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**March 2019**

**SUBMISSION TO THE  
NATIONAL TREASURY  
ON THE  
CONDUCT OF FINANCIAL INSTITUTIONS BILL, 2018**

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## Introduction

On 14 December 2018, the National Treasury made known by General Notice in the *Gazette* that it had published a draft Conduct of Financial Institutions Bill, 2018,<sup>1</sup> which was available on the Treasury's website.<sup>2</sup>

The website page<sup>3</sup> lists<sup>4</sup>—  
that General Notice of 14 December in the *Gazette*,<sup>5</sup>  
a Media Statement (dated 11 December 2018) about the release of the Draft Bill,<sup>6</sup>  
a 188-page Draft Bill,<sup>7</sup>  
a 90-page Explanatory Policy Paper accompanying the Draft Bill<sup>8</sup> and  
a Socio-Economic Impact Assessment<sup>9</sup> regarding the Bill.<sup>10</sup>

## Public comments invited

The General Notice states that the Draft Bill is published for public comment,<sup>11</sup> and the Media Statement indicates that the Treasury invites public comments on the draft.<sup>12</sup>

Comments can be sent to a Treasury email address<sup>13</sup> until 1 April.<sup>14</sup>

## Workshops

The Media Statement<sup>15</sup> indicated that Public Workshops would be arranged.<sup>16</sup>

In January, the Treasury put an “alert” on its website<sup>17</sup> to interested persons<sup>18</sup> stating Workshops are scheduled, one in Pretoria in February<sup>19</sup> and one in Cape Town in March.<sup>20</sup>

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<sup>1</sup> Gen Notice 808 of 2018 (in *Gazette* 42114 of 14 Dec 2018): National Treasury: Draft Conduct of Financial Institutions Bill, 2018: Publication for public comment.

<sup>2</sup> On the Treasury's Twin Peaks page [www.treasury.gov.za/twinpeaks](http://www.treasury.gov.za/twinpeaks).

<sup>3</sup> Under the heading “Conduct of Financial Institutions Bill (COFI) Bill”.

<sup>4</sup> With links to them.

<sup>5</sup> I.e., (see above) Gen Notice 808 of 2018. “Draft Conduct of Financial Institutions Bill”

([http://www.treasury.gov.za/twinpeaks/SKM\\_C364e18121411550.pdf](http://www.treasury.gov.za/twinpeaks/SKM_C364e18121411550.pdf)).

<sup>6</sup> National Treasury: Media Statement dated 11 Dec 2018: Release of Conduct of Financial Institutions Bill for public comment

([http://www.treasury.gov.za/comm\\_media/press/2018/2018121101%20Media%20statement%20-%20COFI%20Bill.pdf](http://www.treasury.gov.za/comm_media/press/2018/2018121101%20Media%20statement%20-%20COFI%20Bill.pdf)).

<sup>7</sup> Conduct of Financial Institutions Bill

(<http://www.treasury.gov.za/twinpeaks/Conduct%20of%20Financial%20Institutions%20Bill.pdf>)

<sup>8</sup> Explanatory Policy Paper accompanying the COFI Bill.

<sup>9</sup> Undated.

<sup>10</sup> Socioeconomic impact assessment on COFI Bill.

(<http://www.treasury.gov.za/twinpeaks/SEIA%20COFI%20Bill.pdf>).

<sup>11</sup> Gen Notice 808 of 2018 (in *Gazette* of 14 Dec 2018).

<sup>12</sup> National Treasury Media Statement dated 11 Dec 2018: Draft Conduct of Financial Institutions Bill, 2018: Publication for public comment.

<sup>13</sup> [marketconduct@treasury.gov.za](mailto:marketconduct@treasury.gov.za).

<sup>14</sup> Gen Notice 808 of 2018, “Draft Conduct of Financial Institutions Bill, 2018: Publication for public comment” (in *Gazette* 42114 of 14 Dec 2018); National Treasury Media Statement dated 11 Dec 2018.

<sup>15</sup> Of 11 Dec 2018.

<sup>16</sup> And that further information about them would be communicated in early 2019.

<sup>17</sup> On its Twin Peaks page.

<sup>18</sup> Alert: Public Workshops on Conduct of Financial Institutions Bill

(<http://www.treasury.gov.za/twinpeaks/Invitation%20for%20COFI%20bill%20workshop.pdf>)

<sup>19</sup> On 22 Feb 2019, at the premises of the Financial Sector Conduct Authority.

<sup>20</sup> On 11 March, at Parliament Imbizo Media Centre.

## Outline of draft Bill

The draft Bill is aimed at supplementing the Financial Sector Regulation Act, 2017,<sup>21</sup> which makes comprehensive new provision for regulating the financial sector.<sup>22</sup>

The draft Bill states that it must be interpreted and applied in a manner that<sup>23</sup> promotes the achievement of that Act's object set out in that Act,<sup>24</sup> and gives effect to the achievement of the Authority's objective set out in that Act.<sup>25</sup>

(Most, if not all, of the provisions of the 2017 Regulation Act are now in operation.<sup>26</sup> The 2017 Regulation Act repeals some statutes dealing with aspects of financial-sector regulation,<sup>27</sup> and amends most others.<sup>28</sup>)

<sup>21</sup> Financial Sector Regulation Act 9 of 2017 (hereinafter also referred to as the "Regulation Act").

<sup>22</sup> See Financial Sector Regulation Act, Long title. That Act states (summarised somewhat) that it— establishes a Prudential Authority and Financial Sector Conduct Authority and confers powers on them; confers powers on the Reserve Bank to preserve and enhance financial stability; establishes a Financial Stability Oversight Committee; makes provision to regulate and supervise financial-product and financial-services providers and improve market conduct to protect financial customers; provides for co-ordination etc. among the Reserve Bank, Prudential Authority, Financial Sector Conduct Authority, National Credit Regulator, Financial Intelligence Centre and other organs of state i.r.t. financial stability and their functions, establishes a Financial System Council of Regulators and the Financial Sector Inter-Ministerial Council; provides for making regulatory instruments, including prudential, conduct and joint standards; makes provision for licensing financial institutions and for powers to gather information and conduct supervisory on-site inspections and investigations; makes provision i.r.t. significant owners of financial institutions and supervision of financial conglomerates i.r.t. eligible financial institutions that are part of such conglomerates; provides for powers to enforce financial sector laws; provide for protection and promotion of rights in the financial sector; establishes an Ombud Council and confers powers on it i.r.t. ombud schemes, and provides for coverage of financial-product and -service providers by appropriate ombud schemes; establishes an independent Financial Services Tribunal and confers on it powers to reconsider decisions by financial-sector regulators, the Ombud Council and certain market infrastructures; establishes a Financial Sector Information Register and provides for its operation; provides for information-sharing; and provides for regulation-making powers of the Minister.

<sup>23</sup> *Inter alia*.

<sup>24</sup> Draft Conduct of Financial Institutions Bill cl 2(1)(b), read with Financial Sector Regulation Act s 7.

Financial Sector Regulation Act s 7 states *inter alia*:

### Object of Act

7. The object of this 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 the Republic, by establishing, in conjunction with the specific financial sector laws, a regulatory and supervisory framework that promotes—

- (a) financial stability;
- (b) the safety and soundness of financial institutions;
- (c) the fair treatment and protection of financial customers;
- (d) the efficiency and integrity of the financial system;
- (e) the prevention of financial crime;
- (f) financial inclusion;
- (g) transformation of the financial sector; and
- (h) confidence in the financial system.

<sup>25</sup> Draft Conduct of Financial Institutions Bill cl 2(1)(c), read with Financial Sector Regulation Act s 57.

Financial Sector Regulation Act s 57 states:

### Objective

57. The objective of the Financial Sector Conduct Authority is to—

- (a) enhance and support the efficiency and integrity of financial markets; and
- (b) protect financial customers by—
  - (i) promoting fair treatment of financial customers by financial institutions; and
  - (ii) providing financial customers and potential financial customers with financial education programs, and otherwise promoting financial literacy and the ability of financial customers and potential financial customers to make sound financial decisions; and
- (c) assist in maintaining financial stability.

<sup>26</sup> Most of the 2017 Financial Sector Regulation Act took effect on different dates in 2018 and January 2019. The rest is scheduled to commence in March and April 2019:

See Gen Notice 169 of 2018 (Commencement of Financial Sector Regulation Act, 2017) in *Gazette* 41549 of 29 Mar 2018, read with Govt Notice R99 of 9 Feb 2018 (Commencement of amendments to Financial Markets Act, 2012, as contained in Financial Sector Regulation Act, 2017).

<sup>27</sup> The 2017 Regulation Act repeals the Financial Services Board Act, 1990; Policy Board for Financial Services and Regulation Act, 1993; Inspection of Financial Institutions Act, 1998; and Financial Services Ombud Schemes Act, 2004.

<sup>28</sup> The 2017 Regulation Act amends *inter alia* the Insolvency Act, 1936; Pension Funds Act, 1956; Friendly Societies Act, 1956; South African Reserve Bank Act, 1989; Banks Act, 1990; Financial Supervision of the Road Accident Fund Act, 1993; Mutual Banks Act, 1993; Financial Intelligence Centre Act, 2001; Co-operative Banks Act, 2007; Financial Markets Act, 2012; and Credit Rating Services Act, 2012.

The 2017 Act also amends statutes which the draft Bill aims to repeal (see later below).

The Draft Bill puts forward further comprehensive changes to the legislative regime governing the financial-services sector.

The Draft Bill aims to repeal both 1998 Insurance Acts,<sup>29</sup> the Financial Institutions (Protection of Funds) Act,<sup>30</sup> the Financial Advisory and Intermediary Services Act<sup>31</sup> and the Collective Investment Schemes Control Act.<sup>32</sup> The Bill would replace them all with its own provisions.<sup>33</sup>

The Draft Bill has 118 clauses (divided into 13 chapters), with five schedules.<sup>34</sup>

### **Treasury description of Bill**

The National Treasury states that the Draft Bill is designed to be “Principles-based”, in that it seeks to set principles specifying “the intention” of regulation rather than to “set rules”, so as to ensure that the actions of the industry and of the regulator (the Financial Sector Conduct Authority<sup>35</sup>) are geared toward “driving the attainment of certain principles” in the financial sector “not only on technical compliance with the law”.<sup>36</sup>

The Treasury also states the Bill is designed to provide for “Outcomes-focused” supervision to allow the regulator to test financial institutions on their delivery of the actual outcomes in order to assess the effectiveness of the financial sector in, not only providing correct customer outcomes, but “supporting the real economy too”.<sup>37</sup>

The Treasury says the Bill is designed to be “Activity-based”, moving away from the institutionally-driven approach, so that “[t]he same regulation will apply to similar activities, regardless of the institution performing the activity”, and this “will create level playing fields”.<sup>38</sup>

The Treasury’s aim is that the Bill be “Risk-based and proportionate” in enabling the regulator to monitor the sector, identify areas that pose greatest market-conduct risks, and use “proportionate regulatory capacity” to address the risks.<sup>39</sup>

### **Short rejoinder to Treasury**

It is respectfully submitted that the Treasury approach exposes a number of the Bill’s clauses to criticism for violating the Constitutional benchmark of the Rule of Law.<sup>40</sup>

<sup>29</sup> Long-term Insurance Act 52 of 1998 and Short-term Insurance Act 53 of 1998.

<sup>30</sup> Financial Institutions (Protection of Funds) Act 28 of 2001.

<sup>31</sup> Financial Advisory and Intermediary Services Act 37 of 2002 (“FAIS”).

<sup>32</sup> Collective Investment Schemes Control Act 45 of 2002 (“CISCA”).

<sup>33</sup> The draft Bill would also amend three statutes, viz: The Pension Funds Act, 1956; the 2017 Financial Sector Regulation Act itself; and the Insurance Act 18 of 2017.

<sup>34</sup> See draft Conduct of Financial Institutions Bill, 2018 on the National Treasury website at <http://www.treasury.gov.za/twinpeaks/Conduct%20of%20Financial%20Institutions%20Bill.pdf>.

<sup>35</sup> Referred to hereinafter also as the “Authority” or “Conduct Authority”.

<sup>36</sup> National Treasury, 2018, *Explanatory Policy Paper accompanying the Conduct of Financial Institutions Bill (Paper accompanying the first draft of the COFI Bill)*, p 32.

