
SECT. 38A OF THE FAIS ACT – IS THIS AN ATTEMPT BY THE FSB TO HIJACK BUSINESS RESCUE OF FINANCIAL SERVICES COMPANIES?

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A recent appointment as business rescue practitioner to two financial services companies raised the issue of Sect. 38A of the Financial and Intermediary Services Act. The companies were placed in business rescue in one of the accepted means as set out by Chapter 6 of the Companies Act, by resolution of the board of directors. Due process was followed during which time Sect. 38A suddenly raised its head. It appears that the FSB introduced this section into the FAIS Act with effect from February 2014 without bringing it to the attention of the CIPC. An intense investigation into the conflict between the two Acts was undertaken to establish the validity of Sect. 38A in the context of Chapter 6 of the Companies Act. A detailed discussion of the investigation, follows. This matter was raised with the Financial Services Board who were adamant That Sect 38A needed to be followed and were of the opinion that Sect. 38A takes precedent over the Companies Act. It appears from our enquiries with the CIPC that, because of the manner in which this Sect was introduced, they were not aware of it and had not been informed of it. To avoid prejudicing the creditors by entering into costly legal proceedings to challenge the validity of Sect 38A, the business rescue process was reversed.

Purpose of the Acts

FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT 37 OF 2002 (FAIS Act):

To **regulate the rendering of certain financial advisory and intermediary services to clients;** to repeal or amend certain laws; and to provide for matters incidental thereto

THE COMPANIES ACT 71 OF 2008 (Companies Act)

Amongst others

To provide inter alia for the **efficient rescue of financially distressed companies**

Section 7 sets out the purposes of the Companies Act further. We refer specifically to Sect. 7(k) that states:

“provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders;”

It is clear from the foregoing that the FAIS Act does not contemplate the business rescue process. Its purpose is set out as to be of a narrowly defined regulatory nature and refers to services provided to clients. The Companies Act on the other hand, indicates that one of its legislated purposes is **‘to provide for efficient rescue of financially distressed companies’**, and further refers to **‘stakeholders’** and **‘Affected Parties’**, a much wider and more inclusive group than referred to in the FAIS Act. Its regulations and sections are designed to govern a company from womb to tomb whereas the FAIS Act regulates the manner in which a financial services company deals with its customers. Any financial services company formed in terms of the Companies Act is bound by the requirements of that Act.

Solvency and Liquidity

Sect 4 of the Companies Act clearly defines the criteria to be met to satisfy the solvency and liquidity test.

The FAIS Act does not deal directly with Solvency and Liquidity other than to try to control the process of sequestration, winding up and closure through the introduction of Sect. 38A. This is a catch all section which covers individuals, companies, closes corporations or other business arrangements. It gives no guidance as to financial distress.

Inconsistencies

Section 5 of The Companies Act clearly defines the manner in which inconsistencies between the Act and any provisions of any other legislation, must be dealt with in terms of Sect 4 to 6

Sect 38A of the FAIS Act, in our opinion, is an attempt to hijack the business rescue process and override Sect 5 of the Companies Act. This enables delinquent directors and others, potentially responsible for the company's distress to hide behind Sect 38A if the company providing financial advisory services is placed under business rescue in terms of Chapter 6 of the Companies Act

Section 6(b) of the Companies Act clearly states;

“to the extent that it is impossible to apply or comply with one of the inconsistent provisions without contravening the second, the provisions of this Act shall prevail except to the extent that this Act expressly provides otherwise.”

Whereas 38A(1) of the FAIS Act states that

“(a)Notwithstanding the provisions of the Companies Act or any other law under which a provider is incorporated, **Chapter 6 of the Companies Act shall, subject to this section and with the necessary changes, apply in relation to the business rescue of a provider, whether or not it is a company.**

(b) This section does not apply if another registrar is authorised in terms of Financial Services Board legislation as defined in section 1 of the Financial Services Board Act, 1990 (Act No. 97 of 1990), or in terms of banking legislation, to make an application for the business rescue of a provider.”

No mention is made under the exceptions contemplated in the Companies Act, of the FAIS Act, which leads us to the conclusion that the FAIS Act, which was promulgated in 2002, some nine years before the Companies Act 71 of 2008, and the Registrar were not contemplated as requiring exemption from compliance with the provisions of The Companies Act, nor are they envisaged as having any authority to amend the provisions of

the Companies Act. However section 38A (1) indicates that the business rescue process of a company, which is a financial services provider (FSB), is subject to the provisions of the section and that the provisions of Chapter 6 of the Companies are applicable subject to 'necessary' changes. It is our opinion that any changes made to the provisions of chapter 6 are null and void and of no legal standing.

