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The regulation of foreign financial services providers under the FAIS act: a proposal for reform

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THE REGULATION OF FOREIGN FINANCIAL SERVICES PROVIDERS UNDER THE FAIS ACT: A PROPOSAL FOR REFORM

Submitted in partial fulfilment of the requirements for the degree of Master of Laws by Coursework and Research Report, at the University of the Witwatersrand, Johannesburg

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DECLARATION

I, Muzikayise Nicholous Mabilane, declare that this Research Report is my own unaided work. It is submitted in partial fulfillment of the requirements for the degree of Master of Laws (by Coursework and Research Report) at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

I have submitted my final Research Report through Turnitin and have attached the report to my submission.

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ABSTRACT

The Financial Advisory and Intermediary Services Act 37 of 2002 (FAISA) was promulgated to afford protection to consumers by ensuring that persons who advise them on financial products are adequately qualified to do so. The Act requires financial services providers to obtain a licence before they may solicit South African consumers in relation to any financial services or financial products. With the advancement of cyber and online-based activities across the globe, consumers now come across financial services providers on the online platform who are based outside South Africa. FAISA is unclear on whether such financial services providers are required to obtain a FAIS licence in instances where they have not solicited the South African customers. The constitutional right to freedom of association should allow individuals who wish to utilise such financial services to do so. However, the state must exercise its mandate to protect those consumers who wish such protection from cyber financial crime perpetrators disguised as legitimate financial services providers or their intermediaries. It is submitted that this should be done in collaboration and partnership with the sector's players because in its own, the Financial Sector Conduct Authority (FSCA) may lack the technical expertise and competence to track offenders in the digital space. Further, the FSCA may find itself accused of over-regulating in an area where is has little competence, the latter being the digital landscape. International best practices point to successful economies such as the United States and the United Kingdom, who sought to allow their financial sectors to self-regulate. Given the pace of growth in e-commerce, if the FSCA attempts to deal with all these fast changes, it may stretch its mandate too wide, especially in the light of the possibility that its capacity to strictly monitor online activity within the limits of its mandate, may currently be inadequate. Further, the is no evidence pointing to the FSCA's technical competence to regulate issues that gravitate more towards high technology instead of financial regulation. The solution supported is that this new growing area in the financial sector must be allowed to self-regulate, where the FSCA will only facilitate partnerships with industry players and monitor the sector *actively but remotely*. It is imperative for the South African government to permit its citizens to partake in economic activities without unnecessary restrictions thereof, so long as the state facilitates, co-ordinates and actively monitors mechanisms to protect the vulnerable.

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CHAPTER 1: INTRODUCTION

(a) Background

The Financial Advisory and Intermediary Services Act 37 of 2002 (FAISA) prohibits the acting or offering to act as a Financial Services Provider (FSP) unless such person (natural or juristic) has been issued with a licence by the Financial Sector Conduct Authority[1] (FSCA).[2] FAISA prescribes certain fit and proper requirements in accordance with the category of the financial services provider. In deciding whether to issue an FSP with a licence or not, the Registrar of FSPs will among other things, consider issues such as the operational capacity and financial soundness of the FSP.[3]

Prior to FAISA, common law placed duties on providers of financial services and their intermediaries.[4] These were later codified by the Policyholder Protection Rules issued in relation to the Long-term Insurance Act 52 of 1998 and the Short-term Insurance Act 53 of 1998.[5] Thus advisors and intermediaries in relation to insurance products were required to act with reasonable care and skill and to act in good faith.[6] Acting in good faith comprised of three pillars, namely to be open and honest, not to make secret profits out of a transaction,[7] and the third pillar being to act

[1] See FSCA'Stakeholder Letter from the FSCA' (undated) available at https://www.fsca.co.za/Documents/FSCA%20stakeholder%20letter.pdf, accessed on 20 November 2018. [With effect from 1 April 2018, the Financial Services Board (FSB) has been transformed into a new regulatory authority called the Financial Sector Conduct Authority (FSCA). This is pursuant to the implementation of the Twin-Peaks Model which was approved by parliament back in June 2011. The FSCA is empowered by the Financial Sector Regulation Act 9 of 2017 (FSRA), which was signed into law on 21 August 2017]. Twin Peaks is a model that consists of two regulatory bodies, namely the Prudential Authority (PA) and the market conduct regulator being the FSCA. The former, housed in the South African Reserve Bank focuses on strengthening the financial soundness and financial safety of financial institutions. Whereas the FSCA focuses on protecting consumers under the financial sector and ensure that they are treated fairly. The PA is responsible for microprudential supervision and for macroprudential supervision, the latter entailing among other things formulating and implementing monetary policy to ensure the mitigation of the risk of the likelihood of using tax-payers' money to bail-out financially distressed financial institutions. See National Treasury: Republic of South Africa (2016) 'Financial Sector Regulation Bill – Impact Study of the Twin Peaks Reforms' 1 – 35, retrieved from http://www.treasury.gov.za/twinpeaks/Impact%20Study%20on%20Twin%20Peaks%20Reforms.pdf, accessed on 20 January 2019.

[2] Section 7(1) in the Financial Advisory and Intermediaries Act 37 of 2002 (FAISA), reads:
'a person may not act or offer to act as a –
(a) Financial services provider, unless such a person has been issued with a licence under section 8.'

[3] See Board Notice 194 of 2017 *GG* 41321 of 15 December 2017. Chapter 6 in the BN deals with Financial Soundness and Chapter 6 with Operational Ability.

[4] See Peter Havenga 'The Duty of the Broker to Inform the Insured about the Terms of the Contract' (2002) 14 *SA Mercantile Law Journal* 819 at 822.

[5] See J P van Niekerk 'Insurance Law' (2008) 1 *Annual Survey of South African Law* 517 at 524.

[6] Ibid.

[7] Ibid.

in the best interests of the client.[8]

When FAISA came into force, it retained the common law principles, and complemented these with specific minimum standards, pursuant to providing better protection for consumers.[9] Matters that were previously dealt with in the Policyholder Protection Rules which dealt with intermediary and advice issues were codified into FAISA through the General Code of Conduct[10] for Authorised FSPs and Representatives. The conduct by an FSP that falls short of the minimum standards is actionable by an aggrieved consumer.[11] The latter is synonymous with the common law duties of company directors, and their codified version in s 76(3) of the Companies Act 71 of 2008.[12] It is sensible that in matters entailing handling consumers' hard-earned money, a high standard be placed for advisors in order to protect consumers against ill-informed advisors.[13] This is crucial, especially where it is reasonable that the consumers may rely on and act in accordance with such advice.[14] Whilst the objectives and intentions of the legislature when FAISA was promulgated are praise-worthy, every cloud has a silver lining. The FAISA era has certainly not gone without problems.

