**Occupational Certificate: Financial Advisor**

**SAQA ID: 105026**

**Regulatory Framework on Financial Advice**

**Module 2**

**NQF Level 5**

**17 credits**

**LEARNER GUIDE**

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**1. HOW TO USE THIS GUIDE**

This guide belongs to you. It is designed to serve as a guide for the duration of your training programme and as a resource for after the time. It contains readings, activities, and application aids that will assist you in developing the knowledge and skills stipulated in the specific outcomes and assessment criteria. Follow along in the guide as the facilitator takes you through the material, and feel free to make notes and diagrams that will help you to clarify or retain information. Jot down things that work well or ideas that come from the group. Also, note any points you would like to explore further. Participate actively in the skill practice activities, as they will give you an opportunity to gain insights from other people’s experiences and to practice the skills. Do not forget to share your own experiences so that others can learn from you too.

**2. ICONS**



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**3. HOW YOU WILL LEARN**

The programme methodology includes facilitator presentations, readings, individual activities, group discussions, and skill application exercises.

**4. OVERVIEW OF THE MODULE**

This Module is at NQF level 05 and successful completion of the module will earn you credits towards Occupational Certificate: Financial (Investment) Advisor. The material will enable you to understand the regulatory framework that governs the rendering of financial advice to by financial advisors to clients.

The time you will spend on this module will be a combination of classroom training, self-study and workplace learning. It involves learning, practising, completing activities of a formative nature, doing self-evaluation and putting into practice, in your workplace, what you have learnt.

The approach of classroom contact session-based training is that an adult learning situation is created (through stimulation) by the facilitator to get as much participation as possible from the course participants.

This module will introduce the learner to some of the most important statutory requirements on financial advice. It has four learning units which cover knowledge components.

Someone who has competence in at least an NQF Level 4 qualification with English Communication is eligible to study this course.

# GLOSSARY OF TERMS

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| **Advice** | Any recommendation, guidance or proposal of a financial nature furnished by any means to a client in respect of purchasing or investing in any financial product, or in respect of incurring any liability or the acquisition of any right or benefit in respect of any financial product. It also includes any recommendation, guidance or proposal on the variation, replacement, or termination of a financial product. |
| **Code of Conduct** | A set of conventional principles and expectations that are considered binding on any person who is a member of a particular group. It sets out appropriate behaviour, procedures and norms for its members. |
| **Corporate governance** | The exercise of ethical and effective leadership by the governing body (board of directors) towards the achievement of the following governance outcomes   * Ethical culture * Good performance * Effective control\ * Legitimacy. (King IV Report on corporate governance) |
| **Debarment** | If an FSP provider debars one of its representatives in terms of section 14 of the FAIS Act 2002 because the representative is no longer fit and proper to be a representative, such representative is debarred on an industry-wide basis from rendering financial services to the public. |
| **Ethics** | Ethics is the moral principles that govern a person's behaviour or the conducting of an activity. It defines what is morally good and bad and right and wrong. |
| **FAIS Act** | It is the Financial Advisory and Intermediary Act, 37 of 2002 which regulates the licensing of financial service providers as well as their professional conduct as they render financial services |
| **FIC Act** | The Financial Intelligence Centre Act, 38 of 2001 which regulates the establishment and verification of client identities, record keeping and the reporting of suspicious and unusual transactions by financial institutions. |
| **Financial Advisor** | An individual who as a sole proprietor or as a representative of an FSP provides financial advice to clients. |
| **Financial literacy** | Refers to the set of skills and knowledge that allows an individual to make informed and effective decisions with all of their financial resources. |
| **Financial service** | The FAIS Act defines financial service as providing advice or intermediary services or a combination of the two |
| **Financial Services Provider (FSP)** | Can formally be defined as any person, other than an intermediary, who as a regular feature of the business of such person:  (a) furnishes advice; or  (b) furnishes advice and renders any intermediary service; or  (c) renders an intermediary service |
| **Intermediary service** | Any act, other than the furnishing of advice, performed by a person on behalf of a client. Administrative work on a policy is an example of intermediary service. |
| **Legislation** | Legislation refers to laws that government makes. They are necessary to regulate and control the insurance industry. |
| **Money laundering** | Money laundering is a process by which criminals hide or disguise the proceeds of their crime so that they appear to have originated from a legitimate source. As an example they make the money stolen from an armoured car robbery to look like the proceeds from a normal investment. |
| **Record Keeping** | A system whereby the records of a company are created, captured, kept and disposed of. |
| **Regulation** | A regulation can be defined as a set of rules on how a law will be implemented. The regulatory body imposes regulations and are circulated by Government Notices. They are divided into (individual) regulations, sub-regulations and paragraphs. Regulations are binding and not just an addendum to an act. |
| **Regulatory body** | A regulatory body is an external organisation empowered by legislation to exercise autonomous authority over some area of human activity. They are mostly used for governance. |
| **Regulatory compliance** | Adhering to the laws, regulations, guidelines and specifications that are industry related. It is the necessary steps that an organisation takes to obey and meet the criteria set out by relevant laws and regulations. |
| **Twin Peaks model of regulation** | The South African Twin Peaks model established a new prudential regulator, the Prudential Authority, tasked with overseeing the system wide safety and financial soundness of financial institutions, as well as a new market conduct regulator, the Financial Sector Conduct Authority, tasked with overseeing how financial institutions act towards clients. |

# LEARNING UNIT 1: PRINCIPLES OF ETHICS



**Learning Outcomes**

By the end of this learning unit and having completed all the formative assessment activities, you should be able to:

* Analyse and explain ethics related requirements in different legislation, regulations and codes.
* Explain the implications of triple bottom line reporting within the financial services industry.
* Describe and explain internationally accepted principles that are the basis of a good code of conduct.
* Illustrate the impact of African value systems on codes of ethics in South Africa.
* Explain the benefits of compliance with codes for an organisation.
* Analyse an organisation’s code of conduct.
* Conduct a gap analysis of a code of conduct against the organisation’s principles and values.
* Use the findings of the gap analysis to develop a plan to initiate or improve commitment to the code of ethics of an organisation.
* Discuss the relationship between reputation and ethics.
* Monitor the implementation and revision of a code of practice based on the gap analysis.

## INTRODUCTION

The financial service’s business environment requires the highest degree of ethical behaviour and standards among the participants. This is so because financial service providers (FSPs) are entrusted with people’s money and for them to take care of the money, they must be well behaved. If clients lose their moneys, they will lose confidence in the financial services industry and thus FSPs will lose their credibility.

Any economy will function well when there is proper market conduct in the financial services industry. With the Gross Domestic Product (GDP) of South Africa standing at R1 131 billion for the second quarter of 2021, 1,4% down from before the pandemic, the financial services industry contributed to 23% of that, am major chunk of the GDP. This represents the biggest sector of the South African economy and as such market conduct must be top notch. All the role-players including FSPs and financial advisors need to demonstrate the highest levels of professionalism to ensure the integrity of the industry. Any unethical or untoward behaviour must be eliminated.

This learning unit focuses on principles of ethics and corporate governance that must be followed and adhered to in the financial services industry.

## 1.1 Corporate governance and ethics

Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

The purpose of corporate governance is to help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies.

Promoting effective corporate governance in the financial sector requires a number of measures to be taken. These include:

* The development of an effective legal framework that specifies the rights and obligations of a company, its directors, shareholders and other stakeholders, specifies disclosure requirements, and provides for effective enforcement of the law;
* The development of a corporate governance culture, including through the development of corporate governance principles by professional or industry associations;
* The creation of an environment conducive to encouraging effective corporate governance, including:
* promoting high quality financial disclosure requirements;

promoting the necessary levels of personal accountability by decision makers.

* promoting bank ownership structures that encourage sound governance;
* strengthening market disciplines on banks, including by eliminating or minimising government support arrangements for individual banks and strengthening the incentives for market participants to monitor banks and other financial institutions;
* encouraging well developed equity and debt markets; and
* encouraging an effective financial news media;
* Appropriate supervisory arrangements, focusing on (among other matters) encouraging the adoption of sound corporate governance practices;
* Education and training initiatives to build capacity in corporate governance at various levels, including directors and senior management of financial institutions and financial regulators; and
* Leadership by example, including by government and regulatory agencies in terms of their own internal governance and transparency practices.

The Organisation for Economic Co-operation and Development (OECD), which is an inter-governmental economic organisation with 36 member countries, founded in 1961 to stimulate economic progress and world trade has come up with principles on corporate governance.

The OECD Principles of Corporate Governance represent an international benchmark for corporate governance, forming the basis for a number of reform initiatives, both by governments and the private sector.

The OECD Principles encompass six main areas:

* ensuring an effective corporate governance framework
* the equitable treatment of shareholders
* institutional investors, stock markets, and other intermediaries
* the role of stakeholders in corporate governance
* disclosure and transparency
* The responsibilities of the board.

The principles are summarised as follows:

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| Ensuring an effective corporate governance framework. | Effective corporate governance requires a sound legal, regulatory and institutional framework that market participants can rely on when they establish their private contractual relations. This corporate governance framework typically comprises elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of a country’s specific circumstances, history and tradition. The desirable mix between legislation, regulation, self-regulation, voluntary standards, etc., will therefore vary from country to country e.g. in South Africa |
| The equitable treatment of shareholders. | Equity investors have certain property rights. For example, an equity share in a publicly traded company can be bought, sold, or transferred. An equity share also entitles the investor to participate in the profits of the corporation, with liability limited to the amount of the investment. In addition, ownership of an equity share provides a right to information about the corporation and a right to influence the corporation, primarily by participation in general shareholder meetings and by voting. |
| Institutional investors, stock markets, and other intermediaries. | In order to be effective, the legal and regulatory framework for corporate governance must be developed with a view to the economic reality in which it is to be implemented. In many jurisdictions, the real world of corporate governance and ownership is no longer characterised by a straight and uncompromised relationship between the performance of the company and the income of the ultimate beneficiaries of shareholdings. In reality, the investment chain is often long and complex, with numerous intermediaries that stand between the ultimate beneficiary and the company. The presence of intermediaries acting as independent decision makers influences the incentives and the ability to engage in corporate governance. |
| The role of stakeholders in corporate governance | A key aspect of corporate governance is concerned with ensuring the flow of external capital to companies both in the form of equity and credit.  Corporate governance is also concerned with finding ways to encourage the various stakeholders in the firm to undertake economically optimal levels of investment in firm-specific human and physical capital. The competitiveness and ultimate success of a corporation is the result of teamwork that embodies contributions from a range of different resource providers including investors, employees, creditors, customers and suppliers, and other stakeholders.  Corporations should recognise that the contributions of stakeholders constitute a valuable resource for building competitive and profitable companies. It is, therefore, in the long-term interest of corporations to foster wealth-creating co-operation among stakeholders. The governance framework should recognise the interests of stakeholders and their contribution to the long-term success of the corporation. |
| Disclosure and transparency | In most countries a large amount of information, both mandatory and voluntary, is compiled on publicly traded and large unlisted enterprises, and subsequently disseminated to a broad range of users. Public disclosure is typically required, at a minimum, on an annual basis though some countries require periodic disclosure on a semi-annual or quarterly basis, or even more frequently in the case of material developments affecting the company.  Companies often make voluntary disclosure that goes beyond minimum disclosure requirements in response to market demand. |
| The responsibilities of the board. | Board structures and procedures vary both within and among countries. Some countries have two-tier boards that separate the supervisory function and the management function into different bodies. Such systems typically have a “supervisory board” composed of non-executive board members and a “management board” composed entirely of executives. Other countries have “unitary” boards, which bring together executive and non-executive board members. In some countries there is also an additional statutory body for audit purposes. The Principles are intended to apply to whatever board structure is charged with the functions of governing the enterprise and monitoring management. |

*Taken from OECD (2015), G20/OECD Principles of Corporate Governance, OECD Publishing, Paris.*

The OECD Principles provide specific guidance for policymakers, regulators and market participants in improving the legal, institutional and regulatory framework that underpins corporate governance, with a focus on publicly traded companies.

**1.1.1 Legislative requirements**

There are various sources of ethical standards in South Africa. The law prescribes certain minimum standards of ethical behaviour. The South African constitution and the Bill of Rights lays down the foundation for ethical behaviour in society by promoting the values that underlie an open and democratic society based on human dignity, equality and freedom.

In the financial services industry, the FAIS Act and in particular the General Code of Conduct prescribes minimum standards of ethical behaviour.

On top of laws, there is also culture and policies of a business. Specific policies reflect the value that a business places on ethics and integrity. For example policies on conflicts of interest, sexual harassment, whistle-blowing, codes of conduct among others. These policies should be taken seriously as they will inform the culture of a business.

Professional bodies like the Financial Planning institute; Financial Intermediaries Association; Institute of Risk Management of South Africa; Insurance Institute of South Africa etc., have ethical codes that must be adhered to by their members. Personal codes of ethics also shape people’s ethical behaviour.

**1.1.2 Corporate misconduct and malpractice**

Many corporate collapses have, as their root cause a conflict between the objectives of the company and those of the custodians of the corporation’s costs, assets and undertakings.

This has given rise to falsification of financial statements, excessive payment of remuneration and a crisis of confidence on managers.

There is a concept called corporate crime. Corporate crime is criminal acts that are the result of deliberate decision-making by those who occupy structural positions within the organisation, such as corporate executives and managers that are intended to benefit themselves at the expense of the corporation, shareholders and stakeholders.

**1.1.3 Forms of corporate misconduct**

The following are examples of corporate misconduct which those working in the financial services sector, including financial advisors should avoid.

**i) Fraud and negligence** – Fraud is the intentional deception or attempted deception of an individual with the promise of goods, services or things of value that do not exist or in other ways are misrepresented; for example, false advertising, tax evasion and falsifying accounts.

It is also dishonest activity occasioning actual or potential financial loss to any person or entity whether or not deception is used at the time, immediately before or immediately following the activity.

It includes the deliberate falsification, concealment or destruction of documentation used or intended for use for the normal business purpose or the improper use of information or position.

Negligence is committed when there has been a failure to take proper care resulting in losses.

**ii) Conflicts of interest** – Arises where the same person or entity can act in more than one capacity and relationship in the care of any contract or transaction.

For example, a director can also be a shareholder of the same company and with any transaction involving both the company and him/her, it must be clear as to whether he or she is acting in the capacity of director or shareholder.

A director of a company may also be a director of other companies and in any business dealings between the respective companies he or she needs to declare his/her interest prior to the transaction taking place where he or she is in a position to gain financially.

**iii) Insider trading** – Insider trading involves dealing in shares when one has confidential, price sensitive information about them that other shareholders do not have. The insider trader then deals in shares before the information becomes public and impacts on their price with the aim of making a profit or avoiding a loss.

Insider trading and market manipulation are the two main categories of market abuse and business malpractices that make the largest contribution to corporate fraud. Their impact directly affects business and economic confidence and disrupts smooth functioning of financial markets and confidence levels of investors and the public as a whole.

**1.1.4 Ethics and ethical conduct**

Ethics is the practice of aligning human life, individually or collectively or institutional structures and practices according to basic standards of conduct. For financial advisors, ethics and ethical behaviour refers to the moral values, personal beliefs, and behavioural standards that guide a financial advisor as they provide advice, make recommendations and problem solving in their relationships with clients.

Human conduct, practices and institutions are usually judged to be good or bad, right or wrong in the light of such standards of conduct. Standards of conduct take on the form of values or principles, obligations, rights and consequences and meeting those standards emanates from good character or virtue.

Ethical business conduct means that a company’s stakeholders, directors, management and employees adhere to defined standards of behaviour in all their business **decisions and actions**.

A company’s code of ethics sets out its standards for an ethical organisation as well as individual conduct and consists of two essential components:

* A statement of values e.g. a mission statement or any short document setting out a company’s core values and
* A code of conduct i.e. a longer, compliance-oriented document setting out more specific principles and rules regarding best practices, addressing issues such as conflicts of interests and acceptance of gifts and the like.

Business activities requiring ethical standards

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| Communications to shareholders | Transparent, open, comprehensive, timely and accurate, balanced against confidentiality |
| Accounting | Accuracy and corrections if necessary |
| Reporting | Accuracy in representation of facts |
| Organisational and ethical values | Accuracy in computation of intrinsic value of tangible and intangible assets |
| Remuneration and rewards | Payment commensurate with performance and deliverables |
| Payment to suppliers | Payment commensurate with deliverables and value for money |
| Customer and client relations | Treating customers honestly and fairly |
| Employees | Treated honestly and fairly and payment commensurate with performance and deliverables. |
| Business code of conduct | Commitment by the whole organisation to compliance |
| Whistle blowing | Protection for whistle-blowers, people who reveal misconduct |
| Decision-making | Includes ethical processes. |

Business values to guide financial advisors:

* Morality – to act in a moral way i.e. to do what is good and right involving self-restraint and discipline in terms of accepted social norms.
* Honesty – to talk straight and to walk one’s talk – no lies.
* Integrity - following moral convictions and doing the right thing in all situations whether someone is watching or not.
* Equity – to act in a fair way i.e. there is no unjustified enrichment at the expense of another. No acceptance of bribes.
* Equality - Individuals and businesses should not be faced with unfair discrimination, but rather with equal opportunity to compete and to collaborate with their peers in all forms of social and business activities.
* Excellence – To establish standards, goals and targets and to recognise and reward achievement and results in relation to these standards. To ensure quality.
* Caring – means allowing oneself to connect with others, respecting human dignity and responding with compassion.
* Loyalty – Reliable and trustworthy commitment to persons whom one has dealings with.
* Fairness – treating people properly and not taking advantage of them.

High ethical standards are fundamental to building relationships of trust with clients and to developing and maintaining a good reputation in the industry.

**1.1.5 Ethics and the financial advisor**

Due to the increase in cases involving unethical behaviour and conflict of interest, there is now more focus on ethical behaviour in the business environment than in the past. This focus is particularly important in the financial services industry where the potential for clients to lose their life savings, investment value or risk cover due to bad advice or unethical behaviour is very high. There are many reasons for this:

* The industry is extremely complex and clients are seldom in a position to gather appropriate information ask the right questions and make decisions which are in their own best interest.
* The imbalance in the power relations between the financial advisor, who has knowledge on his or her side and a client, often results in the client being too trusting.
* The client then acts on the advice of a financial advisor, sometimes to their detriment.

The compliance legislation is an attempt to prevent unethical financial advisors from working in the industry and to protect vulnerable clients. The need for high standards of ethical behaviour in an industry which sells intangible products and services is essential and must be taken seriously.

**A good financial advisor**

A good financial advisor will be held to a fiduciary standard that requires him or her to put the client's interests first. He or she will also have well-known and highly respected professional designations such as CFP® and CFA® among other designations.

Below are some of the characteristics of a good financial advisor:

* **A comprehensive understanding of the client’s situation** *-* The advisor should thoroughly discuss the client’s needs and circumstances with the client, then carefully match products and services with their situation. Those who buy financial service products demand the professional conduct they deserve, and financial advisors must help in that regard.
* **A manageable client base –** a good financial advisor does not need to have so many clients that they will not be able to devote sufficient attention to some of their clients.
* **A solid business continuity plan -** If an advisor retires, changes professions, or passes away, they should have a plan for who will take over the management of the clients’ accounts.
* **Lack of pressure -** Your advisor should give you all the time you need to make decisions. You shouldn't feel like you're on a deadline.
* **A clear communication** *-* A good financial advisor should prepare an investment policy statement that explains the plan for the client’s finances in language that is easy to understand for the client. All communications from an advisor, including the explanation of fees, should also be easy to understand.
* **A clean disciplinary history** – the FAIS Act requires financial advisors, who are representatives of financial service provider to meet personal qualities of honesty, integrity and good standing. Clients should check on the Financial Sector Conduct Authority (FSCA) website if a financial advisor has good standing. The financial advisor should have not been found guilty or convicted in any criminal or liable in any civil proceedings, nor breached fiduciary duties among other things. The FSCA Board Notice 194 of 2017 requires financial advisors (representatives) to disclose to the FSCA any information which may be relevant in determining whether that person complies or continues to comply with the requirements relating to honesty, integrity and good standing.

**A bad financial advisor**

A bad financial advisor is one who does not act in the interests of the client and also whose behaviour is unethical.

Below are some of the characteristics of a bad financial advisor:

* **Changes in performance reporting –** Advisors that change the way performance is reported to the client may be covering up poor performance or worse. Clients must pay attention to more than the rate of return on a given report.

Because there is no standard for performance reporting, there is a lot of room for manipulation, and many advisors switch between different formats of performance reporting so they can choose the format that makes them look best.

* **Product pushing –** Advisors that sell a product rather than their fiduciary advice are at great risk for unethical behaviour. Financial advisors should not push any product to the client, regardless of what it is. Their advice must always be based on the needs and financial circumstances of the client.
* **Fortune telling** – There are someadvisors that claim to know the future – where interest rates will go, how the market will fare in the next half year, if gold is a good buy at current levels, etc. These are bad financial advisors. An advisor should be ethical enough to admit that markets are unpredictable.
* **Flashy behaviour** – There are some advisors who usually want to show off in front of their clients. For instances some advisors that show flashy cars, have flamboyant offices, use industry jargon and smell like money are promoting more than advising.
* **Incomprehensible jargon -** If an advisor communicates in a way that is too complex for a client to understand, it is a sign that they are a bad advisor. Clients should feel comfortable with their advisor. An advisor's inability to explain their investment philosophy, their investment process or any fee arrangements, in a manner that can be easily understood are bad.
* **They put their interests before the client’s** - This is perhaps most common in dealing with financial advisors who are compensated wholly or in part via commissions from the sale of financial products. Some advisors would recommend say, mutual funds, annuities, or insurance products that pay them a higher income while it may possibly not be the best product for the client. Clients ought to understand how their advisor is compensated, and be clear on whether this results in conflicts of interest or not.

**1.1.6 Dealing with ethical dilemmas**

From time to time, financial advisors are faced with ethical dilemmas. 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.

Financial advisors should apply certain ethical tests when faced with ethical dilemmas. Norman M. Scarborough, Effective Small Business Management (11th Edition), 2014 suggests the following tests that will help advisors to make the right decisions:

* The utilitarian principle – this principle states that the solution which offers the greatest good for the greatest number of people should be chosen.
* Kant’s categorical imperative – Always act in such a way that any action taken is in accordance with a universal law or rule of behaviour that applies to the particular circumstances.
* The professional ethic – the only actions that should be carried out are those which an objective panel of professional colleagues would view as proper.
* The platinum rule – you should always treat other people in the way they would like to be treated.
* The television test – would you feel comfortable explaining your actions to a national television audience?
* The family test – Would you be comfortable explaining to your children, your spouse and your parents as to why you made an ethical decision?

Building a relationship of trust with a client must be a priority for financial advisors. Once trust has been broken after behaving unethically, it is unlikely to be re-established. This applies even where the unethical behaviour does not affect a client directly.

**1.1.7 Triple bottom line (TBL) reporting and sustainability of businesses**

Triple bottom-line reporting is now one of the cornerstones of ethical reporting by companies. The idea is to ensure that companies do not only focus on profits but on sustainability and how their activities impact sustainability in the spheres of safety, health, the environment and social aspects of life.



**The triple bottom line (TBL)** is a framework or theory that recommends that companies commit to focus on social and environmental concerns just as they do on profits**. Triple Bottom Line** reporting is accounting for environmental, social and economic performance.

Focus on both internal and external aspects of the organisation.

The TBL posits that instead of one bottom line, there should be three: profit, people, and the planet. A TBL seeks to gauge a corporation's level of commitment to corporate social responsibility and its impact on the environment over time.

The concept was framed by John Elkington in 1994 – a British management consultant and sustainability guru. He coined the phrase "triple bottom line" as his way of measuring performance in corporate America. The idea was that we can manage a company in a way that not only earns financial profits, but which also improves people’s lives and the planet.

**Understanding the Triple Bottom Line**

**The Full Cost of Doing Business**

In finance, a company's bottom line refers to its profits. Elkington's TBL framework advances the goal of sustainability in business practices, in which companies look beyond profits to include social and environmental issues to measure thefull cost of doing business.

Moreover, the TBL tenet holds that if a company focuses on finances only and does *not*examine how it interacts socially, that company cannot see the whole picture, and thus cannot account for the full cost of doing business.

**People + Planet = Social + Environmental Responsibility**

According to TBL theory, companies should be working simultaneously on these three bottom lines:

* **Profit**: The traditional measure of corporate profit—the profit and loss (P&L) account.
* **People**: Measures how socially responsible an organization has been throughout its operations.
* **The Planet**: Measures how environmentally responsible a firm has been.

By focusing on these three interrelated elements, triple-bottom-line reporting can be an important tool to support a firm's sustainability goals.

**Challenges of applying the triple bottom line**

**Measuring the TBL**

A key challenge of the TBL, according to Elkington, is the difficulty of measuring the social and environmental bottom lines. Profitability is inherently quantitative, so it is easy to measure. What constitutes social and environmental responsibility, however, is somewhat subjective. How do you put a dollar value on an oil spill—or on preventing one, for example?

**Mixing Diverse Elements**

It can be difficult to switch gears between priorities that are seemingly diverse, maximizing financial returns while also doing the greatest good for society. Some companies might struggle to balance deploying money and other resources, such as human capital, to all three bottom lines without favouring one at the expense of another.

*Key points*

* *The triple bottom line aims to measure the financial, social, and environmental performance of a company over time.*
* *The TBL consists of three elements: profit, people, and the planet.*
* *TBL theory holds that if a firm looks at profits only, ignoring people and the planet, it cannot account for the full cost of doing business.*

**Repercussions of Ignoring the TBL Framework**

There can be dire repercussions of ignoring the TBL in the name of profits; three well-known cases are the destruction of the rainforest, exploitation of labour, and damage to the ozone layer.

Triple bottom line reporting looks at sustainability development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

Sustainability is practiced by managing environmental, social and economic impacts.

**Environmental**

* Energy
* Emissions
* WaterMaterials
* Waste and Recycle
* Biodiversity

**Economic**

* Governance
* Financial Performance
* Product Responsibility
* Fair Operating Procedures
* Communication

**Social**

* Community Development
* Labour Practices
* Human Relations.

When organisations are reporting, they thus need to report in an ethical manner by not only focusing on the financial side of things but also focusing on the positive impact of their business operations on both the environment and the community.

Financial institutions play a crucial role in the market economy. FSPs act as intermediaries between savers and borrowers, decreasing information asymmetry and enabling investment and covering client assets from risks. They play a crucial part in society by offering financial services to people and enabling corporate investment.

Since triple bottom line reporting focuses on sustainable development, FSPs need to balance economic growth and environmental, ecological and social improvements. Sustainable development at the company level must rely on a combination of strategy making and daily activities to meet stakeholders’ expectations, while protecting, sustaining and enhancing social and natural resources.

FSPs have big impact on sustainable development due to their intermediary role between savers and borrowers and also their role in financing economic projects, corporate innovation and investment. FSPs are similar to other companies in pursuing innovation, as their survival depends on it. When companies integrate sustainability considerations (environmental, social and financial goals) into their idea generation, research and development (R&D) and commercialization activities, they are creating sustainable innovation. FSPs can achieve a competitive advantage if they have a better understanding of their strategy and underlying structure, market and customer demand, factor conditions, and related and supporting industries than their competitors.

## 1.2 Professional Codes of Conduct

A code of conduct defines how a company's employees should act on a day-to-day basis. It reflects the organization's daily operations, core values and overall company culture. As a result, every code of conduct is unique to the organization it represents. It equally provides for the minimum standards of ethical behaviour required in a particular work environment or situation.

The following code of conducts apply to financial advisors:

**a) Legislated codes**

The FAIS Act provide for a general code of conduct as well as for specific codes of conduct for different categories of FSPs. The FAIS general code of conduct covers acceptable behaviour by FSPs and their representatives and will be covered in great detail in learning unit 2.

**b) Business code of conduct**

In addition to the code of conduct prescribed by law, most businesses have their own codes in place. It is important that the owners, management and employees set an example and are seen to be behaving in a manner as prescribed by their internal code.

**c) Professional bodies and industry associations**

Most professional bodies and industry associations have a code of conduct or code of ethics in place. All members of the professional body or association are expected to abide by the code.

**Example of professional code**

**i) Financial Planning Institute (FPI’s) Code of Ethics and Practice Standards**

This code prescribes the ethical principles and rules of conduct. These are minimum standards of ethical and honest behaviour that members are expected to uphold. Acting in accordance with the code demonstrates a commitment to professionalism, integrity and the need to act in the best interests of clients.

The Principles of the FPI code are:

* Principle 1 – Client first
* Principle 2 - Integrity
* Principle 3 - Objectivity
* Principle 4 - Fairness
* Principle 5 - Competence
* Principle 6 – Confidentiality
* Principle 7 – Diligence
* Principle 8 – Professionalism.

If a member does not comply with the principles and rules of conduct as prescribed by the Code, the FPI may invoke disciplinary procedures against the member. If the circumstances are serious enough, membership will be terminated.

**ii) The ASISA**

The Association for Savings and Investment South Africa (ASISA) is a self-regulating body that regulates the nation’s savings and investments industry. The majority of their members are South Africa’s asset managers, collective investment scheme management companies, linked investment service providers, multi-managers and life insurance companies. Membership is also open to service providers such as fund administrators, accounting and legal firms.

ASISA has codes, standards & guidelines which members are expected to abide by. The Codes and the Standards complement the Financial Services Conduct Authority’s (FSCA) Treating Customers Fairly (TCF) framework, and adherence by members assists them to demonstrate that they are embedding a TCF culture within their organisations.

By adhering to these, members will undertake to develop processes and products that provide clients with a quality assurance that goes beyond the legislative and regulatory framework. Compliance with these will be voluntary but are strongly encouraged; they will provide a guide to what is considered to be industry best practice in certain areas.

**iii) The Council for Medical Schemes (CMS) Code of Conduct**

The council for Medical Schemes is a statutory body established in terms of the Medical Schemes Act 131 of 1998 to provide regulatory oversight to the medical schemes industry and to develop recommendations for ongoing regulatory and policy development.

The CMS has a Code of Conduct in respect of Prescribed Minimum Benefits (PMBs). PMBs is a set of defined benefits to ensure that all medical scheme members have access to certain minimum health services, regardless of the benefit option they have selected.

The purpose of the code of conduct is to ensure that PMBs are offered to members of medical schemes in compliance with current legislation. The code covers the following:

* Part I: The accessibility of information on access to PMB benefits
* Part II: Proposed solutions to problems relating to the “payment in full” provisions.
* Part III: Establishing clarity and certainty of the benefits prescribed in Annexure A (including the explanatory notes) to the regulations.
* Part IV: The accessibility of alternative interventions
* Part V: Conduct required to accurately identify PMB conditions
* Part VI: Administrative processes.

**1.2.1 Code of Conduct: Internationally accepted practices and principles**

Internationally accepted practices and principles of business conduct and corporate governance are informed by various codes; both local and international. In South Africa the ethical and governance principles are informed by the King IV Code whereas in the UK there is the UK corporate governance code and in the United States of America there is the Sarbanes Oxley Act.

**a) King IV Code on corporate governance**

The King Report on Corporate Governance is a document with guidelines for the governance structures and operation of companies in South Africa. It is issued by the King Committee on Corporate Governance. The Institute of Directors in Southern Africa (IoDSA) owns the copyright of the King Report on Corporate Governance and the King Code of Corporate Governance. Compliance with the King Reports is a requirement for companies listed on the Johannesburg Stock Exchange (JSE).

The focus of King IV code is on transparency. Good corporate governance requires an acknowledgement that an organisation doesn’t operate in a vacuum, but is an integral part of society and therefore has accountability towards current and future stakeholders.

The code was drafted to apply to all organisations, regardless of their form of incorporation. Sector supplements explain how the King IV Code should be applied by certain organisations/sectors.

It also focuses on outcomes. The King IV Code’s principles and practices are linked to desired outcomes, therefore articulating the benefits of good corporate governance. The code also differentiates between principles and practices. Principles are achieved by mindful consideration and application of the recommended practices.