<sup>37</sup> Gen Notice 808 of 2018 (in *Gazette* 42114 of 14 Dec 2018): National Treasury: Draft Conduct of Financial Institutions Bill, 2018: Publication for public comment.

<sup>38</sup> Gen Notice 808 of 2018 (supra).

<sup>39</sup> “Proportionality” will govern the supervisory approach, standards set, and enforcement action taken. Gen Notice 808 of 2018 (supra).

<sup>40</sup> The Republic is founded on the values of *inter alia* supremacy of the constitution and the rule of law. Constitution of the Republic of South Africa, 1996 s 1(c).

However worthy the underlying sentiments may be, a “Principles-based”, “Outcomes-focused”, and “Risk-based and proportionate” approach exposes some three dozen of the Bill’s provisions to charges of vagueness, unequal treatment, and conferring undue discretions or unjustifiably oppressive powers on the Authority.

These clauses in the Bill violate the principles of the Rule of Law that questions of legal right and liability should be resolved by application of the law and not by exercise of a discretion, that laws should apply equally to all unless objective differences justify differentiation, and that laws should not unreasonably interfere with fundamental rights.

A few clauses are contradictory or have drafting errors. We do not address all such lesser shortcomings.

### **Summary comments**

Clause 1(1)’s definition “assets of financial customers” does not refer to assets administered for “a financial customer” but oddly to assets administered for “another person”.

Clause 5(2)(a) states that the Conduct Authority may impose requirements on the holding company of a prudentially regulated financial group or conglomerate for conduct standards to apply to the whole group or conglomerate. This means that the holding company of a prudentially regulated financial group or conglomerate would be liable, although not itself a financial institution, to being subject to conduct standards prescribed by the Authority, as indeed would other entities that are not financial institutions but are part of the financial group or conglomerate. The provision does not fetter the Authority’s powers to impose requirements on such holding companies and entities that are not financial institutions. This leaves the Authority with wide discretion when imposing such requirements, violating the Rule of Law principle that legal liabilities should be determined by law, not discretion.

Clause 6(1), that the Authority may prescribe conduct standards regulating and imposing requirements on pension funds’ board members and sponsors, contains no criteria to guide the Authority. This gives the Authority unduly wide discretion, violating the Rule of Law.

Clause 7(1)(a)–(e), and (i) and (ii)(aa)–(dd) stipulates that the Authority must adopt a licensing framework, prescribe conduct standards, develop and implement its supervisory approach, enforce compliance and consider the granting of exemptions in a way that promotes the statute’s object and supports achievement of the Authority’s objective and takes into account the nature, size, scale and complexity of the risks associated with a type of activity, the nature, size, scale and complexity of financial institutions, achieving the purpose of the requirement, and the significance of risks to the achievement of the Act’s object and Authority’s objectives. These provisions are not specific enough to provide proper directions to the Authority, and are unduly vague.

Subclause 7(2) that, to minimise regulatory burden, the Authority may issue guidance notices and interpretation rulings to facilitate the statute’s proportionate application to small financial institutions, violates the Rule of Law principle that the laws of the land should apply equally to all, unless objective differences justify. By permitting the

Authority to issue them as appropriate, the subclause violates the Rule of Law principle that liabilities should not be determined by discretion.

Clause 8(1), authorising the Authority to exempt financial institutions from the application of the statute or part of it where applying it is not practical or proportional to the size or complexity of the institution's business or in the public interest, violates the principles that legal liabilities should not be determined by discretion, and that laws should not be vague.

Subclause 8(2), that an exemption may be withdrawn by the Authority on any ground it may deem sufficient, leaves it to the Authority's opinion to determine if continued suspension of a law is merited in the case, violating the principle mentioned of the Rule of Law that legal rights and duties should be determined by law not discretion.

Clause 9(1), stating that financial institutions must meet the Statute's requirements on an on-going basis to support an appropriate corporate culture, is vague and adds nothing.

Subclause 9(4), that the statute's requirements apply, with necessary changes in interpretation and application of provisions and requirements, to prudentially regulated financial groups and conglomerates, is vague in not making clear what are necessary changes in the interpretation and application of provisions and requirements for the statute to apply to prudentially regulated financial groups and conglomerates.

Clause 13(5) states that a person may not structure or arrange businesses in a way that avoids the Bill's licensing requirements. This is too wide and prohibits even lawful arrangements to avoid licensing requirements. Tax law has a broad principle that, if there are two lawful ways to conduct business, one that does not require paying tax while the other does, a person may conduct business in the way that avoids tax; but if an avoidance arrangement is artificial in serving no commercial purpose other than to save tax, the transaction may be taxed as if the arrangement was not adopted. The Bill's subclause should be narrowed following tax law, to prohibit only artificial licensing-avoidance schemes with no genuine commercial effect.

Clause 14(1)(c), that the licensing of an applicant must not be contrary to the interests of financial customers or the public interest is vague in not making clear what constitutes the interests of financial customers or the public interest.

Clause 16(3) states that the Authority may, in conduct standards, stipulate provisions which the memorandum of incorporation or other founding instrument of a financial institution must or must not include. A company's memorandum of incorporation sets out rights and duties of shareholders, directors and others in relation to the company. This subclause would authorise the Authority to vary these rights and duties, but contains no criteria to guide the Authority when it does so, thus giving the Authority wide discretion when prescribing such standards. Legal rights and liabilities should not be subject to official discretion.

Clause 17(3) states that the Authority may require a person to change its proposed name prior to licensing, if the name is unacceptable because it is undesirable. This should be revised to dispense with the vague criterion that a company name should not be undesirable. The previous Companies Act contained a similar provision which gave the companies registrar wide discretion to reject the choice of name of a proposed company, but the current Companies Act uses more specific criteria.

Clause 20(1)(b) states that the Authority may amend, replace or vary any licensing conditions or impose other or additional licensing conditions when in the public interest. This violates the Rule of Law in not making clear what constitutes the “public interest”. Authorising the Authority to vary licensing conditions if in the public interest in effect gives the Authority broad discretion to alter licence conditions according to its own view of the public interest. The subclause would authorise the Authority to impose additional licensing conditions more onerous than those originally in the licence which in effect could take away a substantial portion of a licensee’s rights, thus interfering with the fundamental rights to choose a trade. The practice of a trade may be regulated by law but not so as to regulate it out of existence. This unfettered discretion would also arbitrarily interfere with the licensee’s property rights in his licence, violating the principle of the Rule of Law that laws should afford adequate protection of fundamental rights.

Subclause 20(1)(c), that the Authority may replace or vary any licensing conditions when in the interests of the financial customers or potential customers of the licensee, is vague, in not making clear what constitutes the interests of a licensee’s financial customers or indeed potential customers, and in effect confers on the Authority an unfettered discretion, and would unreasonably interfere with fundamental rights to choose a trade and hold property. Authorising the Authority to impose added licensing conditions on a financial institution on vague discretionary grounds in the interests of its customers may be one-sided and unreasonably interfere with a licensee’s fundamental right to equal treatment.

Clause 22(4)(a) states that legislation providing for a public sector pension fund must be amended in 18 months to align it with the Bill and requirements prescribed i.t.o. the Bill. Parliament cannot bind itself in this Bill to pass a particular piece of legislation in future. The subclause is futile and should be deleted.

Clause 23(2) states that the Authority may prohibit representatives generally or particular categories of representatives or representatives with a particular institutional form from acting for more than one licensee or providing certain financial services i.r.o certain financial products or instruments or foreign financial products. This would allow the Authority to prohibit all representatives from providing any financial services which the Authority specifies i.r.o. any financial products or instruments which it specifies. The subclause does not circumscribe these powers of the Authority to prohibit, and leaves the Authority with unfettered discretion when issuing such prohibitions.

Clause 24(1), that a licensee may appoint a previously debarred person as a representative only if the person complies with requirements prescribed by the Authority in conduct standards for the reappointment of a debarred person as a representative, contains no criteria to guide the Authority when it prescribes such requirements. This gives the Authority unduly wide discretion to determine the requirements, violating the Rule of Law.

Clause 27 empowers the Authority to prescribe licensing requirements in conduct standards. Without limiting the scope of such standards, the Authority may prescribe conduct standards imposing requirements for licensing and licensees, requirements relating to representatives including matters relating to debarment and reappointment, fit and proper requirements, governance requirements, threshold operational ability and capital requirements, threshold requirements for conducting certain activities, naming convention requirements, and requirements to have a local presence. This clause confers unduly wide

powers on the Authority without circumscribing the Authority's discretion to prescribe these matters.

Clause 28, the opening clause of the Bill's Chapter on culture and governance, states that three parts of the chapter do not apply to small enterprises. Yet the Chapter's final clause has a subclause stating that, despite the opening clause, the Authority may in conduct standards prescribe requirements which are applicable to small enterprises on matters referred to in those three parts of the chapter. The opening clause should state that it is subject to the final clause. The Rule of Law requires laws to be clear and accessible.

Clause 30(1), that a financial institution must conduct business in a manner that prioritises fair outcomes for customers so that there is confidence that their fair treatment is central to the corporate culture of the institution, is vague and subjective. It is unclear what is intended by requiring an institution to conduct business so there is confidence that customers' fair treatment is central to its corporate culture.

Subclause 30(2)(b) requires an institution to conduct business in the best interests of customers and the integrity of the financial sector. Requiring an institution to conduct business in the best interests of customers is unduly one-sided in favour of customers and contradicts the draft Bill's central requirement that institutions should give customers merely fair treatment, which appears in remarkably numerous provisions throughout the Bill. The subclause is also vague in requiring an institution to conduct its business in the best interests of the integrity of the financial sector. In effect this provision would give the Authority a subjective discretion to determine if an institution has been conducting business in the best interests of customers and the integrity of the sector.

Clause 31(b), that a financial institution's governing body must ensure that governance arrangements are appropriately embedded in the institution, is unduly vague in requiring the body to ensure that arrangements are embedded, and appropriately embedded.

Clause 32(3) states that, when applying the provision about culture and governance principles to a financial customer that is a pension fund or insurance group scheme, or is otherwise acting for other retail financial customers, the principles must be applied in a manner appropriate for the members of that fund or scheme or those other retail customers. This is vague in not making clear what is intended by this requirement that the principles be so applied in a manner appropriate for those members or other retail customers.

Clause 33(2) declares that a term or condition of an agreement is unfair or unreasonable if the agreement is subject to a term or condition that is unfair or unreasonable. This is circular and should be deleted.

Clause 49(1)(b) states that an institution providing financial products to retail customers must take appropriate steps to identify the needs of the group of customers to whom its products are targeted and to satisfy itself prior to making the products available to the market and on an on-going basis that the products are appropriate to meet the needs. The expression "on an on-going basis" is vague and should be replaced by "annually".

Clause 82 states that a financial institution must maintain sufficient financial resources of adequate amount and quality to carry out its activities, fulfil its obligations and comply with legal requirements, and to ensure there is no risk that its liabilities cannot be met when due. Its assets must exceed its liabilities, and it must have sound, effective and comprehensive strategies, processes and systems to assess and maintain the amounts, types



and distribution of financial resources that it considers adequate to cover the nature and level of the risks to which it is exposed, or is likely to be exposed. An institution that holds assets of financial customers or collects, holds or receives any monies i.r.o. a financial product must comply with any additional asset, working capital and liquidity requirements that are prescribed by conduct standard. This latter provision contains no criteria to guide the Authority in prescribing additional asset, working capital or liquidity requirements. This gives the Authority unduly wide discretion when prescribing such additional requirements.

Clause 85(1) states that a financial institution that belongs to a category prescribed by the Authority may not, without approval of the Authority, conduct any business other than the activity for which it is licensed. This contains no criteria to guide the Authority either when prescribing a category of institution for this purpose or when refusing approval for such an institution to conduct another business. These shortcomings give the Authority unfettered discretions when prescribing such categories and when determining whether to grant an approval to conduct another business. Questions of legal liability should be resolved by application of the law, not exercise of discretions.

Subclause 85(2) states that a financial institution may not conduct business outside the Republic, including one similar to the one for which it is licensed in the Republic, without approval of the Authority. This contains no criteria to guide the Authority when determining whether to grant approval to an institution to conduct a business outside the Republic, and gives the Authority an unfettered discretion, violating the Rule of Law.

