MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA

# Regulatory reform to create a globally competitive and sustainable financial services sector

Address to the Annual Banking Summit by Deputy Minister of Finance

Nhlanhla Nene, MP

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Ladies and gentlemen

Thank you for inviting us to address the Annual Banking Summit. Unfortunately, the Minister could not make it today, and the honour of addressing this Summit has fallen on me in my capacity as Deputy Minister.

On behalf of the Minister, let me begin by congratulating you on organising such an interesting and timely conference. The challenges facing the banking sector mirror those facing the economy at large, and opportunities to discuss and debate these challenges are vital in building a stronger South Africa, particularly its economy

The concept of an Annual Banking Summit is an excellent one – the banking sector is faced with a variety of challenges, particularly after a few international banks in advanced economies sparked the global financial crisis in 2008. These challenges include:

- Increased regulations, both internationally and locally;
- Continuing difficult market conditions and squeezed profit margins; and
- Last but not least, a global consensus that we need to relook the compensation packages of bankers.

I do, however, wonder about your timing. September is not a particularly auspicious month for bankers. Just before 1am (US time) on 15 September 2008, Lehman Brothers announced that it would seek Chapter 11 bankruptcy protection. By that date it had total liabilities of over US$750 billion and assets of US$639 billion.

I do not want to bore you with the gory details of the events leading up to the Lehman's failure, nor any of the specifics of what happened subsequently. I am sure everyone in this room is familiar and keenly aware of how the crisis played out.

What I will do, however, is spend a few moments reflecting on the lessons of the crisis for the South African government, both from an economic perspective and a financial policy one. I will conclude with some thoughts on where the global regulatory debate is going, and how we as a nation should respond.

**The South African macroeconomy**

The main lesson from the crisis for us was that it is important to have the fundamentals right. Our macroeconomic policy framework is built on counter-cyclical policy. When times were good, we ran a fiscal surplus. As you know, the recession hit us when we were in the middle of preparations for the World Cup and as a result were in the process of building the necessary infrastructure. This was in addition to the normal infrastructure build programme that we embarked on. Together with our countercyclical fiscal policy, this helped us during those trying months. The infrastructure projects provided us with a much-needed cushion during the global downturn, and will help us emerge as a stronger and more competitive economy.

In addition, our prudence during times of plenty has enabled government to act aggressively to stimulate the economy in a sustainable way. When we tabled our budget in February for 2010/11, we projected a fiscal deficit of 6.2 per cent for the 2010/11 year, a substantial change from the 1.7 per cent surplus we had in 2007/08. This has given the economy much needed support during very difficult global conditions, and assisted in reducing the negative impact of the global recession on our people.

Also, and most importantly, the expansionary shift in the fiscal policy stance is on a sustainable footing; our overall debt-to-GDP ratio is projected to rise to 40 per cent of GDP by 2015, before beginning to fall again. In contrast, our counterparts in the major economies are gripped between the devil of austerity and the deep blue sea of weak and fragile economies needing support. Germany has a debt-to-GDP ratio of 62 per cent, while the corresponding figure is 115 per cent in Greece. With each of these economies running substantial fiscal deficits this year and into the future, we can expect a further fiscal deterioration across the globe.

Our South African Reserve Bank has also had the space to cut interest rates quite significantly before, during, and after the crisis, providing a timely monetary boost to the economy. As a result, debt service costs have declined from 12.3 percent at the end of 2008 to 8.2 per cent of disposable income, which in money terms is a reduction of R44 billion on interest payments. This will help households begin the process of strengthening their balance sheets.

The ratio of household debt to disposable income remains high at 78.4 per cent in the first quarter of 2010. The number of households with impaired credit records, according to credit bureau data, has risen to 46 per cent from 42 per cent a year earlier.

We can be confident in the knowledge that we saw the storm coming and we took measures to protect our economy. The Registrar of Banks stepped up oversight and monitoring of the banks. While some of the decisions the regulator made at the time may have not been very popular, I think we can all agree that the foresight helped South African banks to weather the crisis.

However, in light of the global crisis we cannot be complacent. We should remain vigilant, and where necessary we should sharpen our regulatory oversight and work together to identify potential problems early and deal with them decisively.

**How has the global financial crisis reshaped our regulatory architecture?**

The severity of the crisis has highlighted the need for ongoing reform of the global financial system. As part of the Group of 20, South Africa is playing a key role in the review of the operation of the international financial system.

At the most recent G20 Heads of State summit in Toronto, our President committed South Africa to a four-pillar approach to reforming financial regulation:

*The first pillar is a strong regulatory framework*. As we know, the Basel Committee on Banking Supervision has proposed a new global regime for bank capital, leverage and liquidity. We have agreed to implement these proposals, bearing in mind different national starting points and circumstances. The South African banking system remained resilient during the crisis, due in part to the fact that our banks maintained a strong capital position. Thus we support the global effort to improve the quality and quantity of capital, and strengthen our banks liquidity positions, provided this is done in a way that does not derail the economic recovery or our long-term growth prospects.

*The second pillar is effective supervision*. It is no use having a new improved formula for regulation without proper implementation. Fortunately we have a set of excellent regulators in South Africa. Nevertheless, we can always improve. In the Budget speech, the Minister announced initiatives to improve the co-ordination and effectiveness of our domestic regulators. Thus far our initiatives are bearing fruit, and our regulatory system is stronger as a result.

