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TECHNICAL NOTE

COLLECTIVE INVESTMENT SCHEMES AND DERIVATIVES

MARKET PROVIDERS MONITORING

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This Technical Note was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in South Africa during the period September 2020 to June 2021 led by Jennifer Elliott, IMF and Eva M. Gutierrez, World Bank, and overseen by the Monetary and Capital Markets Department. IMF, and the Finance, Competitiveness, and Innovation Global Practice, World Bank Group. The note contains the technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at www.worldbank.org/fsap.

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GLOSSARY

AuM	Asset under management
AMF	French Market Authority
AML	Anti-Money Laundering
CFD	Contract for Difference
CSD	Central securities depository
CIS	Collective investment scheme
CISCA	Collective investment schemes control Act 45 of 2002
CIFHF	Collective Investment Scheme that are in the form of a Hedge funds
CISP	CIS in property
CISPB	CIS in participation bonds
CISS	CIS securities
COFI Bill	Conduct of Financial institutions Bill
DG	Director-General of the National Treasury
DMP	Derivative market Provider(s)
EESE	Equity Express Securities Exchange
EU	European Union
FAIS	Financial Advisory and Intermediary Services Act of 2002
FCIS	Foreign collective investment schemes
FHF	Foreign HF
FIC	Financial Intelligence Centre
FSB (SA)	Financial Services Board
FSAP	Financial Sector Assessment Program
FSCA	Financial Sector Conduct Authority
FSCF	Financial Sector Contingency Forum
FSOC	Financial Stability Oversight Committee
FSRA	Financial Sector Regulation Act
FX	Foreign Currency Swaps
HF	Hedge funds
IOSCO	International Organization of Securities Commissions
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IRS	Interest rates Swaps
JSE,	Johannesburg Stock Exchange
LDMIs	Listed Derivative Market Intermediaries
MAS	Monetary Authorities of Singapore
MDD	Minimum Disclosure Document
MOF	Ministry of Finance
MOU	Memorandum of Understanding
NAV	Net asset value
NCA	National Consumer Agency

ODPs	OTC Derivatives Providers
OTC	Over the counter
PA	Prudential Authorities
QIHF	Qualified investors CIS hedge funds
RHF	Retail CIS hedge funds
RM	South African Rand
RMCP	Risk Management and Compliance Plans
SARB	South African Reserve Bank
SRO	Self-regulatory organization
SSF	Single Stock Futures Contract
WBG	World Bank Group
ZAR	South African Rand

EXECUTIVE SUMMARY

Since 2018, the South African authorities operates under a twin peaks' model, with the Financial Sector Conduct Authority ('FSCA") which is in charge of regulating and supervising the market and its participants. The FSCA is the regulatory body for CIS and their managers[1]. It is also in charge of supervising the only listed derivative regulated market currently operated by the Johannesburg stock exchange group ('JSE'). JSE[2] and the FSCA regulate and supervise respectively all Listed Derivative Market Intermediaries ('LDMIs') and Over the Counter Derivative Providers ('ODPs'), altogether referred as Derivative Market Providers ('DMPs').

Over the last four years, South African authorities have initiated a large reform program of the financial market's regulatory framework with the forthcoming single Conduct of Financial Institution Bill ('COFI Bill"), whose objective is to streamline the conduct requirements for financial institutions, that are currently found in a number of different financial sector laws.

CIS managers and CIS distributors operate under a comprehensive regulatory framework; However, conflict of interest rules for CIS managers need to be clarified and accounting principles applicable to CIS, defined. The Law provides general principles which acknowledge that CIS managers must avoid conflicts of interest, act in the best interest of investors, act with honesty and integrity, have adequate human and technical resources, and have adequate risk management in place. However, there is no guidance on CIS managers' best execution obligations, on the timely trading and transaction allocation, on related party transactions or on the prevention of churning. The accounting principle applicable to CIS should also be finalized[3].

The authorities are improving the information disclosure framework to CIS investors; However, CIS manufacturer and distributors duties should be further clarified[4]. Any entity marketing CIS should be required to perform the same type of suitability assessments. This is particularly important in a context where new distribution channels emerge. The authorities have implemented a minimum document disclosure ('MDD") and are in the process of adopting of a prospectus for CIS. This

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[1] The FSCA is also in charge of regulating and supervising the broad spectrum of financial services intermediaries and financial market structures and infrastructures, that are allowed to operate in South Africa.

[2] Which previously hold the status of an SRO.

[3] At the time of the final review of this Technical Note, a draft Standard on Accounting Principles applicable to CIS had finalized by the Authority to send out for final comments.

[4] At the time of the final review of this Technical Note, the FSCA had started to gather and analyze international best practice in the context of CIS manufacturing and distribution and proposed some amendments to be made in future legislation under COFI Bill.

will provide more clarity on the content and format of information presented to investors. This should greatly improve the comparability of the CIS' offer too. The duties of CIS manufacturers and distributors should also be clarified. They should be required to have procedures in place i) to identify and assess target markets and investors for each new product created, as well as ii) a marketing and distribution strategies. These are critical elements in a context where the distribution of CIS through platforms is becoming more important in South Africa. Entities that can market a CIS to the public should also be subject to the same rules governing the suitability assessment.

The authorities should set a list of changes[5] to the CIS operating rules that are considered as 'material', with the corresponding information to be provided to investors. CISCA provides for minimal set of information to be provided to investors. That said, the FSCA requires in practice for some information, such as fund's objectives and investments policy risks, to be included in the CIS documentation for instance at the time of the funds approval. The FSCA has also progressively extended the changes to the CIS operating rules that it considers as important and that requires investors information and consent. Despite the FSCA's efforts to maintain CIS investors' protection, the current legislative and regulatory framework still lacks clarity with a list that clearly sets all the changes in the CIS operating rules that require a notification and consent of investors.

CIS assets must be kept safe and placed in a segregated account. In addition, the CIS depository should perform some due diligence when CIS assets are held in sub-custody. The law should be also clarified on the extent to which the CIS manager cannot be part of the same ownership group as the CIS trustee or the CIS depository. In practice, The FSCA already prevents a CIS manager and a CIS depository to be part of the same group, and to be affiliates. However, this is not explicitly stated in the Law. In addition, the trustee and CIS depository should be subject to additional supervision including routine on-site visits.

The FSCA has effectively implemented the risk-based supervision methodology for CIS managers. This supervisory methodology could be enhanced by adding macro financial elements into the risk profiling of managers and when setting the annual supervisory plan[6]. The FSCA has adopted a robust risk-based supervision and has built a strong compliance culture among markets' participants. The CIS managers' risk profiling methodology could be further improved by considering macro elements relating to changes in the economy of the country and its monetary policy. The FSCA is working on including macro financial elements in its current supervisory methodology. In addition, the FSCA should consider clarifying requirements applicable for risk, internal audit and compliance

[5] Questions relating to disclosure are dealt in Principle 26 of the IOSCO Assessment methodology.

[6] We understand that the authorities are working on that aspect.

functions, and related governance aspects to enable compliance officer to perform their function in a fully independent way.

Capital requirements and risk management rules for OTC Derivatives Providers ('ODPs') needs to be strengthened and more granular. ODPs operate under a newly established regulatory framework with the licensing rules that needs to provide more granular guidance on the level of risks that ODPs and their clients may be exposed to, risks and margins calculation and collateral safekeep [7] to better address potential default or misselling practice.

The FSCA needs to complete the supervisory framework for ODPs. The supervisory framework of derivatives providers shows its limits, especially for OTC activities. As such, the FSCA is encouraged to finalize a risk profiling methodology for ODPs as well as a risk-based supervisory plan that includes a review of ODPs risk management process and capital requirement calculation.

The FSCA also needs to complete a reporting framework for ODPs and short selling. The authorities are encouraged to pursue their efforts to design a comprehensive reporting framework that allows them to promptly identify new emerging systemic risks. Completing the reporting framework for ODPs is crucial for the authorities to deliver on their mission to identify and manage emerging systemic risks. Having data in different areas (ODPs, HFCIS, Banks, exchanges) increases the possibility that the authorities can miss risks building up in their markets. The FSCA and the SARB are already collaborating to improve and streamline market data collection. The South African authorities' efforts to build a consistent reporting framework for all registered entities, must be supported. The authorities are also encouraged to expand the existing institutional cooperation mechanisms with more regular reporting to each other on market activities, and their analysis on the evolution of risks associated with market activities, including on the use of leverage.

The FSCA enforcement decision-process could be reinforced. The FSCA staff is involved at the supervision, inspection, investigation, and enforcement stage, which could ultimately expose the FSCA to questions on the neutrality and objectivity of its decisions. As the market matures and FSCA decisions come under more scrutiny, the FSCA should consider the creation of an enforcement committee composed of non-FSCA staff.

[7] These contracts may be under OTC derivative clearing threshold as well as the non-centrally cleared OTC derivatives margin thresholds.

TABLE OF MAIN RECOMMENDATIONS		
TOPIC	**RESPONSIBLE ENTITY**	**TIMELINE**
CIS MONITORING		
Continue to develop a legislative and regulatory framework with detailed rules on CIS managers' best execution obligations, transactions allocation and transactions' record, related party transaction and churning	FSCA	MT
Finalize the adoption of the accounting standard applicable to CIS portfolio	FSCA	MT
Require the CIS trustee or depository to perform due diligence when CIS assets are held in assets' sub custody	FSCA	ST
Clarify the duties of CIS manufacturers and distributors duties and product governance process	FSCA	MT
Adopt similar suitability assessment requirements for all entities marketing CIS	FSCA	ST
Finalize the adoption of a CIS prospectus aligned to international best practice	FSCA	ST
Define a list of changes in the CIS operating rules that are considered as material and that require prior notifications and eventually consent of investors	FSCA	ST
Include additional macro elements in the CIS managers risk profiling matrix	FSCA	ST
Extent the risk-based assessment and annual supervisory plan to CIS trustees and depositories	FCSA	MT
ODP MONITORING		
Strengthen and develop more granular capital requirements and risk management rules for ODPs	FCSA	MT
Complete the reporting and supervisory framework for ODPs	FCSA	MT
Complete the reporting framework on short selling	FCSA	ST
Use the cooperation mechanisms for regular feedback on capital markets activities.	FSCA, PA, SARB	ST

I = immediate; ST = short-term (0-6 months); MT = medium-term (6 months – 2 years)

INTRODUCTION

1. **This Note summarizes the discussions and recommendations in the context of a South African capital markets review conducted virtually as part of a 2020 FSAP.** A full assessment of the level of implementation of the Principles of the IOSCO was not conducted. Rather, in agreement with the authorities, the WBG conducted a targeted review that aimed at determining whether the South African capital markets regulatory and supervisory authority ('the FSCA") has adopted a robust framework to oversee collective investment schemes ('CIS')[8] and derivatives market providers ('DMPs')[9], and has adequate organizational arrangements in place to deliver on its CIS and DMP regulatory and supervisory mandate[10].

2. **CIS and DMPs were identified for this review, as a result of past FSAPs recommendations as well as the update of the IOSCO standards on derivative trading and the constant growth in asset under management and derivatives' trading in South Africa.** South Africa has already undertaken two assessments of the level of implementation of the International Organization of Securities Commissions Objectives and Principles of Securities Regulation (IOSCO Principles) in 2010 and in 2014. The 2014 assessment found the legal framework provided the authorities with broad supervisory, investigative and enforcement powers, although it recommended more clarity in its institutional design. Main gaps identified mostly related to the regulation and oversight framework for collective investments schemes.

3. **Given its regional leadership, the size and growth of its funds industry, as well as the increasing importance of its derivatives markets, the South African authorities have also expressed an interest in a technical note focusing on investment funds and derivatives market providers**[11]. This decision also echoes the National Treasury Policy Document, that set financial stability and risk-based market surveillance as a policy priority.

4. **To conduct this review, the WBG relied on i) information provided by the FSCA in a self-assessment that was completed in 2019 and ii) virtual on-site meetings organized with both public authorities and market participants, in 2020.** An IOSCO self-assessment questionnaire covering all topics under analysis was sent to the FSCA. Due to the Covid 19, the on-site mission that

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[8] taking reference to the IOSCO Methodology, principles 24 to 28, and principle 6, where relevant.

[9] This review was made taking as a reference the IOSCO Methodology, principles 29 to 32, and 6 and 37, where relevant to derivative trading.

[10] Mainly referring to principles 1 to 5 as a main point of reference.

[11] Given the recent review of regulatory and supervisory framework, a review of the institutional design and in particular the effectiveness of the organization of market supervision may be premature.

was due to be organized in March 2020 had to be postponed and instead, virtual meetings were organized in September 2020 with the FSCA staff, to discuss the information received. During these meetings, specific discussions took place, in particular to illustrate investors protections and emerging market risk. A separate review of enforcement files was not conducted. In addition, the WBG held virtual meetings with a sample of market participants including with the JSE, investment firms, fund managers, the association of the local asset managers and investment firms, both in November and December 2020.

OVERVIEW OF THE CAPITAL MARKETS REGULATORY AND SUPERVISORY STRUCTURE

A. The FSCA market conduct policy and oversight responsibilities

5. Since 2018, the South African authorities operates under a twin peaks' model, with a Financial Sector Conduct Authority ('FSCA") and a Prudential Authority ("PA"). Over the last four years, South Africa has initiated a large reform program of its financial markets regulatory and supervisory framework. The first important step of this reform relates to the introduction of the twin peaks model by the Financial Sector Regulation Act ("FSRA") in 2018. Under this model, the Financial Conduct Services Authorities was created. This authority is responsible for the regulation and the supervision of the conduct of financial institutions, including Collective investment schemes ("CIS") and their managers, financial services providers ("FSPs") and market infrastructures. The FSCA is an administrative body which has the overall objectives[12] to promote, enhance and support the efficiency and integrity of financial markets; protect investors and assist in maintaining financial stability. On the other hand, the Prudential Authority[13] was created with the objectives to promote the safety and soundness of the financial institutions, including those providing financial products and securities services, and the market infrastructures, and assist in maintaining financial stability. Under these new assignments, both authorities are formally in charge of the tasks that were previously held by Financial Services Board (FSB)[14].

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[12] section 57 of the FSR Act.

[13] section 33 of the FSR Act.

[14] The South African Reserve Bank, through its enhanced role of monitoring and maintaining financial stability, is empowered to designate and exercise oversight of systemically important financial institutions (SIFIs), and is also responsible for assessing the observance on international principles developed for market infrastructures, including the CPSS-IOSCO Principles for Financial Market Infrastructures.

6. **The South African authorities are in the process of reviewing the legislative framework for capital markets.** South African authorities have also initiated a large reform program of the financial market's regulatory framework with the forthcoming single Conduct of Financial Institution Bill ('COFI Bill"), whose objective is to streamline the conduct requirements for financial institutions that are currently found in a number of different financial sector law and to better aligned with international best practice. Under the new FSRA, the FSCA's standards and regulatory instruments are adopted after public consultation and published on the website of the authorities. The FSCA also has the ability to co-operate, as necessary, with other local authorities and foreign counterparts.

7. **The FSCA is set as an independent administrative authority, led by a commissioner and deputy commissioners.** Under the FSRA, the decision to appoint the FSCA commissioner and the deputy commissioners is taken by the Minister of Finance. The commissioner and deputy commissioners are appointed for a period of five years, renewable once. They may not be appointed if they have a position or any direct material financial interest in a financial institution. At the date of this review, the FSCA was managed by the Transitional Management Committee (TMC) that comprises the acting Commissioner and its executive management. The Commissioner or Deputy Commissioners can be removed from the office by the Minister of Finance if they become a 'disqualified person 'according to criteria clearly defined under the FSRA and implementing regulations, and if, according to the conclusions of an independent inquiry, they fail to adequately discharge properly their functions and duties. In this later case, the findings of the independent inquiry are submitted to the National Assembly. At the date of this review, no commissioner or deputy commissions has been removed from office. The FSCA is also subject to the Public Finance Management Act and provides National Assembly its annual report.

8. **The Commissioner and the Deputy Commissioners form the FSCA Executive Committee (Exco) which is in charge of the day-to-day management of the FSCA's as well as all supervision and policy decisions.** To date, the Exco functions are assumed by the FSCA Transitional Management Committee (TMC), exclusively composed of FSCA staff members, plus one independent member also appointed by Minister of Finance. The Exco is the only decision-making body of the FSCA. It takes all decisions in relation the regulation and the supervision of the market and its members. Decisions are taken at a majority of votes, with a casting vote for the Commissioner. The FSCA also has some subcommittees for the monitoring the implementation by the FSCA of its corporate governance and conduct standards, including on the staff remuneration policy.

9. **The FSCA is adequately capacitated to meet its mandate.** As shown in the table 1 and 2 below, the FSCA is resourced with both junior and more senior staff. The average staff turnover rate is

between 10 and 12% and its average tenure is 7 years and is reported to be in line with market average[15]. At the time of this review and despite the recruiting difficulties with the pandemic, over 70 % of FSCA positions had been fulfilled. The FSRA provides the FSCA staff and management with adequate legal protection for the *bona fide* discharge of their governmental, regulatory, and administrative functions and powers. Staff are also subject to human resources policies and procedures that do not allow them to have indirect of direct interest in any entity regulated by the FSCA. Staff is also subject to disclosure requirement for other interest they may hold[16]. The FSCA has also adopted training policy to ensure that's the staff receive proper education and training.