**b) UK Corporate Governance Code**

The UK Corporate Governance Code sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. All companies with a Premium Listing of equity shares in the UK1 are required under the Listing Rules to report on how they have applied the Code in their annual report and accounts. As noted above, the Code operates on a ‘comply or explain’ basis. In other words, listed companies are required to report on how they have applied the main principles of the Code, and either to confirm that they have complied with the Code’s provisions or - where they have not - to provide an explanation.

“Comply or explain” is based on two premises:

* When it comes to effective governance, there is no ‘one size fits all’. While it may be possible to identify processes and structures that will be best practice for the majority of companies, there will always be cases where it is in the best interest of a company and its shareholders to adopt different practices.
* If the purpose of corporate governance is to ensure the company is run in the long-term interest of the shareholders, it should be those shareholders, rather than regulators, who decide whether that is actually the case. For this reason, when companies choose not to follow the Code, the explanation is given to the shareholders.

**c) Sarbanes Oxley Act**

The Sarbanes-Oxley Act was signed into US law on 30 July 2002 in response to a series of corporate scandals. It was probably the most radical and dramatic change to US federal securities laws since the 1930s’ legislation, enacted in efforts to rebuild investor confidence and improve corporate governance, and the safety, integrity and efficiency of the capital markets.

Some of the key requirements from this Act includes the following:

* CEO and the CFO must personally sign quarterly and annual financial reports, certifying that:
  + They have reviewed the report
  + based on their knowledge, the report does not contain any untrue statement or omission of a material fact that might make the financial statements misleading
  + based on their knowledge, the financial statements fairly present in all respects the financial conditions and results of the company
* The company’s management is required in the annual report to provide an internal control report assessing the effectiveness of the company’s internal control over financial reporting.
* There must be the monitoring of operational risk and disclosure of material changes in financial condition or operations on ‘a rapid and current basis’.
* It is a criminal offence to fail to retain and protect audit and related documents, including electronic records.

**d) OECD Principles of Corporate Governance**

The OECD principles have already been touched above. The relevance of these principles is that they represent an international benchmark for corporate governance, forming the basis for a number of reform initiatives, both by governments and the private sector. As already highlighted above, the OECD Principles encompass six main areas:

* ensuring an effective corporate governance framework
* the equitable treatment of shareholders
* institutional investors, stock markets, and other intermediaries
* the role of stakeholders in corporate governance
* disclosure and transparency
* the responsibilities of the board.

The OECD Principles provide specific guidance for policymakers, regulators and market participants in improving the legal, institutional and regulatory framework that underpins corporate governance, with a focus on publicly traded companies.

**1.2.2 Impact of African value systems on codes of ethics in South Africa**

The importance of African value systems on the codes of ethics in South Africa and many African countries cannot be over-emphasised. When we talk of African value systems, we talk of Ubuntu, a Zulu term which means humanity. It is often translated as "I am because we are," or "humanity towards others," but is often used in a more philosophical sense to mean "the belief in a universal bond of sharing that connects all humanity.”

Ubuntu captures some of the values below:

* Respect,
* Dignity,
* Caring and
* Sharing.

According to Michael Onyebuchi Eze, an African author, the core of Ubuntu can best be summarised as follows:

*“A person is a person through other people' strikes of an affirmation of one’s humanity through recognition of ‘another’ in his or her uniqueness and difference. It is a demand for a creative intersubjective formation in which the ‘other’ becomes a mirror (but only a mirror) for my subjectivity. This idealism suggests to us that humanity is not embedded in my person solely as an individual; my humanity is co-substantively bestowed upon the other and me. Humanity is a quality we owe to each other. We create each other and need to sustain this otherness creation. And if we belong to each other, we participate in our creations: we are because you are, and since you are, definitely I am. The ‘I am’ is not a rigid subject, but a dynamic self-constitution dependent on this otherness creation of relation and distance.*

The Ubuntu philosophy represents an African conception of human beings and their relationship with the community that embodies the ethics defining Africans and their social behaviours. Africans are social beings that are in constant communion with one another in an environment where a human being is regarded as a human being only through his or her relationships to other human beings. Therefore, the survival of a human being is dependent on other people - the community and society.

**How Ubuntu shape ethics in organisations**

An article written by Tutu, Rossouw, Mbigi et al, in 2005 identified some key characteristics of the Ubuntu value system and how they influence business ethics. They are discussed below:

**i) The community is more important than an individual under the Ubuntu philosophy**

There are several basic management principles derived from African tribal communities that embody this philosophy, including trust, interdependence and spiritualism. In the African management system context, the African Ubuntu philosophy represents humanness, a pervasive spirit of caring within the community in which the individuals in the community love one another. This Ubuntu approach plays a pivotal role in determining the success of any African organisation. Ubuntu transcends the narrow confines of the nuclear family to include the extended kinship network that is omnipresent in many African communities.

**ii) Positive behaviour is related to the Ubuntu philosophy**

Behaviour in line with Ubuntu is identified as an individual’s state of being, where the person’s behaviour is governed by an ability to reason and think within the community context. Rational behaviour thus focuses on positive human values, such as love, sympathy, kindness and sharing. Respect refers to an objective and unbiased consideration of and regard for somebody’s rights, values, beliefs and property.

Under African governance provisions, respect, dignity, caring and sharing are considered critical values that build African communities. The fundamentals of sharing are prevalent in African communities. The Ubuntu philosophy implies that one can only increase one’s good fortune by sharing with other members of the society and thereby also enhancing their status within the local communities.

The issues of corporate consciousness, where equitable allocation and sharing of wealth is very African, have been recognised as a strategic theme.

The positive attributes of Ubuntu also demonstrate what an organisation can gain in terms of understanding the seriousness of embracing a corporate conscience that is in line with African society.

**iii) Synergies and competitive advantages arise under the Ubuntu philosophy**

African organisations can build cooperation and competitive strategies by allowing teamwork based on Ubuntu principles to permeate the organisation. As a people-centred philosophy, Ubuntu stipulates that a person’s worth depends on social, cultural and spiritual criteria. It requires a life that depends on a normative engagement with the community, a substantive appreciation of the common good and a constitutive engagement with one another in a rational and ethical community.

Communalism and collectivism are essential to the spirit of the African Ubuntu philosophy. Equally important in Ubuntu relationships is the aspect of working with others as a team. A spirit of solidarity simultaneously supports cooperation and competitiveness amongst the team by allowing individuals to contribute their best efforts for the betterment of the entire group. In a team setting, the existence of Ubuntu as a shared value system implies that team members are encouraged to strive towards the outlined team values, which consequently enhance their functioning together as a team.

**iv) African culture and leadership styles can be founded on the Ubuntu philosophy framework**

Every geographic environment has its own distinguishing features, including culture. African culture is very different from Western cultures in some ways – this implies that in an African framework, social and cultural linkages are considered to be a key determining factor for the success of any organisation that operates on the continent. The implication of such concerns is that people must come first, before products, profits and productivity. Once people have been given priority and are treated well in their daily endeavours, productivity, products and profits should automatically be realised.

If corporations in Africa adopt the Ubuntu management and leadership styles, which are people-centred, they will be successful.

**v) African Ubuntu collectivism cultivates a team spirit towards work**

Traditionally, African societies tend to be cohesive and productive, working together as one family in their social grouping.

The group tradition or collectivism is so strong that generally Africans view success and failure as caused by traditional spirits that are controlled by the society. For example, before accepting any good offers, such as a promotion, an employee may seek traditional spells before deciding, or can even turn down the promotion altogether for fear of its social consequences. Any achievement or failure is taken as a group obligation – it belongs to the entire community.

Suggests that a wholesale introduction of individualist performance management systems may be socially and economically divisive and costly for any organisation based on Africa. This scenario could also be true with the generic Balanced Scorecard model applications within an African context. The social-cultural framework of an African society is pervasive, even within the management and among employees who have direct attachments with their society.

**vi) Ubuntu philosophy involves recognising an employee’s sociocultural values within an African context**

The successful implementation of any plans and goals by the organisation can be realised only if the human resources component is rejuvenated to perform better. It is important that the spirit and morale of employees be renewed, apart from those of the business processes in order to realise the set goals and strategies. The development of cooperative and competitive employees can be achieved through training and educating them on indigenous knowledge. Such training programmes can encompass critical areas such as patriotism and citizenship, which focus on the constant acquisition of different local skills and the best working techniques, based on Ubuntu and teamwork.

Apart from an emphasis on employee training and learning on the job, it is important for a company that employees uphold a number of values for them to be effective and productive. In the African context, employees’ values emanate from African socio-cultural underpinnings. For example, employees have to be treated as human beings and not necessarily as programmed machines. Employees have extended family systems that should be respected, and these systems may have an impact, for example, in terms of medical needs and funeral services.

It is important to note the above African ideologies and the social obligations that employees are expected to meet. Such perceived social obligations can have a direct impact on corporate performance. The non-fulfilment of perceived obligations (non-monetary) by organisations might cause employees to refrain from deploying their energies effectively in organisational processes.

In an African organisation, efficiency and competitiveness can be achieved by an emphasis on social well-being rather than on purely technical rationality. The Ubuntu philosophy propounds that employees’ cultural values, which include extended family systems, medical and funeral arrangements, must be respected. However, the African employee welfare phenomenon is not fully represented in the generic Balanced Scorecard model, which advocates employee empowerment in the form of knowledge acquisition as a kind of human resources capital. The Ubuntu philosophy recognises the significance of treating employees as human beings and not necessarily as “programmed” human resources capital.

**vii) Respect is shown to one’s elders under the Ubuntu philosophy**

Apart from the usual organisational culture and individual personalities, the content and style of leadership is dictated by culture. In Africa, authority flows from the old to the youth, and respect for the elderly is a guiding principle. In corporate relationships, age is an essential element in Africa. Thus, an older person is automatically expected to hold a certain level of superiority, regardless of his or her rank, title or education.

What this means is that it is very rare for a young man (and arguably even more difficult for a young woman) to be comfortable about assuming high office and leading a group consisting of older people who are regarded as senior to that young person. Equally, it would be awkward for older employees to take instructions from the young. This issue becomes especially complicated in a highly structured system such as the military, where compliance is a prerequisite and the leader is required to be more directive. However, respect for one’s elders still remains a decisive feature of African society. Apart from respect for one’s elders in particular, the Ubuntu philosophy also demands respect for the community in general, where individuals are expected to be socially responsible to their local communities and society at large.

**viii) Respect for the community and corporate social responsibility are part of the African Ubuntu philosophy**

The African Ubuntu philosophy is displayed through compassion, where individuals express a sense of deep caring for and understanding of each other. The Ubuntu approach allows team members to strive towards becoming caring, understanding and sharing. The compassionate approach enables team members to achieve a common goal. Through a common understanding, community members are able to help and care for each other as members of one family, as required in the humanist African Ubuntu approach towards the community and its members.

In line with the people-centric Ubuntu philosophy, individualism is not viable, for it is inadequate as a model to understand the basic human elements of a society. By nature, humans are social beings and their wants and capacities are largely a result of society and its institutions. The most effective human behaviour is that experienced in the web of relationships people have with the groups, organisations, family and other bigger groupings that they belong to, such as the church, the state and other national and international organisations.

Meeting social responsibilities which are human-centred in nature is enshrined in the Ubuntu philosophy and has a positive impact on the long-term sustainability of communities and organisations.

Generally, the caring and sharing concept that forms the core of the Ubuntu philosophy has now been recognised globally. Modern corporations now realise that they are part of the local communities within which their operations are conducted. The literature indicates that the inclusion of the Ubuntu philosophy into organisational systems would enable companies to be more responsive to the call for corporate social responsibility and good corporate governance.

**ix) Good corporate governance is made possible under the African Ubuntu philosophy**

Issues of corporate governance are becoming more pronounced in modern business practices. Corporate governance, which is intertwined with business ethics, is considered critical in organisational practice, as well as in general corporate productivity. The founding principles of business ethics and corporate governance are in line with the Ubuntu philosophy of regarding all members of an organisation as part of the community. It is this direct involvement of and with community members that brings about greater solidarity, love, caring and sharing within a grouping (organisation). A major governance challenge in current governance issues has been corruption, which reveals the moral depravity and badness of the perpetrators). Generally, corruption is caused by a lack of commitment to moral beliefs by the perpetrators, which is in turn due to the weak moral will of an individual towards other people.

When the awareness of moral rights and wrongs is strong, corruption can easily be rooted out. This is the principle behind the community-based Ubuntu philosophy. To curb corruption, for instance, the Ubuntu philosophy must be the essence of a value system that underpins a commitment to eliminate corrupt. There is also a need for strong robust democracies, where all sectors of society, including the media and organisations of civil society, the private sector, trade unions, traditional leaders and faith-based organisations have a responsibility to educate and promote the values of Ubuntu philosophy and anti-corruption.

The above observations indicate that there is much that the Ubuntu philosophy can contribute towards business ethics and good corporate governance issues.

**1.2.3 Benefits of complying with codes of conduct and ethics**

It is one thing to have both internal and external codes of conduct and it is another to have them fully implemented and complied with. The financial services industry is one area where codes must be complied with. The compliance thereof will benefit not only the customers but the companies themselves.

Compliance refers to a company meeting its legal obligations, often to protect the wellbeing of itself and that of its stakeholders such as customers, employees, the public etc.

Below are some of the positive impacts of complying with codes of conduct and ethics:

* Attracts investment
* Reduced legal problems
* Improved operations and safety
* Better public relations
* Higher employee retention.

These are discussed in greater detail below:

**a) Attracts investors**

Every organisation will need funding to ensure that business operations continue unhindered. Whilst funding may come from personal savings of the owners and loans from banks, some will come from investors who invest their money in the business. Investors do not only look at the business prospects of a company but they equally look at the general conduct of the company – how well does the company comply with both laws and codes of conduct. A compliant company will give confidence to the investors as they will invest their money with the comfort that their investment is safe.

**b) Reduced legal problems**

The most obvious consequence of compliance is that it decreases the risk of fines, penalties, work stoppages, lawsuits or a shutdown of a business. When a company does not meet some compliance requirements, such as failure to comply with the FAIS General Code of Conduct, they may get a warning from the regulators. In other situations, they might face costly sanctions. Failing to meet legal obligations, such as treat your customer fairly, can equally result in lawsuits which can be costly.

**c) Improved operations and safety**

Many business codes and regulations are actually good for organisations. For example, codes regarding discrimination and harassment help to create a better working environment for employees, which can lead to more worker productivity. Following safety and security rules helps prevent injuries, fires or building evacuations that hurt profitability.

**d) Better public relations**

When a company meets its legal obligations, one of the benefits of compliance is the ability to tout these on their website and in marketing materials. For example, when placing job advertisements, a company can include the fact that they are an equal opportunity employer. Companies should consider posting their mission statement on their website, state that they do not discriminate based on race, sex, creed or sexual orientation. When they recruit new workers, they must highlight their company's commitment to both physical safety and mental health by referencing key policies and benefits dedicated to proactive healthcare and wellbeing.

**e) Higher employee retention**

Many business compliance issues deal with protecting employees. The more employees feel they work in a fair, professional and safe environment, the more likely they will be to stay with the organisation. Even if they do not harass or discriminate against any employees, if they do not take steps to ensure none of their employees do, they can lose valuable workers. They ought to include policies and procedures in their employee handbook that mirror their legal compliance obligations. Remember, a policy is only strong if it is enforced.

## 1.3 Organisational code of conduct and value system

An organisation’s code of conduct focuses on the corporate level and represents the code of conduct for the company as a whole. It includes a code of ethics. A code of Conduct is intended to encourage appropriate standards of conduct and behaviour by the directors, officers and employees of a company. Employees are expected to act with integrity and objectivity, striving at all times to enhance the reputation and performance of the Company.



**1. Code of Ethics** is a document issued by the top-level management, which consist of a set of principles, designed to guide the members of the organisation to carry out business honestly and with integrity. It describes the core values of the organisation that guides the decision-making.

**2. Code of Conduct** is a document that expresses the practices and behaviour of a person, required or restricted as a condition for becoming a member of the organisation or profession. The code sets out the actual rules, so it lays down the do’s and don’ts of an employee. The members are responsible for its adherence and held accountable for its violation.

**1.3.1. Why do organisations have codes of conduct?**

Regardless of whether an organisation is legally mandated to have a code of conduct (as public companies are), every organisation should have one. A code has value as both an internal guideline and an external statement of corporate values and commitments.

A well-written code of conduct clarifies an organisation’s mission, values and principles, linking them with standards of professional conduct. The code articulates the values the organisation wishes to foster in leaders and employees and, in doing so, defines desired behaviour. As a result, written codes of conduct or ethics can become benchmarks against which individual and organisational performance can be measured.

Additionally, a code is a central guide and reference for employees to support day-to-day decision making. A code encourages discussions of ethics and compliance, empowering employees to handle ethical dilemmas they encounter in everyday work. It can also serve as a valuable reference, helping employees locate relevant documents, services and other resources related to ethics within the organisation.

Externally, a code serves several important purposes:

* **Compliance:** Legislation requires individuals serving on boards and organisational leaders of public companies to implement codes or clearly explain why they have not.
* **Marketing:** A code serves as a public statement of what the company stands for and its commitment to high standards and right conduct.
* **Risk Mitigation:** Organisations with codes of ethics can reduce the financial risks associated with government fines for ethical misconduct by demonstrating they have made a good faith effort to prevent illegal acts.

**1.3.2 Code of conduct: Gap analysis**

Having a code of conduct alone is not sufficient. The code of conduct must be enforced. It must also be analysed against principles and practices currently being held in the organisation to identify any gaps. A code of conduct must cover all the areas where poor behaviour or decision-making could put a business at risk. A good code should combine aspirational corporate values with clear statements and rules of behaviour.

**Conducting gap analysis**

A gap analysis is an examination of your current performance for the purpose of identifying the differences between your current state of business and where you’d like to be. It can be boiled down into a few questions:

* Where are we now?
* Where do we wish we were?
* How are we going to close the gap?

The purpose of gap analysis on a code of conduct is to identify any strengths and weaknesses of the code. Conducting a gap analysis can help you improve a code of conduct and how it is implemented in the organisation. Once a gap analysis is completed, the company will be able to better focus on those identified areas in order to improve them.

The following are steps that can be followed in conducting a gap analysis to check the strength and weakness of a code of conduct:

**i) Identify the current state of your code**

Go through your code of conduct. Review the code of conduct again the behavioural needs of the organisation. This can be done by making use of a checklist.

**ii) Identify where you want to be with your code of conduct**

List the types of behaviours and values that are needed in your organisation. It must be the behaviours and values that will ensure the highest level of ethical conduct in the organisation. These can be identified through brainstorming with the rest of employees and also reviewing latest trends within your industry.

In doing this, think about how you are doing today in your current state (from step one) and where you really want to be within a reasonable timeframe. If you are doing a gap analysis within the context of your strategic plan, take a look at the targets on your plan.

**iii) Identify the gaps in the code**

Now that you’ve recognised where your code is currently and where you want it to be in the future, it’s time to bridge the gap. Having identified the different behaviours and values that are important to your organisation, check if these have been covered in the code of conduct. Note any behaviours and values that are not covered in the code. When identifying gaps, you need to ensure that your goal and your current state exist in the same time period.

**iv) Devise improvements to close the gaps in the code of conduct**

Now that you’ve discovered the gaps and why they exist, it’s time to figure out the proper course of action to close them. Work on a draft to revise the code of conduct and get input from the rest of the employees.

Once the gap analysis process is done, measures must be put in place to monitor the implementation of the new findings in the code. There must also be regular revision of the code to ensure that it is always effective.

The findings of the gap analysis must then be used as a basis from which to develop a plan to initiate or improve commitment to the code of conduct in the workplace. Where possible all the employees must be included in the gap analysis to enhance the buy in and the implementation will become easy.

**1.3.3 The relationship between reputation and ethics**

The connection between reputation and ethics is complex. A pattern of ethical behaviour is clearly essential to establishing a good reputation, which for a company means a reputation as the kind of company people want to do business with.

Businesses need to be perceived to be ethical and from this, a good reputation will come. Having said that, it is not enough for a business to give people the impression that they are ethical because that can be done through good public relations or even outright misrepresentation. Rather businesses ought to do that which is right and in the process convince key stakeholders that they are actually doing the right thing.

Companies such as those listed on the stock exchange are obligated to reveal certain information to the investing public (typically through filings with the relevant regulatory bodies). Companies need to understand that information disclosure is not just a legal game. Failure to disclose important information on a timely basis can harm a company’s reputation. A company’s reputation is formed by a key number of outsiders’ perceptions of its actions, and in that regard companies can incorporate corporate social responsibility, which is part of ethical conduct, to enhance their reputation.



*A good brand is an ethical one. An ethical brand enhances the firm's reputation; such a reputation reinforces the brand in turn.*

|  |
| --- |
| **Importance of ethics and codes**  Read the short excerpt below and answer questions that follow:  Sifiso Zulu, a financial service representative (FSR) was employed by one the major FSPs in South Africa. A client of the FSP lodged a complaint against Sifiso in which she alleged that he signed up a retirement policy for her with the FSP without her consent.  Upon investigation the FSP discovered that Sifiso had re-used a signed declaration form for a life cover policy which the client consented to, reproduced it and completed the additional policy number for the disputed retirement policy. He also forged the complainant’s signature on the quotation for the retirement annuity policy, knowing that the quotation was created a day after a declaration form was signed.  a) What are some of the ethical principles expected of a financial advisor did Sifiso breach? Please explain.  b) What do the actions of Sifiso as demonstrated on the story depict or portray about his value system?  c) What are the likely consequences to Sifiso’s actions?  d) In light of the above, why is it always important to behave in an ethical way for financial advisors? |

## 1.4 Developing and implementing a code of ethics

Ethical business conduct means that a company’s stakeholders, particularly directors, management and employee adhere to defined standards of behaviour in all their business decisions and actions.

The following are some of the reasons for having a code of ethics:

* To define accepted/acceptable behaviour
* To promote high standards of performance
* To provide a benchmark for directors and staff to use for self-evaluation
* To establish a framework for behaviour and responsibilities
* It is also a vehicle for occupational identity and occupational maturity.

The benefits of being an ethical organisation are reflected in good reputation, as discussed above. This facilitates the raising of finance and makes it easier to recruit and retain better staff.

**1.4.1 Steps in developing a code of ethics**

The following steps are a guideline in the development of a code of ethics in the organisation:

*Step1:* Select the top five to ten ethical values that reflect the priorities of the organisation, e.g. honesty, integrity, transparency, equality etc.

*Step 2:* Establish the organisation’s rules to manage ethics e.g. start with a list of dos and don’ts. Define the organisation’s operating values and behaviours e.g. excellence, enterprise, authority, accountability, equity etc.

*Step 3:* Establish an ethics committee to manage and monitor the process.

*Step 4:* Undertake training to clarify ethical and operational values and enhance ethical awareness by employees.

*Step 5:* Establish an ongoing communication channel for the code, for use by employees.

*Step 6:* Enforce the code consistently and uniformly.

*Step 7:* Measure and audit the effectiveness of the ethics programme.

*Step 8:* Review and refine the code, where necessary, to enhance its effectiveness and improve its moral standards.

*Step 9:* The code should be launched and initiated publicly by the board of directors and senior management.

**1.4.2 Content of a code of ethics**

Below is the typical content of a code of ethics. This is a guideline only, each organisation will have its own tailored code of ethics.

* Purpose and values of the business
* How the business values employees
* Importance of customer relations
* Compliance, Integrity and Anticorruption
* Employment Practices
* Ethics and Compliance
* Internet, social networking and social media
* Conflicts of Interest
* Commitment to transparent communications to shareholders
* Prompt settlement of payment to suppliers
* Relationships with third parties
* Compliance with the spirit and letter of the law
* Implementation.

**1.4.3 Steps for implementing a code of business ethics**

The following are some recommended steps in implementing a code of ethics in the organisation.

1. Integrate the code in the running of the business
2. The code must be endorsed by the chairperson of the committee and the CEO
3. Circulate the code to all
4. Define what will be if there are breaches
5. Encourage staff to respond to the code
6. Network on code contents
7. Have a procedures for regular reviewing and upgrading
8. Include the code in employment contracts
9. Redesign company training programmes to include the code
10. Make copies of the code available to business partners, i.e. customers and suppliers
11. Communicate the code as part of the annual report to shareholders.

**1.4.4 Corporate ethics scorecard**

A scorecard is a statistical record used to measure achievement or progress towards a particular goal. In this case, an ethics scorecard is a record which is used to measure the organisation’s progress in the area of ethics.

Below is an example of an ethics scorecard.

|  |  |  |  |
| --- | --- | --- | --- |
|  | Yes | No | Action |
| 1. Existence of a code of conduct 2. Employees aware of the code of conduct 3. Copy given to all staff members 4. Employees familiar with the contents of the code of ethics 5. Enforcement of the code within the organisation 6. Existence of the ethics function and designated responsible person 7. Ethics committee 8. Frequency of communication about ethical issues 9. Existence of ethics education and training 10. Channels existing for those seeking ethical advice 11. Existence of confidential external stakeholder misconduct reporting mechanisms (whistleblowing) 12. Development of organisational culture to reduce unethical practices such as fraud, theft and bribery |  |  |  |

## 1.5 Conflict of interest

A conflict occurs whenever the client and the financial advisor have different interests. For example, the client needs increasing assets to achieve their financial goals. The advisors need the client’s asset to produce personal income. These competing interests are a conflict of interest. Conflicts of interest present a source of risk to the attainment of client objectives. Financial service providers should take all reasonable steps to mitigate and control any conflicts of interest that arise in the course of business.



A **conflict of interest** is defined as a conflict between the private interests and the official responsibilities of a person in a position of trust.



Thomas is a financial advisor and has a number of clients, one of which is Cold Cream, a large ice-cream retailing franchise. Thomas has an ownership interest in Cold Cream. Thomas is approached by Ice Cold, a rival ice-cream retailing franchise, to provide financial advisory services.

A conflict of interest may be an actual conflict or a potential conflict and it can arise before a financial advisor accepts an engagement or at any time during the engagement. Interest includes but not limited to:

* A financial interest
* An ownership interests
* Any relationship with a third party.

Financial interest means cash, cash equivalent, voucher, gift, service, advantage, benefit, discount, domestic or foreign travel, hospitality, accommodation, sponsorship, other incentive or valuable consideration.

Financial services providers must be aware of any possible conflicts of interest in relation to the financial advisor. FSPs must have conflict of interest policy in place to help manage conflict of interest of their employees. They must also request their financial advisors to declare any financial interest that’s may stand in the way of their work and avoid impartiality.

In the investment business, investors are exposed to significant conflicts of interest. Clients are looking for advice, whilst financial service providers and their financial advisors are in the business of selling products and generating profits. Those products can be traditional brokerage services or investment advisory services. Advice from financial advisors is typically considered incidental to the sale of products they are promoting or helping their client buy. In other words, broker-dealer firms are there to facilitate a transaction on behalf of the customer, with the focus on the transaction and not the advice.

Some activities of an advisor may create a conflict of interest with the client. How the advisor operates determines what kind of conflict they’ll have, so you need to understand how an advisor runs their business and how they are compensated to understand their conflicts.

Financial advisors operate under two very different sets of legal guidelines – a fiduciary standard and a suitability standard.

Some financial advisors operate under the “fiduciary standard” which mandates that they work in the best interest of their investors. Alternatively, other financial advisors, insurance agents, and stockbrokers are bound by the weaker suitability standard which merely requires that they recommend suitable products.

Below are some examples of conflict of interest that financial advisors may have:

* **An advisor sells products like unit trusts, stocks, insurance policies, or annuities -** These advisors get paid commissions on the products they sell. Such an advisor has an incentive to sell products to clients, even if the products aren’t the best solution for the client, and even the client doesn’t need any products at all. Often, the worse the product is for the client, the higher the commission for the advisor.
* **An advisor invests client money and charge a percentage of the money they manage** - If for example a client has R1m and the advisor charges 1%, they would pay R10, 000 a year. Such an advisor has an incentive to maximise the amount of money they manage for a client, even if it’s better for the client to instead use that money for a degree or training program that would accelerate their career, or buy a home, or take the trip of a lifetime.
* **If an advisor works on a subscription or retainer basis** - these advisors are paid a flat fee every month or year in return for answering questions whenever the client has them, providing ongoing guidance, and working with the client to make agreed-upon changes in their finances. Such an advisor has an incentive to do as little work as possible for a client.
* **An advisor works on an hourly basis** - such an advisor has an incentive to spend as long as possible working on a client’s project.
* **An advisor works on a flat-fee project basis** - such an advisor has an incentive to spend as little time as possible completing the project.

A financial advisor should use their professional judgment to determine the most appropriate method to identify and manage a particular conflict of interest. A number of mechanisms could be used, such as:

* **Avoid** – they may decide to decline to act for the client in situations where they will be unable to manage the conflicts of interest regardless of arrangements put in place.
* **Control**– this involves identifying, assessing, evaluating, deciding and implementing an appropriate response to manage conflicts of interest. For example, depending on the particular circumstances, they may be able to control a conflict of interest by isolating the persons in their practice who will provide the relevant advice from those who are privy to the material information which may influence the advice.
* **Disclose**– a financial advisor should sufficiently disclose conflicts of interest to their clients in a manner which will enable them to make an informed decision and give them a reasonable time to assess how the conflict may affect the services being provided and about its management.



**LEARNING UNIT 1: Formative Assessments**

**Formative activity 1**

Define ethics and identify any 5 considerations that a financial advisor must make when faced with an ethical dilemma. [10]

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**Formative activity 2**

Describe the three elements of triple bottom line reporting and explain how each of them applies to financial service providers such as banks, insurance companies, investment firms, pension funds and asset managers. [12]

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**Formative activity 3**

Explain the purpose of a code of conduct in an organisation and identify any 4 internationally accepted principles that must guide the development of a code of conduct. [10]

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**Formative activity 4**

Describe in a paragraph what you would consider to be the African value system and identify any 5 values that would describe the African value system. [15]

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**Formative activity 5**

Jonathan is a recently appointed financial advisor with one of the financial service providers in Pretoria. He approaches you for advice on how as an advisor he can comply with the organisation’s ethical requirements. Please help him. [6]

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**Formative activity 6**

The code of conduct for one of the biggest insurers says the following:

“All the employees that interface with clients are required to declare their interests to management at the point of employment or as soon as their circumstances change.”

Describe any five types of interests that the employees must disclose. [10]

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**Formative activity 7**

What is conflict of interest? [3]

Why is it important for a financial advisor to recuse himself or herself when faced with a situation where their personal interests and those of the FSP they represent clash? [5]

Give one example of such a situation. [4]

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**Formative activity 8**

Obtain a code of conduct of your organisation or that of any organisation in the financial service industry. Review the code and conduct a gap analysis by completing the table below: [15]

|  |  |  |
| --- | --- | --- |
| **Core values** | **What the code says on each value** | **Gaps between values and code** |
| 1 |  |  |
| 2 |  |  |
| 3 |  |  |
| 4 |  |  |
| 5 |  |  |

**Formative activity 9**

What steps can you take to address the gaps identified in activity 8 above? [5]

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**Formative activity 10**

Give one example, and a description of the circumstances, of an organisation whose reputation was negatively affected by ethical issues. [6]

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# LEARNING UNIT 2: THE FINANCIAL ADVISORY AND INTERMEDIARY SERVICES (FAIS) ACT 37 OF 2002 AND FINANCIAL REGULATION



**Learning Outcomes**

By the end of this learning unit and having completed all the formative activities, you should be able to:

* Explain the factors that brought the need for the Financial Advisory and Intermediary Services (FAIS) Act 37 OF 2002.
* Explain the concepts of financial service provider and financial products using examples
* Explain using examples, the protection of consumers afforded by FAIS.
* Identify and explain the different work roles affected by FAIS
* Explain the relationship between financial service providers and representatives.
* Describe the process of licencing for financial service providers
* Explain using examples, the conditions under which suspensions, withdrawals and reinstatement of authorisation may be imposed by the FSCA.
* Describe the role and functions of the Commissioner of the FSCA
* Explain the role of the FAIS Ombud and its implications on the financial services sector
* Explain using examples the rights of recourse available to aggrieved clients.
* Discuss complaints handling processes by financial service providers and explain the consequences arising from the Ombud’s rulings.

