Treating Customers Fairly in the Financial Sector:

A DRAFT MARKET CONDUCT POLICY FRAMEWORK FOR SOUTH AFRICA

Discussion Document

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Contents

This document is an edited version of the document first published on 11 December 2014. Minor improvements have been made to enhance reader understanding, including expanded technical explanations, rearrangement of certain sections, and correcting spelling and grammatical errors. Appendix 6 has also been added to guide and support submissions from stakeholders during the comment period.

Executive summary

Financial customers are not adequately protected in South Africa, and more needs to be done to ensure that the providers of financial products and services treat their customers fairly. Some examples of abuse in the financial sector are high fees and a multiplicity of incomprehensible charges, the design and sale of inappropriate products, and reckless lending often paired with disgraceful (and illegal) debt-collection practices. Poor market conduct, where financial institutions are conducting their businesses in ways that prejudice clients and customers, amplifies challenges relating to low savings and over-indebtedness, and undermines steps taken to make the financial sector more accessible to South Africans in order to improve financial inclusion.

While South Africa has made progress on market conduct within the current legal framework, these initiatives can be strengthened through structural change. Weaknesses in the current framework include fragmentation, inconsistency and incompleteness of regulation across the sector, which compromise the ability of the regulators to act against wrong-doers, leading to poor customer outcomes.[1] In many instances poor market conduct practices are driven by inappropriate incentives. This is well illustrated by the deeply conflicted financial advisory industry, as financial advice is frequently linked to commissions paid by product suppliers on product sales, thus raising questions around whose interests are being represented.

This paper aims to facilitate a critical examination by stakeholders of weaknesses in governance, incentives, business practices and government policies that serve to undermine financial sector policy objectives of prudential soundness, stability, integrity, inclusion and treating customers fairly. Falling short of these objectives in turn compromises how effectively South Africans can save, borrow, transact and mitigate their financial risk. For example, to better understand why South African households consume rather than save, government needs to examine whether it can improve policy and law relating to mandation, preservation, consolidation and defaults,[2] and strengthen enforcement. Similarly, the industry needs to examine its practices, for example poorly understood policy terms and layered and high charges, to see whether these disincentivise saving by households. Low participation rates in other financial segments raise similar issues.

Protecting customers and ensuring they are treated fairly by financial institutions is the essence of market conduct policy and law. Indeed market conduct regulation aims to prevent (and manage when prevention is not successful) the dangers that arise from a financial institution conducting its business in ways that are unfair to customers or undermines the integrity of financial markets and confidence in the financial system. Government is taking steps to transform the financial sector by

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[1] To illustrate these outcomes and their effects, personal stories are reflected across the document, showing how policy questions being raised are relevant to ordinary South Africans. The persons in these narratives are fictional, but based on real cases and experiences.

[2] See Chapter 5 for a full explanation on government proposals in support of retirement reform.

regulating it for market conduct through a dedicated market conduct regulator. The decision to establish a market conduct regulator was given impetus by the work of the Competition Commission Banking Enquiry Panel (the Jali Enquiry) in 2008, which first outlined the poor treatment of customers in the retail-banking sector. It was part of a Government decision to make the financial sector safer and serve South Africa better, by shifting towards a Twin Peaks system of regulation. The new system will be formally implemented soon after the necessary legislation - the Financial Sector Regulation (FSR) Bill - is enacted and implemented over 2015/2016.

The FSR Bill implements the key Government principles outlined in the policy document *A Safer Financial Sector to Serve South Africa Better* (2011), including the principle that all financial service providers must be appropriately licensed or regulated, and that tough fit and proper standards should be in place for all providers. However, government is not waiting on the full implementation of Twin Peaks before initiating market conduct reforms. Steps taken since 2011 include implementing the recommendations of the Jali Enquiry through engagements with the banking industry, revised asset spreading requirements for the retirement fund sector to improve protection of retirement investments,[3] and various papers published in support of the broader retirement reform agenda. The Financial Services Board (FSB) is implementing its Treating Customers Fairly (TCF) approach to supervision, and more recently have made public proposals to deal with abuses in consumer credit insurance (CCI) and retail distribution. The National Credit Regulator (NCR) has taken steps to deal more decisively with reckless lending and other abuses related to retail credit. In parallel, government approved the launch of an initiative to assist over-indebted households and to deal in particular with the abuse of emolument attachment orders (otherwise known as garnishee orders).

Equally as important as market conduct policy is the objective of financial inclusion, making the financial sector more accessible to all South Africans. Government has worked with the banking industry to introduce nearly 20 million Mzansi and Mzansi-like accounts aimed at broadening access to banking, and has also engaged with the insurance sector to provide more appropriate and affordable insurance products. The two objectives of market conduct and financial inclusion fall, together with prudential soundness and financial integrity, within a financial stability framework, which framework is essential to protect the country from the type of risks that led to the 2008 global financial crisis.

