
FINANCIAL SERVICES BOARD

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JOINT CIRCULAR FROM THE REGISTRARS OF COLLECTIVE INVESTMENT SCHEMES, STOCK EXCHANGES AND FINANCIAL MARKETS

To managing directors of -

- (1) managers of collective investment schemes (registered in terms of the Collective Investment Schemes Control Act, 2002);
- (2) linked investment services providers (LISPS) and investment managers (approved in terms of sections 4 and 5 of the Stock Exchanges Control Act, 1985, and the Financial Markets Control Act, 1989, respectively).

Dear Mesdames / Sirs

MARKETING OF FOREIGN COLLECTIVE INVESTMENT SCHEMES (SECTION 65 OF THE COLLECTIVE INVESTMENT SCHEMES CONTROL ACT, 2002)

1. PURPOSE OF CIRCULAR

The purpose of this circular is to -

- Provide background information to the prohibition contained in section 65(3) of the Collective Investment Schemes Control Act, 2002 ("the Act"), the precursor of which was section 37A of the Unit Trusts Control Act, 1981;
- state the provisions of section 65;
- discuss its scope and application;

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- provide a number of examples to illustrate its application in various areas; and
- explore the role of the intermediary in soliciting investments in a foreign collective investment scheme.

2. BACKGROUND INFORMATION

The following background information places section 65 in context:

- “Collective investment scheme” is defined in the Act, and it is prohibited on criminal penalty to administer a collective investment scheme in South Africa unless registered in accordance with the Act. A collective investment scheme registered offshore, e.g. in the UK, generally speaking conducts its business in the UK (the portfolio is managed in that country), although it may market its products in other legal jurisdictions.
- The purpose of section 65 is to offer a measure of protection to South African investors against foreign collective investment schemes that aggressively market their products in South Africa, following the relaxation of exchange control restrictions.
- Various local entities are engaged in offering products of foreign collective investment schemes to local investors. LISPs became involved in offering foreign collective investment schemes to such clients from the outset. A LISP is a category of investment manager who usually functions in a non-discretionary capacity and is defined as follows in the Conditions made under section 4 of the Stock Exchanges Control Act:

“LISP means a linked investment services provider approved in terms of section 4(1)(a) of the Act, and whose business consists of implementing or capturing, or both, instructions given by an investment manager or by a client in respect of the management of investments on the basis that the LISP holds, purchases or sells such investments in bulk”.

- Section 65 is therefore principally aimed at prohibiting the local marketing of products of a foreign collective investment scheme unless such a scheme has been so approved by the Registrar of Collective Investment Schemes.
- The owning of a participatory interest or unit in an unapproved foreign collective investment scheme was never prohibited previously and is not prohibited at present by the Act. Any local resident can, of own volition, still buy and own units of an unapproved foreign collective investment scheme, provided that investments in such a scheme is not solicited from investors in South Africa by any means.

3. SECTION 65 OF THE ACT

The wording of section 65 is as follows:

“65. (1) The registrar may approve an application by the manager or operator of a foreign collective investment scheme, to solicit investments in such scheme from members of the public in the Republic if —

(a) the application is in the form determined by the registrar;

- (b) a copy of the approval or registration by the relevant foreign jurisdiction authorising the foreign collective investment scheme to act as such, is submitted;
 - (c) the foreign collective investment scheme can comply with the conditions determined by the registrar; and
 - (d) the fee determined by the registrar has been paid.
- (2) A scheme approved in terms of subsection (1) must, for the purposes of section 15A of the Financial Services Board Act, 1990 (Act No. 97 of 1990), be regarded as a financial institution and the provisions of that section apply, with the necessary changes required by the context, to such a scheme.
- (3) A person who solicits investments in a foreign collective investment scheme which is not approved in terms of subsection (1) is guilty of an offence and liable on conviction to a fine or imprisonment for a period not exceeding five years or to both a fine and such imprisonment.”

4. DISCUSSION

The section is better understood by paraphrasing it in its constituent components. It is framed in a way that it prohibits -

- any person (which includes a natural person and body corporate) from;
- soliciting;
- from members of the public in the Republic;
- investments in a foreign collective investment scheme;
- which is not approved by the Registrar of Collective Investment Schemes; and
- if so approved, does not comply with the approval conditions of the said Registrar.

