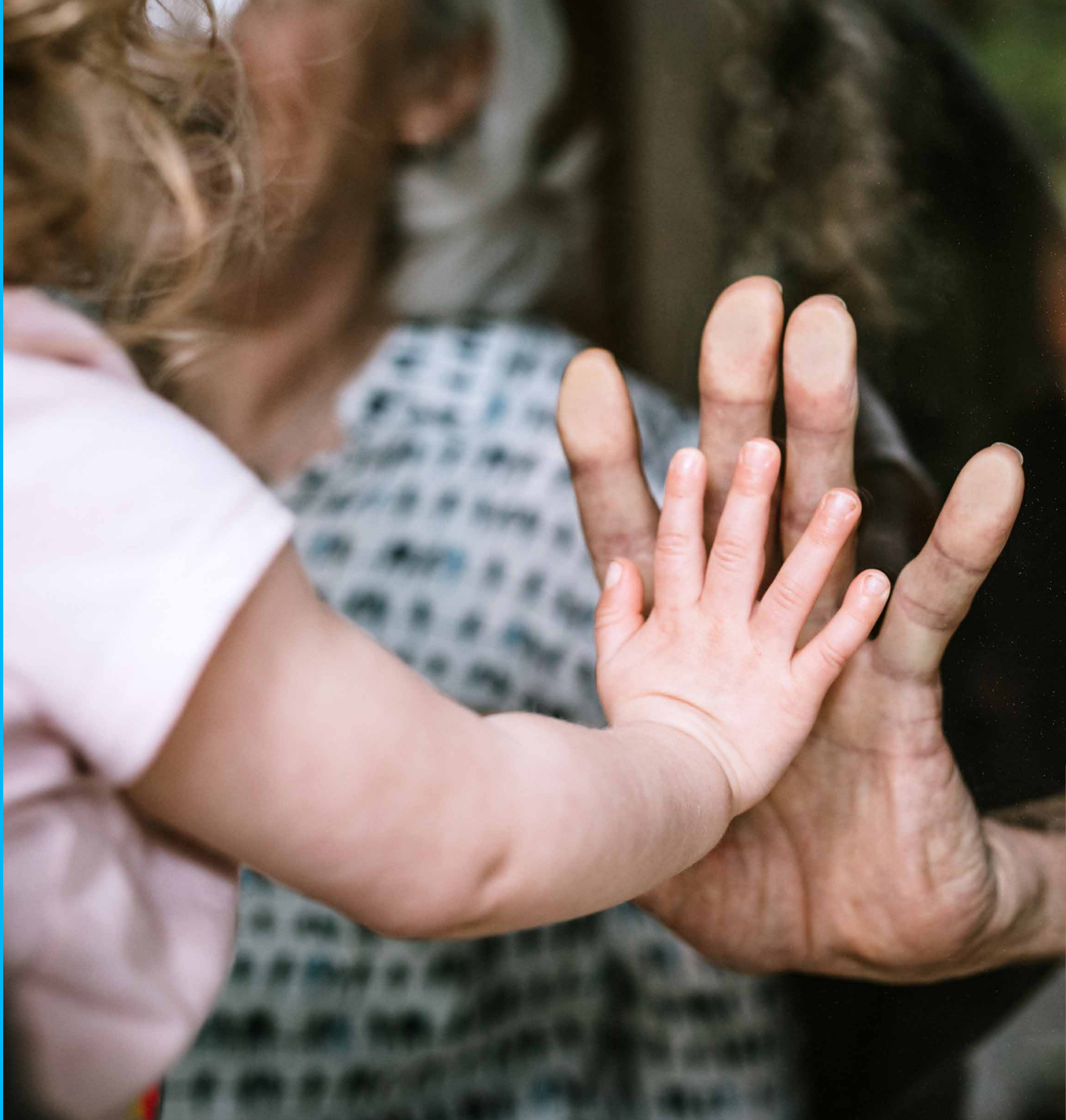

Ben April

Associate Director
ESG, climate and
financial risk management
Tel: +27 79 524 9383
Email: ben.april@kpmg.co.za

