**INTERNAL SUMMATIVE ASSESSMENT - Model Answers**

**105026: Occupational Certificate: Financial Advisor**

**Module 2: Regulatory Framework on Financial Advice**

**Learning units: 1 – 4**

|  |
| --- |
| ***NOTE TO Assessor***  *The model answers given are a guideline and not as conclusive. Use own discretion based on your expertise and knowledge of the subject area.* |
| **Question 1 (8 Marks)**  The financial advisory profession requires an adviser to be honest, maintain transparency and give advice and services free of misrepresentation.  a) Why is such a high standard of ethics required of advisors? [5]  b) What is likely to happen to the financial services industry should the high standards not be upheld? [3]  *Answer*  *a) A high standard of ethics is required because:*   * *Financial services is all about trust* * *This will enhance the credibility of the industry* * *FSPs and their advisors handle so much of the customer funds* * *Dishonesty may result in huge financial loss to customers and to the economy overall.* * *FSPs and their representative have a fiduciary duty.*   *b)* *If high standards are not upheld:*   * *Clients lose their funds* * *The industry will lose its credibility* * *The economy will be negatively affected.* |
| **Question 2 (5 marks)**  Sometimes financial advisors are faced with ethical dilemmas in their job. Define an ethical dilemma and provide any 3 examples of ethical dilemmas faced by a financial advisor. [5]  *Answer*  *An ethical dilemma is a situation in which there is a choice to be made between two options, neither of which resolves the situation in an ethically acceptable fashion.*  *Examples of ethical dilemmas*   * *Offering a client a worse product for your own profit.* * *A client specifically wants a certain product which the advisor knows that it’s not really suitable to their circumstances.* * *An advisor realises after rendering a financial service to a client that they are actually related to the client.* |
| **Question 3 (8 marks)**  “On 1 April 2014 the client, following advice received from the financial advisor, invested an amount of R100 000 in a product called “The FixedGRO Structured Investment Option” (FixedGRO). The investment was presented to the client as a lump sum investment that would provide a fixed monthly return of 5% for a period of six months. The client was therefore assured of a return of 30% on the capital invested during the six-month period.  The client never received the promised rate of interest and upon the expiration of the 6-month term, he was advised to sign various disinvestment forms to affect the sale of the shares to the respondent and recoup his invested capital.  Subsequent to signing the disinvestment forms in October 2014, the complainant received no payment from the financial advisor”.  Identify the various problems that arise from the above case. [5]  What is the best way to advise a client on investment matters? [3]  *Answer*  *The problems:*   * *There was lack of truthfulness by the advisor* * *It does seem that the advisor did not provide the client with sufficient and honest information.* * *Failure to provide the client with the promised rate of interest* * *Requesting the client to sign disinvestment forms without sufficient information* * *Failure to make payment to the client even after signing the disinvestment forms*   *Best way to advise client*   * *When it comes to investments, especially those linked to the stock market, returns are never guaranteed* * *Provide the client with past performance trends* * *Emphasis that past performance is not guarantee for future performance.* |
| **Question 4 (10 marks)**  The Twin Peaks model of regulation is meant to ensure that the financial service industry and markets are stable and that consumers are protected. Describe the role of the two regulators under the Twin Peaks model [10]   |  |  | | --- | --- | | **The Prudential Authority (PA)** | **The Financial Sector Conduct Authority (FSCA)** | | * *The PA is responsible for the prudential regulation and supervision of financial conglomerates, banks, insurers, corporate banks, co-operative financial institutions and certain financial market infrastructures.* * *The role of the PA is to ensure the safety and soundness of financial institutions, market infrastructures and assist in maintaining financial stability.* * *The PA must have a suitably qualified SARB Deputy Governor as the CEO.* * *The current (as at August 2019) Deputy Governor of the Reserve Bank, who is also the as the CEO of the PA is Mr. Kuben Naidoo.* * *The CEO is responsible for the day-to-day management and administration of the PA.* * *There is a Prudential Committee (PC) for the PA and consists of the SARB Governor, the CEO of the PA and other SARB Deputy Governors.* * *The PC oversees the management and administration of the PA to ensure that it is efficient and effective.* | * *The FSCA is responsible for regulating and supervising the conduct of financial institutions.* * *The role of the FSCA is to ensure consumer protection and market conduct.* * *The Minister of Finance appoints fit and proper people with appropriate experience in the financial sector as Commissioner and Deputy Commissioners.* * *The current Commissioner as at August 2019 is Mr. Abel Sithole.* * *The Commissioner is responsible for the day-to-day management and administration of the FSCA.* * *The Executive Committee is established for the FSCA, which consists of the Commissioner and the Deputy Commissioners.* | |
