FSCA

Financial Sector
Conduct Authority

STATEMENT OF NEED AND IMPACT OF CONDUCT STANDARD – REQUIREMENTS FOR MANAGERS OF COLLECTIVE INVESTMENT SCHEMES

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*** This version incorporates changes that were made to the original version of the "Statement supporting the draft Conduct Standard – Requirements for managers of collective investment schemes " that was published on 23 November 2023**

1. BACKGROUND AND PURPOSE OF THE STATEMENT

1.1 This Statement relates to the publication by the Financial Sector Conduct Authority (FSCA) of the Conduct Standard 3 of 2025 (CIS) – *Requirements for Managers of Collective Investment Schemes* (Conduct Standard). The FSCA intends to make the Conduct Standard under by section 106(1) of the Financial Sector Regulation, 2017 (Act No. 9 of 2017) (FSR Act).

1.2 The Statement is published in accordance with section 98(1)(a) of the FSR Act and is intended to support and give context to the Conduct Standard. This Statement explains the need for and impact of the Conduct Standard.

2. STATEMENT OF NEED

2.1 South Africa's financial sector regulatory framework draws from, amongst others, established international best practice and standards to remain effective and fit for purpose. One way to ensure this, is to constantly subject the country's financial regulatory framework to international scrutiny and peer reviews by key international role-players and standard setters, including the International Monetary Fund (IMF) and the World Bank (WB), amongst others.

2.2 Both the IMF and WB, as part of their peer review assessments, be it from a financial stability or market conduct perspectives, issue reports which identifies gaps and or findings as aligned to established international principles which needs to be adopted and implemented by the jurisdictions under review. One such established principles, for present purposes, are the International Organisation of Securities Commission Principles (IOSCO Principles) as they pertain to the regulation and supervision of the Collective Investment Schemes (CIS) environment.

2.3 During the course of 2020 and 2021, South Africa was subject to a Financial Sector Assessment Program (FSAP) conducted by the IMF. On 21 January 2022, the IMF issued their final FSAP Report and made various findings and recommendations aimed at assisting South Africa to identify key sources of systemic risk in the financial sector and implement policies to enhance its resilience to shocks and contagion.

2.4 Various of the recommendations made through the FSAP Report pertained to matters related to the CIS environment that fall within the jurisdiction of the FSCA. These recommendations included, amongst other things, the following:

- The current framework lacks product governance requirements, and there is a need to distinguish between the duties of CIS managers *and* the duties of a distributor. Some of the specific issues identified includes that CIS managers should identify and assess target markets and financial customers for each new product created and should have clear marketing and distribution strategies. The aforementioned were cited as critical elements in the South African context, where the distribution of CIS through online platforms is increasing;

- There is a need for the adoption of a standardised prospectus for a CIS that lists the scheme's operating rules in accordance with international best practice. This approach will provide more clarity on the content and format of information presented to financial customers and will also support better comparability of CIS' offerings. There is also a need to continue to align CIS disclosures requirements to international best practice;

- Issues were raised pertaining to the oversight of trustees, fiduciaries or custodians, especially where the custodial function has been sub-delegated;

- A need was identified to clarify and strengthen the responsibilities and obligations of the risk management function, provide for requirements pertaining to an internal audit function, and in particular establish requirements for the compliance function;

- Notwithstanding the existing general obligation pertaining to conflicts of interest a need was identified to strengthen the conflicts of interest framework and address various specific issues pertaining to conflicts of interest, such as best execution obligations, timely trading and transaction allocation, related party transactions and group structures, the prevention of churning, and the like; and

- There is a need to define a list of changes in a CIS operating rules that are considered as material and that require prior notification and/or consent of financial customers, and eventually redemption at no cost.

2.5 The FSAP Report therefore highlighted a need to affect various changes to the CIS regulatory framework to ensure closer alignment to international standards, enhance the financial sector's resilience to shocks and contagion and support better protection of financial customers.

2.6 The Conduct Standard is aimed at addressing some of the recommendations reflected in the FSAP Report. It might be noted that the Conduct Standard is an interim measure pending the implementation of a holistic conduct regulatory framework applicable to all financial institutions under the envisaged Conduct of Financial Institutions (COFI) Bill.[1] The FSCA considered whether the draft Conduct Standard should be placed on hold and rather be incorporated into the COFI Bill transition project, but it was decided that addressing the FSAP recommendations is a strategic imperative and cannot be dependent on the conclusion of the COFI Bill process.

3. CONSULTATION ON THE CONDUCT STANDARD

3.1 In November 2023, the FSCA published a draft Conduct Standard – Requirements for managers of collective investment schemes, for public consultation. The commentary process was scheduled to and closed on the 16th February 2024 with various comments received from commentators.

3.2 Subsequently, comments as received were considered and accordingly responded to by the FSCA (and the necessary changes effected on to the Conduct Standard).

3.3 Full details of the consultation process is set out in the Consultation Report pertaining to the Conduct Standard.

4. SUMMARY OF THE CONDUCT STANDARD

4.1 The Conduct Standard is intended to address some of the recommendations reflected in South Africa's FSAP Report, as explained above.