## INTRODUCTION

The FAIS Act was introduced to provide a comprehensive and uniform framework to regulate financial services. The Act ensures that any person wanting to work in the financial services sector meets minimum standards of knowledge, educational qualifications, experience, and ethical conduct among others.

The enactment of the FAIS Act signalled a move away from the traditional concept of the insurance salesmen where products were often sold to a client without any assessment of the client’s needs and goals being carried out. As a result, in many cases products sold were not appropriate to the client’s needs or best interests. The requirements of the FAIS Act are designed to protect clients by ensuring that financial advisors provide appropriate advice to them after having assessed their circumstances, needs and goals.

There is an overlap in respect of healthcare benefits which fall within the ambit of both the Medical Schemes Act 131 of 1998 and the FAIS Act as the benefits qualify as financial products. As a result the FAIS Act provides a person granted accreditation in terms of the Medical Schemes Act is also required to be authorised to act as a financial service provider.

This learning unit seeks to give a detailed account of the compliance requirements of the FAIS Act for both the financial services provider and the financial advisor.



It must be noted that the FAIS Act does not make reference to a financial advisor but to a representative, of which a financial advisor is part. Representative is any individual who render financial services on behalf of a financial services provider and is not limited to financial advisors.

## 2.1 Background to compliance legislation

**2.1.1 Objectives of the FAIS Act**

The FAIS Act states its main objective is to “regulate the rendering of certain financial advisory and intermediary services to clients”.

The broader objectives of the FAIS Act are to:

* Protect any person (client) who is purchasing financial products and services
* Make sure that clients are given enough information to make the right decisions and choices about their finances
* Regulate the selling of financial products and the advice-giving activities of financial services providers and their representatives
* Professionalise the financial services industry.

Despite these objectives, many clients still lose their money through poor, inappropriate or unethical advice. It is the responsibility of every financial advisor to minimise the chances of this happening by keeping these objectives in mind at all times when dealing with clients and by meeting all the applicable requirements of the Act.

Although the Act alone will not prevent unethical and dishonest behaviour from occurring, it plays an important role in minimising the behaviour.

The Act seeks to achieve the above objectives by:

* Setting standards through the Fit and Proper requirements
* Prescribing processes that must be followed when engaging with a client
* Making sure sufficient information is gathered from clients to provide appropriate advice
* Instructing what information must be disclosed to clients to assist them in making the correct decisions
* Providing for alternative dispute resolution through the FAIS Ombud.

**2.1.2 Application of the FAIS Act**

The Act applies to financial service provider who can either be natural (sole proprietors) or juristic (legal persons created by law).

Juristic persons include:

* Organ of state
* Companies
* Close corporations
* Partnerships
* Trusts
* Any body of persons corporate or unincorporated.

**2.1.3 FAIS Act international comparability**

The FAIS Act and the Financial Sector Regulation Act 9 of 2017 are the main pieces of legislation regulating financial services in South Africa. It is worthwhile to compare this regulatory framework with other countries to gauge if South Africa is in the right direction in terms of its regulation.

Comparison is made with regulation in the United Kingdom, United States of America, New Zealand, Australia and Nigeria.

**a) United Kingdom (UK)**

In the UK, the main piece of legislation that regulates financial services is the **Financial Services Act 2012**. This Act introduced the Twin peaks model where there are two main financial services regulators which are; the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA). The FCA’s role is mainly to regulate market conduct and consumer protection, whereas the PRA regulates the prudential side of things such as issues of capital adequacy, solvency and adequacy of risk controls for financial institutions. It seems that the South African regulation is tailored to the UK one.

**b) United States of America (USA)**

The regulation of financial services in America is more decentralised as individual states are allowed to have different regulatory regimes. However at Federal level there is still legislation some of which we will look at:

* **Securities Act of 1933** – it has two basic objectives; requires that investors receive financial and other significant information concerning securities being offered for public sale; and prohibits deceit, misrepresentations, and other fraud in the sale of securities.
* **Investment Company Act of 1940** - this Act regulates the organization of companies, including mutual funds, that engage primarily in investing, reinvesting, and trading in securities, and whose own securities are offered to the investing public. The regulation is designed to minimize conflicts of interest that arise in these complex operations.
* **Sarbanes-Oxley Act of 2002** - the Act mandated a number of reforms to enhance corporate responsibility, enhance financial disclosures and combat corporate and accounting fraud, and created the "Public Company Accounting Oversight Board," to oversee the activities of the auditing profession.
* **Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010** **-** The Act was created to reshape the U.S. regulatory system in a number of areas including but not limited to consumer protection, trading restrictions, credit ratings, regulation of financial products, corporate governance and disclosure, and transparency.

Below are some of the financial sector regulators in the United States of America.

* **Securities & Exchange Commission (SEC)** - is an independent government agency tasked with overseeing U.S. securities markets, enforcing securities law, and monitoring exchanges for stocks, options, and other securities.
* **Financial Industry Regulatory Authority (FINRA)** – It is a private corporation that acts as a self-regulatory organisation. It oversees all U.S. stockbrokers and brokerage firms.
* **Federal Deposit Insurance Corporation (FDIC)** – It is an agency that insures holdings in cheque and savings accounts at member banks. It was created as a financial backstop to provide the broader U.S. population a guarantee that individual savings wouldn’t evaporate when a bank did.
* **The Commodities Futures Trading Commission (CFTC**) – it is an agency founded in 1974 to provide a regulatory framework for the increasingly complex market in futures contracts (through which traders agree to buy or sell a good at a specific time in the future for a specific price).

**c) Australia**

Financial regulation in Australia is split mainly between the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulatory Authority (APRA). ASIC's role is to enforce and regulate company and financial services laws to protect Australian consumers, investors and creditors, while APRA is a statutory authority that supervises institutions across banking, insurance and superannuation and promotes financial system stability in Australia.

The **Corporations Act 2001** sets up a uniform approach to the regulation of financial services through a uniform licensing and disclosure regime. The general regulatory position is that a person (whether an individual or corporate entity) carrying on a financial services business in Australia must, unless exempted, hold an Australian financial services licence (AFSL) issued by ASIC.

**d) New Zealand**

The **Financial Markets Conduct Act 2013 (FMC Act)** governs how financial products are created, promoted and sold, and the ongoing responsibilities of those who offer, deal and trade them.

The main purposes of this Act are to:

* promote the confident and informed participation of businesses, investors, and consumers in the financial markets; and
* Promote and facilitate the development of fair, efficient, and transparent financial markets.

The regulatory body is the Financial Markets Authority (FMA) established by the Financial Markets Authority Act 2011.

**e) Canada**

The main Act that regulates the activities of financial institutions in Canada is the **Financial** **Consumer Agency of Canada Act of 2001**.

The Office of the Superintendent of Financial Institutions (OSFI) and the Financial Consumer Agency of Canada (FCAC) are the primary regulatory bodies for FRFIs. Generally, OSFI is responsible for prudential regulation and establishing guidelines for capital, reporting and business practices, and FCAC is responsible for consumer protection.

The Department of Finance is the government body responsible for federally regulated FIs (FRFIs), including banks, trust and loan companies, insurance companies and credit unions.

**The Financial Institutions Act, 1985** establishes the Office of the Superintendent Financial Institutions.

**f) Nigeria**

Nigeria has a number of key laws that govern the regulation of their financial services industry. These are some of the Acts:

* **The Investments and Securities Act 2007** – it is the apex regulatory authority for the Nigerian capital market as well as regulation of the market to ensure the protection of investors, maintain fair, efficient and transparent market and the reduction of systemic risk.
* **National Insurance Commission Act 1997 and Insurance Act 2003** – these are the main acts that govern the regulation of insurance business in Nigeria. The objective is to ensure the effective administration, supervision, regulation and control of insurance business in Nigeria.

The regulatory bodies are as follows:

* Securities and Exchange Commission (Nigeria)
* National Insurance Commission (NAICOM) (Nigeria)
* National Pension Commission (PENCOM) (Nigeria)

It can be noted from this comparison that South Africa’s financial sector regulation is not too far off from the rest of the world. That said, more can still be done to improve the regulatory environment.

**2.1.4 Key role-players under FAIS**

|  |  |
| --- | --- |
| **Role-player** | **Responsibilities** |
| FSCA | It is a regulatory authority established in terms of section 56 of the Financial Sector Regulation Act, 9 of 2017.  The FSCA is responsible for enhancing and supporting the efficiency and integrity of financial markets, protecting financial customers, and assisting in maintaining financial stability.  The role of the Authority includes the implementation and monitoring of compliance legislation and ensuring that the respective role players meet the applicable requirements and standards of the FAIS Act. |
| Commissioner | The Commissioner is a natural person appointed in terms of section 61 (1) of the FSR Act and runs the FSCA.  The Commissioner and deputy commissioners are responsible for administration of the FAIS Act and its subordinate legislation. |
| Financial Service Provider (FSP) | A natural or juristic person, other than a representative who renders financial services to clients.  FSP includes sole proprietors.  FSPs who are product suppliers are licenced to sell financial products to clients. |
| Key Individual | A natural person employed by an FSP, who is responsible for managing and overseeing, either alone or together with other so responsible persons the activities of a financial service provider and/or representatives.  If the FSP has only one natural person as a member, director, shareholder or trustee then that person is the key individual. |
| Compliance Officer | A compliance officer is a natural person appointed by an FSP to render compliance services. Must be approved by the commissioner.  The role of the compliance officer is to monitor compliance by the FSP with the requirements of the FAIS Act. A financial service provider can appoint either an internal compliance officer or they can outsource the compliance function to an external compliance officer. |
| Representative | A representative is a natural person who is either employed (signs employment contract) or mandated (signs mandate agreement) by a financial service provider to provide financial services to clients on behalf of the FSP.  A representative:   * Renders a financial service to a client; * For or on behalf of a financial services provider; * Acting in terms of conditions of employment or any other mandatory agreement; but * Excluding a person who renders clerical, technical, administrative, legal, accounting or other services in a subsidiary or subordinate capacity; and which clerical, technical, administrative, legal, accounting or other service does not require judgment on the part of that person or does not lead a client to conclude any specific transaction in respect of a financial product in response to general enquiries.   In terms of FAIS:  A financial services provider is liable for the conduct of its representatives whether they are employees or mandated. This is because the representative acts as the agent of the financial services provider and thereby binds it as the principal with all the actions taken as a representative. The financial services provider is, furthermore, required to maintain an up-to-date register of its representatives with the Financial Sector Conduct Authority (FSCA). |
| FAIS Ombud | A natural person appointed to mediate or resolve complaints brought by clients against financial service providers.  The FAIS Ombud considers and disposes of complaints regarding FSPs in a fair, informal, economical and fast manner taking into consideration what is fair and equitable in all circumstances. |

**2.1.5 The meaning of financial service, advice and intermediary service**

Section 1 of the FAIS Act defines a financial service as:

* Furnishing advice
* Furnishing advice and rendering an intermediary service
* Rendering an intermediary service.

**a) Advice** refers to any recommendation, guidance, or proposal of a financial nature furnished by any means or medium to any client or group of clients in respect of the:

* Purchase of or investment in any financial products
* Conclusion of any other transaction aimed at incurring any right or benefit or liability in respect of any financial product (including a loan or cession as the rights of the parties in terms of a policy agreement will be affected.
* Variation, replacement or termination of any financial product

This applies irrespective of whether or not such advice:

* Is given when doing financial planning for the client
* Results in any purchase, investment, transaction, replacement or termination taking place.

The giving of advice must be a regular feature of a person’s business and the advice must be financial in nature – must only deal in monetary matters.

When providing financial advice, a financial advisor is required to take into account a client’s financial situation, financial experience, and their financial and other objectives.

Any financial products recommended must be appropriate to the client’s risk profile and financial needs.



**Exclusions to the definition of advice**

Although the definition of advice is broad, the following do not constitute advice:

* Explaining the procedure for entering into a financial product transaction
* A description of a financial product
* Answering routine administrative questions
* Objective information about a particular financial product
* The display or distribution of promotional material.

From the above it can therefore be said that a person involved in clerical, technical, administrative, legal and accounting services in a subordinate capacity is not considered to be a representative as defined in the act, as long as they are not required to use their judgement in carrying out the above actions.

**b) Intermediary service**

Intermediary service refers to any act, other than furnishing of advice, performed by a person:

* As a result of which the client may enter into, offers to enter into or enters into any transaction in respect of a financial product;
* With a view to:
  + Buying, selling, or dealing in (whether on a discretionary or non-discretionary basis) , managing , administering, keeping in safe custody, maintaining or servicing a financial product
  + Collecting or accounting for premiums or other moneys payable by the client in respect of a financial product.
  + Receiving, submitting or processing the claims of a client in respect of a financial product.



Sifiso had an engagement with a new client, Karabo. At the first appointment, Sifiso establishes Karabo’s level of financial knowledge. He also gathers all the information necessary to analyse her financial situation. He asks her a series of questions including her life, financial goals and objective and levels of tolerance to risk. Karabo tells Sifiso that that she is particularly concerned with her life cover shortfall as well as her medical aid gap. At a follow up meeting, Sifiso discusses the recommendations and the financial plan he has drafted with Karabo. She understands and she is satisfied with the recommendations and decides to take out a life policy and a health gap cover policy. These activities are all part of the process of “**giving advice”** to Karabo.

On the other hand, the filling in of the application forms for the two policies and submitting it to the product supplier concerned is part of the **“intermediary service”.** There is no giving of advice involved, rather it consists of administrative activities of implementing the policies. Should Karabo come back to Sifiso again with a request to change the beneficiaries on the policies, this would again be considered an intermediary service.



The giving of advice does not necessarily have to result in the selling of a product. It may merely involve a recommendation, guidance or a proposal offered by an FSP or representative to a client and the client not taking it up. On the other hand, an intermediary service is where a person acts as an intermediary between the client and the product supplier.

**2.1.6 Financial service providers and financial products**

Financial service provider may be natural or juristic person.

**a) Natural person**

The term natural person refers to a living human being, with certain rights and responsibilities under the law.

**b) Juristic person**

By contrast, a juristic person, or a legal person is a group of people that is considered by law to be acting as a single individual.

It is important, when applying to be licensed as a financial service provider, to distinguish between a ‘natural person’ and a ‘juristic person’ since this differentiation affects the assigning of responsibility for actions that are undertaken by the financial service provider. Natural persons are, in this respect, distinguished from juristic persons such as companies, close corporations and trusts which are recognised as separate legal entities existing apart from their members and from the natural persons which form part of the legal entity concerned. While a juristic person necessarily acts through natural persons, it is the juristic person which acquires rights and/or incurs duties and not those natural persons in their personal capacities.

**2.1.7 Consumer Protection**

One of the main objectives of the FAIS Act is to protect clients who purchase financial products and services.

Section 1 of the Act defines a client as a “specific person or group of persons to whom a financial service is rendered intentionally, but excluding the general public”.

This means that the protection offered by the Act is extended to any person to whom a financial service or financial advice has been specifically provided.

The definition of client also includes successor in title as well as beneficiaries. A successor in title may include a person who has legally acquired a right, for example when a policy has been ceded as security for a loan or the executor of a deceased estate.

**2.1.8 Treating customers fairly**

Treating Customers Fairly (TCF) is an outcomes based regulatory and supervisory approach designed to ensure that regulated financial institutions deliver specific, clearly set out fairness outcomes for financial customers. Regulated entities are expected to demonstrate that they deliver the following six TCF Outcomes to their customers throughout the product life cycle, from product design and promotion, through advice and servicing, to complaints and claims handling:

* Customers can be confident they are dealing with firms where TCF is central to the corporate culture
* Products & services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly
* Customers are provided with clear information and kept appropriately informed before, during and after point of sale
* Where advice is given, it is suitable and takes account of customer circumstance
* Products perform as firms have led customers to expect, and service is of an acceptable standard and as they have been led to expect
* Customers do not face unreasonable post-sale barriers imposed by firms to change product, switch providers, submit a claim or make a complaint.

These principles and outcomes will be legislated by the FSCA as part of the Twin Peaks Model of regulation. Financial advisors are required to take into account these principles and outcomes in their day-to-day work.

## 2.2 Financial Sector Regulation Act, 9 of 2017

This Act was introduced in 2017 as part of reforming regulation of the financial services industry in South Africa. It is part of the broader regulation of the financial services together with the FAIS Act.

The objective of the Act is to achieve a stable financial system that works in the interests of financial customers and that supports balanced and sustainable economic growth in South Africa, by establishing, in conjunction with the specific financial sector laws, a regulatory and supervisory framework that promotes:

* Financial stability;
* The safety and soundness of financial institutions;
* The fair treatment and protection of financial customers;
* The efficiency and integrity of the financial system;
* The prevention of financial crime;
* Financial inclusion;
* Transformation of the financial sector; and
* Confidence in the financial system.

**2.2.1 Twin Peaks model**

In April 2018, South Africa started a transition to a Twin Peaks model of regulation. Twin Peaks refers to the creation of two regulatory bodies; a Financial Sector Conduct Authority (FSCA) and a Prudential Authority (PA).

The Financial Sector Regulation (FSR) Act 9 of 2017 became the first in a series of legislative changes in the financial sector regulation landscape.

Both regulatory Authorities are authorised to issue prudential standards, conduct standards or joint standards. For example the FSCA may issue standards with regard to the requirements for the fair treatment of clients, including the design and suitability of financial products, the marketing material of the products, disclosures or measures to combat abusive practices.

The standards provide for the requirements necessary to give effect to the objectives of the Financial Sector Regulation Act.

**a) New regulatory authorities**

|  |  |
| --- | --- |
| **Financial Sector Conduct Authority (FSCA)** | **Prudential Authority (PA)** |
| * 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. * From 1 June 2021 Mr Unathi Kamlana was appointed as Commissioner and Ms Astrid Ludin as Deputy Commissioner. In August 2021 Ms Katherine Gibson and Ms Farzana Badat was appointed as additional Deputy Commissioners. * 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. | * 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 1 January 2022) 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 two Authorities are supported by the Financial Services Tribunal. The role of the Tribunal is to act as an independent tribunal and to confer on it powers to reconsider decisions by financial sector regulators, the Ombud Council and certain market infrastructures; to establish the Financial Sector Information Register and make provision for its operation.

The FSR Act also establishes the Financial Stability Oversight Committee whose role is to support the Reserve Bank when the Reserve Bank performs its functions in relation to financial stability and to facilitate co-operation and collaboration between, and co-ordination of action among, the financial sector regulators (PA, FSCA, Financial Intelligence Centre and National Credit Regulator) and the Reserve Bank in respect of matters relating to financial stability.

The previous compliance system is South Africa was compliance and rules-driven whereas the Twin Peaks regulatory model is risk-based and focuses more on positive client outcomes.

**b) Financial Sector Law**

The scope of regulation and actions is based on financial sector law in terms of an exhaustive list of sources. Schedule 3 of the Act assigns jurisdiction to the newly created authorities accordingly:

|  |  |
| --- | --- |
| **FSCA** | **PA** |
| * Pension Funds Act * Friendly Societies Act * Financial Advisory and Intermediary Services Act * Collective Investment Schemes Control Act * Financial Markets Act * Credit Rating Services Act * Long-term Insurance Act and Short-term Insurance Act, as they relate to matters within the specific objectives of the Financial Sector Conduct Authority * Regulations issued in terms of any of the above | * Banks Act * Mutual Banks Act * Co-operative Banks Act * Financial Supervision of the Road Accident Fund Act * Long-term Insurance Act and Short-term Insurance Act, as they relate to matters within the specific objectives of the Prudential Authority * Regulations issued in terms of any of the above. |

## 2.3 FAIS Licensing requirements

Section 7 (1) of the FAIS Act provides that no person may act or offer to act as a financial services provider unless such person has been issued with a licence by the Authority.

Before a licence is granted by the FSCA, both the applicant and their key individuals must meet fit and proper requirements applicable to the licence category being applied for.

**2.3.1 Process of applying for licence**

An application must be made on the prescribed form and manner as provided for on the Authority’s website. A prescribed fee must be paid when making the application. The application form must be accompanied by all the information and documentation required by the Authority.

The Authority will grant the application for a licence to a financial services provider once satisfied that the applicant complies with the FAIS requirements; failing which the Authority will refuse the application. When an application is approved the Authority issues a licence to the applicant authorising the applicant to act as a financial services provider.

The authority may also impose conditions and restrictions on the licence. These may be amended or withdrawn after the licence holder has been given an opportunity to respond to the Authority on the proposed conditions or restrictions.

When an application has been turned down, the Authority will give reasons for refusal.

Operating without a licence attracts penalties. The penalty of any person who contravenes or does not comply with the authorisation and licencing requirement will be guilty of an offence and on conviction is liable to a fine not exceeding R10, 000 000 or to imprisonment for a period not exceeding 10 years or to both a fine and imprisonment.



In *Mashiloane v Tshukudu Investment Group* and SE Matsepe (2010), the respondents, who were not licenced, provided a financial service in terms of which the complainant, Mashiloane invested R300,000 with them and he was promised to receive R9,000 every month. The R9,000 interest was only paid for a period of 9 months after which it was stopped. The complainant approached the Ombud.

The FAIS Ombud ruled that even though the respondents were not licenced to offer financial advice and intermediary services, the provisions of the FAIS Act still applied as they had essentially given advice and invested the money of the client in financial products.

As a result, the respondents were found liable for the amount of loss suffered by the complainant. They were ordered to repay the money owing plus interest.

**2.3.2 Categories of licences**

The licences issued by the FSCA are not all the same. There are different categories of financial services providers. The fit and proper requirements differ according to the category applied for. The categories and sub-categories of licences are:

|  |  |
| --- | --- |
| Category I | This category includes FSPs who are not Category II, IIA, III and IV FSPs. This category consists of the following sub-categories, each one relating to a different class of financial product.  1.1 Long-term Insurance subcategory A  1.2 Short-term Insurance Personal Lines  1.3 Long-term Insurance subcategory B1  1.4 Long-term Insurance subcategory C  1.5 Retail Pension Benefits  1.6 Short-term Insurance Commercial Lines  1.7 Pension Fund Benefits  1.8 Shares  1.9 Money-market instruments  1.10 Debentures and securitised debt  1.11 Warrants, certificates or other instruments  1.12 Bonds  1.13 Derivative instruments  1.14 Participatory interest in one or more collective investment schemes  1.15 Forex Investment  1.16 Health Service Benefits  1.17 Long-term Deposits  1.18 Short-term Deposits  1.19 Friendly Society Benefits  1.20 Long-term Insurance subcategory B2  1.21 Long-term Insurance subcategory B2-A  1.22 Long-term Insurance subcategory B1-A  1.23 Short-term Insurance Personal Lines A1  1.24 Structured Deposits  1.25 Securities and instruments  1.26 Participatory interest in a CIS hedge fund |
| Category II | This category is for discretionary FSPs. Discretionary FSPs render intermediary services of a discretionary nature as regards the choice of a particular financial product, but without implementing any bulking. For example, based on the mandate from a client, a discretionary FSP makes investment decisions on behalf of clients such as switching portfolios or products. They are also known as investment managers.  2.1 Long-term Insurance subcategory B1  2.2 Long-term Insurance subcategory C  2.3 Retail Pension Benefits  2.4 Pension Fund Benefits  2.5 Shares  2.6 Money market instruments  2.7 Debentures and securitised debt  2.8 Warrants, certificates and other instruments  2.9 Bonds  2.10 Derivative instruments  2.11 Participatory Interests in one or more collective investment schemes  2.12 Forex Investment  2.13 Long-term Deposits  2.14 Short-term Deposits  2.15 Long-term Insurance subcategory B2  2.16 Long-term Insurance subcategory B2-A  2.17 Long-term Insurance subcategory B1-A  2.18 Structured Deposits  2.19 Securities and instruments  2.20 Participatory interest in a CIS hedge fund |
| Category IIA | This category applies to hedge fund FSPs.  A hedge fund is an alternative investment vehicle available to all but normally recommended to wealthy investors, such as institutions and individuals with significant assets. |
| Category III | This category applies to administrative FSPs who render intermediary services in respect of financial products on the instructions of a client or another FSP and through the method of bulking, for example a linked investment services provider (LISP).  Bulking is whereby a broker (FSP) combines a large number of orders to buy or sell financial products and executing them as one; and subsequently allocating such financial products to each client separately in the records of the FSP. |
| Category IV | This category applies to assistance business FSPs. Assistance policies are life insurance policies whose value of benefits does not exceed R30,000.  Funeral policies, burial societies and friendly societies fall in this category. |

**2.3.3 Display of licence and other obligations**

* A certified copy of the licence must be displayed in a prominent and durable manner in every business premises of the FSP.
* Reference must be made to the fact that the FSP holds a licence on all business documentation, advertisements and other promotional material.
* The licence must at all times immediately or within a reasonable time, be available to any person requesting proof of the licenced status under authority of a law or for the purpose of entering into a business relationship with the licensee.

**2.3.4 Suspensions or withdrawal of licence**

Section 7 of the FAIS Act deals with authorisation whereas section 9 deals with suspensions and withdrawals. The Authority can suspend (temporarily take away the licence) or withdraw a licence (take away the licence altogether permanently), if satisfied that an FSP including its key individuals or director, member, trustee or partner:

* Does not or no longer meets the applicable fit and proper requirements
* Did not disclose all the necessary information when applying for a licence
* Provided false or misleading information when applying for a licence
* Has not complied with any provision of the FAIS Act or the Financial Sector Regulation Act including a conduct standard, prudential standard or joint standard.
* Has failed to pay a levy, administrative penalty or any interest in respect thereof
* Does not have an approved key individual
* Has failed to comply with the regulator’s directive
* Has failed to comply with any condition or restriction imposed under the FAIS Act.

**2.3.5 Action to be taken by FSCA before withdrawing or suspending a licence**

Before suspending or withdrawing a licence the FSCA may consult with any regulatory authority. The Authority must inform the FSP that its licence may be suspended or withdrawn and give reasons why.

The FSP must be given a reasonable opportunity to respond to the Authority. The Authority must also inform the FSP the length of the suspension any terms attached to the suspension or withdrawal (this includes a prohibition on concluding new business and measures that must be taken which protect the client in relation to any unconcluded business and of the actions that can be taken by the FSP to get the suspension lifted.

After considering the response of the FSP, the Authority must decide whether to suspend or withdraw the licence and advise the FSP accordingly. If the Authority decides to withdraw or suspend the licence, a notice of withdrawal or suspension must be published on the official website and any other appropriate public media. The notice must include the reasons for the withdrawal or suspension and any terms decided on by the Authority.

Terms that may be attached to suspension include:

* A prohibition on concluding any new business by the licensee as from the effective date of the suspension and, in relation to unconcluded business.
* Such measures as the registrar may determine for the protection of the interests of clients of the licensee: and
* Terms designed to facilitate the lifting of the suspension, and must give the licensee a reasonable opportunity to make a submission in response.

Under urgent circumstances, the Authority can also provisionally suspend or withdraw a licence if satisfied that prejudice to clients or the general public may occur. The process followed by the Authority is the same as discussed above.



An FSP is not authorised to offer financial advice or intermediary services if their licence has been provisionally or finally suspended or withdrawn. An FSP whose licence has been withdrawn under the provisions of section 9(6) is debarred for the period decided on by the Authority from applying for a new licence.

**2.3.6 Conditions under which a licence may be reinstated**

A suspended licence can be reinstated once the authority is satisfied that the conditions imposed on the FSP at the time of suspension have been met. Although the FAIS Act does not provide for the reinstatement of a withdrawn licence, the Authority may reinstate a withdrawn licence once certain operational or compliance issues have been resolved.

The Act also provides that an FSP who has had their licence withdrawn may be debarred for a period from applying for a new licence.

**2.3.7 Lapsing of an FSP licence**

Lapsing means that the licence is no longer valid due to a number of reasons. The suspension and withdrawal of a licence is usually instigated by the Authority when the requirements of the FAIS Act are not being met by an FSP.

However, the lapsing of a licence is usually voluntary or unavoidable on the part of an FSP and is not due to a failure to meet the requirements of the FAIS Act.

If the FSP licence holder is a natural person, the licence will lapse when the person:

* Becomes permanently incapable of carrying on the business due to physical or mental diseases or serious injury
* Is finally sequestrated or
* Dies.

If the FSP licence holder is not a natural person, but a juristic person like a company, trust, CC, partnership, the licence may lapse

* If the juristic person is finally liquidated or dissolved

A licence will also lapse for both natural and juristic person.

* If the business becomes dormant or
* When it is voluntarily or finally surrendered to the FSCA.

When the licence of an FSP lapses, the licence holder, key individual or person in control of the affairs of the FSP is required to advise the Authority in writing of the reasons for the lapsing of the licence. The Authority may make the lapsing of the licence known by publishing a notice on their official website and if necessary, make an announcement in the public media.

**2.3.8 Profile changes**

Any changes to the information submitted during the application process must be communicated to the Authority within 15 days of such a change.

The new information must be submitted to the Authority on the appropriate forms. For examples, should an FSP employ a representative, the FSP is required to make a profile change by filling a FSP 5 form and submitting it to the authority.

## 2.4 Fit and Proper requirements

The requirements are prescribed in **Board Notice 194 of 2017**, the Determination of Fit and Proper Requirements for Financial Service Providers. For an FSP, key individual, compliance officer or representative to remain authorised, approved or appointed, that person must at all times comply with fit and proper requirements applicable to them.

The table below summarises the fit and proper requirements; detail will be given underneath the table.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Requirements** | **FSP (Company, CC, Partnership, Trust)** | **FSP (sole proprietor)** | **Key individuals** | **Representatives** | **Compliance Officers** |
| Personal character qualities of honesty, integrity and good standing | ✓  (Director, member etc.) | ✓ | ✓ | ✓ | ✓ |
| Competence: Minimum Experience |  | ✓ | ✓ | ✓ | ✓ |
| Competence: Minimum Qualifications |  | ✓ | ✓ | ✓ | ✓ |
| Competence: Regulatory Examinations |  | ✓ | ✓ | ✓ | ✓ |
| Competence: Class of business and product specific training |  | ✓ | ✓ | ✓ |  |
| Continuous professional development |  | ✓ | ✓ | ✓ | ✓ |
| Operational Ability | ✓ | ✓ | ✓ |  | ✓ |
| Financial Soundness | ✓ | ✓ |  |  | ✓ |

The general requirements of fit and proper are discussed below:

**2.4.1 Personal character qualities of honesty, integrity and good standing**

The Financial services industry deals with people’s moneys therefore it requires people who are honest to work therein. A person (both natural and juristic) who renders financial services must be:

* Honest and have integrity
* Of good standing.

In determining whether a person complies with the honesty, integrity and good standing requirements, the Authority may refer to any information in their possession or brought to their attention.

There are different situations listed in the determinations (although not limited to these) which constitute evidence that a person does not qualify with respect to the requirements of honesty, integrity and good standing.

Some example includes when a person has been found guilty of theft, fraud, forgery, perjury, or an offence involving dishonesty, breach of fiduciary duty, dishonourable or unprofessional conduct among others.

Any information relating to whether a person complies with these requirements must be disclosed to the Authority promptly and at their own initiative.

**2.4.2 Competence requirements**

An FSP, key individual and representative must:

* Have adequate, appropriate and relevant skills, knowledge and expertise in respect of the financial services, financial products and functions that that person performs;
* Comply with the minimum competency requirements and
* Maintain their competence.

An FSP is responsible for establishing, maintaining and applying adequate policies, internal systems, control and monitoring mechanisms to ensure that it, its key individuals and representatives comply and continue to comply with the requirements.

A representative may be exempt from the competency requirements whilst rendering financial services under supervision.

**i) Minimum experience**

An FSP and its representatives must have adequate and appropriate experience in the rendering of a particular financial service in respect of a particular financial product and particular category.

A key individual must have adequate and appropriate experience to manage and oversee the rendering of a particular financial service in respect of the particular category of FSP. Experience gained is considered to have lapsed if the FSP, key individual or representative has not acted in their respective capacities for a period of five consecutive years.

The minimum experience requirements per category of FSPs, key individuals and representatives are listed in Annexure one of Board Notice 194 of 2017. The experience must involve the active and ongoing gaining of knowledge, skills and expertise. Depending on the subcategory:

* The minimum experience required relating to the giving of advice varies from **six months** to two years
* The minimum period relating to intermediary services varies from **two months** to two years.