The regulatory and sustainable finance impacts and challenges of the Conduct of Financial Institutions (COFI) Bill for insurers

Introduction

As the South African market conduct regulator, the Financial Sector Conduct Authority's (FSCA) ESG-related strategic objective is to promote a transformational role in ensuring that South Africa's financial system best supports the country's sustainability goals. This will be achieved through the introduction of customer protection and market integrity mandates, and greater positive economic, environmental, and social outcomes, including alignment with South Africa's Climate Change National Determined Contributions, the Just Transition Framework and the United Nation's Sustainable Development Goals (SDGs).

The enactment of the COFI Bill (the Bill) will be instrumental in enabling the FSCA to meet its ESG strategic objectives. The ESG and climate-related areas of focus, measures and actions for a developing country such as South Africa, with very high levels of inequality, poverty and youth unemployment, will be different from that of a developed country or region such as the European Union.

The financial services industry in South Africa has seen significant changes to legislation and regulation over the last decade. The COFI Bill, which is the second leg of the Twin Peaks Financial Sector reforms, addresses inappropriate market conduct practices and introduces new ESG conduct requirements. The Bill is also expected to pave the way for a vastly refreshed regulatory landscape for the insurance sector, whilst introducing new ESG conduct risk and disclosure requirements.

The COFI Bill will require financial institutions to provide consumers with information about their services, fees and the risks associated with products they buy while moving away from a 'rules and regulations' based approach (tick box exercise) to a 'principles and outcomes' based approach. The shift from rules-based to principles-based regulation will require ongoing investment of time and resources from industry players.

The South African financial services industry is dominated by a small number of large financial institutions. A conglomerate is a group of companies that conducts material activities in at least one or more of the following regulated industries: banking, securities services and/or insurance. The requirements contained in the Banks Act, Insurance Act and Financial Sector Regulation (FSR) Act provide for the regulation and supervision of financial conglomerates and insurance groups involved in banking and insurance activities, respectively.

What does the COFI Bill mean for insurers and insurance groups?

The COFI Bill will apply to the wider financial services sector including banks, insurers, asset managers, brokers, financial advisors, administrators, pension funds, collective investment schemes, hedge funds, private equity funds, custodians, brokers and rating agencies (credit and ESG). The Bill introduces the following licencing changes:

- Schedule 1 licensed activities include the provision of a financial product, distribution, financial advice, discretionary investment management, administration, fiduciary or custodian service, payment service, debt collection service, financial market activities and corporate advisory services.
- **New licensing requirements for "credit to non-retail" lenders not regulated by the National Credit Act**. This will increase regulatory risk and compliance requirements and costs for insurance groups operating in the "credit to non-retail" lenders market.
- **A new licence category for "corporate advisory services" will apply to investment banking activities, advisory services in relation to M&A activities, arrangement of debt and equity issues, and on- and off-balance sheet financing of transactions, such as guarantees or letters of credit, operating leases, accounts receivable financing, factoring of receivables, invoice discounting, debtor financing, participating in joint ventures and research and development partnerships.** This will increase regulatory risk and compliance requirements and costs for insurance groups operating in the corporate advisory space not currently licensed.

Under COFI there will be new and additional requirements for entities operating in the insurance industry such as:

- **New sustainable finance conduct regulations and standards** for ESG.
- **The FSCA will be provided with the power to effect social transformation on employment equity, procurement, black economic empowerment and issue substantial fines.** Product providers will be scored on their procurement spend and will be negatively impacted when paying commissions to untransformed entities.
- **The introduction of conduct standards that will result in more fair customer outcomes.** This will require insurers to assess the effectiveness of the current control environment and consider the implementation of more robust systems, processes and controls.
- **The introduction of a senior management governance regime** which will hold managers personally accountable.
- The introduction **of new regulations around the outsourcing of premium collection and the governance of outsourcing contracts** in general.
- **More onerous capital requirements** to ensure entities are sufficiently capitalised to cover the current and potential future conduct risks.