| **Question 5 (6 marks)**  A financial adviser needs to avoid being influenced by outside interests or elements, such as gifts, and to have honesty and impartiality.  Give three conflict of interest situations which a financial advisor may experience in the course of their work. [6]  *Answer*  *Three conflict of interest situations:*   * *The interest to get a profit from certain products vs what the actual products the client wants which do not earn an advisor much profit.* * *To disclose certain information which will put the provider in a worse off position vs what will put the client in a good position* * *To receive a gift from a client so as to give them a favourable rate vs to do what is right.* |
| **Question 6 (8 marks)**  Mncedi was appointed on 1 October 2019 as a trainee financial advisor. He completed Matric a year ago and does not possess any tertiary qualification. The FAIS Act allows him to render financial services under supervision.  a) By when must he:  i) Have passed the relevant regulatory examination [1]  II) Have completed class of business and product specific training. [1]  ii) Have obtained a requisite qualification? [1]  b) During the course of supervision, what are the duties that his supervisor must perform to help him during the supervision period? [5]  *Answer*  a) By when must he:  i) Have passed the relevant regulatory examination [1]   * *Must pass the examination within two years of the date of first appointment*   II) Have completed class of business and product specific training. [1]   * *Must complete class of business training within 12 months of date of appointment.*   ii) Have obtained a requisite qualification? [1]  *Within 6 years of the date of first appointment.*  b) During the course of supervision, what are the duties that his supervisor must perform to help him during the supervision period? [5]   * *Implement and ensure compliance with the supervision agreement* * *Mentor and coach the supervised representative on financial products and services and products for which they are appointed* * *Review and assess the learning activities and progress of supervised representative at regular intervals* * *Immediately report to the FSP any unfair treatment of customers by the actions of the supervised representative* * *Record and document the method, frequency and level of intensity of supervision.* |
| **Question 7 (10 marks)**  A prospective financial service provider is planning to lodge an application for a licence as an FSP with the Financial Sector Conduct Authority. Two major requirements are that they must have operational ability and financial soundness.  a) Describe what operational ability and financial soundness entail. [8]  b) Once they are granted the licence, what does the FAIS Act say about the display and reference to the licence as they operate their business? [2]  *Answer*  a) Describe what operational ability and financial soundness entail. [8]  ***Operational ability*** *means – The FSP has adequate and appropriate human, technical and technological resources to effectively function as a particular category of FSP. The FSP must also adopt, document and implement an effective governance framework that provides for the prudent management and oversight of the financial services provided by it and which ensures the fair treatment of clients*  ***Financial soundness*** *means – the FSP must at all times maintain financial resources that are adequate both as to the amount and quality to carry out their activities and supervisory arrangements and to ensure that liabilities are met as they fall due.*  b) Once they are granted the licence, what does the FAIS Act say about the display and reference to the licence as they operate their business? [2]   * *The FSP must display the licence durably and prominently in every business premises* * *Reference must be made to the licence in every marketing and promotional material.* |
| **Question 8 (10 marks)**  Siyamthanda intends to pursue a career as a financial advisor. She is not sure of the requirements. Please outline to her the fit and proper requirements as per the FAIS Act. [10]  *Answer*  *The following are fit and proper requirements:*  *Minimum experience – the minimum experience ranges depending on the product category from 2 months to 3 years.*  *Minimum qualifications – She must have a qualification that includes any 3 subject from the prescribed list.*  *Regulatory examinations – Regulatory RE5 Exam is the one for representatives.*  *Class of business training – There are 9 classes and each class has its own financial products. She can choose any class under which she is employed.*  *Personal qualities of good standing, Honesty and integrity – She must prove a high degree of good conduct from the past.*  *Continuous professional development - An FSP, key individual and representative must maintain the required competence to render the financial services that the FSP, key individual and representative are authorised, approved or appointed to render;* |
| **Question 9 (5 marks)**  Specify 5 negative activities that shrewd financial advisors do. [5]  *Answer*   * *They fail to research, or have inadequate understanding of, a financial product they recommend;* * *They provide advice that does not meet your financial objectives or is inappropriate for your circumstances;* * *They do not properly examine the risks associated with an investment or they fail to give you an adequate explanation of the risks;* * *They make misleading statements about the risks associated with a financial product;* * *They fail to follow the internal procedures and policies of their financial services provider;* * *They fail to disclose how they will be remunerated and the conflicts of interest this presents;* |