4.2 The Conduct Standard sets out the following:
- high-level requirements pertaining to business principles, governance and control functions, the latter entailing the risk management, compliance and internal audit functions;
- requirements pertaining to the identification, avoidance and management of conflicts of interest, and the adoption of a conflicts of interest management policy;

[1] In this regard, please refer to the FSCA's 3-year Regulation Plan that was published on 30 June 2023.

- substantial requirements pertaining to portfolio development, including the establishment of a portfolio development framework, principles related to portfolio design, development and distribution, and portfolio approval, monitoring, review and reporting;
- requirements pertaining to the adoption of a prospectus and what must be contained therein;
- requirements pertaining to the appointment of a sub-custodian;
- requirements relating to trade execution and related party transactions.

4.3 Acknowledging that CIS managers can differ in, amongst other things, size, nature and complexity, the Conduct Standard allows a CIS manager to apply the conduct standard in such a way that it is proportional to the nature, size, scale and complexity of the CIS manager, taking into account its business and operating model, scope of activities, financial customer profile and associated level of risk exposure.

5. STATEMENT OF IMPACT OF THE CONDUCT STANDARD

5.1 It is envisaged that the Conduct Standard will ensure that the South African CIS regulatory environment is more closely aligned to international standards, thereby improving confidence in the South African market. The Conduct Standard is also expected to ensure better protection and outcomes for financial customers.

5.2 Through the consultation process, commentators expressed differing views in respect of the expected impact of the Conduct Standard.

5.3 One commentator advised that –

- one if its members indicated that while the requirements of the new Conduct Standard will clearly lead to more work, they believe that the cost impact on a larger firm such as theirs will not be excessive as there are already substantial governance / structures etc. in place, and they will be able to absorb the new requirements within existing headcount / processes. Over time, they do however expect that compliance resource allocation will inevitably increase given the increase in regulations and change management;
- one of its members indicated that they expect an additional cost of approximately R1 million per annum. This estimated cost was however not supported by any quantitative or qualitative assessment, nor did it specific which requirements in the Conduct Standard will contribute towards this cost.;
- a minority of members do not expect a material increase in operational costs;
- when compliance costs increase, operational costs increase. Their members therefore generally expect operational costs to increase; and
- the additional investor notification requirements could translate into a significant increase in operational costs, and these must be weighed against the benefit of such notifications.

5.4 Three other commentators advised that the Conduct Standard –

- will result in additional resources being required, particularly if the requirement will be to set up a separate internal audit function within the manager. Additional resources will further be required from a risk and compliance perspective to adhere to the additional governance requirements, policy development and monitoring. IT development will be necessary for the implementation and monitoring of the EPM, and training and monitoring of distributors will require additional resources;
- might result in an administrative burden, and significant costs incurred, in complying with the Conduct Standard, but they believe that most are, or should already, be in place. If the proportionality expectations are further defined it could further reduce the impact and cost implications; and

- will result in CIS managers incurring operational cost to draft the prospectuses across its scheme and portfolios.

5.5 The views expressed are therefore diverse in nature ranging from substantial cost implications to minimal cost implications, which makes it difficult to formulate an informed view on costs. One of the biggest cost implications seems to be the establishment of an internal audit function. In our view we have largely mitigated through the fact that the Standard allows for proportional application and outsourcing of the function. In addition, if this remains a problem in the case of very small managers, the manager has the option of applying for exemption from this requirement and the FSCA will assess such application in the context of the nature, size, scale, complexity etc of the manager.

5.6 The other areas which it is claimed will have a relatively substantial cost implication is investor notifications and drafting of prospectuses. Although we take note of these concerns, The requirements surrounding these two areas addresses important risks and these two areas were specifically flagged as shortcomings through the FSAP, meaning that South African is misaligned with international standards insofar as it relates to these two areas. Therefore, the FSCA maintains that these two areas should be addressed as the risks needs to be mitigated and continued misalignment with international standards might have devastating consequences for South Africa.

5.7 General comments pertaining to increased governance, control functions and operational costs are also noted, but the FSCA is of the view that cost implications are substantially mitigated through the application of proportionality, which is enabled through the Conduct Standard. Lastly, we are satisfied that the benefits brought about by the draft Conduct Standard will outweigh the remaining potential cost implications.

5.8 In conclusion, it must be acknowledged that it is inevitable that legislative interventions will have a cost implication. The key is finding an appropriate balance between the expected costs and the envisaged benefits.

6. STATEMENT OF INTENDED OPERATION OF THE CONDUCT STANDARD

6.1 The Conduct Standard applies to all CIS Managers and the CIS's and portfolios which they manage in terms of the CISCA.

6.2 The Conduct Standard is consistent with the objectives of the FSR Act, and specifically the mandate of the FSCA to protect financial customers by promoting the fair treatment of financial customers by financial institutions. It is expected that the draft Conduct Standard will lead to improved practices in the CIS environment that supports better outcomes for and protection of financial customers, in line with the FSCA's mandate. The Conduct Standard will also ensure closer alignment with international standards, thereby improving confidence in the South African market.

6.3 The Conduct Standard is intended to come into operation 12 months after date of publication.