5. APPLICATION DEMONSTRATED BY EXAMPLES

In the examples that follow, the issue of foreign exchange approval by the SA Reserve Bank for local residents is ignored, as it has no bearing on the matter. Clearly the expatriation of funds must always be subject to appropriate approval in this regard, but such approval is irrelevant to decide whether section 65 is contravened.

- **Basic Position**

Any South African resident (whether a natural person or a body corporate) may invest in any financial product offered by any financial institution anywhere in the world, which that resident elects out of own free will unless doing so is explicitly prohibited. Neither the act of so investing nor the subsequent holding of such investments is prohibited by section 65 or any other provision of the Act. Therefore it is lawfully available to local residents to select and invest in foreign collective investment schemes not approved in terms of section 65.

From this basic position follows the corollary that if such a local resident were to make the choice as stated, and were to then instruct another person (as his agent) to execute that decision, the person executing the decision would not run foul of section 65 either. Although the second person would be performing an act as a result of which the first person acquires the products of an unapproved scheme, his actions were those of the instructing party who could himself do so, and were not done to solicit investments in an unapproved scheme. However, where an arrangement or agreement already exists

between an investment manager and a product supplier of an unapproved foreign collective investment scheme, it is the opinion of this Office that the investment of the money of a client by the investment manager in such a scheme would be a contravention of section 65.

- **Discretionary Investment Manager**

All investment managers, whether discretionary or not, deal with assets belonging to their clients. These assets never become the property of the investment manager.

If a South African resident were to engage a locally approved investment manager who accepts discretionary appointments, and were to instruct that investment manager to invest on his behalf offshore, and to employ his skill to select the best investment (or collective investment scheme), then the investment manager is also at liberty to invest in unapproved schemes. Again the investment manager is but the agent of the client and the client has merely mandated his own choice as to an appropriate foreign scheme to the investment manager. Such action was not performed to solicit investments in the scheme, but to discharge the obligations the investment manager assumed in his investment mandate. In this instance it is also important to note that in the Conditions made by the Registrar of Stock Exchanges in terms of section 4(1) of the Stock Exchange Control Act, it is stipulated that an investment manager should avoid conflicts of interest in its dealings with clients. If, therefore, an investment manager who has a relationship with a specific foreign product supplier of an unapproved foreign collective investment scheme, utilises a discretionary mandate to invest clients' funds in such scheme, such action will be regarded as soliciting investments in an unapproved scheme in contravention of section 65 of the Act.

If an investment manager were to be given a wide mandate to manage a wrap fund, on a similar basis, he may include products of an unapproved scheme in the wrap fund and doing so in pursuance of his mandate, he will not contravene section 65 unless he is subject to an agreement with the product supplier and places the clients' funds in a collective investment scheme of that product supplier. The existence of an agreement will therefore serve to indicate that soliciting is taking place in contravention of the prohibition. If the provider of a wrap fund advertises the components of his fund, such provider would be seen to be contravening the said section.

- **Non-Discretionary Asset Manager**

The position with regard to a non-discretionary investment manager is slightly more complex. These investment managers, of which LISPs are the best example, are primarily engaged in the administration of investment assets and never advise on investment decisions. They therefore do not fall foul of the prohibition on soliciting on behalf of an unapproved scheme as they do not advise clients to invest in any particular scheme. However, by including unapproved schemes on their "menus" of schemes which they offer to the public, a LISP will be in contravention of section 65.

- Certain investment managers were already engaged in administering the assets of unapproved schemes at the time when the prohibition came into operation, and continued to administer the investments of their existing clients who had invested in such unapproved schemes. If the legislature had intended to prohibit the "administration" of portfolios including such assets it would have done so in clear wording which prohibits administration. Instead it prohibited soliciting only. That

indicates that the intention was not to implicitly include "administration" in the concept of "soliciting".

Both discretionary and non-discretionary investment managers (including a LISP) may in terms of an explicit instruction from a client invest in and administer the products of unapproved foreign schemes on behalf of such client and in so doing are not soliciting investments in these schemes as contemplated by section 65.

