



**STATEMENT SUPPORTING THE DRAFT CONDUCT
STANDARD – REQUIREMENTS FOR MANAGERS OF
COLLECTIVE INVESTMENT SCHEMES**

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1 PURPOSE OF THE STATEMENT

- 1.1 The purpose of this document is to explain the need for, expected impact and intended operation of the draft Conduct Standard – Requirements for Managers of Collective Investment Schemes (draft Conduct Standard) as required by section 98(1)(a) of the Financial Sector Regulation, 2017 (Act No. 9 of 2017) (FSR Act).
- 1.2 The Financial Sector Conduct Authority (FSCA) is intending to make the draft Conduct Standard pursuant to sections 106(1)(a), read with 106(2)(b) of the FSR Act. These sections empower the FSCA to make conduct standards necessary to achieve the objectives of the FSR Act and relevant financial sector laws, including the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002) (CISCA).

2 STATEMENT OF NEED – POLICY CONTEXT AND PROBLEM DEFINITION

- 2.1 South African's financial sector regulatory framework draws from, amongst others, established international best practice and standards to remain effective and fit for purpose. One way to ensure this, is to constantly subject the country's financial regulatory framework to international scrutiny and peer reviews by key international role-players and standard setters, including the International Monetary Fund (IMF) and the World Bank (WB), amongst others.
- 2.2 Both the IMF and WB, as part of their peer review assessments, be it from a financial stability or market conduct perspectives, issue reports which identifies gaps and or findings as aligned to established international principles which needs to be adopted and implemented by the jurisdictions under review. One such established principles, for present purposes, are the International Organisation of Securities Commission Principles (IOSCO Principles) as they pertain to the regulation and supervision of the Collective Investment Schemes (CIS) environment.
- 2.3 During the course of 2020 and 2021, South Africa was subject to a Financial Sector Assessment Program (FSAP) conducted by the IMF. On 21 January 2022, the IMF issued their final FSAP Report and made various findings and recommendations aimed at assisting South Africa to identify key sources of systemic risk in the financial sector and implement policies to enhance its resilience to shocks and contagion.
- 2.4 Various of the recommendations made through the FSAP Report pertained to matters related to the CIS environment that fall within the jurisdiction of the FSCA. These recommendations included, amongst other things, the following:
 - The current framework lacks product governance requirements, and there is a need to distinguish between the duties of CIS managers *and* the duties of a distributor. Some of the specific issues identified includes that CIS managers should identify and assess target markets and financial customers for each new product created and should have clear marketing and distribution strategies. The aforementioned were cited as critical elements in the South African context, where the distribution of CIS through online platforms is increasing;
 - There is a need for the adoption of a standardised prospectus for a CIS that lists the scheme's operating rules in accordance with international best practice. This approach will provide more clarity on the content and format of information presented to financial customers and will also support better comparability of CIS' offerings. There is also a need to continue to align CIS disclosures requirements to international best practice;

- Issues were raised pertaining to the oversight of trustees, fiduciaries or custodians, especially where the custodial function has been sub-delegated;
 - A need was identified to clarify and strengthen the responsibilities and obligations of the risk management function, provide for requirements pertaining to an internal audit function, and in particular establish requirements for the compliance function;
 - Notwithstanding the existing general obligation pertaining to conflicts of interest a need was identified to strengthen the conflicts of interest framework and address various specific issues pertaining to conflicts of interest, such as best execution obligations, timely trading and transaction allocation, related party transactions and group structures, the prevention of churning, and the like; and
 - There is a need to define a list of changes in a CIS operating rules that are considered as material and that require prior notification and/or consent of financial customers, and eventually redemption at no cost.
- 2.5 The FSAP Report therefore highlighted a need to affect various changes to the CIS regulatory framework to ensure closer alignment to international standards, enhance the financial sector's resilience to shocks and contagion and support better protection of financial customers.
- 2.6 The draft Conduct Standard is aimed at addressing some of the recommendations reflected in the FSAP Report. It might be noted that the draft Conduct Standard is an interim measure pending the implementation of a holistic conduct regulatory framework applicable to all financial institutions under the envisaged Conduct of Financial Institutions (COFI) Bill.¹ The FSCA considered whether the draft Conduct Standard should be placed on hold and rather be incorporated into the COFI Bill transition project, but it was decided that addressing the FSAP recommendations is a strategic imperative and cannot be dependent on the conclusion of the COFI Bill process.