Clause 98(1) states that a financial institution must have in place and implement a framework for the retention of data and records i.a.w. requirements prescribed in conduct standards. The meaning of framework is unclear, and it is unclear if the institution must actually retain data or if it need merely implement a framework for retaining data, whatever that may mean. The subclause would be clearer if it stated merely that an institution must retain data and records i.a.w. requirements prescribed in conduct standards.

Clause 107(1) states that the Authority may make a conduct standard on any matter i.r.o. which it is required or permitted to make a conduct standard i.t.o. the Bill.

Subclause 107(2) then states that, when prescribing conduct standards, the Authority must consider the nature, scale and complexity of different financial institutions, products and services; and also the needs to provide fair access to appropriate financial products and services, enable financial customers to understand and compare the nature, value and cost of financial products and services, enable customers to benefit from fair competition for quality financial products and services, support sustainable business models that enable financial institutions to be able to deliver fair customer outcomes, and facilitate access to market for emerging institutions. This subclause, in requiring merely that the Authority consider these matters, violates the Rule of Law in being relatively vague and not circumscribing the Authority's discretion when it prescribes conduct standards. A requirement that the Authority must merely consider certain matters means not much more than that it must have regard to or not overlook them. Words such as these mean that the body need merely bear the matters in mind, but retains a discretion. A requirement to have regard to something is merely a guide not a fetter. This subclause should be revised so that it properly circumscribes the Authority's discretion when it prescribes conduct standards.

Clause 110(3)(a) states that the Authority and supervisory authorities that have entered into supervisory co-operation arrangements must establish and maintain appropriate confidential safeguards to protect non-public supervisory information obtained from another supervisory authority. This is ambiguous. It is unclear if the authorities must actually protect information, or if they must merely maintain safeguards to protect information. What would amount to appropriate safeguards is also unclear. The provision would be clearer if it merely stated that the authorities must safeguard such information.

Clause 116(1) states that anything done under a section, subsection or paragraph of an Act amended by the Bill remains valid to the extent that it is not inconsistent with the Bill and until anything done under the Bill overrides it. It is unclear why the subclause should refer to a section, subsection or paragraph, but not also to a subparagraph, item or subitem of an Act. It is unnecessary to refer in such level of detail to provisions of statutes and it would suffice if the subclause were simply to refer to anything done under a provision of an Act. It is also unclear why the subclause aims to save only things done under statutes amended, and not also to things done under statutes repealed by the Bill.

Clause 117 states that laws listed in a schedule are amended or repealed. The clause's heading mentions only amendment and should also mention repeal of laws.

Schedule 1's heading mentions laws amended and should include laws repealed.

Schedule 1 lists these five statutes, without stating if they are to be repealed or amended: Long-term Insurance Act 1998, Short-term Insurance Act 1998, Financial Institutions (Protection of Funds) Act 2001, Financial Advisory and Intermediary Services Act 2002, and Collective Investment Schemes Control Act 2002. It should provide expressly for their repeal.

## Clause-by-clause comments

### **Clause 1(1) (definitions: “assets of financial customers”)**

***Does not refer to assets administered for “a financial customer”, but to assets administered for “another person”***

The draft Bill defines the expression “assets of financial customers”<sup>41</sup> as any money or asset<sup>42</sup> invested or administered<sup>43</sup> for<sup>44</sup> “another person”.<sup>45</sup>

Oddly, the draft Bill does not define “assets of financial customers” as any money or asset invested or administered for “a financial customer”.

The Bill states that<sup>46</sup> words<sup>47</sup> which are not defined in its “definitions” clause<sup>48</sup> but are defined in the 2017 Regulation Act, have the same meaning in the Bill.<sup>49</sup>

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<sup>41</sup> Draft Conduct of Financial Institutions Bill cl 1(1) svv “assets of financial customers”.

<sup>42</sup> In full— “any money, or any corporeal or incorporeal, movable or immovable asset”.

<sup>43</sup> In full— “invested, held, kept in safe custody, controlled, administered or alienated”.

<sup>44</sup> Or on behalf of.

<sup>45</sup> Draft Conduct of Financial Institutions Bill cl 1(1) svv “assets of financial customers”. Italics added.

<sup>46</sup> Unless the context otherwise indicates.

<sup>47</sup> And expressions.

<sup>48</sup> I.e., cl 1(1) of the draft Conduct of Financial Institutions Bill.

<sup>49</sup> Draft Conduct of Financial Institutions Bill cl 1(1).

The 2017 Regulation Act defines “financial customer” in broad terms, as a person to or for whom a financial product or service is provided “in whatever capacity”.<sup>50</sup>

But, oddly, the Bill’s definition “assets of financial customers” does not rely on the Regulation Act’s definition “financial customer”.

It is unclear why the draft Bill does not define “assets of financial customers” as any money or asset invested or administered by any person for “a financial customer”.

The draft Bill employs the expression “financial customer”<sup>51</sup> on 272 occasions. On those occasions it is presumably intended that the expression “financial customer” should bear the meaning given to it by the 2017 Act’s definition of the expression.

It is not clear why, on this one occasion where it is apt to refer to “a financial customer” (in the Bill’s definition of the expression “assets of financial customers”), the Bill does not define the expression by reference to a financial customer.

### **Clause 5 (application of Act to prudentially regulated financial groups and financial conglomerates)**

#### ***(2)(a) Authority may, after consulting Prudential Authority and Reserve Bank, impose requirements on holding company of prudentially regulated financial group or conglomerate in conduct standards that apply to whole group or conglomerate***

This subclause states that the Authority may, after consulting<sup>52</sup> the Prudential Authority and Reserve Bank, impose requirements on the holding company of a “prudentially regulated financial group or financial conglomerate”,<sup>53</sup> in conduct standards that “apply to the group or conglomerate as a whole”.<sup>54</sup>

This means that the holding company of a prudentially regulated financial group or conglomerate would be liable, although not itself a financial institution, to being subject to conduct standards prescribed by the Authority

It also means that other entities which are not financial institutions, albeit part of a financial group or conglomerate, could be subject to conduct standards (for these reasons:

The Bill defines a “prudentially regulated financial group or conglomerate” as<sup>55</sup> a “banking group” (referred to in the *Banks Act*<sup>56</sup>), “insurance group” (designated i.t.o. the *Insurance Act, 2017*<sup>57</sup>) or “financial conglomerate” (designated i.t.o. of the *Financial Sector Regulation Act, 2017*):

<sup>50</sup> See Financial Sector Regulation Act s 1(1) svv “financial customer”:

“**financial customer**” means a person to, or for, whom a financial product, a financial instrument, a financial service or a service provided by a market infrastructure is offered or provided, in whatever capacity, and includes—

(a) a successor in title of the person; and  
(b) the beneficiary of the product, instrument or service;

<sup>51</sup> Or “financial customers”.

<sup>52</sup> The Bill inelegantly states “after having consulted with”. Draft Conduct of Financial Institutions Bill cl 5(2)(a). The language of the clause is unduly unwieldy.

<sup>53</sup> The expression in this clause is not identical to the defined expression in the Bill. Compare Draft Conduct of Financial Institutions Bill cl 5(2)(a) “prudentially regulated financial group or *financial conglomerate*” (italics added) and cl 1(1) “prudentially regulated financial group or conglomerate”.

<sup>54</sup> Draft Conduct of Financial Institutions Bill cl 5(2)(a).)

<sup>55</sup> Draft Conduct of Financial Institutions Bill cl 1(1) svv “prudentially regulated financial group or conglomerate”.

<sup>56</sup> Banks Act 94 of 1990 s 1(1) svv “banking group”.

<sup>57</sup> Insurance Act 18 of 2017.

The *Banks Act* refers to a “banking group” as a group of persons predominantly engaged in financial activities, “one of which” is a bank, and also “each person” who is an associate of<sup>58</sup> or financially interconnected with<sup>59</sup> any of the other persons in the group.

The *Insurance Act* states that the Prudential Authority may designate an “insurance group” from a group of entities, and must include in the group an insurer, “any juristic person” that is part of the same group as the insurer, and “any associate”<sup>60</sup> or any “related” or “inter-related person”<sup>61</sup> of any juristic person in that group.<sup>62</sup> The designated group need not include all entities in the group or all such associates or related or inter-related persons<sup>63</sup> but must include the holding company or other juristic person controlling the designated group that must apply for a licence as controlling company of that insurance group.<sup>64</sup>

And the *Financial Sector Regulation Act*<sup>65</sup> states that the Authority may designate members of a group of companies as a “financial conglomerate” and must include in the conglomerate an “eligible financial institution”<sup>66</sup> and a holding company of the eligible financial institution, but need not include in the conglomerate all companies in the group.<sup>67</sup>

It follows, that an entity which, albeit part of a financial group or conglomerate, is not itself a financial institution, could be subject to such conduct standards.

As mentioned, the Bill’s subclause states that the Conduct Authority may impose requirements on the “holding company” of a prudentially regulated financial group or conglomerate, in conduct standards that “apply to the whole group or conglomerate”.<sup>68</sup>

The subclause does not fetter these powers of the Authority to impose requirements on holding companies of prudentially regulated financial groups or conglomerates, or conduct standards that apply to the whole group or conglomerate. This would leave the Authority with wide discretion when imposing requirements on such holding companies, and indeed to such groups or conglomerates.

The subclause thus violates the Rule of Law principle that questions of legal right and liability should ordinarily be resolved by application of law, not by exercise of a discretion.<sup>69</sup>

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<sup>58</sup> Banks Act s 1(1) svv “banking group” par (a) read with s 37(7).

<sup>59</sup> As defined in Banks Act s 1(1) svv “banking group” par (b).

<sup>60</sup> “Associate” has the meaning in the International Financial Reporting Standards issued by the International Accounting Standards Board or a successor body. Insurance Act, 2017 s 1(1) sv “associate”.

<sup>61</sup> Insurance Act s 1(1) svv “inter-related person” and “related person” (read with Companies Act 71 of 2008 ss 1(1) svv “inter-related person” and “related person” and s 2(1)(a), (b), (c)).

<sup>62</sup> Insurance Act s 10(1)(a).

<sup>63</sup> Insurance Act s 10(1)(b).

<sup>64</sup> Insurance Act s 10(2).

<sup>65</sup> Financial Sector Regulation Act s 1(1) svv “financial conglomerate”

<sup>66</sup> An “eligible financial institution” is a financial institution which is either: A bank licensed as (or required to be) under the Banks Act; an insurer registered as a long- or short-term insurer under a 1998 Insurance Act or licensed (or required to be) under the 2017 Insurance Act; a market infrastructure; or a prescribed entity. Financial Sector Regulation Act s 1(1) svv “eligible financial institution”.

<sup>67</sup> Financial Sector Regulation Act s 160(1) and (2).

<sup>68</sup> Draft Conduct of Financial Institutions Bill cl 5(2)(a).

<sup>69</sup> Lord Bingham, “The Rule of Law.” Sixth Sir David Williams Lecture, 2006. Centre for Public Law, University of Cambridge: second sub-rule.

(It is submitted that the Bill’s general clause about the making by the Authority of conduct standards, dealt with later below,<sup>70</sup> does not contain sufficient such fetters.)

**Clause 6 (application of Act to pension funds and activities related to pension funds)**

*(1) Board member of pension fund nominated by employees or employer, or sponsor, is not required to be licensed, but Authority may prescribe conduct standards regulating and imposing requirements on pension funds’ board members and sponsors.*

This subclause of the Bill states that a board member of a pension fund that is nominated by employees or the employer, or a sponsor, is not required to be licensed i.t.o. the Bill, but the Authority may prescribe conduct standards regulating and imposing requirements on board members and sponsors of pension funds.<sup>71</sup>

This contains no criteria that would guide the Authority when prescribing standards regulating and imposing requirements on board members and sponsors of pension funds.

This would give the Authority an unduly wide discretion when prescribing standards regulating and imposing requirements on pension fund board members and sponsors, in violation of the Rule of Law principle that legal rights and liabilities should not be determined by discretion.

