## CHAPTER 5:

## Regulation of the Financial Markets

# Textbook Questions

###  Review questions

*The following questions appear in the textbook on page 134.*

*Answer the following questions.*

**In South Africa, economic policy is based on the philosophy that the market ensures efficiency at all times. Do you agree with this statement? Explain your answer.**

**No, regulation is needed to counter market imperfections. The economic policy of a country determines the philosophy that underlies its approach to regulation. South Africa currently follows largely a market-orientated approach with regard to the role and operation of the economy. This implies minimum intervention by the authorities as the market mechanism is assumed to achieve the highest efficiency in terms of the allocation of resources.**

**However, governments that follow this approach acknowledge that market imperfections do occasionally arise and that intervention by the authorities by way of regulation is sometimes justified. They do, therefore, promulgate legislation to regulate industries and create regulatory authorities, and authorise them to influence the economy according to government policy.**

**Should a regulator do a cost-benefit analysis of proposed regulations? Explain your answer.**

**Yes, as unnecessary or burdensome regulations may adversely affect the economy.**

**Regulation may have adverse consequences in the economy. True or false? Explain your viewpoint.**

**True. Regulation does not, however, come without a cost. Regulatory authorities must therefore ensure that the economy is not burdened with unnecessary costs, or that the efficiency of the economy is adversely affected.**

**List the three elements of regulation.**

**Regulatory rules relate to other matters over and above conduct and behaviour such as reporting, auditing and prudential matters.**

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**Discuss the objectives of regulation.**

**The objectives of regulation are to**

* **protect consumers or investors**
* **ensure the solvency and financial soundness of the country’s financial institutions**
* **promote fairness, efficiency and transparency in the securities markets**
* **promote a stable financial system by monitoring, mitigating and managing systemic risk.**

**What additional function does an exchange have in terms of the legislation apart from its normal function of conducting a market?**

**Self-regulation.**

**Discuss how ethical rules of behaviour have become matters of law in South Africa.**

**The FSB gave legal effect to codes of conduct by issuing them as subordinate legislation. For example, in terms of the Financial Advisory and Intermediary Services Act 2002 (FAIS) several codes of conduct have been issued whose main aim is the protection of consumers. There is an all-encompassing General Code of Conduct, with special codes, for example for specific sections of the industry.**

#### The Financial Markets Act also makes provision for codes of conduct to be issued for various market participants, including authorised users, participants of central securities depositories and clearing members of independent clearing houses.

**Explain how the regulatory landscape is split horizontally in South Africa.**

**In terms of the Financial Markets Act (FMA), a licensed exchange, and a central securities depository operate as SROs, regulating the activities of authorised users (members of exchanges) and participants (members of central securities depositories) in terms of the provisions of the SSA.**

**The FAIS Act makes use mainly of prudential regulatory measures in regulating and supervising the activities of financial advisors and intermediaries. True or false? Give reasons for your answer.**

**False. The FSB concentrates on rules of market conduct for the protection of consumers since prudential regulation of the individuals and smaller companies acting as advisors and intermediaries is not deemed necessary. However, the FSB is investigating the possible introduction of prudential requirements in certain cases and is also now requiring liquid assets of varying amounts depending on the category of FSP. In addition, FSPs are required to have guarantees and professional indemnity and fidelity guarantee insurance in place depending on the category of FSP and whether an FSP receives or holds clients’ cash or financial products.**

**What are the functions of an exchange in its capacity as an exchange and its capacity as an SRO?**

**The functions of an exchange in terms of the SSA are to establish, maintain and provide an infrastructure to bring together buyers and sellers of securities and match their orders. As an SRO, an exchange must issue and enforce rules, directives and listing requirements; ensure compliance with the rules by authorised users and listing requirements by the issuers of securities; suspend rules and listing requirements under certain circumstances; and facilitate the clearing and settlement of transactions.**

**What are the functions of the Directorate of Market Abuse?**

**The Directorate of Market Abuse is responsible for investigating insider trading in addition to manipulative, improper, false or deceptive practices of trading as well as false, misleading or deceptive statements, promises and forecasts, and taking civil action if necessary.**

**What rules exist to protect consumers in the long- and the short-term insurance industries?**

**Policyholder Protection Rules.**

**Discuss the powers of an inspector in terms of the Inspection of Financial Institutions Act 80 of 1998.**

**With regard to an institution, an inspector may**

* **administer an oath or affirmation, or examine any person who is or was a director, servant, employee, partner, member or shareholder of a financial institution**
* **without prior notice enter and search the premises of the institution and require the production of documents relating to the institution**
* **open any strong room, safe or other container in which he or she suspects any documents are kept**
* **examine and make extracts from and copies of any documents, or, against the issue of a receipt, remove the above temporarily from the premises for that purpose**
* **against the issue of a receipt, seize any document which may afford evidence of an irregularity**
* **retain such seized documents for as long as they may be required for any criminal or other proceedings.**

**What are the functions of an actuary in a retirement fund?**

**Retirement funds use actuaries to do actuarial valuations and to ensure that assets and liabilities are matched.**

**Discuss the investor protection measures contained in the pension fund legislation.**

**Specific consumer (member) protection measures include**

* **member representatives on the boards of trustees**
* **benefit statements**
* **internal complaints resolution and access to the pension funds adjudicator (ombudsman)**
* **allowing members to share in pension fund surpluses**

**Discuss the measures used to regulate collective investment schemes.**

**The following measures are used:**

* **Managers of CISs must be registered in terms of the Act.**
* **Managers of CISs must comply with the Fit and Proper Requirements in terms of the Board Notice issued in terms of the Act.**
* **Managers of CISs must comply with capital requirements and provide seed capital for each portfolio they administer.**
* **Portfolios must comply with prudential investment guidelines.**
* **The prior approval of the Registrar is required in respect of each new portfolio.**
* **Managers must comply with quarterly reporting requirements.**
* **Investors must receive annual reports containing prescribed information.**

**Who regulates anti-money-laundering activities in South Africa?**

**The regulatory authority responsible for the implementation of FICA is the Financial Intelligence Centre.**