Kern argues that FAISA compliance implications have inevitably led foreign FSPs to contemplate withdrawing from the South African market (which Kern argues that is somewhat of lesser business significance compared to conglomerates like the UK, the US, and Japan).[15] This may have dire consequences on South Africa's outlook to the international investment community.[16] Notwithstanding this, there has been several commendable attempts by the FSCA

[8] Ibid.
[9] Ibid.
[10] See Board Notice 80 of 2003 *GG* 25299 of 8 August 2003. This BN constituted the General Code of Conduct for Authorised Financial Services Providers and Representatives published in terms of s 15 of FAISA.
[11] For example, section 14 (1) of FAISA permits an FSP to act against representatives who are seen to be incompetent or unfit to render financial services. Also see Daleen Millard 'Bespoke Justice – On financial ombudsmen, rules and principles' (2011) 44 *De Jure* 232 at 237.
[12] Section 76(3) in the Companies Act, reads:
'Subject to ss (4) and (5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director-
(a) in good faith and for a proper purpose;
(b) in the best interests of the company; and
(c) with the degree of care, skill and diligence that may reasonably be expected of a person-
(i) carrying out the same functions in relation to the company as those carried out by that director; and
(ii) having the general knowledge, skill and experience of that director.'
[13] See op cit note 11 at 233.
[14] Ibid.
[15] See Kirsten Kern 'Relief for Foreign Financial Service Providers…?' (2012) 12 *Without Prejudice* 27 at 27.
[16]See Kenneth Spong 'Banking Regulation: Its purposes, implementation and effects' (2000), retrieved from https://www.kansascityfed.org/publicat/bankingregulation/RegsBook2000.pdf, accessed on 4 January 2019.

to avoid the double-regulation of foreign-FSPs. For example, Board Notice 61 of 2012 *GG* 35251 of 10 April 2012, sought to exempt Category I FSPs which do not have physical presence in South Africa from writing the South African exams.

The constituents of a foreign-based FSP, namely the key individual, the FSP's representatives and compliance officers, became exempt from holding academic qualifications expressly recognized by the Registrar.[17] The exemption allowed them to hold academic qualifications that are recognised by a foreign regulator, whereas the foreign regulator would have to be recognised by the FSCA. Other exemptions previously granted in relation to foreign-FSP, are in relation to not having to maintain a South African bank account and to appoint South African auditors, as contemplated in Board Notice 166 of 2011 *GG* 34691 of 19 October 2011.

These exemptions are commendable strides aimed at fostering the interest and engagement of foreign financial services providers. One of the major challenges faced by the FSCA, comprehensively addressed in this thesis, stems from the lack of clarity in FAISA regarding foreign FSPs in relation to the most fundamental determination – Whether or not a foreign FSP who operates on the online platform, must obtain a licence from the FSCA. The contemplated foreign-based company has no physical presence in South Africa.[18] However, while they do not have a physical office in South Africa, they have inadvertent digital presence which may result in unintended solicitation of South African consumers utilising their services via the online platform. FAISA does not provide clarity as to when such foreign FSP will be required to comply by obtaining a licence, especially given the fact that it would not have solicited the South African clients.[19] FAISA stipulates that such products if marketed in South Africa, are included in the Act's

[17] Board Notice 166 of 2011 *GG* 34691 of 19 October 2011.

[18] Foreign companies must be distinguished from 'external companies' for the purposes of this thesis. Section 23 in the Companies Act deals with 'external companies' and these have been dealt with in chapter 2 para (c) of this thesis.

[19] Regulation 3 of the FAISA Regulations of 2003, reads:
'No person other than an authorised FSP may solicit for business relating to the rendering of financial services in South Africa. This includes a person domiciled outside the Republic who solicits for business in South Africa'. These Regulations do not define what 'solicit' means and neither any Board Notices that have been issued by the FSCA. The ECTA is also silent on what 'solicit' entails. In interpreting documents, including legislation, the law directs us to have regard to the language used in the light of the ordinary rules of grammar and syntax, the context in which the provision appears, the apparent purpose to which it is directed and the material known to those responsible for its production. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusiness-like results or undermines the apparent purpose of the document (see *Natal Joint Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) at para 18). The *Oxford Learners Dictionary* defines 'solicitation' as the act of "asking somebody for something, such as support, money or information; the act of trying to get something or persuading somebody to do something" (retrieved form https://www.oxfordlearnersdictionaries.com/definition/english/solicitation, accessed on 5 February 2019.

definition of 'financial product', that is if such products in their nature and character are similar or corresponding to any of the products defined in the Act.[20] However, this is not enough to suggest that a foreign-based company, dealing in these products, should obtain a licence. Numerous financial products falling under the Act's definition of 'financial product' are offered by companies across the globe. Section 1(1) of FAISA is clear that South African companies that offer foreign-based financial products, are also required to be licensed, given that these products are marketed to South Africans.[21] .

Contraventions of the Act relating to non-compliance can lead to penalties of up to R1 million, five years imprisonment, or both. The Act also empowers the Registrar to take entities that have not complied with the Act to court, which may determine suitable compensation for losses suffered, plus costs, and may further determine a penalty of up to three times the amount of any profit and gains arising from the alleged contravention. Millard indicates that the FSCA is increasingly taking tighter enforcement measures to ensure compliance.[22]

This thesis will critically consider the South African *status quo* in relation to the regulation

[20] Section 1(1)(*i*) in FAISA, reads:
' `financial product' means…-
(a) securities and instruments, including-
(i) shares in a company other than a 'share block company' as defined in the Share Blocks Control Act, 1980;
(ii) debentures and securitised debt;
(iii) any money-market instrument;
(iv) any warrant, certificate, and other instrument acknowledging, conferring or creating rights to subscribe to, acquire, dispose of, or convert securities and instruments referred to in subparagraphs (i), (ii) and (iii);
(v) any 'securities' as defined in section 1 of the Financial Markets Act, 2012;
(b) a participatory interest in one or more collective investment schemes;
(c) a long-term or a short-term insurance contract or policy, referred to in the Long-term Insurance Act, 1998 and the Short-term Insurance Act, 1998, respectively;
(d) a benefit provided by-
(i) a pension fund organisation as defined in section 1 (1) of the Pension Funds Act, 1956 (Act 24 of 1956), to the members of the organisation by virtue of membership; or
(ii) a friendly society referred to in the Friendly Societies Act, 1956, to the members of the society by virtue of membership;
(e) a foreign currency denominated investment instrument, including a foreign currency deposit;
(f) a deposit as defined in section 1 (1) of the Banks Act, 1990;
(g) a health service benefit provided by a medical scheme as defined in section 1 (1) of the Medical Schemes Act, 1998,
(h) any other product similar in nature to any financial product referred to in paragraphs (a) to (g), inclusive, declared by the registrar by notice in the Gazette to be a financial product for the purposes of this Act;
(i) any combined product containing one or more of the financial products referred to in paragraphs (a) to (h), inclusive;
(j) any financial product issued by any foreign product supplier and which in nature and character is essentially similar or corresponding to a financial product referred to in paragraph (a) to (i), inclusive.'
[21] op cite note 20.
[22] See Daleen Millard 'The Impact of the Twin Peaks Model on the Insurance Industry' (2016) 19 *PELJ* 1 at 24.

of non-resident financial services providers under FAISA. It will then review the national laws of various foreign jurisdictions in relation to the former issue, to establish international best practices. Given all the considerations from foreign law, this thesis then proposes a reform of the current regulatory framework. This research also invokes a perspective based on the Constitution.[23] It has looked at whether or not there is a challenge in relation to constitutional rights, namely the right to association.[24] A typical scenario would be where a South African has already invested money with a non-compliant foreign company, whom s/he found online. The inadvertent consequence of the FSCA issuing a compliance notice, leading to the company immediately discontinuing its dealings with the South African consumer, would ultimately be this South African consumer losing all his/her investment.

