was passed by Parliament (National Assembly and National Council of Provinces) on 17 May 2022 and is awaiting signing into law by the President.

It was also proposed that the current policy and legislative framework for transformation should include a reference to the Financial Sector Regulation Act and its definition of transformation of the financial sector.

In addition to the comments that the regulatory frameworks outlined in the strategy are too narrow, comments noted that the institutional mechanisms for monitoring transformation outlined in the strategy did not include all stakeholders in the transformation value chain.

The strategy mentions the Department of Trade, Industry and Competition (DTIC), the B-BBEE Commission, and the Financial Sector Transformation Council (FSTC) as comprising the institutional mechanisms for monitoring and evaluating B-BBEE in the country and in the financial sector, respectively. Commentators proposed that the Competition Commission (public interest considerations) and the DoEL (Employment Equity legislation, including the EEA Bill) be included in the section of the strategy outlining institutional mechanisms for monitoring transformation.

The FSCA's response:

The FSR Act is referenced in the background section of the draft strategy, which sets out the rationale for developing the FSCA's transformation strategy. Revisions have been made to appropriately cater for other comments, including reference to the employment equity legislation where relevant.

The comments regarding the broader legal landscape for transformation are noted. However, it should be noted that the draft strategy aims to outline the primary legislative framework for transformation in South Africa – namely, the B-BBEE Act. This Act is given effect in different sectors through sector Codes and in the financial sector specifically through the FS Code. Accordingly, the institutional mechanisms mentioned in the draft strategy focus on those that are specified for in the B-BBEE Act and the FS Code (i.e. the DTIC as a policy maker, B-BBEE Commission, and FSTC).

As a national objective, transformation is undoubtedly also supported through other legislation and by other stakeholders, as has been noted. The draft strategy does not seek to provide an exhaustive overview of the various legislative frameworks for promoting transformation in South Africa. Rather it is intended to provide an overview of the legislative frameworks that guide the FSCA in considering its role in relation to the transformation of the financial sector.
The FSCA takes note of the concerns raised regarding the coordination of efforts and where possible harmonisation of approaches relating to the EEA Bill. The FSCA has held engagements with the National Treasury, PA and DoEL regarding areas of potential coordination and collaboration. The strategy does indicate that the FSCA will coordinate with relevant stakeholders in the transformation landscape in South Africa.

3 FEEDBACK ON SECTION 3 OF THE DRAFT STRATEGY - THE ROLE OF FINANCIAL SECTOR REGULATORS IN PROMOTING TRANSFORMATION

3.1 Stakeholder feedback: The role of the FSCA in setting transformation targets

Commentators raised questions regarding the FSCA's role in setting transformation targets. A view was expressed that the FSCA need not set new regulatory parameters or propose new B-

BBEE targets in relation to transformation, as this has already been provided for under the B-BBEE Act and FS Code framework.

The FSCA's response:

The comment is aligned to the approach already taken in the strategy. The strategy recognises the FS Code as a product of negotiations among trade associations, labour, community, government and the Association of Black Securities and Investment Professionals (ABSIP). It will continue to be through this process that transformation targets for the sector are set and agreed upon. The FSCA will not set different targets. Our approach is intended to ensure regulated entities have plans in place setting out how they will achieve the existing targets and that they implement those plans.

3.2 Stakeholder feedback: Setting out the role of the FSCA without finalisation of the COFI Bill is premature

A minority of views expressed that Phase 2 of the Strategy, which is reliant on the provisions in the COFI Bill, should be reconsidered and postponed until such time that the Bill has been assented into law and promulgated for implementation. The Bill is still subject to consultation as and legislative processes. It was felt that it is thus premature for the FSCA to rely on what is currently proposed therein. It was also felt that it was unclear how provisions will be comprehensively integrated and work in harmony with existing legislation and regulation and transformation objectives. It was proposed that the strategy must be periodically reviewed and updated based on changes in the environment including policy, legislation, and regulation.