Table 1 FSCA Resources affected to market conduct regulation and supervision

Divisions	No of employees	Vacancies in 2019
Administration and Support	181	49
Licensing and Business Centre	75	20
Regulatory Policy	40	13
Conduct of Business Supervision	90	40
Market Integrity Supervision	24	2
Retirement Fund Supervision	72	24
Investigation and Enforcement	56	11
Total (2018)	**538**	**159**

FSCA Annual report 2018-2019

Table 2 FSCA staff per experience

Level	No of employees	Vacancies in 2019
Top management	11	-
Senior management	29	10
Professional qualified	244	77
Skilled	165	52
Semi-skilled	89	20
Total (2018)	**538**	**159**

FSCA Annual report 2018-2019

10. Since 2018, the budget for capital market supervision has remained at a stable level, despite the growth in the regulatory and the supervisory work. The FSRA sets the FSCA's sources of funding[17], which include amounts received by the financial sector, such as fees and levies that are determined pursuant to the FSCA budget's previsions. The FSRA requires the FSCA to provide a budget

[15] Although these estimates are not easy to confirm.

[16] It includes close relatives too.

[17] Chapter 16 of the FSR Act, effective on April 1st, 2020.

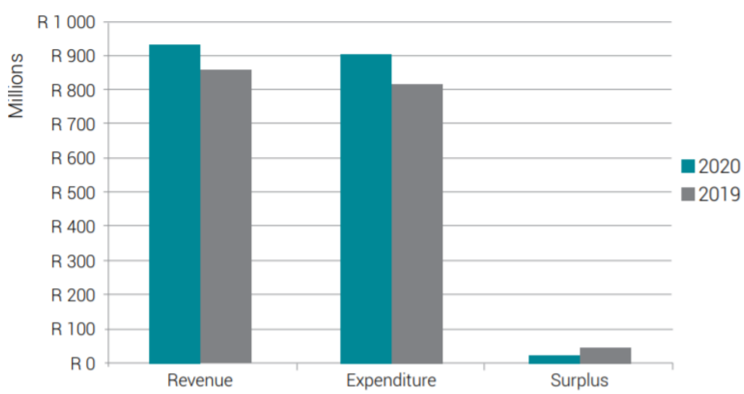
based on estimated expenditure for the next 2 years and a proposal for adjusted fees and levies. As showed under table 3 and 4, the FSCA has kept a steady funding level and managed to monitor its expenditure, even during the first months of the Covid-19 crisis.

Table 3 Contribution to Levy income by industry

	2018	2019	2020
Pension	28	28	28
Market abuse	3	3	3
CIS	5	5	5
Hedge funds	3	3	2
Insurance	26	27	26
FAIS	32	31	33
Capital markets	3	3	3
Total Budget	R723 Million	R707 Million	R827 Million

FSCA 2019 and 2020 annual reports

Table 4 Overview of the FSCA financial performance



FSCA 2019 and 2020 annual reports

11. The FSCA is in the process of reviewing its organizational arrangement to best fit market needs. The FSCA operates with an activity and sectoral based organizational chart with a total 10 operational units, 5 of which are involved in market conduct policy and supervision, as described under table 5[18]. The division executives report to the heads of department that report to the Transitional Management Committee. The heads of department report to the Divisional Executives who in turn report to the EXCO of the FSCA.

[18] Please also refer to the FSCA Organization chart in Annex 8.

12. On one hand, the Regulatory Division is responsible for all the development of the regulatory frameworks.

13. On the other hand, the supervision of CIS and DMPs involves:

- the division in charge of licensing which work includes the licensing of CIS and OTC Derivative Providers ('ODPs')),
- the division in charge of "Conduct of Business Supervision" of CIS and FSPs, also in charge of products distributed to the public including product design, and pre & post-sale services, with an emphasis on promoting fair treatment of financial customers by financial advisers, and,
- the division in charge of the "Market Integrity Supervision Division" which supervises market infrastructures (i.e., exchanges) as well as derivatives OTC market participants (ODPs). It has for objective to ensure the efficiency and integrity of the financial markets and assist in maintaining financial stability.

14. Finally, the Division on investigations and enforcement carries out all FSCA enforcement matters, including those relating to market abuse matters and breach of financial sector laws and regulations[19].

Table 5 FSCA Divisions involved Supervision of CIS, FSP and DMPs

Name of the Division	Scope of work
Regulatory Policy	• Market Conduct policy and regulation
Licensing and business center	• Processing license applications of market participants Handling with queries and complaints
Conduct of Business Supervision division	• Ongoing supervision of the business conduct rules of all financial entities and products (except those supervised by the MISD)
Market Integrity Supervision Division (MISD)	• Licensing and conduct supervision of market infrastructures • Licensing and conduct supervision of ODPS • Licensing and conduct supervision of credit rating agencies
Investigations and enforcement	• Carrying out investigations related to market abuse matters and other potential breach of financial sector laws and regulations

Source: FSCA – Self assessment questionnaire 2019 and annual report 2019

[19] This division also carries out preliminary assessment in relation to complaints that are not dealt with by the licensing and the supervisory divisions.

B. Discussions and recommendations on the FSCA market conduct policy and oversight responsibilities

15. Despite challenging circumstances, the FSCA has adopted an organizational arrangement to best fit market needs. As shown in annex 8, the FSCA organizational arrangements have been set using existing synergies and competencies that can be found in different FSCA divisions. As an example, the supervision of derivative markets and their participants is hosted by the Market Integrity Supervision Division, which was already in charge of the license and supervision of JSE listed derivative market (and its participants), rather than by the conduct of business supervision division that supervises other regulated financial services providers[20]. There is no universal model that can be recommended and in a fast-evolving environment, the FSCA is striving to find a balance and flexible organization to fit its market needs. The FSA is encouraged to continue to do so, providing staff capacity building training[21] and to develop strong coordination mechanisms between divisions on cross-cutting issues, in the context of a fast-evolving market.

16. The FSCA has adequate regulatory and supervisory authority over all CIS managers and DMPs. As the south African market develops, the FSCA could straighten some aspects of its policy decision-making process. The regulatory division in charge of initiating and driving all policy decision process, where necessary in collaboration with other operational divisions. The FSCA has adopted some organizational safeguard: the regulatory division has a separate line of reporting from the operational divisions in charge of the supervision of market players, and except for the adoption of individual exemption orders, the policy adoption process includes a consultation with the public.

17. However, the policy decision-making process is exclusively in the hand of the FSCA Staff[22] and in a fast-developing environment, the objectivity of the FSCA staff when adopting new policies may be placed under scrutiny[23]. Deputy Commissioners should be able to present their staff work and positions for the Commissioner final review but should not be involved in the final decision-making process, to avoid potential conflict. A solution could consist in adding a subcommittee composed of independent experts[24] to advise the Commissioner. Another solution

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[20] As an ex-SRO, the JSE supervise its cash market members.

[21] For example, on fast evolving and growing industries such as private equity. https://savca.co.za/wp-content/uploads/2021/08/SAVCA-VC-Survey-2021.pdf

[22] The Exco members only involves one independent-non FSCA staff persons, also appointed by the Minister of finance

[23] In line with the IOSCO Principle 4.

[24] Each could be appointed in accordance with their financial and legal expertise as well as their experience, by one of the following highest administrative and judiciary courts, the SARB, the PA, The NCC.

could consist in adopting additional safeguards with the systematic publication of a statement of support, with a detailed impact assessment and cost- benefit analysis, for each new regulation.

COLLECTIVE INVESTMENT FUNDS' MONITORING

A. CIS market overview

18. The South African collective industry schemes[25] consist in five major types of CIS that are mainly be differentiated by their type of strategy and investors. On one hand, 'Classic' CIS are subject to a full set of operating rules and leverage restrictions, both in terms of limit, with 100% of the funds' portfolio, and use of derivatives for hedging purpose only. CIS can be distributed to the public. CIS are divided in 'three subcategories, characterized by the type of assets they can invest in and their investment objectives, namely:

- CIS can be that can mostly invest in securities -including money market funds, feeder funds and funds of funds (CISS)[26].
- CIS in participation bonds to grant mortgages (CISPB)[27]
- CIS that has an investment objective targeted to real estate (CISP, also named property trust or "PUT")[28].

19. On the other hand, CIS Hedge Funds ("CISHF") are mainly characterized by their use leverage[29] and their ability to have invest in more diverse assets than non CISHF. They are subject to different sets of rules depending on whether they are distributed to retails ('RHF") or qualified investors (QIHF). The Law does not provide for a formal definition of retail versus sophisticated investors. Instead, the regulation for hedge funds refers to 'qualified' investors, defined under Notice 52/2015. Qualified investors are for instance, able to invest a minimum of 1 million Rand in a HF and can demonstrated that they have some knowledge and experience or have appointed an advisor that has been able to point to the investor the risk and limits to its investment. CISCA also recognize the possibility to allow "declared CIS" means a CIS other than a CIS in securities, property, or participation bonds, which has been declared to be a CIS by the Minister of Finance by notice in the Gazette Sections 62-63 CISCA.

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[25] Collective investment schemes (CIS) are defined as a scheme where members of the public are invited to invest money or other assets in a portfolio and hold a participatory interest in a portfolio of the scheme through shares or unit.

[26] Section 39 CISCA.

[27] Section 52 CISCA.

[28] Section 47 and 49 CISCA.

[29] the legislation limits for Retail Hedge Funds the total exposure to the market to 200 percent (i.e., obligations may not exceed the NAV of the portfolio).

CISHF can use a variety of investment strategies, including long/short, market neutral and fixed income strategies, although a major part of CISHF investments are in equities with long/short strategies.

20. Over the last five years, the asset management industry has been growing fast, with an AuM exceeding 2.5 RMb[30]. They are over 1600 funds registered, including almost 300 hedge funds, and over 50 firms authorized CIS local managing firms[31]. The rapid expansion of the asset management industry[32] in South Africa seems to have been driven by a number of factors, such as the economic growth, the level of savings and a rising in demand for life insurance as well as other investment products[33]. Over the last few years, CIS distribution channels have evolved. The adoption of new forms of distribution channels such as online platforms, makes investment products available to more investors and has allowed the financial sector to expand.

Table 6 Type of CIS managers and number of CIS

Type of CIS	Number of authorized managers
CISS	51
CISPB	2
CISP	2
FCIS	117
HF	15
FHF	7

FSCA annual report 2019

21. The South African CIS industry is concentrated with the top five funds CIS managers holding over 50% of the market share. The market for institutional investors is concentrated with the top ten asset managers handling more than half of total AuM and the top three managers holding one-quarter of total AuM. Retail investors seem to form a smaller proportion of CIS investors. The market for retail investors seems more fragmented with the top ten asset managers handling just over one fifth of CIS AuM. Offshore collective investment schemes (FCIS) need to be authorized by the FSCA to be distributed in South Africa. In 2018, 498 FCIS were distributed in South Africa representing 494,704.88 RM total Assets. FCIS are mainly distributed to South African institutional investors.

[30] Asisa Data, and FSCA -2019 data.

[31] 2018 FSCA Annual Report and Novare Hedge Fund Survey 2018.

[32] In addition to AuM growth in collectively managed portfolio, it is worth noting that a large part of the institutional assets is still managed through mandates.

[33] https://savca.co.za/wp-content/uploads/2021/08/SAVCA-VC-Survey-2021.pdf

B. CIS Managers Operating framework

22. CIS managers and entities that market CIS operate under separate regulatory frameworks. Each framework provides for eligibility, governance, organizational and conduct rules that are specific to their activities. On one hand, the Financial Advisory and Intermediary Services Act ("FAIS Act") regulates the provision of financial services by Financial Services Providers (FSPs). It includes the provision of 'advice' and 'intermediary services', including for CIS[34], as well as to private equity structures[35] FAIS typically regulates persons that have a mandate from clients to manage their portfolio on a discretionary base (single portfolio), and that offer brokerage services to their clients with or without providing some advice. On the other hand, entities that manage CIS are regulated under Collective Investment Schemes Control Act, ("CISCA") which allow CIS managers to administrate, and also to distribute the CIS they manage to the public[36].

23. The FSCA has the power to adopt implementing regulation to guide CIS managers in their operations. Over time, the market authorities have developed a dense regulatory framework with some definitions such as the definition of 'securities' that can actually be found in different FSCA notices, rather than in the law, giving the perception of a fragmented and outdated framework This legislative framework is currently under a full review with a single Bill that will replace existing sectoral laws approach and use a principle-based approach, introducing a more consistent framework.[37] The FSCA has in place adoption mechanisms of new regulatory instruments, which includes a consultation phase with the industry, but with no specific timelines on the overall regulatory adoption-process.

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[34] Under the FSP category I. for entities.

[35] Private equity funds are not regulated as such but service providers such as private equity fund managers are subject to the FAIS : fund administrators must obtain authorisation from the FSCA to provide non-discretionary intermediary services (Category I license) or use aggregated investment and disinvestment orders (Category III license) (*FAIS Act*).

[36] CIS managers are exempted from the FAIS requirements; JSE members are also exempted from the FAIS registration.

[37] Please refer to the annex. Please note that the review of the regulatory perimeter by the authorities was not formally part of this review. However, discussion with market participants suggest that similar inconsistencies may subsist under the new framework: in adopting the COFI Bill, authorities are encouraged to also streamline existing implementing regulations also following a principle-based approach.

Table 7 CIS list of relevant Legislation and regulation overview

CIS Legislation and regulation overview		
General Regulatory architecture	Financial Sector Regulation Act, No. 9 of 2017 (FSRA).	Establishes the FCSA and sets its regulatory, supervisory and enforcement powers.
Financial advisory and intermediary law	FAIS	Regulation the Provision of financial services (advice / marketing/ trading)
CIS Law	CISCA	Regulation and control of CIS located in South Africa
Licensing	Notice 911 of 2010	Application form for registration as a manager
	Declaration in terms of section 63	Declaration of hedge funds business as collective investment scheme
Delegation	FSCA Conduct standard 2/2020	Delegation of administrative functions by a CIS manager
Capital requirements	Board Notice 91	Capital adequacy requirements for managers of CIS in securities
	Board Notice 138	Capital requirements for manager of a collective investment scheme in participation bonds
	Board Notice 84	Capital requirements for hedge funds manager
	Notice 910	Determination of fit and proper requirements and conditions for managers of CIS
Fees	Board Notice 39	Determination of permissible deductions from a portfolio
	Board Notice 71	Fees payable in terms of the cis control act 2002
Investments and eligible assets	Board Notice 101	Levies on financial institutions
	Board Notice 920	CIS in Securities
	Board Notice 92	Advertising, marketing of CIS
	Notice 140	Exemption of a category of persons conducting the business of a hedge fund from certain provisions of the CIS control act, 2002
	Notice 70	Determination on the requirements for hedge funds
	Notice 52 of 2015	Determination on the requirements for hedge funds
	Notice 574 replaced by Notice 2073	Foreign countries in which CISS or in CISP may invest
	Board Notice 40	Exemption of manager of a CISP from certain provisions of collective investment schemes control act, 2002 Conversion of Scheme into a REITS
	Board Notice 104	Exemption of managers of the cis in securities from duty to maintain seed capital in exchange traded portfolios

CIS Legislation and regulation overview		
		No Seeding required in ETF
	FSCA CIS Notice 2	Exemption of managers of collective investment schemes from certain requirements relating to the administration of portfolios as required by the Collective Investment Schemes Control Act, 2002- Suspension in time of Covid 19
	FSCA CIS Notice 3	Exemption of managers of collective investment schemes from section 44(2) and (3) of the Collective Investment Schemes Control Act, 2002 – Valuation of illiquid assets.
	FSCA CIS Notice 2	Exemption of managers of collective investment schemes from section 44(2) and (3) of the Collective Investment Schemes Control Act, 2002 – Valuation of CIS portfolio.
	Notice 573 of 2003	Suspension of repurchase of participatory interests by manager of CISS -
Reporting	Board Notice 569	Financial statement
Suspension of redemption	Board Notice 42	Conditions for the winding up of a CISP under certain circumstances
Winding up	Board Notice 92	Advertising, marketing, and information disclosure
Foreign funds	Board Notice 62	Levies on financial institutions
Marketing	Board Notice 257	Conditions in terms of which foreign collective investment schemes may solicit investments in the republic
Marketing / Tax	Board Notice 53	Determination of conditions and the manner in which participatory interests in CIS, CISP and CISPB may be issued to an investor as a tax-free investment

24. The FSCA can also grant an exemption allowing the CIS industry or to an individual firm[38] not to apply some provisions of the Law and of the FSCA regulation. Exemption orders allow the FSCA to adopt rules in order to disable some provisions set in the law, without following a legislative reviewing process; During the Covid crisis, this process has allowed the FSCA to react when market conditions dictated fast action and provide for the necessary exemptions to the CISCA redemptions rules. The FSCA has put in place some safeguards and adopted an internal process that documents the circumstances under which such exemptions may be granted. Over the last few years, this process has become more transparent and for each exemption granted, the FSCA now publishes on its website, the elements that have been considered to grant an exemption.