3 SUMMARY OF THE DRAFT CONDUCT STANDARD

- 3.1 The draft Conduct Standard is intended to address some of the recommendations reflected in South Africa's FSAP Report, as explained above.
- 3.2 The Conduct Standard sets out –
- high-level requirements pertaining to business principles, governance and control functions, the latter entailing the risk management, compliance and internal audit functions;
 - requirements pertaining to the identification, avoidance and management of conflicts of interest, and the adoption of a conflicts of interest management policy;
 - substantial requirements pertaining to portfolio development, including the establishment of a portfolio development framework, principles related to portfolio design, development and distribution, and portfolio approval, monitoring, review and reporting;
 - requirements pertaining to the adoption of a prospectus and what must be contained therein;
 - requirements pertaining to the appointment of a trustee, fiduciary or custodian, including a sub-custodian;
 - requirements relating to trade execution and related party transactions.
- 3.3 Acknowledging that CIS managers can differ in, amongst other things, size, nature and complexity, the draft Conduct Standard allows a CIS manager to design and establish its governance arrangements and control functions in such a way that it is proportional to the

¹ In this regard, please refer to the FSCA's 3-year Regulation Plan that was published on 30 June 2023.

nature, size, scale and complexity of the CIS manager, taking into account its business and operating model, scope of activities, financial customer profile and associated level of risk exposure.

4 STATEMENT OF IMPACT OF THE CONDUCT STANDARD

- 4.1 The draft Conduct Standard will ensure that the South African CIS regulatory environment is more closely aligned to international standards, thereby improving confidence in the South African market. The draft Conduct Standard is also expected to ensure better protection and outcomes for financial customers.
- 4.2 However, the FSCA acknowledges that there may be instances in which the implementation of the draft Conduct Standard could have some cost implication for CIS managers in aligning their business practices with the new requirements.
- 4.3 In this regard the FSCA is of the view that the enhanced governance requirements, as well as risk management function and compliance function requirements, will not have a significant impact on CIS managers as the baseline set in the draft Conduct Standard in this regard should already be standard practice. However, the requirement to have an internal audit function could have a relatively big cost implication for CIS managers, especially smaller CIS managers. In this regard the FSCA is of the view that the principle of proportionality will alleviate some of the potential cost implications.
- 4.4 The requirements pertaining to conflicts of interest might also result in certain cost implications, especially initial costs required to establish a compliance risk management framework in line with the draft Conduct Standard. The latter will, however, mostly affect CIS managers who do not already have a robust conflict of interest management framework in place. Notwithstanding the FSCA is of the view that the potential cost implications of establishing a robust conflict of interest management framework is justified because of the critical importance of managing conflicts of interest. Inadequate management of conflicts of interest has the potential of causing great harm to financial customers.
- 4.5 It is possible that the requirements pertaining to portfolio development may result in relatively substantial cost implications for managers. However, a robust portfolio development process that takes into account the CIS's manager's target market is critically important as this will ensure that portfolios are developed responsibly, and that portfolios offered are suitable and not distributed to financial customers for whom the portfolio is likely to be inappropriate.
- 4.6 Other requirements contained in the draft Conduct Standard are also likely to have some cost implication, e.g. the requirements pertaining to prospectuses and performing a due diligence when appointing a trustee, fiduciary or custodian.
- 4.7 In general, the FSCA acknowledges that the draft Conduct Standard will have cost implications, but we hold the view that the benefits brought about by the draft Conduct Standard will outweigh the potential disadvantages (cost implications).
- 4.8 Notwithstanding, the FSCA specifically requests commentators to provide further insight into the potential impact of the draft Conduct Standard to assist the FSCA in having a better understanding of the potential implications, as the latter will inform any final decisions taken in respect of the draft Conduct Standard. In providing inputs on the potential impact, commentators are requested to provide specific detail and to distinguish the potential impact

based on specific requirements. Commentators are also requested to provide both quantitative and qualitative input and data.

5 STATEMENT OF INTENDED OPERATION OF THE CONDUCT STANDARD

- 5.1 The draft Conduct Standard applies to all CIS Managers and the CIS's and portfolios which they manage in terms of the CISCA.
- 5.2 The draft Conduct Standard is consistent with the objectives of the FSR Act, and specifically the mandate of the FSCA to protect financial customers by promoting the fair treatment of financial customers by financial institutions. It is expected that the draft Conduct Standard will lead to improved practices in the CIS environment that supports better outcomes for and protection of financial customers, in line with the FSCA's mandate. The draft Conduct Standard will also ensure closer alignment with international standards, thereby improving confidence in the South African market.
- 5.3 The draft Conduct Standard is intended to come into operation on a date determined by the FSCA.