The FSCA's response:

Although the COFI Bill has not been passed by Parliament and is not yet law, the versions that have been published for consultation already sets out the National Treasury's proposed policy position in respect of the FSCA's role in promoting transformation. National Treasury has published versions of the COFI Bill for the purposes of consulting with affected stakeholders and affording them the opportunity to comment and become familiar with matters that are provided for the draft Bill.

It is within this context that the FSCA has drafted its transformation strategy. Implementing the provisions of the COFI Bill, once enacted, will carry significant implications for the FSCA as it undertakes its functions, not only in relation to transformation but also in terms of the broader mandate of the FSCA. It is not feasible to only begin considering these implications once the Bill is enacted.

The transformation strategy allows the regulator to engage stakeholders in response to the strong signal the COFI Bill provides regarding the anticipated future role of the FSCA regarding transformation.

It is a given that the FSCA's actions in relation to transformation will ultimately depend on the final provisions of the COFI Bill once enacted. The FSCA will communicate with the industry should there be significant deviations in the policy approach signaled through the draft Bill. Section 5 of the strategy has also been revised to note that further engagement with industry will occur as the COFI Act is implemented; this will include engagement on matters regarding transformation.

3.3 Stakeholder feedback: The FSCA does not have powers to promote the transformation of the financial sector

It was argued that the FSCA currently does not have power (under either the B-BBEE Act or the FSR Act) to require financial institutions to have a transformation plan, to set minimum B-BBEE levels that must be targeted by each firm, to require progression through levels of transformation over defined periods of time, to supervise the progress of financial institutions against their plans, or to take action when there is a lack of achievement of targets set in transformation plans.

The FSCA's response:

The FSCA agrees that, as set out in the strategy, many actions of the regulator will only be able to be undertaken within an appropriately enabling legislative context. The COFI Bill, once enacted, is likely to provide this enabling legal context, given the draft versions of the Bill that have been published.

It is for this reason that the strategy focuses on a two-phase approach, with activities in Phase 2 being dependent on the implementation of the COFI Act as primary law in South Africa. The strategy has been revised to emphasise this point. Please see also the response above in paragraph 3.2.

3.4 Stakeholder feedback: The role of the FSCA in promoting the transformation of credit providers

Clarity was sought on how the FSCA's strategy will affect credit providers and how it will impact on the licensing and adjudication process within the ambit of the National Credit Regulator (NCR). Furthermore, clarity was sought on whether the NCR has been engaged specifically as it relates to credit providers and credit agreements.

The FSCA's response:

The FSCA strategy will apply to institutions that are regulated by the FSCA and that will be licensed in terms of the COFI Act. Institutions providing services in relation to credit agreements will be required to abide by provisions of the COFI Bill including those relating to transformation. The FSCA and the NCR have in place an MOU to ensure cooperation and coordination between the regulators and will continue to engage as the COFI Act is implemented and requirements are set on financial institutions

4 FEEDBACK ON SECTION 4 OF THE STRATEGY – THE FSCA'S APPROACH TO PROMOTING FINANCIAL SECTOR TRANSFORMATION

Phase 1: Promoting transformation under the existing policy and legislative framework

4.1 Stakeholder feedback: Engaging with financial institutions on existing transformation plans and the extent to which targets identified in the plan are achieved

It was noted that engaging with financial institutions and industry bodies on existing transformation plans and levels of compliance would be beneficial to both the FSCA and the regulated entity. The FSCA was called upon to expand its universe of stakeholders to be engaged to include specifically the organisations representing Black Professionals and Entrepreneurs and/or Black Industrialists and Labour with a view to get first-hand information and to gain deeper insights from the perspective of those affected the most by the success or failure of transformation in the financial sector.