(b) Problem Statement

With the advancement of cyber technology, companies increasingly make use of digital platforms to either solicit for business, to contract with clients, or to service existing clients.[25] A legal question arises pertaining to the determination of whether a foreign-based company that renders services that qualify under FAISA's definition of 'advice' or 'intermediary services',[26] using a website accessible to South African consumers, will be required to apply for an FSP licence, despite not having solicited the South African clients. An example is that of a company offering web-based financial advice and intermediary services in relation to foreign-based investment instruments. Firstly, one may argue that it will be taking it too far to require such a company to perform a due diligence on the financial laws of all the states whose citizens will potentially access their website, and to therefore restrict access to those consumers whose states prohibit the rendering of such services without a licence. Is there any legal duty for this, and upon which laws would it be based? In the event of a non-compliance notice from the FSCA and a fine, what defences (if any), would the foreign-based company have to rely on?

[23] The Constitution of the Republic of South Africa of 1996.
[24] Section 18 in the Constitution, reads:
'Everyone has a right to freedom of association.'
[25] Sarika Kader and Anthony Minnaar 'Cybercrime investigations: Cyber processes for detecting cybercriminal activities, cyber intelligence and evidence gathering' (2015) 5 *Acta Criminologica: Southern African Journal of Criminology* 67 at 68.
[26] Section 1(1) of FAISA.

Secondly, given that the FSCA places some burden on consumers to identify unregistered FSPs and to refrain from dealings with the latter, the second legal question pertains to whether the former will sufficiently warrant a potential defence for the foreign-company, based on and alleging negligence on the part of the South African consumer, who while surfing the web utilises the services of the foreign-company.

The third scenario relates to circumstances under which the FSCA issues a compliance-notice to the foreign-company, calling upon it to comply with FAISA or to face penalties. If the company finds it not feasible to seek compliance in South Africa and therefore terminates its dealings with all its South African consumers, this could have devastating consequences. The inadvertent consequences of such a compliance-notice could among others, be the South African consumers losing all their investments. Notwithstanding this, South Africa has a duty to protect its citizens by placing adequate mechanisms that will protect vulnerable ones. This must be done without invoking unnecessary restricting that may protract economic growth. One may never over-emphasise the spate of online-based financial crimes, making it necessary for any caring nation to tighten its belt and afford its citizens protection from the former.[27] The applications of technology to financial crimes is increasing.[28] Making this situation even more worrying, is the prevalence of unidentifiable predatory perpetrators on the web, who may be disguised as anything from accredited financial advisors to experienced investment brokers. These perpetrators can from the press of a button based anywhere around the world, cause serious financial impediment to innocent people.[29] The latter factor is considered as a mitigating factor against arguments that may be raised by advocates of minimal state intervention.

(c) Research Methodology

There is currently no legal framework, whether within FAISA, its Regulations, or Board Notices that have been issued by the FSCA and published in the *Government Gazette*, that adequately address the problems identified in the problem statement. Exploratory research has been undertaken in the form of a literature review. The exploratory research entailing mostly academic

[27] Nigel Fletcher 'Challenges for regulating financial fraud in cyberspace' (2007) 14(2) *Journal of Financial Crime* 190 at 191.
[28] Ibid.
[29] Ibid.

scholarly literature with the aim to propose a feasible reform of the FSCA in relation to how it deals with foreign-based FSPs.

Legislative provisions that were reviewed to address the issues contemplated in the problem statement above, are from the following pieces of legislation:

- Companies Act 61 of 1973 (old Companies Act)
- Companies Act 71 of 2008 (Companies Act)
- Constitution of the Republic of South Africa of 1996 (Constitution)
- Consumer Protection Act 68 of 2008 (CPA)
- Electronic Communications and Transactions Act 25 of 2002 (ECTA)
- Financial Advisory and Intermediary Services Act 37 of 2002 (FAISA)
- Financial Sector Regulation Act 9 of 2017 (FSRA)

Foreign law has been reviewed through foreign legislation and legal journals, to clarify the position in various jurisdictions and contrast these with South Africa. This is pursuant to identifying international best practices.

CHAPTER 2: CONSIDERATIONS FROM VARIOUS LEGISLATIVE PROVISIONS

(a) The Constitution of the Republic of South Africa, 1996

Section 18 of the Constitution provides for the right to the freedom of association.[30] This right is often used in the context of trade unions, bargaining and the right to strike, but hardly ever invoked in issues relating to business transactions. If the main objective of financial regulation is to protect consumers, then it is submitted that an individual who prefers to use his/her financial resources in a way s/he deems appropriate, should be allowed to do likewise. Budeli points out that the right to freedom of association is simply the right of ordinary people who wish to form their own institutions in order to pursue common interests and to shelter them against the arbitrary power of the state.[31]

Woolman identifies two reasons rendering the right to freedom of association a necessity in a constitutional dispensation. She argues that this right enables individuals to pursue and

[30] Section 18 of the Constitution, reads:
'Everyone has a right to the freedom of association'.
[31] See Mpfari Budeli 'Understanding the right to freedom of association' (2010) 31(1) *Obiter* 16 at 27.

maintain personal attachments that they believe in, and which are constitutive of their well-being. Secondly, this right allows for a rich and varied society, which in turn may ensure economic progress and advancement.[32] It is submitted that a free-market society allows for enormous growth.[33] As is indicated below in Chapter 4 of this thesis, compared to the UK and South Africa, the US financial regulation landscape in relation to foreign financial services providers is less onerous. One may reasonably infer that the US' global ranking as a leading economy may be attributed to laws that foster creativity, innovation, and freedom of association (in relation to business transactions). While one may never overstate for instance the dire consequences of relaxed financial regulation laws pertaining to issues such as fraud, the benefits of relaxed restrictions for foreign-based investors, may result in more good than bad.

It is therefore submitted that South Africa's financial regulation laws should be measured against economic rights guaranteed in the Constitution, mainly the right to freedom of association. Indisputably, adequate protection should be made available to vulnerable citizens. However, a consumer who despite public notices by the FSCA and promotional campaigns warning against unlicensed financial services providers, decides to use his/her resources and enter into dealings with such individuals, should be allowed to do as such. This will be pursuant to his/her guaranteed right of freedom of association. States should permit its citizens to partake in economic activities without unnecessary restrictions thereof, so long as the state has put in mechanisms to protect the vulnerable. (us in summary and recommendations).