**Clause 7 (Proportional application of statute)**

*(1)(a)–(e), and (i) and (ii)(aa)–(dd): Authority must adopt licensing framework, prescribe standards, enforce compliance and consider granting exemptions in manner that promotes statute’s object, supports achievement of Authority’s objective, and takes in account and is proportionate to “nature, size, scale” and “complexity of the risks associated with” type of activity, “nature, size, scale and complexity of” financial institutions, achieving purpose of the requirement, and “significance of risks” to achievement of statute’s object and Authority’s objectives*

This clause<sup>72</sup> stipulates in its first subclause<sup>73</sup> that the Authority<sup>74</sup> must “adopt a licensing framework”,<sup>75</sup> “prescribe conduct standards”,<sup>76</sup> “develop and implement its supervisory approach”,<sup>77</sup> “enforce compliance”<sup>78</sup> and “consider the granting of exemptions”<sup>79</sup> in a manner that “promotes the object of th[is] Act and supports the achievement of the

<sup>70</sup> Draft Conduct of Financial Institutions Bill cl 107 (conduct standards and joint standards made by Authority).

<sup>71</sup> Draft Conduct of Financial Institutions Bill cl 6(1).

<sup>72</sup> Draft Conduct of Financial Institutions Bill cl 7 (proportional application of statute).

<sup>73</sup> Draft Conduct of Financial Institutions Bill cl 7(1)(a)–(e), and (i) and (ii)(aa)–(dd).

<sup>74</sup> The Financial Sector Conduct Authority. Draft Conduct of Financial Institutions Bill cl 1(1) sv “Authority” read with Regulation Act s 56 (establishment of Financial Sector Conduct Authority).

<sup>75</sup> Draft Conduct of Financial Institutions Bill cl 7(1)(a).

<sup>76</sup> Draft Conduct of Financial Institutions Bill cl 7(1)(b).

<sup>77</sup> Draft Conduct of Financial Institutions Bill cl 7(1)(c).

<sup>78</sup> “[W]ith this Act”. I.e., with the Bill, once enacted and brought into operation. Draft Conduct of Financial Institutions Bill cl 7(1)(d).

The Bill defines “this Act” as including its schedules and standards prescribed in terms thereof.

<sup>79</sup> As contemplated in cl 8 of the Bill (“Exemptions from application of Act, or part, provision or requirement of Act”). Draft Conduct of Financial Institutions Bill cl 7(1)(e).

objective of the Authority”,<sup>80</sup> and that takes into account and “is proportionate” to the “nature, size, scale” and “complexity of the risks associated with” a type of activity,<sup>81</sup> “the nature, size, scale and complexity of” financial institutions;<sup>82</sup> achieving the purpose of the requirement;<sup>83</sup> and the “significance of risks” to the achievement of the Act’s object<sup>84</sup> and the Authority’s objectives.<sup>85</sup>

These general objectives and guidelines are not specific enough to provide proper directions to the Authority. It is submitted that the subclause<sup>86</sup> is unduly vague.

The requirement that laws should not be vague is founded on the Rule of Law, which is a foundational value of our constitutional democracy, and requires that laws must be written in a clear and accessible manner.<sup>87</sup>

It is true that the rule that laws should not be vague does not require absolute certainty. Laws need merely indicate with reasonable certainty to those who are bound by them what is required of them so that they may regulate their conduct accordingly.<sup>88</sup>

It may also be true that this requirement against vagueness ought to recognise the government’s role to further legitimate social and economic objectives, and not be used unduly to impede or prevent the furtherance of such objectives.<sup>89</sup> The Canadian Supreme Court has observed:<sup>90</sup>

[L]aws that are framed in general terms may be better suited to the achievement of their objectives, inasmuch as in fields governed by public policy circumstances may vary widely in time and from one case to the other. A very detailed enactment would not provide the required flexibility, and it might furthermore obscure its purposes behind a veil of detailed provisions. The modern State intervenes today in fields where some generality in the enactments is inevitable. The substance of these enactments remains nonetheless intelligible. One must be wary of using the doctrine of vagueness to prevent or impede State

<sup>80</sup> As contemplated in 2017 Regulation Act s 57. Draft Conduct of Financial Institutions Bill cl 7(1)(i). The 2017 Regulation Act states there:

**Objective**

57. The objective of the Financial Sector Conduct Authority is to—

- (a) protect financial customers by—
  - (i) promoting fair treatment of financial customers by financial institutions; and
  - (ii) providing financial customers and potential financial customers with financial education programs, and otherwise promoting financial literacy and the ability of financial customers and potential financial customers to make sound financial decisions; and
- (b) assist in maintaining financial stability.

<sup>81</sup> Draft Conduct of Financial Institutions Bill cl 7(1)(ii)(aa).

<sup>82</sup> Draft Conduct of Financial Institutions Bill cl 7(1)(ii)(bb).

<sup>83</sup> Draft Conduct of Financial Institutions Bill cl 7(1)(ii)(cc).

<sup>84</sup> The object of the Bill is set out in cl 3:

**Object of Act**

3. (1) The object of this Act is to establish a consolidated, comprehensive and consistent regulatory framework for the conduct of financial institutions that will—

- (a) protect financial customers;
- (b) promote the fair treatment and protection of financial customers by financial institutions;
- (c) support fair, transparent and efficient financial markets;
- (d) promote innovation and the development of and investment in innovative technologies, processes and practices;
- (e) promote trust and confidence in the financial sector;
- (f) promote sustainable competition in the provision of financial products and financial services;
- (g) promote financial inclusion;
- (h) promote transformation of the financial sector; and
- (i) assist the South African Reserve Bank in maintaining financial stability.

(2) When performing functions in terms of this Act, the Authority must take into account and seek to promote the object of this Act.

<sup>85</sup> Draft Conduct of Financial Institutions Bill cl 7(1)(ii)(dd).

<sup>86</sup> Draft Conduct of Financial Institutions Bill cl 7(1).

<sup>87</sup> *Affordable Medicines Trust and others v Minister of Health of Republic and ano* 2005 (6) BCLR 529 (CC) par [108] Ngcobo J.

<sup>88</sup> *Affordable Medicines Trust v Minister of Health* supra, par [108] ibid Ngcobo J.

<sup>89</sup> *Affordable Medicines Trust v Minister of Health* supra, ibid Ngcobo J.

<sup>90</sup> After reviewing the caselaw of the European Court of Human Rights on this issue.

action in furtherance of valid social objectives, by requiring the law to achieve a degree of precision to which the subject-matter does not lend itself.<sup>91</sup>

But that is not enough, it is submitted, to cure the overall vagueness in the sweeping terms of the subclause.

The Rule of Law requires more. The subclause should contain more precise parameters and instructions.

Also, the clause does not properly fetter or circumscribe the discretions which the Authority will have when it adopts a licensing framework, prescribes conduct standards, enforces compliance with the statute, and considers applications for exemption.

The clause thus also violates that principle of the Rule of Law which affirms that questions of legal right and liability should ordinarily be resolved by application of the law, and not by the exercise of a discretion.<sup>92</sup>

***(2) Authority may issue “guidance” notices and “interpretation” rulings to “facilitate” proportionate application of statute to financial institutions that are small enterprises***

The clause,<sup>93</sup> in its second subclause, states that the Authority may issue “guidance” notices and “interpretation” rulings “as appropriate” to “facilitate” the “proportionate application” of the statute to financial institutions that are small enterprises<sup>94</sup> and financial cooperatives, in order to “minimise regulatory burden”.<sup>95</sup>

This means that the Authority will be authorised, by means of the *ad hoc* issue of mere guidance or interpretation notices or rulings, to facilitate the proportionate application of the Bill to small financial institutions and minimise the regulatory burden on them.

This violates the principle of the Rule of Law that the laws of the land should apply equally to all, save to the extent that “objective differences justify differentiation”.<sup>96</sup>

That some financial institutions are small enterprises and others are financial cooperatives, could be “objective differences [which] justify differentiation”.

But the contemplated guidance and interpretation notices and rulings that the Authority will be authorised to issue by this second subclause, may well differentiate between small enterprises to a far greater degree than any objective differences justify.

The subclause also, by permitting the Authority to issue such guidance notices and interpretation rulings “as appropriate”, violates the principle of the Rule of Law mentioned that legal rights and liabilities should be determined by law and not the exercise of discretion.

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<sup>91</sup> “A delicate balance must be maintained between societal interests and individual rights. A measure of generality also sometimes allows for greater respect for fundamental rights, since circumstances that would not justify the invalidation of a more precise enactment may be accommodated through the application of a more general one.” *R v Nova Scotia Pharmaceutical Society* [1992] 2 SCR 606 [SCC] 641 et seq, Gonthier J for the court. Cited in *Affordable Medicines Trust v Minister of Health* supra, ibid Ngcobo J.

<sup>92</sup> Bingham, “The Rule of Law” (supra) second sub-rule.

<sup>93</sup> Draft Conduct of Financial Institutions Bill cl 7 (proportional application of statute).

<sup>94</sup> As defined in the National Small Enterprise Act 102 of 1996. Draft Conduct of Financial Institutions Bill cl 1(1) svv “small enterprise”.

The National Small Enterprise Act defines a “small enterprise” National Small Enterprise Act 102 of 1996.

<sup>95</sup> And promote financial inclusion and transformation of the financial sector. Draft Conduct of Financial Institutions Bill cl 7(2).

<sup>96</sup> Bingham, “The Rule of Law” (supra) third sub-rule.

## **Clause 8 (Exemptions)**

### ***(1) Authority may exempt financial institutions from application of the statute***

This clause, in its first subclause,<sup>97</sup> states that the Authority may, on application by a financial institution or “on its own initiative”, exempt financial institutions from the application of the statute, or a part, provision or requirement of it, *inter alia*—

Where application of the statute, or a part, provision or requirement of it, is “not proportional” to the nature, size, scale or complexity of the risks or business of the financial institution or activity or type of persons conducting the activity;<sup>98</sup>

Where “practicalities impede” the application of a part, provision or requirement of the statute;<sup>99</sup> or

If it is in “the public interest”.<sup>100</sup>

The subclause violates principles (referred to earlier) of the Rule of Law, in a number of respects:

By enabling the Authority<sup>101</sup> to exempt financial institutions from the application of the statute or part of it, it would in effect give the Authority discretion to suspend the operation of a law. (This violates the principle of the Rule of Law that legal rights and liabilities should be determined by law and not the exercise of discretion.)

The provision to enable the Authority to exempt financial institutions from the application of the statute if it is in “the public interest”<sup>102</sup> is vague in not making clearer what circumstances will constitute “the public interest”. (This would violate the principle of the Rule of Law that laws should not be vague.)

### ***(2) Exemption may be withdrawn by Authority on any ground it may deem sufficient***

This subclause states that an exemption may<sup>103</sup> be withdrawn, wholly or in part “on any ground which the Authority may deem sufficient”.

The subclause, by in effect leaving it to the opinion of the Authority whether withdrawal of an exemption is justified, gives the Authority an unfettered discretion to determine whether continued suspension of operation of a law is merited in the particular case.

This violates the principle mentioned of the Rule of Law that legal rights and duties should be determined by law and not the exercise of discretion.

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<sup>97</sup> Draft Conduct of Financial Institutions Bill cl 8(1)(a).

This subclause is incorrectly numbered subcl (8)(1)(a): There is no subcl (8)(1)(b).

<sup>98</sup> Draft Conduct of Financial Institutions Bill cl 8(1)(a)(i).

<sup>99</sup> Draft Conduct of Financial Institutions Bill cl 8(1)(a)(ii).

<sup>100</sup> Draft Conduct of Financial Institutions Bill cl 8(1)(a)(vi).

<sup>101</sup> Whether “on its own initiative” or on application.

<sup>102</sup> Draft Conduct of Financial Institutions Bill cl 8(1)(a)(vi).

<sup>103</sup> Subject to the Promotion of Administrative Justice Act 3 of 2000.



## **Clause 9 (General application and supervision of requirements)**

### ***(1) Statute's requirements must be met by financial institutions on on-going basis to support appropriate corporate culture***

This subclause states that the requirements set out in the statute must be met by financial institutions “on an on-going basis” to “support” an “appropriate” corporate “culture”.<sup>104</sup>

The phrase “on an on-going basis” is vague.<sup>105</sup> Presumably the phrase “at all times” is intended. The draft Bill utilises the phrase “at all times” on twelve occasions.<sup>106</sup> It is unclear why it should depart from that settled usage in favour of “on an on-going basis” in this clause.