The FSCA's response:

The FSCA supports the sentiments expressed in this regard. The successful implementation of the FSCA strategy is dependent on regulated entities' commitment to contribute towards the transformation of the financial sector. The FSCA will continue to engage with the sector and other stakeholders on its transformation approach to ensure that it achieves the intended outcome of encouraging financial institutions to meaningfully contribute to transformation.

4.2 Stakeholder feedback: Improving the availability and quality of transformation data, especially in relation to ownership

Commentators agree that reliable data is required for effective policymaking and supervision. It is the key to understanding the current situation in the industry and formulating appropriate regulatory responses. Complex ownership structures should be carefully considered to ensure that the data collected supports a broad-based view of transformation.

The FSCA's commitment to avoid the duplication of data submission, as it creates inefficiencies and creates an unnecessary burden, was welcomed. It was argued that this will require careful planning to avoid reporting the same or similar information to four bodies (FSTC, B-BBEE Commission, DoEL and the FSCA).

The FSCA's response:

The comments are welcomed. The first step in improving the availability and quality of transformation data is to identify data already collected by other stakeholders and leverage on this data where possible. This includes understanding the ownership patterns in the financial sector. When additional data is required to achieve a specific objective, information will be requested from regulated entities in accordance with the prescripts of the law. Similarly, the data sharing among regulators and stakeholders will happen within the prescripts of the law including the POPI Act.

4.3 Stakeholder feedback: Building strong co-operative relationships with the FSTC and the B-BBEE Commission

The commitment to build strong co-operative relationships with the FSTC and the B-BBEE Commission is welcomed. It was argued that collaboration and cooperation between the FSCA and other regulators are important and should be included in the strategy in some detail. This will also ensure that the regulatory jurisdiction, roles, and functions of each regulator are clear. In this regard, it was recommended that the building of strong relationships should be extended to all parties that regulate transformation in the financial sector.

The FSCA's response:

As stated in the draft strategy, the FSCA recognises that successful implementation of its strategy requires strong collaboration with other stakeholders in the transformation value chain. While the strategy emphasises building a strong relationship with the B-BBEE Commission and the FSTC, this does not preclude the FSCA from developing relationships with other stakeholders. The strategy is revised to make it clear that strong relationships will be developed with all relevant stakeholders.

4.4 Stakeholder feedback: Coordinate supervisory transformation initiatives with the PA

The coordination between the PA and the FSCA was widely welcomed. It was noted that this will support consistent approaches and lead to improved certainty for industry and potential strategies which could reduce duplication of efforts and any undue administrative reporting burdens on financial institutions. Furthermore, given that the PA is already enabled through the Insurance Act to set transformation requirements for insurance companies and can also consider transformation at licensing stage for insurance companies, it was argued that it may be prudent to consider what lessons the PA has learned in their consideration of transformation at licensing stage for insurance companies, as that may be of value to the FSCA going forward. These lessons, if any, may provide the FSCA with insights that will better inform its approach at either Phase (1 or 2) and beyond.

The FSCA's response:

The FSCA agrees with the sentiment expressed. As part of the twin peaks model the FSCA and the PA engage on a regular basis through several different platforms and cooperate and coordinate on their respective regulatory and supervisory approaches, including approaches to transformation. This will continue as the role of the FSCA on this subject is strengthened.

4.5 Stakeholder feedback: Support initiatives of NEDLAC and the FSTC related to financial sector transformation

It was noted that the first Financial Sector Summit was held in 2002, and while the Summit resulted in the signing of the Financial Sector Charter which was later translated into the FS Code, a significant amount of time has passed during which any new, emerging or potential challenges were not addressed nor confronted. A collaborative approach (such as a new Summit) was proposed, even if it is on a smaller scale, to be held regularly, and the mandate thereof should go beyond the scope of merely considering current issues but also to developing methods on how to better anticipate and respond to challenges that could arise in the near future.

Further to this, it was proposed that smaller initiatives aimed at promoting transparency and accountability should be launched whereat participants/stakeholders can voice the challenges faced in the implementation or execution phase of action points agreed upon at the Summit/ the equivalent thereof. This would allow for swift responses, adequate attention and resources being directed toward imminent issues.

