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Financial sector regulation and reform

Introduction

The National Development Plan and the 2016 State of the Nation Address call for a financial centre for Africa[1] to develop regional links for the financial services sector and support economic growth on the continent. There is substantial potential – estimates suggest that South Africa has a 2 per cent market share of rest-of-Africa services imports.[2] By comparison, Brazil has 26 per cent of the market share in South America.

A series of reforms has positioned South Africa as a regional financial hub, with a substantial expansion in Africa-related financial services business. Revenue from the rest of Africa made up 17 per cent of total revenues for South Africa's four largest banks in 2014, bringing benefits in the form of foreign exchange, domestic jobs and tax revenue. The financial and related business services sector contributes 18.8 per cent of GDP and 31.9 per cent of corporate tax revenue.

Financial services reforms

Financial inclusion

About 84 per cent of South African adults used some form of financial service in 2015, and 80 per cent of South Africans have a bank account. However, the inappropriate and unproductive use of credit has led to high levels of over-indebtedness.

Although the use of financial services is increasing, there remains a need to focus on the small business sector. Only 30 per cent of registered small businesses have access to finance. To improve this situation, government plans to introduce a shared business credit infrastructure for small businesses.

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[1] National Development Plan 2030, page 149.

[2] McKinsey Global Institute (Sept 2015) *South Africa's Big Five: Priorities for Inclusive Growth*.

The National Treasury will also publish a financial inclusion policy document for public comment. The document assesses the state of financial inclusion in South Africa, and puts forward general principles to guide more comprehensive improvements.

Foreign exchange market conduct modernisation

Remittances

South Africa is home to four of the five most expensive remittance corridors in the world, with an average cost of just above 20 per cent of the value of the remittance, compared to the worldwide average of just below 9 per cent.

The National Treasury will expand market conduct reforms to apply to the retail foreign exchange market, which, together with more competition and exemptions in the Financial Intelligence Centre Act (2001), should reduce the compliance burden for low-risk remittances and lower charges.

Financial surveillance manual

The Reserve Bank will publish a simplified financial surveillance manual on its website in July 2016. Authorised dealers will also be encouraged to digitise and modernise the functioning of the foreign exchange market system.

Foreign investment limits

For a period of 12 months, institutions affected by the depreciation of the rand will not be required to rebalance their portfolios, but no further offshore investments will be allowed until the institution is within the prescribed offshore investment limit.

Enhancing financial integrity

The integrity and stability of the international financial system rests on its ability to effectively combat financial crime. Parliament is considering amendments to the Financial Intelligence Centre Act to align it with international standards, which will include a risk-rated approach. The National Treasury, the Financial Intelligence Centre, the Reserve Bank and the South African Revenue Service are working with relevant stakeholders to combat financial crime and minimise illicit financial flows.

Twin peaks update

A strong regulatory system is key to the success of any financial hub. Parliament is considering legislation to implement a "twin peaks" framework for financial regulation. In line with global trends, the framework will establish two complementary regulators. The Prudential Authority, situated in the Reserve Bank, will be responsible for the safety and soundness of financial institutions, and the Financial Sector Conduct Authority, which will replace the Financial Services Board, will be responsible for market conduct and securities regulation.

Improving financial stability

With the twin peaks model at an advanced stage in the legislative process, the National Treasury has begun developing additional reforms to improve financial stability. These reforms aim to reduce the probability of a systemic event occurring, and contain the effects if it does.

Resolution policy framework

An effective framework to deal with the resolution of banks, major insurers and other systemically important financial institutions ensures that the costs of private firms are borne by private creditors with no recourse to taxpayer funds. In 2015, the National Treasury, together with the Reserve Bank and the Financial Services Board, published a discussion document with proposals for an effective resolution regime and aims to present a draft bill by the end of 2016.

Prudential reforms

South Africa's strength as a financial hub for Africa relies on the safety and soundness of its banks and insurance companies. From 1 April 2016, new banking regulations will align the current framework with the Basel Committee's latest guidance.

Basel III calibration

The Registrar of Banks has proposed a recalibration of the net stable funding ratio, which forms part of the Basel III framework. This recalibration will reflect the volatility of wholesale funding. A run-off rate of 35 per cent is proposed for wholesale deposits of less than six months. This will ensure compliance with international standards without causing undue harm to the economy. The ratio will become a minimum standard on 1 January 2018.

Insurance Bill

Parliament is considering an Insurance Bill to implement international standards for insurers. The bill provides a consolidated legal framework for the prudential supervision of the insurance sector that is consistent with international standards. It seeks to consolidate existing insurance legislation and facilitate financial inclusion through a micro-insurance framework.

Improving market conduct

A market conduct policy framework and a draft Conduct of Financial Institutions Bill will be released in 2016. The bill is intended to simplify and modernise market conduct regulation. If these proposals are adopted, all participants in the financial sector will be affected, from traditional providers like banks and insurers, to relatively new entrants to the industry like mobile network providers. This will ensure a level regulatory playing field that facilitates market innovation, strengthens competition and ultimately serves the customer better.

