

Unpacking the draft Conduct Standard for Banks...

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On 29 April 2019, the Financial Sector Conduct Authority (FSCA) released a statement supporting the draft Conduct Standard applicable to the conduct of banks under section 106(2)(b) of the Financial Sector Regulation Act 9 of 2017 (FSR Act).



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The draft Conduct Standard (published for public comment on 3 May 2019) aims to introduce requirements applicable to banks, mutual banks and co-operative banks that promote the fair treatment of financial customers of banks. The draft Conduct Standard is published for a period of six weeks for public comment. Interested parties are invited to submit written comments to the [FSCA](#) on or before 18 June. After consideration of the submissions received, the FSCA will make any necessary changes to the draft Conduct Standard and either submit it to Parliament or publish it for another round of public comment.

The draft Conduct Standard is intended to be consistent with the objective of the FSR Act, to promote the fair treatment of financial customers by financial institutions. It intends to balance principles-based and rules-based requirements to ensure that banks deliver fair customer outcomes in a disciplined, transparent and consistent manner. Banks will be expected to design and implement appropriate governance arrangements and other control mechanisms to ensure that the fair treatment of customers is central to their organisational culture. In addition, banks will be required to demonstrate to the FSCA that fair outcomes for customers are consistently delivered in the provision of financial products and services.

Monitoring

Once enacted, the FSCA will monitor compliance with the draft Conduct Standard by using pro-active supervisory approaches in terms of which potential areas of concern are identified. There will be greater emphasis on pre-empting concerns about negative customer outcomes. This pro-active approach will cover both emerging risks within a specific bank (micro conduct risks), as well as concerns at sector or business model level (macro conduct risks).

Once risks have been identified, the FSCA will engage with the relevant bank in attempt to pre-empt or remedy the harm. The FSCA intends to develop a reporting framework through which information will be gathered and used as an offsite

supervisory tool to identify conduct risks and trends specific to any particular bank. On-site supervision will also be conducted to examine and assess processes and management information relating to the fair treatment of customers. More significantly, measures such as "mystery shopping", interactions with banks and intermediaries and surveys conducted with respect to intermediaries and customers will be implemented in order to test customer experience.

Unpacking the basics of the draft Conduct Standard

The need for meaningful supervision of banks

The FSCA noted the weaknesses that have been identified in the South African banking sector over the past decade with particular reference to poor customer outcomes and a clear gap in the regulation of market conduct of retail banks.

In 2016/2017, National Treasury commissioned the World Bank to assess potential deficiencies from a fair-treatment perspective in the provision of transactional and fixed deposits by banks, and how any identified deficiencies could appropriately be addressed through market conduct regulation taking into account international good practices and the South African context. The diagnostic report made various recommendations, some of which called for the implementation of regulatory standards.

With the Financial Sector Regulation Act coming into effect in 2018, the FSCA has been given the explicit mandate of regulating and supervising the conduct of banks. The FSCA has identified the need for an enforceable market conduct regulatory framework within which the FSCA can measure conduct across the banking sector. Pursuant to this, the FSCA has released a draft Conduct Standard for banks that purports to enable it to supervise banks directly. The draft Conduct Standard is the first step towards the rolling out of a comprehensive market conduct regulatory framework for the banking sector.

Proposed conduct standards

The draft Conduct Standard has been designed to follow the sequencing of six Treating Customers Fairly (TCF) Outcomes and the sequencing of the typical financial product lifecycle. These requirements apply in addition to any other requirement already imposed on banks by any other financial sector law. They have been crafted in a way so as to avoid inconsistencies with the requirements which are already in place, but commentators are requested to highlight any potential inconsistencies that may have been overlooked.

Each requirement set out in the draft Conduct Standard has been directly informed by the TCF Outcomes as follows:

TCF Outcome 1: *Customers are confident that they are dealing with financial institutions in which the fair treatment of customers is central to their culture.*

Section 3 of the draft Conduct Standard sets out the manner in which banks are expected to demonstrate that fair customer treatment is central to their culture, which includes the entrenchment of governance and oversight frameworks to this end.

TCF Outcome 2: *Products and services marketed and sold in the retail market must be designed to meet the needs of identified customer groups and must be targeted at these customer groups.*

Section 4 of the draft Conduct Standard proposes to regulate the design, suitability and performance requirements for financial products and financial services. In addition, the section requires that banks must have certain oversight arrangements in place in order to ensure that the objectives of this TCF Outcome are met. It is important to note that the application of the draft Conduct Standard is not limited to retail financial customers (although the applicability of specific sections, for example section 5, are limited in this way).

TCF Outcome 3: Customers must be provided with clear information and kept appropriately informed before, during and after point of sale.

Section 6 of the draft Conduct Standard sets minimum standards for advertising, including the governance processes that must be in place for the approval of advertisements. In addition, section 7 sets out the disclosures that must be made to a financial customer in order to ensure that the financial customer is aware of and understands all the relevant facts that could reasonably be expected to influence the financial customer's decisions relating to the financial product or financial service.

TCF Outcome 4: Where advice is given, such advice is suitable and takes into account the circumstances of the customer.

Section 7 of the draft Conduct Standard identifies the factors that need to be taken into account when making disclosures to financial customers, such as the nature and complexity of the financial product, in order to ensure that a financial customer is given appropriate information about a financial product or financial service when the information is most useful to the financial customer's decision-making in relation to entering into, using, or maintaining the product or service.

TCF Outcome 5: Products perform as firms have led customers to expect, and service is of an acceptable standard and as customers have been led to expect.

Section 5, which is only applicable to retail financial customers, sets out the standards for the prohibition of unfair product terms and conditions including additional product design standards applicable to this market segment.

TCF Outcome 6: Customers do not face unreasonable post-sale barriers imposed by firms to change products, switch providers, submit claims or make complaints.

Section 8 deals with the Complaints Management Framework to be established by a bank, including appropriate training of responsible staff, categorisation of complaints and other procedures that need to be in place. Sections 8 and 9, deal with account closure and switching, whether initiated by the bank or the financial customer.

The impact of the draft Conduct Standard

The FSCA does not envisage that the draft Conduct Standard will have an adverse impact on customer choice, quality of banking products or services, or the efficiency of providing banking products and services. Instead, the FSCA envisages that the draft Conduct Standard is likely to lead to improved outcomes for customers in terms of improved disclosure mechanisms and the requirement that product offerings must be designed and targeted to appropriate customer groups.

The FSCA acknowledges that this is a preliminary assessment of the impact of the draft Conduct Standard subject to input from commentators. Thus, it is requested that commentators identify clearly any risks, benefits and potential effects envisaged in the draft Conduct Standard. The FSCA also acknowledges that the implementation of the draft Conduct Standards may have cost implications for banks, and as such comments on cost implications are requested. Comments will be analysed to understand the anticipated cost and other impacts of implementing the draft Conduct Standard, including the extent to which transitional provisions are required in respect of any of the proposed requirements.

ABOUT THE AUTHOR

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