The FSCA's response:

The FSCA will support the transformation of the financial sector to the extent that it is empowered to do so. It cannot duplicate or replace the role and responsibilities of other stakeholders such as NEDLAC or the FSTC. Comments such as the above are well noted but are not within the purview of the FSCA, except to raise it in engagements with relevant stakeholders such as the FSTC. As noted in the strategy, the FSCA will play a strong supporting role to the extent it is required.

4.6 Stakeholder feedback: Support small businesses in the financial sector

Commentators argued that the support provided by the FSCA to small businesses in the financial sector needs to be better understood so the success thereof is quantifiable/ measurable. It was therefore suggested that the FSCA should expressly define the form and kind of support that will be offered to small businesses in this sector.

The FSCA's response:

The challenges that South African small businesses face include (but is not limited to) challenges of regulatory burden. For small businesses in the financial sector, the FSCA is well-placed to reduce regulatory burden where it is possible to do so. It is also able to assist small businesses in understanding and navigating regulatory requirements set by the FSCA. Our assistance is therefore focused on compliance issues, licencing readiness, and support for regulatory examinations. This is already being provided.

We recognise that small businesses in the financial sector may also require financial and operational support to expand and compete with other providers. Other government entities with mandates to support small businesses in this regard include the Small Enterprise Finance Agency for access to financing and the Small Enterprise Development Agency for non-financial assistance.

4.7 Stakeholder feedback: Developing regulatory frameworks that promote the transformation of the financial sector

The strategy notes that the FSCA can promote transformation by minimising regulatory barriers to entry for small black-owned entities in the financial sector and supporting small black businesses with suitably enabling regulatory compliance requirements.

Commentators support a proportional approach to regulation and where possible, would welcome the removal of barriers to entry and elements of regulation that threaten the ongoing sustainability of all small entities. Further information was requested on the barriers to entry that are considered and the controls that the FSCA will introduce to ensure that it can reduce barriers, without sacrificing the appropriateness of those requirements. It was argued that regulatory barriers to entry should be reduced for all small financial institutions and not only small black-owned entities. Further, minimising regulatory barriers should be consistent and aligned with principles-based regulation and the application of the concept of proportionality.

The FSCA's response

The FSCA will minimise barriers to entry by ensuring that regulatory requirements are proportionate to the risks, nature, and scale of financial institutions. It can also allow for the progressive realisation of requirements, including consideration of implementing tiered licensing requirements. For example, the Financial Advisory and Intermediary Services Act No. 37 of 2002 exemption framework allows for the progressive realisation of legislative compliance.

Where current regulations are a barrier to entry for small entities, the FSCA encourages stakeholders to engage with the FSCA and submit motivations demonstrating how certain requirements are a barrier to entry.

The removal of barriers to entry is aimed at facilitating the registration and operation of small businesses. In the South African context, many of these small businesses are black-owned as a result of the demographics of the country. Further, where direct support is provided by the FSCA, consideration will be given to supporting black-owned businesses in particular in ways that are accessible to such businesses – for example through engagements that take place in different regions of the country to reach those outside of the major metropolitan areas.

4.8 Stakeholder feedback: Internal readiness for Phase 2

The training of the enforcement, licensing, supervision and regulatory divisions of the FSCA is crucial. This will ensure that in their investigations and approval of licenses, they are able to scrutinise evidentiary documents submitted by financial institutions and identify their level of compliance with transformation targets. The FSCA should consider engaging with the DTIC policy unit, South African National Accreditation System, accredited B-BBEE verification agents and potentially, transformation strategists and consultants for assistance in equipping its staff with knowledge and understanding of the transformation framework.