*The third pillar is resolution and addressing systemic institutions*. The focus of the G20 has been to design and implement a system that reduces the risk to taxpayers. Here again, we are fortunate that we did not have to call upon our taxpayers to save our banks. However, we take note of the experiences of our colleagues in other countries, and work to improve our domestic resolution framework.

*The final pillar is a transparent international assessment and peer review*. The National Treasury Director General, Lesetja Kganyago, is leading an international process to design a new peer review system for members of the Financial Stability Board. As part of this process, we have committed ourselves to regular assessments by the International Monetary Fund (IMF) and the Financial Stability Board. These assessments are both on the strength of the country's regulatory framework and on cross-country thematic issues (such as bankers' compensation). During May this year, the IMF completed a comprehensive review of South Africa's adherence to international standards in banking, insurance and securities regulation. The results of this Financial Sector Assessment Programme process are expected shortly, but in our discussions with the reviewers, it was noted that our financial regulatory standards are on par with the rest of the world.

**The future of financial services in South Africa**

The central role of the financial services sector in growth and development became incredibly clear during the financial crisis. But what also became clear is that the sector has more than its fair share of greedy and aggressive personalities who think they are above the law.

Policy makers are thus caught between punishing the sector for its past transgressions and trying to ensure that it remains healthy.

This begs the question: how are we going to balance the need for stronger regulation with the need to support economic growth?

There are no easy answers. As is the case globally, the financial services sector in South Africa has grown rapidly since 1994. Its annual average growth rate has been 5.5 per cent, second only to construction. The sector employs over a quarter of a million people. The strength of the economy is due in no small part to our healthy and strong financial services sector. But we have seen how other countries that relied on financial services have failed. Ireland, once dubbed the Celtic Tiger, now languishes in the same company as Portugal, Italy, Greece and Spain; the so-called PIGS.

So we do need to think through how the rapid financialisation of our economy may bring both benefits and potential risks.

**Additional challenges**

These international debates and concerns are interesting, ladies and gentlemen. But in South Africa we have our own challenges. One of these is to reconcile the South African first world banking sector, characterised by exceptional infrastructure and technology, with the enormous demand for financial services.

Inheriting a highly concentrated financial sector, and financial service providers with little incentive to reduce the cost of banking services or spur innovation, we had to act to improve access to the banking system for all South Africans. Our desire to broaden access to banking was not only motivated by pure altruism. Banking to all our people ensures that the allocation of capital and the developmental needs of the country are adequately matched; and ensures that the benefits of economic growth accrue to all.

In trying to bridge the divide between the First and the Second economy, government also undertook to address South Africa's unique dilemmas. Financial inclusion, a common thread in all policy areas, is a priority as far as providing access at reasonable costs for a wide range of financial needs and within sound and sustainable institutions. Government recognises that including people in the formal system brings growth to those communities and provides them with the commensurate consumer protection. We recognise the financial sector as an important tool in bridging the divide and as part of the reform programme to assist on the challenges of development and poverty alleviation. An integral part of addressing these challenges is providing appropriate savings, risk and transactional products, through technology and innovation.

The Financial Sector Charter, launched in November 2003, signalled a key milestone in the achievement of this objective and in the transformation of the financial sector. It demonstrated the possibility of a sustainable partnership between government and industry by embodying an agreement among the major financial institutions (banks, insurance companies, brokers and exchanges) on a set of service provision and empowerment targets. One of the key initiatives flowing from the Charter process is the innovative Mzansi account, a low cost national bank account, launched in October 2004.

Although the numbers are viewed by some with scepticism, the Charter's value lies not in the Mzansi numbers but in the spin-offs and bringing to the industry's attention the possibilities of an untapped market. Banks have innovated their own Mzansi-style products to address the needs of the domestic remittance market and other low value bank products. The insurance industry has also started to focus on providing micro insurance and appropriate products like funeral policies that meet these unique segments. National Treasury lauds this work and will actively engage the industry going forward.

The Charter is also further complemented by other initiatives to encourage innovation and greater consumer standards. This included the promulgation of the Co-operative Banks Act which promotes grassroots and community-based sustainable institutions; recent engagements with major retail banks on the recommendations of the Banking Enquiry to improve disclosure and transparency of retail banking transactions; and the National Credit Act that addresses consumer protection in the credit environment. Also, National Treasury is considering legislative changes to accommodate second tier banks, deposit insurance as well as policy on micro-insurance and remittances.

Of particular importance, both internationally and to the National Treasury, is the issue of consumer protection. This includes consumer literacy and greater transparency and disclosure of all financial products. Historically, consumers have been an afterthought, characterised by the selling of inappropriate products and opaque disclosure of costs and terms and conditions. Consumer protection is a moral and economic imperative that the industry must address.

Through the process of addressing the recommendations of the Banking Enquiry, National Treasury will address competition and efficiency in the banking sector, greater access within an appropriate legislative framework to the payment system, and market conduct.

**Conclusion**

I have tried to sketch some of the important issues that are occupying the minds of policy makers, both up the road in Pretoria, and across the seas in Basel, London and Washington.

How do we ensure that the financial sector is strong, but competitive? How do we balance growth and regulation? How do we take financial services to all?

These are the difficult questions you will wrestle with at this Summit. I am sure you will have some interesting ideas, and I hope you will find some answers. Whatever it is you decide, I have no doubt the discussions will be robust, interesting, intellectually challenging and fruitful.

I wish you all the best of luck, and look forward to the results.

Thank you.