It is unclear what is intended by requiring financial institutions to comply with the statute to “support” a corporate culture. Presumably “maintain” is intended.

It is likewise unclear what is intended by requiring financial institutions to comply with the statute to maintain an “appropriate” corporate culture: The Bill does not state what would be deemed “appropriate”. (This violates the principle of the Rule of Law that laws should not be vague.)

Presumably it is intended that the Authority would determine whether the corporate culture which any particular financial institution had been maintaining was “appropriate”. This in effect would give the Authority some discretion to determine whether the behaviour of any financial institution was “appropriate”. This would violate the principle of the Rule of Law mentioned, that legal duties should be determined by law, not by discretion.

It is unnecessary to refer in the subclause to “corporate culture”. The meaning and intended content of “corporate culture” is fully dealt with in a later clause.<sup>107</sup>

A clearer grammatical and logical result could be achieved by recasting the subclause into the active rather than its present passive form, thus:

(1) Financial institutions shall comply with this Act at all times.

The subclause<sup>108</sup> is however redundant. It adds nothing to what is stated or implied in and throughout the Bill. It is respectfully submitted that the subclause be deleted.

### ***(4) Bill's requirements apply, unless expressly excluded in Bill or exemption has been granted by Authority, to financial institutions, and with necessary changes in interpretation and application of provisions and requirements, to prudentially regulated financial groups and conglomerates.***

This subclause states that the requirements in the Bill apply (unless expressly excluded in the Bill or an exemption is granted by the Authority) to financial institutions, and with the “necessary changes in the interpretation and application of provisions and requirements”, to prudentially regulated financial groups and conglomerates.

<sup>104</sup> Draft Conduct of Financial Institutions Bill cl 9(1).

<sup>105</sup> As well as being wordy and inelegant.

<sup>106</sup> For example (italics added):

**12.** (1) A financial institution must *at all times* conduct its business in a manner that prioritises fair outcomes for financial customers

<sup>107</sup> Draft Conduct of Financial Institutions Bill cl 30 (Principles relating to culture and governance for financial institutions).

<sup>108</sup> Draft Conduct of Financial Institutions Bill cl 9(1).

The Bill does not make clear what “necessary changes in the interpretation and application of provisions and requirements” are needed for the Bill to apply to prudentially regulated financial groups and conglomerates.

It is submitted that the subclause<sup>109</sup> is therefore unduly vague.

As mentioned, the Rule of Law requires that laws should not be vague and must be written in a clear and accessible manner.<sup>110</sup>

**Clause 13 (Licensing required per authorisation categories and subcategories)**

***(5) Person may not structure, arrange, separate or combine businesses in a way that avoids or attempts to avoid licensing requirements i.t.o. Bill.***

This subclause states:

(5) A person may not structure, arrange, separate or combine businesses in a way that avoids or attempts to avoid licensing requirements in terms of this Act.

This avoidance subclause is too wide in that it would prohibit even lawful arrangements to avoid the licensing requirements:

There is a broad principle in tax law that, if there are two lawful ways to conduct business, one that does not require paying a tax while the other does, a person may conduct business in a way that avoids the tax.

A taxpayer is entitled to enter into a *bona fide* transaction which, when carried out, has the effect of avoiding or reducing liability to tax.<sup>111</sup> Taxpayers are entitled to arrange their affairs so as to pay the least amount of tax.<sup>112</sup>

But the broad principle, that tax avoidance is not per se unlawful,<sup>113</sup> is subject to a narrow qualification that, if an avoidance arrangement is artificial in that it serves no commercial purpose other than to save tax, the transaction may be taxed as if the

<sup>109</sup> Draft Conduct of Financial Institutions Bill cl 9(4).

<sup>110</sup> *Affordable Medicines Trust and others v Minister of Health of Republic and ano* supra par [108] Ngcobo J.

<sup>111</sup> *Bradford Corporation v Pickles* [1895] AC 587.

<sup>112</sup> *Silke on South African Income Tax* De Koker et al §19.1 (Distinction between tax evasion and avoidance).

*Levene v Inland Revenue Commissioners* [1928] AC 217 [HL]: Taxpayers are free to make their own arrangements so that their cases fall outside the scope of the taxing Acts. They incur no legal penalties if they make it their business to walk outside the lines drawn by the legislature.

*Ayrshire Pullman Motor Services, DM Ritchie v Inland Rev Csr* (1928-1929) Ct of Sess (Sc) 14 TC 754: No man is obliged to arrange his legal relations to his business or property to enable the Inland Revenue to put the largest possible shovel into his stores. The Revenue is not slow—and quite rightly—to take every advantage open to it under the taxing statutes for the purpose of depleting the taxpayer’s pocket. The taxpayer is likewise entitled to prevent, if he honestly can, depletion of his means by the Revenue.

*Duke of Westminster v Inland Revenue Commissioners* [1936] AC 1 [HL]: Every man is entitled, if he can, to order his affairs so that the tax attaching is less than it otherwise would be. If he succeeds in ordering them to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow-taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

<sup>113</sup> And taxpayers are entitled to arrange their affairs so as to pay the least amount of tax.

arrangement was not adopted.<sup>114</sup> (The Income Tax Act, 1962<sup>115</sup> now expressly reflects<sup>116</sup> this qualification.<sup>117</sup>)

It is submitted that the unduly broad scope of the draft Bill's subclause in question<sup>118</sup> should be narrowed, so that the subclause is restricted to prohibiting only artificial licensing-avoidance schemes with no genuine commercial effect.

This may be achieved by deleting from the Bill the unduly-broad avoidance subclause,<sup>119</sup> and by inserting provisions which apply a narrower qualification, derived

<sup>114</sup> *WT Ramsay Ltd v IRC* [1981] 1 All ER 865 [HL]: To attach a tax consequence to a transaction, the Revenue must ascertain its legal nature. If the legal nature emerges from a series of transactions intended to operate in combination, regard is to be had to the combination rather than the individual transactions. If a taxpayer uses a scheme comprising a number of separate transactions with the object of avoiding tax, the Revenue is not limited to considering the genuineness of each individual step, but can consider the scheme as a whole. If it is found that the composite scheme produces neither gain nor loss, it can be treated as a nullity.

<sup>115</sup> Income Tax Act 58 of 1962.

<sup>116</sup> Income Tax Act ss 80A (impermissible tax avoidance arrangements), 80B (tax consequences of impermissible tax avoidance), 80C (lack of commercial substance), 80G (presumption of purpose), 80L (definitions). These provide (irrelevant material omitted):

**Impermissible tax avoidance arrangements**

**80A.** An avoidance arrangement is an impermissible avoidance arrangement if its sole or main purpose was to obtain a tax benefit and—

- (a) in the context of business—
  - (i) it was entered into or carried out by means or in a manner which would not normally be employed for *bona fide* business purposes, other than obtaining a tax benefit; or
  - (ii) it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C; [...]
- (c) in any context—
  - (i) it has created rights or obligations that would not normally be created between persons dealing at arm's length; or
  - (ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).

**Tax consequences of impermissible tax avoidance**

**80B.** (1) The Commissioner may determine the tax consequences under this Act of any impermissible avoidance arrangement for any party by—

- (a) disregarding, combining, or re-characterising any steps in or parts of the impermissible avoidance arrangement; [...]
- (d) reallocating any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties;
- (e) re-characterising any gross income, receipt or accrual of a capital nature or expenditure; or
- (f) treating the impermissible avoidance arrangement as if it had not been entered into or carried out, or in such other manner as in the circumstances of the case the Commissioner deems appropriate for the prevention or diminution of the relevant tax benefit.

**Lack of commercial substance**

**80C.** (1) For purposes of this Part, an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party (but for the provisions of this Part) but does not have a significant effect upon either the business risks or net cash flows of that party apart from any effect attributable to the tax benefit that would be obtained but for the provisions of this Part.

(2) For purposes of this Part, characteristics of an avoidance arrangement that are indicative of a lack of commercial substance include but are not limited to—

- (a) the legal substance or effect of the avoidance arrangement as a whole is inconsistent with, or differs significantly from, the legal form of its individual steps; or
- (b) the inclusion or presence of— [...]
- (iii) elements that have the effect of offsetting or cancelling each other. [...]

**Presumption of purpose**

**80G.** (1) An avoidance arrangement is presumed to have been entered into or carried out for the sole or main purpose of obtaining a tax benefit unless and until the party obtaining a tax benefit proves that, reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement.

(2) The purpose of a step in or part of an avoidance arrangement may be different from a purpose attributable to the avoidance arrangement as a whole. [...]

**Definitions**

**80L.** For purposes of this Part—

**“arrangement”** means any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property;

**“avoidance arrangement”** means any arrangement that, but for this Part, results in a tax benefit;

**“impermissible avoidance arrangement”** means any avoidance arrangement described in section 80A; [...]

<sup>117</sup> What may be termed the “*Ramsay*” qualification (named after a taxpayer in the case in a previous footnote).

<sup>118</sup> Draft Conduct of Financial Institutions Bill cl 13(5).

<sup>119</sup> I.e.—

(5) A person may not structure, arrange, separate or combine businesses in a way that avoids or attempts to avoid licensing requirements in terms of this Act.

from the Income Tax Act<sup>120</sup> (that if an arrangement is artificial, serving no commercial purpose other than to avoid the statute's requirements, the transaction concerned may be treated as if the arrangement was not adopted), as follows:<sup>121</sup>

**Impermissible arrangement to avoid licensing requirements in terms of this Act**

**13A.** (1)(a) An impermissible avoidance arrangement shall, for the purposes of licensing requirements, be deemed not to have been entered into or carried out.

(b) An avoidance arrangement is an impermissible avoidance arrangement if its sole purpose was to avoid licensing requirements and—

- (i) it was entered into or carried out by means or in a manner which would not be employed for *bona fide* business purposes, other than avoiding licensing requirements; or
- (ii) it lacks commercial substance, in whole or in part.

(2)(a) For purposes of subsection (1)(b)(ii), an avoidance arrangement lacks commercial substance if (but for the provisions of this section) it would relieve a person of compliance with licensing requirements, but does not have a significant effect upon the business risks or net cash flows of that person, apart from any effect that would be attributable to avoidance of licensing requirements.

(b) Characteristics of an avoidance arrangement that are indicative of a lack of commercial substance include, but are not limited to—

- (a) the legal substance or effect of the arrangement as a whole being inconsistent with, or differing significantly from, the legal form of its individual steps; or
- (b) the inclusion or presence of elements that have the effect of offsetting or cancelling each other.

(3 For purposes of this section—

**“arrangement”** means any transaction, operation, scheme, agreement or understanding (whether enforceable or not), including all steps therein or parts thereof;

**“avoidance arrangement”** means any arrangement that, but for this section, would relieve a person of compliance with licensing requirements;

**“impermissible avoidance arrangement”** means any avoidance arrangement described in subsection (1);

**“licensing requirements”** means licensing requirements in terms of this Act.

**Clause 14 (general requirements for licensing)**

**(1) To qualify for licensing—**

**(c) applicant's licensing may not be contrary to interests of financial customers or public interest**

This subclause states<sup>122</sup> that, to qualify for licensing, an applicant's licensing may not be contrary to the “interests of financial customers” or the “public interest”.<sup>123</sup>

This is vague in not making clear what constitutes “interests of financial customers” or the “public interest”.

The subclause would violate the Rule of Law principle that laws should not be vague.

**Clause 16 (legal status, institutional form and structure of requirements for licensing)**

**(3) Authority may prescribe conduct standards i.r.t. provisions that memorandum of incorporation of financial institution that is a company (or equivalent constitution, deed or founding instrument of financial institution or rules of retirement fund that is not a company) must or may not include**

<sup>120</sup> I.e., Income Tax Act ss 80A, 80B, 80C, 80G, 80J, 80L as aforesaid.

<sup>121</sup> Numbered cl “13A” for convenience for present purposes.

<sup>122</sup> Clause 14 (general requirements for licensing).

<sup>123</sup> Draft Conduct of Financial Institutions Bill cl 14(1)(c).

