FSCA
Financial Sector
Conduct Authority

FSCA COMMUNICATION 22 OF 2022 (GENERAL)

PUBLICATION OF NOTICE OF DRAFT AMENDMENT OF THE EXEMPTION BY THE FINANCIAL SECTOR CONDUCT AUTHORITY OF CERTAIN PERSONS FROM JOINT STANDARD 1 OF 2020 FOR COMMENT

1 PURPOSE

The purpose of this Communication is to inform stakeholders that today the Financial Sector Conduct Authority ("FSCA") published for comment on its website a draft amendment to the Exemption by the Financial Sector Conduct Authority of Certain Persons from Joint Standard 1 of 2020, published originally under FSCA General Notice 3 of 2020.

2. BACKGROUND

2.1 In 2002, the FSCA and the Prudential Authority ("PA") published Joint Standard 1 of 2020: Fitness, propriety and other matters relating to significant owners ("Joint Standard"), in terms of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) ("FSR Act"). The Joint Standard became effective on 1 December 2020 and applies to the significant owners of financial institutions, as well as to financial institutions.

2.2 When the Joint Standard was published certain entities were exempted from the application of the Standard: The "Statement of need for, expected impact and intended operation of a regulatory" published together with the Joint Standard explained as follows:[1]

"The draft Joint Standard applies to significant owners of all financial institutions, unless otherwise exempted. Given the size and complexity of some of the institutions (e.g. financial services providers other than a CIS) as well the practicality of complying with the Joint Standard in view of the nature and structure of ownership which is member-based (e.g. pension funds, cooperative banks), the Authorities propose to exempt

[1] Extracted from the *Statement of the need for, expected impact and intended operation of a regulatory instrument: Joint Standard on fitness, propriety and other matters related to significant owners.*

significant owners of financial institutions in table 1. The rationale for the exemption of significant owners of each of the financial institutions in table 1 from the requirements of the Joint Standard is set out in column 2 of the table."

2.3 Table 1 referred to in paragraph 2.2 indicated that significant owners of Financial Service Providers (FSPs) will be exempted from the Joint Standard,[2] and included the following rationale for the decision to exempt significant owners of FSPs at the time that the Joint Standard was published:

"*These financial institutions vary significantly in nature, scope, size, complexity and the type of services provided. Further work on appropriate fit and proper person requirements best suited for these types of financial institutions will be undertaken. Once this work is completed significant owners of financial service providers, or specific types of financial service providers, might be included in the standard*.".

2.4 Accordingly, when the Joint Standard was made final, significant owners of FSPs were exempted from the requirements of the Joint Standard through the Exemption by the Financial Sector Conduct Authority of Certain Persons from Joint Standard 1 of 2020 ("The Exemption").

3. RATIONALE INFORMING THE AMENDMENT OF THE EXEMPTION

Reassessment of Joint Standard

3.1 Following the publication of the Joint Standard, the FSCA initiated a cross-sector project born by the need to identify owners of financial institutions more effectively, considering the extent to which such owners are able to influence and control the business of financial institutions.

3.2 In addition, the FSCA has reassessed the requirements in the Joint Standard to determine the extent to which such requirements should apply to significant owners of FSPs. In this regard, the following was concluded:

3.2.1 Honest and integrity

The main aim of the Joint Standard is to ensure that significant owners are honest

[2] Excluding FSPs that are also banks, insurers and CIS Managers.

and have the necessary integrity. In the FSCA's opinion, honesty and integrity is a fundamental characteristic that should be displayed by significant owners of all financial institutions. In addition, the FSCA is of the view that the requirement to be honest and have integrity will not create an undue burden on significant owners of FSPs, including significant owners of small FSPs.

3.2.2 *Competence and financial standing required to support the business of a financial institution*

The Joint Standard also requires that significant owners have the competence and financial standing required to support the business of a financial institution of which it is a significant owner. It is acknowledged that the impact of the requirements to have the competence and financial standing to support the business of a financial institution, might be onerous on some significant owners of FSPs, especially smaller FSPs. In many instances it will likely to be difficult for significant owners of smaller FSPs to ensure and evidence financial backing to support the business of the FSP. If a significant owner of a small FSP is required to have substantial financial resources to support the busines of the FSP and is found lacking, this would amount to a contravention of the Joint Standard and may result in the removal of the significant owner. In the FSCA's opinion, the latter would be contrary to the objective of supporting development of small businesses and for this reason the FSCA is of the view that the Exemption, insofar as it relates to a significant owner of an FSP having competence and financial standing to support the business of the FSP, should be perpetuated for now.