(b) The Financial Advisory and Intermediary Services Act 37 of 2002 (FAISA)

FAISA regulates the rendering of financial advisory and intermediary services. It requires that all financial service providers be registered and that all key individuals and representatives in relation to those financial service providers are adequately qualified. Only persons licensed pursuant to the terms of FAISA are authorised to provide financial services to clients. Section 7(1) of FAISA prohibits the acting or offering to act as a financial services providers, unless the person has been issued with a licence. Further, only those who meet and maintain the FSCA's Fit and Proper requirements will be licenced as authorized.[34] Fit and Proper requirements relate to the

[32] See Mpfari Budeli 'A Journal of Legal History - Workers' right to freedom of association and trade unionism in South Africa : an historical perspective' (2009) 15(2) *Fundamina: A Journal of Legal History* 57 at 57.
[33] Ibid.
[34] See Germa Beukes 'How the FAIS Act Protects you' (2005) 47(7) *South African Family Practice* 54 at 54.

competency, qualifications, regulatory examinations, experience, and the on-going professional development of the concerned individuals.[35] Organisations seeking to obtain an FSP licence must evidence their operational ability and financial soundness in order to be given a licence.[36]

The relevant legal framework for FSPs is broader than FAISA itself and includes FAIS Regulations, Codes of Conduct and Board Notices that being secondary legislation, are published in the *Government Gazette*. FAISA also impacts the retail sector to the extent that such retail merchants sell 'bolt-on' products such as warranties that fall under FAISA's definition of 'financial product'. Such retailers are required to obtain an intermediary licence in relation to those add-on products that they either market or administer on behalf of insurance companies.[37]

However, both FAISA and the FSRA are silent in relation to prospective FSPs who while they don't have physical presence in South Africa, they have digital presence in South Africa through the online platform. [38] As indicated above in Chapter 1, the FSCA has issued Board Notices aimed at affording some relief to foreign FSPs who are already licensed by the FSCA.[39] Such relief only relates to some on-going compliance requirements under FAISA. The burden to obtain an FSP licence still remains. Cobbet submits that the FSCA may effectively be a toothless regulator despite all the legislation currently in place pursuant to consumer protection.[40] He argues that Morgan Finch has for some time been rendering financial advice to South African consumers at a price without the possession of a FAIS licence.[41] This is despite the fact that Norwegian authorities had warned Morgan Finch to comply with Norwegian financial regulation laws, failing which they should halt servicing Norwegian consumers.[42] As a result of failing to comply with the notice, a warning against Morgan Finch was published on the website of Norway's financial authority.[43]

Further, Dutch authorities, along with a number of other European financial authorities, tagged the Norwegian warning and placed Morgan Finch on a list of foreign warnings.[44]

[35] Ibid.
[36] Ibid.
[37] Ibid.
[38] FSB Notice 24 of 2015 only goes as far as stating that a foreign financial services provider may not 'solicit' South African clients, but it does not explain what 'solicit' entails for the purposes of FAISA, specifically in relation to those prospective FSPs who operate in the online platform.
[39] op cit note 10 and 16.
[40] Julius Cobbet 'Beware unlicensed foreign share peddlers' (2008) 330 *Personal Finance* 13 at 14.
[41] Ibid.
[42] Ibid.
[43] Ibid.
[44] See ISOG 'Fraud Warnings Fraud Alerts M from Financial Authorities' available at https://isog.org/fraud-warnings-and-alerts/fraud-warnings-fraud-alerts-m/, accessed on 15 December 2018. ISOG is UK-based private investigation

Norwegian authorities issued their warning based on their belief that their citizens would be vulnerable and fall prey to Morgan Finch.

Whilst various jurisdictions around the world were alerting their consumers about Morgan Finch, and taking all steps necessary thereto, the FSCA did not do anything.[45] Morgan Finch continued to service South African consumers for very long without the FSCA's intervention. Personal Finance Newsletter has reported that Morgan Finch has since changed its name.[46] Could one therefore argue that the FSCA has been a toothless regulator, armed with ambiguous legislation as its weapons, but failing to use such weapons to protect consumers?

(c) The Companies Act 71 of 2008

The FSCA sent a letter dated 6 September 2017 to its registered foreign FSPs advising them that all registered foreign FSPs must be registered as external companies in terms of s 23 of the Companies Act.[47] Section 23(1) in the Companies Act provides that a foreign company must register as an external company with the Companies and Intellectual Property Commission (CIPC) within 20 days after it first begins to 'conduct business'. It is to be regarded as conducting business in South Africa in one of two circumstances.

The first trigger under of the requirement for a foreign company to register with CIPC as an external company is if the foreign company is a party to an employment contract in South Africa.[48] There are no exceptions under these circumstances. One may easily infer that one of the rational for the CIPC to require that foreign companies that are conducting ongoing business in

agency, law firm and forensics service provider. Kindly see their website at https://isog.org accessed by the writer on 5 January 2019.

[45] Ibid.

[46] Ibid.

[47] Section 23(1) and (2) in the Companies Act, reads:

'(1) An external company must register with the Commission within 20 business days after it first begins to conduct business, or non-profit activities, as the case may be, within the Republic-

(a) as an external non-profit company if, within the jurisdiction in which it was incorporated, it meets legislative or definitional requirements that are comparable to the legislative or definitional requirements of a non-profit company incorporated under this Act; or

(b) as an external profit company, in any other case.

(2) For the purposes of ss (1), and the definition of 'external company' as set out in s 1, a foreign company must be regarded as 'conducting business, or non-profit activities, as the case may be, within the Republic' if that foreign company-

(a) is a party to one or more employment contracts within the Republic; or

(b) subject to ss (2A), is engaging in a course of conduct, or has engaged in a course or pattern of activities within the Republic over a period of at least six months, such as would lead a person to reasonably conclude that the company intended to continually engage in business or non-profit activities within the Republic'.

[48] Section 23(2)(a).

South Africa must register, is to enable its South African creditors to be able to establish jurisdiction in the case of court litigation for local courts. Further, It is only sensible that a foreign company that employs staff in South Africa be required to be registered for the protection of its employees where such employees seek relief from the Commission for Conciliation Mediation and Arbitration (CCMA), for instance. The CCMA would not be able to establish jurisdiction over a foreign company that does not have any presence in South Africa, unless such foreign company has used a South African employment agent to recruit such employees.[49] In such cases, CCMA will have jurisdiction only on the South African employment agent but not on the agent's client who may be based abroad unless such employees have been working for such a client (based abroad) for a period exceeding three (3) months.[50]

The Companies Act determines that where the foreign company employs at least one person in South Africa, it is required to be registered as an external company and have an office in South Africa. Section 198A in the Labour Relations Act 66 of 1995 (LRA) provides that where an employee of a temporary employment agency performs work for the agent's client for a period longer than three months, the employee is, for the purpose of the LRA, deemed to be an employee of the client.[51] It is unclear whether the latter would render the foreign based company required to register as an external company in terms of s 23(2)(*a*) in the Companies Act, given that s 198A of the LRA specifies 'for the purpose of the LRA'.[52] This issue does not fall under the scope of this research though.

The second circumstance is where a foreign company is engaging in a course of conduct or has engaged in a pattern of activities within South Africa over a period of at least six months, such as would lead a person to reasonably conclude that the company intended to continually engage in business within South Africa.[53] Section 23(2) lists these activities. The external company

[49] See *MECS Africa (Pty) Ltd v Commission for Conciliation, Mediation & Arbitration & others* (2014) ILJ 745 LC at para 75 - 78 . In the *MECS* case, it was held that the place where an employment agent conducts business is clearly 'the place where it recruits and procures labour' and not the place where its clients have operations. The implication of this ruling is that the CCMA has jurisdiction to hear disputes referred to it by employees of a South African employment agent, even if those employees are placed with a client outside South Africa's borders [par 75 – 78]. The newly enacted s 198 (4A) of the LRA allows for an aggrieved temporary employee to institute proceedings against either the employment agent or its client based abroad.
[50] Ibid.
[51] See Melanie Hart 'The CCMA's Jurisdiction Beyond SA's Borders' (2015) 15(10) *Without Prejudice* 24 at 25.
[52] Ibid.
[53] Section 23(2) in the Companies Act.

needs to have only engaged in one of these activities within South Africa.[54] The test under the old Companies Act[55] was somewhat clearer, in that it required a foreign company to register as an external company when the foreign company 'established a place of business' in South Africa.[56] The current Companies Act does not require a place of business to be established to trigger the obligation on a foreign company to register as an external company.