An example is the Long-term insurance category A which require one year minimum experience related to the giving of advice and six month’s minimum experience for intermediary services.

**ii) Minimum qualifications**

The minimum qualification requirement applies to all FSPs, key individuals and representatives. The Authority has published a list of Appropriate Subjects in Table 1 in Annexure Two.

The Annexure stipulates the following:

In the case of a **non-unit standards-based qualification**:

* It must contain at least three modules/subjects that appear in the Appropriate Subject List in Table 1 in Annexure Two;
* Where the qualification is at Certificate or Diploma level and it provides for major subjects, at least one of the subjects must be a major subject at final year level; and
* where the qualification is at Degree level, at least one of the subjects must be a major subject at final year level.

In the case of a unit standards-based qualification, the core and elective unit standards must relate to at least three modules/subjects that appear in the Appropriate Subject List in Table 1 in Annexure Two; and

For purposes of a Category II, IIA or III FSP and a key individual, or representative of such FSP, the qualification must be at degree level.

However, the requirements do not apply to a Category 1 FSP, its key individuals and representatives that are authorised, approved or appointed only to render financial services or manage or oversee financial services in respect of the financial products: Long-term insurance Subcategory A and/or Friendly Society Benefits and a representative of a Category 1 FSP that is appointed only to **perform the execution of sales** in respect of a financial product.

**iii) Regulatory Examinations**

A financial service provider (who is a sole proprietor), key individuals and representatives, unless exempted must take and successfully pass the regulatory examinations set by the FSCA.

A regulatory examination refers to an examination with the purpose to test a person’s knowledge, understanding and application of legislation, including any financial sector law defined in the Financial Sector Regulation Act.

All FSPs, key individuals and representatives are required to sit regulatory examinations. However, a category 1 FSP, its key individuals and representatives that are authorised, approved or appointed only to render financial services of manage or oversee financial services in respect of the financial products: Long-term Insurance subcategory and/or Friendly Society Benefits; and a representative of a Category 1 FSP appointed only to perform the execution of sales in respect of Tier 1 financial product (certain requirements must still be complied with) and or render financial services in respect of Tier 2 financial product are exempt from sitting the examinations.

**TIER 1 AND TIER 2 FINANCIAL PRODUCTS**

|  |  |
| --- | --- |
| **Column A**  **Tier 1 Financial Products** | **Column B**  **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 one or more collective investment schemes |  |
| Participatory interest in a 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 |  |

The Board Notice provides for the following regulatory examinations for FSPs, key individuals and representatives.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **REGULATORY EXAMINATIONS** | | | | | |
|  | **Category I** | **Category II** | **Category IIA** | **Category III** | **Category IV** |
| FSP | RE1 | RE1 and RE3 | RE1 and RE3 | RE1 and RE4 | RE1 |
| Key Individual | RE1 | RE1 and RE3 | RE1 and RE3 | RE1 and RE4 | RE1 |
| Representative | RE5 | RE5 | RE5 | RE5 | RE5 |

**iv) Class of business training and product specific training**

The competence requirements relating to class of business and product specific training apply to all FSPs, key individuals and representatives. However, there is an exemption that applies to a Category I FSP, its key individuals and representatives that are authorised, approved or appointed to render financial services only in respect of the financial products: Long-term Insurance subcategory A and/or Friendly Society Benefits; and a representative of a Category I FSP that is appointed to furnish advice or render an intermediary service in respect of a Tier 2 financial product; or perform only the execution of sales in respect of a Tier 1 financial product.

The competency requirements relating to product specific training contained in this Part do not apply to a Category II, Category IIA or a Category III FSP.

An FSP must ensure that it, its key individuals and representatives, before rendering financials services, are proficient, understand and have completed training on both the class of business in which a product falls as well as on the financial product itself. Assessments must also be carried out on the class of business and product specific training.

An FSP and representative must attend class of business training and product specific training relevant to the financial products they are authorised or appointed to sell.

The training and assessments must include the following information on the products within the **class of business**:

* The range of financial products within the class of business;
* The general characteristics, terms and features of financial products in the class of business;
* The typical fee structures, charges and other costs associated with products in the class of business;
* General risks associated with investing, purchasing or transacting in the products in the class of business;
* Investment and risk principles, options and strategies in respect of products in the class of business
* The appropriateness of different products or product features in the class of business for different types of clients or groups of clients;
* The typical role players or market participants in respect of products in the class of business, including their legal structure;
* The impact of applicable legislation, including taxation laws, on products in the class of business;
* The impact of applicable economic and environmental factors such as-
  + The economic and business environment and cycles;
  + Inflation;
  + Government monetary and fiscal policies; and
  + Interest rates and exchange rates.
* On the products in the class of business and the performance of those products;
* Any inter-relationship within and between particular classes of business;
* Industry standards and codes of conduct relevant to the class of business.

The training and assessment relating to **the financial product** must include training and assessment on:

* The specific, characteristics, terms and features of the product, including any specific complexities or material differentiation from the general characteristics, terms and features of products in the class of business concerned;
* The nature and complexity of the financial product and any underlying components of that product;
* How the financial product and any underlying components of the product are structured and priced;
* The fee structure, charges and other costs associated with the product and their impact on the real return or benefits of the product;
* The nature and features of any guarantees and the costs associated with them;
* The risks associated with investing, purchasing or transacting in the product and any underlying components of the product;
* The risks associated with particular investment concepts and strategies in respect of the product;
* The impact of tax on the benefits or real return of the product;
* The potential impact of abnormal or extreme market, economic or other relevant conditions on the performance of the product;
* Any investment options or strategies within the product;
* Any flexible benefit or service options available within the product;
* The accessibility of benefits or funds under the product and any restrictions or limitations on such accessibility;
* The level of liquidity of the product or its underlying components;
* The intended target market of the product and the outcomes it is intended to deliver for customers, including identifying customers or groups of customers for whom the product is not expected to be suitable;
* The identity of the product supplier and the providers of any underlying components of the product, including their good standing and regulatory status; and
* Particular disclosures, whether or not prescribed by legislation, applicable or relevant to the product, its underlying components and the product supplier.
* The lock-in periods and relevant termination conditions, exit options and associated costs;
* The accessibility of benefits or funds under the financial product and any associated restrictions or limitations;
* The expected outcomes that will be achieved for clients.

**2.4.3 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;
* Comply with the minimum CPD requirements
* Ensure that the type and combination of CPD activities undertaken
* are relevant to the functions and role of the FSP, key individual and representative;
* contributes to the skill, knowledge, expertise and professional and ethical standards of the FSP, key individual and representative;
* addresses any identified needs or gaps in-
* the technical knowledge of the FSP, key individual and representative;
* in the generic knowledge and understanding of the environment in which the financial service is rendered; and
* the knowledge and understanding of applicable laws; and
* Adequately takes into account changing internal and external conditions relevant to the classes and subclasses of business and the category of financial services and financial products for which the FSP, key individual or representative is authorised, approved or appointed.

**a) Minimum CPD hours**

An FSP, key individual and representative authorised, approved or appointed to render or manage or oversee the rendering of financial services in respect of:

* A single subclass of business within a single class of business must complete a minimum of 6 hours of CPD activities per CPD cycle;
* More than one subclass of business within a single class of business must complete a minimum of 12 hours of CPD activities per CPD cycle; or
* More than one class of business must complete a minimum of 18 hours of CPD activities per CPD cycle.

An FSP must ensure that key individuals and representative submit evidence of their CPD activities to the FSP within 15 days after expiry of the CPD cycle.

The CPD cycle means a period of 12 months commencing on 1 June every year and ending on 31 May the following year. Provision is made for the reduction of CPD hours due to a continuous absence from work due to maternity, paternity or adoption leave, long-term illness or disability or the representative’s responsibility to care for a family member who has a long-term illness of disability.

**2.4.4 Operational ability**

An FSP must:

* Have the operational ability to effectively function as a particular category of FSP and to render the financial services in relation to the financial product for which that person is authorised; and
* 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.

These requirements include, but are not limited to a fixed business address, adequate access to communication facilities, adequate storage and filing systems for the safe keeping of records, business communications and correspondence, a bank account for clients and adequate and appropriate key individuals to effectively manage and oversee the activities of the FSP.

The governance framework of an FSP must be appropriate to the nature, scale, risks and complexity of the business. It must include, but not limited, to effective and adequate systems of corporate governance, risk management and internal controls. The governance framework is made up of the business plan, risks management policies and procedures, accounting policies and procedures, sound and sustainable remuneration policies, a business continuity policy, a recovery plan and a system to provide for the regular monitoring and evaluation of the adequacy and effectiveness of systems, processes and internal control mechanisms.

**2.4.5 Financial soundness**

An FSP and a juristic representative must at all times maintain financial resources that are adequate both as to amount and quality to carry out their activities and supervisory arrangements and to ensure that there is no risk that its liabilities cannot be met as they fall due.

The assets of the FSP and a juristic representative must at all times exceed the liabilities of the FSP and juristic representative respectively.

An FSP and a juristic representative (other than a category 1 FSP who does not hold or receive monies) must have sound, effective and comprehensive strategies, processes and systems to assess and maintain the amounts, types and distribution of financial resources considered adequate to cover risks exposed to and risks it may not be in a position to meet as required.

An FSP or juristic representative may not be an unrehabilitated insolvent or be under liquidation or provisional liquidation or fail to manage any of its financial obligations satisfactorily. No person may become an FSP or juristic representative if business rescue proceedings have commenced in respect of that person.

There are also reporting requirements that must be complied with by the FSP. Provision is also made for early warning requirements for example when the liabilities of an FSP exceed their assets by less than 10%, this must be immediately communicated to the Authority in writing.

## 2.5 Exemption of services under supervision

There are certain exemptions for representatives who render financial services under supervision. A representative may work under supervision when they do not meet the competence aspects of the fit and proper requirements. If a representative is working under supervision, they may only act under the guidance, instruction and supervision of a supervisor when dealing with clients. This enables the representative to be appointed by an FSP without complying with all the required standards at the date of first appointment.

FAIS Notice 86 of 2018: Exemption of Services under Supervision came into effect 1 March 2019. The notice exempts an FSP and a supervised representative from complying with the competency requirements of experience, qualification, regulatory examination and class of business and product specific training on certain conditions that we will explore below.

The Notice defines a supervised representative as a representative who does not meet one or more of the competency requirements and who renders financial services under supervision.

Supervision is defined as guidance, instruction and oversight by any means or medium, by a supervisor using a variety of assessment, observation and oversight methods or tools that are appropriate for the assessed level of competence of the supervised representative.

**Supervision exemption conditions:**

|  |  |
| --- | --- |
| **Condition** | **Requirement** |
| Entry level requirements | A supervised representative of a:   * Category I or IV FSP must have a grade 12 or grade 12 equivalent qualification * Category 1 FSP that is appointed only to perform the **execution of sales** must have grade 10 or an academic achievement equivalent to grade 10. * Category II, IIA or III FSP representatives must have qualification at degree level.   The above entry level requirements do not apply to a supervised representative of a category I FSP that is appointed only to render financial services in respect of the financial products: Long-term Insurance Subcategory A and/or Friendly Society Benefits. |
| Specific compliance periods | **Regulatory examinations**  A supervised representative must within **2 years** from the date of first appointment pass the RE5 examination.  **Class of business training**  A supervised representative must within **12 months** from the date on which they were first appointed as a representative in respect of a financial product comply with the class of business training applicable to that financial product.  **Qualifications**  A supervised representative must within six years from the date on which they were first appointed as a representative in respect of a particular financial product comply with the qualification requirements applicable to that financial product.  **CPD**  A supervised representative (other than the one appointed to render financial services on Tier 2 products or execution of sales) must comply with applicable CPD requirements from the date on which they meet the class of business training requirements, regulatory examination requirements or qualifications requirements or after 6 years from date of first appointment, whichever comes first.  A supervised representative that has only been appointed to render financial services in respect of a Tier 2 financial product or perform execution of sales must comply with CPD requirements from the date they meet class of business training requirements, regulatory examination requirements and qualification requirements applicable to Tier 1 financial product.  **Experience**  A supervised representative must work under supervision for at least the minimum period applicable to categories of financials services and financial products for which they are appointed to work under supervision and remain under supervision until being assessed as having the required experience in respect of the particular category for which they are appointed.  The minimum experience period may run concurrently where the supervised representative is appointed for multiple categories of financial services and/or financial products and commence on the date the supervised representative was first appointed as a representative in respect of the particular category. |
| Supervision agreement | The FSP and supervised representative, prior to rendering of financial services must enter into a written supervision agreement, which may form part of the relevant agreement or FSP’s performance management process.  The agreement needs to identify the supervisor, the tasks and functions to be performed, the appropriate and relevant knowledge, skills and expertise required to perform the tasks and set out the training needs of the supervised representative.  The agreement must also set supervision arrangements such as duties of the supervisor and supervised representative, supervision methodology, tools, processes and procedures, criteria for assessment, sign-off criteria by the supervisor among others. |
| Duties of FSP | An FSP that appoints a supervised representative must have the operational ability including adequate and appropriate human, technical and technological resources, controls and procedures and a governance framework to appoint supervised representatives and to monitor and supervise the supervised representatives.  The FSP must also assign a supervisor to the supervised representative and ensure that there is a working relationship between the supervisor and the supervised representative. It must also review at regular interval the appropriateness, effectiveness and adequacy of supervision agreements.  The FSP is also required to reflect on its register of representatives, the central register and the competency register whether the representative is rendering financial services under supervision. The registers must be updated within 15 days after a representative cease to render financial services under supervision. |
| Duties of supervisor | The supervisor must, as part of his duties:   * Implement and ensure compliance with the supervision agreement * Mentor and coach, the supervised representative in respect of financial services and products they are appointed. * Review and assess at regular interval the learning activities and progress of the supervised representative and keep all records relating to the supervision among others. |
| Duties of representative | The supervised representative must:  Actively pursue the completion of the class of business training, regulatory examinations and recognised qualification within the prescribed time periods.  Adhere at all times to the provisions of the supervision agreement and disclose to all clients that they are rendering financial services under supervision. |
| Intensity of supervision | An FSP must determine the level of intensity of supervision that must apply to the supervised representative taking cognisance of the nature, scale, and complexity of the financial services and financial products to be rendered by the supervised representative, the supervised representative’s assessed level of competency and the risk to clients and FSP.  The level of intensity of the supervision must be reviewed at regular intervals. They FSP must also determine the criteria and procedures to assess whether it is appropriate for a supervised representative to work under a reduced level of intensity of supervision. |

## 2.6 Enforcing the FAIS Act and the FSR Act

There is an Enforcement Department within the FAIS Division of the FSCA. Its main responsibilities include:

* Requesting Inspections and interacting with FSB’s Inspectorate.
* Follow-up on inspection reports (inspection cost / prosecution recoveries)
* Dealing with and investigating all complaints of misconduct of FSPs
* Suspension and withdrawals of licenses 3 6. Handling appeals relating to suspension and withdrawals.
* Recording of Debarment of representatives.
* Handling queries emanating from the above processes.

In the past there was an Enforcement Committee established to adjudicate on all alleged contraventions of legislation, regulations, codes of conduct, etc. administered by the FSCA. This committee was made of up non-FSCA employees. The FSCA now imposes its own sanctions with oversight carried out by the Financial Services Tribunal.

**2.6.1 The Financial Sector Conduct Authority (FSCA) and enforcement of FAIS Act**

The Financial Sector Conduct Authority is established by section 56 (1) of the FSR Act, as a juristic person. The FSCA replaces the Financial Services Board all the mandates of the FSB were taken by the FCSA since 1 April 2018.

**2.6.2 The role and functions of the Commissioner**

The FSR Act establishes the position of Commissioner, where previously under the FSB there was a Registrar.

The Commissioner is the accounting authority of the Financial Sector Conduct Authority. The Commissioner is appointed by the Minister of Finance. The requirement is that the person so appointed must be fit and proper and has appropriate expertise in the financial sector as the Commissioner of the Financial Sector Conduct Authority. The FSR Act also provides that the Minister must also appoint at least two, but no more than four, persons who have appropriate expertise in the financial sector as Deputy Commissioners to assist the Commissioner.

The Commissioner and Deputy Commissioners serve in a full-time executive capacity. The Commissioner, with his or her Deputies:

* is responsible for the day-to-day management and administration of the Financial Sector Conduct Authority; and
* Must perform the functions of the Financial Sector Conduct Authority, including exercising the powers and carrying out the duties associated with those functions.

The Commissioner and the Deputy Commissioners are part of the FSCA Executive Committee, whose responsibilities, includes among others, the following:

* generally overseeing the management and administration of the Financial Sector Conduct Authority to ensure that it is efficient and effective; and
* Acting for the Financial Sector Conduct Authority in the following matters:
* Authorising the Commissioner to sign, on behalf of the Financial Sector Conduct Authority, a memorandum of understanding with the Reserve Bank as per sections 27 and 77 ofFSR Act and any amendments to such a memorandum;
  + Delegating powers of the Financial Sector Conduct Authority to the Prudential Authority in terms of the memorandum of understanding;
  + Adopting the regulatory strategy of the Financial Sector Conduct Authority, and any amendments to the strategy;
  + Adopting the administrative action procedures of the Financial Sector Conduct Authority, and any amendments to those procedures;
  + Appointing members of subcommittees of the Financial Sector Conduct Authority required or permitted by a law, and giving directions regarding the conduct of the work of any subcommittee
  + Making conduct standards, joint standards and other regulatory instruments in terms of financial sector laws for which it is the responsible authority;
  + Granting, varying, suspending and revoking licences in terms of a financial sector law;
  + Making determinations of fees in terms of financial sector laws;
  + Any other matter assigned in terms of a financial sector law to the Executive Committee.

The Commissioner will impose penalties to any persons who fails to comply with the requirements of both the FAIS Act and the FSR Act.

**2.6.3 The Compliance officer and Compliance arrangements**

THE FAIS Act requires an authorised financial services provider to establish and maintain procedures to be followed by the provider and any representative concerned in order to ensure compliance with the Act.

The FSP will be able to effectively comply with the Act when they appoint a compliance officer under the following circumstances:

* If the FSP has more than one key individuals
* If the FSP has one or more representatives.

More than one compliance officer may be appointed to monitor compliance with the Act by the provider and its representatives.

The role of the compliance officer is to assist the management of an FSP to establish and maintain a compliance function as part of the risk management framework of the FSP. The compliance officer is responsible for support, monitoring and training.

The compliance function must be supervised by an approved compliance officer where required in terms of the FAIS Act or otherwise managed under the control and responsibility of the provider alone in the case of a sole proprietorship.

The compliance function must be exercised with diligence, care and degree of competency as may be reasonably expected from a person responsible for such a function. It is the responsibility of the compliance officer to provider the FSP with written reports on the level of compliance within the business as well as highlight areas that require more compliance efforts. The compliance officer must on an ongoing basis, monitor compliance with processes, procedures as well as compliance with the applicable legislation and must make recommendations to the FSP as regards any aspect of the required compliance or monitoring functions.



Even though a compliance officer may have been appointed and is responsible for managing the compliance function, ultimately the responsibility for compliance with the requirements and standards of the FAIS Act lies with the FSP.

Failure to establish a compliance function can result in the FSP running into regulatory compliance problems which can ultimately negatively taint such FSP`s reputation in the long run.

An FSP may appoint an internal or external compliance officer:

* Internal compliance officer – is one that is a natural person in the permanent employ of a financial services provider and that renders compliance services in respect of that particular provider or another financial services provider that is a subsidiary or holding company of the FSP. An internal compliance officer can be a director, member, auditor, trustee, public officer or company secretary of the FSP.
* External compliance officer – is a compliance officer other than an internal compliance officer and includes a compliance practice.

A compliance practice means a company, close corporation or partnership that appoints one or more natural persons to render compliance services in respect of a particular provider and such natural persons are approved by the FSCA for that purpose as compliance officers.

A compliance officer who does not meet the necessary requirements on application to the Authority may work under supervision for a period of three years from the date of approval.

**a) Duties of a compliance officer**

* Monitoring compliance with the requirements and standards of the FAIS Act and subordinate legislation
* Submitting compliance report annually and in a prescribed format to the FSCA
* Creating, implementing and monitoring systems and procedures to ensure compliance with the requirements of the FAIS Act by the FSP, its key individuals and representatives
* Organising and carrying out training as identified
* Giving input on compliance issues at meetings
* Providing the FSP with written reports at least quarterly indicating any issues, together with proposed solutions following the monitoring of compliance by the FSP.
* Carrying out regular compliance audits
* Offering support with regard to identified compliance problems or queries
* Assisting with the development and maintenance of a compliance culture
* Talking responsibility for liaison with the FSCA. This includes reporting to the Authority any irregularities or suspected irregularities that the compliance officer becomes aware of whilst performing their duties
* Supervising the compliance function on behalf of the FSP.



**Independence of compliance officer**

The role of the compliance officer must be structured to be independent from management. Management should respect the independence of the compliance officer and should not make it difficult for the compliance officer to perform their role objectively. The compliance officer plays an essential role in ensuring compliance within the FSP and they must not be susceptible to undue influence from management or anyone else within or outside of the FSP.

**b) The compliance report and the soon to be Conduct of Business Report (COBR)**

All FSPs must submit a compliance report to the FSCA. The report is usually submitted by the compliance officer on behalf of the FSP. The report is in the format of a questionnaire and is used by the authority to gauge the level of compliance of the FSP.

The report must be submitted on an annual basis. The submission date is determined by the category of FSP. Unlike previous reporting periods, the financial year end of the FSP no longer influences the submission date of the compliance report. The Authority publishes the various submission dates for the compliance reports on their website. The report can be submitted either as a hard copy (posted or hand delivered) or electronically (preferred method). The current report is available on the Authority’s website.

The FSCA intends to replace the current compliance reports with the **Conduct of Business Report (COBR)**. The COBR was necessitated by the changing regulatory landscape and the focus on outcomes-based regulation and proactive supervision. It further seeks to address the inefficiencies created by requiring providers, regulated in terms of other laws administered by the FSCA, to submit the same information more than once to the FSCA.

**c) Avoidance of conflict of interest**

The FSP must be aware of any possible conflict of interest in relation to the compliance officer. To avoid conflict of interest, the duties of the compliance officer must not be subordinated to the interested of the FSP. The overriding priority of the compliance officer is to manage and monitor compliance. In circumstances where a conflict of interest arises, it becomes more difficult for the compliance officer to maintain an objective approach to compliance and this may compromise the overall compliance of the FSP.

**d) Terminating the services of a compliance officer**

Should the services of a compliance officer be terminated, the compliance officer is required to make a statement which includes the reason why the relationship has come to an end. This is irrespective of whether the reason for the termination is resignation or the end of a contract with an FSP. The compliance officer is also required to confirm whether there is any information they should bring to the attention of the FSCA and would have done so if their services had not been terminated.

**2.6.4 Record keeping duties of an FSP**

The FAIS Act prescribes record-keeping requirements for FSPs unless exempted by the FSCA. The following records must be kept for a minimum period of five years:

* Known pre-mature cancellations of transactions of financial products
* Complaints received together with an indication of whether or not they have been resolved
* The continued compliance with the requirements on licensing and authorisation
* Any case of non-compliance with the Act and the reasons for the non-compliance
* The continued compliance by representatives with the fit and proper requirements.

The General code of conduct requires an FSP to have the following procedures and systems in place to:

* Record verbal and written communications relating to the financial services given to the client (including all disclosures made to the client)
* Store and retrieve these records and any other material documentation relating to the client or the financial service given to the client.
* Keep the client records and documentation safe from destruction.

All these records must be kept for a period of five years after termination (as long as the FSP has knowledge of this) of any product sold or financial services given.

An FSP is not required to keep records themselves. However, if the records are stored off-site, they must be available for inspection within seven days of a request from the Authority.

Records may be kept in an appropriate electronic or recorded format; however these must be accessible and easily reduced to written or printed form.



**Confidentiality of records**

The FAIS General Code of Conduct specifies that no confidential information obtained from a client or product supplier (or in regard to that client or product supplier) may be disclosed to anyone without the written consent of the client or the product supplier. However, in very particular circumstances, this information may be disclosed if it is in the public interest or as is required by any law.

**2.6.5 Debarment of a representative**

Generally speaking, debarment means that a person is excluded from something or from doing something. In financial services, debarment of a representative means that a representative’s authority to render financial services has been withdrawn, until they are reappointed after the reasons for debarment have been addressed.

Debarment is a requirement of the FAIS Act and section 14 of the FAIS Act requires an FSP to ensure that a representative who is no longer fit and proper, or who has contravened the FAIS Act in a material manner is prohibited by the FSP to provide any new financial services.

If debarred, a representative may no longer work for the FSP. This means the representative cannot give advice or render intermediary services to clients as the FSP has withdrawn the authority to act on their behalf. To debar a representative, the FSP should have procedures in place that are fair and comply with the requirements of labour law (employee) or the law of contract (mandatory).

**a) Debarment by FSP**

Debarment is done under section 14 of the FAIS Act, which was replaced by a new section in 2018. In 2019 the FSCA published Guidance Note 1 of 2019 stipulating the procedure to be followed during the debarment process.

***Obligation to debar***

An FSP must debar a representative or key individual who no longer meets the applicable fit and proper requirements or has contravened or failed to comply with any part of the FAIS Act. As many employees simply resign before the debarment process is completed, section 14(4) and (5) now caters for such circumstances. Where the reason for the debarment becomes known by the FSP while the individual is still employed, it must commence with the debarment process within 6 months after the employee has resigned.

From this it is clear that the FSP cannot start debarment processes where the actions giving rise to the debarment only becomes known after the employee has left or if the process only starts 6 months after he has left. In these cases the matter must be referred to the Authority.

***Requirements for debarment***

The following steps summarises the requirements:

1. Give adequate notice in writing to the individual of the intention to debar.

It should provide the grounds and reasons for the intent to debar, a copy of the FSPs debarment policies and provide the individual with a reasonable opportunity to make a submission.

1. Consider the submission received and any other facts it may receive.
2. Take a decision on whether to debar the individual.

If the individual is debarred provide him with a written copy of the decision, the reason for the decision and his right to have it reviewed by the Tribunal.

***FSPs duties after debarment***

The FSP debars a representative by:

* Withdrawing the authority of the representative to act for and on behalf of the FSP; and
* Removing the name of the representative from the representative register.

The FSP must also:

* Take immediate steps to ensure that the debarment does not prejudice the interests of the clients of the representative; and
* Ensure that unconcluded business of the representative is properly concluded.

The FSP must then, within 15 days of the removal of the representative's name from the register, inform the Authority of the removal in writing. This notification must include the details of the reasons for the debarment and must be in the prescribed format. Remember that the Authority does not (ordinarily) debar representatives, but only updates the central register after having been notified by FSPs of the debarment of representatives.

A representative may be linked to more than one FSP. If such a representative has been debarred by FSP 1 then FSP 2 will be notified by the Authority that the said representative has been debarred by FSP 1.

The Authority may make known any debarment as well as the reasons for it on the official web site or in any appropriate public media. This is to ensure that the public is informed of representatives who are unfit to render a financial service and are no longer authorised to do so.

**b) Debarment by the FSCA**

The Financial Sector Regulation Act empowers the FSCA to debar a person in certain circumstances. A debarment order prevents the person from acting within their capacity as an FSP, key individual and a representative.

When the Authority wants to debar a representative, the Registrar must inform the representative of the following:

* The grounds for the intention to debarment and give the representative a reasonable opportunity to make a submission in response thereto;
* Any terms to be attached to the intended period of suspension, including:
* a prohibition on concluding any new business by the representative as from the effective date of the debarment and, in relation to unconcluded business, such measures as the Registrar may determine for the protection of the interests of clients of the licensee; and
* Terms designed to facilitate the lifting of the debarment.

The Authority must consider any response received. He may thereafter decide to debar or not to debar the representative and must notify the representative of the decision.

An FSP must, within a period of five days after being informed by the Authority of the debarment, remove the names of that representative and key individuals from the register.

The Authority may publish the debarment or the lifting of the debarment.

**c) Reappointment of a debarred representative**

If a representative is debarred, he may be reappointed provided that he complies with the requirements of reappointment as determined by the Authority in the Government Gazette.

Before a debarred representative can be reappointed, he needs to meet the following requirements:

* Twelve months must have elapsed since the debarment date. However, if debarment results from lack of competence and personal character qualities then the debarment can be lifted as soon as full competence is achieved, even if it is before 12 months have elapsed. However, it is difficult to see how a person who has been debarred for not being honest of having integrity would be able to be reappointed after 12 months only. This is due to the nature of the honesty and integrity requirements, as discussed earlier.
* All unconcluded business of the debarred representative must have been properly concluded.
* All complaints or legal proceedings (if any) submitted by clients to the applicant or the debarring provider, or the Ombud or any court of law; or other administrative or legal procedures or proceedings in terms of the FAIS Act or any other law, arising out of any acts or omissions in which the applicant was directly or indirectly involved prior to the debarment date, have been properly and lawfully resolved or concluded, as the case may be, and that the applicant has fully complied with any decision, determination or court order in connection therewith, given or issued in respect of the applicant.
* All applicable fit and proper requirements must be met.

## 2.7 Consumer complaints

Consumers of financial products have the right to complain about any inappropriate advice given or service rendered in relation to a particular financial product. The FAIS Ombud's role is to resolve disputes between financial services providers and their clients in a fair, informal, quick and effective manner.

Whilst the role of the FAIS Ombud is to try and resolve customer complaints, the FAIS General code of conduct requires that complaints be handled internally between the client and the FSP before being brought to the attention of the FAIS Ombud.

A financial services provider must:

* request that any client who has a complaint against the provider, lodge such complaint in writing;
* maintain a record of such complaints for a period of five years;
* handle complaints from clients in a timely and fair manner;
* take steps to investigate and respond promptly to such complaints; and
* Where such a complaint is not resolved to the client’s satisfaction, advise the client of any further steps which may be available to the client in terms of the FAIS Act or any other law.

**2.7.1 Internal complaints resolution**

An FSP provider must maintain an internal complaint resolution system and procedures based on the following:

* Maintenance of a comprehensive complaints policy outlining the provider’s commitment to, and system and procedures for, internal resolution of complaints;
* transparency and visibility: ensuring that clients have full knowledge of the procedures for resolution of their complaints;
* accessibility of facilities: ensuring the existence of easy access to such procedures at any office or branch of the provider open to clients, or through ancillary postal, fax, telephone or electronic helpdesk support; and
* Fairness: ensuring that a resolution of a complaint can during and by means of the resolution process be affected which is fair to both clients and the provider and its staff.

The internal complaint resolution system and procedures of the provider excluding a representative must be designed to ensure the existence and maintenance of at least the following for purposes of effective and fair resolution of complaints:

* availability of adequate manpower and other resources;
* adequate training of all relevant staff, including imparting and ensuring full knowledge of the provisions of the Act, the Rules and this Code with regard to resolution of complaints;
* ensure that responsibilities and mandates are delegated to facilitate complaints resolution of a routine nature;
* ensure that there is provision for the escalation of non-routine serious complaints and the handling thereof by staff with adequate expertise;
* Internal follow-up procedures to ensure avoidance of occurrences giving rise to complaints, or to improve services and complaint systems and procedures where necessary.

One of the most effective mechanisms for resolution of customer complaints is the ombud schemes. These schemes are ensuring a fair, equitable and speedy resolution to customer complaints against financial service providers. The Ombud schemes work under the Ombud’s Council.

**2.7.2 The Ombud Council**

The Financial Sector Regulation Act establishes the Ombud Council. The Ombud Council does not replace the existing ombud schemes but is rather an additional mechanism to improve the handling and resolution of consumer complaints.

The objective of the Ombud Council is to assist in ensuring that financial customers have access to, and are able to use, affordable, effective, independent and fair alternative dispute resolution processes for complaints about financial institutions in relation to financial products, financial services, and services provided by market infrastructures – Section 176.