The ombud system

South Africa has a fragmented statutory and non-statutory ombud system, with different approaches for different industries. Government proposes to merge various ombuds into a single system. In the interim, Parliament is considering the National Treasury's proposal to create an ombud council with a chief ombud.

Abuse of emolument attachment orders for credit granted against public servants

The Department of Public Service and Administration and the National Treasury have appointed a service provider to investigate the extent and abuse of emolument attachment orders ("garnishee orders") in the public service. This will help ensure that no illegally issued or flawed orders are served on national and provincial government officials.

Demarcation of medical schemes

Government aims to publish final regulations early in 2016 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.

Consumer credit insurance

The National Treasury continues to engage with the Department of Trade and Industry on credit insurance. A National Treasury study in 2014 showed that consumer credit insurance can increase the cost of credit by up to 15.6 percentage points for furniture loans, 4 percentage points for personal loans and 3 percentage points for vehicle finance. Some furniture loans with credit insurance can cost nearly 50 per cent a year. The Department of Trade and Industry has published proposals to cap the cost of credit life insurance.

In addition to the high costs, there is misselling, including cases of companies selling retrenchment insurance to self-employed individuals and pensioners. The National Credit Regulator and the Financial Services Board are already taking stronger action against such firms. Proposed interventions to enhance consumer protection include standardised policy wording and improved disclosure. Measures to improve data collection and streamline regulatory reporting will also be considered.

A roadmap for implementing stronger reforms in the consumer credit insurance market will be released in early 2016. Proposed interventions include improving consumer choice (for example, many furniture retailers offer credit insurance from related companies), the degree of standardisation and disclosure.

Agricultural insurance

Many agricultural producers in South Africa are not insured against the negative impacts resulting from natural disasters, such as drought. Government is considering the feasibility of improving existing agricultural insurance programmes. The project comes against the backdrop of two insurance companies withdrawing cover from the agricultural market due to increased frequency and scale of drought and hail.

A financial centre for Africa

HoldCo reforms

Companies in banking and insurance groups will be allowed to apply for "HoldCo" status, subject to the Governor of the Reserve Bank's approval, after consulting the bank supervision and financial surveillance departments. The bank macroprudential limit formula will be adjusted to include exposures to HoldCos.

Financial market infrastructure

South Africa's sophisticated financial market infrastructure enables financial transactions to be traded, cleared, settled and recorded. Further improvements to this infrastructure are set out below.

Multi-currency settlement

About 65 per cent of South African Development Community transactions are settled in currencies other than the rand, and these transactions are typically settled outside the region. The planned introduction of multi-currency settlement in the next two years will allow settlement to take place onshore. It will also facilitate the introduction of domestically settled, foreign-currency-denominated bonds in due course.

External financial market infrastructure

To support South Africa's status as a financial hub, regulations will be finalised in 2016 for foreign market infrastructure to apply to provide services in South Africa. The regulations include:

- *Proposed central securities depository "link-ups":* Central securities depositories are the backbone of securities settlement. Cross-border settlement requires legal and regulatory link-ups between domestic and foreign depositories, and proposed regulations will provide for these links. The increased integration of central securities depositories will be measured against the risks involved and will require efficient oversight.
- *Offshore clearing houses:* More than 60 per cent of domestic derivatives[3] trading involves offshore players. To reduce risks, these transactions are often cleared through offshore central counterparties. To facilitate the appropriate supervision of such counterparties, the Financial Sector Regulation Bill has proposed a licencing regime. This will have the additional benefit of requiring these central counterparties to operate from South Africa and offer services to the rest of Africa.

[3] Including interest rate swaps, but excluding foreign exchange swaps.

In 2013, the National Treasury entered into an agreement with the Johannesburg Stock Exchange to introduce a new trading platform for government bonds. In late 2015, the Johannesburg Stock Exchange finalised the technology provider. It is expected that the platform will be tested in 2016.

Update on social security and retirement reforms

Over the last 20 years, government has made significant progress in bringing about a fairer and more effective retirement system. Government is committed to the release of the comprehensive social security reform paper later this year, led by the Ministers of Social Development and Finance.

Government has made significant progress in retirement reforms since 2012. It has taken the first legislative steps towards achieving tax harmonisation in the treatment of retirement contributions, transforming the industry so that it serves members of retirement funds better and more fairly, laying the basis for improving governance and transparency in funds, and lowering charges and improving default arrangements. Despite the postponement of annuitisation for provident funds, government remains committed to its retirement reform objectives as announced in the 2014 Budget update on retirement reforms paper, released on 14 March 2014. The National Treasury intends to publish the final default regulations later this year, after considering comments received from the public.

Key elements of the reforms include:

- Mandation or auto-enrolment
- Improving fund disclosures
- Getting defaults right
- Consolidating the number of funds
- Simplifying retirement savings products and enabling portability between providers
- Ensuring effective intermediation.

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