[38] A table in annex list the exemption granted between 2003 and 2019.

Table 8 Example of Covid 19 responses by the FSCA

- Publication of a joint directive with the Prudential Authority on lockdown specific measures including some practical and specific directives to financial institutions to take appropriate precautionary measures when performing essential financial services.
- Publication of specific guidance on the regulator's expectations on regulated entities in terms of operations during the Covid-19 stress period. This guidance addressed issues such as: Business continuity, complaints management and cyber security. For CIS the FSCA has issued a the FSCA CIS notice 2 OF 2020, exempts managers of collective investment schemes from complying with certain requirements on the suspension of creation, issue, sale and repurchase of CIS units.
- Addressed possible "naked" short selling through issuing a warning statement and engaging market participants on the matter as volatility levels were disrupting the normal operations of securities lending.
- Addressed practical restrictions that a lockdown poses by pushing out certain return and compliance deadlines.

Licensing and capital requirements

25. All CIS managers are approved by the FSCA under the CISCA Act[39]. Managers are responsible for all aspects of the management and administration of the CIS portfolio, which includes:

i) The management or control of a CIS,

ii) Receiving, paying or investment of money or other assets in respect of a CIS,

iii) Sale, repurchase, issue or cancellation of a participatory interest in a CIS,

iv) Advising or disclosing information on CIS to investors or potential investors; and

v) Buying and selling of assets or the handing over of them to a trustee or custodian for safe custody. A manager can operate multiple CIS[40], but a separate registration is required for managing of each different category of CIS. During the licensing process the FSCA verifies that[41]:

[39] CISCA Act and Notices 210, 211 and 141 for HF. CIS are not subject to a formal registration requirement in South Africa. However, the FSCA has to be satisfied that the deed which is one of the constituting documents of the CIS does not contain anything inconsistent with CISCA.

[40] CIS are not authorized by the FSCA but goes through a registration process where the FSCA will check the motivation for creating the CIS additional portfolio, its objectives, Investment policy and parameters; income distribution (iv) any limitation of portfolio size (if applicable); and industry association portfolio classification. Investor market to be targeted, distribution and marketing strategies and the Pro-forma supplemental deed.

[41] Section 42, 51 and 64 of the CISCA There is no specific deadline in the law for the FSCA to process a registration application.

26. CIS managers can delegate all core administrative functions to another approved management company[42]. Delegations are approved by the FSCA and does not discharge a CIS manager from discharging its duties. Delegations can be only be done at one level in order to avoid multiple of layers of sub-delegation. In 2020, the FSCA has adopted additional standards on delegation. It requires managers to adopt a delegation policy approved by its board, as well as processes for assessing the risks involved with the delegation arrangements. The new standards also outline the minimal contractual conditions under which delegation may be done. Although, the FSCA considers the outsourced entity for approval, the regulation does not formally prohibit systematic and complete delegation of all the core functions of a CIS manager, with no prior notice to investors.

27. Managers are subject to minimum capital rules to operate a CIS. CIS Management operations can start with a capital of ZAR 1 million, to be invested in each portfolio administered by the manager. Seeded capital can subsequently be reduced as the CIS AuM increase[43]. Managers must maintain on an ongoing basis, a capital which is at least equivalent to 13 weeks of its operating expenses.[44] CIS managers financials are prepared in accordance with IFRS and reported to the FSCA annually.

Governance and conduct rules

28. CIS Managers are subject to general governance principles that require them to act in an honest and fair manner, with skills, care, and diligence and in the interest of investors. The law prescribes for CIS managers to be subject to a set of general governance principles to ensure that they only operate in the interests of CIS investors. In particular, CIS managers are expected to[45]:

- Avoid conflict between the interests of the manager and the interests of investors;
- Disclose the interests of its directors and management to the investors;
- Maintain adequate financial resources to meet its commitments and to manage the risks to which its CIS is exposed;
- Organize and control the CIS in a responsible manner;
- Keep proper records;
- Employ adequately trained staff and ensure that they are properly supervised;
- Have well-defined compliance procedures;

[42] Section 4(5) of CISCA

[43] Seeded capital may be withdrawn when the portfolio reaches ZAR 50 million of AuM.

[44] Section 88 of the CISCA, notice 91 For HF Manager and Notice 84 for CIS Manager.

[45] Notice 911 of 2010.

- Maintain an open and cooperative relationship with the office of the Registrar and promptly inform it about anything that might reasonably be expected to be disclosed to such office;
- Promote investor education.

29. The FSCA Board notice 910 further prescribes specific governance requirements. As such, CIS managers must have a minimum of four directors, of which at least 50% must be non-executive directors or independent trustee that provides an oversight of the CIS managers activities. Collectively, members of the board must have sufficient experience and expertise in CIS management". CIS managers also must appoint an independent auditor which is approved by the FSCA. Besides these requirements, the regulation does not provide for further guidance on how CIS managers are to comply with their best execution obligations, the duties to timely allocate transactions between funds, avoid churning practices and related party transactions[46].

30. CIS managers must have appropriate human and technical resources with adequate and experienced staff. [47] In practice, CIS managers share with the FSCA, the names and curriculum vitae of the chairperson, directors and managing director during their approval process, as well as the names and curriculum vitae of all staff with information on their experience in their functions. Change of CIS manager's directors are subject to the FSCA prior approval[48].

31. CIS managers' organizational rules include requirements on risk management and internal control. It requires the manager to have appropriate internal policies and procedures, record keeping and documented business processes, policies, and controls as well as disaster recovery, in place. All CIS managers must have in place risk management systems and programs to control that the portfolios are in line with their investment rules and objectives[49]. Besides these general requirements, no more specific rules are provided on compliance function arrangements that needs to be in place.

[46] Notice 910 Part III only requires only the disclosure the interests of its directors and management to the investors. No other form of conflict of interest managing guidance are provided.

[47] Notice 910 and 911. The FSCA is working to enhancements these requirements as new Conduct Standards under future COFI Bill

[48] But no information to investors is required.

[49] Board Notices 910 and 911.

Management, investment, and valuation rules of CIS assets

32. CIS are only allowed to invest in specific assets in strict accordance with their strategy. CIS must be invested financial instruments. As an example, CIBP must invest between 65 and 75 % of their portfolio in the value of the immovable property mortgaged or to be mortgaged under a participation bond[50]. CISS to invest in equities and fixed income or have mixed strategies. CISS can also invest in foreign securities subject to specific due diligence requirements that include verifying the clearing and settlement arrangements and the procedures for the funds' repatriation in South Africa. CISS can also take the form of a money market fund, fund of fund or a feeder fund, subject to additional investment and management rules. The FSCA is currently revising its regulation to better reflect all the IOSCO policy recommendations on money market funds.

Table 9 Extract from the IOSCO 2019 Peer Review of Regulation of Money Market Funds (recommendations on valuation and liquidity management)

In 2018, the FSCA reported that on 23 June 2017, (as the FSB) it had issued an Invitation for Public Comment on the Proposed Net Asset Valuation Calculation and Pricing for CIS Portfolios. The proposed notice for the first time sets out legislative requirements for the valuation of CIS, which up until now have been set by industry standards. Most notably, the proposed notice sets out in Article 6.1(1) an overriding principle that "any asset must be valued at its fair market price". This principle is then supported by practical guidance in Article 6.2, which among other things, requires (a) "that price of each security is retrieved on a consistent basis and at valuation point on each valuation day in a manner which is consistent with the deed". While amortized cost is allowed, it appears to be restricted to constant NAV funds with the Article 6.2 guidance setting out several alternatives in the case that a market value is unavailable or that value does not represent fair value. While the proposed notice sets out Article 9.5 MMF Portfolio Pricing for CNAV, it does not appear to set new or amend any existing safeguards for reinforcing the resilience of stable NAV MMFs and the ability for managers to face significant redemptions[51]. These safeguards were earlier reported in Board Notice 573 of 2003, including the ability to suspend redemptions and stepped redemption; the legal authority to declare the application of side pocketing on an ad hoc basis; and MMFs being permitted to borrow up to 10% of the value of its portfolio assets to provide liquidity for redemptions. The FSCA confirmed that Board Notice 573 of 2003 has not been repealed. Furthermore, the FSCA report that its ability to declare other measures to address risks on short term basis is entrenched in the Financial Sector Regulation Act, 21 which will be developed further under the Conduct of Financial Institutions Bill (currently being drafted).

[50] Reduced by the maximum possible indebtedness secured under a possible pari-passu ranking charge. Other investments in the fund must be kept in the form of a deposit or in a money market fund and allocated within a 60 days' time allowance for not complying with the investment limits.

[51] Theis issue should be addressed in an amended version of the Board notice 90 for portfolio asset related matters and in in an amended version of the Board notice 573 for other measures.

33. CIS are also subject to investment limits and risk diversification rules, including sectorial ones. CIS can lend assets according to the regulation and terms of the deed[52] and enter into repo agreements. They are authorized to borrow up to 10 % liquidity (cash) to face redemption requests. Classic CIS can use listed and OTC instruments, including derivative contacts, with a leverage limit fixed at 100% of their NAV and for hedging purpose only. It is the CIS managers responsibility to demonstrate to the FSCA that the positions are taken to hedge a CIS portfolio. Derivative contracts used by CIS are mainly currency swaps and futures. For classic CIS, such as CISS, CFDs are not allowed. CISHF can use derivatives for any purpose, including speculative ones.[53]

34. CIS Investments, valuation, and limits are monitored daily by the CIS trustee or the CIS custodian. CIS Managers are also required to report CIS portfolio holdings and NaV to the FSCA, on a quarterly basis. The valuation of CIS assets is controlled annually by the CIS auditors. Assets held by CIS must be valued at a 'fair market price' and the CIS NAV is calculated in accordance with the new FSCA standards [54], which includes guidance for dealing with pricing error. FSCA has also adopted standards for CIS asset valuation when market price is not available[55], with for example, the use of a third-party valuator. For CIS distributed to the public, the NaV must published at least daily in one national newspaper and the CIS manager's website[56]. Additional rules apply to the valuation periodicity for other assets that can be held by some CIS, such as immovable property[57].

35. For HFQI, the redemption periodicity is at least every 3 months and no more than once on a monthly base, with also at least a daily valuation of the fund's assets. Information about the CIS calculation of NaV are to be disclosed to investors in the deed. Pricing processes and procedures are also to be conform to generally accepted accounting practice, although CIS accounting standards are yet to be adopted. Finally, if the aggregate amount the redemption requests exceed 5% of the CIS portfolio, subscription can be suspended. The regulation also allows for gating provisions as long as they are disclosed in the funds' deeds.

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[52] Section 5, 46 85 and section 95 of CISCA and Board Notice 80.

[53] HF are defined schemes that can **"***use any strategy or take any position which could result in the arrangement incurring losses greater than its aggregate market value at any point in time, and which strategies or positions include but are not limited to (a) leverage; or (b) net short positions* ". The exposure of Retail Hedge Fund is limited to 100% of assets. They are no exposure formal limits for Qualified Investor Hedge funds[53].

[54] FSCA Conduct standard n1 of 2020 on Net Asset Valuation Calculation and Pricing for Collective Investment Scheme Portfolios.

[55] FSCA Notice 03/2020.

[56] Board Notice 92.

[57] For CISPB, immovable property, which is subject to a mortgage bond, is valued at least once every five years and whenever a loan is three months in arrears; when additional amounts are advanced to a borrower; or at any other time at the manager's request if he views that the value of the immovable property may be affected.

Custody functions of the CIS assets

36. CIS assets must be safekept by a trustee or a depository, in segregated accounts. CIS depository must meet eligible criteria set under CISCA[58]. They must public company, a bank, a long-term insurance company, with minimum capital of 10 million-rand. They are registered with FSCA. In practice all CIS trustees are banks. CISCA provides that : " *The registrar may not register any company or institution as a trustee or custodian (…) unless he or she is satisfied that (i) the company or institution is not, in relation to the manager, either a holding company or a subsidiary or fellow subsidiary company and (ii) the general financial and commercial standing and independence of the company or institution is such that it is fit for performing the functions of a trustee or custodian and that the company or institution is by reason of the nature of its business sufficiently experienced and equipped to perform such functions."* As a result, CIS depository must not be a holding or a subsidiary of the CIS manager, but CIS managers, trustee and depository can still be affiliates and part of the same ownership group. In practice, The FSCA has taken a conservative approach and understanding of the CISCA provision and requires for the trustee or the custodian of a CIS not to be part of the CIS managers' group.

37. The CIS depository's main missions are to control the regularity of the CIS managers decisions, to safekeep CIS moneys and assets in the best interest of investors, and to verify that subscriptions and redemptions are done in accordance with the CIS rules. CIS assets are to be held in custody in an account segregated from the depository 's own assets and identifiable as such[59]. The depository must indemnify CIS investors against any loss or damage suffered in respect of money or other assets hold in the custody, "caused by a wilful or negligent act or omission". The regulation does not provide more specific rules with regards to delegation of the asset's custody or on the right for the depository to re-use CIS assets.

C. Disclosures to CIS investors

Initial disclosure

38. CISCA prescribes that CIS unitholders must be provided with the necessary information to make an informed decision. **Disclosures must be fair, consistent, transparent, and accurate.** According to the law, the list of the information to be disclosed by the CIS managers to investors includes:

- The investment objectives,

[58] Section 68 to 70 of CISCA

[59] Section 2 of CISCA. section 104 of CISCA provides that the assets of investors must be excluded from the assets of a manager or trustee in the event of a claim against either the CIS manager or trustee; this includes instances of insolvency.

- The calculation of the net asset value,
- CIS and managers charges,
- The risk factors,
- Distribution of income accruals.

39. In practice, prior or at the time of their investment, investors are provided with:

- *Marketing and advertising material*: CIS Marketing material should not be misleading[60]. It must include some mandatory disclosures such as on the fact the manager does not provide any guarantee with respect to the capital or the return of a portfolio[61]. Marketing material must also clearly explain the nature of the CIS, where information of charges and fees can be obtained, a fair indication of the nature and risks of the investment identifying any specific areas of risk relating to the investment, and the CIS performance[62]. All CIS marketing material, MDDs are sent to the FSCA prior to publication or use of the material.
- *The Minimum Disclosure Document ("MDD"):* The MDD's objectives are similar to the Key Information Document (KID) used in Europe and the simplified prospectus that can be found in some non-European countries. This is very a concise document (a few pages) which purposes is to describe the CIS's main characteristics in plain language.

Table 10 Extract from Notice 92 on MDD format and minimum content

- Registered portfolio name. - Investment objective and a summary of the investment policy of the portfolio. - Risk reward profile of the investment, including appropriate guidance on and warnings of the risks associated with investment. - The portfolio benchmark, where applicable. - Fees and charges associated with the most expensive class available (total expense ratio, management fees, initial fees, performance fees, advisory fees, and any other applicable fees); - Portfolios launch or inception date. - Portfolio category or classification. - Portfolio size. - Distribution dates - Performance of the portfolio. - Name of the manager, trustee and/or custodian and their relevant and contact details. - Portfolio valuation and transaction cut-off time.

[60] Board Notice 92.

[61] Board Notice 91.

[62] They are additional statements to be made in MMF's marketing material such as the fact that money market portfolio is not a bank deposit account; if the MMF is a CNaV or a VNaV, that excessive withdrawals from the portfolio may place the portfolio under liquidity pressures and that in such circumstances a process of ring-fencing of withdrawal specific pay-outs process may be followed.

- Asset allocation.
- Mandatory disclosures set out in paragraph 6 of the notice.
- Frequency of publication of prices and where or how prices are published or made available; and
- Where and how to obtain, free of charge, additional information on the proposed investment including, but not limited to, brochures, application forms and the annual report and any half-yearly report.

- Notice 92 is currently under review to align the minimal information disclosures for CIS and CISHF, that as currently stated under the FSCA notice 52. The objective of the FSCA review work is also to better align with international best practice well as with the 2014 IOSCO policy recommendation of MMF on liquidity and risk management, and ESG matters. In addition, the FSCA is working on introducing a prospectus for CIS in a standardized format, that will list all CIS operating rules in accordance with international best practice and will further help investors in their investment choice.

- *CIS deed:* It sets the basic CIS rules. The deed is reviewed by the FSCA at the initial stage of the registration of the CIS, and in case of changes. Information that should appear in the deed are prescribed under CISCA. They relate to the investment policy, asset valuation methodology of the asset, periodicity for redemption and eventual gating provisions, and the charges. There is no disclosure of the investors' rights attached to the legal form of a CIS[63], delegation of management functions. In practice the FSCA requires and verifies during the CIS 's application process that the CIS documentation to state the CIS investment objectives of the fund, time horizon and benchmark, as well as information on the CIS risk reward profile.

[63] CIS Manager has to be constituted as a company, in practice, all CIS are established as trust, although technically there are no specific restrictions on the permitted legal forms for CIS.