In its role of overseeing ombud schemes, the Council will effectively become a ‘regulator’ of ombuds, with authority to standardise best practice and to promote and coordinate cooperation amongst ombuds. The Ombud Council will have oversight powers over both the statutory and industry Ombuds, namely:

* Office of the Pension Fund Adjudicator
* Office of the FAIS Ombud
* Office of the Credit Ombud
* Ombudsman for Long – Term Insurance
* Ombudsman for Short – Term Insurance
* Ombudsman for Banking Services
* Johannesburg Stock Exchange Ombud

The Minister of Finance appointed Ms Eileen Meyer as the Chief Ombud for the Ombud Council for a short period.

**2.7.3 The Ombud schemes**

The objective of a financial ombud is to resolve complaints by clients against banks, insurers and other financial institutions. This system plays a very important role in protecting clients. The Financial Services Ombud Schemes Act 37 of 2004 Establishes the Office of the FAIS Ombud.

The purpose of the Act is to provide for the recognition of financial services ombud schemes; to lay down minimum requirements for ombud schemes; to promote consumer education with regard to ombud schemes; to co-ordinate the activities of ombud of recognized schemes with the activities of the Pension Funds Adjudicator and the Ombud for Financial Services Providers; to develop and promote best practices for complaint resolution; to empower the Ombud for Financial Services Providers to act as a statutory ombud in certain cases.

An ombud scheme investigates complaints on behalf of financial clients against financial service providers. This is done independently and impartially at a very low cost to the client. It provides an “independent, impartial, fair, timely and efficient dispute resolution process that is free to consumers. It is independent of and external to the companies that are being complained about.

The ombud schemes in South Africa provide clients with an alternate to going to court in the event of a dispute between themselves and an industry participant. Currently there are seven Ombud schemes in the financial services industry some of which have been established in terms of legislation whilst some are industry initiatives. This ensures that there is a consistent approach amongst all ombud schemes and that minimum standards are followed.

**a) FAIS Ombud**

The Office of the Ombudsman for Financial Service Providers (FAIS Ombud) was established by the FAIS Act. The main objective of the Ombud is to consider and dispose of complaints by clients against financial services providers in a fair, informal, economical and speedy manner with reference to what is equitable in the circumstances. In doing so, the Ombud acts independently, impartially and objectively. The FAIS Ombud provides a mechanism for handling disputes between clients and FSPs without going to court.

**i) Complaints adjudicated on by the FAIS Ombud**

The FAIS Ombud deals with specific complaints made by clients against FSPs or representatives. The complaint must relate to a financial service carried out by an FSP and/or representative to the person making the complaint. Either the FSP or the representative must have been giving financial advice or carrying out an intermediary service in order for a compliant to be brought against them.

The complaint will be considered if it is alleged that the FSP or representative has:

* Contravened or failed to comply with a provision of the FAIS Act and that as a result the client has suffered or may suffer financial prejudice or damage.
* Deliberately or negligently (carelessly or without proper care) carried out a financial service to the client and has caused prejudice or damage to the client or which is likely to cause prejudice or damage.
* Treated the client unfairly.

**ii) Maximum Monetary value of the complaint**

The FAIS Ombud has a monetary jurisdictional limit of R 800 000. This means, they will not entertain a case where the amount claimed is more than R 800 000 unless two events take place:

* The complainant abandons the amount in excess of R800 000 to bring their claim within the jurisdictional limits of the FAIS Ombud;
* The person against whom the complaint is lodged agrees that the FAIS Ombud entertains the complaint.

Should the amount exceed R800 000 the complainant can go to the courts or limit the claim to R800 000 so that it may be decided upon by the FAIS Ombud.

**iii) Complaints that cannot be adjudicated on by the FAIS Ombud**

The FAIS Ombud cannot hear any complaint that relates to the investment performance of a financial product. However, the Ombud can hear a complaint of this nature when:

* The investment performance was guaranteed in express terms
* It appears to the FAIS Ombud that the poor investment performance may be as a result of negligence, fraud or poor administration on the part of the FSP.

**iv) Time limit for registration of complaint**

Before going to the FAIS Ombud with a complaint, the client must first try to resolve the complaint directly with the FSP or representative. This must be done in writing and the proof thereof must be kept safe.

The client then has six months after the final response from the FSP or representative within which to submit a complaint to the FAIS Ombud.



A complaint will not be investigated by the FAIS Ombud if court proceedings have already been instituted.

It therefore follows that the courts will handle cases:

* Where the claim amount at the FAIS Ombud exceeds R800, 000.
* Where the client has already taken the matter to court and only later try to bring it to the FAIS Ombud.

**v) Complaints procedure**

The complaints procedure goes as follows:

* Both parties (the client and the FSP or representative) may be entitled to legal representation
* The FSP or representative must be notified about the complaint so that they are in a position to respond to the complaint.
* The FSP or representative must act professionally, reasonably and cooperate in order to try and resolve the complaint
* The FAIS ombud must first try and reach a settlement by mediating between the parties or by making recommendations as to how the complaint can be settled.
* Only if the matter cannot be settled or the recommendations is not accepted by the either of the parties, will the FAIS Ombud make a final determination which may include:
  + Dismissal of the complaint
  + Upholding the complaint (the whole complaint or part of the complaint) by awarding the client an amount as fair compensation for financial prejudice of damage suffered.
* The FAIS Ombud must give reasons for the decision. The decision must be in writing and signed by the Ombud. It is then lodged with the Clerk or Registrar of the Court and has the effect of a civil judgment of a court.
* The decision can be appealed against by either the client or the FSP or representative concerned.

**vi) Obligations of an FSP in respect of an investigation**

If the FAIS Ombud decides that it is necessary, the FSP is required to discuss a complaint with the Ombud and provide the Ombud any further information needed. The FSP is required to act professionally and reasonably and to cooperate with a view to making sure the complaint is resolved.



**b) Ombudsman for banking services**

The Ombudsman for Banking Services is a voluntary service that provides a free, informal dispute resolving service for individual complaints about baking services and products. It is an independent and impartial body that reports to the Banking Adjudicator’s Commission, not the banks.

The Ombudsman cannot make rules for the banking industry nor deal with policy issues nor give general advice about banking or financial matters. Commercial decisions taken by banks regarding fees or the granting of credit are also beyond its jurisdiction, unless maladministration has occurred. However, any bank customer who has a complaint against their bank with regard to service or banking products may approach the Ombudsman for assistance.

**c) Pension Funds Adjudicator**

The Pension Funds Adjudicator was established to investigate complaints lodged in terms of the Pension Funds act 24 of 1956 in a cost-effective manner. In order to lodge a complaint, the complainant must be a member or former member of a pension fund, a beneficiary or former beneficiary of a fund or an employer who participates in a fund. In addition, the Management Board of a fund or a member of the Management Board may also lodge a complaint to the Adjudicator.

**d) Ombudsman for short term insurance (non-life insurance)**

The purpose of the Ombudsman for Short-term Insurance is to resolve short-term insurance disputes between members of the South African Insurance Association (SAIA) and consumers in an independent, impartial, cost-effective, efficient, informal and fair manner. The Ombudsman’s duty is to evaluate claims received in proper format. It is limited to deal with personal lines claims against short-term insurers where the insurer has repudiated a claim under a policy and the insured party claims that the insurer’s repudiation was wrong or legally unsound.

The Ombudsman is specifically precluded from dealing with cases concerning statutory third-party insurance matters, commercial or industrial insurance or cases where the insured party is an artificial person, namely a limited liability company or a close corporation. The Ombudsman does not handle complaints that are already in the hands of an attorney especially in situations where ligation is pending or in existence between parties, unless specifically requested to do so by both parties.

**e) Ombudsman for Long-term insurance (life-insurance)**

The main objective of the Ombudsman for Long-term Insurance is to mediate between long-term insurers and policyholders in disputes regarding long-term insurance. The Office of the Ombudsman was established to speed up the process of resolving disputes within this arena, the objective being to provide a cost-effective and efficient system of resolving complaints.

However, the Ombudsman does not deal with complaints about the underwriting of a policy, actuarial standards, tables and principles used by long-term assurers in their business, calculation of certain values on policies, bonus rates or the performance to which a policy is linked.

While the Ombuds for life and non-life insurance still exist separately, the have amalgamated resources in an effort to improve service and lower costs.

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| **Consumer complaints**  InsureLaw an authorised FSP employed two people; John Smith was employed as Chief Executive Officer for approximately 14 years and Lerato Chauke as General Manager for approximately 8 years. In their roles, they also acted as financial services representatives and key individuals.  During October 2018 InsureLaw, obtained information indicating that both John and Lerato no longer qualified as being fit and proper in terms of section 8(1)(a) of the FAIS Act. The information pertained to allegations that the two were making secret profits in respect of business that InsureLaw was conducting with one of its clients. According to the information obtained, an amount of R2.3 million had been paid to them by the client. This, according to InsureLaw, was in breach of the fiduciary duty they owed it. The InsureLaw considered the dealings of its two employees with its client as a breach, as in effect they were competing with InsureLaw.  a) Which FAIS fit and proper requirement did John and Sifiso fail to meet and why?  b) Describe what a fiduciary duty is and explain why it is important?  c) Why are the actions of John and Lerato deplorable and what are the likely consequences? |

## 2.8 FAIS General Code of conduct

The FAIS General Code of Conduct prescribes the minimum standards that must be complied with by an FSP and its representatives when engaging with clients.

The current code covers the following areas:

|  |  |
| --- | --- |
| Part I | Introductory provisions |
| Part II | General provisions |
| Part III | Information on product suppliers |
| Part IV | Information on providers |
| Part V | Contacting of client |
| Part VI | Information about financial service |
| Part VII | Furnishing of advice |
| Part VIII | Custody of financial products and funds |
| Part IX | Risk Management |
| Part X | Advertising and direct marketing |
| Part XI | Complaints |
| Part XII | Termination of agreement or business |
| Part XIII | Waiver of rights |

In this guide, we will focus mainly on the provisions that are critical for a financial advisor and thus the following will be addressed in greater detail:

* General and specific duties of an FSP
* Conflict of interest policy
* Disclosures
* Process of furnishing advice
* Risk Management
* Custody of funds.

**2.8.1 General duties required of an FSP**

An FSP and its representatives must always provide financial services:

* Honestly
* Fairly
* With due skill, care and diligence
* In the interests of the client
* With the integrity of the financial services industry.

**2.8.2 Specific duties of an FSP**

i) Any representations made and information given to a client:

* Must be factually correct
* Must be in plain language, avoid uncertainty or confusion and not be misleading
* Must be adequate and appropriate. THE FSP must factually establish or reasonably assume the level of knowledge of the client. This can be done by asking appropriate questions.
* Must be given to the client timeously so that the client has reasonably sufficient time in which to make an informed decision about a proposed transaction.
* Can be given orally and at the client’s request, it must be confirmed in writing within a reasonable time after the request.
* In writing or on a standard form and must be clear and of readable print size, spacing and format.
* Must show in specific monetary terms all amounts, sums, values, charges, fees, remuneration or monetary obligations payable to the product supplier or FSP; need not be duplicated or repeated to the same client unless it is important or major changes affecting the client take place or the financial service makes it necessary to do so, in which case disclosure of the changes must be made to the client without delay.

ii) The client must be told by the FSP of the existence if any personal interest in the relevant service or of any circumstances that give rise to an actual or potential conflict of interest. All reasonable steps must be taken to make sure the client is treated fairly.

iii) Non –cash incentives and/or other indirect considerations payable by another FSP, product supplier or any other person to the FSP could be viewed as a potential conflict of interest

iv) The financial service must be provided according to the contractual relationship and reasonable request or instruction of the client. These requests and instructions must be executed as soon as reasonably possible and with due regard to the interests of the client which must be accorded appropriate priority over any interests of the FSP.

v) The transactions of a client must be accurately accounted for.

vi) The FSP must not deal in any financial product for their own benefit, account or interest where the dealing is based on advance knowledge of pending transactions for or with clients, or any non-public information where the disclosure of this information would be expected to affect the prices of the products.

vii) The FSP must have appropriate procedures and systems in place to:

* Record all verbal and written communications relating to the financial service
* Store and retrieve these records and any other important documentation relating to the client or the financial service.
* Keep the records and documents safe from destruction.

viii) All records must be kept for a period of five years after termination, to the knowledge of the FSP, of the product concerned, or in any other case after the rendering of a financial service.

ix) Although the FSP is not required to keep all records onsite, the records must be available for inspection within seven days of the Authority’s request.

x) Records can be stored electronically or another recorded format

xi) FSPs cannot disclose client information unless the client has given written consent (letter of authority) beforehand or the disclosure of the information is required in the public interest or under any law.

xii) A provider may not indicate or imply that it is authorised, regulated or otherwise supervised by the Authority in respect of business for which it is not so authorised, regulated or supervised or that its provision of certain products or services is regulated by the Authority, if they are not.

xiii) A provider may not describe itself or the financial services it renders as being “independent” if the provider or its associate is a significant owner of any product supplier or its associate in respect of whose products the provider renders financial services or vice versa, or it receives any additional financial interest from a product supplier.

**2.8.3 Conflict of Interest Management Policy**

Financial advisors may only receive the following:

* Regulated commission under the Long-term Insurance Act, Short-term Insurance Act or Medical Schemes Act as well as fees allowed by these Acts.
* Where these commissions or fees are not applicable, fees for the rendering of a financial service can be agreed to with the client, provided it is in writing and can be stopped at any time.
* Fees or remuneration for the provision of a service to a third party
* An immaterial interest (less than a R1000 annually) from any provider
* A fee for any other service that is reasonable and commensurate with such service.

The fee earned by a representative from its FSP, may not be based on the volume of business without measuring quality of compliance, service levels and treatment of clients, nor may it give preference to one product or product provider above another.

The FSP or representative may only receive the fees negotiated with a client if it is reasonably commensurate with the service being rendered, taking into account the nature of the service and the resources, skills and competencies reasonably required to perform it; it does not result in the provider or representative being remunerated more than once for performing a similar service; any actual or potential conflicts between the interests of clients and the interests of the person receiving the financial interests are effectively mitigated; and the payment of those financial interests does not impede the delivery of fair outcomes to clients.

***Conflict of interest policy***

Every FSP must adopt, maintain and implement a conflict of interest management policy that complies with the provisions of the Act. A conflict of interest management policy must—

* provide for the management of conflicts of interest;
* specify the type of financial interest that the provider will offer a representative and the basis on which a representative will be entitled to such a financial interest;
* include a list of all its associates;
* include the names of any third parties in which the provider hold an ownership interest;
* include the names of any third parties that holds an ownership interest in the provider; and
* include the nature and extent of the ownership interests above

The policy must be drafted in an easily comprehensible form and manner.

**2.8.4 Disclosure requirements**

The code of conduct prescribes the disclosures that must be made to clients. These include:

* Information on a product supplier
* Information on the FSP or representative
* Contacting the client
* Information about the financial service.

**a) Information on a product supplier**

An FSP must provide a client with appropriate information on product suppliers at the earliest opportunity. If the information is given orally to the client must be confirmed in writing within 30 days. The information that must be disclosed to a client includes:

* Name, physical location, and postal and telephone contact details of the product supplier
* the contractual relationship with the product supplier (if any), and whether the provider has contractual relationships with other product suppliers;
* Names and contact details of the relevant compliance and complaints departments of the product supplier.
* The existence of any conditions or restrictions imposed by the product supplier with regard to the types of financial products or services that may be provided or rendered by the provider.
* where applicable, the fact that the provider –
  + directly or indirectly holds more than 10% of the relevant product supplier’s shares, or has any equivalent substantial financial interest in the product supplier;
  + During the preceding 12 month period received more than 30% of total remuneration, including commission, from the product supplier.

Clients must be notified at the earliest opportunity of any changes regarding these matters:

* A product supplier who is an authorised FSP and enters into a contract with another FSP to sell their financial products, must supply all their details to that FSP (within a reasonable time after being asked to do so) to enable them to comply with the disclosure requirements of the code.
* An FSP who is able to offer a choice of products from different product suppliers, must exercise judgement objectively in the interests of the client concerned.
* An FSP may not compare different financial products, product suppliers, providers or representatives unless the differing characteristics of each are made clear. The FSP may not make inaccurate, unfair or unsubstantiated criticisms of any financial service, financial product, product supplier, FSP or representative.

**b) Information on the FSP or representative**

Information about the FSP must be disclosed to the client at the earliest opportunity. If the information is given orally to the client, it must be confirmed in writing within 30 days. The information that must be disclosed include:

* Full business and trade names, registration number (if any), postal and physical addresses, telephone and, where applicable, cellular phone number, and internet and e-mail addresses, in respect of the relevant business carried on, as well as the names and contact details of appropriate contact persons or offices;
* concise details of the legal and contractual status of the provider, including details as regards the relevant product supplier (or, in the case of a representative, as regards the relevant provider and product supplier), to be provided in a manner which can reasonably be expected to make it clear to the client which entity accepts responsibility for the actions of the provider or representative in the rendering of the financial service involved and the extent to which the client will have to accept such responsibility;
* Names and contact details of the relevant compliance department or, in the case of a representative, such detail concerning the provider to which the representative is contracted;
* Details of the financial services which the provider is authorised to provide in terms of the relevant licence and of any conditions or restrictions applicable on it
* Whether the provider holds guarantees or professional indemnity or fidelity insurance cover or not.
* Whether a representative of a provider is rendering services under supervision as defined in the Determination of Fit and Proper Requirements; and
* The existence of a specific exemption that the Authority may have granted to the provider with regard to any matter covered by the FAIS Act.

**c) Contacting the client**

When making arrangements, and in all communications and dealings with a client, an FSP or representative must act:

* Honourably and professionally, and
* take into account whether it is convenient to the client.

At the beginning of any contact, visit or call, initiated by the FSP or representative, the purpose of the contact, visit, or call must be explained. If it is the first contact, the information on the FSP must be provided to the client, at the earliest convenience.

**d) Information about the financial service**

An FSP must provide the client with information about the financial service it aims to provide. This is to assist the client in making an informed decision about the financial service. The information that must be disclosed includes:

* A reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision;
* Whenever reasonable and appropriate, provide to the client any material contractual information and any material illustrations, projections or forecasts in the possession of the FSP.

Where applicable, the FSP must also disclose to the client, at the earliest reasonable opportunity, full and appropriate information of the following:

* Name, class or type of financial product concerned;
* nature and extent of benefits to be provided, including details of the manner in which such benefits are derived or calculated and the manner in which they will accrue or be paid.
* On investments, concise details of the manner in which the value of the investment is determined, including concise details of any underlying assets or other financial instruments.
* On request, information concerning the past investment performance of the product over periods and at intervals which are reasonable with regard to the type of product involved including a warning that past performances are not necessarily indicative of future performances.
* the nature and extent of monetary obligations assumed by the client, directly or indirectly, in favour of the product supplier, including the manner of payment or discharge thereof, the frequency thereof, the consequences of non-compliance.
* the nature and extent of monetary obligations assumed by the client, directly or indirectly, in favour of the provider, the amount, frequency and payment method thereof, details of the services that are to be provided by the provider or its representatives in exchange therefor; and the client’s rights in relation to terminating those obligations and the consequences of terminating or failing to meet those obligations; which information should, wherever feasible, be included in a written agreement between the client and the provider.
* The nature, extent and frequency of any incentive, remuneration, consideration, commission, fee or brokerages (“valuable consideration”), which will or may become payable to the provider, directly or indirectly, by any product supplier or any person other than the client. The product supplier or any other person paying these amounts must be notified.
* Concise details of any special terms or conditions, exclusions of liability, waiting periods, loadings, penalties, excesses, restrictions or circumstances in which benefits will not be provided.
* Any guaranteed minimum benefits or other guarantees
* To what extent the product is readily realisable or the funds concerned are accessible
* Any restrictions on or penalties for early termination of or withdrawal from the product, or other effects, if any, of such termination or withdrawal.
* material tax considerations
* whether cooling off rights are offered and, if so, procedures for the exercise of such rights;
* any material investment or other risks associated with the product; and
* In the case of an insurance product in respect of which provision is made for increase of premiums, the amount of the increased premium for the first five years and thereafter on a five-year basis but not exceeding twenty years.

An FSP must fully inform a client in regard to the completion or submission of any transaction requirement.

* that all material facts must be accurately and properly disclosed, and that the accuracy and completeness of all answers, statements or other information provided by or on behalf of the client, are the client’s own responsibility;
* that if the provider completes or submits any transaction requirement on behalf of the client, the client should be satisfied as to the accuracy and completeness of the details;
* of the possible consequences of the misrepresentation or non-disclosure of a material fact or the inclusion of incorrect information; and
* that the client must on request be supplied with a copy or written or printed record of any transaction requirement within a reasonable time.

An FSP may not, in the course of carrying out a financial service, request a client to sign any written or printed form or document unless all details required to be inserted have been completed by the client or on behalf of the client.

The FSP must, where applicable, provide the client with a statement of account in connection with any financial service rendered to the client.

**2.8.5 Process of providing advice**

Providing clients with appropriate advice is the cornerstone of the FAIS Act. When providing advice, there are certain requirements which must be followed with regard to the suitability of the advice, replacement of a financial product, a situation where insufficient information is given by the client or a situation in which the client does not follow advice and the record of advice.

**a) Suitability of the advice**

Before advising a client, an FSP must:

* obtain from the client such information regarding the client’s needs and objectives, financial situation, risk profile and financial product knowledge and experience as is necessary for the provider to provide the client with appropriate advice, which advice takes into account the client’s ability to financially bear any costs or risks associated with the financial product; the extent to which the client has the necessary experience and knowledge in order to understand the risks involved in the transaction; and where the client is a pension fund, medical scheme, friendly society, employer or other entity that is being advised on entering into a financial product or transaction aimed at providing benefits for its members, employees or other underlying natural persons, the reasonably identified collective needs and circumstances of such members, employees or other natural persons;
* conduct an analysis, for purposes of the advice, based on the information obtained;
* identify the financial product or products that will be appropriate to the client’s risk profile and financial needs, subject to the limitations imposed on the provider under the Act or any contractual arrangement; and
* where, as a result of the limitations referred to above, the provider is not able to identify a financial product or products that will be appropriate to the client’s needs and objectives, financial situation, risk profile and product knowledge and experience, the provider must make this clear to the client, decline to recommend a product or transaction and suggest to the client that they should seek advice from another appropriately authorised provider;

**b) Advice on replacement of products**

Where the financial product (“the replacement product”) is to replace an another financial product wholly or partially (“the terminated product”) held by the client, fully disclose to the client the actual and potential financial implications, costs and consequences of such a replacement.

Where applicable, the following information must be disclosed to a client:

* Fees and charges in respect of the replacement product compared to the terminated product;
* Special terms and conditions, exclusions of liability, waiting periods, loadings, penalties, excesses, restrictions or circumstances in which benefits will not be provided, which may be applicable to the replacement product compared to the terminated product;
* In the case of an insurance product, the impact of age and health changes on the premium payable compared to the terminated product;
* Differences between the tax implications of the replacement product and the terminated product;
* Material differences between the investment risk of the replacement product and the terminated product;
* Penalties or unrecovered expenses deductible or payable due to termination of the terminated product;
* To what extent the replacement product is readily realisable or the relevant funds accessible, compared to the terminated product; and
* Vested rights, minimum guaranteed benefits or other guarantees or benefits which will be lost as a result of the replacement.

The FSP must take reasonable steps to ensure that the client understands the advice and that the client is in a position to make an informed decision.

An FSP providing advice to a client to replace an existing long-term insurance contract or policy with any other financial product must at the earliest practicable opportunity after providing such advice, but in any event no later than the date on which any transaction requirement is submitted to a product supplier in respect of any replacement product, notify the issuer of the existing long-term insurance contract or policy of such advice.

**c) Instances where insufficient information is provided or no full analysis has been done**

In performing the analysis referred to above for the client, the FSP may, in determining the extent of the client information necessary to provide appropriate advice, take into account:

* any specific objectives or needs of the client that the client has explicitly requested the provider to focus on, or not to focus on, in performing the analysis;
* any specific objectives or needs of the client that the client and the provider have explicitly agreed to focus on or not to focus on in performing the analysis;
* applicable surrounding circumstances that make it clear that the analysis can reasonably be expected by the client to focus only on specific objectives or specific needs of the client; or
* the fact that the client has explicitly declined to provide any information requested by the provider.

Where an analysis is performed in any of the circumstances referred to above, the FSP must alert the client as soon as reasonably possible that there may be limitations on the appropriateness of the advice provided in light of such circumstances; and the client should take particular care to consider on its own whether the advice is appropriate considering the client’s objectives, financial situation and particular needs, particularly any aspects of such objectives, situation or needs that were not considered in light of the aforementioned circumstances.

**d) Should the client elect not to follow the advice given**

If the client decides to conclude a transaction that differs from that recommended by the provider, or otherwise elects not to follow the advice furnished, or elects to receive more limited information or advice than the FSP is able to provide, the FSP must:

* Alert the client as soon as reasonably possible of the clear existence of any risk to the client, and must
* Advise the client to take particular care to consider whether any product selected is appropriate to the client’s needs, objectives and circumstances.

**e) Record of Advice**

In addition to the record keeping duties required under the FAIS Act, an FSP must also carry out the record keeping on information that forms part of advice to a client.

The record of must reflect the basis on which the advice was given as well as:

* A brief summary of the information and material on which the advice was based;
* The financial products which were considered; and
* The financial product or products recommended with an explanation of why the product or products selected, is or are likely to satisfy the client’s identified needs and objectives.

An FSP or representative must provide a client with a copy of the record of advice in writing.

**2.8.6 Custody of financial products and funds**

If an FSP receives or holds financial products or funds for or on behalf of a client, the following must be done properly and promptly:

* When a FSP receives funds into safe custody without the mediation of a bank, the provider must on receipt of the money, issue a written confirmation of receipt thereof;
* Where the FSP, or a third party on behalf of either of them, is in control of such financial products or funds, take reasonable steps to ensure that they are adequately safeguarded;
* The FSP must open and maintain a separate account, designated for client funds, at a bank.
* When funds have been received from the client without the mediation of a bank, the funds must, within one business day of receipt be paid into the separate bank account;
* The separate account must only contains funds of clients and not those of the FSP;
* All bank charges in respect of the separate account except that bank charges specifically relating to a deposit or withdrawal of the funds of the client that are for the client’s own account, must be borne by the FSP;
* Any interest accruing to the funds in the separate account is payable to the client or the owner of the funds.
* At all times such financial products or funds are dealt with strictly in accordance with the mandate given to the provider;
* Client financial products or funds must be readily discernible from private assets or funds of the FSP;
* Subject to any applicable contractual or statutory provisions, a client must have ready access to any amount paid into the separate account, less any deductions which are authorised, and charges and fees required or authorised to be paid by law.

Where a transaction or agreement has been recorded in writing, the provider who dealt with the client, must ensure that the original agreement is delivered to the client for safe custody.

**2.8.7 Risk Management processes and procedures**

An FSP must at all times have and effectively employ the resources, procedures and appropriate technological systems that can reasonably be expected to eliminate as far as reasonably possible, the risk that clients, product suppliers and other providers or representatives will suffer financial loss through theft, fraud, other dishonest acts, poor administration, negligence, professional misconduct or culpable omissions.

The FSP must structure the internal control procedures to make sure that:

* the relevant business can be carried on in an orderly and efficient manner;
* financial and other information used or provided by the provider will be reliable; and
* all applicable laws are complied with.

An FSP, excluding a representative, must, if, and to the extent, required by the Authority maintain in force suitable guarantees or professional indemnity or fidelity insurance cover. These will help to cover the FSP with regard to errors and omissions by the FSP and its representatives should a client decide to pursue a civil claim against the FSP. Category I FSPs who do not deal with client funds, must, maintain professional indemnity cover of a minimum of R1 million. No fidelity insurance cover is required.

Category 1 FSPs who deal with client funds, must maintain professional indemnity cover of a minimum of R1 million and fidelity insurance cover of a minimum of R1 million. Any person (legal or natural) who is licensed as An FSP must meet applicable requirements within 6 weeks from the date of being authorised as an FSP.

**2.8.8 Advertising by an FSP**

An FSP must have documented processes and procedures for the approval of advertisements by a key person or a person of appropriate seniority to whom the key person has delegated the approval. Prior to publishing an advertisement, the FSP must take reasonable measures to ensure that the information provided in the advertisement is consistent with the Code. Where feasible, measures must provide for an objective review of an advertisement other than by the person that prepared or designed it.

Where an advertisement is produced or published by another person the FSP must where the person producing or publishing the advertisement is not acting on behalf of the FSP, but the FSP is aware or ought reasonably to be aware of the production or publication, take reasonable steps to mitigate the risk of the advertisement not being consistent with this Code.

Where an FSP becomes aware that an advertisement that relates to its business, financial services or related services, whether published by the provider or any other person, is not consistent with this section, the FSP must as soon as reasonably practicable correct or withdraw the advertisement and notify any person who it knows to have relied on the advertisement.

Advertisements must be factually correct, excluding aspects of an advertisement constituting puffery; provide a balanced presentation of key information; and not be misleading.

An advertisement that references statistics, performance data, achievements or awards must disclose the source and the date thereof; and the identity of the grantor of an award and must make it clear if the award is granted by an associate of the FSP or product supplier.

An advertisement that refers to premiums or other periodic investment amounts must in the case where the premium or periodic investment amount will escalate automatically, indicate the escalation rate or basis; and where the premium, in the case of an insurance policy, (with or without automatic escalations) may change at a future date, indicate the period for which the premium is guaranteed.

Descriptions in an advertisement must not give benefits or returns undue prominence compared with risks; and exaggerate benefits or returns or create expectations regarding financial product or financial service performance or the performance of related services that the FSP does not reasonably expect to achieve.

Descriptions in an advertisement, in respect of a specific financial product, financial service or related service, must include key limitations, exclusions, risks and charges, which must be clearly explained and must not be worded positively to imply a benefit. Where an FSP can demonstrate that, due to the nature of the medium used for the advertisement, it is not reasonably practicable for the information to be fully included, the advertisement must indicate that additional information on key limitations, exclusions, risks and charges related to the financial product, financial service or related service being advertised is available; and where and how the additional information may be accessed, which must be readily available and easily accessible.

References to a fee or cost must give a realistic impression of the overall level of fees or costs a person is likely to pay, including any indirect fees or costs.

An advertisement, when examined as a whole, must not be constructed in such a way as to lead the average targeted client to any false conclusions he or she might reasonably rely upon. Each piece of information in an advertisement must be prominent enough and proximate enough to other information so as not to mislead the average targeted client.

An advertisement relating to a financial product that is targeted at a particular type or group of client must make this clear. An advertisement must not obscure information.

An advertisement must not be designed to exaggerate the need for urgency which could encourage the average targeted client to make unduly hasty decisions.

Warnings, disclaimers and qualifications contained in an advertisement must not be inconsistent with other content in the advertisement; and have sufficient prominence to effectively convey key information.

An advertisement relating to a financial service must disclose any relevant limitations on the extent of the financial service and the range of financial products on which the financial service is based; not create a misleading impression about the nature and extent of a provider’s skills, experience, knowledge and expertise insofar it relates to the financial service; and not create a misleading impression about the cost of a financial service including that it is ‘free’ if the service is in fact paid for by the client directly or indirectly through other costs or charges.

An advertisement must not disparage or make inaccurate, unfair or unsubstantiated criticisms about any financial product, financial service, product supplier or provider.

An advertisement relating to a financial product or financial service must clearly and prominently identify the product supplier or provider or both, as applicable, including in the case of a white labelled product.

An advertisement must use plain language. Terms must be defined or explained if the average targeted client could not reasonably be expected to understand them. An FSP must consider the appropriateness of the medium to be used to publish any advertisement in relation to the complexity of the features of the financial product or financial service or other information being communicated.

An FSP must keep adequate records of all advertisements for a period of at least 5 years after publication.

The Code sets out additional requirements prohibiting negative option marketing, the ability to be removed from unwanted direct advertising lists as well as with regards to comparative marketing. It also deals with requirements regarding puffery and endorsements as well as loyalty benefits or bonuses. It sets principles with regards to prominence of advertisings as well as principles relating to forecasts, illustrations, hypothetical data or projected benefits and past performance data.