How is the FSCA currently implementing the COFI Bill?

The insurance industry will likely face a lengthy implementation period and will have to wait until the second half of 2024 before the COFI transition is fully mapped out and its impact on different sectors of the industry is fully understood.

The COFI framework development is made up of three phases, all of which will be progressed concurrently as depicted below:

Phase 1 **High-level design of the regulatory framework**	**Phase 2** **Harmonisation of the regulatory frameworks**	**Phase 3** **Transition to the COFI Bill framework**
• Defining the role of regulatory instruments to support the framework, for example, conduct standards, and how these instruments are to be grouped, numbered and positioned. • This phase of the framework has been finalised.	• Thematic frameworks were developed in line with the conduct theme. • Expansion of thematic frameworks to include sector-specific requirements. • Targeted consultation on the themed frameworks under this phase will start in the second half of 2023.	• Focus on transitioning existing subordinate legislation into the COFI Bill framework. • The existing financial sector laws impacted have been assessed. • The next step is to determine how the requirements set out above should be transitioned into the new COFI framework. • The Phase 3 work will continue throughout 2023, to have initial formal proposals ready in the first half of 2024.

What is the COFI sustainable finance implementation plan?

In preparation for the implementation of the COFI Bill, the FSCA has established various thematic workstreams, to consider best practices regarding sustainable finance, to promote transparency, support the effective channelling of credit and savings for good, and reduce the risk of green-washing, social-washing and impact-washing.

The FSCA's graphic below illustrates the elements within the sustainable finance regulatory landscape.

Sustainable finance				
Environmental			**Social**	**Governance**
Climate change mitigation	Climate change adaption	Biodiversity, resource efficiency and pollution prevention	Gender, health, human rights, equality, SME and heritage	Board oversight, shareholder rights, transparency, disclosure and executive pay etc

The **FSCA Sustainable Finance Work Programme consist of five pillars: taxonomy; disclosure, reporting and assurance; market development; active ownership; and consumer education**. Each pillar is informed and supported by capacity building, research and stakeholder engagement, regulatory and supervisory framework development, and coordination and cooperation with other stakeholders.

Pillar 1	Pillar 2	Pillar 3	Pillar 4	Pillar 5
Taxonomy	**Disclosure, reporting and assurance**	**Market development**	**Active ownership**	**Consumer education**
Capacity building				
Research and stakeholder engagement				
Regulatory and supervisory framework development				
Coordination and cooperation with other stakeholders				

The National Treasury Green Finance Taxonomy will form the basis for both FSCA and South African Reserve Bank (SARB) disclosure, reporting and assurance requirements. FSCA disclosure requirements will be set at both product and service levels. Assurance providers, including ESG ratings agencies, and ESG data providers will be consulted during the drafting of disclosure requirements. The FSCA will issue a position paper clarifying its stance on International Standards.

During the current implementation of the Sustainable Finance Work Programme, the FSCA will track and monitor insurers' actions in areas such as:

- The ceasing of cover for specific risk types or customer segments;
- Significant premium increases;
- Claims assessments; and
- Benefit exclusions or policy wording changes.

The FSCA will expand its role in promoting active ownership to drive the company's strategy and actions in the direction of a more sustainable future. Final guidance from the Organisation for Economic Co-operation and Development (OECD) Corporate Governance Committee will be instrumental.

Under Pillar 5, consumer education, the FSCA will empower retail investors and consumers through financial education to assist their decision to support and engage with companies that follow climate change, diversity, equity and inclusion objectives.

Conclusion

National Treasury will continue to drive the COFI Bill to entrench better ESG and customer outcomes in the financial services sector. As the adoption and enactment date of the COFI Bill draws closer, insurers and insurance groups need to work closely with the FSCA, the South African Insurance Association (SAIA) and the Association for Savings and Investment South Africa (ASISA) on the development of the ESG conduct standards and what needs to be actioned based on the transitional arrangements.