Table 11 Extract form CISCA Annex 1 - Information content of the Deed for CISS

- Investment policy to be followed in respect of each portfolio. - Manner in which the assets of a portfolio are to be valued for purposes of calculating the selling and repurchase prices of participatory interests. - Frequency of calculation of selling and repurchase prices of participatory (subscription and redemption of units) - Interests, and the point in time at which such calculations will be performed on a specific day (valuation point). - If assets other than securities listed on an exchange may be included in any portfolio, the basis on which the market value of such assets is to be determined for the purposes of determining selling and repurchase prices. - Manner in which and a point in time at which the valuation point will be applied either to the creation, sale, repurchase or cancellation of participatory interests. (valuation methodology and periodicity) - Manner in which distributions are to be calculated and settled. - Limits, terms, and conditions under which securities may be lent. - Limits, terms, and conditions under which a manager may borrow money - Charges that may be levied and the method of calculation of those charges. - That not less than three months' written notice must be given to every investor of an increase in any charge and of any change in the method of calculation which could result in an increase or the introduction of any additional charge; and - The manner in which a deed may be amended.

Both CIS Deed and the MDD are considered to be part of the CIS offering documentation but in South Africa, the MDD has also serve as a report to the CIS investors and is automatically updated quarterly[64].

40. The law lists a few changes in the CIS operating rules that are considered to be material and require prior notification of the investors. CISCA considers as material, events such as a merger, a cession, a transfer, and takeover of a CIS[65]. In that case, the supplemental deed must be approved by the majority in value of the investors and in the manner prescribed in the Deed. Section 98 of CISCA also requires the consent of investors when there is a "fundamental change" to the deed. Although Fundamental changes are not defined in CISCA, the FSCA has indicated that it has consistently considered that a change of the investment objective and policy is a fundamental change to the deed. A similar approach has been adopted by the authority for changes in the investment policy of the fund. As a result, the FSCA considers that changes in the investment policy do require a consultation and an

[64]The MDD is required to be updated quarterly but are not required to be dated.

[65] Section 99 of CISCA. Board Notice 577 of 2003 includes specific notification requirements in case of a termination of a CIS in participation bonds.

agreement of the CIS investors. Finally, in accordance with CISCA, CIS manager is only required to give a three months' prior notice to investors in the case of an increase in the fees and charges. It does not require a prior notification or allows investors to redeem their shares at no cost in case of other important changes, for example in the CIS other operating rules occur, such as a complete delegation of all the core management functions or of the fund's objectives.

Ongoing disclosures

41. CIS are subject to ongoing disclosure obligation to investors that includes the MDD, a quarterly investment statement and annual financial statements. As mentioned, CIS investors gets an updated MDD's every quarter which is published on CIS managers' website [66] . They also receive every quarter, a personal investment statement. This statement includes information such as the number of participatory interests held in the CIS, the CIS net asset value per participatory interest, the total expense ratio applicable to the portfolio, changes in the composition of the portfolio and if the portfolio has adhered to the CIS policy objective[67]. Investors are also provided with the CIS audited financial reports annually[68].

D. Marketing

Marketing of CIS in South Africa

42. Distribution of CIS can be done either by the CIS manager itself or by an authorized Financial Service Provider ('FSP')[69]. Both are subject to different set of requirements in terms of information disclosure and suitability assessment. As mentioned, under CISCA, the CIS manager is responsible for providing investors with a basic set of information, necessary to enable the investor to make an informed decision, placing the onus of the products' suitability on investors. Under the FAIS Act, an FSP has the obligation to seek from its clients appropriate and available information on their financial situation, experience, and objectives[70]. FSP's code of conduct specifically provides that:

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[66] For HF, notice 52 details the information to be provide to investors on a quarterly base too.

[67] Notice 65. For CISPB investors, the regulation requires more specifically for the statement to show the capital owned and interest and how it has been calculated.

[68] Notice 569.

[69] JSE members may also distribute CIS.

[70] Notice 79/2003

- For discretionary management services, the mandate states the investment objectives of the client and whether there are any investment or jurisdiction restrictions that apply to the rendering of intermediary services in relation to the financial products involved.
- For other selling practice, the FSP must render to the client, *on request* and in a comprehensible and timely manner, any *reasonable* information regarding the financial products, market practices and the risks inherent in the different markets and products concerned. It must also obtain and transmit to a client any information which a relevant product supplier must disclosed[71]. Again, and following CISCA requirements, these information only relate to the investment objectives, the calculation of the net asset value, fees and charges, risk factors, and distribution of income accruals, available in the MDD.

43. Although very detailed, the FSPs code of conduct does not require CIS distributors to have a clear distribution strategy with a target market identification process in place to decide what range of services and products are going to distributed, what products are going to be either recommended, offered or actively marketed to certain groups of clients, and what should be the clients' characterized features in terms of knowledge, experience, income. It does not provide specific guidance on the relationship between CIS manufacturers and CIS distributors, with, for example an obligation for the CIS distributor to provide the CIS manufacturer with some feedback on the CIS sales information for the CIS manufacturer update and improve its product governance process.

Marketing of Foreign funds in South Africa

44. The FSCA can approve an application by the manager or operator of a foreign CIS (FCIS) to distribute foreign funds to the public in South Africa. In 2018, over 490 FCIS portfolios have been approved for distribution in South Africa, representing over R442 billions total assets under management. The approval is guided by Notice 257 which requires for the FCIS to be authorized and supervised by its home regulator, to be available for distribution in its registered location of registration to a similar public, and to operate under regulatory environment that is similar standing to the South African one. FCIS must also have a representative office in South Africa. Offshore funds that are approved for marketing to the public in South Africa, can also be marketed by any authorized FSP[72].

[71] Unless the client opts out.

[72] The term "solicit" is defined to include any action to promote investment.

E. CIS supervisory and enforcement framework

Resources and risk-based supervision methodology

45. The FSCA has implemented a risk-based methodology to supervised CIS managers, based on off and on site qualitative and quantitative review**, and is supporting the development of a strong compliance culture among local market participants.** Based on the 2020 FSCA report, the supervision of CIS managers and FSPs has been reorganized between several departments. Staff has been reallocated as follows:

i) the Supervision of Investment Providers ('SIP') division, that supervises CIF, including HF managers, and discretionary investment management[73], and

ii) the Supervision of Financial Advisers and Intermediaries ('SFAI') division, that supervises other financial advisory and intermediary services, and entities who are authorized for the activity of product sales and execution on a non-advice basis (FSPs).

Both departments are part of the Conduct of Business Supervision Division and have the support of dedicated technical experts and analysts.

Every year, a supervisory plan provides for the next cycle of on-site visits for CIS managers as well as a detailed reporting of the work which has been undertaken and where issues have been identified. As such, the SIP team has developed a SWOT[74] methodology which is a market intelligence tool that is used to implement more efficiently a risk-based approach in the FSCA supervision. It allows the FSCA staff to have a better understanding of local industry trends and practice, and identify when CIS managers show some difficulties, for example when implementing new and existing regulatory requirements.

The risk-based supervision process starts with a comprehensive risk scoring of CIS managers in ordered to define their risk profile. It considers the business model of the manager, the size of its activities, the nature of its clients, and potential changes in management, key staffs, and activities. It is based on information collected through the offsite desk review and on-site visits. The risk scoring process also takes into account the quality of the compliance procedures CIS managers has in place, the controls they have performed and corrective measures that have been taken. The risk scoring of each CIS managers helps FSCA staff to i) build a risk-based annual supervisory plan and ii) allocate adequate resource to supervise sectors and areas which are identified as the riskiest.

[73] FSP Category 1, such as broker and advisers.

[74] Strength, Weakness, Opportunities, Threats

For other FSPs, including FSPs that market CIS to the public[75], the SFAI has also adopted a risk-based approach that categorizes FSPs according to risks inherent in their business activities and the impact of a failure on investors. The supervision of these FSPs also include documented desk-based review as well on-site monitoring.

Offsite supervision

46. The FCSA has extensive supervisory tools and powers to oversee the CIS industry, starting with a number of reportings. The FSCA receives:

- Monthly managers capital adequacy reports[76];
- Quarterly reviews of portfolio holdings with portfolio investment policies and investment limit[77] ;
- Quarterly self-compliance report[78];
- Annual reports and financial audited by the funds' the external auditors[79];
- Quarterly and annual reports from the trustees or the custodians of the funds[80];
- All marketing material;
- Quarterly updated MDD / fund fact sheet;

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[75] These are Category I and IV FSPs that are authorized for all financial products, but act without discretion. They are over 10.000 FPS licensed in Category I and IV. Category IV includes FSPs that provide specific administrative functions in relation to assistance business (funeral) policies.

[76] CIS manager must submit the calculation of its capital position to the Registrar as at the last business day of each calendar month within 14 business days after the end of the month (Board Notices 2072, 2074 and 2076).

[77] include the market value of each asset.

included in each portfolio as well as the value of each asset expressed as a percentage

of the total value of assets in the portfolio and as a percentage of the total amount of assets of that class issued by the group in which the investment is held. The report has to indicate which assets are exchange securities and on which exchange such assets are listed. If any asset is not listed on an exchange, the manager must indicate the mechanism used in the pricing of such asset.

[78] Board Notice 90 para 20. For example, on compliance of internal system for the use of derivatives. within 30 days after the end of each calendar quarter, furnish to the Registrar a full list of all underlying assets included in any

portfolio administered by it.

[79] within 90 days after the close of its financial year.

[80] A trustee or custodian is required to prepare a report on the administration of the CIS by the manager during each annual accounting period, which must state whether the CIS has been administered in accordance with the limitations imposed on the investment and borrowing powers of the manager by CISCA and the CIS deed. If the manager does not comply with these requirements, the report must state the reason for non-compliance and outline the steps taken by the manager to rectify the situation. This report has to be sent to the Registrar and to the manager in good time to enable the manager to include a copy of the report in its annual report.

- All notices of deed change (for example in case of change of its name, the name of the portfolio. changes of its directors and shareholders) [81].

CISHF are subject to additional reporting[82] that includes:

- The list of all gross and net assets in the portfolio, with all long and short positions, reflecting the market value of each asset and exposure,
- The VaR limits, explanation on the methodology for calculating exposures or value-at-risk, showing how limits have been complied with
- Sources of leverage, including the type, the amount, and the providers of leverage.
- Level of collateralization and the re-hypothecation of assets; level of counterparty exposure.
- The current risk profile of the portfolio and the systems employed by the manager to manage risks, including market, liquidity, counterparty, derivatives, operational and other risks.

The daily compliance monitoring to the funds rules, investment policy and the daily control of the valuation of the CIS assets are performed by CIS trustee and custodian.

The FSCA is currently working on implementing an automated system to review all reportings and CIS annual financial statements.

Table 12 Number and type of Documents files by CIS managers and reviewed by the FSCA in 2018

	Securities	Participation bonds	Property	HF
Advertisement	295	16	3	3
Website updates	379	1	6	6
MDD	8261	3	19	19
Marketing material	2512	8	101	101

FSCA annual report 2020

47. CIS monitoring consists in a quantitative analysis but also in a detailed qualitative assessment of the information periodically submitted. As an example, in 2019, FSCA reports provided by FSCA staff showed that most **supervisory** issues related to smaller CIS managers to comply with the R1million seeding requirements. Desk reviews also revealed that risk disclosures were

[81] Sections 6 and 43 of CISCA.

[82] Notice 52.

too generic, leading to additional thematic on-site visits to understand how managers were, in practice, assessing the risk of different portfolio.

Table 13 Financials and risk reports files with FSCA by CIS Managers in 2019

Investment Providers		
Collective Investment Schemes		
	2018/19	2019/20
Capital Adequacy Reports	760	708
Mark to Market Valuation Reports	532	550
Quarterly Portfolio Holding Reports	6 103	6 254
Annual Financial Statements	51	54
Collective Investment Schemes in Hedge Funds		
Annual Financial Statements	15	16
Monthly Risk Reports	1 080	148
Quarterly Portfolio Holding Reports	1 031	229

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As shown in table 13, The SFAI off site monitoring of the FSPs mainly consists in the review of financial statements. Most actions were taken due to firms not meeting to provide their financial requirements on time. Table 14 shows the supervisory activities undertaken for FSPs.[83]

Table 14 Document filed and reviewed by the SFAI in 2019

	2018/19	2019/20
Authorised Cat I and IV FSPs	11 068	10 534
Desk-based supervision		
Financial statements	9 415	8 424
Compliance reports	10 486	01
Extension requests	655	569
Material irregularity reports	123	100
Referrals for regulatory action		
FSPs	78	133
Individuals	0	2
On-site inspections		
FIC inspections with an educational aim	297	0
FIC inspections for compliance with the FIC Act	0	74
Ad hoc inspections for FAIS issues	0	4
Communication with industry		
SME workshops	5	10

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[83] Compliance report for the year 2020 has been withhold by the FSCA.

Onsite inspections, and supervisory plan

48. FSCA conducts routine and thematic on-site inspections[84]. The annual inspection plan is based the managers' risk rank, as well as on a routine inspection cycle. Ad-hoc inspections can also be performed in case of suspected breach. Selected CIS managers can be subject to a full scope or to a thematic review, based on concerns that may have been uncovered during a regular on-site visit program, a desk-based review, complaints, press reports and the prevailing trends and innovations in CIS industry. The reviews conducted in 2018-2019 focused on delegated management functions, based on the fact that over 32% of managers delegated their core functions to third parties, representing over 43 % of the number of registered CIS. The table below summaries the number and type of CIS managers on-site visits conducted over the last three years. On site visits concerned a mix of CIS and CIS HF Managers, to verify that they complied with the CISCA and FICA rules, which relates to anti-money laundering matters. No on-site visits appear to have been conducted on CIS trustees and entities holding CIS assets in custody.

Table 15 Number and type of inspection carried out for CIS

	On site Routine inspection	On site Thematic inspection	Entity types	Total Inspections
2019	10	10 on 3rd party due diligence on Mancos that offered co-named funds	20 CISS	20
2018	26	0	24 CISS 1 CISP 1 CISPB	26
2017	21	5 CIS administrators	20 CISS 1 CISPB	26

FSCA self-assessment questionnaire 2019

FSPs are also subject to onsite inspections, based on offsite monitoring findings, as well as tips off and complaints[85]. Inspections are done to verify the compliance with the FAIS Act as well as the FICA rules. Visits to small FSPs with no compliance officers are conducted by one inspector only and over one day. Main concerns identified in 2019 related to the absence of proper Risk Management and Compliance Plans (RMCP) with adequate and documented process to assess clients' risk profile[86].

[84] Chapter 9 of the FSRA.

[85] Alleged non-compliance of the FAIS Act referred by the Business Centre.in 2019, 1 664 complaints were received.

[86] FSCA annual report 2020.

Table 16 Number and type of inspection carried out for FSPs

Number and themes of onsite inspections	2017	2018	2019
FSP category I, small firms with no compliance officers	60 Provide guidance in developing compliance culture	60 Provide guidance in developing compliance culture	297 in total for all Cat I, II and III
other FSP category I	60 Focus on compliance requirements by FSP representatives	60 Focus on compliance requirements by FSP representatives	Provide guidance in complying with the FIG act

FSCA self-assessment questionnaire 2019

Enfoncement actions

49. The FSCA has comprehensive enforcement powers that includes a set of hard and soft enforcement tools. Sanctions are applied depending on the seriousness of the breach. FSCA as an enforcement toolbox that includes warnings, administrative penalty, registration and licensing withdrawal.[87] FSCA can also apply to the court for the winding-up of a CIS manager or a CIS, apply to the court for the appointment of a curator for the business of a CIS manager and require a manager to appoint a new trustee. The FSCA enforcement staff first uses communication and capacity building actions, with warning and objection letters to deter managers' misconducts. Discussions with FSCA staff suggested that, the used of soft enforcement tools has resulted in an overall improvement in the quality of the CIS information. The table below summaries the number sanctions pronounced over the last two years.

[87] Managers can also be subject to criminal sanctions. Section 120 and 121 CISCA.

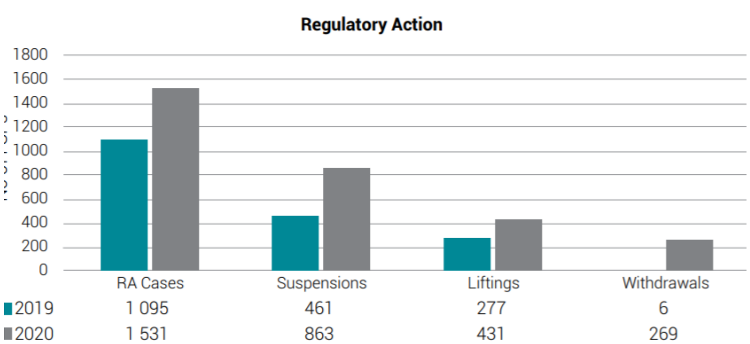
Table 17 Number and type of enforcement actions carried out for CIS

Enforcement actions	
2018	1 Dissemination of misleading information: R500 000 fine for charging performance fees that were not stipulated and provided for in the Supplemental deed of the portfolio by a top five AM 1 (MDD)
2019	R100 million fine – for an AM did not have proper risk management process on derivatives 2 Dissemination of misleading information (Advertisement and MDD) have been sanctioned with R50.000 Fines.

