The Cofi Act takes the financial services sector into a new era

While South Africa came through the 2008 global financial crisis relatively unscathed, evidence of poor market conduct and outdated legislation were among the factors that led to a reform of the country's financial sector.

Johan Ferreira, chief legal and compliance officer, African Unity

The Twin Peaks reform, brought into operation the Prudential Authority for prudential regulation and the Financial Sector Conduct Authority (FSCA) for market conduct regulation.

A cornerstone of this reform is the need for stronger market conduct regulation, resulting in better customer outcomes and fair treatment of customers. While the FSR Act focuses primarily on the regulators, the Conduct of Financial Institutions Act (Cofi) will have its focus on the institutions.

The Cofi Act is also supportive of financial inclusion for all South Africans, a principle that is backed up by National Treasury's explanatory paper accompanying the Cofi Bill, says Johan Ferreira, chief legal and compliance officer at African Unity.

This paper stresses the role that an efficient financial sector can play in creating greater economic inclusion, especially of historically marginalised people, by fostering growth and creating employment.

Strong market conduct policy

The document further states that: "Strong market conduct policy is a critical pillar in building a financial sector that delivers these outcomes. It can support and facilitate better competition and participation in the financial sector, including of emerging black-owned financial institutions."

The Bill streamlines all of the current market conduct legislation into one and, unlike most other legislation, is outcomes-based. “Cofi is based on a set of key principles which will focus on achievements within the spirit of the law rather than a tick-box approach to compliance with the letter of the law," he says.

These principles include that the legislation is:

- ## Activity based

  The Bill provides for regulation and supervision of activities undertaken, regardless of the institution performing the activity, thereby closing the gaps that exist in the current legal framework.
- ## Principles based

  The Bill specifies standards related to the intention of the regulation rather than rules for compliance of the regulation. This will enable the regulator to monitor and enforce the outcomes achieved. That is, focus on the spirit of the law, rather than the letter of the law.
- ## Outcomes-focused

  The Bill supports the delivery of required policy outcomes and provides for monitoring of the extent to which the outcomes are being achieved and interventions for poor outcomes. This approach requires that, the market conduct of licensed financial institutions; the financial sector regulatory framework; and, the effectiveness of the market conduct regulator is tested against the desired financial sector outcomes.
- ## Risk-based and proportionate

  The Bill provides for a risk-based approach to monitoring outcomes. The legislation will enable the regulator to identify areas of greater risk and to address these risks in a proportional manner. This will allow a fairer environment for institutions of differing sizes and will encourage new entrants into the market by reducing barriers to entry.

Risk-based approach

The risk-based approach will support competition, making it easier for new entrants into the market through provisions for different licensing to be applied to different types of companies.

This will afford the regulator greater flexibility and better tools to encourage emerging institutions and black-owned businesses to enter the market. “This will foster transformation because it allows new entrants more compliance leeway providing an environment for the company to develop and grow," says Ferreira.

Transformation of the sector is also taken into account in the Act, which will require that all financial institutions have policies in place to comply with the B-BBEEE Code. Ferreira explains that the FSCA will have the responsibility of supervising the implementation of these policies.

While there have been critics of the introduction of the Twin Peaks reform, Ferreira believes that this has mostly been around the costs of implementing new legislation.

“Initially, financial institutions may have to increase their compliance budgets and upgrade their systems to accommodate these new requirements, but over time they will become entrenched into the busines," he says.

“For customers, it will mean that they can be confident that they’re being properly informed and treated fairly. For financial institutions, it will mean a certain amount of flexibility in achieving the required outcomes."