While it may be reasonable for the Registrar via the FAIS Act to impose additional requirements for a FSB to comply with during the business rescue process, they have no legal standing to place the Registrar above the authority of the Commissioner where the entity is a company created in terms of the Companies Act, nor can the provisions of the FAIS act regulate or amend provisions of the Companies Act. S38A is clearly inconsistent with the provisions and spirit of Chapter 6 of the Companies Act and therefore, in terms of S5 of the Companies act, the provisions of the Companies Act must prevail. Furthermore, Sect 38A reads more into business rescue as Sect. 38A(1)(a) states:

“Notwithstanding the provisions of the Companies Act or any other law under which a provider is incorporated, Chapter 6 of the Companies Act shall, subject to this section and with the necessary changes, apply in relation to the business rescue of a provider, **whether or not it is a company.**”

It is quite clear from the above, that proper consideration was not given to Chapter 6 of the Companies Act when drafting Sect 38A, as it applies **only** to Companies and cannot apply to any other entity whether it be a legal or natural persona. Sect 38A(1)(a) introduces the possibility of natural persons being placed under business rescue, which is not possible, nor the intention of Chapter 6

Powers of the Board

S66 of the Companies Act sets out how the business affairs of the company must be managed and **S76 and S 77** of the Companies Act deal with the duties and liabilities of Directors, and while the Companies Act deals specifically with the duties and liabilities of directors, the FAIS Act does not refer to the liabilities of directors at all. Again Sect 38A attempts to curtail these responsibilities in that the board of a FSP must defer to the Registrar before it can place an FSB in business rescue. This is not in the spirit intended in Chapter 6 of the Companies Act

AFFECTED PERSONS and the application of provisions and definitions

The FAIS Act regulates the rendering of financial services to clients. Business Rescue under the Companies Act relates to affected persons as set out in Sect 128(1)(a) of the Companies Act and clearly does not include clients.

Of significant interest is the development and implementation of a business plan which may include the continued trading of the company as part of a turnaround process. Sect 38(A)(6) states :

“As from the date upon which a business rescue practitioner is appointed, the business rescue practitioner of a provider shall not conduct any new business unless the practitioner has been granted permission by the court.”

The purpose of business rescue is to turn the company around so that it is in a position to provide a better return for its creditors and this may include the continued trading and obtaining of new business. Again Sect 38(A) takes away the powers of the creditors, provided for under business rescue in the Companies Act and forces the company to incur further unnecessary cost by applying to court for approval.

Company Resolution to begin Business Rescue

Section 129 of the Companies Act sets out the procedures to initiate the business rescue process

Sect 38(A) removed the powers of the directors by including veto rights in Sect 38(A)(3). It is, in certain instances, placing its authority above that of the court by trying to give itself the right of veto against any court application.

Objections

Section 130 of the Companies Act deals with objection to the business rescue process and to the appointment of the Business rescue practitioner, whereby affected parties are afforded various procedures to lodge and pursue objections.

The FSB would probably be regarded as an affected party and if it has objections to the company being placed in business rescue, this section allows it to oppose the business rescue application by applying to court, which in our opinion is the route to be followed instead of having carte blanche to stop it without considering the interests of creditors.

Court Order to begin Business Rescue

Section 131 of the Companies Act deals with the procedure of instituting the business rescue process via a court order

This statement in Sect 38(A) is superfluous as Sect 131 provides for opposition by affected parties.

Qualification of a Business Rescue Practitioner

Section 138 defines the qualifications required to be appointed as a business rescue practitioner

The FAIS Act does not address these matters so we are left to assume that the provisions of this section apply in their entirety. However sec 38 A does empower the Registrar to effectively veto the appointment by creating the opportunity for vetting the appointment in the pre-approval phase which requires the FSP to obtain approval from the FSB prior to initiating the Business Rescue process.

In Summary

There are enough problems besetting a company in business rescue and the business rescue practitioner without attempting to legislate from the sidelines by introducing further obstacles. The

business rescue practitioner is already having to deal with a very prescriptive section of the Companies Act added to which the issue of post commencement finance is a very real issue. Now we have an attempt by the FAIS Act to introduce further prescriptive requirements to hamper the business rescue process. In fact some of the requirements of Sect 38A are virtually impossible to implement, such as regarding clients in the same light as creditors. Imagine trying to call a meeting of creditors and clients. In many cases it would require a stadium to seat all these parties if they all turned up for the meeting.

In our opinion the introduction of Sect 38A is nothing more than an attempt by the Financial Services Board to hijack the business rescue process without understanding the requirements of business rescue and is a piece of legislation that should be removed forthwith from the FAIS Act. It has obviously been written in haste (like so many other pieces of legislation) without considerations as to its content and effect on business rescue.

Representation has been made to the standing committee on the Companies Act with regard to this piece of legislation with a request to resolve this by having it removed from the FAIS Act.