Source: FSCA 2020 and FSCA self-assessment questionnaire 2019

In 2019, enforcement actions have also been undertaken against FSPs, with over 250 licenses being withdrawn where FSPs were found not to be acting with honesty and integrity, or that failed to comply with the conditions for the lifting of a suspension.

Table 18 Number and type of enforcement actions carried out for FSPs



50. The enforcement decision making process involves FSCA staff only. Persons aggrieved by an FSCA decisions can appealed to the Financial tribunal. Only FSCA staff is involved during the onsite investigation but also when making recommendations and deciding on enforcement actions and penalty fines. At no moment the staff's recommendations to sanction a market participant is also reviewed by an independent non FSCA staff expert. So far, very few cases have been appealed to the Financial tribunal, although the appeal process is starting to be used more often. In one instance, the Financial Tribunal has lowered the level of monetary fine imposed by the FSCA. All enforcement action and appeals are accessible online.

F. Discussions and recommendations for CIS monitoring

51. CIS managers and CIS distributors both operate under a comprehensive market conduct framework; However, conflict of interest rules for CIS management need to be further clarified.

The law provides general principles which acknowledge that CIS managers must avoid conflict of interest, act in the best interest of investors, act with honesty and integrity, have adequate human and technical resources, and have adequate risk management in place. However, there is no rules on CIS managers' best execution obligations, on timely trading and transactions' allocation, related party transactions or on the prevention of churning[88]. Guidance on these matters is important to preserve an adequate level of protection of the investors' interest, in particular retail ones. Finally, the FSCA has adopted standards on CIS asset valuation and NAV calculation, but is still working on setting of accounting standard applicable to CIS.

Recommendations are:

- Adopt guidelines on best execution duties, transactions allocation and transactions' record, related party transaction and churning in the specific context of context of CIS management;[89]
- Finalize the adoption of the accounting standard applicable to CIS portfolio.

52. The authorities are improving the CIS information disclosure framework; CIS manufacturers and distributors duties should be further clarified, and all entities offering CIS to investors should be subject to similar suitability assessments requirements. [90] The authorities have implemented a minimum document disclosure ('MDD") and are working on the adoption of a CIS prospectus which will provide more clarity on the content and format of information presented to investors. All entities allowed to distribute CIS, including CIS managers, should be subject to the same disclosures requirements and authorities are encouraged to continue their work in order to align CIS disclosures to best international practices, in particular to improve the way information on charges, fees and rebates are presented to the investors. This should greatly improve the comparability of the CIS' offer.

53. All entities offering CIS to investors should also be subject to the same suitability assessment requirements, as well as to clear distribution governance process. This is becoming crucial as more CIS are now distributed through electronic platforms. For instance, when creating a new CIS, CIS manufacturers should have in place a product approval process that assess and identifies target markets and investors and define what the CIS marketing strategy will be. Distributors should also be required to have a distribution strategy in place, clearly defining their choices on the range of services and products to distribute, what products are going to be only recommended or more actively

[88] Elements on conflict of interest covered under principle 24, Question 14 of the IOSCO Assessment methodology.

[89] Examples of guidance adopted in the countries are provided in Annex 3.

[90] Please refer to Principle 25 of the IOSCO Assessment methodology on material changes.

marketed, identify groups of targeted clients, based on characterized features such as knowledge, experience, income, but also considering including liquidity risk, as well as how innovative the CIS is.[91]

Recommendations are to:

- Clarify the duties of CIS manufacturers and distributors duties and product governance process.
- Adopt similar suitability assessment requirements for all entities offering CIS to investors.

54. The Law requires for CIS assets to be kept safe and placed in a segregated account[92] . It should also require the CIS Depository to perform specific diligence when placing assets in sub-custody. CISCA rules preventing the CIS manager and the depository to be part of the same ownership group should **be clarified [93].** CISCA rules do require for the CIS assets' depository to be entity separate from the manager but does not prevent both entities to affiliates. In Practice, The FSCA has developed an understanding of the Law preventing both entities to be part of the same group in order to prevent potential conflict of interest, However, this approach should be reflected in the Law. Sub-custody of assets raises investors protection issues even if CIS investors have, in theory, a legal claim against the depository in case of asset loss, it can take years to be settled. To improve investors' protection against asset loss, the Law should impose minimum due diligence requirements to be performed before transferring the CIS asset to a sub-custodian[94].

Recommendations are:

- Require the CIS trustee or depository to perform due diligence when CIS assets are held in assets' sub custody.
- Clarify in the Law that the fact that CIS manager and CIS trustee or the CIS depository cannot be part of the same ownership group as holdings, subsidiaries and even affiliates.

55. The list of changes[95] to the CIS operating rules that can be considered as 'material' and the corresponding information to be provided to investors should be clarified. The Law provides

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[91] Detailed examples are provided in Annex 1 and 2. Extract of the EU DIRECTIVE 2014/65/EU on financial instruments manufacturing; Extract if the 2018 ESMA guidelines on product manufacturing and product distributor.

[92] The law also places a general limit on the depository right to use and recall the CIS assets, which are the same as the general limit placed on other counterparties. In terms of clause 6.6.2 no more than 50% of the value of assets may be lent out and 6.6.6 requires that there must always be a right of recall.

[93] Please refer to Principle 25 of the IOSCO Assessment methodology on CIS asset safekeeping.

[94] These are critical information to disclose in the CIS prospectus.

[95] Questions relating to disclosure are dealt in Principle 26 of the IOSCO Assessment methodology

for minimal set of information to be provided to investors and in practice the FSCA requires CIS managers to include additional information such as fund's objectives and investments policy risks in the CIS documentation. Notably, The FSCA does consider that changes made to this information is important and requires investors information. However, and despite the FSCA efforts to improve the level of the investors' protection, the current legislative and regulatory framework still lacks clarity and that authorities should adopt clearer guidance with a list of changes in the CIS operating rules that require a notification and consent of investors.

Recommendations are:

- Finalize the adoption of a CIS standardized prospectus, listing all the CIS operating rules in accordance with international best practice.
- Define a list of changes in the CIS operating rules that are considered as material and that require prior notifications, consent of the investors, and eventually redemption at no cost.

56. The FSCA has implemented a robust risk-based supervision for CIS managers[96]. The risk scoring methodology **could be enhanced with additional macro financial elements.** The FSCA has adopted a robust and detailed risk-based supervision for CIS and CIS managers. A few improvements should be envisaged:

- A successful risk approach supervision first relies on quality of audits and controls performed at firm's level., and to that end the regulation should provide for more explicit guarantees for the compliance function to operate with the necessary authority and independence form the executive management of the company[97].
- At micro level, the CIS managers' profiling methodology could be further improved by refining the impact measurement. For example, the existing matrix sets the absence of CIS assets segregation, which could result in a fraud and loss of assets for investors, as having an equivalent impact as the late submission of a compliance report.
- The risk profiling methodology should also by consider taking into consideration macro financial elements for example in relation to the changes in the global or financial environment, the economy of the country, for example a change in monetary policy, potential real estate

[96] Questions relating to CIS supervision are dealt in Principle 26 of the IOSCO Assessment methodology.

[97] Example of such regulatory framework is provided in the annex 7. The requirement to have a regulatory system that ensure the implementation of an effective compliance program, is under Principle 12 of the IOSCO Assessment methodology.

assets bubble, Covid 19 …[98] The process involves the identification of the most predominant macro or 'environmental' risks that are i) the most likely to happen, ii) can have the most critical of a specific CIS asset class, and iii) can also have the most critical impact on the CIS market. This identification and stress testing process is generally done with a team economist. To take an example, in some countries that have implemented a full risk based approach supervisory process, monetary policy change are often identified as one the most significant risk for CIS portfolio with a predominant asset allocation in bonds (corporate and government) and short term deposits, which can represent a large size of the asset class in an emerging market.to take another example, a sharp change in the monetary policy may add pressure on the business model of some CIS distributors and translate into more aggressive sell practices , therefore mandating specific attention and possible targeted reviews on product suitability assessment by the authorities.

- Finally, the supervision of CIS could be completed with additional assessments of CIS trustees and depositories functions.

Recommendations are:

- Consider including additional macro/ environmental elements in the CIS managers risk profiling matrix;
- Clarify the guarantees and protections provided to compliance officers when performing their function, for example to operate independently, with all necessary authority, resources, expertise, and access to relevant information;[99]
- Extent the risk-based assessment and annual supervisory plan to CIS trustees and depositories

57. The FSCA enforcement decision-process could be reinforced. The fact that only the FSCA staff is involved in the enforcement decision process can ultimately expose the FSCA to questions on the neutrality and objectivity of its decisions. As the market matures, and FSCA decisions will come under more scrutiny, and the FSCA could consider the creation of an enforcement committee composed of experts that are non-FSCA staff, to better protect it enforcement decision-process against procedural challenges, especially for sensitive matters like market abuse[100].

[98] This type of arrangements is in place in Jurisdiction like Canada, France, Italy, Spain, Hong Kong, and the United States and in other frontier markets such as Romania.

[99] Examples of guidance adopted in the countries are provided in Annex 7.

[100] This has been implemented in most EU countries, as well as some non-EU developing countries such as Russia.

DERIVATIVE MARKETS PROVIDERS MONITORING

A. Market overview

58. The JSE is the only licensed exchange for derivative instruments. Listed derivatives are traded on the JSE which also acts like an SRO[101] and JSE Clear acts as a clearing house for listed derivatives contracts[102]. Over the last few years, volumes have kept growing, stimulated by volatility, relatively high interest rates, and high participation of offshore dealers and investors[103]. Local banks but also other financial institutions such as pension funds and insurance, asset managers and corporate treasurers mainly use derivatives to hedge their positions, although banks and hedge funds can also use derivatives for speculative purpose. In 2019, the share of banks in the derivatives market was the highest, whereas the share of other financial institutions was only a third of the notional outstanding amount, with the share of corporate investors using derivatives being the smallest[104].

59. Interest rate and currency futures & options are amongst the most actively traded contracts in South Africa. The South African derivatives market represents less than 1% of the global derivatives market. South Africa's total gross notional outstanding OTC derivatives was estimated in 2018 at about R44.7 trillion, mainly consisting of interest (74%), foreign exchange (12%), equities (8%) and commodities (5%) derivatives[105]. Tables below, represents each OTC and listed derivative asset class in the form of a chart showing the predominance of interest transactions. The majority of the aggregate outstanding gross notional OTC derivative contracts were held by banks, with asset managers and insurers accounting for the remainder of the balance. Most DMPs deal for their own account, on behalf of institutional investors and retail customers and are selling contract like CFDs. The share of corporate and retails investors in the OTC derivative market remains marginal, although over the recent year, there was a notable increase and interest in activity in FX and CFD products' offer, in particular to retail investors[106].

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[101] Although the SRO concept is no longer recognized in the South African legislation: The FMA provides specific directions relating to the specific provisions to be adopted in the exchange rules and SROs are still able to issue rules in respect of the matters prescribed in the FMA.

[102] JSE Clear and Strate in respect of these activities have no SRO obligations. JSE Clear has applied to clear OTC product and is waiting for a license extension.

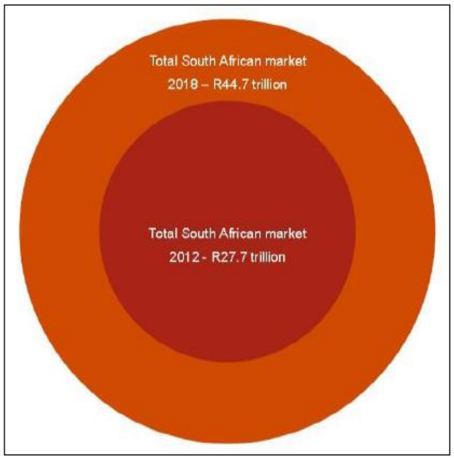
[103] Source IMF.

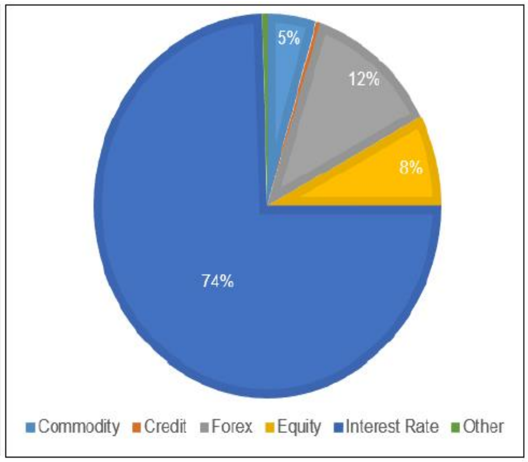
[104] BIS Triennale Survey 2019 –data on FX and IRS.

[105] FSCA, 2018 OTC policy paper.

[106] The south African investors are not necessarily solicited by south African licensed ODPs only to buy these products.

Table 19 Derivative market per asset class, 2018





Source: Research commissioned by the PA on OTC derivative market in SA and conducted by PwC

Table 20 Turnover on the JSE derivative market total

	2020 Year-to-Date	Q1 2020	2019	2018	2017	2016
Futures						
Trades	3,143,287	1,110,867	3,566,007	3,608,867	3,180,985	3,591,024
Volume (000)	60,538	19,453	70,407	99,815	293,559	412,077
Value (R bn)	3,778	1,251	5,527	5,957	6,132	6,894
Open Interest	7,888,766	5,904,738	5,943,501	7,952,641	19,047,404	40,320,362
Options						
Trades	6,482	2,488	10,667	11,785	23,654	22,261
Volume (000)	11,854	5,100	12,160	13,366	18,006	15,373
Value (R bn)	602	259	637	40	41	47
Open Interest	3,207,395	2,254,743	2,799,509	2,075,303	2,296,842	2,300,487

Table 21 Turnover on the JSE Interest rate derivative market

	2020 Year-to-Date	Q1 2020	2019	2018	2017	2016
Futures						
Trades	11,976	4,106	12,780	12,477	12,791	14,410
Volume	9,496,889	3,146,910	10,461,871	11,788,350	11,946,344	9,230,179
Value (R Mil)	962,693	338,338	1,158,376	1,282,927	1,329,270	1,073,119
Open Interest	1,031,519	1,030,319	947,574	829,599	1,021,723	802,030
Options						
Trades	1,264	524	1,550	949	809	825
Volume	569,101	324,351	961,911	428,713	307,322	205,539
Value (R Mil)*	1,059	510	93,866	42,643	29,060	21,987
Open Interest	236,877	426,139	275,198	140,000	97,761	36,955
*****Nominal Value traded, note the value in the previous publications is premium***						

Table 22 Turnover on the JSE Currency Derivatives Market

Turnover on the JSE Currency Derivatives Market						
	2020 Year-to-Date	**Q1 2020**	**2019**	**2018**	**2017**	**2016**
Futures						
Trades	41,004	12,855	42,134	51,664	65,590	66,920
Volume	29,009,573	9,195,700	40,806,350	41,807,458	47,794,037	34,293,431
Value (R Mil)	496,444	148,280	609,007	581,025	656,092	522,169
Open Interest	1,468,002	3,891,230	1,333,559	1,408,969	2,066,426	1,090,978

Options						
Trades	1,949	623	2,700	3,561	4,441	3,271
Volume	22,241,410	9,430,259	28,280,105	32,395,827	20,574,664	14,030,889
Value (R Mil)* **	383,419	156,545	424,563	534,906	290,641	212,036
Open Interest	4,783,519	18,974,993	6,033,839	5,489,721	4,526,266	1,240,499
******Effective January 2013 options value calculation is based on nominal and not premium***						

Table 23 Turnover on the JSE Commodities Derivatives Market

	2020 Year-to-Date	Q1 2020	2019	2018	2017	2016
Futures						
Trades	360,858	142,305	436,351	401,483	345,698	343,265
Volume	2,381,689	767,551	3,206,466	3,080,836	2,718,489	2,955,019
Value (R Mil)	648,126	195,310	805,011,157	674,379.250	566,036,701	943,338,200
Open Interest	151,165	119,767	114,681	111,034	117,783	65,553
Options						
Trades	16,329	6,129	27,189	34,033	30,024	43,815
Volume	213,276	65,628	304,220	351,110	291,204	471,061
Value (R Mil)	2,004	559	4,720,230	4,094,265	3,232,858	14,527,470
Open Interest	53,907	38,848	43,126	71,176	50,578	36,968

Source – JSE 2020

Operating standards for Derivatives Market Providers ("DMPs")

60. All DMPs must be licensed and comply with operating standards[107]. In practice, the JSE is in charge of approving, regulating and supervising DMPs that trade listed derivatives on its exchange ("LDMIs"). Since 2018, the FSCA has also created a Market Integrity Division which is specifically in charge of the licensing and supervising OTC derivative providers (ODPs), that issue or sell to client and counterparties derivatives instruments or contracts over the counter ("ODPs")[108]. The JSE has the power to grant but also to suspend or withdraw the licenses of LDMIs. The FSCA has the power to grant but also to suspend or withdraw the licenses of ODPs . [109]

61. Licensing requirements include an assessment of DMPs in terms of competence, governance, resources, and ethic. All DMPs must adhere to broad principles of fair dealing and owe fiduciary duties to their clients that are broadly similar under the JSE rules and FAIS regime. The licensing criteria for all DMPs include a 'fit and proper' assessment that requires DMPs to act with honesty, integrity, have the necessary competences (experience, qualifications…) and adequate operational organization[110]. Information on the DMP structure and operations must be kept to date. Material changes, for example relating to DMPs' shareholders[111], directors, representatives, auditors, compliance officer but also in their use of clearing and custodian firms, must be immediately reported to their authorities[112]. DMPs are also subject to conflict-of-interest management policies[113] with related disclosure obligations. The JSE rules prescribe for LDMIs to have risk management, internal control, and compliance functions in place. The JSE has also adopted a derivatives trading rules books that sets the obligations for its member to follow when trading listed contracts on the exchange, either for their own account or on behalf of their clients. The rules set requirements on position managements and limits, record keeping and margin calls[114]. For ODPs The FSCA licensing criteria also introduces minimum and high-level requirements on risk management, compliance, and internal controls. The FSCA has also recently adopted a joint standard with the prudential authority on margin requirements

[107] Financial Advisory and Intermediary Services Act of 2002 (FAIS) and the Financial Markets Act of 2012 – section 8.