**2.8.9 Termination of agreement or business with a client**

Note that the termination of an agreement or business with a client is subject to the requirements of the FAIS Act and subordinate legislation. This includes the requirements of recording verbal and written communications relating to a financial service and that of not disclosing confidential information without the written consent of the client. With regard to termination of an agreement or business:

* An FSP must, subject to any contractual obligations, give immediate effect to a request of a client who voluntarily seeks to terminate any agreement with the provider or relating to a financial product or advice;
* Where the client makes the request on the advice of the provider, the provider must take reasonable steps to ensure that the client fully understands all the implications of the termination;
* An FSP, other than a representative who ceases to operate as such, must immediately notify all affected clients accordingly and take, where reasonably necessary or appropriate in consultation with the clients and product suppliers concerned, reasonable steps to ensure that any outstanding business is completed promptly or transferred to another provider; and
* Where a representative cease to operate as a representative of an FSP, such provider must immediately take, where reasonably necessary or appropriate in consultation with the clients and product suppliers concerned, reasonable steps to notify all affected clients accordingly and ensure that outstanding business is completed or transferred to such FSP or another representative of that FSP.



**LEARNING UNIT 2: FORMATIVE ASSESSMENTS**

**Formative activity 1**

The FAIS Act was enacted in 2002 and became effective in 2004. Name any 4 factors that brought the need for that piece of legislation [4]

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**Formative activity 2**

Briefly describe the role of a financial service providers and name any 5 examples of financial products. [7]

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**Formative activity 3**

Discuss any 5 measures that financial service providers can put in place to protect their customers against any form of financial loss. [10]

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**Formative activity 4**

Distinguish between the roles of the following FAIS role players: [12]

* The FSCA
* A financial provider
* A key individual
* A compliance officer.

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**Formative activity 5**

List any 3 typical advice-related duties and any 2-intermediary service-related duties of a representative. [5]

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**Formative activity 6**

Your uncle wants to start a new financial service provider. He is not yet sure of what is required to get a licence as well as to maintain it. Name any 5 requirements for getting a licences and any 5 requirements to maintain a licence once granted by the FSCA. [10]

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**Formative activity 7**

Provide a distinction, using examples between a suspension and withdrawal of a licence. [6]

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**Formative activity 8**

What is the role of the Commissioner of the Financial Sector Conduct Authority? [5]

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**Formative activity 9**

Describe the manner in which the office of the FAIS Ombud must handle complaints received from consumers of financial services? [5]

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**Formative activity 10**

Mr. D submitted a claim to an insurer in respect of fire damage to the outbuilding on his property, which occurred on 2 May 2018. The insurer rejected the claim on the grounds that Mr D was using the outbuilding for business purposes and that batteries that were charging caused the fire. The insurer submitted that the policy only covered the building for private use.

Mr. D is not happy about this.

Describe the procedure that he must follow in order to get a recourse on his complaint. [8]

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# LEARNING UNIT 3: ANTI-MONEY LAUNDERING AND COUNTER TERRORISM FINANCING LEGISLATION



**Learning Outcomes**

By the end of this learning unit and having completed all the formative activities, you should be able to:

* Explain using examples the concepts of money laundering and unlawful activities.
* Identify the purpose of the Acts on money laundering and explain how they contribute to prevention of money laundering.
* Identify the statutory bodies and other stakeholders that support the anti-money laundering legislation.
* Explain the concept of accountable institution and describe its key duties.
* Describe and explain the role and functions of the Money laundering reporting officer, using examples.
* Name the categories of clients indicated in the money laundering legislation and list the documents required to identify and verify each client.
* Identify the circumstances or products that are exempt from the “know your clients” requirements.
* List the records required to be kept by legislation and explain the retention periods.
* Explain the red flags for suspicious and unusual transactions and how these must be reported.
* Explain penalties for non-compliance with anti-money laundering legislation.
* Explain the impact of non-compliance with anti-money laundering legislation to the South African economy.
* Explain whistle blowing and describe its consequences for an individual who whistle blows.

## INTRODUCTION

Criminals always try to hide or disguise the illegal nature of the proceeds of unlawful activities by changing them into legal funds – cleaning the dirty money as it were.

Their main motive is to avoid imprisonment and to protect the funds from forfeiture.

In the past, the focus was on the crime rather that the proceeds of the crime. Globally governments are committed to the prevention of money laundering and terrorism financing by focusing on the proceeds of crime.

This learning unit unpacks the requirements of the anti-money laundering legislation and how financial service providers (who are called accountable institutions in this regard) and their financial advisors must contribute to anti-money laundering and counter-terrorist activities through compliance to the Acts.

## 3.1 Background to anti-money laundering legislation

Money Laundering is considered to be the third biggest industry in the world which in addition makes one realise how vast the problem really is. Financial Action Task Force (FATF) has an agreement with governments all over the world. Governments especially united in the fight to combat money laundering and crime. FATF was founded in 1989 by the World’s largest countries known as the G7 countries. Today its activities are to combat money laundering for criminal and terrorist purposes. It also represents most countries around the world who have money laundering legislation in place. FATF has issued 40 recommendations for action against money laundering.  Therefore it also forms the basis of legislation in many countries. These recommendations are regularly being reviewed and updated, for legislation worldwide to keep it on track.



*International pressure on countries to adopt measures that meet with FATF requirements has led to the Financial Intelligence Centre Act (FICA) 2001.*

In South Africa, the following legislation forms the framework in the fight against money laundering and terrorism financing:

* **The Financial Intelligence Centre Act (FICA),** 38 of 2001 as amended by the FIC Amendment Act, 1 of 2017 – the Act contain the control measures for countering money laundering and financing of terrorism and related activities as well as for financial sanctions.
* **Prevention of organised crime Act** (POCA), 121 of 1998 as amended – the Act creates the money-laundering offences.
* **Protection of Constitutional Democracy against Terrorist and Related Activities Act** (POCDATARA), 33 of 2004 - the Act creates the terrorism offences.

The three Acts should be read in conjunction with each other in order to get a clear picture and understanding of anti-money laundering and counter-terrorism financing legislative requirements.

The legislation will be discussed below to provide a better understanding of the responsibilities of a financial service provider in relation to the money laundering and terrorism financing legislation in South Africa.

## 3.2 Money laundering and financing of terrorism



Section 1 of the FICA defines money laundering as an activity which has or is likely to have the effect of concealing or disguising the nature, source, location, disposition or movement of the proceeds of unlawful activities or any interest which anyone has in such proceeds and includes any activity which constitutes an offence in terms of section 64 of that Act (conducting transactions to avoid reporting duties under the Act) or under section 4 (money laundering), 5 (assisting another to benefit from the proceeds of crime) or 6 (acquisition, possession or use of proceeds of unlawful activities) of POCA.

*“Effective anti-money laundering and combating the financing of terrorism regimes are essential to protect the integrity of markets and of the global financial framework as they help mitigate the factors that facilitate financial abuse.” - Min Zhu, Deputy Managing Director of the IMF.*

There are 3 stages to money laundering:

**1. The placement stage** – where the proceeds of crime are secreted in or deposited, on the understanding that they will be mixed with lawful assets.

Converting these bills to larger denomination, cashier’s cheques, or other negotiable monetary instruments is often accomplished using cash incentive business (like restaurants, hotels, vending machine companies, casinos and car washes) as fronts.

**2. The layering stage** – where proceeds are transferred or modified – the criminal tries to obscure the trail linking the funds to the criminal activity.

**3. The integration stage** – where the proceeds are handed back to the criminal or his agent for consumption or other use. This stage is the big payoff for the criminal.

It is a crime to commit money laundering or to assist anyone else to do so. A trend has developed internationally whereby anti-money laundering legislation no longer applies simply to the proceeds of organized crimes. Anti-money laundering legislation now covers the illegal proceeds of ALL CRIMES.

**Reasons for laundering money**

* Avoid prosecution
* Increase profits/reinvest in criminal activities
* Avoid seizure of accumulated wealth
* Appear legitimate
* Enables criminal to expand and carry on with criminal activities



Money laundering is NOT about cash – it’s about the PROCEEDS of crime

**3.2.1 Effects of money-laundering and terrorism financing**

Money laundering requires an underlying, primary, profit-making crime (such as corruption, drug trafficking, market manipulation, fraud, tax evasion), along with the intent to conceal the proceeds of the crime or to further the criminal enterprise. These activities generate financial flows that involve the diversion of resources away from economically- and socially productive uses - and these diversions can have negative impacts on the financial sector and external stability of member states. They also have a corrosive, corrupting effect on society and the economic system as a whole.

**3.1.2 FSPs role in preventing money laundering and terror financing**

Financial institutions including financial service providers and representatives (financial advisors) are targets as the business can be used as a facility to launder money or promote terrorism financing operations.

The South African Reserve Bank is the country’s central bank and therefore fulfil the role of managing the national money and banking system. This includes supervision and bank regulations.

SARS monitors the activities of Financial Institution operating in South Africa to ensure that they adhere to regulations and laws, including Bank Act and also the Mutual Bank Act.

## 3.3 The Financial Intelligence Centre Act (FICA) 38 of 2001

As amended by FIC Amendment Act 1 of 2017 prescribes the framework for the money laundering and terrorist financing duties and obligations that must be met by accountable institutions.

The purpose of the FICA includes the following:

* To combat money laundering activities and also the financing of terrorist and related activities.
* In 2001 the FICA Act creates the requirement to ensure that money laundering is controlled.
* The aim is to identify suspicious transactions so that people who engage in money laundering activities can consequently be charged under POCA.
* Suspicious transactions must be reported under FICA; that will also provide the infrastructure to curb money laundering activities.
* The Act also requires “Accountable Institutions” that could serve as a pipeline for “dirty money” to comply with certain legal duties relating to combat money laundering.

**3.3.1 The Financial Intelligence Centre**

The Financial intelligence Centre is a statutory regulatory body that is responsible for implementation and monitoring of the duties and obligations by accountable institutions.

It is established in terms of section 2 of the FIC Act.

**a) Functions of the financial intelligence centre**

* Collect, process, analyse and interpret information
* Inform, advise and cooperate with investigating authorities, supervisory bodies, SARS and the intelligence services
* Monitor and give guidance to accountable institutions, supervisory bodies and other persons regarding FIC Act duties and responsibilities
* Retain information in a manner as set out in the FIC Act
* Implement a registration system in respect of all AIs and RIs
* Supervise and enforce compliance with the FIC Act

**3.3.2 Accountable institutions**

An accountable institution is a natural or legal person that is most likely to be used to facilitate money laundering and terrorism financing activities. Financial service providers (including their key individuals and representatives), except for short-term insurers, are regarded as accountable institutions and are legally required to play a role in the:

* Prevention
* Detection and
* Investigation of money laundering and financing of terrorism.

The table below provides a list of accountable institutions as per schedule 1 of the FIC Act.

|  |  |
| --- | --- |
| Accountant (Public Accountant) | Attorney |
| Bank or person carrying on the business “of the bank” | Board of executors |
| Estate Agent | Financial instrument trader |
| Foreign Exchange dealer | Gambling business requiring a gambling licence |
| Investment manager (registered) | Investment advisors and broking services |
| Local businesses where securities are placed as collateral (Money lenders) | Ithala Development Finance Corporation Limited |
| Money Order business – sale, issue, or redemption thereof | Long Term Insurance Business including an insurance broker and an agent of an insurer. |
| Post bank | Mutual Bank |
| Travellers’ cheques business – sale, issue or redemption | Stock exchange member |
| Unit trust management | Trust company or any person that keeps in safe custody, controls or administers trust property. |
| Registrar of Financial Markets’ approved person or category of persons | Money remitter |
|  | Registrar of Stock Exchanges’ approved person or category of persons. |

The following legal obligations are imposed by FICA upon accountable institutions:

* Identify and verify clients
* Record keeping requirements
* Reporting any suspicious transactions
* Formulate and implement a set of internal rules
* Appoint a money laundering reporting officer
* Reporting cash transactions over the prescribed limit
* Training staff on anti-money laundering.

A key requirement of money laundering regulations is that not even one single transaction may be concluded unless certain established steps have been taken to identify and verify the client or the intermediary.



Accountable institutions must have all the necessary policies, procedures and systems while ensuring full compliance with the FICA Act and other applicable money laundering or terrorist financing legislation.

**3.3.3 Reporting Institutions**

The entities under Schedule 3 do not have an industry/ sector specific supervisory body that oversees their governance and are required to report directly to the FIC. The FIC Act identifies the following types of entities:

* Motor Vehicle Dealers
* Krugerands Dealers.

Businesses, such as motor vehicle dealers and Krugerrand dealers, are required to make reports to the FIC but not to implement the administrative obligations attributed to accountable institutions.

The information and documents provided in each stakeholder site is targeted at all companies and individuals owning, managing or working as a compliance officer for the entity.

**3.3.4 Identification and verification clients**

The Amended FIC in s1 defines a client as **‘client’**, in relation to an accountable institution, means a person who has entered into a business relationship or a single transaction with an accountable institution.

Knowing your client helps you differentiate between what is unusual and what is normal. The key to an accountable institution knowing its client is establishing and verifying its identity of the client.

Section 21 of FICA places a duty on accountable institutions to identify clients and other persons who may act on behalf of clients. An essential element in combating money laundering is therefore, getting to know your customer (KYC), for accountable institutions.

**Know Your Customer** (**KYC**) is the process of a business identifying and verifying the identity of its clients. It is also a concept that refers to the steps taken by a financial institution (or business) to establish the identity of the customer.

Accountable institutions usually frame their KYC policies to cover the following four key elements:

* Customer Acceptance Policy
* Custom Identification procedures
* Monitoring of Transactions
* Risk Management.

KYC controls typically include the following:

1. Collection and also analysis of basic identity info – ID Document.
2. Name matching against list of known parties or Domestic prominent influential persons or Foreign prominent public officials
3. Determination of, terrorist finance or identity theft
4. Creation of an expectation of a customer’s transactional behaviour
5. Monitoring of customer’s transaction against expected behaviour and also recorded profile and that of the customer’s peers.

Establishing and verifying the identity of the prospective client offers accountable institution advantages, such as:

* Enabling the accountable institution to identify suspicious activity
* Providing the accountable institution with an element of protection against fraud
* Protecting the AI’s reputation
* Protecting the AI from financial risks
* Establish who exactly the client is
* Be satisfied that the prospective client is really who he/she/it claims to be.

An accountable institution “must take steps to find out who its client is by obtaining sufficient evidence of the identity of any client who comes into contact with the firm to be able to show that the client is who he claims to be.

Whenever a business relationship is established and there is the expectation of money flowing, evidence of identity must be obtained. Business relationships include the giving of advice that is likely to result in investment action, i.e. money flowing.

Any information that has been updated needs to be recorded.

The following are general principles to be applied when identifying and verifying identity:

* Original documentation – documents need not be original – there is no difference between original and certified documentation.
* Accumulation of Evidence – More than one document should be used to verify identity, and no single document must be used to verify both a client’s name and permanent address.
* Face to face or in person – establishment and verification of client identity takes place via a face-to-face meeting with the prospective client during which time original documents or certified copies are produced as evidence of identity and address.

The identity of a natural person comprises of:

* Full names
* Date of Birth
* Identity Number / Passport number
* Income Tax number
* Residential Address.

It is vital for an organisation’s system to be able to establish the true identity and address of the client and for effective checks to be in place to guard against substitution of identity by the applicant.

Where there are no face-to-face dealings, where the prospective client or applicant is requesting a transaction or services that falls within the scope of “higher risk business”, additional measures are required.

Section 20A stipulates that an accountable institution may not establish a business relationship or conclude a single transaction with an anonymous client or a client with an apparent false or fictitious name. Doing so is an offence under the Act.

How to verify a non-face to face client:

* Make telephone contact with the client at numbers listed in his/her name in the telephone directory.
* Conduct interviews with the client’s employer or business partners.
* Obtain references from well-known and reputable financial institutions that are also accountable institutions.
* Confirm that a cheque drawn by a client in exactly the same name as the one provided to the institution has been cleared by a locally registered bank.
* Require payment or a deposit by means of a cheque drawn on a locally registered bank.
* Require the client to visit the institution in person to conduct the first transaction or collect documentation in the course of business and at the same time to present his/her official ID document.

Because of their complex structures, corporate and legal entities are the most likely to be used for money laundering purposes.

A legal purposes identity comprises of:

* The registration numbers
* The registered corporate name and trading names used
* The registered address and any separate principal trading address
* The income tax and tax number, if applicable
* The names of the legal entity’s manager and / or director
* The name of the person authorized to represent the legal person
* The name of the owners or shareholders.

In the case of a trust, the AI must establish:

* The name and registration number of the trust;
* The Master’s Office where it is registered;
* The identity of the Founder;
* The identity of the Trustees;
* The identity of everyone authorised to act on behalf of the Trust;
* The identity of each named beneficiary and for where beneficiaries are not named the particulars of how beneficiaries are identified used to identify them.

FICA3 refers to two situations where an accountable institution will not only have to identify the prospective client or client, but also other additional persons. These situations are:

* The “client” supplies his/her identifying information, but is acting on behalf of another person.
* The “client” provides another person’s identifying information

Where the intermediary is establishing a business relationship or entering into a business transaction, the accountable institution must:

* Identify and verify the intermediary
* Look through the intermediary and establish whether the intermediary is an accountable institution that has legally compliant money laundering procedures in place.

**a) Categories of clients**

The FIC Act and the Regulations require that accountable institutions identify all clients with whom they do business unless an exemption applies in a given circumstance. Accountable institutions, however, are not required to follow a “one size fits all” approach in the methods that they use and the levels of verification that they apply to all relevant clients. It is imperative that the money laundering risk in any given circumstance be determined on a holistic basis. In other words, the ultimate risk rating accorded to a particular business relationship or transaction must be a function of all factors that may be relevant to the combination of a particular client profile, product type and transaction.

Clients may be categorised as follows:

* High Risk
* Medium Risk
* Low Risk.

A combination of the following factors may be applied to differentiate between high risk, medium risk and low risk clients:

* product type;
* business activity;
* client attributes, for example, whether the client is on the United Nations list, duration of client relationship with the accountable institution, etc.;
* source of funds;
* jurisdiction of client;
* transaction value;
* Type of entity.

In terms of Regulation 21 of the Regulations, an accountable institution must obtain certain additional information whenever this information may reasonably be required to identify:

* a business relationship or single transaction that poses a particularly high risk of facilitating money laundering activities; or
* The proceeds of unlawful activity or money laundering activities.

In most instances it is a combination of factors, not any one factor that will lead to a conclusion that a transaction or relationship poses a money laundering risk. All circumstances surrounding a business relationship or transaction should be reviewed.

Over and above the risk factors identified above, there are a number of further factors that may indicate that a business relationship or single transaction poses a high risk of facilitating money laundering activities, or the presence of the proceeds of unlawful activity. The following examples of such activities are applicable to the banking sector but can also be useful for nonbanking institutions:

* a client appears to have accounts with several banks in one geographical area;
* a client makes cash deposits to a general account of a foreign correspondent bank;
* a client wishes to have credit and debit cards sent to destinations other than his or her address;
* a client has numerous accounts and makes or receives cash deposits in each of them amounting to a large aggregated amount;
* a client frequently exchanges currencies;
* a client wishes to have unusual access to safe deposit facilities;
* a client’s accounts show virtually no normal business-related activities, but are used to receive or disburse large sums;
* a client has accounts that have a large volume of deposits in bank cheques, postal orders or electronic funds transfers;
* a client is reluctant to provide complete information regarding the client’s activities.
* a client’s financial statements differ noticeably from those of similar businesses;
* a business client’s representatives avoid contact with the branch;
* a client’s deposits to, or withdrawals from, a corporate account are primarily in cash, rather than in the form of debit and credit normally associated with commercial operations;
* a client maintains a number of trustee accounts or client subaccounts;
* a client makes a large volume of seemingly unrelated deposits to several accounts and frequently transfers a major portion of the balances to a single account at the same bank or elsewhere.
* a client makes a large volume of cash deposits from a business that is not normally cash intensive;
* a small business in one location makes deposits on the same day at different branches;
* there is a remarkable transaction volume and a significant change in a client’s account balance;
* a client’s accounts show substantial increase in deposits of cash or negotiable instruments by a company offering professional advisory services;
* A client’s accounts show a sudden and inconsistent change in transactions or patterns.

*- Taken from FIC’s FIC Guidance Note 3A for accountable institutions on customer identification and verification and related matters, March 2013.*

**3.3.5 Protection of whistle-blowers**

Section 38 of the Act provides protection for people who make reports to the FIC. They are immune from any type of legal action, be it civil or criminal. They are also not able to be compelled to give evidence in criminal proceedings arising from the report. In addition, should they so require it, their identity can be kept a secret in court proceedings.

**3.3.6 Record keeping requirements**

An accountable organisation’s record keeping needs to achieve the following objectives:

* Legal requirements must be fully met.
* The organisation’s anti-money laundering policies and procedures should be recorded in such a way that they can be independently assessed as adequate and effective.
* Any money laundering related query should be responded to within a reasonable period of time.
* Internal and external reports on suspicion or knowledge of money laundering are identifiable and accessible.
* Records related to the identification and verification of the organisation’s clients are established and retained by the organisation and are easy to access.
* Any transaction executed for a client is recorded and easy to track or recreate.

The objective of record keeping is to ensure that in any ensuing investigation the accountable institution can quickly and adequately provide the authorities with its part of the audit trail.

According to FICA, an accountable institution must keep the required records for a minimum of five years from the date the relationship is terminated (for business relationship records, or the date the transaction is concluded (for transaction records).

A business relationship is considered to have ended on the date of one of the following:

* On the date of the execution of a once-off transaction
* On the date of the last in a series of transactions
* On the date of the closing of the account or accounts.

**3.3.7 Reporting Requirements**

Section 27 requires Accountable institutions, reporting institutions and persons subject to reporting obligations to provide information that may be requested by the FIC.

Section 28 requires Accountable institutions, reporting institutions and persons subject to reporting obligations to report to the Centre particulars concerning a cash transaction concluded with a client if the transaction amount is in excess of the prescribed amount.

**a) Recognising and reporting suspicious transactions**There are three basic principles of money laundering detection and investigation:

* Intermediaries to the financial system must know with whom they are doing business.
* The paper trail of transactions through the financial system must be preserved.
* Possible money laundering transactions must be brought to the attention of investigating authorities.

In South Africa, accountable institutions are obliged to report to the Financial Intelligence Centre (FIC) in terms of FICA:

* When cash transactions above a prescribed limit take place (since 2005). Reporting on cash transactions takes place in terms of Section 28 of FICA. You will recall that Section 28A of FICA was amended by POCDATARA to include the reporting of any property that is associated with terrorist and related activities to the FIC.
* When suspicious or unusual transactions are noted or suspected. Suspicious or unusual transactions are reported in terms of Section 29. These reports relate to the reporting of suspicious or unusual transactions that a person “knows or ought reasonably to have known or suspected” to be suspicious or unusual.

Transactions must be reported to the FIC where cash above a prescribed limit is received from or paid to a client, or a person acting on behalf of a client or a person on whose behalf a client is acting. FICA imposes the obligation to report:

* Cash transactions above a prescribed limit.
* The conveyance of cash into or out of South Africa above a prescribed limit.
* The electronic transfer of funds into or out of South Africa above a prescribed limit.

This threshold above which transactions must be reported is determined by the South African regulations. Currently the prescribed limit is at R24, 999.99

Suspicion is personal and subjective and carries no established objective measures or standards. It is the “something” that doesn’t look or feel right, but with something tangible to back it up.

A suspicion is not a belief, but at the same time it must be more than a mere speculation and must be based on some foundation.

FICA deems a person to have knowledge of a fact in the following situations:

* He/she has actual knowledge of that fact.
* He/she believes that there is a reasonable possibility of the existence of that fact.
* He/she fails to obtain information to prove or disprove the existence of the fact.

What happens to a transaction or business situation if a STR has been made to the FIC? The accountable institution may continue with and execute the transaction unless the FIC intervenes and directs the institution not to proceed with the transaction.

A directive not to proceed with the transaction is made in writing to the accountable institution for a period of not more than five working days.

During this period the FIC makes any necessary inquiries concerning the transaction and informs an investigating authority, if necessary.

Of course, the accountable institution must still apply the sound commercial judgement it normally employs. The accountable institution is not committed to continuing the business relationship if by doing so it is putting the organisation at commercial risk.

When terminating a business relationship or transaction, the accountable institution must be careful not to tip off the client or prejudice a money laundering investigation in anyway.

An employee’s legal obligation is discharged through reporting the suspicion in accordance with established internal anti-money laundering procedures.

An external STR should not be made without undertaking reasonable internal enquiries to determine that all available information has been taken into account. Only the MLRO may decide whether or not to make an external report and this decision must be made in good faith.

**3.3.8 Training and monitoring of compliance**

Section 43 (a) of the FIC Act requires an accountable institution to provide training to its employees to enable them to comply with the provisions of this Act and the internal rules applicable to them.

Although there is no fixed approach with regard to how accountable institutions should promote general awareness and provide training to relevant staff, simply providing staff with copies of the relevant Acts or guidance notes is not considered sufficient training.

In order to understand some of the reasons why accountable institutions (bank tellers specifically) have little or limited knowledge of what the entire FICA process aims to achieve, one needs to look at some of the training programmes being offered to employees. Employees are offered the following programmes:

* Awareness programmes, for example, videos, presentations and messages aimed at raising awareness regarding employee obligations. More often than not, employees are required to simply attend or undergo such programmes.
* Formal training programmes – here there are clear training objectives and, on completion of the programme, employees are then assessed. Employees are required to attain an acceptable level of knowledge before they can be deemed to have successfully completed the programme.

**3.3.9 Compliance Officer**

Section 43(b) of the FIC Act requires accountable institutions to appoint a compliance officer.

In the event of a sole proprietor, the owner or most senior person in the accountable or reporting institution may assume the role and functions of the Compliance Officer in terms of section 43(b) of the FIC Act.

It is the duty of the Compliance Officer to ensure that the information held on record with the Centre is accurate and up to date. It is also the responsibility of the Compliance Officer to approve of any subsequent users being added to the entity profile.

**3.3.10 Money laundering reporting officer**

A Money Laundering Reporting Officer (MLRO), is a user appointed by the accountable or reporting institution to assist the Compliance Officer in the execution of the reporting obligation to the Centre.

The Financial Intelligence Centre defines “Money laundering reporting officer” (MLRO) as a person, other than the Compliance Officer, with the responsibility and authority to submit regulatory reports to the FIC on behalf of the accountable or reporting institution. Not all AI/RI will have MLROs. Institutions that require reports to be submitted by persons other than the Compliance Officer, must register an MLRO.

**3.3.11 Exemptions**

Section 74 of FICA provides exemptions for accountable institutions in certain circumstances. The exemptions do not apply in the event that a suspicious or unusual transaction is involved.

If a primary accountable institution has identified and verified a client in terms of FICA, a secondary accountable institution is not required to repeat the verification procedure when dealing with the primary accountable institution acting on behalf of that client.

This is on condition that the secondary accountable institution obtains a letter from the primary one, confirming that verification of the client’s identity has taken place in terms of the law.

In certain circumstances the following parties, as defined in terms of Schedule 1 of FICA, are exempt from the duties to identify, verify and keep records (sections 21-26, FICA):

* A unit trust management company
* A long-term insurance agent, a broker or insurer
* An investment advisor or investment broker
* A person approved by the Registrar of Financial Markets.

The exemption covers the following products or situations:

* **Long-term insurance fund policy or fund member**
* A **unit trust or linked product investment** by an approved pension fund, provident fund or retirement annuity fund
* A **compulsory annuity** purchased in terms of the rules of an approved pension fund, provident fund or retirement annuity fund.
* A **reinsurance policy** issued by another accountable institution
* An **assistance policy**
* Any policy paying out on **death, disability, sickness or injury**
* Any **long-term insurance policy** with recurring premiums of less than R25 000 or a single premium of less than R50 000
* Any **long-term insurance policy** on condition that the policy surrender value in first 3 years does not exceed 20% of the value of the premiums paid
* Any **unit trust or linked product investment** with recurring payments of less than R25 000 or a single premium of less than R50 000.

**3.3.12 Internal Risk Management and Compliance Programme for organisations on money laundering legislation compliance**

Section 42 requires every accountable institution to formulate and implement an internal Risk Management and Compliance Programme (RMCP). A RMCP must—

* 1. enable the accountable institution to identify, assess, monitor, mitigate and manage the risk that the provision by the AI of products or services may involve or facilitate money laundering activities or the financing of terrorist and related activities;
  2. provide for the manner in which the AI determines if a person is a prospective client or a client who has established a business relationship;
  3. provide for the manner in which the AI deals with anonymous clients and clients acting under false or fictitious names;
  4. provide for the manner in which and the processes by which the establishment and verification of the identity of persons is performed in the AI;
  5. provide for the manner in which the AI determines whether future transactions that will be performed in the course of the business relationship are consistent with the AI’s knowledge of a prospective client;
  6. provide for the manner in which and the processes by which the AI conducts additional due diligence measures in respect of legal persons, trust and partnerships;
  7. provide for the manner in which and the processes by which ongoing due diligence and account monitoring in respect of business relationships is conducted by the AI;
  8. provide for the manner in which the examining of complex or unusually large transactions; and unusual patterns of transactions which have no apparent business or lawful purpose, and keeping of written findings relating thereto, is done by the AI;
  9. provide for the manner in which and the processes by which the AI will confirm information relating to a client when the AI has doubts about the veracity of previously obtained information;
  10. provide for the manner in which and the processes by which the AI will perform the customer due diligence requirements when, during the course of a business relationship, the AI suspects that a transaction or activity is suspicious or unusual;
  11. provide for the manner in which the AI will terminate an existing business relationship when required;
  12. provide for the manner in which and the processes by which the AI determines whether a prospective client is a foreign prominent public official or a domestic prominent influential person;
  13. provide for the manner in which and the processes by which enhanced due diligence is conducted for higher-risk business relationships and when simplified customer due diligence might be permitted in the AI;
  14. provide for the manner in which and place at which the records are kept;
  15. enable the AI to determine when a transaction or activity is reportable to the Centre;
  16. provide for the processes for reporting information to the Centre;
  17. provide for the manner in which the RMCP is implemented in branches, subsidiaries or other operations of the AI in foreign countries and will inform the Centre and supervisory body concerned if the foreign country does not permit the implementation of measures required under FICA;

Section 42A of FICA, refers to the appointment of a person with the responsibility of ensuring compliance:

* By the employees with the internal rules (and effectively the Act)
* By the accountable institution with its obligations in terms of the Act.

Employees working for an accountable institution must report their knowledge or suspicion of money laundering to their organisation’s MLRO or the “appropriate person” (as designated by the organisation).

The identity of the person reporting knowledge or suspicion of money laundering is kept confidential, and once a report is made to the appropriate person, the employee’s legal obligation has been discharged.

***Remember:***

*The MLRO is responsible for overseeing the accountable institution’s anti-money laundering activities*

Although a MLRO has responsibilities and accountabilities, the ultimate responsibility for money laundering prevention within an organisation lies with those who **control the business**, i.e. the organisation’s highest level of management.