Training is also required for financial institutions to understand and interpret the complex FS Code and rules. Compliance with transformation very often requires specialized consultants to provide detailed analysis and opinions and therefore failure to undergo comprehensive training on the Codes will result in significant loss of money and time and could lead to reputational damage for FSPs. The FSCA was requested to coordinate with the FSTC in providing training to financial institutions. Consideration should be given to lowering the cost of training, particularly for small financial institutions.

The FSCA's response:

Suggestions regarding other stakeholders that can assist the FSCA in preparing to play a more prominent role in promoting financial sector transformation are noted and welcomed. The FSCA will consider these in its ongoing training efforts.

In addition, the FSCA recognises that financial institutions themselves may require knowledge and understanding of the FS Code requirements. In this regard, the FSCA will collaborate with the FSTC to determine how the sector can be better supported through cost-effective training, taking into account the size of some of the institutions.

Phase 2 - Promoting transformation under a new legislative framework

4.9 Stakeholder feedback: Requiring financial institutions to have in place a transformation plan, aimed at achieving targets set under the FS Code

The requirement that financial institutions must have in place a transformation plan, aimed at achieving targets set under the FS Code, was widely welcomed. It was argued that by imposing mandatory commitments that financial institutions must adhere to, this approach would ensure accountability and aid enforcement. The FSCA was encouraged to engage directly with financial institutions on transformation targets or metrics based on their business models and operational needs, as a transformation plan (depending on the size, business models and complexity of the business entity), could range from being very complex to relatively simple. The viability of the plan and how realistic it is would be highly subjective and open to a wide variety of interpretations. This could lead to ambiguity and debate between the FSCA and regulated entities.

A question was raised on how the FSCA would standardise the adjudication and assessment of such plans on a like-for-like, fair and transparent manner. Furthermore, to ensure that milestones are set and that financial institutions do not delay in developing and implementing transformation plans, it was recommended that the FSCA consider setting specific periods within which financial institutions should have their transformation plans developed and presented to the FSCA.

A concern was raised regarding the submission of transformation plans by all entities including those that have achieved the highest B-BBEE compliance level (i.e. B-BBEE level 1). It was argued that this could result in perpetual monitoring and impose an unjustifiable burden on the FSCA, as each plan must be reviewed for the exercise to be meaningful.

It was suggested that the FSCA consider BBBEE Level 4 as the acceptable level of compliance and that only entities with lower levels should submit appropriate transformation plans. This will also promote consistency and reduce subjectivity in the evaluation processes to be implemented, as well as allow for flexibility in how entities may deploy strategies towards achieving the goals in accordance with their transformation plans.

The FSCA's response:

As regulated entities differ in size, business models and complexity, the FSCA agrees that a proportionate approach must be taken in relation to transformation requirements. The strategy has been revised to indicate this more explicitly.

In terms of the COFI Bill, the FSCA will be empowered to make standards relating to transformation. These standards will set out further detail on specific requirements in relation to transformation plans.

Assessing the transformation plans will be undertaken in line with the FSCA's principles and risk-based approach to regulation and supervision. Such an approach is necessary as financial institutions will not be expected to follow a 'one-size-fits-all' approach to transformation. Consultation and debate can be useful in finding common ground, and financial institutions will be aware that the FSCA operates within a legal framework that ensures it operates transparently and can be held accountable for the decisions it makes and actions it may undertake.

Regarding the comments about the undue burden to the FSCA by requiring all institutions to submit transformation plans, including those that have already achieved B-BBEE level 1, it is important to note that the requirement is not only intended to encourage financial institutions to contribute to the transformation of the sector, but also to improve information availability and reporting. From this perspective, it is necessary to require all financial institutions to submit a transformation plan. Furthermore, attaining a specific B-BBEE level (including Level 1) does not necessarily imply that targets in all elements of the FS Code have been met; institutions may still have room for improvement in meeting certain targets. The intention is to make sure that the sector remains progressive in driving transformation objectives where relevant.