In a recent court case, *La Lucia Sands Share Block Ltd v Flexi Holiday Club and Others*[57] , the term 'business' was described as 'anything which occupies the time and attention and labour of a man for the purpose of profit'.[58] It appears that consideration needs to be given as to whether a foreign company's activities inside of South Africa constitute 'business activities' for purposes of s 23(2)(*b*) of the Companies Act. The Companies Act does not define 'business activities'. What it does stipulate is that a foreign company must be regarded as 'conducting business activities' within South Africa solely on the ground that the foreign company is or has engaged in one or more of the activities contemplated in s 23 (2). [59]

Accordingly, if a foreign company is engaged in any of the listed activities, that in itself will indicate that the company is 'conducting business' and will trigger an obligation for the foreign company to register as an external company. Therefore, the determination in terms of s 23(2)(*b*) relating to whether a foreign company is conducting 'business activities' in South Africa or not, may require a measure of subjective determination, with a balancing of factors – it is a

[54] Paragraphs (a) to (g) in this section, reads:
'(a) Holding a meeting or meetings of the shareholders or board of the foreign company, or otherwise conducting the internal affairs of the company;
(b) establishing or maintaining any bank or other financial accounts;
(c) establishing or maintaining offices or agencies for the transfer, exchange or registration of the foreign company's own securities;
(d) creating or acquiring any debts, mortgages or security interests in any property;
(e) securing or collecting any debt, or enforcing any mortgage or security interest;
(f) acquiring any interest in any property; and
(g) entering into contracts of employment'.
[55] Companies Act 61 of 1973.
[56] Chapter XIII of the Old Companies Act was dedicated to external companies and provided that all external companies that had established 'a place of business' in South Africa had to periodically lodge specified documentation and information with the Registrar of Companies, obtain a local company registration number, appoint an external auditor and a person authorised to accept service of process and identify themselves as external companies.
[57] See *La Lucia Sands Share Block Ltd v Flexi Holiday Club* 2012 JDR 0531 (SCA) [para 15 – 25].
[58] op cit note 54 at para 16 – 18.
[59] Section 23(2)(*a*) – (*g*).

question of fact to be determined in the light of all relevant circumstances. In this regard, the following is noted in relation to s 23 (2):

- In the case of *Lord Advocate v Huron & Erie Loan & Savings Co*,[60] it was held that the mere appointment of an agent for a particular purpose pertaining to a company's affairs is not the establishment for the foreign company of a place of business at such agent's office. In the absence of a provision stating the contrary either from the Companies Act or case law, it is proposed that the above common law position be interpreted broadly.[61]
- Section 23(2) provides that the creating or acquiring of debts does not necessarily trigger the obligation to register as an external company, neither does acquiring an interest in property (A lease agreement could arguably be regarded as an interest in property). Therefore, the conclusion of certain contracts by local persons with a foreign company will not necessarily trigger the requirement for that foreign company to register as an external company in South Africa.
- If a foreign-based company concludes an agreement as contemplated above, it becomes enabled to sue the South African-based party in South African courts. However, if the local party intends taking legal action against the foreign company (that is not registered in South Africa as an external company), then the local company would need to first establish that South African courts have jurisdiction over the matter. This will require making out a case that such foreign company's activities fall within the ambit of s 23(2). If it is successful, then the CIPC will be required to issue the foreign company with a compliance notice to register as an external company.[62]

The Companies Act does not take into account the income that a foreign company derives from customers in South Africa as factor in determining whether the foreign company is conducting 'business activities' in South Africa. It is submitted that the latter should be a factor which a court of law, or CIPC, should take into account in assessing whether a foreign company should register as an external company. The deriving of more than nominal income from customers in South Africa is arguably commercially indicative of business activities being conducted. As indicated

[60] See *Lord Advocate v Huron & Erie Loan & Savings Co* [1911 SC 612].
[61] op cit note 54.
[62] Ibid.

in the *La Lucia* case, the term 'business' is described as 'anything which requires time, attention and labour of a man for the purposes of profit'.[63]

Consequences of not registering a foreign company as an external company in South Africa

The current Companies Act no longer imposes any liability on a director, officer or agent in the case of not registering an external company. Section 23(6) provides that where an external company is required to register as an external company, and fails to do so within three months of commencing activities in South Africa, the CIPC may issue a compliance notice to the external company requiring it to register within 20 business days after receiving such notice or, if the foreign company fails to register within the time allowed, to cease carrying on its business or activities within South Africa. [64]

(d) The Electronic Communications and Transactions Act 25 of 2002 (ECTA)

The ECTA came into force on 30 August 2002 and is based on the principles of functional equivalence,[65] technological neutrality,[66] and compatibility with international best practices.[67] It therefore goes without saying that the object of the ECTA is to protect consumers by prescribing measures for those trading on the internet platform to conclude valid contracts on the internet. The scope of the ECTA in relation to regulatory issues is therefore very limited.

Section 42(2)[68] of the ECTA excludes financial services from the application of s 44 which

[63] Ibid.

[64] Section 23(6) in the Companies Act, reads:
'If an external company has failed to register in terms of subsection (1) within 12 months after commencing its activities within the Republic, the Commission may issue a compliance notice to that external company requiring it to—
(a) register as required by subsection (1) within 20 business days after receiving the notice; or
(b) if it fails to register within the time allowed in paragraph (a), to cease carrying on its business or activities within the Republic'.

[65] See Wanette Jacobs 'The Electronic Communications and Transactions Act: Consumer Protection and Internet Contracts' (2004) 16(4) *SA Mercantile Law Journal* 556 at 557 footnote 13. This concept means that the law should treat paper-based transactions in the same way as electronic transactions, without favouring one over the other or prejudicing either.

[66] Ibid at 557 footnote 14. This concept means that the law should not prescribe the use of a specific medium of technology but should be drafted in a broad, wide and general terms.

[67]Ibid at 557 footnote 15. The ECTA was drafted based mainly on the Model Law on Electronic Commerce, drafted by the United Nations Commission on International Trade Law.

[68]Section 42(2)(a) in the ECTA, reads:
'Section 44 does not apply to an electronic transaction-
(a) for financial services, including but not limited to, investment services, insurance and reinsurance operations, banking services and operations relating to dealings in securities.'

deals with a cooling-off period. Further, s 42(3) specifically restricts the ECTA scope in relation to a regulatory body established in terms of a law, if that law deals with electronic communications.[69] The regulatory body assigned with the implementation of FAISA is the FSCA, which is established in terms of s 56 in the FSRA. Therefore, if one were to view the FAISA in the light of the ECTA, it would only have to be to the extent of determining how a contract may be concluded with a financial services provider online. However, the compliance with FAISA of such a financial services provider will fall outside the scope of the ECTA.