| **Question 10 (4 marks)**  You are a financial advisor for one of the FSPs. You receive cash from one of the clients which is part of their investment.  a) What must you do with the cash, upon receipt and subsequently to ensure safe keeping? [2]  b) Regarding client finds, how are the bank charges borne? [2]  *Answer*  a) What must you do with the cash, upon receipt and subsequently to ensure safe keeping? [2]   * *Provide a receipt to the client* * *Deposit the money into a bank account within one business day.*   b) Regarding client finds, how are the bank charges borne? [2]   * *Funds related to ordinary bank charges must be borne by the FSP* * *Funds relating to the deposit or withdrawal of the client funds must be borne by the client.* |
| **Question 11 (10 marks)**  Respondent advised complainant to invest in a high-risk scheme that was incompatible with her personal circumstances as a pensioner. Unfortunately the investment did not perform and the client lost on her life savings.  a) The client approaches you for advice regarding the process they must follow in order to get redress. [5]  b) What process must be followed in order to provide a client with appropriate advice that take cognisance of their financial circumstances? [5]  *Answer*  a) The client approaches you for advice regarding the process they must follow in order to get redress. [5]   * *Approach the FSP and notify them of the complaint* * *Put the complaint in writing* * *Provide the reasons for the complaint* * *Wait for the FSP to respond* * *Discuss proposed solution with FSP and agree to it if applicable* * *If not agreeable to the suggested solution, approach the Ombuds Office.*   b) What process must be followed in order to provide a client with appropriate advice that take cognisance of their financial circumstances? [5]   * *Take steps to obtain appropriate and available information from the client* * *Obtain the client’s financial objectives* * *Conduct an analysis of the information obtained* * *Identify financial product(s) that will be appropriate to the client’s risk profile and financial needs* * *Recommend the products* |
| **Question 12 (5 marks)**  Daphne had been debarred as a representative of a financial service provider for a failing to disclose a previous conviction. She approaches you for advice. She wants to know some of the reasons that will result in the reinstatement of a debarred representative. [5]  *Answer*   * *12 months should have lapsed since the time of the debarment* * *All unconcluded business of the former representative must have been properly concluded* * *All complaints or legal proceedings against the former representative must have been properly and lawfully resolved or concluded.* * *All fit and proper requirements must have been met* * *Any other reasons that the Authority will deem necessary to lift debarment.* |
| **Question 13 (5 marks)**  Trafford (Pty) Ltd, a subsidiary of Billboard Financial Holdings fired a financial adviser for "gross misconduct" but failed to report that to the FSCA. The advisor simply moved back to his previous employer, Billboard Financial Holdings, where he defrauded innocent clients by, among other things, issuing fraudulent policies.  Billboard says that when the adviser applied for the job, it checked whether he was on the FSCA's register of debarred representatives. He was not listed as a debarred representative.  Billboard did not, however, check with its subsidiary Trafford. Unfortunately both Trafford and Billboard were fined as they were negligent in the loss suffered by the clients.  If you were to be the compliance officer of both the subsidiary and the holding company, which controls would you recommend for the future to ensure that the problem above would not happen again? [5]  *Answer*   * *Ensure the FSCA is informed within 15 days when a representative has been debarred* * *Ensure each a candidate’s past information is verified at recruitment and selection* * *Upon debarment, ensure that the debarred representative’s unconcluded business is conducted* * *Create a system which automatically flags a representative involved in misconduct* * *Ensure an automatic tipoff system where employees and clients can report any misconduct by FSP employees.* |
| **Question 14 (8 marks)**  **Read the following suspicious transactions report:**  “A certain businessman’s transactional activities had criminal features of fraud and corruption. When he opened his personal bank account he claimed to be employed by an entity and provided a payslip from this entity. However, careful analysis revealed that the businessman only received one payment from this entity into his personal account over a two-year period. Most of the funds emanated from his business bank account and an investment bank account. The business bank account was being credited with large amounts of money from three entities, including the entity the subject claimed was his employer. Funds were mostly disposed of through cash withdrawals and electronic fund transfers to different bank accounts linked to him. Large sums were paid to different individuals and car dealerships. The business bank account did not reflect transactions indicative of operational expenses, such as salary payments for employees.”  Based on the red flags highlighted in the report, how should the financial institution proceed to ensure that a determination is made of whether or not there was money laundering? [8]  *Answer*   * *The financial institution must notify the client of their suspicions and indicate their intention to investigate the client* * *The financial institution must freeze the bank accounts of the businessman and his company and launch an investigation* * *They must request the source of funds for the transaction* * *The financial institution must report this suspicious and unusual transactions to the Financial Intelligence centre so that the SAPS may even be roped in the investigations.* |