4.9.1 Stakeholder feedback: Requirement for a minimum B-BBEE level 4 that must be targeted by each firm and documented in the transformation plan

Many commentators raise concerns and questions regarding the proposal that all financial institutions must demonstrate a B-BBEE Level 4 score or have a transformation plan in place that shows how they will achieve this level within a specified period. These include:

a. **A “one size fits all” approach** - some commentators argued that a "one-size-fits-all" approach will not work and that a 5-year time frame is insufficient for the transformation of all types of businesses, particularly Qualifying Small Financial Institutions (QSFIs). While many of the QSFI have a turnover in excess of R10 million, they are small and have a simple structure (e.g. sole proprietors) that relies on the key individual's skill. These companies typically have a team of 10-15 people or less, consisting of 1-2 Key Individuals, a few representatives, and administrative personnel. It would therefore be unrealistic to subject these businesses to the minimum BBBEE level 4 requirement and to expect them to meet some of the elements of the FS Code, particularly the elements of Ownership and Management Control. As a result, it was argued that QSFI should not be subjected to the same requirements as larger businesses with a turnover of more than R10 million and more than 30 employees. When determining the required B-BBEE level, the FSCA should consider other factors such as staff turnover, business activities, and ownership structure (meaning the complexity of the ownership structure) rather than just the business's revenue. By focusing solely on a company's revenue, the focus shifts away from other critical aspects such as determining the ownership structure of large companies, which is a key objective in Phase 1 of the strategy.

   The FSCA was also urged to carry out its strategy in a proportional manner. This approach, for example, will enable QSFIs to improve their B-BBEE scores by providing more flexible options, such as an increased contribution requirement on the other B-BBEE elements of Skills Development, Enterprise and Supplier Development, and Socio-Economic Development. Furthermore, the Procurement Spend element, which appears on the generic FS Code scorecard, should be included as an option for QSFI FS Code scoring, allowing for greater flexibility.

b. **What informed the proposal for a minimum BBBEE level 4 requirement?** The proposed strategy does not provide a basis for requiring financial institutions to achieve B-BBEE level 4. Furthermore, achieving the proposed level will be difficult because transformation requires significant attention, resources, and money from financial institutions. It is important not to underestimate the cost of remaining compliant.

   The FSCA indicates it also intends to engage with financial institutions that are already at B-BBEE Level 4 on an individual basis to assess their achievement of the scorecard's various elements. The FSCA's approach is perceived to be overbearing, putting unnecessary strain on transformation initiatives on multiple fronts.

   The FSCA's power in determining licencing criteria and transformation or B-BBEE scorecards was acknowledged. However, it was argued that under the FS Codes, level 8 is currently the minimum level of compliance. More discussions with the sector are needed to establish BBBEE Level 4 as a minimum benchmark for elements.

c. **B-BBEE Level 4 is not enough** - the proposed B-BBEE level 4 requirement is insufficient, and B-BBEE level 2 compliance should be required across the board. Minimum requirements for Level 2 B-BBBEE status should include a combination of 51 per cent black ownership and at least 50 per cent black representation at the management and senior management levels. ESD support should be targeted to companies in the same industry, e.g. asset managers should spend ESD funds on emerging black businesses.

The FSCA's response:

In light of the feedback received, the FSCA has reconsidered its proposal to implement a minimum B-BBEE Level 4 requirement. This is in line with implementing a proportionate approach to transformation and to avoid limiting the FSCA and financial institutions to a 'one size fits all' approach.

The strategy has been refined to outline the FSCA's proportionate approach. This includes allowing for exemptions and differing requirements to be provided for entities:

- below a certain turnover threshold;
- with specific ownership structures;
- with certain types of business models;
- who has attained a specific B-BBEE level.

Furthermore, by removing a minimum B-BBEE Level 4 requirement, the FSCA will also be able to better implement a risk-based approach, focusing resources on where there is a greatest need for transformation efforts. This could include, for example, entities with a 'high' B-BBEE Level rating but with poor performance in specific elements; entities that show no progress in terms of their transformation levels or targets; and entities that cannot motivate why they are unable to achieve higher levels of transformation.