Consumers are protected by the ECTA against unsolicited goods, services, or communications. The sending of an unsolicited commercial communication is not an offence in itself. The sender is required in terms of s 45 of the ECTA to give the consumer a chance to opt-out. Such soliciting communications must immediately be halted by the sender after receipt of notice to that effect — It is an offence to send an unsolicited commercial communication to a person who has indicated that they don't want such. A consumer's failure to respond to an unsolicited communication does not amount to acceptance of an offer and does not bind the consumer contractually.

(e) Cyber Law Regulation and Financial Crime

The increasing spate of financial crime committed on the online platform by perpetrators who may be based anywhere around the world, aggravates the need for all jurisdictions around the world to tighten their belt and protect their citizens.[70] The questions arising is whether or not the FSCA has the capacity and expertise to deal with online-based financial crime. Over-regulation in the absence of pro-active monitoring of such crimes, defeats the purpose of financial regulation.[71] In other words, there may be laws administered by the FSCA seeking to regulate financial services, however if there are no means to monitor the adherence to such laws and enforcing these, such laws become pointless. An authority tasked with the former, must have the technical and technological competence to trace non-compliance and not merely add pages of irrelevant

[69] Section 42(3) in the ECTA, reads:
'This Chapter does not apply to *a regulatory authority established in terms of a law* if that law prescribes consumer protection provisions in respect of electronic transactions.' (Italics for emphasis)
[70] See Tyler Hodgson 'From famine to feast – The prosecution of multi-jurisdictional financial crime in the information age' (2008) 15(3) *Journal of Financial Crime* 320 at 329.
[71] Ibid.

regulation.[72] It is submitted that instead of over-regulating, an authority should consider self-regulation as an alternative. For example, the ECTA provides for the limitation of liability of internet service providers against actions based on unlawful content placed on their websites.[73] The legislature's approach is to emphasise self-regulation of the internet by providing in s 72 of the ECTA that only those service providers which belong to an Industry Representative Body (IRB), recognized by the Minister of Communications, will qualify for the protection accorded by the ECTA. Such an IRB must then, through its Code of Conduct, regulate service providers belonging to it. Such a model has its weaknesses and strengths.[74] Some jurisdictions around the world such as the European Union, consider co-regulation to be more flexible that traditional government regulation and control.[75]

It is therefore submitted that South Africa should move towards an inclusive regulatory model, given that the FSCA on its own, may not have the capacity and technical aptitude to keep abreast of online financial crime 'tricks'. Public policy should be developed to nurture engagement and partnership of internet service providers with the FSCA, pursuant to curbing online-based financial crime.

The United Stated and the European Union are both leaders in technological development and can provide examples of internet regulation for developing nations. Both the United States and the European Union emphasise self-regulation of the internet, which is becoming an international trend.[76]

(f) The Consumer Protection Act 68 of 2008 (CPA)

One would expect the CPA to deal with problematic issues in relation to financial services that are offered on the online platform, given the ever-increasing trends indicating that a majority of consumer transactions are now taking place on the online platform. However, this is not the case.

[72] Ibid.
[73] See Frans Marx 'To regulate or to over-regulate? Internet Service Provider Liability: The Industry Representative Body in Terms of the ECT Act and the Regulations' (2011) 32(3) *Obiter* 537 at 537.
[74] Ibid.
[75] Ibid.
[76] Corien Prins 'Fighting Untrustworthy Internet Content: In Search of Regulatory Scenarios' (2005) 10 *Information Polity* 129 at 132.

In fact, s 10 in the FSRA specifically excludes the CPA from application in any transactions falling under the FSCA's regulation.[77]

(g) Cybercrimes and Cybersecurity Bill (the bill)[78]

The primary aim of this bill is to tackle cybercrimes and to promote cybersecurity. Cybercrimes are crimes committed by means of, or facilitated using data, a computer program, a computer data storage medium or a computer system. Cybersecurity on the other hand refers to means and measures to protect data, computer programs, computer data storage mediums or computer systems against interference, cybercrimes or damage.

Currently cybercrimes are investigated in terms of the Criminal Procedure Act 51 of 1977 (CPA). The investigative procedures provided for in the CPA are inadequate to deal with the procedures required to investigate cybercrimes, which involve electronic evidence which is of an incorporeal nature. It is therefore imperative that specialised procedures are invoked to ensure the integrity of the evidence presented in such criminal cases. Clause 2 of the bill criminalises unlawful securing of access to a computer system, without authority. Clause 3 created the offence of unlawful acquiring of data.

Clause 4 criminalises software or hardware tools used in the commissioning of cybercrimes. Clause 8 develops the common-law crime of fraud, such that it criminalises fraud committed by means of data or a computer program in the digital space, whereas clause 13 develops the common-law crime of theft to include theft of a corporeal. Clause 9 creates the crime of cyber uttering which entails passing off with the intention to defraud, to the ctual or potential prejudice of another person.

The bill once passed as law, may only be useful to the end of the prosecution of cybercrimes but as it stands, it does not adequately deal with the position of foreign-based financial services

[77] Section 10(1) in the FSRA, reads:
'(1) The Consumer Protection Act does not apply to, or in relation to-
(a) a function, act, transaction, financial product or financial service that is *subject to* the National Payment System Act or a financial sector law, and which is regulated by *the Financial Sector Conduct Authority in terms of a financial sector law*; or
(b) the Reserve Bank, the Prudential Authority, *the Financial Sector Conduct Authority*, the Prudential Committee, the Executive Committee, the Chief Executive Officer, the Commissioner or a Deputy Commissioner.' (Italics for own emphasis)

[78] See LSSA 'Comments: Cybercrimes Cybersecurity bill' (2005), retrieved from https://www.lssa.org.za/upload/LSSA%20CYBERCRIMES%20AND%20CYBERSECURITY%20BILL%20Comment%2030%20Novemeber%202015.pdf, accessed on 20 February 2019.

providers who render financial service online without a licence. The bill may only go as far as prescribing the way in which evidence may be adduced during criminal proceedings relating to the foreign-based financial services provider. However, in the absence of the clear criminalisation of the offences in relation to FAISA and adequate clarity in respect of the problem statement, the bill will be futile in that regard.

(h) The Financial Sector Regulation Act 9 of 2017

The Financial Sector Regulation Act 9 of 2017 (FSRA) is an-overaching legislation pursuant to the implementation of twin-peaks. It is therefore reasonable that it will entail only generic provisions that apply across the individual sector laws. For example, section 111 in the FSRA prohibits the rendering of financial services, among others, unless the person holds the requisite licence. Section 115 provides the objective guidelines in relation to the granting of licences. The latter will apply across the financial sector laws. The operational requirements of a financial services provider in terms of FAISA, are also uttered in s 116(2) of the FSRA.

CHAPTER 3: FOREIGN JURISDICTIONS

(a) United Kingdom [79]

Financial advisory and intermediary services in the United Kingdom are regulated by the Financial Conduct Authority (FCA).[80] The latter came into force during the year 2013, the empowering legislation being the Financial Services Act of 2012. Preceding the FCA was the Financial Services Authority. The FCA has wide powers, including the power to regulate conduct related to the marketing of financial products. It is authorised to set the minimum standard which financial services providers must comply with and standards relating to their financial products.