| **Question 15 (5 marks)**  “The FIC received several Suspicious Transactions Reports (STRs) indicating that an entity and its directors may be operating a Ponzi investment scheme. The entity’s two bank accounts were receiving large cash deposits. Using information available on the internet, the FIC discovered that the scheme was being advertised online, promising its investors inflated opportunities. The Ponzi scheme was operating through multiple entities and individuals. Funds were primarily received through cash deposits and then transferred to others involved in the scheme. The funds paid by existing investors were used to pay new investors. The FIC requested bank statements for all the entities and individuals involved in running the scheme using section 27A of the FIC Act. After receiving the bank statements, the FIC analysed the transactions. The FIC also requested an affidavit from the Financial Sector Conduct Authority, which confirmed that the main entity was not authorised as a financial services provider.”  What are the likely consequences to the main entity and its directors as a result of their activities? [5]  *Answer*   * *The entity can be fined* * *The entity if they operate with a licence may have their licence revoked* * *The directors may be fined* * *The directors may be imprisoned* * *The reputation of the company is affected* * *The directors may be blacklisted such that they will not be able to open a bank account with any bank in South Africa.* |
| **Question 16 (5 marks)**  The duty to report suspicious and unusual transactions is governed by section 29 of the FIC Act. Why is this important and to whom does the obligation lie? [5]  *Answer*  *This is important:*   * *It helps to quickly identify cases of money laundering* * *Ensures that the banking system does not lose funds to money laundering* * *It is a risk management and internal control measure* * *It ensures the integrity of financial institutions*   *The obligation is applicable to accountable and reporting institutions.* |
| **Question 17 (8 marks)**  Accountable institutions are required by the FIC Act to establish and verify the identity of a client.  a) What information should be obtained from the client? [5]  b) What are the consequences of failure to identify and verify a client? [3]  *Answer*  a) What information should be obtained from the client? [5]   * *Identify document of the client and other personal information* * *The client’s source of income* * *The client’s proof of residence* * *The details of the client’s proxy should they request the proxy to transact on their behalf.* * *The client’s transactional behaviour.*   b) What are the consequences of failure to identify and verify a client? [3]   * *Fine* * *Imprisonment* * *Loss of reputation by the FSP.* |
| **Question 18 (8 marks)**  Section 29 of the Medical Schemes Act provides for Open Access and Community rating as far as membership to a medical scheme is concerned.  a) Describe each of these two concepts [4]  b) Explain the rationale of each. [4]  *Answer*  a) Describe each of these two concepts [4]  ***Open Access***  *Medical schemes may not exclude anyone from being a member or a dependant of a member as a result of their state of health or the medical conditions from which they suffer. Open schemes have to admit anyone who applies for membership. Restricted medical schemes can restrict membership to people who fall within the specified category that the schemes serves, for example the employees of a particular employer or within a trade profession, professional association, industry or union. They can refuse membership to someone outside of that specified category, but must admit anyone within the category. These schemes are subject to the same regulations as open schemes, and also are governed by the Medical Schemes Act of 1998. Examples of restricted schemes in South Africa include: GEMS (Government Employees Medical Scheme), Transmed, Sasolmed, Bankmed, Platinum Health, Profmed and Nedgroup among others.*  ***Community rating*** *means that all members who join a particular medical scheme option pay the same contributions. Members cannot be made to pay more than others on the same option because of their age, past or present state of health, gender or frequency with which health services are rendered to a particular applicant or their dependants.*  b) Explain the rationale of each. [4]  ***Open Access*** *– To ensure that no one is excluded from accessing medical health based on their status. This is meant to promote access to quality healthcare.*  ***Community rating*** *– To ensure that the same rate applies to every member on a particular plan on a scheme so that no one is excluded on the basis of their current health or medical history.* |
| **Question 19 (4 marks)**  How does the POPI Act apply to financial service providers and their representatives? [4]  *Answer*   * *The****PoPI****conditions impact technology, processes and the manner in which employees process personal information.* * *Personal information may only be used for the purpose agreed with your customers and employees.* * *Marketing by means of unsolicited e-mail is prohibited unless certain provisions apply - organisations need to implement opt-in and opt-out strategies.* * *Personal information may only be retained for as long as necessary - organisations need to specify retention periods.* * *Organisations should not process more personal information than is necessary.* * *Processing of special personal information is prohibited unless certain provisions apply.* |
| **Question 20 (8 marks)**  What are the 8 Acts that the COFI Act seeks to replace? [8]  *Answer*   * *FAIS Act* * *CISCA Act* * *Long-term Insurance Act* * *Short-term Insurance Act* * *Financial Markets Act* * *Credit Ratings Services Act* * *Pension Funds Act* * *Friendly Societies Act.* |