[108] The FMA Regulations defines an "OTC derivative" as an unlisted derivative instrument that is executed, whether confirmed or not confirmed, excluding foreign exchange spot contracts, and physically settled commodity derivatives.

[109] Section 9 of the FAIS Act.

[110] Fit and proper requirements as set under the FAIS act and implementing regulations.

[111] For example, when triggering a threshold of 20% of beneficial interest in the firm.

[112] To the FCSA and to the JSE for DMIs operating on the regulated market.

[113] section 3A of the 2003 General Code of Conduct and Board Notice 58 of 2010.

[114] As specified by the JSE Derivative rules and equity derivatives rules, as well as JSE Clearing rules.

for OTC derivatives applicable to ODPs, setting the minimum thresholds for the exchange of margin with gradual phasing in[115].

62. In terms of advisory and intermediation activities to clients, JSE members that exclusively undertakes their activities on the JSE and who therefore are exempted from the FAIS registration, only apply JSE rules. These rules require LDMIs to ensure that clients understand the investment advice, the nature of the investment and the risk involved to be enabled to make an informed decision[116]. ODPs are registered as Financial Service providers ('FSPs') under the FAIs and are therefore subject to suitability assessment requirements set by the law and FSPs code of conduct applicable, adopted by the FSCA.

63. All DMPs must comply with minimum capital requirements. ODPS capital requirements rule still largely focus on the coverage of their operating expenses only. LDMIs that are not banks and CIS[117], are to maintain a minimum amount of capital on an on-going basis which is the higher of R400 000 or 13 weeks of operating costs[118], taking into account their position and settlement risks, the objective being to address the range of risk that LDMIs can be exposed to. While there is no explicit requirement in the JSE rules for member firms to calculate capital adequacy requirements on a daily basis, JSE members are required to commit to have enough and adequate capital to cover their activities every day, and report on their capital to the JSE on a monthly base. In addition, the size of the LDMIs market exposure is monitored by the exchange[119], and risk of LDMIs default is dealt by the clearing house, with margin calls.

64. For OTC derivatives transactions, the licensing standards adopted by the FSCA [120] requires ODPs to have enough to cover at least 6 months of operating expenses, with have a viable plan to raise additional equity should the firm's equity be not enough to cover operating expenses as required by the regulation. The regulation provides that ODPs must also at all times hold 'sufficient capital and liquid assets to meet their potential general business losses'. ODPs licensing standards do not provide for more specific guidance on how potential general business losses are to

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[115] Clearing and derivatives market infrastructures are not part of the scope of this review.

[116] JSE rule 8.130 on advice. Also refer to the Derivatives Client Agreement.

[117] These are broker -dealers other than banks and HFCIS. CIS and HFCIS are 'captured' under CISCA and specific Board notices, where banks' capital is under the supervision of the PA. The JSE also reports to the Prudential Authorities.

[118] The quantum of liquid capital may also change based on the applicant's business model and the anticipated services that the applicant will provide.

[119] As defined in the JSE's derivatives directives rules.

[120] FSCA Conduct Standard, No 1 of 2018, Criteria for Authorisation of OTC Derivatives Providers.

be assessed and the corresponding amount of necessary capital to hold should be calculated[121]. ODPs report quarterly to the FSCA on the amount of capital the hold. At the time of this review, the FSCA staff was also considering implementing additional capital requirements on ODPs trading CFDs, to better cover the counterparty risk, in a manner comparable to margin mechanisms that are in place for listed derivative contracts.

DMPs' supervision and reporting framework

65. The JSE has processes and systems in place to supervise LDMIs. The JSE supervises LDMIs, to ensure that they are complying with the exchange rules. It has adopted a risk-based membership supervision that describes JSEs on and offsite supervisory process. A risk-based supervisory plan is prepared on quarterly cycle and is subject to monthly review by JSE management that helps supervisory team in defining their next on-site inspections cycle[122] and steer monitoring level where it is most needed. The RBS plan is based on approximately 12 risk drivers, rating capital adequacy, IT risk as well as the accuracy of internal control and compliance process of the LDMI. LDMIs risk profiling also takes into consideration client complaints and qualitative inputs from desk monitoring based on professional judgement.

66. In terms of reporting, LDMIs report daily their cash and derivatives trading to feed the JSE's market and capital adequacy monitoring systems as well as derivatives clearing systems[123]. LDMIs also report their OTC derivative positions to the JSE via a separate spreadsheet, although discussion to market participants suggest that the JSE may have information of LDMIs OTC activities, depending on how LDMIs activities are organized[124]. In addition, JSE' s interest in supervising their members OTC activities only applies to the extent members' OTC positions are relevant to offset positions opened through a listed contract[125]. All LDMIs positions including large market exposure, are monitored by the exchange[126] that calculates each member's net market exposure for each listed instrument. Once LDMIs open positions are calculated, the JSE may call for additional funding to prevent potential capital shortfall[127]. So far, JSE group has only experienced the failure of one

[121] FSCA Conduct standard 1 of 2018.

[122] With prior notice.

[123] LDMIs are member of the JSE clearing house and positions generating margin calls to mitigate potential market risk.

[124] For instance, some groups may lodge their listed and OTC derivatives activities in separate branches or entities.

[125] It offers the possibility for member to offset their exposure and potentially their capital requirements

[126] Section 11 of the JSE Equity Derivatives rules and Derivatives rules.

[127] JSE clearing house is still waiting to be approved to clear some OTC products, which may also help in terms of risk monitoring.

brokerage house, due to a large clients' position. The risk was managed by the clearing house and did not threaten the stability of the market or its participants.

67. The FSCA is in the process of adopting a reporting and supervisory framework dedicated to the activities of ODPs.

68. To date, there is no licensed local or external trade repository in South Africa. The SARB collects information on OTC derivatives positions of banking institutions on a monthly basis but, does not collect information relating to non-banks DMPs. According to the FMA, ODPs, including non-bank ODPs are under the obligation to report their transactions to a licensed trade repository, with the reporting scope, content, and frequency yet to be prescribed by the FSCA. At the moment of this review, the FSCA team was working on trade repository framework and on an RBS framework, with a risk rating methodology and risk-based supervision plan. As the ODPs licensing regimes have been recently adopted and implemented, most interactions between the FSCA and ODPS have focused on follow up monitoring on how ODPs are implementing their licensing requirements, where necessary in liaison with PA's team. As a result, no ODP supervisory methodology and inspection plans have yet been finalized.

69. Finally, JSE members, including LDMIs, can short sell securities. Naked short selling is not permitted, as transactions are executed only pre-settled by a CSD. Authorities are nevertheless working to put in place a short selling reporting framework, with the disclosure of an aggregate short position per security.

Market's surveillance

70. The JSE has the prior responsibility to monitor the market activities on a daily base with suspicious activities being referred to the FSCA, to take the necessary enforcement actions. The JSE uses electronic surveillance systems to monitor its market and identify potential and market manipulation. While the FSCA does not have a direct access into the JSE surveillance system, the FSCA's Market Abuse Department staff meet with the JSE market surveillance team on a biweekly basis to review all information and market monitoring information compiled by the JSE. In addition, the FSCA team can request at any time any additional information from the JSE. Suspicious cases of market abuse are automatically transferred to the FSCA which has the possibility to conduct ad hoc inspections. The FSCA has also the power to initiate its own investigation-based complaints and tip-offs, as well as in case of suspicious OTC trading activity.

Table 24 Type and number of suspected Market abuse cases (Total) referred by JSE to the FSCA

Referral Period	Insider Trading	Market Manipulation
2018	12	13
2019	10	9
2020	9	6

Source – JSE 2021

Enforcement

71. The FSCA is responsible to take enforcement actions and sanction DMPs unlawful activities, including in the use of derivatives contracts. In the past, the FSCA has used its power to impose administrative penalties to sanction market abuse. The FSCA can also suspend or withdraw a license, provide for debarment order and, since 22019, agree to additional remedy that can include repayments to clients, disclosures, refraining a person to use marketing material and provide financial services. The type of sanction and the level of penalties is evaluated in accordance to the seriousness and amount of benefit realized through the infringement and the damages it has caused. Just for 2020, The FSCA has published over ten orders sanctioning insider trading and market abuse, which included the publication of misleading information on companies listed on the JSE. The FSCA regularly informs the public on the status of ongoing enforcement proceedings and settled administrative decisions. The calculation of administrative penalties is published on the FSCA website, together with ample information on all administrative and criminal enforcement actions [128]. Persons sanction by the FSCA can ask the Tribunal to reconsider FSCA orders.

Systemic risk identification, monitoring and cooperation mechanisms between authorities

72. Cooperation and coordination's mechanisms between authorities are in place, although the reporting framework on capital market activities still needs to be completed. Market infrastructures and industry representative are under the obligations to share information with the authorities through Financial Sector Contingency Forum ("FSCF") as soon as they become aware of any matter that they reasonably believe may give rise to or increase systemic risk[129]. The FSCF has an Operational Risk Sub-committee whose objective is specifically to identify and monitor operational

[128] https://www.fsca.co.za/Enforcement-Matters/Pages/default.aspx

[129] The member this organization include the SARB, FSCA, National Treasury, Banking Association of South Africa (BASA), South African Insurance Association (SAIA), JSE, Payments Association of South Africa (PASA), South African Bankers Services Co Limited (BankServ), Strate and ASISA.

risks in the financial sector that could potentially have a systemic impact, and to develop, test and maintain suitable crisis management and contingency plans to mitigate these risks.

73. They are also information sharing arrangements and cooperation's mechanisms between the FSCA, the PA and the SARB[130]. The FSCA is a member of the Financial Sector Oversight Committee[131] ("FSOC") overseen by the SARB[132], which undertakes an assessment of the stability of the financial system every six months. It allows the FSCA to share but also collect information including on potential systemic risk that may steam or affect the market, although minutes from previous meetings suggest that, so far these meetings have been focused on operational and governance matters, with the authorities sharing, for example, progress on the implementation of new regulations. The FSCA also meets regularly with the SARB to improve data collection and sharing[133].

B. Discussions and recommendations for DMPs

74. Capital requirements, and risk management rules for ODPs[134] needs to be strengthened. Today the OTC derivative providers environment is largely divided between large wholesale firms that mainly operates with a banking licenses and smaller non-bank firms that intermediate OTC derivative contracts, such as CFDs, and sold to retails investors. These firms operate under the ODPs licensing rules which requires them to i) hold sufficient capital (6 months) to cover their business losses meet operating expenses and ii) adopt 'sound risk management principles' with prudent processes to identify, control and mitigate risks, considering the ODP's risk appetite'. The current licensing standards do not provide for the risk management function to be kept 'in house' with minimum dedicated staff[135], leaving the possibility for smaller actors to operate empty shell, Although, in practice the authorities look at risk arrangements aspects at the licensing stage and when supervising ODPs, given the level of risk involved in OTC products and activities. The current standards do not provide for granular

[130]www.resbank.co.za/PrudentialAuthority/FinancialSectorRegulation/Pages/Financial-Sector-Regulation-Act.aspx; https://www.fsca.co.za/Regulatory%20Liaison/Forms/AllItems.aspx

[131] Composed of the PA, FSCA, NCR and FIC.

[132] The FSRA has established the FSOC and the FSCF. The primary objectives of the FSOC are to support the Reserve Bank when the Reserve Bank performs its functions in relation to financial stability; and facilitate co-operation and collaboration between, and co-ordination of action among, the financial sector regulators and the Reserve Bank in respect of matters relating to financial stability. The primary objective of the FSCF is to assist the Financial Stability Oversight Committee with the identification of potential risks that systemic events will occur; and the co-ordination of appropriate plans, mechanisms, and structures to mitigate those risks.

[133] The FSCA is also a signatory of the IOSCO MMoU and has put in place 98 bi-lateral and multi-lateral MOUs with foreign regulators. In 2019 and 2020, the FSCA has shared information in the context of 254 requests from its counterparts in foreign jurisdictions.

[134] Elements on OTC supervision are covered under Principle 31 of the IOSCO Assessment methodology.

[135] Minimum staffing only applies to the compliance function.

guidance on the level of risks and exposure that ODPs and their clients may take, how risks and margins should be calculated, how collateral posted by clients should be safekept and eventually re-used by the ODPs[136]. The current licensing requirements should be revisited to adequately protect investors in case of an ODPs' default,[137] and misselling practice. All operating ODPs should be subject to sound prudential, organizational and, where applicable, conduct and conflict of interest rules that reflect the risk they pose to themselves as well as to their clients and eventually the market[138].

75. The ODPs reporting and supervisory framework needs to be finalized. The supervision of LDMIs is delegated to the JSE team which conduct regular reviews of its members to assess and mitigate the potential risk they may present to the market with necessary capital and margin requirements. The JSE has also developed reporting mechanism to monitor each members' positions. However, this supervisory framework shows its limits for OTC activities. With the newly adopted ODPs regime, the FSCA has been conducting "post licensing" reviews, focusing on governance, staff structure, risk and information technology management. The FSCA is also developing its own risk-based supervision for ODPs. The FSCA is encouraged to finalize a risk based ODPs supervisory methodology with detailed ODPs risk profiling and monitoring processes.

76. The authorities need to adopt a reporting framework that includes short selling and OTC activities, and to use existing cooperation mechanisms to identify risks associated with capital markets activities. To that end, the authorities are encouraged to pursue their efforts to design a reporting framework that allows them to have a holistic view of the financial system and promptly identify where new emerging systemic risks may be. Currently, the authorities have different sources of data:

- CIS provide regular portfolio reporting to the FSCA
- In addition, HFCIS report the level and source of leverage to the FSCA;
- LDMIs report activities on derivatives that affect their market positions, to the JSE;
- Banks also report all their activities to the PA's and to the SARB;
- ODPs reporting framework is under construction.

Having data in different areas increases the possibility that the authorities can miss risks building up in their markets. This is a challenge that is faced in many countries and building a reporting framework,

[136] These contracts may be under OTC derivative clearing threshold as well as the non-centrally cleared OTC derivatives margin thresholds.

[137] This relates to non-professional clients that are unable to carry their own due diligence.

[138] Please refer to US CFTC and ASIC rules on derivative providers: https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-181-licensing-managing-conflicts-of-interest/

for example through a licensed TR, is critical. The FSCA and the SARB are already collaborating to improve and streamline market data collection and it is important to support the South African authorities in their efforts. For systemic risk monitoring, mechanisms are in place for authorities can report their concerns to the FSOC. The authorities are also encouraged to use these institutional cooperation mechanisms, by sharing regular reporting on each sectoral activity (Banks, CIS, capital Market), and their analysis of where potential risks may materialize, including on the use of leverage[139].

Recommendations are as follows:

- Strengthen and adopt more granular rules on ODPs capital and risk management requirements;
- Complete the reporting and supervisory framework for ODPs;
- Finalize a reporting framework on OTC activities and short selling and Use existing cooperation mechanism to share regular analysis on the risks associated with capital market activities.

[139] Including Private equity fund and managers that today seem unregulated.

Annex 1. Extract of the EU DIRECTIVE 2014/65/EU on financial instruments manufacturing

An investment firm which manufactures financial instruments for sale to clients shall maintain, operate, and review a process for the approval of each financial instrument and significant adaptations of existing financial instruments before it is marketed or distributed to clients.

The product approval process shall specify an identified target market of end clients within the relevant category of clients for each financial instrument and shall ensure that all relevant risks to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market.

An investment firm shall also regularly review financial instruments it offers or markets, taking into account any event that could materially affect the potential risk to the identified target market, to assess at least whether the financial instrument remains consistent with the needs of the identified target market and whether the intended distribution strategy remains appropriate.

An investment firm which manufactures financial instruments shall make available to any distributor all appropriate information on the financial instrument and the product approval process, including the identified target market of the financial instrument.