This states that the Authority “may prescribe conduct standards” i.r.t. the provisions that “any memorandum of incorporation” of a financial institution that is a company or the “equivalent constitution, deed or founding instrument” of a financial institution or “rules” of a retirement fund that is not a company “must include” or “may not include”.<sup>124</sup>

(The Companies Act defines a company’s Memorandum of Incorporation as the document<sup>125</sup> that “sets out rights, duties and responsibilities of shareholders, directors and others within and in relation to a company”<sup>126</sup> and by which the company was incorporated.<sup>127</sup>

(A company’s Memorandum of Incorporation is binding, between the company and each shareholder; between and among the shareholders of the company; and between the company and each director of the company or person who regularly participates to a material degree in the exercise of general executive control over and management of the whole or a significant portion of the business and activities of the company;<sup>128</sup> and any other person serving the company as a member of a committee of the board.<sup>129</sup>)

The Bill’s subclause would enable the Authority to prescribe provisions which the founding document of a financial institution must or may not include.

This subclause would authorise the Authority to prescribe conduct standards that vary the rights and duties between a company and its shareholders, directors and others involved in its control and management.

But it contains no criteria to guide the Authority when it prescribes conduct standards i.r.t. provisions that a financial institution’s founding document must or may not include.

This gives the Authority unduly wide discretion when prescribing such standards.

The clause thus violates that principle of the Rule of Law that legal rights and liabilities should be resolved by application of the law and not by the exercise of a discretion.

(The draft Bill’s general clause about the making by the Authority of conduct standards, dealt with later below,<sup>130</sup> does not contain sufficient fetters.)

### **Clause 17 (requirements for application for licensing)**

***(3) Authority, prior to licensing, may require person to change its proposed name, if the proposed name is unacceptable because it—(e) is undesirable***

This subclause states that the Authority may require a person to change its proposed name prior to licensing, if the proposed name is unacceptable because it<sup>131</sup> is “undesirable”.<sup>132</sup>

<sup>124</sup> Draft Conduct of Financial Institutions Bill cl 16(3).

<sup>125</sup> As amended from time to time.

<sup>126</sup> And other matters: see Companies Act 71 of 2008 s 15 (Memorandum of Incorporation, shareholder agreements and rules of company).

<sup>127</sup> Companies Act s 1 svv “Memorandum of Incorporation”.

<sup>128</sup> I.e., a “prescribed officer”. Companies Act s 1 svv “prescribed officer” read with s 66(10) and with reg 38(1)(b) in Companies Regulations, 2011 in Govt Notice R351 of 26 Apr 2011 (*Gazette* 34239).

<sup>129</sup> In exercise of their functions in the company. Companies Act s 15(6)(a), (b), (c)(i) and (ii).

<sup>130</sup> Draft Conduct of Financial Institutions Bill cl 107 (conduct standards and joint standards made by Authority).

<sup>131</sup> *Inter alia*.

<sup>132</sup> Draft Conduct of Financial Institutions Bill cl 17(3)(e).

The 1973 Companies Act<sup>133</sup> had contained similar provisions,<sup>134</sup> to the effect that if it appears “in the opinion of the Registrar”<sup>135</sup> in a period after registration of a company’s memorandum of association or registration<sup>136</sup> of a company name,<sup>137</sup> that the name is “undesirable”, he shall order the company to change the name.<sup>138</sup>

Under the 1973 Act, the Registrar<sup>139</sup> therefore had a wide discretion to reject the choice of name of a proposed company.<sup>140</sup>

The current, 2008 Companies Act<sup>141</sup> does not use this general criterion that a company name should not be “undesirable” but employs more specific criteria.<sup>142</sup>

It is recommended that this subclause be revised to dispense with the vague criterion that a company name should not be “undesirable”.

## **Clause 20 (variation of licensing conditions)**

***(1) Authority may amend, delete, replace or vary any licensing conditions or impose other or additional licensing conditions—***

***... (b) when in the public interest***

The subclause<sup>143</sup> states that the Authority may “amend”, delete, “replace or vary” any licensing conditions or “impose other or additional” licensing conditions when in the “public interest”.

This subclause violates the Rule of Law in a number of respects:

*Vagueness.* Authorising the Authority to replace or vary licensing conditions or impose additional licensing conditions if it is in the “public interest” is vague in not making clear what circumstances will constitute “the public interest”.

*Unfettered discretion.* Authorising the Authority to replace or vary licensing conditions or impose additional licensing conditions if it is in the “public interest” would in effect give the Authority broad discretion to alter licence conditions according to its view of the “public interest”. The broader a discretion, the greater the scope for subjectivity and hence for arbitrariness, which is the antithesis of the Rule of Law.<sup>144</sup>

*Unreasonable interference with fundamental rights.* The subclause would authorise the Authority, unilaterally<sup>145</sup> and after a licence had already been issued, to impose additional

<sup>133</sup> Companies Act 61 of 1973, since repealed.

<sup>134</sup> Companies Act 1973 s 45(1), (2) and (2A).

<sup>135</sup> Of companies.

<sup>136</sup> Or renewal of registration.

<sup>137</sup> Or after the date of an amended certificate of incorporation or a certificate of change of name.

<sup>138</sup> See, e.g., Companies Act 1973 s 45(1) (now repealed).

<sup>139</sup> Now, Commissioner of the Companies and Intellectual Property Commission.

<sup>140</sup> *Kredietbank van Suid-Afrika Bpk v Registrateur van Maatskappye* [1978] 2 All SA 478 (W) 484 par 3.8.

<sup>141</sup> Companies Act 71 of 2008.

<sup>142</sup> Thus:

(2) The name of a company must—  
 (d) not include any word, expression or symbol that, in isolation or in context within the rest of the name, may reasonably be considered to constitute—  
 (i) propaganda for war;  
 (ii) incitement of imminent violence; or  
 (iii) advocacy of hatred based on race, ethnicity, gender or religion, or incitement to cause harm.

Companies Act 2008 s 11(2)(d)(i), (ii), (iii).

<sup>143</sup> Draft Conduct of Financial Institutions Bill cl 20(1).

<sup>144</sup> Bingham, “The Rule of Law” (supra) second sub-rule.

<sup>145</sup> Based on its view of when this would be in “the public interest”.

licensing conditions far more onerous than those originally in the licence, and which in effect take away a substantial and important portion of the licensee's existing trading rights.

This would interfere with the fundamental right to choose a trade.<sup>146</sup> The practice of a trade may be regulated by law<sup>147</sup> but not so as to regulate it out of existence.<sup>148</sup>

This unfettered discretion to vary licensing conditions or impose added ones in the "public interest" would also interfere with vested property rights. A retail liquor licence is property, it has been held.<sup>149</sup> No law may permit arbitrary deprivation of property.<sup>150</sup>

It is a principle of the Rule of Law that the law must afford adequate protection of fundamental human rights.<sup>151</sup>

**... (c) when in the interests of financial customers or potential financial customers of the licensee**

The draft Bill states that the Authority may amend, delete, replace or vary any licensing conditions or impose other or additional licensing conditions, when in "the interests of the financial customers" or "potential" financial customers of the licensee.<sup>152</sup>

What is stated immediately above (about amending licensing conditions in the "public interest") applies also to this provision, that the Authority may amend licensing conditions when in the interests of the licensee's customers: The provision—

Is *vague* (in not making clear what circumstances would constitute the "interests of the financial customers" or "potential" financial customers of the licensee);

In effect confers on the Authority an unfettered *discretion*;

Would unreasonably *interfere with fundamental rights* to choose one's trade and hold property.

Also, authorising the Authority to impose added licensing conditions on a financial institution on vague and discretionary grounds in the interests of the institution's customers may well be one-sided and unreasonably *interfere with a licensee's fundamental right to equality of treatment*.<sup>153</sup>

**Clause 22 (transitional arrangements in relation to pension funds)**

**(4) (a) Legislation providing for establishment and operation of public sector pension fund must be amended to align with Act within 18 months**

<sup>146</sup> Constitution s 25(1).

<sup>147</sup> Constitution s 25(2).

<sup>148</sup> "You cannot, under the guise of regulating, in fact prohibit the usual and prevalent method of [trading]. You cannot so frame your regulations that you virtually regulate the subject matter out of existence. No doubt a power to regulate implies a power to restrict, and therefore even to prevent, but only in a small degree, and not so substantially that very little of the former rights remains. ... [I]f a regulation takes away a substantial and important portion of existing rights, it becomes in fact a prohibition." *R v Williams* 1914 AD 460 468, 469-470.

<sup>149</sup> *Shoprite Checkers (Pty) Ltd v Member of Executive Council for Economic Development, Environmental Affairs & Tourism Eastern Cape and others* 2015 (9) BCLR 1052 (CC) by bare majority, par [70] Froneman J (Cameron and Nkabinde JJ and Jappie AJ concurring) and par [169] Madlanga J (Tshiqi AJ concurring), *contra* par [130] Moseneke DCJ (Mogoeng CJ, Khampepe J and Molemela and Theron AJJ concurring).

<sup>150</sup> Constitution s 25(1).

<sup>151</sup> Bingham, "The Rule of Law" (supra) fourth sub-rule.

<sup>152</sup> Draft Conduct of Financial Institutions Bill cl 20(1)(c).

<sup>153</sup> Everyone is equal before the law and has the right to equal protection and benefit of the law, and the state may not unfairly discriminate directly or indirectly against anyone. Constitution s 9(1) and (3).

This subclause<sup>154</sup> states that “legislation” which provides for establishment and operation of a public sector pension fund “must be amended” to the extent necessary to align with this Act and requirements prescribed i.t.o. this Act, within 18 months.

It is submitted that Parliament cannot bind itself by means of this Bill to pass a particular piece of legislation in future. Parliament, when exercising its legislative authority, is bound only by the Constitution.<sup>155</sup>

The subclause is thus futile and should be deleted.

### **Clause 23 (appointment and registration of representatives)**

#### ***(2) Authority may prohibit—***

- (a) representatives generally;***
- (b) particular categories of representatives; or***
- (c) representatives with particular institutional form,***  
***from—***

- (i) acting on behalf of more than one licensee; or***
- (ii) providing certain financial services in respect of certain financial products, financial instruments or foreign financial products.***

This subclause<sup>156</sup> states that the Authority may “prohibit” representatives “generally”, particular “categories” of representatives or representatives with a particular institutional form from acting o.b.o. more than one licensee or providing “certain” financial services i.r.o “certain” financial products, financial instruments or foreign financial products.

This would mean that the Authority could prohibit all representatives<sup>157</sup> from providing any financial services which the Authority specifies i.r.o. any financial products or instruments which it specifies.

(Presumably the Authority would exercise these powers to prohibit by way of a “conduct standard”, although this is not expressly stated.)

This subclause does not circumscribe these powers of the Authority to prohibit.

It thus leaves the Authority with unfettered discretion to prohibit representatives or categories thereof or those of a particular institutional form from acting o.b.o. more than one licensee or providing certain financial services i.r.o certain financial products or instruments or foreign financial products.

The clause thus violates that principle of the Rule of Law that legal rights and liabilities should be resolved by application of the law and not by exercise of a discretion.

(The draft Bill’s general clause about the making by the Authority of conduct standards<sup>158</sup> does not contain sufficient fetters.)

<sup>154</sup> Draft Conduct of Financial Institutions Bill cl 22(4)(a).

<sup>155</sup> Constitution s 44(4).

<sup>156</sup> Draft Conduct of Financial Institutions Bill cl 23(2).

<sup>157</sup> Or any class of them.

<sup>158</sup> Draft Conduct of Financial Institutions Bill cl 107 (conduct standards and joint standards made by Authority).



**Clause 24 (requirements for appointment of representatives)**

*(1) A licensee may only appoint a representative if—*

*(c) the person complies with requirements prescribed by Authority in conduct standards for reappointment of a debarred person as representative, if that person was previously debarred.*

This paragraph states that a licensee may only appoint a previously debarred person as a representative if<sup>159</sup> the person complies with the requirements “prescribed by the Authority in conduct standards” for the reappointment of a debarred person as a representative.<sup>160</sup>

The paragraph contains no criteria to guide the Authority when it prescribes requirements in conduct standards for reappointment of debarred persons as representatives.

This gives the Authority an unduly wide discretion to determine requirements for reappointing of debarred persons as representatives, in violation of the Rule of Law.

