



FSCA COMMUNICATION 7 OF 2019 (PFA)

Directive PF No. 8 of 2018: Prohibition on the Acceptance of Gratification

The role and independence of the Principal Officer

12 December 2019

1. PURPOSE

- 1.1 The purpose of this Communication is to inform the industry and stakeholders about the Financial Sector Conduct Authority's ("the Authority") approach to addressing the existing conflict of interest relating to principal officers appointed on boards of funds while also being employed by service providers.

2. BACKGROUND

- 2.1 Section 8(1) of the Pension Funds Act, 1956 ("PFA") requires every fund to have a principal executive officer ("principal officer").
- 2.2 The principal officer has a legal duty to protect the members of the fund by reporting to the Authority any matter that may prejudice the members of the fund. Such duty involves reporting the conduct of the board members and service providers where they act in a manner that prejudices the members of the fund. It should be noted that, in terms of section 8(6)(a) of the PFA, the principal officer's duty to report to the Authority extends beyond the principal officer's appointment.
- 2.3 The duty to protect extends to the fact that the principal officer is usually the official contact person with the Authority and is required to satisfy him/herself with the authenticity of statutory submissions made to the Authority. In this regard, the principal officer must sign various statutory submissions such as the fund's annual financial statements, valuation reports, section 14 transfer applications, applications for exemption or extension etc. before it can be submitted and considered by the Authority.
- 2.4 In most funds, the principal officer is the first contact with third parties and manages service providers. The principal officer is responsible for reporting to the board, and in appropriate cases to the Authority where there may be prejudice to the members, matters arising from such interactions or the performance of such service providers to the fund. The principal officer is also expected to provide guidance to the board on matters requiring the board's decision and for the execution of such decisions. This will include the guidance on the appointment or termination of service providers.

- 2.5 Importantly, it is often found that, for practical purposes, the decision-making powers of the board are delegated to the principal officer subject to a certain limited threshold and ratification by the board.
- 2.6 It follows from the foregoing that a principal officer owes a fiduciary duty to the fund/s, and should therefore avoid conflicts of interest in much the same way that a board is required to do so pursuant to section 7C(2)(c) of the PFA.
- 2.7 The duties of the board are set out in section 7D of the PFA which *inter alia* provides that it is the duty of the board to ensure that the rules, operation and administration of the fund comply with this Act, the Financial Institutions (Protection of Funds) Act, 2001 (Act No. 28 of 2001) (“FI Act”), and all other applicable laws.
- 2.8 Section 2 of the FI Act provides that persons dealing with funds of, and with trust property controlled by, financial institutions must, with regard to such funds, observe the utmost good faith and exercise proper care and diligence required of a trustee in the exercise or discharge of his or her powers and duties; and may not gain directly or indirectly any improper advantage for any person to the prejudice of the financial institution or principal concerned.
- 2.9 Directive PF No. 8 provides that principal officers are not permitted to accept any gratification which objectively viewed creates a conflict of interest with their fiduciary duty towards the fund in which they serve. Gratification is defined in Directive PF No. 8 as including “*any office, status, honour, employment, contract of employment or services, any agreement to give employment or render services in any capacity...*” This issue was set out in paragraph 3.8.4. of Guidance Notice 2 of 2018 published on 27 June 2018.
- 2.10 As such, the simultaneous employment of the principal officer by a service provider is impermissible and is also undesirable. The principal officer’s ability to comply with his/her duty to report on the activities of such service provider is likely to be impaired by virtue of their employment relationship with the service provider.
- 2.11 The Authority is aware that there are several funds that remain in contravention of section 7C(2)(c) of the PFA and Directive PF No. 8 because their principal officers are in simultaneous employment with a service provider to the fund, which is usually the administrator or consultant firm. To ensure a principal officer’s independence, it is desirable that the principal officer is employed directly by the fund and is not in receipt of any type of prohibited gratification.
- 2.12 The Authority will be writing to those funds that have been identified to obtain an Enforceable Undertaking, in terms of section 151 of the Financial Sector Regulation Act, 2017 (“the FSR Act”), from the fund concerned and all relevant parties including the principal officer, to take remedial actions within a specified period of time in order to bring the fund into compliance.

3. REGULARISING NON-COMPLIANCE

- 3.1 Due to the fact that this has been a long-standing practice and noting the nature of the remedial action required to be taken by funds in order to become compliant, the Enforceable Undertaking will allow funds and the relevant parties a period of **6 (six) months** within which to regularise the appointment of the new principal officer.
- 3.2 The proposal for an Enforceable Undertaking is appropriate in matters where there is a high level of co-operation and is consistent with previous actions taken by the Authority in dealing with issues of a similar nature.
- 3.3 An Enforceable Undertaking must be published pursuant to section 151(5) of the FSR Act.
- 3.4 In instances where there is no co-operation, or no agreement can be reached, the Authority will be obliged to take the necessary regulatory action.
- 3.5 Funds and principal officers that are aware that they are or might be in breach of Directive PF No. 8 must approach the Authority as soon as possible if they have not yet been approached.

4. CONTACT

- 4.1 For further information regarding this Communication, please contact Naheem Essop at naheem.essop@fsca.co.za