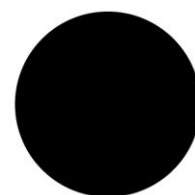


**STATEMENT SUPPORTING DRAFT CONDUCT
STANDARD – REQUIREMENTS FOR THE CONDUCT
OF MANAGERS OF A COLLECTIVE INVESTMENT
SCHEME IN RELATION TO THE DELEGATION OF
ADMINISTRATION FUNCTIONS**



1 BACKGROUND AND PURPOSE OF THE STATEMENT

The Financial Services Laws General Amendment Act, No. 45 of 2013 (“the FSLGAA”) was assented to on 14 January 2014 and commenced, with the exception of certain provisions, on 28 February 2014. The FSLGAA amended several financial services laws including the Collective Investment Schemes Control Act, No. 45 of 2002 (“CISCA”). Of particular significance is the insertion of section 4(5) to CISCA, which addresses the delegation of administration functions, as defined. Section 4(5) of CISCA effectively places persons to whom such functions are delegated or outsourced, referred to as “delegated persons”, within the regulatory ambit of the Financial Sector Conduct Authority (“the Authority”). It further empowers the Authority to supervise delegated persons as it does to managers of collective investment schemes. It is also important to note that an authorised agent, as defined in CISCA, includes a delegated person.

In terms of section 4(5), a manager of a collective investment scheme needs to obtain the approval of the Authority prior to the entering into of a delegation arrangement. On 14 March 2014, the former Financial Services Board (“FSB”) published Guidance Note 4, titled “*Guidance Note on applications for approval of delegation of administration functions in accordance with the Collective Investment Schemes Control Act, 2002*” (“the Guidance Note”). The objective of the Guidance Note was to provide guidance to industry on the new provision and set out the process for obtaining the approval of the Authority (formerly the FSB) for delegation arrangements. In addition the Guidance Note addressed transitional issues to assist industry in their efforts to ensure compliance with section 4(5).

The Authority is making this Conduct Standard pursuant to section 106(1) and 106 (3)(e) of the Financial Sector Regulation Act, No. 9 of 2017 (“FSRA”) read with Section 114(4)(b) of the CISCA. The draft Conduct Standard is aimed at:

- Ensuring that the risks associated with a delegation arrangement are fully assessed and managed on a continued basis throughout the subsistence of the relationship between the manager and the delegated person. This translates into market and investor confidence and transparency regarding the value chain of end-to-end customer servicing; and
- Optimising investor protection by ensuring that the manager’s risk will not be materially increased as a result of the delegation arrangement.

The purpose of this statement is to explain the need for, expected impact and intended operation of the draft Conduct Standard as required by section 98 of the FSRA.

2 STATEMENT OF NEED - POLICY CONTEXT AND PROBLEM DEFINITION

The primary function of a manager of a collective investment scheme is the administration of the scheme. Administration as defined in CISCA includes the following:

- The management and control of a collective investment scheme;
- The receipt, payment or investment of money or other assets, including income accruals, in respect of a collective investment scheme;
- The sale, repurchase, issue or cancellation of a participatory interest in a collective investment scheme and the giving of advice or disclosure of information on any of those matters to investors or potential investors; and
- The buying and selling of assets or the handing over thereof to a trustee or custodian for safe custody.

It is standard practice in industry that some of these functions, and in some instances all administration functions as defined, are delegated (outsourced) by the manager to an investment manager, also known as the asset manager. Proper administration of portfolio

assets forms the cornerstone of a manager delivering on its mandate to investors who hold participatory interests in the portfolio. Furthermore, by delegating certain functions it also touches on the fiduciary responsibility of the manager and the safeguarding of assets. One of the primary principles relating to the administration of a collective investment scheme, as enshrined in CISCA, is that “a manager must administer a collective investment scheme honestly and fairly, with skill, care and diligence and in the interest of investors and the collective investment scheme industry”. In giving effect to this principle, it would be important for a manager to do a proper due diligence on a person (entity) to whom such functions would be delegated. In addition, in order to ensure that any additional risks that may be introduced as a result of the delegation of functions are properly identified and mitigated, it is important that the delegation arrangement be monitored on a continuous basis by the manager as part of the manager’s obligations under CISCA as well as for there to be appropriate regulatory oversight over these arrangements.

As mentioned earlier, section 4(5) imposes an obligation on the manager to obtain prior approval from the Authority before delegating an administration function. Furthermore, the section stipulates that the accountability of administering the scheme remains with the manager, regardless of any delegation arrangement. It further enhances the powers of the Authority by subjecting the delegated person to regulatory oversight by the Authority. This section came into effect on the 28th of February 2014. On 14 March 2014, the then Registrar of Collective Investment Schemes issued the Guidance Note setting out the process for regulatory approvals of delegation arrangements as envisaged in section 4(5) of the CISCA. Paragraph 8 of the Guidance Note highlighted the documents that needed to be submitted in order to obtain regulatory approval for such delegation arrangements.

Subsequent to the Guidance Note being issued, there was still a need to formalise the application process and confirm the criteria to be considered by the Authority prior to the approval of delegation arrangements.

In light of the above, it is intended that the draft Conduct Standard will ensure better oversight and supervision of these arrangements, in line with the mandate of the Authority to enhance investor protection. The implementation of the draft Conduct Standard is expected to achieve greater transparency of these arrangements and ultimately better risk identification and mitigation, where applicable. The Authority will be better positioned to monitor concentration risk in the market and ensure that there are sufficient alternatives in place with regards to service providers to ensure continuity of service to investors, which translates into market efficiency.