Where an investment firm offers or recommends financial instruments which it does not manufacture, it shall have in place adequate arrangements to obtain the information and to understand the characteristics and identified target market of each financial instrument.

Annex 2. Extract if the 2018 ESMA guidelines on CIS manufacturing and CIS distributor

Guidelines for manufacturers

Identification of the potential target market by the manufacturer: categories to be considered

The potential target market identification by manufacturers should not be solely conducted on the basis of quantitative criteria but needs to be based on sufficient qualitative considerations as well. Services for the mass market in particular, may require automation of processes and this automation is usually based on formulas or algorithmic methodologies that process quantitative criteria for products and clients. Such numerical data is usually generated through scoring systems (for example, by using product features like volatility of financial instruments, rating of issuers, etc. or through "conversion" of factual data into numerical systems). With regard to the target market identification, firms should not solely rely on such quantitative criteria but sufficiently balance them with qualitative considerations.

Manufacturers should use the list of categories set out in these guidelines as a basis for identifying the target market for their investment products. The list of the categories is cumulative: when assessing the target market, each manufacturer should use each of those categories. In doing so, a manufacturer should analyze the relevance of each category for a certain product and then align the depth of the identification in proportion to the type, nature, and other features of the product.

When detailing/describing each one of these categories, manufacturers should consider the relationship between different categories since they all contribute to the definition of the target market for a given product.

Manufacturers should not exclude any of the five below mentioned categories. If, in the manufacturers view, these five categories are too restrictive to identify a meaningful target market, additional categories may be added. In the decision, whether to use such additional categories or not, manufacturers may consider the characteristics of the information-channels with distributors. For example, in order to facilitate the exchange of information with distributors and to foster open architecture, manufacturers may limit the use of additional categories to cases where these are essential to define a meaningful target market for the product.

Manufacturers need to identify a potential target market.

As they usually do not have direct client contact, and in accordance with subparagraph 2 of Article 9(9) of the MiFID II Delegated Directive, this means that their target market identification may be based inter alia on their theoretical knowledge and experience of the product. 18. Manufacturers should use the following list of five categories:

a) **The type of clients to whom the product is targeted:** The firm should specify to which type of client the product is targeted. This specification should be made according to the MiFID II client categorization of "retail client", "professional client" and/or "eligible counterparty".
b) **Knowledge and experience:** The firm should specify the knowledge that the target clients should have about elements such as: the relevant product type, product features and/or knowledge in thematically related areas that help to understand the product. For example, for structured products with complicated return profiles, firms could specify that target investors should have knowledge of how this type of product works and the likely outcomes from the product. Regarding experience, the firm could describe how much practical experience target clients should have with elements such as: relevant product type, relevant product features and/or experience in thematically related areas. The firm could specify, for example, a time period for which clients should have been active in the financial markets. Knowledge and experience may be dependent on each other in some cases (i.e. an investor with limited or no experience could be a valid target client if they compensate missing experience with extensive knowledge).
c) **Financial situation with a focus on the ability to bear losses:** The firm should specify the percentage of losses target clients should be able and willing to afford (for example, from minor losses to total loss) and if there are any additional payment obligations that might exceed the amount invested (for example, margin calls). This could also be phrased as a maximum proportion of assets that should be invested.
d) **Risk tolerance and compatibility of the risk/reward profile of the product with the target market:** The firm should specify the general attitude that target clients should have in relation to the risks of investment. Basic risk-attitudes should be categorized (for example, "risk oriented or speculative", "balanced", "conservative") and clearly described. Since different firms in the chain may have different approaches to defining risk, the firm should be explicit about the criteria that must be met in order to categorize a client in this way. Firms should use the risk indicator stipulated by the PRIIPs Regulation or the UCITS Directive, where applicable, to fulfil this requirement.
e) **Clients' Objectives and Needs**: The firm should specify the investment objectives and needs of target clients that a product is designed to meet, including the wider financial goals of target clients or the overall strategy they follow when investing. For example, reference could be made to the expected investment horizon (number of years the investment is to be held). Those objectives can be "fine-tuned" by specifying particular aspects of the investment and expectations of targeted clients. The particular clients' objectives and needs a product is intended to fulfil may vary from

specific to more generic. For example, a product may be designed to meet the needs of a specific age demographic, to achieve tax efficiency based on clients' country of tax residence, or be designed with special product features to achieve specific investment objectives such as "currency protection", "green investment", "ethical investment", etc., as relevant.

Depending on the characteristics of the specific product manufactured, the description of one or more of the above categories may result in the identification of a broad group of target clients that could also encompass a more restricted group. For example, if a product is considered compatible with target clients possessing general relevant knowledge and experience, obviously it will be compatible with a sophisticated level of knowledge and experience.

In order to avoid the risk of misinterpretations and misunderstandings, manufacturers should clearly define the concepts and terminology used when defining the target market across the five categories listed above.

Identification of the potential target market: differentiation on the basis of the nature of the product manufactured

The identification of the potential target market should be done in an appropriate and proportionate manner, considering the nature of the investment product. This means that the target market identification should consider the characteristics of the product including its complexity (including costs and charges structure), risk-reward profile or liquidity, or its innovative character. 8

Consequently, for more complicated products, such as structured products with complicated return profiles, the target market should be identified with more detail. For simpler, more common products it is likely that the target market will be identified with less detail:

- For some types of investment products the manufacturer may identify the abovementioned target market categories referred to in paragraph YY following a common approach for financial instruments of one type with sufficiently comparable product features (for example due to an external benchmark, or because they belong to a stock-exchange segment with certain requirements).

- Depending on the investment product, the description of one or more of the abovementioned categories may be more generic. The simpler a product is, the less detailed a category may be.

However, in all cases, the target market must be identified at a sufficiently granular level to avoid the inclusion of any groups of investors for whose needs, characteristics, and objectives the product is not compatible.

For bespoke or tailor-made products, the target market of the product will usually be the client who ordered the product unless the distribution of the product to other clients is also foreseen.

Articulation between the distribution strategy of the manufacturer and its definition of the target market

According to Article 16(3) of MiFID II, the manufacturer shall ensure that its intended distribution strategy is consistent with the identified target and, according to Article 24(2) of MiFID II, the manufacturer needs to take reasonable steps to ensure that the financial product is distributed to the identified target market. The manufacturer should define its distribution strategy so that this strategy favors the sale of each product to the target market of this product. This includes that, when the manufacturer can choose the distributors of its products, the manufacturer makes its best efforts to select distributors whose type of clients and services offered are compatible with the target market of the product.

In defining the distribution strategy, a manufacturer should determine the extent of clients' information necessary to the distributor to properly assess the target market for its product. Hence, the manufacturer should propose the type of investment service through which the targeted clients should or could acquire the financial instrument. If the product is deemed appropriate for a sale without advice, the firm could also specify the preferred acquisition channel.

Guidelines for distributors

Timing and relationship of target market assessment of the distributor with other product governance processes

The distributor's target market identification (i.e. the 'actual' target market for that product) should be conducted as part of the general decision-making process about the range of services and products the distributor is going to distribute. Hence, the actual target market identification should occur at an early stage, when the firm's business policies and distribution strategies are defined by the management body and, on an ex-ante basis (i.e. before going into daily business).

In particular, distributors should take responsibility to ensure, from the very beginning, the general consistency of the products that are going to be offered and the related services that will be provided with the needs, characteristics, and objectives of target clients.

The decision making process about the service and product universe in combination with the target market identification process should directly influence the way in which the firm's daily business is conducted, as the management body's choices are implemented along the firm's decision chain and hierarchy. Those processes will jointly have a direct impact on the compatibility of products and services offered and will influence all other relevant processes connected with the services provided, especially the definition of budgeting objectives and staff remuneration policies.

Firms should especially focus on the investment services through which the products will be offered to their respective target markets. In this context, ESMA expects that the nature of the products is duly considered, paying particular attention to those products characterized by complexity/risk features or by other relevant features (such as, for example, illiquidity and innovation). For example, if a distributor has detailed information on some clients (for example, through an existing relationship with them for the provision of investment advice), it could decide that, considering the particular risk-reward profile of a product, the interest of this group of clients would be best served if execution services are excluded for them. Similarly, the distributor could decide that some non-complex products which could potentially be offered under the execution-only regime will only be offered in accordance with appropriateness or suitability requirements, so as to grant a higher degree of protection to clients.

Specifically, distributors should decide which products are going to be recommended (also through the provision of portfolio management) or offered or actively marketed to certain groups of clients (characterized by common features in terms of knowledge, experience, This is in line with Recital 18 of the MiFID II Delegated Directive, which clarifies: 'in light of the requirements set out in Directive 2014/65/EU and in the interest of investor protection, product governance rules should apply to all products sold on primary and secondary markets, irrespective of the type of product or service provided and of the requirements applicable at point of sale. However, those rules may be applied in a proportionate manner, depending on the complexity of the product and the degree to which publicly available information can be obtained, considering the nature of the instrument, the investment service, and the target market. Proportionality means that these rules could be relatively simple for certain simple, products distributed on an execution-only basis where such products would be compatible with the needs and characteristics of the mass retail market'. financial situation, etc.). Distributors should also decide which products will be made available to (existing or prospective) clients at their own initiative through execution services without active marketing, considering that in such situations the level of client information available may be very limited.

In any case, where on the basis of all information and data that may be at the distributors' disposal and gathered through investment or ancillary services or through other sources, including the information obtained from manufacturers, the distributor assesses that a certain product will never be compatible with the needs and characteristics of its existing or prospective clients, it should refrain from including the product in its product assortment (i.e. the products that will be offered, to whom, and through the provision of which investment services).

Relation between the product governance requirements and the assessment of suitability or appropriateness

The obligation of the distributor to identify the actual target market and to ensure that a product is distributed in accordance with the actual target market is not substituted by an assessment of suitability or appropriateness and has to be conducted in addition to, and before such an assessment. In particular, the identification, for a given product, of its target market and related distribution strategy should ensure that the product ends up with the type of customers for whose needs, characteristics and objectives it had been designed, instead of another group of clients with whom the product may not be compatible.

Identification of the target market by the distributor: categories to be considered

Distributors should use the same list of categories used by manufacturers, as a basis for defining the target market for their products. However, distributors should define the target market on a more concrete level and should consider the type of clients they provide investment services to, the nature of the investment products and the type of investment services they provide.

As the manufacturer has to specify the potential target market based on its theoretical knowledge and experience with a similar product, it will determine the product's target market without specific knowledge of individual clients. Therefore, the manufacturer's assessment will be conducted with a more general view of how the features/nature of a product would be compatible for certain types of investors, based on their knowledge of the financial markets and their past experience with similar products. In this way, a set of boundaries is introduced on a more abstract level.

The distributor on the other hand has to specify the actual target market, considering the boundaries of the potential target market set by the manufacturer. Distributors should base their target market on their information and knowledge of their own client base and the information received from the manufacturer (if any) or information that has been obtained by the distributor itself via desk research (especially in cases where the distributor is a new firm that does not yet have enough-actual information about its own clients).
Distributors should use the manufacturer's more general target market assessment together with existing information on their clients or prospective clients to identify their own target market for a product that is the group of clients to whom they are effectively going to offer the product through the provision of their services.

To this end, distributors should conduct a thorough analysis of the characteristics of their client base, i.e. existing clients, as well as prospective clients (for example, a distributor may have clients with bank deposits to whom they intend to offer investment services). Distributors should use any information and data deemed reasonably useful and available for this purpose that may be at the distributors' disposal and gathered through investment or ancillary services. In addition, they could use any information and data deemed reasonably useful and available that may be at the distributors' disposal and gathered through sources other than the provision of investment or ancillary services.

When refining the manufacturer's target market, the distributor should not deviate from the fundamental decisions made therein. However, distributors cannot just rely on the manufacturer's target market without considering how the target market defined by the manufacturer would fit to their client base. For that purpose, distributors should implement and maintain a dedicated process, which needs to be run in all cases. This process is subject to proportionality, i.e. the scrutiny and – if necessary – the refinement of the manufacturers target market by the distributor should be more intensive for more complex products and could be less intensive in case of simpler, more common products. If, as a result of the process, the distributor concludes that the target market of the manufacturer does not need to be refined, the distributor may use the manufacturer's target market as it is.

Usually, the target market assessment of the distributor will occur after the manufacturer has communicated its target market to him. However, it is possible that manufacturer and distributor could define both the manufacturer's target market and the distributor's target market, including any review and refinement process, at the same time. This could, for example, occur where the manufacturer and the distributor jointly develop a common target market standard for the products, they usually exchange. Both the manufacturer and the distributor retain their responsibility for their obligations to identify a target market as described in MiFID II and the MiFID II Delegated Directive and further specified in these guidelines to identify a target market. A manufacturer has still to take reasonable steps to ensure that products are distributed to the identified target market and a distributor has to ensure that products are offered or recommended only when this is in the interest of clients.

When distributors define their product assortment, they should pay particular attention to situations where they might not be able to make a thorough target market assessment by virtue of the type of services they provide (in particular, execution services under the appropriateness test or the execution-only regime). This is especially important for products characterized by complexity/risk features (or other relevant features such as, for example, illiquidity or innovation), as well as for situations where there might be significant conflicts of interest (such as in relation to products issued by the firm itself or by other entities within the group). In such circumstances, it is most important that distributors take into due consideration all relevant information provided by the product manufacturer, both in terms of target market and distribution strategy. Identification of the target market: differentiation on the basis of the nature of the product distributed

The identification of the target market assessment by the distributor should also be done in an appropriate and proportionate manner, considering the nature of the investment product.

Where the manufacturer has identified a target market for simpler, more common products the distributor's target market identification does not necessarily have to result in a refinement of the manufacturer's target market.

Identification and assessment of the target market by the distributor: interaction with investment services

As noted above, distributors are required to identify and assess the circumstances and needs of the group of clients to whom they are effectively going to offer or recommend a product, so as to ensure the compatibility between that product and the respective target clients. This obligation should apply in a proportionate manner depending, not only on the nature of the product (see paragraph above), but also on the type of investment services that firms provide.

In this regard, it should be noted that, on one hand, the ex-ante assessment of the actual target market is influenced by the services provided, since it can be conducted more or less thoroughly depending on the level of client information available, which in turn depends on the type of services provided and the conduct of rules attached to their provision (in particular, investment advice and portfolio management allow for the acquisition of a wider set of information on clients compared to the other services). On the other hand, the target market assessment influences the decision on the type of services that are going to be provided in relation to the nature of the product and the circumstances and needs of the identified target clients, considering that the level of investor protection varies for different investment services, depending on the rules that apply at the point of sale. In particular, investment advice and portfolio management services allow for a higher degree of investor protection, compared to other services provided under the appropriateness regime or under execution-only.

It is therefore expected that when distributors define their product assortment, they pay particular attention to situations where they might not be able to conduct a thorough target market assessment by virtue of the type of services they provide. In particular, where distributors only carry out execution services with the assessment of appropriateness (for example through a brokerage platform), they should consider that they will usually be able to conduct an assessment of the actual target market which is limited to the sole categories of clients' knowledge and experience ; where they only conduct execution services under the execution-only regime, not even the assessment of clients' knowledge and experience will usually be possible. In this respect, firms should pay particular attention to the distribution strategy suggested by the manufacturer.

This is especially relevant for products characterized by complexity/risk features (or other relevant features such as, for example, innovation), as well as for situations where there might be significant conflicts of interest (such as in relation to products issued by entities within the firm's group or when distributors receive inducements from third parties), being also mindful of the limited level of protection afforded to clients at the point of sale by the appropriateness test (or no protection at all, in the case of execution-only). In such circumstances, it is most important that distributors take into due consideration all relevant information provided by the product manufacturer, both in terms of potential target market and distribution strategy. For example, where the manufacturer's target market describes a product with particular features which requires, not only detailed client's knowledge and experience, but also a specific financial situation as well as unique objectives/needs, the distributor may decide to adopt a prudent approach by not including it in its product assortment (even though the firm would be in the position to assess ex-ante the compatibility of that product with its client base in terms of knowledge and experience).

Moreover, taking into account that the client's protection decreases when information available is not sufficient to ensure a full target market assessment, distributors may also decide to let clients operate on a non-advised basis after having warned them that the firm is not in the position to assess their full compatibility with such products.

On the contrary, if distributors intend to approach clients or prospective clients in any way to recommend or actively market a product or consider that product for the provision of portfolio management, then a thorough assessment of the target market should always be conducted.

Distribution strategy of the distributor

The distributor should take the distribution strategy identified by the manufacturer into account and review it with a critical look. However, ultimately, including when a manufacturer is an entity not subject to MiFID II and thus it is not obliged to identify a distribution strategy, the distributor should define its own distribution strategy in light of information on its client base and type of services provided.