The FCA is also empowered to investigate such financial services providers and individuals affiliated thereto. The first of its three operational objectives, is to 'secure adequate protection for consumers',[81] the second being to 'protect and enhance integrity of the UK financial

[79] See Baker McKenzie 'Baker McKenzie's Global Financial Services Regulatory Guide' available at https://www.bakermckenzie.com/-/media/files/insight/publications/2016/07/guide_global_fsrguide_2017.pdf?la=en, accessed on 10 October 2018.
[80] Alison Lui 'Single or twin? The UK financial regulatory landscape after the financial crisis of 2007-2009' (2012) 13(1) *Journal of Banking* 2435 at 2437.
[81] Ibid.

system',[82] and thirdly to 'promote effective competition in consumers' interests'.[83] All these operational objectives are synonymous with and sum-up the objectives of South Africa's new FCSA.[84] It is submitted that the migration of South Africa from the fragmented model of financial regulation to the current twin-peaks model, indicates strives by South Africa's Treasury to adapt a system very similar to that in the UK. However, this argument falls outside the scope of this thesis. Notwithstanding the former, it is clear from s 7 (read together with s 57) in the FSRA that the consumer is central and absolute a priority in the functions of the FSCA.

The UK FCA distinguishes between Independent Financial Advisers or IFAs, and Restricted Advisers.[85] The former may give financial advice on products across the market and are required to give an unbiased and unrestricted view. What 'unbiased and unrestricted view' entails is unclear and there is no case law giving clarity on this yet. Restricted advisers on the other hand, focuses on a particular area such as for example, either short-term insurance or pension.[86] The significance of an adviser being a 'restricted adviser' is that his advice is very limited to either one product or only those products that his or her employer offers. Foreign financial services providers will typically be subject to UK laws.[87] The financial services provider is expected to consider whether any UK licensing obligation will be triggered and will be required to determine whether they are complying with UK marketing rules. In relation to marketing, UK laws regulate the issuance of 'financial promotions', which is defined as an 'invitation or inducement' to engage in an investment activity.[88] Communications with UK counterparties or clients will most likely constitute financial promotions.

[82] Ibid.
[83] Ibid.
[84] Section 7 in the FSRA, reads:
'(1) The object of this Act is to achieve a stable financial system that works in the interests of customers and that supports balanced and sustainable economic growth in the Republic, by establishing, in conjunction with the specific financial sector laws, a regulatory and supervisory framework that promotes-
(a) financial stability;
(b) the safety and soundness of financial institutions;
(c) the fair treatment and protection of financial customers;
(d) the efficiency and integrity of the financial system;
(e) the prevention of financial crime;
(f) financial inclusion;
(g) transformation of the financial sector; and
(h) confidence in the financial system.'
[85] op cit note 80 at 415.
[86] Ibid.
[87] op cit note 80 at 418 - 422.
[88] Ibid.

Various exemptions exist in relation both to the need to be authorised and in relation to marketing to UK persons.[89] Law firms established outside the European Economic Area are called Third Country Firms (TCFs). Currently, certain exemptions are available in the UK, enabling TCFs to easily deal with UK-based clientele.[90] Such exemptions apply only where the contemplated activities are being physically carried outside the territory of the UK and therefore not subjected to UK laws are presently available under UK regulation, which enable TCFs to deal with UK-based clients. For example, the following activities are regarded as being carried on outside the UK and therefore not subject to UK regulation (firms are still required to consider UK marketing restrictions):[91]

- Cash deposits: A UK-based individual who deposits funds to a bank account that they hold outside the UK, will not be contravening UK laws. The foreign-bank accepting the deposit is also not considered as conducting business in the UK and does not have to comply with UK regulation laws as a result. The only restrictions in this regard, will the marketing of off-shore bank accounts which is allowed but restricted to an extent.

- Asset Management (Investments): Where all members of an investment committee reside outside the UK, the activity of making discretionary investment decisions will be deemed to be based outside the UK and not subject to UK regulation. If on the other hand a person located in the UK participates in the making of discretionary investment decisions, this will trigger a licensing obligation.

- Insurance: The effecting and carrying out of insurance-related matters is regarded as being carried on where underwriting decisions are taken.

However, a foreign based financial services provider who gives advice to a UK-based individual, the activities of such foreign-based company will be deemed to have been carried in the UK.[92] The same analysis applies in relation to the activity of dealing, so that where a counterparty to a transaction is located in the UK the activity of dealing will be regarded as being carried on in the

[89] Ibid.
[90] Ibid.
[91] Ibid at 419 - 426.
[92] Ibid.

UK.[93]

There is an exemption in relation to a foreign-based financial services provider who has not solicited the UK-based client (reverse solicitation), referred to as the 'overseas persons' exemption.[94] Under the former circumstances, the foreign-based financial services provider will be exempted from having to obtain a UK licence.[95] This exemption going as far as even allowing such foreign-based advisor to travel to the UK to render its services to the client.[96]

The UK position deals well with and clarifies the question regarding the online presence of a foreign-based financial services provider. Furthermore, the foreign-based financial services provider may also seek exemption from the UK's rules on financial promotion, pursuant to which the foreign-based financial services provider may be able to even market certain investments on UK grounds.[97] The effect of this is that overseas persons can carry on certain activities with other financial institutions, large corporates and, subject to some limitations, high net worth individuals in the UK, without having to obtain a UK licence.[98] There are a few exceptions to these exemptions though.

A company that does not actively market its services in European Union jurisdictions might fall outside local regulations. Where a client or counterparty approaches the firm for the provision of services or to enter into a transaction, then this would be permissible under the reverse solicitation principle.[99]

(b) United States

Activities under financial services that are regulated in the US are the following:[100]

- The soliciting or receiving funds for deposit;
- Lending activities, including loans to consumers and certain commercial lending;
- Providing trust services (which may require a separate licence or special powers);

[93] Ibid.
[94] Ibid.
[95] Ibid.
[96] Ibid.
[97] Ibid.
[98] Ibid.
[99] Ibid.
[100] Edward Balleisen *Government and Markets: Toward a New Theory of Regulation* (2010) 350.

- Any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, is required to register as a broker-dealer in the US.
- Any person that issues securities and is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities, or that owns or proposes to acquire a certain amount of investment securities is required to be registered as an investment company, unless an exemption is available.
- The provision of investment advice to others or issuing reports or analyses regarding securities, for compensation, would be considered an investment adviser and be required to be registered as such, unless an exemption is available.
- Insurance: Insurance-related activities that require a licence are determined by state law. Activities that would most likely be considered insurance-related, and requiring a licence, include soliciting insurance business and selling insurance policies.

The US takes a broad view of these types of activities and requires registration before conducting such activities if the person uses the mails or any means or instrumentality of interstate commerce (commonly referred to as 'US. jurisdictional means').[101] Accordingly, any person that uses US phone lines, mail or other jurisdictional means in connection with securities or investment activities will be required to register as appropriate, unless an exemption is available. A number of exemptions are available under the federal securities statutes, which should be carefully analyzed before being relied upon.[102]

US banking laws and regulations apply if a foreign bank or financial services firm has a presence in the United States where it conducts banking business, or solicits or conducts banking business through employees or agents based in the US or otherwise through the use of US jurisdictional means (namely: the US mail or US telephone lines).[103] It is noted that the US does not use Twin-Peaks, as a result its regulation is fragmented and does not distinguish core financial services from advisory and intermediary services relating to core financial services. This makes it difficult to analyse its regulation of financial advisory in relation to financial products.