A minimum B-BBEE level may still be set over time should it be deemed necessary and following due consultation.

4.10 Stakeholder feedback: Considering transformation plans during the licensing process

Many commentators recognised the powers vested in state organs, such as the FSCA, under section 10 (1)(a) of the B-BBEE Act to consider transformation during licensing. It was argued that this would ensure that the FSCA does not take a reactive approach to transformation after licenses are issued, but that transformation concerns are addressed prior to firms' active participation in the sector. However, it was strongly argued that such powers should be limited to "promoting" rather than "enforcing," in order to prevent FSCA from regulating beyond their mandated scope, i.e. enforcement of the B-BBEE Act and its supplementary legislative framework should remain the responsibility of the DTIC. This will also ensure that the appropriate approach is taken when incorporating the transformation objectives as part of the licensing processes, as well as in the enforcement, process..

Some commentators also indicated the manner in which the FSCA will consider transformation at the licensing stage remains unclear and the following questions were raised for clarity:

a. How will the inclusion of transformation in the licensing process impact the entities' ability to enter the sector and operate?
b. What impact would the transformation plans have on licensing, particularly for already licensed institutions? For example, where the FSCA deems a regulated entity's transformation plan inadequate, how will this affect the already licensed entity?
c. What aspects of the transformation plan will be considered during the licensing process? Will preference be given to priority elements?

It was also argued that the requirement of a transformation plan is beyond what is currently applicable within the existing regulatory framework. The weighting attached to such a plan is also unclear. It was submitted that licensing should not be affected by or linked to adherence and implementation of transformation plans.

The FSCA's response:

The FSCA's transformation requirements will rely on provisions in the COFI Act, which will also empower the FSCA to regulate and supervise against these requirements. Consequently, the FSCA will not be enforcing provisions of legislation over which is has no jurisdiction (such as the B-BBEE Act). When implementing the strategy, including at licensing stage, the FSCA will balance its transformation objective with its objectives of customer protection, market integrity and financial stability.

a. How will the inclusion of transformation in the licensing process impact entities' ability to enter the sector and operate?

In terms of the COFI Bill, institutions will be required to have in place transformation plans. This is likely to become a mandatory licensing requirement. Failure to submit a transformation plan at licensing stage will therefore mean a license application is incomplete. Transformation plans submitted at the licensing stage will be assessed to ensure that they demonstrate a commitment to the objective of transformation and the FS Code targets. Institutions will be expected to develop plans that are tailored to their specific business model. Ongoing supervision will assess the performance of financial institutions against their transformation plans. Further guidance will be provided as licensing frameworks are developed to implement the COFI Bill appropriately.

b. What impact will the transformation plans have on already licensed institutions?

It is envisaged that once the COFI Bill becomes law, a license conversion process will be undertaken to move from existing sectoral licenses to licenses and authorisations under the COFI Act. As part of this conversion process, licensed entities are likely to be required to submit their transformation plans to the FSCA within a specified time frame. Details on how the new licensing framework will be phased in, including the license conversion process, will be confirmed and communicated as the COFI Act is implemented.

c. What aspects of the transformation plan will be considered during the licensing process? Will preference be given to priority elements?

The FSCA takes a holistic approach to promote transformation and will ensure that the institutions' transformation plans cover all applicable elements of the FS Code. No preference will be given to specific elements at licensing stage.

The strategy has been revised to clearly outline the activities that the FSCA will undertake during phase 2 of the strategy. This includes the approach to transformation at the licensing stage. Further details will be communicated as the COFI Act is implemented.

4.11 Stakeholder feedback: Regulatory and supervisory actions to promote transformation

The FSCA correctly states that the B-BBEE Act does not impose obligations upon any enterprise to achieve specific targets and that failure to achieve a certain level of compliance is not an offence. Similarly, section 2.3.2 states that the FSTC is not mandated to act against financial institutions in relation to the lack of achievement of targets of the FS Code, or failure to report on compliance.

