VERBATIM
January 2025
ISSUE 111

THE CONDUCT OF FINANCIAL INSTITUTIONS BILL – JANUARY 2025

To understand the Conduct of Financial Institutions Bill (known as COFI), we need to take a step back and look at the regulatory reform journey South Africa has been on for some time.

In 2018 the Twin Peaks regulatory model was formalised by the Financial Sector Regulation (FSR) Act, with the purpose of strengthening financial sector regulation and oversight. The Twin Peaks regulatory reform was a direct response to the weakness of the financial services regulatory system revealed by the 2008 global financial crisis, such as inappropriate market conduct and the systemic risks of large insurers.

The FSR Act established the Financial Sector Conduct Authority (FSCA) and the Prudential Authority (PA) as the primary regulators, with the former focusing on market conduct and the latter responsible for prudential regulation. As one of the final steps in the Twin Peaks reform process, the COFI bill was drafted in conjunction with the FSR Act and published for comment in December 2018.

At a high level, COFI is an umbrella piece of legislation governing financial institutions, with the intention to **replace** existing industry specific conduct regulation, where there are many gaps and many overlaps. COFI will streamline and harmonise the legal landscape that financial institutions operate in, by providing a single, holistic legal framework for market conduct regulation in South Africa that is consistently applied to all financial institutions.

At its heart, COFI's focus is regulating the general market conduct of financial institutions and the fair treatment of customers.

PRINCIPLES UNDERPINNING THE COFI BILL

- ***Activity based approach***: There are currently 13 different financial sector laws that regulate and supervise financial institutions. These laws are specific to each institutional definition, for example retirement funds, financial services providers, etc. The new legal framework under COFI will shift away from this sectoral approach and will focus on the activities being performed instead. In other words, the law will cover the activity, rather than the type of institution.
- ***Principle based approach:*** COFI moves away from a rules-based approach to compliance (tick box exercise) and sees the industry and regulator shifting towards making sure that their actions and processes are geared towards desired outcomes (or the *spirit* of the law). Financial institutions will thus need to support and uphold principles rather than simply follow rules – and regulators will have a wider latitude to supervise the spirit, and letter, of the rules.

- ***Outcomes-focused approach:*** Regulators will test institutions on the delivery of the outcomes, but the institutions can decide what processes and actions are required to meet the outcomes.
- ***Risk-based approach****:* The new framework enables the regulator to identify and address areas that pose higher risks to customers and financial stability. This approach supports transformation and financial inclusion while ensuring compliance with relevant codes like the B-BBEE Code.

OBJECTIVES OF COFI

- Regulate how financial institutions treat their customers, aligning to the Treating Customers Fairly principles.
- Consolidate the existing range of laws applicable to the financial sector
- Promote:
  - trust and confidence in the financial sector
  - innovation
  - competition
  - financial inclusion
  - financial literacy
  - transformation
  - governance
- Support fair and efficient financial markets

COFI AND TRANSFORMATION

Under COFI, financial institutions will have to comply with the Financial Sector Code. Institutions will have to design, publish and implement a transformation policy, and then report on how they are meeting the set targets.

FAIR TREATMENT OF CUSTOMERS

A core objective is to ensure that financial institutions prioritise the fair treatment of customers. This includes designing products and services that meet the needs of identified customer groups and providing clear, understandable information to customers.

LICENSING

Currently, the licensing of financial institutions is done on an institutional basis, for example, as a bank or an insurer, etc. The bill proposes a comprehensive licensing schedule for all regulated entities and envisages that a financial institution carrying out one or more identified activities will have to be authorised for each activity. A licence will be granted on three levels: activity being performed, product involved and targeted customer.

The proposed licensing requirements emphasise the importance of robust governance structures within financial institutions, including the appointment and debarment of representatives.

COFI AND RETIREMENT FUNDS

It has been proposed that initially retirement funds will have to be **licensed** under both the Pension Funds Act (PFA) and COFI to ensure consistency in the way customers are treated. Over time, conduct requirements will however be shifted from the PFA to COFI.

Retirement fund administrators and other service providers currently regulated under the PFA, will, in future, only be licensed and authorised under COFI. There will be a transitional period to ensure alignment between the provisions of the PFA and COFI.

Boards of management of retirement funds will remain responsible and accountable for compliance with all applicable legislation as part of their wider fiduciary duties. Given this important function, boards will have to comply with certain **fit and proper requirements** to be prescribed by the FSCA under COFI, which will be issued as conduct standards.

A trustee who is elected by the employees, the participating employer or the fund's sponsor will not be required to be licensed under COFI. Professional or independent trustees will however have to be licensed and will also be subject to fit and proper requirements as part of their wider regulatory obligations.

The Financial Sector Code currently only applies voluntarily to the top 100 retirement funds. If these **transformation** principles are now made law under COFI , it could mean that all retirement funds will have to comply with the transformation requirements prescribed by the Code.

Retirement funds can also expect **enhanced supervision.** The FSCA will adopt a more proactive and intrusive supervisory approach, which may include desktop reviews and on-site visits for high impact funds. This could lead to more rigorous oversight and enforcement of compliance standards

Overall, COFI will require trustees to be more proactive in ensuring that their governance practices, decision-making processes and operational systems align with COFI's objectives of fairness, transparency, and customer protection

WHEN WILL COFI BE PUBLISHED?

In their latest 3-year regulation plan, the FSCA confirmed that the development of a "*holistic, cross-sector, robust, and customer-focused regulatory framework*" under COFI remains a top priority. The COFI bill is a critical development that will shape the future conduct framework, and many of the FSCA's current conduct regulatory framework projects have some dependency on its promulgation.

Given the sweeping changes by COFI, it is expected that the FSCA will follow a phased approach for its implementation:

- **Phase 1:** The initial high-level design of the new regulatory framework, which will inform the development of the underlying regulatory frameworks.
- **Phase 2:** Targeted consultation on the themed frameworks.
- **Phase 3:** Transition the regulatory instruments under the existing sectoral laws into COFI.

To date, no firm dates have been provided. The FSCA have confirmed that "*Timelines for completion are outside of their control but support will continue as long as necessary*."

In the interim, the FSCA will regulate financial institutions using conduct standards.

IN SUMMARY ...

COFI is a significant piece of legislation in South Africa aimed at reforming and strengthening the regulation of financial institutions, aligning with global best practices. It seeks to enhance the existing regulatory framework by:

- focusing on the conduct of financial institutions,
- ensuring fair treatment of customers, and
- promoting financial stability.

COFI is part of a broader effort to enhance South Africa's financial regulatory environment and aims to create a more transparent, efficient and customer-centric financial sector. The implementation of this bill will require significant changes in how financial institutions operate, including retirement funds.