In particular, while taking into due consideration the suggested distribution strategy of the manufacturer, the distributor could decide to follow a more prudent approach by providing investment services that afford a higher level of protection to investors, such as investment advice. For instance, if the manufacturer considers that the features of a given product are. As explained above, for the definition of the target market, in addition to information gathered through investment or ancillary services, distributors could use any further information and data deemed reasonably useful that may be at their disposal and gathered through other sources. Therefore, even firms only providing investment services under appropriateness or execution-only regime, could be in the position to conduct a more thorough assessment of the target market, compatible with a distribution strategy through non-advised services, the distributor may still decide that the characteristics of its existing or prospective clients (for example, very limited knowledge and no experience with investments in that type of product, unstable financial situation and very short-term objectives) are such that investment advice would be the most appropriate choice to ensure their best interests.

On the contrary, the distributor could decide, in certain circumstances, to take a less prudent approach in relation to the distribution strategy defined by the manufacturer. For example, if the manufacturer deems that a given product, due to its specific features, should be offered through investment advice, the distributor could still make that product available through execution services to a specific segment of clients. In these situations, ESMA expects that the distributor would do so only after a thorough analysis of the features of the products and the target clients. Moreover, this decision should be reported to the manufacturer as part of the distributor's obligation to provide the manufacturer with sales information in a way that the manufacturer can take it into account in their product governance process and when selecting suitable distributors.

Annex 3. Example of Code of conduct for CIS managers on best execution, churning, soft dollars (extract from the Code on CIS – Monetary Authority of Singapore (MAS))

Function and responsibility of the CIS manager:

Best execution

The manager should have arrangements in place to take all reasonable steps to obtain the best possible result for the scheme, taking into account the following execution factors: price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of a trade or transaction.

Cash rebates and soft dollars

The manager should not retain for its own account, cash or commission rebates arising out of transactions for the scheme executed in or outside Singapore.

The manager should not retain soft dollars in the management of the scheme unless the following conditions are met:

i) the soft dollars received can reasonably be expected to assist in the manager's provision of investment advice or related services to the scheme;

ii) best execution is carried out for the transactions; and

iii) the manager does not enter into unnecessary trades in order to achieve a sufficient volume of transactions to qualify for soft dollars. i) The receipt of goods and services such as travel, accommodation and entertainment does not meet the condition set out at chapter 3.2(h)(i) and is prohibited.

In its sei annual report, CIS managers are also required to provide a statement describing the soft dollars received from each broker which executed transactions for the scheme. If the broker also executed trades for other schemes managed by the manager, a statement to that effect may be included. The manager should also confirm that the goods and services received were for the benefit of the scheme, the trades were made on a best execution basis and there was no churning of trades;

Transactions with related corporations

The manager should:

- not invest the monies of the scheme in the manager's own securities or those of any of its related corporations unless the securities are constituents of the scheme's reference benchmark, which is constructed by an independent party, and the scheme complies with paragraph 2.3 of Appendix 1; Guidance For the avoidance of doubt, this prohibition does not extend to schemes managed by the manager or its related corporations.

- not lend monies of the scheme to its related corporations; Guidance For the avoidance of doubt, deposits made with banks licensed under the Banking Act (Cap.19), finance companies licensed under the Finance Companies Act (Cap. 108), merchant banks approved as financial institutions under section 28 of the Monetary Authority of Singapore Act (Cap. 186) or any other deposit-taking institution licensed under an equivalent law in a foreign jurisdiction, in the ordinary course of business of the scheme, shall not be construed as monies lent to such institutions.
- not purchase real estate assets owned by the manager or its related corporations for the scheme unless such purchases are allowed by Appendix 6: Property Funds; Transactions at arm's length iv) conduct all transactions with or for a scheme at arm's length; and Transactions consistent with scheme's objective and approach v) acquire permissible investments and enter into transactions which are consistent with the investment objective and approach of the scheme.

Use of financial derivatives

The manager should not act as the counterparty of an OTC financial derivative that is invested into by the scheme.

Use of credit ratings

The manager should not rely solely or mechanistically on ratings issued by credit rating agencies. The manager should establish a set of internal credit assessment standards and put in place a credit assessment process to ensure that its investments are in line with these standards. For the purposes of the Code, the manager should, where possible, make its own credit assessments to verify ratings issued by credit rating agencies. In the event of a difference between the ratings issued by credit rating agencies, or between such external ratings and the manager's internal credit assessment, the lowest rating should be used. For the avoidance of doubt, all ratings used should be based on a rating scale that is globally comparable.

Where the manager relies on ratings issued by credit rating agencies, the manager should provide the following in the scheme's prospectus:

i) a statement that the manager has established a set of internal credit assessment standards and has put in place a credit assessment process to ensure that its investments are in line with these standards; and

ii) a statement that information on the manager's credit assessment process would be made available to investors upon request. Guidance For the purpose of Chapter 3.1(h)(ii), the manager may enter into agreements with the investor to keep the disclosed information confidential.

Significant influence

The manager should not, through the scheme, carry out its investment activities in a manner which would enable it to exercise significant influence over the management of an issuer of permissible investments.

Annex 4. Example of guidance to notify material changes to the authorities and to CIS investors (extract from the Code on CIS – Monetary Authority of Singapore (MAS))

Notification of significant changes

The manager should inform the Authority and existing participants of any significant change to be made to a scheme not later than one month before the change is to take effect. Significant changes include, but are not limited to, the following:

- i) a change in the investment objective or focus of the scheme or in the investment approach of the manager as stated in the prospectus or trust deed, where "investment approach" refers to how the manager selects investments for the portfolio of the scheme;
- ii) an increase in the remuneration payable to the manager or trustee (even where the remuneration is not increased beyond the maximum amount provided for in the trust deed or prospectus) or a change in the basis upon which such remuneration is determined;
- iii) an increase in any other fees or charges payable by the scheme that are substantial (i.e. fees that are 0.1% or more of the scheme's NAV) or in any fees or charges payable by the participants, unless the trustee certifies that the increase in such fees or charges are not material;
- iv) an amendment to the trust deed or prospectus to allow a new form of remuneration or expense payable by the scheme;
- v) the replacement, removal or appointment of a manager, sub-manager, investment adviser or trustee to the scheme;
- vi) a variation in the rights or obligations of participants as set out in the trust deed and prospectus, where the variation is materially prejudicial to participants; Guidance Where there is doubt as to whether such variation would be prejudicial to participants, advance notification to the Authority and participants is not required if the trustee certifies that the variation is not materially prejudicial to participants. vii) a change from direct investment to feeder fund structure or vice versa;
- vii) a change in the collateral policy from that disclosed in the prospectus; or
- viii) a change referred to in chapter 3.2(d)(i) to (viii) in relation to an underlying fund into which the scheme feeds substantially (i.e. 30% or more of the scheme's NAV).

The manager should take reasonable steps to obtain prior notification of any material change in relation to the underlying scheme. Where such prior notification is neither possible nor practicable, notification should be made in accordance with chapter 3.2(e).

Notifications should be made in clear and simple language that participants can easily understand.

Managers should avoid using technical terms but where the use of such terms is unavoidable, participants should be provided with clear explanations.

Notwithstanding chapter 3.2(d), where a significant change cannot be determined by the manager at least one month in advance, the manager should inform the Authority and existing participants of the significant change as soon as practicable.

Examples of such changes include, but are not limited to, the following:

i) suspension and resumption of dealings as a result of exceptional circumstances;
ii) any change which may materially affect the risks and returns of a scheme; Changes which cannot be determined at least one month in advance but may materially affect the risks and returns of a scheme include significant unexpected changes in general market conditions, the industry, sector or country or specific aspects of the financial instruments which the scheme invests in.
iii) any change which may materially affect the ability of any key counterparty of an over the-counter (“OTC”) financial derivative, securities lending or repurchase transaction to fulfil its obligations to the scheme (For example, the counterparty of an OTC financial derivative used by an index fund to replicate an index would be considered a key counterparty) ; or
iv) the cessation of market making activity by designated market makers.

Annex 5. Example of material changes in CIS and notification request (extract from French AMF CIS Regulation)

Modifications of CIS the MDD	Authorization	Prior and special notification to each individual investor	No redemption fees or penalties	Public notification (by all means)
Modification of CIS into HFCIS	Not authorized			
ISIN Code				X
Name of the CIS				
Asset manager	X	X	X	X if intra group with no change of nationality
Management objective and investment policy	X	X	X	X
Benchmark indicator				X
Other information: recommended investment period				X
Methods of allocation of distributable sums: allocation of net income and realized capital gains				X
Risk and reward profile	X	X	X	X In the event of a change in the level of the risk scale linked to a change in the investment objective or policy equal to or strictly less than 20% of the net assets in terms of exposure)
New extra-Financial éléments on the management méthodologie		X		

Modifications of CIS the MDD	Authorization	Prior and special notification to each individual investor	No redemption fees or penalties	Public notification (by all means)
Change of master CIS	X	X	X	
redemption fees		X if increase	X if increase	
Subscription fees				X if increase *Posteriori*
Outperformance fee		X if increase	X if increase	X If decreasing *Posteriori*
Place to get information on the CIS				X
Place of get CIS NaV				X
Change in Depositary or trustee	X	X	X	X - if change is intra group only
Tax treatment		X In the event of elimination of eligibility for tax measures	X In the event of elimination of eligibility for tax measures	

Please refer to AMF instruction DOC -2011-19 for similar information of prospectus changes

Annex 6. Example of definitions in draft COFI bill and existing regulation - financial service providers

Party	Comments	FMA	FMA Regs	Margin Rules	ODP Conduct Std	Conduct Std for Banks	FSRA	COFI
Client		X						
Client	In relation to an ODP provider – not the same as FMA		X					
Counterparty	In ODP does not give definition- refers to FMA Regs		X		X			
Counterparty	In relation to Margin rules			X (different definition to FMA Regs)				
Provider				X				
Provider					X			
Authorized OTC derivatives provider			X					
OTC derivative provider			X					
Retail Financial Customer						X		
Financial Customer							X	
Juristic Person							X	
Retail Financial Customer	Similar to CSFB but adds the NCA							X

DEFINITIONS AS PER LEGISLATION

Party	Definition	FMA	FMA Regs	Margin Rules	ODP Conduct Std	Conduct Std for Banks	FSRA	COFI
Client	Means any person to whom a regulated person provides securities services, and includes a person that acts as an agent for another person in relation to those services in which case it would include the agent or exclude the other person if the contractual arrangement between the parties indicates this to be the intention	X						
Client	"client" in relation to an OTC derivative provider, means any person, other than a counterparty, with whom an OTC derivative provider- a) executes an OTC derivative transaction; or b) enters into a relationship with the intention of executing OTC derivative transactions;		X					
Counterparty	"counterparty" in relation to an OTC derivative provider, means - (a) another authorized OTC derivative provider; (b) an authorized user; (c) a bank; (d) a person who is registered, licensed or authorized - (i) to administer a collective investment scheme Collective Investment Schemes, Control Act, 2002 (Act No. 45 of 2002); (ii) to provide financial services in derivative instruments in terms of the Financial Advisory and Intermediary 2002 (Act No. 37 of 2002);		X		X (refers to FMA definition)			

Party	Definition	FMA	FMA Regs	Margin Rules	ODP Conduct Std	Conduct Std for Banks	FSRA	COFI
	(iii) to conduct long-term insurance business of the Long-term Insurance Act, 1998 (Act No. 52 of 1998); and (iv) to conduct short-term insurance business of the Short-term Insurance Act, 1998 (Act No. 53 of 1998); (e) a person outside the Republic who- (i) is authorized by a supervisory authority to perform a service or services similar to one or more of the services referred to in the definition of an OTC derivative provider or the services performed by an authorized user; or (ii) is registered, licensed, recognized, approved or otherwise authorized to conduct the business of a bank or to render services of a business referred to in paragraph (d) by a supervisory authority with functions similar to those of the Authority referred to in the legislation listed in paragraph (d); (f) a central bank or other national monetary authority of any country, state, or territory; (g) a private equity fund; (h) any other person who elects, in writing, to be categorized as a counterparty and who is not- (i) a natural person;							

Party	Definition	FMA	FMA Regs	Margin Rules	ODP Conduct Std	Conduct Std for Banks	FSRA	COFI
	(ii) a pension fund organization as defined in section 1(1) of the Pension Funds Act, 1956 (Act No. 1956) (iii) a friendly society referred to in the Friendly Societies Act, 1956 (Act No. 25 of 1956); (iv) a medical scheme or the board of trustees of such scheme as defined in section 1(1) of the Medical Schemes Act, 1998 (Act No.131 of 1998); and (i) any other person declared by the Authority to be a counterparty; with whom an OTC derivative provider executes an OTC derivative transaction or enters into a relationship with the intention of executing OTC derivative transactions;							
Counterparty	"counterparty means - (a) an authorized user; (b) a bank, bank controlling company or branch as defined in terms of the Banks Act; (c) a financial services provider authorized to provide financial services in derivatives instruments as contemplated in the Financial Advisory and Intermediary Services Act; (d) an insurer licensed or deemed to be licensed to conduct life insurance business in terms of the Insurance Act; (e) an insurer licensed or deemed to be licensed to conduct non-life			X				

Party	Definition	FMA	FMA Regs	Margin Rules	ODP Conduct Std	Conduct Std for Banks	FSRA	COFI
	insurance business in terms of the Insurance Act; (f) an investment fund; (g) a provider; (h) any other person declared by the Financial Sector Conduct Authority, with the concurrence of the Prudential Authority, to be a counterparty;							
Provider	'provider' means an authorized OTC derivatives provider as defined in the FMA Regulations"			X				
Provider	'provider' means an authorized OTC derivative provider				X			
Authorized OTC derivatives provider	'authorized OTC derivatives provider' means an OTC derivatives provider authorized by the Authority under Regulation 2 and section 6(8) of the FMA		X					
OTC derivatives provider	'OTC derivatives provider" means a person who as a regular feature of its business and transacting as principal- (a) originates, issues, or sells OTC derivatives; or (b) makes a market in OTC derivatives"		X					
Retail Financial Customer	"retail financial customer" means a financial customer that is: (a) a natural person; or (b) a juristic person, whose asset value or annual turnover is less than the threshold value as determined by the Minister of Trade and Industry in terms of section 6(1) of the Consumer Protection Act, 2008 (Act No. 68 of 2008);					X		
Financial customer	"financial customer" means a person to, or for, whom a					X	X	

Party	Definition	FMA	FMA Regs	Margin Rules	ODP Conduct Std	Conduct Std for Banks	FSRA	COFI
	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;							
Juristic Person	"juristic person" includes– a) a company, close corporation or co-operative incorporated or registered in terms of legislation whether in the Republic or elsewhere; b) an association, partnership, club, or other body of persons of whatever description, corporate or unincorporated; c) a trust or trust fund; d) an entity referred to in paragraph (a), (b) or (c) that is in liquidation, under business rescue proceedings or under judicial management; and e) the estate of a deceased or insolvent person;						X	
Retail Financial Customer	''retail financial customer'' means a financial customer that is— a) a natural person; or b) a juristic person, whose asset value or annual turnover is less than the threshold value as prescribed after consideration of any similar threshold values determined under the Consumer Protection Act and the National Credit Act;							X

Annex 7. Permanent compliance function (Extract from EU legislation)

1. The funds shall establish, implement and maintain adequate policies and procedures designed to detect any risk of failure to comply with its obligations and the associated risks, and put in place adequate measures and procedures designed to minimize such risk and to enable the competent authorities to exercise their powers effectively under that Directive. The fund shall consider the nature, scale and complexity of its business, and the nature and range of services and activities undertaken in the course of that business.

2. A fund shall establish and maintain a **permanent and effective compliance function which operates independently and has the following responsibilities**:

(a) monitoring and, on a regular basis, evaluating the adequacy and effectiveness of the measures, policies and procedures put in place in accordance with paragraph 1 and the actions taken to address any deficiencies in the fund's compliance with its obligations;

(b) advising the relevant persons responsible for carrying out services and activities and assisting them in complying with the fund's obligations.

3. In order to enable the compliance function to perform its responsibilities properly and independently, the fund shall ensure that:

(a) the compliance function has the **necessary authority, resources, expertise, and access to all relevant information**;

(b) a compliance officer is appointed and is **responsible for the compliance function and for reporting on a frequent basis, and at least annually, to the senior management on matters of compliance**, indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies;

(c) **persons in the compliance function are not involved in the performance of services or activities they monitor**;

(d) **the method of determining the remuneration of a compliance officer and other persons in the compliance function do not affect their objectivity** and are not likely to do so.

However, the fund shall not be required to comply with point (c) or (d) of the first subparagraph where it is able to demonstrate that in view of the nature, scale and complexity of its business, and the nature and range of its services and activities, that the requirement is not proportionate and that its compliance function continues to be effective.

Permanent internal audit function

1. A fund shall, where appropriate and proportionate in view of the nature, scale and complexity of their business and the nature and range of collective portfolio management activities undertaken in the course of that business, establish and maintain an internal audit function which is separate and independent from the other functions and activities of the fund.

2. The internal audit function shall:

(a) establish, implement, and maintain an audit plan to examine and evaluate the adequacy and effectiveness of the fund's systems, internal control mechanisms and arrangements;

(b) issue recommendations based on the results of work carried out in accordance with point (a);

(c) verify compliance with the recommendations referred to in point (b);

(d) report internal audit matters.

Annex 8. FSCA 2020 Organizational chart