6. FINANCIAL ADVISERS

With regard to financial advisers (brokers and other intermediaries) the issue of solicitation is more difficult to assess. If a financial adviser handed out brochures and advertises on behalf of an unapproved scheme, there is no question he would be contravening section 65. It is also clear that if a financial adviser advises clients to invest in investments in unapproved schemes, he would be contravening the prohibition on soliciting. Even more so if he makes application forms available and receives remuneration for any investments made as a result thereof.

Furthermore, if a financial adviser during a conversation with a prospective client recommends an unapproved scheme, then the adviser would be soliciting investments in the scheme and would be contravening section 65, even if he did not persuade the client to invest. If the adviser were to offer application forms or assist the investor to enter into the investment it will definitely become a contravention at that point.

7. PENALTY

A contravention of section 65 of the Act is a criminal offence.

8. CONCLUSION

Soliciting includes, in our opinion, soliciting by means of media advertising, press releases, presentations to third parties, providing sale and promotional materials and advertising on the electronic media such as television, e-mail, internet or website.

It should, however, be taken into consideration that before the 1998 introduction of section 37A into the Unit Trusts Control Act, LISPS were allowed to invest clients' monies in unapproved schemes and certain of these clients remained in these funds subsequent to the requirement that only approved funds may be marketed in South Africa. These investments have not been affected by the later amendments.

The following table illustrates what is permitted and not permitted when investing in foreign collective investment schemes not approved in terms of section 65:

PERMITTED	NOT PERMITTED
Investment managers with discretionary mandates may invest clients' monies in unapproved schemes but may not solicit investments in these schemes.	Even though these investment managers have discretionary mandates and may invest in unapproved schemes, they may not promote these funds by way of media advertising, press releases, presentation to third parties, sale and promotional materials and advertising on the electronic media or inclusion on product lists.
Investment managers with non-discretionary mandates may invest in unapproved schemes only in response to specific requests from clients.	Investment managers with non-discretionary mandates may not market these schemes by way of media advertising, press releases, presentation to third parties, sale and promotional materials and advertising on the electronic media or inclusion on product lists.
Foreign investment managers (an investment manager based outside South Africa) with discretionary mandates are allowed to invest clients' monies in unapproved schemes.	Foreign investment managers may not market these schemes by way of media advertising, press releases, presentation to third parties, sale and promotional materials and advertising on the electronic media in South Africa.
A wrap fund manager acting under a discretionary mandate could use an unapproved scheme because this does not fall within the definition of marketing unless in the marketing material of such wrap fund manager, investments in the unapproved scheme are solicited. Usually wrap fund portfolios are constituted in accordance with the risk profile of a client.	A wrap fund manager may not market these schemes by way of media advertising, press releases, presentation to third parties, sale and promotional materials and advertising on the electronic media in South Africa.
Fund of funds managers could also use globally approved schemes as this would not fall within the definition of soliciting business for the fund, subject to paragraph 22 of Notice 570 of 2003, published in terms of the Collective Investment Schemes Control Act, 2002.	
LISPS with discretionary mandates are allowed to invest clients' monies in unapproved schemes.	Although LISPs may have discretionary mandates and are thus allowed to invest in unapproved schemes, they may not market these funds by way of media advertising, press releases, presentation to third parties, sale and promotional materials and advertising on the electronic media or inclusion on product lists.
All clients whose funds were invested by discretionary and non-discretionary LISPS in unapproved schemes prior to the 1998 amendment of the Unit Trusts Control Act may remain in those schemes.	LISPS' marketing material may not include these schemes even though the clients were placed in these schemes before July 1998.

The latest pro-forma approval letter of an investment manager or LISP contains the following condition:-

“In respect of foreign collective investment schemes, this authorisation only entitles XYZ (Pty) Ltd. to solicit investments in schemes that this Office has approved under section 65 of the Collective Investment Schemes Control Act, 2002.”

A transgression of this condition will be regarded in a serious light and could lead to consideration of the withdrawal of such approval.

It is trusted that the foregoing explanation eliminates any confusion that may have existed on this issue.

REGISTRAR OF COLLECTIVE INVESTMENT SCHEMES, STOCK EXCHANGES AND FINANCIAL MARKETS