[101] Hans Christensen 'Capital-Markets Effects of Securities Regulation: Prior Conditions, Implementation, and Enforcement' (2016) 29(11) *The Review of Financial Studies* 2885 at 2887.
[102] op cit note 79 at 428.
[103] James Barth 'Bank regulation in the United States' (2010) 56(1) *CESIFO Economic Studies* 112 at 130.

In the US, the Financial Industry Regulatory Authority (FINRA) regulates and oversees the activities of brokerage firms whereas the Securities and Exchange Commission (SEC) regulates investment advisers and their investment adviser representatives.[104] The regulation of the relationship between a financial advisor and a client in relation to insurance products is not comprehensive. The relationship is currently of a fiduciary nature.[105]

(c) Germany

German regulatory laws distinguish between offering services in a 'directed' or 'target-oriented way'—which require a licence—And providing services passively, namely those transactions initiated by a German resident—Which do not require a licence.[106] The thin line between the former and the latter makes the determination of the requirement to get a licence slightly intricate.

As a result, foreign-based financial services providers dealing with German residents will require the German client to confirm in writing that they did not solicit his/her business.[107] In order to be able to rely on this 'passive freedom of services exemption', foreign institutions must document that a transaction was solely based on the customer's initiative. This is synonymous with the UK's 'reverse solicitation' principles, currently unknown in South Africa.[108]

Foreign institutions are required to obtain a licence in order to offer on a cross-border basis banking or financial services to customers in Germany where they cannot rely on the passive freedom of services exemption.[109] In terms of s 2(4) of the KWG,[110] foreign entities may be exempted from the licence requirement on a case-by-case review if 'the enterprise does not require supervision, given the nature of the business it conducts.' Such an exemption from the licence requirement can only be considered for limited business operations and in principle is only granted to entities that the German regulator can assume will not require additional supervision in Germany due to the effective supervision in their home country.[111]

[104] op cite note 79 at 118.
[105] Ibid.
[106] Andreas Hackethal 'Financial Advisers: A Case of Babysitters?' (2012) 36(2) *Journal of Banking and Finance* 509 at 515.
[107] op cit note 79 at 118.
[108] Ibid.
[109] Ibid.
[110] The Kreditwesengesetz (KWG) is the German Banking Act.
[111] op cit 79 at 120.

Foreign institutions may be exempted for transactions involving interbank business and transactions with institutional investors such as the German federal government, the states, local authorities and their institutions, and credit and financial services institutions, including investment companies, insurance companies as well as certain major corporations.[112] Exemptions may also be granted where a foreign entity is a member of a group of an institution licensed in Germany. Furthermore, the applicant must submit a certificate from the authority of the home country, which confirms that the foreign institution has a licence in its home country, that the intended cross-border activities do not raise any supervisory concerns and that any future concerns will be reported to the German regulatory bodies.[113]

CHAPTER 4: INCIDENTAL TOPICS FOR CONSIDERATION

(a) Regulation of the Auditing profession: Lessons that may be learnt[114]

Odendaal submits that the manner in which the auditing profession is regulated in South Africa, may be the cause of the growing critism and unsatisfaction over the auditing profession. He argues that failure to understand, among others, the following factros, has led to the catastrophe and the recent debacles in the auditing sector:

- Regulation must be pursuant to public interests: Odendaal submits that if government decides to allow a sector to self-regulate or if government elects to delegate a regulatory function similarly to how the auditing profession is regulated in South Africa, government must find a way to hold those agents accountable. Regulation is described as a dynamic process whereby, through actual or implied coercion, an indeoendant party brings about actions in another party, all in the public interest. Odendall argues that the crisis in the auditing sector is a result of regulation having being done pursuant to private interests rather than public interests.
- A regulator must have adequate competence: Regulators must be trusted to act efficiently and in the public interest. If the public perceives that the regulator lacks expertise or competence in some aspects in relation to the sector it regulates, the public may loose

[112] Ibid.
[113] Ibid.
[114] See Eliza Odendaal 'Regulating of the auditing profession' (2018), retrieved from https://repository.up.ac.za/handle/2263/5415, accessed on 2 March 2019.

confidence in that regulator. It will subsequently be very difficult to convince the public that decisions and judgements made by that regulator are fair and appropriate. It is therefore crucial that the regulator should always maintain public confidence.

By contextualising on the latter point, one can see that since the FSCA is not an expert in digital technology, attempting to regulate this space on its own with its current competencies, may only serve to weaken public perceptions of the FSCA's decisions and judgements. Whereas, allowing industry-players in that space to meet and agree on a practice code that binds all the players in that space, may serve to protract the negative view of government being a dictator in a space it has no competence in. It is submitted that the FSCA's role should only be to actively facilitate, co-ordinate, enforce the rules that the sector has made itself, and to oversee the sector, in relation to problem statement.

(b) Arguments supporting licensing a regulatory mechanism

Baldwin submits that objective of regulation should be to protect consumers. Society has a need for credible and accessible information. Licensing as a regulatory mechanism, seeks to set minimum standards: if services or goods do not meet the minimum standards, they may not be offered. Often services are difficult to evaluate in advance and in many instances the consumer has to assume the quality of goods if the supplier does not have well-established reputation. Regulation must therefore be imposed to set minimum standards.

Services must comply with such minimum standards because society deserves services that are of high quality. Regulation must also take place to ensure that the qualifications and competence of those rendering the services are verified in advance by the regulator, the latter being an added layer of security and assurance for consumers that the services provider is competent enough. Further, licensing may serve to ensure that the financial services providers are held under scrutiny by the South African Revenue Services (SARS) in relation to the tax affairs. It may become impossible for SARS to monitor financial service providers who are unlicensed yet present and active in the digital space and generating revenue.

CHAPTER 5: RECOMMENDATIONS AND CONCLUSION

It has been shown that South Africa's Twin Peaks model of financial regulation is very similar to the UK's. The spate of online-based financial crime makes it necessary for the government to intervene through regulation and adequate enforcement thereof in order to protection vulnerable ones. This should however be done in collaboration and partnership with the sector players.

International best practices indicate that successful economies such as the United States and the United Kingdom, have sought to allow the sector to self-regulate. This may be high time for South Africa to head towards that direction. The latter has been rationalised by the fact that FSCA lacks the expertise and competence to regulate activities that are largely taking place in the digital platform. It is submitted that given the extensively broad scope of online commercial activity, the FSCA should foster partnerships with industry players and shift towards a more inclusion regulatory model, where industry players will nominate representatives and establish associations that represent the interests of both consumers and financial services providers. This thesis used the example of IRBs that have been established in terms of ECTA, allowing more participation by active sector players. In the light of the pace at which online commercial activity is growing, attempting to shield everything under the full authoritative wing of the FSCA, may serve to stretch the capacity of the FSCA too wide.

The right to freedom of association should allow those who wish to explore foreign-based financial services providers, even with those financial service providers who are unlicensed by the FSCA. Concepts such as 'reverse solicitation' should be introduced to the South African financial regulation space to allow those who wish to explore unlicensed online platforms to do as such. It is imperative that the South African government permit its citizens to partake in economic activities without unnecessary restrictions thereof, so long as the government has put in mechanisms to protect the vulnerable.

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