(The Bill’s general clause about the making by the Authority of conduct standards<sup>161</sup> does not contain sufficient fetters.)

**Clause 27 (conduct standards regarding licensing)**

*(1) Authority may prescribe licensing requirements in conduct standards i.r.t. matters referred to in this Chapter.*

*(2) Without limiting scope of such standards, Authority may prescribe conduct standards i.r.o.—*

- (a) requirements for licensing, including general requirements and requirements for specific categories of licensees;*
- (b) requirements for licensees;*
- (c) transitional matters in relation to licensing, including transitional arrangements relating to pension funds, credit providers and debt collection services;*
- (d) requirements relating to representatives, including matters relating to the debarment of representatives and the reappointment of debarred representatives;*
- (e) fit and proper requirements;*
- (f) governance requirements that must be satisfied at the time of licensing;*
- (g) threshold operational ability requirements;*
- (h) threshold operational capital requirements;*
- (i) legal status, institutional and structural form, requirements set out in section 16;*
- (j) other threshold requirements for conducting certain activities, other than operational ability and operational capital requirements;*
- (k) naming convention requirements; and*
- (l) requirements to have a local presence.*

These provisions confer unduly wide powers on the Authority to prescribe licensing requirements in conduct standards i.r.t. matters referred to in the Bill’s licensing chapter

This clause does not properly fetter or circumscribe the discretions which the Authority will have when it prescribes conduct standards i.r.o. each of these matters.

<sup>159</sup> Inter alia.

<sup>160</sup> Draft Conduct of Financial Institutions Bill cl 24(1)(c) read with s 26.

<sup>161</sup> See later below. Draft Conduct of Financial Institutions Bill cl 107 (conduct standards and joint standards made by Authority).

The clause thus violates that principle of the Rule of Law which affirms that questions of legal right and liability should ordinarily be resolved by application of the law, and not by the exercise of a discretion.<sup>162</sup>

### **Clause 28 (application of chapter)**

#### ***Parts of Chapter to apply to small enterprises***

This Chapter (on culture and governance<sup>163</sup>) in its opening clause<sup>164</sup> states that three parts of the Chapter<sup>165</sup> do not apply to small enterprises.<sup>166</sup>

Yet without reference to it in the Chapter's opening clause, the Chapter's final clause in a subclause<sup>167</sup> states that, "despite" the Chapter's opening clause, the Authority may prescribe conduct standards providing for requirements<sup>168</sup> on matters referred to in those three parts of the Chapter<sup>169</sup> that *are* applicable to small enterprises.<sup>170</sup>

It is submitted that, to make the Bill easier to understand, the Chapter's opening clause should state that it is subject to the final clause's subclause, thus:<sup>171</sup>

#### **Application of Chapter**

**28.** Parts 2, 3 and 5 of this Chapter do not apply to small enterprises, subject to section 45(2).

It is an important principle of the Rule of Law that laws be stated in a clear and accessible manner.<sup>172</sup>

### **Clause 30 (Principles relating to culture and governance)**

#### ***(1) Institution must conduct business in manner prioritising fair outcomes for customers so there is confidence fair treatment is central to its corporate culture***

This subclause<sup>173</sup> states that a financial institution must at all times conduct its business in a manner that prioritises fair outcomes for financial customers so that there is confidence that their fair treatment is central to the corporate culture of the institution.

This is unduly vague and subjective:

It is unclear what is intended by requiring an institution to conduct business such that "there is confidence" that customers' fair treatment is "central" to its corporate culture.

#### ***(2) Institution must—***

#### ***(b) conduct business in best interests of customers and integrity of sector***

This paragraph<sup>174</sup> requires an institution to conduct its business in the "best interests" of financial customers and the "integrity of the financial sector".

<sup>162</sup> Bingham, "The Rule of Law" (supra) second sub-rule.

<sup>163</sup> Draft Conduct of Financial Institutions Bill Chap 3 "Culture and governance" (cls 28–45).

<sup>164</sup> Draft Conduct of Financial Institutions Bill Chap 3 cl 28 (application of chapter).

<sup>165</sup> Draft Conduct of Financial Institutions Bill Chap 3 Part 2 (Governance policy), Part 3 (Transformation policy), Part 5 (Avoidance or mitigation of conflict of interest).

<sup>166</sup> Draft Conduct of Financial Institutions Bill cl 28 read with cl 1(1) svv "small enterprise".

<sup>167</sup> Draft Conduct of Financial Institutions Bill cl 45(2).

<sup>168</sup> Or limitations or prohibitions.

<sup>169</sup> I.e., Draft Conduct of Financial Institutions Bill Chap 3 Parts 2, 3 and 5.

<sup>170</sup> Draft Conduct of Financial Institutions Bill cl 45(2).

<sup>171</sup> Underlining inserted for clarity.

<sup>172</sup> *Dawood and ano v Minister of Home Affairs and others; Shalabi and ano v Minister of Home Affairs and others; Thomas and ano v Minister of Home Affairs and others* 2000 (8) BCLR 837 (CC) par [47] O'Regan J (all other judges concurring).

<sup>173</sup> Draft Conduct of Financial Institutions Bill cl 30(1).

<sup>174</sup> Draft Conduct of Financial Institutions Bill cl 30(2)(b).

Requiring an institution to conduct business in the “best” interests of financial customers is unduly one-sided in favour of customers.<sup>175</sup>

The paragraph also contradicts the draft Bill’s central requirement that institutions should give financial customers merely “fair” treatment, which appears in remarkably numerous provisions throughout the Bill.<sup>176</sup>

It is also vague in requiring an institution to conduct its business in the “best” interests of the “integrity of the financial sector”.

In effect this paragraph would give the Authority a subjective discretion to determine if an institution has been conducting business in the “best” interests of customers and of the “integrity” of the sector.

### **Clause 31 (obligations of governing body)**

#### ***Governing body of financial institution must—***

##### ***(b) ensure that governance arrangements are appropriately embedded in institution***

This paragraph states that the governing body of a financial institution must ensure that governance arrangements are “appropriately embedded” in the financial institution.<sup>177</sup>

The paragraph is unduly vague:

It is unclear what is intended by requiring a governing body to ensure that governance arrangements are “embedded” in the institution.<sup>178</sup>

And no clearly evident meaning can be discerned in the requirement that the body must ensure that the arrangements are “appropriately” embedded.

### **Clause 32 (prohibited practices i.r.t. financial customers)**

#### ***(3) When applying the culture-and-governance-principles provision to a financial customer that is a pension fund or insurance group scheme or is otherwise acting for other retail financial customers, those principles must be applied in manner appropriate for members of pension fund or scheme or those other retail customers***

The Bill states that, when applying the provision about principles relating to culture and governance<sup>179</sup> to a financial customer that is a pension fund or insurance group scheme, or is otherwise acting for<sup>180</sup> other retail financial customers, the principles must be applied in a manner that is “appropriate” for the members of the pension fund<sup>181</sup> or insurance group scheme or those other retail financial customers.

This is unduly vague.

It is unclear what is intended by requiring that the principles be applied to such a fund or scheme or customers acting for other retail customers in a manner “appropriate” for fund or scheme members or those other retail customers.

<sup>175</sup> Laws should apply equally unless objective differences justify differentiation. Bingham, “The Rule of Law” (supra) third sub-rule.

<sup>176</sup> The requirement of “fair” and no “unfair” treatment appears throughout the Bill. Draft Conduct of Financial Institutions Bill, Long title and ss 3(1)(b), 14(1)(b)(ii), 19(4)(h), 24(b)(i) and (iii), 29(1) and (1)(a), 30(2)(g), 40, 41(1)(a), 45(3)(i)(iii), 48(2)(f), 52, 57, 70 and 71(1) and (2).

<sup>177</sup> Draft Conduct of Financial Institutions Bill cl 31(b).

<sup>178</sup> The term “embedded” is a metaphor, which should be replaced by clearer provisions.

<sup>179</sup> Principles relating to culture and governance

<sup>180</sup> Or on behalf of.

<sup>181</sup> In the draft Bill “fund” is here misspelt “find”.

**Clause 33 (unfair contract terms in contracts with retail financial customers)**

**(2) *Term or condition of contract or agreement i.r.o. a financial product or service is unfair or unreasonable if—***

***(f) the transaction or agreement is subject to a term or condition and—***

***(i) the term or condition is unfair or unreasonable***

This subparagraph<sup>182</sup> stipulates that a “term or condition” of a contract or agreement<sup>183</sup> is “unfair or unreasonable” if the transaction or agreement is subject to a “term or condition” and the “term [or] condition” is “unfair [or] unreasonable”.

This states that a term or condition of an agreement is unfair or unreasonable, if the term or condition is unfair or unreasonable.

This is circular. The subparagraph should be deleted.

**Clause 49 (design and suitability of products for retail financial customers)**

**(1) *Financial institution that provides financial products to retail customers must—***

***(b) take appropriate steps to identify needs of group to whom products are targeted and to satisfy itself, prior to making products available to market and on on-going basis, that the products are appropriate to meet those needs***

This<sup>184</sup> states that a financial institution that provides financial products to retail customers must take appropriate steps to identify the needs of the group<sup>185</sup> of customers to whom its products are targeted and to satisfy itself, prior to making the products available to the market and “on an on-going basis”, that the products are appropriate to meet those needs.

The expression “on an on-going basis” is vague. It should, in the context of this clause, probably be replaced by the expression “annually”.<sup>186</sup>

**Clause 82 (operating capital)**

**(1) *Institution must maintain sufficient financial resources of adequate amount and quality to carry out its activities, fulfil obligations and comply with legal requirements, and to ensure there is no risk that its liabilities cannot be met as they fall due.***

***(2) Assets of a financial institution must exceed liabilities.***

***(3) Financial institution must have sound, effective and comprehensive strategies, processes and systems to assess and maintain the amounts, types and distribution of financial resources it considers adequate to cover the nature and level of the risks to which it is exposed, or is likely to be exposed.***

***(4) In addition, a financial institution that holds assets of financial customers, or that collects, holds or receives any monies i.r.o. a financial product, must comply with any additional asset, working capital and liquidity requirements that are prescribed.***

<sup>182</sup> Draft Conduct of Financial Institutions Bill cl 33(2)(f)(i) read with cl 33(1).

<sup>183</sup> In respect of a financial product or financial service. Draft Conduct of Financial Institutions Bill cl 33(1).

<sup>184</sup> Draft Conduct of Financial Institutions Bill cl 49(1)(b).

<sup>185</sup> Or groups.

<sup>186</sup> Alternatively, the expression “at all times” might perhaps be used.

This clause states<sup>187</sup> that a financial institution must maintain sufficient financial resources of adequate amount and quality to carry out its activities, fulfil its obligations and comply with legal requirements, and ensure there is no risk its liabilities cannot be met as they fall due.<sup>188</sup>

The assets of a financial institution must at all times exceed its liabilities.<sup>189</sup>

A financial institution must have sound, effective and comprehensive strategies, processes and systems to assess and maintain the amounts, types and distribution of financial resources that it considers adequate to cover the nature and level of the risks to which it is exposed, or is likely to be exposed in the future.<sup>190</sup>

In addition,<sup>191</sup> a financial institution that holds assets of financial customers or collects, holds or receives any monies i.r.o. a financial product must “comply with any additional asset, working capital and liquidity requirements that are prescribed”<sup>192</sup> by conduct standard.<sup>193</sup>

This latter provision<sup>194</sup> contains no criteria to guide the Authority in prescribing additional asset, working capital or liquidity requirements for such institutions.

This, it is submitted, gives the Authority an unduly wide discretion when prescribing any such additional requirements. This unfettered discretion violates the principle of the Rule of Law that questions of legal right and liability should ordinarily be resolved by application of the law and not by the exercise of a discretion.<sup>195</sup>

(The Bill’s general clause about the making by the Authority of conduct standards<sup>196</sup> does not contain sufficient fetters.)