**3.3.13 Penalties for non-compliance**

Non-compliance with the FIC Act attracts the following sanctions and penalties.

|  |  |  |
| --- | --- | --- |
| **Section** | **Offence** | **Maximum Penalty** |
| 46 | Failure to identify Persons | 15 years imprisonment or a fine of R10 million |
| 47 | Failure to keep records | 15 years imprisonment or a fine of R10 million |
| 48 | Destroying or tampering with records | 15 years imprisonment or a fine of R10 million |
| 49 | Failure to give assistance | 15 years imprisonment or a fine of R10 million |
| 50 | Failure to advise the FIC of client | 15 years imprisonment or a fine of R10 million |
| 51 | Failure to report cash transactions | 15 years imprisonment or a fine of R10 million |
| 52 | Failure to report suspicious or unusual transactions | 15 years imprisonment or a fine of R10 million |
| 53 | Unauthorised disclosure | 15 years imprisonment or a fine of R10 million |
| 54 | Failure to report conveyance of cash into or out of South Africa | 15 years imprisonment or a fine of R10 million |
| 55 | Failure to send a report to the FIC | 5 years or a fine of R1 million |
| 56 | Failure to report electronic transfers | 15 years imprisonment or a fine of R10 million |
| 57 | Failure to comply with a request | 15 years imprisonment or a fine of R10 million |
| 58 | Failure to comply with a direction by the FIC | 15 years imprisonment or a fine of R10 million |
| 59 | Failure to comply with a monitoring order | 15 years imprisonment or a fine of R10 million |
| 60 | Misuse of information | 15 years imprisonment or a fine of R10 million |
| 61 | Failure to formulate and implement internal rules | 5 years or a fine of R1 million |
| 62 | Failure to provide training or appoint a compliance officer | 5 years or a fine of R1 million |
| 63 | Obstructing an official in the performance of functions | 15 years imprisonment or a fine of R10 million |
| 64 | Conducting transactions to avoid reporting duties | 15 years imprisonment or a fine of R10 million |
| 65 | Unauthorised access to computer system or application or data | 15 years imprisonment or a fine of R10 million |
| 66 | Unauthorised modification of contents of computer system | 15 years imprisonment or a fine of R10 million |

## 3.4 Prevention of Organised Crime Act (POCA) 121 of 1998

The POCA 121 of 1998 as amended by Prevention of Organised Crime Amendment Act, 24 of 1999]. The purpose of the ACT is:

* To introduce measures to combat organised crime
* To provide for the recovery of the proceeds of unlawful activity; for the civil forfeiture of criminal property that has been used to commit an offence, property that is the proceeds of unlawful activity or property that is owned or controlled by, or on behalf of an entity involved in terrorist and related activities.

Money laundering is a crime under POCA.

The objectives of POCA are as follows:

* Create a general reporting obligation for businesses therefore getting hold of suspicious property.
* Criminalize racketeering and also offences relating to activities of criminal gangs.
* Criminalize money laundering and a number of serious offences in respect of laundering and racketeering.
* Create a mechanism for criminal confiscation of proceeds of crime and civil loss of proceeds.

**3.4.1 Offences under POCA**

The general money laundering offences provided for in the Act are contained in chapter 3 – Offences relating to proceeds of unlawful activities sections 4, 5 and 6.

The sections are summarised below:

* **Section 4:** Any person who knows or ought reasonably to have known that property is or forms part of the proceeds of unlawful activities commits an offence.
* **Section 5:** A person who assists another to benefit from the proceeds of unlawful activities commits a crime.
* **Section 6:** A person who acquires, uses or has possession of property and who knows or ought reasonably to have known that it is or forms part of the proceeds of unlawful activities of another person commits an offence.

**3.4.2 Applicable penalties**

The penalties for an offence committed in terms of sections 4, 5 and 6 of POCA are quite severe.

Any person who is convicted of any of the above offences can be liable to a maximum fine of R100 million or to imprisonment for a period not exceeding 30 years.

**3.4.3 Implications on financial service providers**

The above-mentioned offences can only be committed by a person who knows or ought to reasonably have known that the property concerned constituted the proceeds of unlawful activities.

For the purposes of POCA, a person had knowledge of a fact if he actually knew that fact or if the court is satisfied that he believed that there was a reasonable possibility of the existence of that fact and then failed to obtain information to confirm or disprove the fact.

A money laundering activity can therefore be committed by a person who negligently fails to identify the true nature of illicit property. A person acts negligently if he fails to recognise or suspect a fact which a person with the general knowledge, skill, training and experience that may reasonably be expected of a person in the position of the particular person as well as the general knowledge, skill, training and experience that he in fact has, would have recognised or suspected.

This means that if a financial advisor knows or ought to have reasonably known that the proceeds that a client is asking them to invest on their behalf are proceeds from unlawful activities, they can be found liable in terms of the POCA.

**3.4.4 Asset forfeiture**

Asset forfeiture or asset seizure is a form of confiscation of assets by the state. It typically applies to the alleged proceeds or instruments of crime.

A basic principle: No person should benefit from criminal activity

The principle accords with common law principles: –

* Unjustified enrichment at the expense of others
* No person should benefit from actions that the community regards as reprehensible.

**a) Rationale for Asset Forfeiture**

* Making sure that crime does not pay
* Conventional methods of fighting crime are not adequate
* Remove the means (instrumentalities) to commit crime
* To deter people from using property for crime
* To target the untouchables/kingpins of crime.

## 3.5 Protection of Constitutional Democracy against Terrorist and Related Activities Act 33 of 2004

POCDATARA has the following objectives:

* To provide for measures to prevent and combat terrorist and related activities.
* To provide for an offence of terrorism and other offences associated or connected with terrorist activities.
* To provide for Convention offences
* To give effect to international instruments dealing with terrorists and related activities.
* To provide for a mechanism to comply with the United Nations Security Council Resolution, which are binding on member States, in respect of terrorist and related activities.
* To provide for measures to prevent and combat the financing of terrorist and related activities.
* To provide and investigate measures in respect of terrorist and related activities; and
* To provide for matters connected therewith.

Any person who:

* Acquires, collects, uses, possesses, owns, provides or makes available property.
* Provides or makes available any financial or economic service or who facilitates the above services
* Intends that the property, financial services or economic support will be used to commit or facilitate the commission of a specified offence is guilty of an offence.

Any person who deals with a party that directly or indirectly deals with any transaction in connection with property when they ought to reasonable have known or suspected that it was an offence is guilty of such an offence.

Any person who knows or ought to have known that property is being referred to and enters into an agreement which has the effect of controlling the property- converting the property- concealing the nature, source, location of the property- removing such property or transferring such property is guilty of an offence.

If one person has reason to suspect that another person is about to commit an offence, they should report this person to a police official.

|  |
| --- |
| **KYC compliance**  Africa Invest (Pty) Ltd, a stockbroking firm was fined R500,000 by the Financial Intelligence Centre after they had failed to fulfil their duty as an accountable institution identification of clients.  The firm provided investment and securities trading services to approximately 4 300 private clients. Following an internal audit conducted in 2015, it identified that, in respect of a number of these private clients, it had established a business relationship (as authorised user) with these clients or had previously established a business relationship, and concluded securities transactions on behalf of these clients.  It was also established that it failed to take all the prescribed steps to establish or verify the identity of these clients (including the clients’ full names, date of birth, identity number and residential address).  a) Why is it important for an accountable institution to identify and verify clients?  b) What could have motivated Africa Invest to establish business relationships without fully identifying and verifying their clients?  c) What other anti-money laundering duties other than identifying and verifying clients are expected of accountable institutions? |

## 3.6 Effects of money-laundering to the economy

The negative effects of money laundering on economy are hard to put into numbers. However, it is clear that such activities damage not only the financial institutions directly, but also country’s productivity in its various economic sectors, such as real sector, international trade sector and capital flows, among others; indirectly. Many of the existing formal economic analyses of money laundering have sought to quantify the extent of money laundering, rather than qualify its effects on individual economies or groups of economies. The negative economic effects of money laundering on economic development can be qualified in terms of three sectors of the economy: financial, real and external. Money laundering damages the financial-sector institutions that are critical to economic growth (internal corruption & reputational damage); reduces productivity in the economy's real sector by diverting resources and encouraging crime and corruption, which slow economic growth; distorts the economy's external sector international trade and capital flows (reputational damage & market distortion) to the detriment of long-term economic development. Developing countries' strategies to establish offshore financial centres (OFCs) as vehicles for economic development are also impaired by significant money laundering activity through OFC channels. Effective anti-money-laundering policies reinforce a variety of other good governance policies that help sustain economic development, particularly through the strengthening of the financial sector.

Although difficult to quantify, it is clear that money laundering is detrimental to the economy of a country. The effects are detailed below:

**a) Economic distortions**

Money laundering impairs the development of the legitimate private sector through the supply of products priced below production cost, making it therefore difficult for legitimate activities to compete. Criminals may also turn enterprises which were initially productive into sterile ones to launder their funds leading ultimately to a decrease in the overall productivity of the economy. Furthermore, the laundering of money can also cause unpredictable changes in money demand as well as great volatility in international capital flows and exchange rates.

**b) Erosion of financial sector**

While the financial sector is an essential constituent in the financing of the legitimate economy, it can be a low-cost vehicle for criminals wishing to launder their funds. Consequently, the flows of large sums of laundered funds poured in or out of financial institutions might undermine the stability of financial markets. In addition, money laundering may damage the reputation of financial institutions involved in the scheming, resulting in a loss of trust and goodwill with stakeholders. In worst case scenarios, money laundering may also result in bank failures and financial crises.

**c) Reduction in government revenue**

Money laundering also reduces tax revenue as it becomes difficult for the government to collect revenue from related transactions which frequently take place in the underground economy.

**d) Socio-economic costs**

The socio-economic effects of money laundering are various because as dirty money generated from criminal activities are laundered into legitimate funds; they are used to expand existing criminal operations and finance new ones. Further to that money laundering may lead to the transfer of economic power from the market, the government and the citizens to criminals, abetting therefore crimes and corruption.

Drives out foreign investors – Rampant money-laundering is a sign of a less transparent and unstable financial system and as a consequence will scare away foreign investors.

Corrupt and opaque financial systems are inherently unstable. Excessive money laundering can cause increased volatility of international capital flows and exchange rates, market disparities, and distortions of investment and trade flows.

## 3.7 Personal liability for non-compliance

The Financial Intelligence Centre has consistently indicated that the responsibility for compliance accrues higher up in the organisation. The compliance officer needs to be able to make a difference in an organisation’s Anti-Money Laundering (“AML”) compliance and he/she must be senior enough to make that difference.

The FIC Amendment Act inserts a new section 42A into the FIC Act which became effective on 2 October 2017. This section was a total game changer and demands of the board of directors and senior management (where there is no board of directors) to ensure compliance, by the accountable institution and its employees, with the provisions of the FIC Act and the Risk Management and Compliance Programme (“RMCP”).

It is the board of directors or senior management who must create a culture a culture of compliance within the accountable institution, ensuring that the institution’s policies, procedures and processes are designed to limit and control risks of money laundering and terrorist financing and are fully consistent with the law and that staff adhere to them.

The Centre emphasises on the following:

*The board of directors or senior management is responsible to create a culture of compliance within the accountable institution and they must ensure that the institution’s policies procedures and processes are designed to limit and control risks of money laundering and terrorist financing and are fully consistent with law and that staff adhere to them.*

Previously, the onerous duty to comply with the Act was on the shoulders of compliance officers. For far too long compliance officers were branded that they stifle sales and are responsible for the increased cost in compliance. Now the anti-money laundering compliance and especially the risk of non-compliance fall squarely on boards of directors or senior management.

*The board of directors and senior management should be fully engaged in decision making processes and take ownership of the risk-based measures adopted and they will be held accountable if the content of the RMCP is found to be inadequate.*

This is broader than simply Customer Due Diligence and includes financial intelligence reporting. Board of directors will have to ensure that ultimate aims of the FIC Act is achieved.

–        *The RMCP should include a description of the board of directors’ or senior management’s accountability and the appointment of a person with adequate seniority and experience to assist with ensuring compliance with the FIC Act. The Centre suggests that the overall responsibility for the establishment and maintenance of effective AML/CFT systems and controls be allocated to a specific director or senior manager and that this be clearly set out in the RMCP.*

What does the amendments mean for compliance officers? Does it mean that they can now sleep sounder than before, do they have less exposure and are they off the hook?

* The shift in the FIC Act to make board of directors and senior management accountable is not only desirable but obligatory. The tone is set at the top.
* Being FIC Act compliant is but one aspect of doing business ethically and doing business ethically sits at the top and should filter down the institutions.
* Sending the right message to staff members on the FIC Act compliance culture in an organisation, is a must for any accountable institution who wishes to do business ethically.
* Compliance officers remain a vital tool in achieving that result. The shift in focus demands that directors and senior management sit up and take notice.

Boards of directors and senior management should invest in the right people who has the right attitude, to assist with their FIC Act compliance and manage their own exposure and liability.

What this means is that personal liability for non-compliance will fall on board of directors and senior management.



**LEARNING UNIT 1: Formative Assessments**

**Formative activity 1**

Describe money laundering and explain why people or syndicates launder money. [5]

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**Formative activity 2**

Name the three Acts that govern anti-money laundering and counter terrorist activities and explain the purpose of each Act. [9]

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**Formative activity 3**

Describe the roles of the Financial Intelligence Centre (FIC) and the South African Police Service (SAPS) in combating money laundering. [8]

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**Formative activity 4**

Explain what an accountable institution is and give three examples of accountable institutions. [5]

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**Formative activity 5**

XYZ is a short-term insurance broker, whose main task is to provide advice to clients on behalf of ABC insurance company. State whether or not they are an accountable institution and explain your answer. [5]

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**Formative activity 6**

Name any five typical functions of a money laundering reporting officer and explain how their role differs from that of a compliance officer under FICA. [9]

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**Formative activity 7**

You have recently been appointed to work as a service consultant for a bank. A customer approaches you to open a bank account. Which documents will you request from the client in order to identify and verify him/her? [5]

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**Formative activity 8**

Explain the rationale for the “Know your client” KYC requirements and explain the applicable exemptions to KYC. [10]

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**Formative activity 9**

a) Explain the importance of record keeping to accountable institutions. [4]

b) List any 5 types of records that accountable institutions must keep and indicate the retention period for each. [10]

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**Formative activity 10**

Name any 5 possible Indicators for unusual transactions and suspicious [5]

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**Formative activity 11**

Explain the impact of FICA on financial service providers. [5]

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**Formative activity 12**

a) Define whistle blowing [3]

b) Discuss any three way of anonymous whistleblowing [6]

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# LEARNING UNIT 4: FURTHER LEGISLATION IMPACTING ON FINANCIAL SERVICES



**Learning Outcomes**

By the end of this learning unit and having completed all the formative activities, you should be able to:

* Identify various legislation that is applicable to the work of a financial advisor. The legislation may include promotion of access to information, electronic transactions, protection of personal information, consumer protection, collective investment, medical schemes, pension funds and insurance among others.
* Explain the purpose of each Act
* Describe the requirements of each of the legislation as far as rendering financial services is concerned
* Explain the consequences of non-compliance with any of the Acts.

## INTRODUCTION

There are pieces of legislation which have not been included on the above three learning units which a financial advisor must be aware of. Whilst a financial advisor is not expected to be a legal expert, it is essential for the financial advisor to be in the know of the legislation that affect the provision of financial services. By nature, financial transactions are done in form of contracts and thus a financial advisor must be aware of the law of contract.

**A contract** is an agreement between two or more persons and which must be legally valid and enforceable. A contract is concluded when an offer made by one person is accepted by the person to whom it is made, in accordance with this law.

For a contract to be considered valid and binding in South Africa, the following requirements must be met:

1. There must be *consensus ad idem* between the contracting parties.
2. The parties must have seriously intended the agreement to result in terms which can be enforced.
3. The parties must have the capacity to contract.
4. The agreement must have certain and definite terms.
5. The necessary formalities must be observed.
6. The agreement must be lawful.
7. The contractual obligations must be possible of performance.
8. The content of the agreement must be certain.

The modern concept of contract is generalised so that an agreement does not have to conform to a specific type to be enforced, but contracting parties are required to conduct their relationship in good faith (bona fides).

This learning unit will not necessarily focus on contract law, but rather focuses on other pieces of legislation that are relevant to a financial advisor as he/she provides financial advice to clients. We will look at various Acts and their requirements.

## 4.1 Insurance Act 18 of 2017

To provide for a legal framework for the prudential regulation and supervision of insurance business in the Republic that is consistent with the Constitution of the Republic of South Africa, 1996, and promotes the maintenance of a fair, safe and stable insurance market; to introduce a legal framework for micro-insurance to promote financial inclusion; to replace certain parts of the Long-term Insurance Act, 1998, and the Short-term Insurance Act, 1998.

The Act became effective on 1 July 2018.

The objective of this Act is to promote the maintenance of a fair, safe and stable insurance market for the benefit and protection of policyholders, by establishing a legal framework for the prudential regulation and supervision of insurers and insurance groups and ultimately enhance the protection of policyholders and potential policyholders.

The Insurance Act, 2017, provides a consolidated legal framework for the prudential supervision of the insurance sector that is consistent with international standards for insurance regulation and supervision, and seeks to replace and consolidate substantial parts of the Long-term Insurance Act, and the Short-term Insurance Act.

The Act brings with it changes to the Long-term Insurance Act (LTIA), Short-term Insurance Act (STIA) and more specifically the Policyholder Protection Rules (PPR), creating new opportunities for existing insurers and providing for licensed micro-insurance products.

The Act requires insurers to go through a process with the Prudential Authority to convert their existing licences which can include a number of different life and non-life classes of insurance as set out in Schedule 2 of the Insurance Act. If part of their strategy, apply for a micro-insurance licence

Schedule 1 of the Insurance Act amended the LTIA and STIA to differentiate between registered insurers and licensed insurers.

During the transition period, under these new amendments the LTIA and the STIA will govern market conduct while the Insurance Act will apply from a prudential point of view to all insurers.

These amendments are designed to introduce micro-insurance products – traditionally funeral plans – more accessible, affordable and fair for consumers.

It also aims to turn informal insurance providers into formal, regulated and resourced insurance providers.

The Insurance Act, 2017 further seeks amongst other things, to provide for stricter regulation of foreign based insurers underwriting risks emanating from South Africa, to deal with the solicitation of insurance and reinsurance business by foreign insurers and reinsurers from within South Africa, prohibit foreign insurers and reinsurers from soliciting business in South Africa on a cross-border basis unless the foreign reinsurers conduct the reinsurance business (no direct insurance will be licensed) through a branch established in South Africa.

**4.1.1 Penalties for non-compliance**

The Insurance Act requires that certain information be submitted to the Prudential Authority. The information to be submitted may include information on group structures, information relating to application and maintenance of a licence etc.

Section 68 provides that failure to submit any document or provide any required information attracts a penalty not exceeding R5 000 for every day during which the failure continues, unless the Prudential Authority, on good cause shown, waives the penalty or any part thereof.

Section 69 provides that any person who commits an offence is on conviction liable to a fine not exceeding R10 million. An insurer who commits an offence is on conviction liable to a fine not exceeding R50 million if that insurer fails to comply with a directive issued by the Prudential Authority.

## 4.2 Promotion of Access to Information Act 2 of 2000

The Promotion of Access to Information Act 2 of 2000 (commonly known as PAIA) is South Africa's access to information law and it enables people to gain access to information held by both public and private bodies.

**4.2.1 What the PAIA is about**

* The most important theme is access to information (ATI).
* The main role players are the requester on the one hand and a public or private body on the other hand.
* It is all about access to information held in records.
* A requester needs to request access.

In terms of the Promotion of Access to Information Act, all private bodies (entities mentioned above as defined in PAIA) and public bodies (mainly state departments and state administrations as defined in PAIA) must give access to their records, if someone requests a record in terms of PAIA.

The PAIA is regulated by the Information Regulator which is an independent body established in terms of section 39 of the Protection Of Personal Information Act 4 of 2013. It is subject only to the law and the constitution and it is accountable to the National Assembly.

The information Regulator has extensive powers to regulate and enforce both the Promotion of Access to Information (PAIA) and the Protection of Personal Information (POPI) Acts.

## 4.3 Protection of Personal Information Act 4 of 2013

The purpose of the Protection of Personal Information Act (POPIA) is to protect people from harm by protecting their personal information. It aims to stop their money being stolen, to stop their identity being stolen, and generally to protect their privacy, which is a fundamental human right.

To achieve this, the Protection of Personal Information Act sets conditions for when it is lawful for someone to process someone else’s personal information.

**4.3.1 Key role-players**

The Protection of Personal Information Act (POPIA) involves three parties (who can be natural or juristic persons):

* **The data subject**: the person to whom the information relates.
* **The responsible party:** the person who determines why and how to process. For example, profit companies, non-profit companies, governments, state agencies and people. (Called controllers in other jurisdictions.)
* **The operator:** a person who processes personal information on behalf of the responsible party. For example, an IT vendor. (Called processors in other jurisdictions.)

The Protection of Personal Information Act places various obligations on the responsible party, which is the body ultimately responsible for the lawful processing of personal information. Responsible parties should only use operators that can meet the requirements of lawful personal information processing prescribed by the Protection of Personal Information Act.

**4.3.2 Implications of the POPI Act to FSPs and their representatives**

* 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.

**4.3.3 Direct marketing**

Section 69 of the Act outlaws direct marketing by means of any form of electronic communication unless the subject has given their consent. Such an electronic communication obviously includes emails and SMSs. Automatic calling machines are also included.  A subject can only be approached once to obtain such a consent. Once such consent is refused, it is refused for ever.

Slightly different rules apply if the subject is a customer.  Here the customer’s contact details must have been obtained in the context of the sale of a product or a service, the direct marketing by electronic communication can only relate to the suppliers own similar products or services, and the customer must have been given the right to opt out at the time that the information was collected and each time such a communication is sent.

Anybody sending out direct marketing electronic communications must disclose the identity of the advertiser and provide an address to which the customer can send a request to opt out.

Any subject whose name is included in any type of directory must be advised of the purpose of the directory and about any future uses to which the directory might possibly be put, based on search functions embedded in electronic versions of the directory. Such a subject must be given the opportunity to object to such use of the personal information.  This will however not apply to directories that were printed or which were created in off-line electronic form prior to the commencement of this section.

If your personal information is contained in a public subscriber directory which has been prepared in accordance with the safeguards set out in the Act, prior to the commencement of this portion of the Act, your personal information can remain in the directory provided that the subject has received notification about the purposes of the directory and the future uses to which the directory might be put. Once again, the subject must be given the opportunity to opt out. (section 70)

The Act controls the transfer of personal information from South Africa to foreign countries and prohibits this unless: (section 71)

* The person receiving the information is subject to similar laws;
* The subject has agreed to the transfer of information;
* Such transfer is part of the performance of a contract which the subject is a party to; or
* Transfer is for the benefit of the subject and it is not reasonably practicable to obtain their consent and that such consent would likely be given. (section 72)

**4.3.5 Penalties for non-compliance**

Sections 100 – 106 deal with instances where parties would find themselves “guilty of an offense”. The most relevant of these are:

* Any person who hinders, obstructs or unlawfully influences the Regulator;
* A breach of confidentiality while working for the Regulator;
* A responsible party which fails to comply with an enforcement notice;
* Offences by witnesses, for example, lying under oath or failing to attend hearings;
* Unlawful Acts by responsible party in connection with account numbers;
* Unlawful Acts by third parties in connection with account numbers.

Section 107 of the Act details which penalties apply to respective offenses. For the abovementioned offences the maximum penalties are a fine or imprisonment for a period not exceeding 10 years or to both a fine and such imprisonment.  For the less serious offences, for example, hindering an official in the execution of a search and seizure warrant the maximum penalty would be a fine or imprisonment for a period not exceeding 12 months, or to both a fine and such imprisonment.

The POPI Act is important because it protects data subjects from harm, like theft and discrimination. The risks include reputational damage, fines and imprisonment, and paying out damage claims to data subjects. The biggest risk, after reputational damage, is a fine for failing to protect account numbers.

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| **Protection of Personal Information**  The POPI Act cuts across all industry types (public and private), and it is constantly being disrupted by the adoption of new technologies, which changes how personal information is stored, processed and transmitted. The concepts of Privacy and Technology are closely related and their impact on each other has been an ongoing research subject for many years now. Among other types of organisations, the operations of financial service providers including banks, insurance companies, investment firms, retirement funds and medical schemes are greatly affected by the POPI Act.  a) Under what circumstances can a financial service provider disclose a client’s personal information without their consent?  b) What measures can financial service providers put in place to ensure compliance with the POPI Act given that they hold so much client information? |

## 4.4 National Credit Act 35 of 2005

The National Credit Act (35 of 2005) is part of a comprehensive legislation overhaul designed to protect the Consumer in the credit market and make credit and banking services more accessible.

The Purpose of the National Credit Act is to: promote a fair and non-discriminatory marketplace for access to Consumer credit; regulate Consumer credit and improve standards of Consumer information; prohibit certain unfair credit and credit marketing practices; promote responsible credit granting and use; prohibit reckless credit granting; provide for debt re-organization in case of over-indebtedness; to regulate credit information; and establish recourse for unfair credit practices.

The NCA does this by simplifying and standardising credit agreements and information disclosure; providing for the use of simple language that is easy to understand for comparing credit agreements from different credit providers; ensures all credit products are handled in the same way by credit providers; assisting over-indebted Consumers to restructure their debt with the help of a Debt Counsellor (DC) and encourage responsible lending; regulates credit bureaux in terms of their Consumer information and records; establishing the National Credit Regulator (NCR) to regulate the entire credit market; and establishing the National Consumer Tribunal (CT) to adjudicate on Consumer complaints and disputes with credit providers, contraventions of The Act and decisions of the Regulator.

**4.4.1 Structure of the Act**

The National Credit Act consists of 189 sections in 9 chapters:

Chapter 1: Interpretation, Purpose and Application of Act

Chapter 2: Consumer Credit Institutions

Chapter 3: Consumer Credit Industry Regulation

Chapter 4: Consumer Credit Policy

Chapter 5: Consumer Credit Agreements

Chapter 6: Collection, Repayment, Surrender and Debt Enforcement

Chapter 7: Dispute Settlement other than debt enforcement

Chapter 8: Enforcement of Act

Chapter 9: General Provisions

The Act also includes 3 schedules:

Schedule 1 – Rules Concerning Conflicting Legislation

Schedule 2 – Amendment of Laws

Schedule 3 – Transitional Provisions

**4.4.2** [**Whom does the National Credit Act affect?**](https://www.banking.org.za/consumer-information/consumer-information-legislation/national-credit-act/#Five)

The National Credit Act affects anyone dealing with the credit industry such as credit grantors, credit grantees and intermediaries. The NCA defines a “credit agreement” broadly as any instalment purchase agreement of goods or services, as well as the extension of credit in the form of money i.e. home loans, personal loans, credit cards, store cards and short-term loans. Therefore, a credit agreement applies to any party involved in the credit agreement which is classified into three categories namely incidental credit agreements; intermediate agreements; and large credit agreements.

Credit Providers Include:

* Banks;
* Micro lenders;
* Retailers such as furniture and clothing stores;
* All businesses, companies, close corporations, partnerships and individuals who do business on credit, provide loans or charge interest on overdue accounts; and
* Those who offer credit within the prescribed threshold values in terms of the Act.

Consumers Include:

* Natural person (individuals)
* Certain juristic persons [e.g. companies, close corporations, trusts (with more than three individual trustees), partnerships and an association of persons] whose asset value or annual turnover, together with the combined asset value or annual turnover of all related juristic persons, at the time the agreement is made, equals or exceeds the threshold value of R1 million.

Other Organisations Include:

* Debt Counsellors
* Credit bureaux.

**4.4.3 Consumer rights**

The NCA lists a number of Consumer rights, which are protected by the Act. A party who breaches Consumer rights protected by the Act, commits an offence in terms of credit law which enables Consumer recourse through the established dispute channels.

The following are Consumer rights protected in the NCA:

* To apply for credit
* To be protected against discrimination in the granting of credit
* To be informed why credit has not been granted, should you ask
* To receive a free copy of your credit agreement
* To receive a credit agreement in plain and simple language
* To have your personal and financial information treated confidential
* To understand all fees, costs, interest rates, the total instalment and any other details
* To say no to increases on your credit limit
* To decide whether or not you want to be informed about products or services via telephone, SMS, mail or e-mail campaigns
* To apply for debt counselling should you be overwhelmed by debt.

**4.4.4 Key** [**points of the National Credit Act**](https://www.banking.org.za/consumer-information/consumer-information-legislation/national-credit-act/#Seven)

**a) Marketing to consumers**

The National Credit Act restricts and outlaws certain practices of loan canvassing such as door to door selling, uninvited canvassing at workplaces or homes. The NCA also increased control over marketing practices and advertisements such as automatic credit limit increases and negative option marketing i.e. if you do not decline, we will assume you agree. In addition, the National Credit Act provides for clear and understandable marketing communication. Consumers must receive a detailed written quote, which is valid for 5 business days, to enable quote comparisons from different credit providers.

**b) Capped interest rates and other fees and charges**

The National Credit Act effectively caps the interest rates, fees and other charges which credit providers can charge, depending on the type of credit and when the credit was granted. The maximum interest rate, in most cases, is based on a formula which is dependent on the SA Reserve Bank Repurchase (Repo) rate at the time that the credit was granted. Essentially, there are seven rate categories namely mortgage agreements; credit cards/facilities; unsecured credit transactions; short-term credit transactions; developmental credit agreements; other credit agreements and incidental credit agreements.

The NCA places a cap on the maximum amount that a credit provider can charge for other fees such as initiation fees, monthly service, and default and collection costs. While a loan protection policy is permitted, the charges must “be reasonable” and the Consumer may use/cede an existing insurance cover.  
**c) Loan application**The National Credit Act requires credit providers to supply simple contracts that are easy to understand, in two official languages and the Consumer must receive a free copy. Consumers are also entitled to a reason, on request, when credit is denied by the credit provider. The NCA requires credit providers to do due diligence to ensure the Consumer can afford the loan and all loans must be recorded on a register to prevent Consumers becoming over-indebted.

**d) Reckless lending**Credit providers are in contravention of the NCA and may be judged guilty of reckless lending if the Consumers ability to afford loan repayments is not assessed before granting credit. Credit providers may be subject to severe penalties and may even forfeit their right to recover the debt if they are judged guilty of reckless lending. However, Consumers who failed to fill in the loan application fully and honestly are not protected by the NCA.

**e) The debt counsellor & counselling**

The National Credit Act gives Consumers the right to apply for financial management and debt counselling assistance if he or she is unable to pay their debts. The Debt Counsellor (DC) is registered by the NCR after successful course and exam completion. Debt counsellors will help over-indebted Consumers restructure/rearrange their debt repayments, this process can be voluntary or made an order of the court.

All DCs must be registered with the National Credit Regulator and fees are prescribed in terms of the NCA. Consumers must understand and accept the process, charges and payments before undergoing debt counselling. Once the Consumer has signed for debt counselling, the credit bureaux are notified and the Consumer will be unable to obtain further credit for the duration of debt counselling until the process is finalised/withdrawn.

**f) Credit bureau**The National Credit Act requires all credit bureaux to be registered with and submit reports to the National Credit Regulator. Credit bureaux are required to ensure data is accurate at all times and that inaccurate information is immediately removed without cost to the Consumer after the Consumer has lodged a complaint. The NCA regulations stipulate how Credit bureau information is obtained, used, and for how long it should remain on a Consumer’s profile.

In addition, Consumers are eligible for one free credit report from each credit bureau each year in order to effectively manage their credit profiles.

## 4.5 Consumer Protection Act 68 of 2008

The South African National Consumer Protection Act (CPA) came into effect on 1 April 2011. The Act is aimed at promoting fairness, openness and good business practice between the suppliers of goods or services and consumers of such goods and services. The Act only applies to contracts signed after 1 April 2011, and won't affect anything signed before then. All suppliers of goods and services need to comply with the Act.

The CPA is aimed at establishing a uniform national benchmark for improved standards of consumer protection and at promoting historically disadvantaged market participants’ rights.

**4.5.1 Overselling and overbooking**The Act provides for the "reasonableness" test for overselling and overbooking. In terms of this test a supplier may not accept payment for goods or services where it has no reasonable intention to supply the goods or services, or where it intends to supply goods or services that are materially different to the goods or services for which the consumer has paid.

**4.5.2 Consumer Rights**

The Consumer Protection Act gives eight rights to consumers:

1. The right to consumer education

* Consumers must be able to access the knowledge and skills needed to make informed and confident choices about goods and services, while being aware of basic consumer rights and responsibilities and how to act on them.

2. The right to disclosure and information

* Consumers must be provided with the facts needed to make informed choices and ensure their protection against dishonest or misleading advertising and labelling.

3. The right to choice

* Consumers should be able to choose from a range of products and services, offered at competitive prices, with the assurance of satisfactory quality.

4. The right to representation

* Consumer interests should be represented in the making and execution of government policy, and development of products and services.

5. The right to redress

* Consumers must receive a fair settlement of just claims, including compensation for misrepresentation, or shabby goods or services.

6. The right to safety

* From a trade and industry perspective, consumers should be protected against production processes, and products and services that are dangerous to health or life.

7. The right to a healthy environment

* Consumers should be able to live and work in an environment that is not threatening to the well-being of present and future generations.

