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Financial sector regulatory reforms

Introduction

An inclusive, efficient financial sector that treats customers fairly can support accelerated economic growth and development. The National Treasury's long-term programme of regulatory reform for the financial sector aims to help achieve these goals, as set out in the 2011 publication, *A safer financial sector to serve South Africa better*. This report[1] outlines four major areas for reform:

- Strengthening financial stability
- Improving how financial services firms conduct their business and treat customers (market conduct)
- Expanding the reach of financial services to all (financial inclusion)
- Combating financial crime and enhancing financial integrity.

In addition to domestic initiatives, South Africa continues to be an active participant in the development of new global standards for the financial sector. Members of the Group of 20 (G20), including South Africa, have made significant progress in reforming the regulatory fault lines that contributed to the 2008 global financial crisis.

In line with international best practice, in 2014 the International Monetary Fund (IMF) conducted a five-yearly evaluation of South Africa's regulatory system. The Financial Sector Assessment Programme[2] concluded that South Africa has a generally well-regulated and well-capitalised financial sector. Nevertheless, it recommended enhancing regulator coordination, including group-wide supervision; conducting system-wide stress tests; introducing deposit insurance; improving collective investment scheme regulation, particularly for money market funds; and increasing supervision of over-the-counter derivatives. Government is considering these recommendations and will respond later in 2015 after consulting interested parties.

[1] See www.treasury.gov.za/twinpeaks.

[2] See http://www.imf.org/external/country/zaf/index.htm.

Update on “twin peaks” implementation

Flowing from *A safer financial sector to serve South Africa better*, the National Treasury is undertaking a comprehensive regulatory overhaul of the financial sector, centred on the “twin peaks” model. This approach makes the financial sector safer by empowering the Reserve Bank to oversee financial stability, entrenching a culture of coordination among regulatory authorities and strengthening the protection of financial customers. Supervision of financial institutions will be more intensive and intrusive, in keeping with the understanding that the financial sector is highly innovative, with attendant risks to both proper market conduct and financial system stability. The twin peaks approach establishes two complementary regulators: the Prudential Authority, responsible for the safety and soundness of financial institutions, and the Financial Sector Conduct Authority, covering market conduct and securities regulation.

These reforms are contained in a second draft of the Financial Sector Regulation Bill, published in December 2014 for consultation. An amended bill will be tabled for Parliamentary consideration before June 2015.[3]

Prudential framework

A robust prudential framework will be applied consistently across the financial sector, including capital, liquidity and leverage requirements where appropriate.

The Insurance Bill, which will be introduced in 2015, will apply prudential standards to insurance companies from January 2016. This will align South Africa with international prudential standards by providing for group supervision, governance and risk management, and promoting financial access to insurance products. It will also promote consistency with Basel III, the prudential framework for banks.

In line with its more intensive approach to regulation, government is strengthening the supervision of all investment funds, starting with hedge funds. From 1 April 2015, hedge funds will be treated as collective investment schemes with appropriate governance and tax implications. The regulatory framework will also be updated to reflect future globally agreed standards. An appropriate treatment of unlisted property schemes will be introduced in 2015/16.

Annexure C contains further proposals on the tax treatment of certain financial instruments such as hedge funds, real estate investment trusts, securities lending and insurance.

Improving market conduct

Financial products often fail to live up to customer expectations. They can be complex, with opaque fee structures that make it difficult to assess real value or ultimate cost. As a result, customers may purchase incomprehensible or inappropriate products. A draft market conduct policy framework and a retail distribution review,[4] published in late 2014, set out proposals to improve the regulatory environment, including streamlining fragmented and inconsistent legislation.

Market conduct measures to reduce over-indebtedness

One of the biggest challenges facing households is their high level of indebtedness, with the associated financial harm and wider negative effects that bring great hardship to many working families. This has been exacerbated by poor market conduct by credit providers and debt collectors. Based on the December 2013 Cabinet decision, steps will be taken to enable customers to confirm debit orders before they take effect; deal with unlawful emolument attachment (“garnishee”) orders; introduce affordability assessment criteria; harmonise the treatment of debt collectors, particularly legal firms; and finalise holistic measures to deal with problems in consumer credit insurance.

[3] Further information is available at www.treasury.gov.za/twinpeaks.

[4] Available at www.treasury.gov.za/twinpeaks and www.fsb.co.za respectively.

Government welcomes employer initiatives to help over-indebted employees, including taking steps to review and, where possible, stop emolument attachment orders that apply to their employees. Government also supports steps taken by major banks to restructure payment terms for over-indebted consumers, and will consider proposals to expand voluntary debt mediation measures to non-bank lenders.