#### **Clause 85 (conducting business other than licensed activities)**

##### ***(1) Financial institutions belonging to category prescribed by Authority may not, without approval of Authority, conduct any business other than its licensed activity.***

The first subclause states that a financial institution that belongs to a category<sup>197</sup> of financial institution “prescribed by the Authority”<sup>198</sup> may not “without the approval of the Authority” conduct any business other than the activity<sup>199</sup> for which it is licensed in the Republic.<sup>200</sup>

This subclause contains no criteria to guide the Authority, either when prescribing a category of financial institution for the purpose of this prohibition, or when granting or

<sup>187</sup> In part (the first four of the clause’s twelve subclauses being addressed here).

<sup>188</sup> Draft Conduct of Financial Institutions Bill cl 82(1).

<sup>189</sup> Draft Conduct of Financial Institutions Bill cl 82(2).

<sup>190</sup> Draft Conduct of Financial Institutions Bill cl 82(3).

<sup>191</sup> To what is stated in the previous subclause (viz. cl 82(3)).

<sup>192</sup> Draft Conduct of Financial Institutions Bill cl 82(4).

<sup>193</sup> Draft Conduct of Financial Institutions Bill cl 1(1) sv “prescribed”.

<sup>194</sup> Draft Conduct of Financial Institutions Bill cl 82(4).

<sup>195</sup> Bingham, “The Rule of Law” (supra) second sub-rule.

<sup>196</sup> See later below. Draft Conduct of Financial Institutions Bill cl 107 (conduct standards and joint standards made by Authority).

<sup>197</sup> Or subcategory or type.

<sup>198</sup> For the purposes of this subsection.

<sup>199</sup> Or activities.

<sup>200</sup> Including any activity or a part of an activity performed o.b.o. another financial institution. Draft Conduct of Financial Institutions Bill cl 85(1).

refusing approval for such an institution to conduct a business other than its licensed activity.

These shortcomings give the Authority unfettered discretions when prescribing categories of financial institutions for this prohibition, and when determining whether to grant approval for such institutions to conduct another business.

These unduly wide discretions violate the Rule of Law. Questions of legal right and liability should be resolved by application of the law, not by exercise of discretions.<sup>201</sup>

(The Bill's general clause about the making by the Authority of conduct standards<sup>202</sup> does not contain sufficient fetters.)

***(2) Financial institutions may not, without approval of Authority, conduct business outside Republic, including business similar to its activity licensed in Republic.***

The second subclause states that a financial institution may not conduct any business outside the Republic, including a business similar to the activity or activities for which it is licensed in the Republic, "without the approval of the Authority".<sup>203</sup>

This contains no criteria to guide the Authority when determining whether or not to grant approval to a financial institution to conduct a business outside the Republic.

The subclause gives the Authority an unfettered discretion when determining whether to grant such approval. This unduly wide discretion violates the Rule of Law.<sup>204</sup>

(The Bill's general clause about the making by the Authority of conduct standards<sup>205</sup> does not contain sufficient fetters.)

**Clause 98 (retention of records)**

***(1) Institution must have in place and implement framework for retention of data and records i.a.w. requirements prescribed in conduct standards***

This clause<sup>206</sup> in its first subclause states that a financial institution must "*have in place and implement a framework for the retention of*" data and records, i.a.w. requirements prescribed in conduct standards.<sup>207</sup>

The italicised expression renders the clause vague and ambiguous, and is unduly wordy.

The meaning of "framework" is unclear.

And it is unclear if a financial institution must actually retain data, or if it need merely implement a "framework for" retaining data.

The subclause would be clearer if it merely stated that a financial institution must "*retain*" data and records i.a.w. requirements prescribed in conduct standards.

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<sup>201</sup> Bingham, "The Rule of Law" (supra) second sub-rule.

<sup>202</sup> See later below. Draft Conduct of Financial Institutions Bill cl 107 (conduct standards and joint standards made by Authority).

<sup>203</sup> Draft Conduct of Financial Institutions Bill cl 85(2).

<sup>204</sup> As mentioned above.

<sup>205</sup> See later below. Draft Conduct of Financial Institutions Bill cl 107 (conduct standards and joint standards made by Authority).

<sup>206</sup> Draft Conduct of Financial Institutions Bill cl 98 (retention of records).

<sup>207</sup> I.r.t. the activities that the financial institution is conducting, and other applicable legislation. Draft Conduct of Financial Institutions Bill cl 98(1).

**Clause 107 (conduct standards and joint standards made by Authority)**

**(2) When prescribing conduct standards, Authority must consider—**

**(a) nature, scale and complexity of different institutions, products and services; and**  
**(b) need to—**

- (i) provide fair access to appropriate products and services;**
- (ii) enable customers to understand and compare nature, value and cost of products and services;**
- (iii) enable customers to benefit from fair competition for quality products and services;**
- (iv) support sustainable business models that enable institutions to deliver fair customer outcomes; and**
- (v) facilitate access to market for emerging institutions.**

The clause's<sup>208</sup> first subclause<sup>209</sup> states that the Authority may make a conduct standard on any matter i.r.o. which it is required or permitted to make a conduct standard i.t.o. the Bill.

Its second subclause<sup>210</sup> then states that, when prescribing conduct standards, the Authority must “consider” the nature, scale and complexity of different financial institutions, products and services; and also the needs to provide fair access to appropriate financial products and services, enable financial customers to understand and compare the nature, value and cost of financial products and services, enable customers to benefit from fair competition for quality financial products and services, support sustainable business models that enable financial institutions to be able to deliver fair customer outcomes, and facilitate access to market for emerging institutions.

This subclause, in requiring merely that the Authority “consider” these matters, violates the Rule of Law in being relatively vague and not circumscribing the Authority’s discretion when it prescribes conduct standards.<sup>211</sup>

It is submitted that a requirement that the Authority “consider” certain matters means not much more than that it must “have regard to”, “bear in mind”, “not overlook” them.<sup>212</sup>

Words such as these mean that the body concerned need merely bear the matters in mind, but retains a discretion.<sup>213</sup> A requirement to “have regard to” something is merely a guide, not a fetter.<sup>214</sup>

It is contended that this subclause<sup>215</sup> should be substantially revised so that it properly circumscribes the Authority’s discretion when it prescribes conduct standards.<sup>216</sup>

<sup>208</sup> Conduct of Financial Institutions Bill cl 107 (conduct standards and joint standards made by Authority).

<sup>209</sup> Conduct of Financial Institutions Bill cl 107(1)(a).

<sup>210</sup> Draft Conduct of Financial Institutions Bill cl 107(2)(a), (b)(i)–(v).

<sup>211</sup> See also discussion above about the draft Bill’s clause dealing with proportional application of the Bill: Draft Conduct of Financial Institutions Bill cl 7(1)(a)–(e), and (i) and (ii)(aa)–(dd).

<sup>212</sup> See the discussion of the expression “have regard to” in *Joffin and ano v Commissioner of Child Welfare, Springs and ano* [1964] 3 All SA 49 (T) at 52 per Ludorf J, Snyman J concurring.

<sup>213</sup> *Illingworth v. Walmsey* (1900) 2 QBD 142.

<sup>214</sup> *Perry v. Wright*, (1908) 1 K.B. 441.

<sup>215</sup> Draft Conduct of Financial Institutions Bill cl 107(2)(a), (b)(i)–(v).

<sup>216</sup> It is submitted that the Financial Sector Regulation Act gives no clear guidance on this question. It states:  
**Conduct standards**

**106. [...]**

(3) [A] conduct standard may be made on any of the following matters: [...]

(e) matters on which a regulatory instrument may be made by the Financial Sector Conduct Authority in terms of a specific financial sector law; [...].

### **Clause 110 (principles of co-operation)**

#### **(3) Authority and supervisory authorities must—**

##### **(a) establish and maintain appropriate confidential safeguards to protect all non-public supervisory information**

This paragraph<sup>217</sup> states that the Authority and supervisory authorities that have entered into supervisory co-operation arrangements must “*establish and maintain appropriate confidential safeguards to protect*” all non-public supervisory information obtained from another supervisory authority.

This is ambiguous.

It is unclear if the authorities must actually protect information, or if they need merely “*establish and maintain appropriate confidential safeguards to protect*” information.

It is also unclear what “*appropriate*” safeguards would be.

The paragraph would be clearer if it merely stated that the authorities must “*safeguard*” all such information.

### **Clause 116 (savings)**

#### **(1) Anything done under a section, subsection or paragraph of an Act amended by this Act remains valid to the extent that it is not inconsistent with this Act, and until anything done under this Act overrides it**

This subclause states that anything done under a “*section, subsection or paragraph*” of an Act “*amended*” by this Act remains valid to the extent that it is not inconsistent with this Act, and until anything done under this Act overrides it.

It is unclear why the subclause should refer to a “*section, subsection or paragraph*” of an Act, but not also to a “*subparagraph, item or subitem*”.

Nevertheless, it is unnecessary to refer in such level of detail to sections, subsections, paragraphs etc of other statutes. It would suffice if the subclause were simply to refer to anything done under a “*provision*” of an Act amended by this Act.

It is also unclear why the subclause aims to save only things done under statutes “*amended*” by this Act, and not also to things done under statutes “*repealed*” by this Act.

### **Clause 117 (amendment of laws)**

The clause<sup>218</sup> states that the laws listed in a schedule<sup>219</sup> are amended “or repealed” as set out in that Schedule.

But this clause is headed merely “Amendment of laws”.

The heading to this clause<sup>220</sup> should be altered so that it reflects what the clause itself states, namely that the Bill is not only to amend laws, but also to repeal laws, thus:

Amendment or repeal of laws

117. The Acts listed in Schedule 1 are amended or repealed as set out in that Schedule.

<sup>217</sup> Draft Conduct of Financial Institutions Bill cl 110(3)(a).

<sup>218</sup> Draft Conduct of Financial Institutions Bill cl 117 (amendment of laws).

<sup>219</sup> Draft Conduct of Financial Institutions Bill, Sched 1.

<sup>220</sup> Draft Conduct of Financial Institutions Bill cl 117 (amendment of laws).



### Schedule 1: “Laws amended”

First, this Schedule is headed “Laws amended”. The Schedule does not make clear that some laws listed in it are not to be amended, but to be repealed by the Bill.<sup>221</sup>

It is accordingly submitted that the heading of this Schedule<sup>222</sup> should be altered so as to reflect that the Schedule will not only amend laws, but repeal some. Thus:

#### SCHEDULE 1

#### LAWS AMENDED OR REPEALED

Second, this Schedule (of laws to be amended or repealed) lists<sup>223</sup> these five statutes:

<i>No. and year of Act</i>	<i>Short title</i>	<i>Extent of amendment or repeal</i>
...	....	....
Act No. 52 of 1998	Long-term Insurance Act, 1998	The whole
Act No. 53 of 1998	Short-term Insurance Act, 1998	The whole
Act No. 28 of 2001	Financial Institutions (Protection of Funds) Act, 2001	The whole
Act No. 37 of 2002	Financial Advisory and Intermediary Services Act, 2002	The whole
Act No. 45 of 2002	Collective Investment Schemes Control Act, 2002	The whole
...	...	....

This Schedule does not state whether these five are to be repealed or to be amended.<sup>224</sup>

The intention of the Bill is that they be repealed.<sup>225</sup> It is thus recommended that the Schedule be altered to expressly provide for their repeal, thus:

<i>No. and year of Act</i>	<i>Short title</i>	<i>Extent of amendment or repeal</i>
...	....	....
Act No. 52 of 1998	Long-term Insurance Act, 1998	The <u>repeal of the</u> whole
Act No. 53 of 1998	Short-term Insurance Act, 1998	The <u>repeal of the</u> whole
Act No. 28 of 2001	Financial Institutions (Protection of Funds) Act, 2001	The <u>repeal of the</u> whole
Act No. 37 of 2002	Financial Advisory and Intermediary Services Act, 2002	The <u>repeal of the</u> whole
Act No. 45 of 2002	Collective Investment Schemes Control Act, 2002	The <u>repeal of the</u> whole
...	...	....

—ooo0ooo—

<sup>221</sup> It is evident that the Bill is intended, not only to amend some laws, but also to repeal certain others.

<sup>222</sup> Draft Conduct of Financial Institutions Bill, Sched 1 (laws amended).

<sup>223</sup> Inter alia.

<sup>224</sup> And, if amended, in what respects.

<sup>225</sup> National Treasury, 2018, *Explanatory Policy Paper accompanying the Conduct of Financial Institutions Bill (Paper accompanying the first draft of the COFI Bill)*.