However, from the reading and interpretation of section 23 of the COFI Bill, together with section 3 and section 4 of this draft strategy, it is the intention of the FSCA to set requirements (at BBBEE Level 4) at licensing stage and on an ongoing basis and to take action to enforce the minimum level requirement. The approach of setting the upfront licensing requirements indicates that actions will be taken against FSPs found to be non-compliant. This approach is punitive in nature and may have unintended consequences.

It is inevitable that the issuing of directives for non-compliance with an enforcement undertaking and administrative penalties for non-compliance with the COFI Act’s transformation requirements will result in some financial institutions being unable to operate, thus having to close their doors. Such outcomes should be avoided given the high unemployment rate the country is facing.

It is proposed that the FSCA’s approach should be more aligned to the “incentivised approach” that has been established under the B-BBEE Act, in that it encourages institutions to transform through incentives, by setting qualifying contribution requirements (e.g. qualifying procurement spend), or setting minimum entry requirements for those who want to enter into specific segments of the business.

The FSCA was urged to ensure that its regulatory and supervisory actions are taken in such a manner that it does not disrupt the provisioning of financial products and services offered by Systemically Important Financial Institutions (SIFIs), such as banks. It was argued that refusal or suspension of any license because of institutions not meeting the transformation requirements would impact clients, business partners and the financial system of the country. It was further argued that because of the high degree of interconnectedness between different financial institutions and groups of financial institutions, failure of one introduces the risk of contagion by others and will ultimately lead to the destabilization of the financial system, to the detriment of the broader economy. Therefore, due consideration must be given to the risks that may be introduced by the cancellation, suspension, varying or amending of the license. It was recommended that a thorough assessment of the potential impact of the proposed actions that the FSCA can take in promoting transformation be conducted to avoid and minimize unintended consequences of those actions.

The FSCA’s response:

Developing the FSCA’s role in relation to financial sector transformation is intended to strengthen rather than replicate existing mechanisms in the sector. This includes leveraging the regulatory role of the FSCA, which includes the ability to set requirements on regulated entities and ensure that these are complied with. Accordingly, section 12 and section 17 of the COFI Bill require all licensed financial institutions to have in place a transformation plan and to promote transformation in a manner consistent with their transformation plans.

Where the FSCA, in its supervisory engagements, determines that an institution has failed to meet the commitments made, the FSCA will be able to employ the range of supervisory and enforcement actions it has available to remedy this – not all of which are punitive. This can range from engaging the entity and agreeing to a way forward, to issuing enforceable undertakings, issuing directives, or imposing administrative penalties. While the withdrawal or suspension of a license is a tool that is available to the FSCA, such an action is never taken without following due process and in full consideration of the impact that such an action would have.

Actions of the FSCA aimed at promoting transformation cannot be taken in a manner that may harm other objectives of the regulator – including enhancing and supporting the efficiency and integrity of financial markets; protecting financial customers by promoting fair treatment of financial customers and assisting in maintaining financial stability. The provisions of the FSR Act ensure that actions undertaken by any regulator in relation to systemically important financial institutions are undertaken in a manner that does not pose a risk to the stability of the financial system. These provisions will continue to apply to the FSCA as it implements its approach to transformation.

4.11.1 Stakeholder feedback: Cost of B-BBEE verification certificates is too high

The cost of verifying B-BBEE scorecards will be prohibitively expensive, putting a significant additional burden on small institutions. The question of whether the provisions for reporting under the FS Code will continue to apply was raised.

The FSCA's response:

The FS Code's verification requirements for each category of measured entities will continue to apply. To avoid duplication and inconsistencies, the FSCA's requirements will be similar. Further engagement will be held within the sector and relevant agencies regarding this issue, to see whether prohibitive costs can be addressed.