8. The right to access basic needs and services

* Consumers should have access to basic goods and services, such as adequate food, clothing, housing, health care, education, clean water and sanitation.

**4.5.3 Financial service providers and the Consumer Protection Act**

Advice or intermediary services provided by or on behalf of financial service providers under the Financial Advisory and Intermediary Services Act are exempted entirely because the FAIS Act already provides adequate consumer protection.

FSPs will be bound by the Consumer Protection Act in relation to business which is not related to the underwriting and assumption of risks, or the provision of advice and intermediary services under the FAIS Act. Insurers who engage in other business or activities will have to be aware of the provisions of the CPA. Even something as simple as an 'owner's risk' clause in a parking garage attached to the business of the insurer will require minimum compliance in regard to any disclaimer.

The more important insurance services affected by the CPA:

* A policy would be interpreted in favour of the consumer, in the event of ambiguity allowing for more than one reasonable interpretation. This reflects the existing law, but is now an unalterable right.
* Any exclusion within the insurance contract would be measured against whether a reasonable person in the position of the consumer would have expected such exclusion, taking into account the contract’s contents, the manner in which it was presented and the circumstances around concluding it. Policy exclusions may have to be drawn to the consumer’s attention.
* Insurers will not be allowed to take advantage of the fact that the consumer is unable to understand the terms of the contract being concluded with it as a result of either physical or mental disability, illiteracy, ignorance or inability to understand the language of the contract.
* Terms of the policy may be ruled as unfair, unjust or unreasonable if they are excessively one sided, contain terms so adverse to the insured as to be inequitable, or if the consumer was misled by the insurance company.
* The terms of the contract must be in writing and in plain language.
* Exclusions may still be utilised but the exclusions need to be in writing and in plain language, conspicuously presented to the insured allowing the latter a full opportunity to understand their terms.

Insurers who deal in replacement goods or salvage will have to take into account provisions of the CPA whenever they deal with protected consumers (including all-natural persons) in a transaction not directly related to the insurance policy. Even if the salvage is disposed of on behalf of the insured (urgently after a fire for instance) and goods are sold to a protected consumer (any individual or small business), then the CPA will have to be complied with in all its details. Consumers have extensive rights in relation to goods purchased and those rights may only be limited by the supplier giving a specific description of any potential defects in the goods or the circumstances affecting the sale. If second-hand salvaged goods are being disposed of, a very clear description of the state of what is being sold will be necessary. If the goods sold present a significant risk of personal injury or damage to property because of defects resulting from damage or if their quality cannot be warranted in any way, then this needs to be pointed out to the consumer even if the defect is patent.

## 4.6 Financial Institutions (Protection of Funds) Act 28 of 2001

The purpose of the Financial Institutions (Protection of Funds) Act 28 of 2001 is to regulate the investment, safe custody and administration of funds and trust property by financial institutions, enable the registrar to protect such funds and trust property and improve the enforcement powers of the registrar.

Some of the most important sections deal with the management of funds and trust property held by financial institutions. These are:

* Section 2 - Duties of persons dealing with funds of, and with trust property
* Section 3 – Declaration of interest
* Section 4 - Investment of trust property

We will briefly discuss the requirements of each section below:

**a) Duties of persons dealing with funds of, and with trust property**

A financial institution or nominee company, or director, member, partner, official, employee or agent of the financial institution or nominee company, who invests, holds, keeps in safe custody, controls, administers or alienates any funds of the financial institution or any trust property –

* must, with regard to such funds, observe the utmost good faith and exercise proper care and diligence;
* must, with regard to the trust property and the terms of the instrument or agreement by which the trust or agency in question has been created, observe the utmost good faith and exercise the care and diligence required of a trustee in the exercise or discharge of his or her powers and duties; and
* may not alienate, invest, pledge, hypothecate or otherwise encumber or make use of the funds or trust property or furnish any guarantee in a manner calculated to gain directly or indirectly any improper advantage for any person to the prejudice of the financial institution or principal concerned.

**b) Declaration of interest**

A director, member, partner, official, employee or agent of a financial institution or of a nominee company who takes part in a decision to invest any of the funds of the financial institution or any trust property in a company or other undertaking in which he or she has a direct or indirect financial interest, must declare that interest in writing to the board of management or other governing body of the financial institution or nominee company, indicating the nature and extent of such interest, before such decision is made.

Investing includes:

* the purchase of shares in a company, or of an interest in a close corporation or partnership
* The granting of a secured or unsecured loan.
* Acquiring a financial interest in an agreement or other matter in which the financial institution or nominee company has a material interest.

A declaration of interest made above must be recorded in the minutes of the meeting of the board or governing body at which the declaration is made or considered.

**c) Investment of trust property**

A financial institution or nominee company, or director, member, partner, official, employee or agent of a financial institution or nominee company which administers trust property under any instrument or agreement may not cause such trust property to be invested otherwise than in a manner directed in, or required by, such instrument or agreement.

In the absence of a direction or requirement referred above, a financial institution or nominee company, or director, member, partner, official, employee or agent of the financial institution or nominee company, may not cause any trust property to be invested otherwise than in the name of:

* the principal concerned;
* the financial institution in its capacity as administrator, trustee, curator or agent; or
* A nominee company.

A financial institution must keep trust property separate from assets belonging to that institution, and must in its books of account clearly indicate the trust property as being property belonging to a specified principal. Despite anything to the contrary in any law or the common law, trust property invested, held, kept in safe custody, controlled or administered by a financial institution or a nominee company under no circumstance forms part of the assets or funds of the financial institution or such nominee company.

The section also applies in a case where a financial institution invests, holds, keeps in safe custody, controls, administers or alienates trust property under any instrument or agreement jointly with another person.

## 4.7 Financial Markets Act 19 of 2012

The purpose of the Act is to provide for the regulation of financial markets; to license and regulate exchanges, central securities depositories, clearing houses and trade repositories; to regulate and control securities trading, clearing and settlement, and the custody and administration of securities; to prohibit insider trading, and other market abuses. It also seeks to provide nominees and provides for codes of conduct.

The regulator of the Financial Markets Act is the FSCA.

The Financial Markets Act (2012) has a specific role with respect to the fairness and integrity of wholesale financial markets. The objectives of the FMA are to:

* ensure that South African financial markets are fair, efficient and transparent;
* increase confidence in South African financial markets by:
  + requiring that securities services be provided in a fair, efficient and transparent manner; and
  + contributing to the maintenance of a stable financial market environment
* promote the protection of regulated persons, clients and investors;
* reduce systemic risk; and
* Promote the international and domestic competitiveness of South African financial markets and securities services.

Under the Financial Markets Act, the regulator may prescribe conduct standards for regulated entities in support of these objectives.

The FMA specifies that such conduct standards should be based on certain principles, including that participants act honestly and fairly, with due skill, care and diligence, avoid or mitigate conflicts of interest, and uphold the integrity of financial markets.

Furthermore, the FMA promotes market integrity by setting out prohibitions on market practices that constitute market abuse, namely, insider trading, market manipulation, and the making of false, misleading or deceptive statements, promises and forecasts.

Two important frameworks for sound conduct and integrity in the South Africa financial system given effect through legislation are:

(i) conduct requirements set out in the JSE Rules and Directives that apply to the JSE equity, debt and derivatives markets, consistent with the FMA - and similarly the rules and regulations set by the newly-licensed exchanges in line with the FMA; and

(ii) The general code of conduct for authorised financial services providers under the Financial Advisory and Intermediary Services Act (2002). The overall approach will be strengthened by new codes of conduct that will apply to over-the-counter (OTC) markets.

The Act seeks to ensure that financial markets in South Africa operate fairly, efficiently and transparently to promote investor confidence.

The FMA seeks to ensure that:

* financial markets in South Africa operate fairly, efficiently and transparently to promote investor confidence, reduce systemic risk and promote international competitiveness of South Africa’s securities services; and
* The legislative and regulatory framework in South Africa is brought in line with the recommendations of international standard setting bodies such as the Group of Twenty (G20), Financial Stability Board (FSB), Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO).

The FMA primarily focuses on the licensing and regulation of exchanges, central securities depositories, clearing houses, trade repositories and market infrastructures as well as the prohibition of insider trading and other market abuses.

In addition, the FMA provides a framework for regulating OTC derivatives in South Africa, which is a key G20 commitment.

“The act primarily focuses on the licensing and regulation of exchanges, central securities depositories, clearing houses, trade repositories and market infrastructure, as well as the prohibition of insider trading and other market abuses.

## 4.8 Pension Funds Act 24 of 1956

The purpose of the Act is to provide for the registration, incorporation, regulation and dissolution of pension funds.

**4.8.1 Purpose of the Act**

The purpose of this Act is to provide for the registration and management of all funds established to provide retirement benefits for their members. It also protects the rights of the members and beneficiaries by regulating the financial management and administration of the funds. It also provided for, among others things, the distribution of benefits upon death and the office of the Pension Funds Adjudicator.

**4.8.2 Pension fund organisation**

The Pension Funds Act refers to the definition of a pension fund organisation rather than a pension fund, provident fund and retirement annuity fund. The distinctions between a pension fund and a provident fund are found in the Income Tax Act and not the Pension Funds Act.

The definition of a pension fund in terms of the Act mentions three types of retirement funds:

* Occupational schemes (funds established by an employer for the benefit of its employees)
* Non-occupational schemes (funds where there is no employer-employee relationship such as a retirement annuity fund)
* Beneficiary funds (funds established specifically for purposes of managing death benefits awarded to beneficiaries of deceased retirement fund members)

Beneficiary funds have been introduced to provide a regulated vehicle for payment of retirement fund death benefits as an alternative to trusts which are not regulated or governed by the Pension Funds Act.

**4.8.3 Registration of a retirement fund**

Prior to a fund being authorised to operate as a pension fund organisation, the fund must register via the Authority In terms of the Pension Funds Act. The objectives to be met prior to registration of the fund include:

* The fund must be established to provide an annuity or lump sum to its members at retirement
* The fund must be established to provide benefits to dependant when members (pensioners) die.

To apply for registration by the Registrar of Pension Funds, the fund must submit:

* Two signed and certified copies of the fund rules in the format prescribed by the Pension Funds Act
* Authorisation for establishment of the Fund (board resolution by the sponsoring employer)
* Application for valuation exemption (if required)
* The prescribed fees.

The following details must be contained in the letter of application:

* The name of the fund
* The physical and postal address of the registered office of the fund
* The name and address of the administrator with effect from the date of registration
* The initial rate of contributions payable by each participating employer if not stated on the rules.

Once the Authority has been satisfied that the retirement fund has met the requirements of the Pension Funds Act, a certificate of registration will be returned to the fund together with an endorsed copy of the rules of the fund as proof of registration. Thereafter, the fund may begin its business. On registration the fund becomes a separate legal entity capable of suing and being sued in its own capacity.

**4.8.4 Rules of a retirement fund**

The rules of a fund, once registered, become binding on all parties to the fund, namely the employer, the members, shareholders, officers and beneficiaries who claim under the rules. The rules set out how the find will operate and from the basis for the fund’s terms of reference. The Pension Funds Act‘s prescribed format for submission of fund rules includes the following provisions:

* The fund name, commencement date, street address of the registered office of the fund
* Objects of the fund
* Eligibility for membership and membership termination conditions
* Details of the contributions paid to the fund by the members and/or employer
* Details of the types and value of benefits granted by the fund
* Conditions under which members become entitled to benefits
* Financial management and investment parameters of the fund
* Appointment and removal of officers and trustees of the fund
* The powers of the trustees
* Manner in which the rules may be amended
* Dispute resolution procedures
* Termination or dissolution procedures

Before any changes can be made to the rules of a retirement fund, a rule amendment must be registered by the Registrar of Pension Funds before such changes have any legal effect.

**4.8.5 Relevant sections**

The Pension Funds Act has 100 sections. We will however, look at a few sections that would be relevant to a financial advisor.

**Section 1**

Section 1 contains the definitions. Here it is noted that a provident fund is considered to be a pension fund for the purposes of the Act. The business of a pension fund is limited to the provision of retirement and death benefits for its members and beneficiaries.

**Section 2**

This section deals with which funds are exempt from compliance with the Pension Funds Act such as State Funds, funds established in terms of the Labour Relations Act and foreign funds with South African members.

**Section 5**

Once a fund is registered all assets belong to the fund. Proper books and records must be maintained by the fund.

**Section 8**

All funds are required to appoint a principal officer who shall act as the main contact between the FSCA and the Fund. The principal officer oversees the day-to-day running of the fund and is responsible for signing all official documents of the fund. If the principal officer is absent from office for more than 30 days, the trustees are required to appoint a new principal officer of appoint an interim principal officer in his absence. Details of the appointment must be communicated to the FSCA.

**Section 13**

The rules of the fund are binding on its members

**Section 13A**

This section requires all employers to pay contributions to the fund’s bank account within 7 days of the month in which they become due. For example, contributions deducted for the month of June must be paid over to the fund bank account by 7 July. It is the responsibility of the trustees to monitor that all payments to the fund are made within the prescribed timeframes. The section also provides that late payment interest be levied on contributions paid after the due date.

**Section 13B**

Specific conditions have been laid out in this section for any company who administers investments or disposes of benefits provided by the rules of a fund on behalf of the fund. Administrators are required to be approved by the FSC before they start administering a pension fund organisation. Administrators are also required to enter into a written administration agreement with the fund recording the specific duties and responsibilities of each party.

Administrators are required to appoint an independent auditor to review the appropriateness of the administrators bookkeeping, computer and control systems as well as the administrators’ annual financial statements.

**Section 20**

This section deals with the procedures for documentation to be submitted to the Registrar of Pension Funds. The chairman of the board and principal officer are required to sign all documents submitted to the FSCA.

**Section 24**

In terms of this section, the Registrar has the power to make an enquiry of a fund. The fund must reply to any queries by the FSCA within 30 days.

**Section 30**

This section deals with dispute resolution procedures provided to funds and their members. It also provides for the establishment and operation of the Office of the Pension Funds Adjudicator.

**Section 35**

The Act provides for members to have access to copies of the following official documentation of the fund:

* Rules
* Last financial statements
* Last valuation.

**Section 37**

This section deals with the protection of benefits and the disposal of benefits from a fund.

**4.8.6 Regulation 28 of the Pension Funds Act**

It is important to know that the Pension Funds Act regulates the maximum exposure a fund may have to certain shares, companies and asset classes. Furthermore, exchange control regulations prohibit South African funds from investing more than 25% of the assets offshore. This has proved to be a valuable safety net to South African funds when the local and global investment market have suffered poor performance. Investment managers have designed Regulation 28 compliant portfolios to suit these specific investment parameters.

Prior to 1 July 2001, the regulations applied to the investments at fund level. Subsequent to the amendment to Regulation 28, the compliance is now required at individual member investment level. The trustees have a fiduciary responsibility to invest the member’s savings in a way that promotes the long-term sustainability of the asset values.

Regulation 28 contains certain limits on the various types of assets in which a retirement fund may invest:

|  |  |
| --- | --- |
| **Asset class** | **Maximum Investment** |
| Shares | 75% |
| Any single large cap shares | 15% |
| Any other single share | 10% |
| Commodities (including exchange traded funds) | 10% |
| Kruger rands | 5% |
| Immovable property | 25% |
| Participating employer | 5% (may apply up to 10%) |
| Cash | 100% (no more than 20% in any one bank) |
| Off-shore | 25% (subject to other asset class limitations) |
| Other assets (derivatives, hedge funds, structures, private equity) | 15% (with no more than 10% to any of these asset classes) |

In order to promote economic growth in South Africa changes to Regulation 28 is currently out for comment. The changes will increase the ease and level of investment into infrastructure as well as private equity funds that will hopefully develop the economy. It is also recommended that investments into crypto-currencies are prohibited.

## 4.9 Collective Investment Schemes Control Act 45 of 2002

The Collective Investment Schemes Control Act, Act No. 45 of 2002 regulates the administration, management and sale of collective investments.

The Act defines a collective investment scheme as a 'scheme, in whatever form, including an open-ended investment company where members of the public are invited to invest money or other assets in a portfolio, and in terms of which two or more investors contribute money and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest. The investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed'.

Section 2 of the Act outlines the principles for administration of collective investment scheme, which are as follows:

* A manager must administer a collective investment scheme honestly and fairly, with skill, care and diligence and in the interest of investors and the collective investment scheme industry.
* The assets of an investor must be properly protected by application of the principle of segregation and identification.

Section 3 outlines the disclosure of information requirements. It says that before entering into a transaction with an investor:

* Information about the investment objectives of the collective investment scheme, the calculation of the net asset value and dealing prices, charges, risk factors and distribution of income accruals must be disclosed to the investor; and
* Information that is necessary to enable the investor to make an informed decision must be given to the investor timeously and in a comprehensible manner.

The duties of a collective investment scheme manager are outline under section 5. The duties are as follows:

* The manager must avoid conflict between the interests of the manager and the interests of an investor.
* The manager must disclose the interests of its directors and management to the investors.
* A manager must maintain adequate financial resources to meet its commitments and to manage the risks to which its collective investment scheme is exposed.
* On top of the above, the manager must also:
  + organise and control the collective investment scheme in a responsible manner;
  + keep proper records;
  + employ adequately trained staff and ensure that they are properly supervised;
  + have well-defined compliance procedures;
  + maintain an open and cooperative relationship with the office of the registrar and must promptly inform that office about anything that might reasonably be expected to be disclosed to such office; and
  + Promote investor education, either directly or through initiatives undertaken by an association.
* A manager may, with the approval of the registrar and in writing, delegate any function listed in the definition of 'administration' to any person (in this section referred to as the 'delegated person').
* Anything done or omitted to be done by the delegated person in the performance of a function so delegated, must be regarded as having been done or omitted by the manager.
* The registrar has, in respect of a delegated person, all the powers and duties conferred or imposed upon the registrar in respect of a manager.
* A manager may not delegate any function listed in the definition of 'administration' to any person without the prior approval of the registrar.

Section 5 requires that no person may perform any act or enter into any agreement or transaction for the purpose of administering a collective investment scheme unless such person:

* is registered as a manager by the registrar or is an authorised agent; or
* Is exempted from the provisions of this Act by the registrar by notice on the official website.

The Collective Investment Schemes Control Act, Act No. 45 of 2002 effectively changed the name of 'unit trusts' to 'collective investment schemes'. The Act refers to 'a participatory interest' in a scheme, as opposed to 'a unit' in a unit trust fund. However, despite the fact that the terminology was changed, investors continue to refer to 'units' and 'unit trusts'.

In terms of the Collective Investment Schemes Control Act (CISCA):

Unit trust funds are not allowed to invest more than 10% in the shares of unlisted companies.

They are also not permitted a weighting of more than 5% in any one listed share, unless

* The market capitalisation of the company concerned is in excess of R2 billion.
* The company concerned has a weighting of more than 5% in the index against which that unit trust is benchmarked.

Unit trusts fund managers may not borrow money to invest; neither may they short the market (sell shares they do not own).

The Association of Savings and Investments South Africa (ASISA) is the industry body which assists the FSCA with the regulation of the industry.

## 4.10 Medical Schemes Act 131 of 1998

The Medical Schemes Act 131 of 1998, as amended, regulates the registration and control of certain activities of medical schemes, seeks to protect the interests of members of medical schemes and provide for measures for the coordination of medical schemes.

The Act introduced three important principles namely:

* Open access or open enrolment
* Community rating
* Prescribed minimum benefits.

**4.10.1 Open Access or open enrolment (section 29(2) and (3)**

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 are also 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.

On the flipside, the principle of open enrolment makes schemes vulnerable to anti-selection. Anti-selection is as term used to describe the practice in terms of which members wait until they need medical cover before joining a medical scheme. Schemes are therefore entitled to impose two measures; waiting periods and late-joiner penalties to mitigate such anti-selection.

Waiting periods are periods during which benefits are denied or restricted and late-joiner penalties are loadings on contributions for those who join medical schemes late in life without having been a member for a specific period of time. The waiting periods and late joiner fees are prescribed by law and the schemes cannot apply any others that are outside the prescribed ones.

A medical scheme cannot cancel or suspend a member’s membership or that of any of their dependants unless the member:

* Fails to pay the membership fees within the time allowed in the medical scheme’s rules
* Fails to repay any debt due to the medical scheme
* Submits fraudulent claims
* Commits any fraudulent act
* Fails to disclose material information.

**4.10.2 Community rating (sections 29(1)(n) and 26 (5))**

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.

Schemes cannot load or discount members’ contributions in any way, except to apply late-joiner penalties to individuals joining late in life. The only exception is that recently some schemes have been given exemptions from the Act to discount contributions for members of a particular option who agree to use certain providers and an amendment to the act to allow this kind of discounting has been proposed.

The only criteria that can be used to determine contributions are a member’s income or number of dependants or both. The act provided for schemes to set a lower contribution rate for a child dependant (under age of 21 or older if scheme rules allow). Community rating prevents schemes from risk rating and ensures that as long as a medical schemes options have young (relatively healthier) members, that they subsidise the medical expenses of the older (relatively less healthy) beneficiaries.

**4.10.3 Minimum benefits (section 29(o) and (p), regulations 4, 7, 8 and 10 and Annexure A to the regulations)**

All schemes must provide certain benefits to all members. These benefits are known as the prescribed minimum benefits (PMBs). Currently there are about 300 PMBs covering:

* Emergency medical conditions
* A list of conditions (currently 271) that are life threatening or seriously affect quality of life
* 26 common chronic conditions.

The PMB regulations include minimum treatment standards for each condition. During the pandemic COVID-19 vaccines has also been included as a PMB.

## 4.11 Electronic Communications and Transactions Act 25 of 2002

The main purpose of the Electronic Communications and Transactions Act is to provide for the facilitation and regulation of electronic communications and transactions; to provide for the development of a national e-strategy for the Republic; to promote universal access to electronic communications and transactions and the use of electronic transactions by SMMEs; to provide for human resource development in electronic transactions; and prevent abuse of information systems.

The ECT Act applies to any form of communication by e-mail, the Internet, SMS etc. except for possibly voice communications between 2 people. It is also “an enabling” piece of legislation in that it provides functional equivalents for paper-based concepts (including writing, original and signature), some of which were encountered in over 300 pieces of legislation identified by the Department of Communications in 1999 as not being suitable to the information age as they all had paper-based concepts within them.

The ECT Act is also a very wide piece of legislation and also deals with issues which are not related to electronic communications and transactions (such as cyber inspectors, liability of service providers and domain names). It also attempts to provide legal certainty in areas of law where there was legal uncertainty prior to August 2002 (e.g. the formation of contracts and the status of so-called “click wrap” agreements).

The Act has 14 chapters which are as follows:

|  |  |
| --- | --- |
| **Chapter** | **Detail** |
| Chapter I | Interpretation, Objects and Application |
| Chapter II | Maximising Benefits and Policy Framework |
| Chapter III | Facilitating Electronic Transactions |
| Chapter IV: | E‑government services |
| Chapter V: | Cryptography Providers |
| Chapter VI: | Authentication Service Providers |
| Chapter VII: | Consumer Protection |
| Chapter VIII: | Protection of Personal Information (all sections deleted) |
| Chapter IX: | Protection of Critical Databases |
| Chapter X: | Domain Name Authority and Administration |
| Chapter XI | Limitation of Liability of Service Providers |
| Chapter XII: | Cyber Inspectors |
| Chapter XIII ‑ | Cyber Crime (all section deleted) |
| Chapter XIV: | General Provisions |

Few of the chapters are discussed below. These have a major bearing on the work of financial advisors.

**Chapter III: Facilitating Electronic Transactions**

This Chapter deals with the removal of legal barriers to electronic transacting and comprises two parts.

Part 1 provides for the legal requirements of data messages (a form of electronic communication). Various sections are drafted from the perspective of where a requirement is prescribed by “law”. It also attempts to create technology neutrality in respect of the legal treatment of data messages.

Part I gives legal recognition to electronic documents and recognises that electronic documents and signatures can serve as the electronic functional equivalent of their paper-based counterparts. Provision is made for the legal recognition of electronic signatures and the ECT Act does not prescribe what type of technology must be used. Examples of electronic signatures include:

* your typed name at the end of your e-mail,
* a scanned image of your handwritten signature embedded into a Word document and
* A so-called digital signature.

The ECT Act also creates a special type of electronic signature, known as an “advanced electronic signature” (AES), which is a particularly reliable form of signature. Where a law (such as the Credit Agreements Act) requires a signature, only an AES will be valid.

Provision is made for the legal recognition of the electronic version of paper-based concepts and electronic data will, subject to certain conditions, be regarded as “writing” and constituting a “original”. The Act permits the keeping of records in electronic form. However, the ECT Act states the general legal principle but does not provide details or guidelines on what organisations should implement in practice.

Provision is also made for integrity being key to ensuring proper evidentiary weight of electronic evidence and the ability to notarise, acknowledge or certify electronic documents.

The Part also permits one to send a document by e-registered post through the South African Post Office.

Part 1 also recognises that information can be incorporated into a document through the use of hyperlinks and that contracts can be performed by machines functioning as electronic agents for parties to an electronic transaction.

Part 2 creates certain presumptions as to the time when and place where you are deemed to have received information. Part 2 also provides legal certainty as to the status of so-called “click wrap” (mouse-click-on-icon) and “web wrap” agreements. It also covers situations where data messages are deemed to have been sent by someone. The Part also provides for the acknowledgement of receipt of a data message, although there is not a legal requirement to do so.

**Chapter VI: Authentication Service Providers**

Identification and authentication of the parties in cyberspace remains a challenge and poses threats to consumers and businesses. The ECT Act seeks to provide for the establishment of an Accreditation Authority within the Department, allowing voluntary accreditation of electronic signature technologies in accordance with minimum standards. Once accredited, these Government endorsed “advanced” electronic signatures can be used by parties who have to sign by means of an “advanced” electronic signature where required “by law”. In addition, the legislature has created a presumption of integrity where “advanced” electronic signatures are used – i.e. they will allow a party to place reliance on its authenticity by shifting the burden of proof onto the signatory to disprove its authenticity. It has also created a benefit in favour of those processes which have been accredited, that are recognised as particularly reliable. The Regulations governing accreditation were published on Wednesday, 20 June 2007 (in Government Gazette No. 8701, No. 29995, Vol. 504).

**Chapter VII: Consumer Protection**

Suppliers of goods or services on a website must provide consumers with a minimum set of information, including:

* the price of the product or service,
* the name, contact details, and a brief description of the business, and
* The right to withdraw from an electronic transaction before its completion.

A consumer is defined as a natural person acting as end-user of the goods or services. Consumers are also entitled, under certain circumstances, to a “cooling off” period within which they may cancel certain types of transactions concluded electronically without incurring any penalty.

**Spam**

Consumers also have the right not to be bound to unsolicited communications (spam) offering goods or services and the sender of the unsolicited communication must at the request of the consumer provide the identifying particulars of the source from which it obtained the consumers personal information. A person who continues to send unsolicited communications to a consumer after having been advised that the unsolicited communications are not welcome, commits an offence.

The ECT Act also seeks to place the responsibility on businesses trading online to make use of sufficiently secure payment systems. If a payment system is breached as a result of the system not being sufficiently secure, the supplier must reimburse the consumer for any loss suffered.

**Chapter VIII: Personal Information and Privacy Protection**

This Chapter has been deleted after the enactment of the POPI Act.

**Chapter IX: Protection of Critical Databases**

In terms of its definition, critical data is information which, if compromised, may pose a risk to the national security of the Republic or to the economic or social well-being of its citizens. The Minister may prescribe matters relating to the registration of critical databases and require certain procedures and technological methods to be used in their storage and archiving. In November 2003 the Minister of Communications awarded a tender to a consortium of Consultants to undertake an inventory of all major databases in South Africa. The purpose of this according to the press release was to assist the Minister to (i) put in place regulations, with respect to the development, maintenance, validity, integrity and security of these databases and related systems, (ii) review progress and compliance on an ongoing basis, (iii) refine policy, legislative and regulatory requirements where appropriate and (iv) ensure that databases and data, in the Republic of South Africa, that could negatively impact on companies and citizens, are developed, maintained and secured to meet appropriate standards.

**Chapter X: Domain Name Authority and Administration**

The ECT Act has established a Domain Name Authority (the .za Domain Name Authority (Zadna)) to assume responsibility for the .za domain name space. All citizens and permanent residents of the Republic are eligible for membership of the Authority and must be registered as members upon application and on payment of a nominal fee.

The functions of the Authority are provided for in the Act. Provision is made for finances and reporting and for disputes involving Domain Names to be settled by means of alternate disputes resolution methods. In August 2007, Zadna published new policies and procedures for its members. The regulations state inter alia that domain names are to be allocated on a first come, first serve basis, with dispute resolution processes to be utilised if needs be to protect the rightful owners of domain names.

**Chapter XI Limitation of Liability of Service Providers**

Chapter XI deals with the limitation of the liability of service providers or so‑called “intermediaries” in cases where they may otherwise have been liable for third party data hosted on their servers. It creates a safe harbour for service providers who were previously exposed to a wide variety of potential liability by virtue of merely fulfilling their basic technical functions. The service providers may seek to limit their liability where they have acted as mere conduits for the transmission of data messages. In each situation, the ECT Act seeks to provide for specific requirements that the actions of the service providers must meet before the clause may be invoked to limit his or her liability.

**Chapter XIII ‑ Cyber Crime**

This Chapter has been deleted after the enactment of the Cybercrimes Bill.

## 4.12 Conduct of Financial Institutions Bill

This is still only a Bill and open for consultation but due to its massive impact on the study material in this learner guide reference is made to its existence and its intent. The FSCA currently oversees 8 Acts that impacts on the market conduct of financial institutions. These are:

* 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.

All of the Acts have their own regulations, interpretation and guidance notes, conducts standards and more. The following graph illustrates the current position:

Chart, bubble chart

Description automatically generated

Source: FSCA

These regulatory silos impede reform and lead to regulatory arbitrage and fragmented supervision. This results that the level of customer protection depends on the industry and distribution channel chosen. The Conduct of Financial Institutions Act (COFI) was therefore created to establish a holistic legal framework for conduct regulation that significantly streamlines the legal landscape for conduct regulation in the financial sector and aims to strengthen customer protection by ensuring more consistent customer outcomes across the financial sector as a whole is achieved.

The intent is to combine all 8 Acts into one COFI Act:

Diagram

Description automatically generated

Source: FSCA

This transition will happen in a two-phased approach, first harmonisation and secondly an assessment of remaining requirements. In the harmonisation phase 15 crucial projects have been identified where the regulations will be harmonised across all 8 Acts. These projects are:

Chart, bubble chart

Description automatically generated

Source: FSCA

In phase 2 there will be a focus on rationalising requirements, shifting towards outcomes and principle based requirements and consolidating requirements as far as possible:

Diagram

Description automatically generated

Source: FSCA

It is expected that the whole transition will take about 6 years.



**LEARNING UNIT 1: Formative Assessments**

**Formative activity 1**

Describe the main purpose of the Insurance Act 18 of 2017 [5]

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**Formative activity 2**

Explain how financial service providers can comply with the requirements of the Promotion of Access to Information Act 2 of 2000? [5]

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**Formative activity 3**

Describe the key role-players under the POPI Act. [6]

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**Formative activity 4**

Goldair Bank is a registered credit provider and they have recently been granted a licence. Their credit manager approaches you for assistance with various terminology applicable in the credit granting space. Explain to him what reckless lending is. [3]

Identify any 5 consumer rights under the National Credit Act 35 of 2005. [5]

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**Formative activity 5**

Explain how the Consumer Protection Act 68 of 2008 apply to financial service providers. [6]

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**Formative activity 6**

Why must those who deal with investment of customer funds declare their interests under the Financial Institutions (Protection of Funds) Act 28 of 2001? [5]

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**Formative activity 7**

Name the 5 objectives of the Financial Markets Act 19 of 2012. [5]

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**Formative activity 8**

Distinguish between a pension fund and a provident fund. [6]

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**Formative activity 9**

Describe collective investment schemes and explain why they are important as an investment vehicle. [8]

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**Formative activity 10**

Explain the importance of community rating under the Medical Schemes Act 131 of 1998. [5]

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