Improving market conduct for the retirement industry

Government will continue to build on its retirement reform initiative, which aims to facilitate an environment in which all employees can retire comfortably and not face poverty in their old age.[5] It will:

- Encourage preservation before retirement and annuitising at retirement
- Improve governance and disclosure of retirement funds
- Reduce costs including enabling greater use of passive funds
- Harmonise regulation and supervision between private and public retirement funds
- Design a uniform tax and contribution system.

Many of these reforms are urgent, and delays will be at the cost of pensioners. As noted in the 2014 Budget, government is committed to engaging with key stakeholders (trade unions, trustees, employers and industry) directly and through the National Economic Development and Labour Council (NEDLAC), to finalise the legislative framework for retirement reform.

The policy measures outlined here seek to address critical shortcomings in the current system. Over the past three years, government released several technical papers on retirement reforms, and various policy reforms have been legislated. These reforms are expected to be largely consistent with further progress on social security reform, which is expected to take longer given its complexity. The social security reform process will be initiated after Cabinet has approved a framework for consultation with key stakeholders.

Progress has also been made on non-retirement savings, which will be supported by the introduction of the tax-free savings account from 1 March 2015.

Harmonisation and annuitisation

The Taxation Laws Amendment Act (2013) outlined a system that harmonises the taxation of retirement contributions and benefits in retirement. As a result of consultations with the labour constituency in NEDLAC, government postponed the effective date of the act to 1 March 2016 to enable further public communication and discussion with affected parties.

In addition, annexure C in the *Budget Review* contains a proposed amendment to correct an omission in the Tax Law Amendment Act (2013) that inadvertently excludes some retirement funds which enjoy the benefit of higher deductions without being subject to the uniform annutisation rules.

Default regulations

The 2014 Budget announced that draft regulations on default preservation, investment strategy and annuities would be released for public comment in 2014. Drafting the regulations has taken longer than expected due to their complexity, and they are now projected to be released early in 2015.

Mandatory system under consideration

The 2014 Budget announced that government would consider a mandatory contribution system and a retirement system to help vulnerable workers save for their retirement. It will discuss these initiatives

[5] See *2014 Budget update on retirement reforms*, released 14 March 2014.

with key stakeholders to ensure that a cost-effective and suitable retirement system is designed for this group of workers – or, at a minimum, that a cost-effective default fund is established.

Demarcation between medical schemes and health insurance

The National Treasury and the Department of Health aim to publish final regulations before June 2015 to demarcate medical schemes and health insurance products. Parameters are proposed for health insurance products to preserve the principles of social solidarity and cross-subsidisation embedded in medical schemes, while affordable medical schemes for low-income individuals are also being considered. A roadmap for implementing consumer credit insurance proposals will also be released. Annexure C contains further proposals on the tax treatment of certain financial instruments.

Financial inclusion

Extending access to poorer households and communities is an important developmental objective. More than 80 per cent of adults now use a financial service or product, with 75 per cent using formal banking and more than 50 per cent accessing credit. But more work is needed to expand transactional services, lower fees, reduce over-reliance on credit and expand small enterprises' access to financial services. New, viable financial service providers need to be encouraged, particularly in the low-income segment. The cooperative banking sector is growing and forthcoming legislation will facilitate the entry of dedicated banks. The corporatisation of Postbank will expand its provision of financial services to poorer communities. Government is supporting the extension of mobile payments and remittances to enable affordable and convenient services. It also seeks to improve the availability of credit for small enterprises.

To facilitate these reforms, in 2015 the National Treasury plans to publish a more comprehensive financial inclusion policy framework and establish a national financial inclusion forum.

Combating financial crime and enhancing financial integrity

Illicit financial flows and transactions have gained international prominence, with fines levied on international and domestic institutions. The Financial Intelligence Centre Act (2001) is being reviewed to align it with international practices to reduce illicit financial flows. Legislation to this effect will be introduced in 2015.

Modernising capital flow management

Rules and conditions continue to be modernised to attract investment and enable South African firms to expand internationally, particularly into Africa. The exchange control manual is being simplified and this process will be completed in 2015. The following threshold changes will take effect from 1 April 2015:

- Authorised dealers may process corporate investment up to R1 billion per year, from R500 million previously, as well as the carrying forward of any unused allowance.
- South African residents' foreign capital allowance will increase from R4 million to R10 million per calendar year or upon emigration, or R20 million per family unit.
- The subcategories under the individual single discretionary allowance are removed and the annual R1 million allowances may be used for any legal purpose abroad.
- The dispensation for credit card usage, currently limited to individuals, will be extended to corporates.

These dispensations are subject to the statutory requirements of the Reserve Bank and the South African Revenue Service. Further administrative details will be communicated by the Reserve Bank.