3.2.3 *Procedures for assessing fitness and propriety, and reporting*

The Joint Standard requires significant owners to have procedures in place for assessing and attesting to, on an annual basis, its fitness and propriety, as per the requirements of this Joint Standard. In addition, the Joint Standard requires significant owners to notify the FSCA of non-compliance with this Joint Standard or if a change in the fit and proper status of the significant owner occurs. Lastly, the Joint Standard places an obligation on a financial institution to notify the FSCA if it becomes aware of –

- significant ownership or potential significant ownership; and
- non-compliance with this Joint Standard by a significant owner.

The FSCA is of the view that the above requirements will not place an undue burden on significant owners of FSPs, including significant owners of small FSP's. The FSCA is further of the view that these requirements are necessary to support implementation of, and monitoring compliance with, the requirements discussed in paragraph 3.2.1, and to support the FSCA in executing its project focused on identifying owners of financial institutions more effectively.

3.3 In summary, the FSCA is of the view that the requirements in the Joint Standard pertaining to honesty, integrity, reporting and procedures for assessing fitness and propriety, is appropriate in the context of significant owners of FSPs.

Financial Action Task Force ("FATF") Mutual Evaluation Report ("MER")

3.4 South Africa is a member of the FATF, an inter-governmental global anti money laundering and terrorist financing body, that sets international standards aiming to prevent these illegal activities and the harm such cause to society. As a member of FATF, South Africa must adhere to the FATF Recommendations.

3.5 During 2019, the FATF conducted a country review of South Africa in the context of the FATF Recommendations, and made findings and accompanying recommendations to be remediated in its MER. Recommendations not fully remediated or significantly progressed by October 2022 can lead South Africa to be placed on the FATF grey-list, which could have dire consequences for the country as a whole.

3.6 FATF Recommendation 26 states that (emphasis added): "Countries should ensure that financial institutions are subject to adequate regulation and supervision and are effectively implementing the FATF Recommendations. <u>Competent authorities or financial supervisors should take the necessary legal or regulatory measures to prevent criminals or their associates from holding, or being the beneficial owner of, a significant or controlling interest or holding a management function in, a financial institution</u> … …".

3.7 One of the key findings in the MER related thereto that (emphasis added) *while fit and proper criteria are in place for many sectors, <u>these often do not apply to beneficial owners</u>. Most regulators do not conduct criminal checks or verify self-declarations of applicants, although police criminal clearance certificates are required for applicants in the ADLA and CIS manager sectors*[3]*.*

[3] Extracted from FATF Anti-money laundering and counter-terrorist financing measures, South Africa MER, October 2021

3.8 Although it is acknowledged that a significant owner and a beneficial owner is not exactly the same thing, the definition of a significant owner in the FSR Act captures a relatively broad scope of beneficial owners. However, as significant owners of FSPs are currently exempted from the Joint Standard, such significant owners are currently not subject to any fit and proper requirements.

3.9 Should the Exemption insofar as it relates to significant owners of FSPs be withdrawn, this will have the effect that a broader scope of beneficial owners (through the definition of significant owner) will be brought within the scope of the Joint Standard, thereby subjecting them to the fit and proper requirements and, as a result, partially addressing the FATF MER finding referred to above, which was identified in the context of FATF Recommendation 26.

3.10 The FATF MER has therefore exacerbated the need to amend the Exemption in this point in time on an urgent basis.

3.11 It might be noted that the longer-term objective of the FSCA is to make a proposal to National Treasury pertaining to the potential amendment of the FSR Act, to create an enabling framework for the regulation and supervision of beneficial owners of financial institutions, holistically.

Conclusion

3.12 The FSCA is proposing to amend the Exemption to ensure that significant owners of FSPs are subject to the requirements in the Joint Standard pertaining to honesty, integrity, reporting and procedures for assessing fitness and propriety. This will ensure that, amongst other things, regulatory measures aimed at preventing criminals or their associates from controlling financial institutions exist.

3.13 The proposed amendment to the Joint Standard aligns to the FSCA's objective of identifying owners of financial institutions more effectively, and is viewed as an urgent interim step to address a finding reflected in the FATF MER, pending further legislative amendments that will create an enabling framework for the regulation and supervision of beneficial owners holistically.

4. INVITATION TO COMMENT ON DRAFT RULE AMENDMENT NOTICE

4.1 In the above context, the FSCA, publishes for public consultation a draft amendment of the Exemption by the Financial Sector Conduct Authority of Certain Persons from Joint Standard 1 of 2020.

4.2 The documents referred to in paragraph 1 is available on the FSCA's website at www.fsca.co.za.

4.3 Interested parties are invited to submit comments on the draft amendment using the Comments Template published with the draft amendment, in Word format, on or before **29 August 2022** to FSCA.RFDstandards@fsca.co.za.

5. CONTACT

For further information regarding this Communication please contact the Regulatory Framework Department of the FSCA by emailing Hannelie Hattingh at Hannelie.hattingh@fsca.co.za.

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