In addition to the above, delegation arrangements could potentially result in conflicts of interest leading to poor outcomes for investors. The draft Conduct Standard, in line with section 4(1) of the CISCA, confirms the obligation of a manager to avoid conflicts between the interests of the manager, the interests of investors and the interests of delegated persons, and where such conflicts cannot be avoided, that they be appropriately mitigated.

3 SUMMARY OF THE DRAFT CONDUCT STANDARD

The draft Conduct Standard sets out the minimum requirements for the delegation of administration functions by the manager of a collective investment scheme. The requirements are designed to ensure that the delegation of administration functions does not impair the prudent management of the administration of a collective investment scheme by a manager and that the risks associated with a delegation arrangement are adequately assessed and managed by the manager, initially before entering into an arrangement with a delegated person but also on an on-going basis.

The draft Conduct Standard further requires managers of collective investment schemes who want to delegate administration functions to have a Board approved policy and related processes in place for assessing the risks involved with the delegation of such functions and to ensure compliance with the draft Conduct Standard. The draft Conduct Standard places a limitation on the sub-delegation of functions. It requires a manager to make an application to the Authority for approval of a delegation arrangement. If the delegated person intends on further delegating the function, the manager must apply to the Authority for additional approval of the sub-delegation arrangement and such sub-delegation may only be done one level further. It is also a requirement that, as part of the application to the Authority, the manager must provide proof that the basis for the decision to delegate to a particular person (entity) was considered by the Board of Directors of the manager (for example this would entail supporting documents such as the due diligence report, the contract between the manager and the delegated person, minutes of Board or Executive Management meetings etc.).

In addition to the above, the draft Conduct Standard sets out the factors that a manager must consider prior to making a decision to delegate administration functions as well as the legal provisions that must be included in any delegation agreement. Regardless of the requirements as stipulated in the draft Conduct Standard, the manager of a collective investment scheme ultimately retains the accountability for the administration of the scheme.

Some of the general principles to be considered when entering into any delegation arrangement contained in the draft Conduct Standard include the avoidance and, where not possible, the mitigation of conflicts of interest and market related remuneration payable in respect of a delegation arrangement commensurate with the actual function being delegated.

What will qualify as a delegation arrangement?

A delegation arrangement for purposes of the draft Conduct Standard would constitute:

- A manager of a collective investment scheme licenced in terms of the Cisca who delegates a function of administration as defined in the Cisca to a delegated person; and
- Any sub-delegation in respect of which the manager of the collective investment scheme obtained approval for from the Authority.

A delegated person includes an authorised agent. Any arrangement for the provision of a function to a manager by the manager's controlling company, a subsidiary of the manager, or related or inter-related party of the manager, is a delegation arrangement and therefore requires prior approval from the Authority.

Reporting requirements

The draft Conduct Standard makes provision for the notification of termination of an arrangement that was previously approved by the Authority and requires details to be provided in relation to the contingency arrangements in place subsequent to the termination. This will aid in the effective monitoring of all delegation arrangements with the purpose of ensuring compliance with the draft Conduct Standard by managers of collective investment schemes in the interest of ensuring the consistent and continued delivery of fair outcomes for investors. It is therefore proposed that managers of collective investment schemes must, within 7 days after terminating a delegation arrangement, notify the Authority in writing of the termination thereof.

4 STATEMENT OF IMPACT OF THE CONDUCT STANDARD

It is envisaged that the draft Conduct Standard will not have an adverse impact on investor choice, quality of investment products or the efficiency of investment product services rendered by existing delegation structures and will actually aid in ensuring efficiencies.

With due regard to paragraph 2 of this statement, which provides an overview of the regulatory developments in respect of delegation arrangements commencing in 2014, the requirements contained in the draft Conduct Standard are not unfamiliar to the collective investment scheme industry. The CISCA was amended to provide for regulatory oversight over these arrangements, which is primarily aimed at enhancing the asset management duty of the manager.

The Authority acknowledges that there may be instances in which the implementation of the draft Conduct Standard could have a cost implication for managers of collective investment schemes, however due to the history of engagements relating to implementation dating back to 2014 and the fact that the proposed requirements are rooted in long standing industry practice, the potential cost implication is envisaged to be minimal.

5 STATEMENT OF INTENDED OPERATION OF THE CONDUCT STANDARD

The draft Conduct Standard is consistent with the objective of the FSRA, and specifically the mandate of the Authority to protect financial customers by promoting the fair treatment of financial customers (including investors) by financial institutions. The draft Conduct Standard applies to managers licenced in terms of the CISCA in respect of any delegation and sub-delegation of an administration function as defined in the CISCA. Existing delegation arrangements approved by the Authority prior to the commencement of the draft Conduct Standard will be deemed to comply with the relevant requirements set out in the draft Conduct Standard. Notwithstanding this, a manager must ensure compliance with the requirements applicable to a delegation arrangement between a manager and a delegated person as set out in the draft Conduct Standard within one year from the date of the publication of the draft Conduct Standard.

The requirement that a manager must notify the Authority of a termination of a delegation arrangement within 7 days of such termination will follow a “file and use” notification process.

6 WAY FORWARD

The draft Conduct Standard will be submitted to Parliament for a period of at least 30 days while Parliament is in session as required in terms of section 103 of the FSRA.