This paper is published with the revised (second) draft of the Financial Sector Regulation (FSR) Bill, and provides information on the proposed approach to market conduct regulation in South Africa, in support of Twin Peaks. The FSR Bill is part of Phase 1 in implementing the Twin Peaks model. It creates the Financial Sector Conduct Authority (FSCA) as the new market conduct regulator, as well as the Prudential Authority (PA) responsible for financial soundness within the South African Reserve Bank (Reserve Bank). The FSCA and PA will, in addition to their respective core objectives, support the Reserve Bank in fulfilling its mandate of protecting financial stability. A strong emphasis has been placed on coordination and cooperation between financial sector regulators, in line with the overall aim of consolidating and harmonising regulation to minimise the potential for regulatory arbitrage. These regulators should to the extent possible develop and implement shared work plans to deliver on Government's agreed policy objectives.

The policy proposed in this document introduces Phase 2 in the reform process, explaining the policy framework within which the FSCA could operate. It builds on the policy proposals outlined in the 2011 policy document, and *Implementing a Twin Peaks model of financial regulation in South Africa* (2013), which together led to the FSR Bill. The TCF initiative, as reflected in the *Treating Customers Fairly Roadmap* (2011), further informs the approach.

Working towards a stronger and more effective market conduct framework for South Africa's financial sector creates a unique opportunity to holistically review and revise the current regulatory

[3] These requirements formed part of the revised Regulation 28 (of the Pension Funds Act) implemented in 2011.

environment, considering which aspects of the existing regime work well in supporting positive outcomes and which do not, and working with stakeholders to develop a best-of-breed framework that will put in place *more effective*, rather than just *more* regulation.

This document initiates public debate on how best to achieve this. Given the broad scope of financial sector activity in South Africa, this document does not cover every market conduct challenge. The focus is rather on developing the overarching strategic framework within which conduct challenges can be resolved more easily and consistently by the regulator, based on sound conduct principles. It is published to engage policymakers and policy analysts, financial institutions, consumer rights organisations and South Africans more broadly, setting out initial clear proposals for conduct oversight and raising key issues for debate. Stakeholders are encouraged to comment on what the market conduct regulator should be doing when established, in order to achieve better outcomes for financial customers. Appendix 6 poses chapter questions to further stimulate discussion and guide stakeholder submissions.

The following main topics are covered:

Chapter 1 – The problem statement

Poor conduct practices and the unfair treatment of customers in the financial sector suggest that South Africa's financial sector could be delivering better outcomes for financial customers and the economy more broadly. This chapter highlights some of these market conduct challenges. Domestic circumstances, in particular the rise of financial groups, the increasing overlap in activities across all financial institutions in the sector, and the fact that conduct challenges tend to persist despite regulatory interventions made to date, have also highlighted structural weaknesses in the legal framework relating to conduct regulation. The problem is compounded by financial customers who are not yet sufficiently empowered to hold financial institutions to account.

Chapter 2 – What is market conduct regulation? How does it better protect financial customers?

The nature of the financial sector means that ordinary, generic customer protection laws do not go far enough in protecting financial customers. The potential for economic disruption and consumer hardship should a financial institution fail to meet its “promises” means that the sector requires much higher regulatory standards relative to other sectors, which standards should be tailored to respond to market conduct risks. Market conduct regulation aims to better protect financial customers by responding to these risks, and is a key pillar of the Twin Peaks system being implemented in South Africa. A dedicated regulator for market conduct, the FSCA, will supervise financial institutions more intensely and intrusively to mitigate the risk of poor conduct and take steps to end unfair or harmful practises as they emerge, to ensure that the sector is delivering good customer outcomes across the product cycle.

Chapter 3 – A strategy underpinned by a consolidated and harmonised market conduct law

The proposed approach to strengthen the market conduct policy framework is multi-pronged. One aspect is the reform of the legal landscape, which aims to provide a strong, consolidated law within which the FSCA can exercise its mandate. This is informed by current regulatory weaknesses that have been highlighted by specific conduct failings in the South African financial sector, and also takes into account international standards and reform experiences in other jurisdictions. The core component of the new legal framework is a proposed Conduct of Financial Institutions (CoFI) Act, which will significantly consolidate and harmonise the conduct of business elements of the relevant existing sectoral laws. The new legal framework will aim to ensure that complete, consistent and outcomes-focused conduct standards are applied across an increasingly converging and complex financial sector.

Chapter 4 – Accelerating and intensifying industry interventions

Addressing current market conduct challenges cannot rely only on a new legal framework. Interventions to address conduct failures in various sub-sectors will continue to take place within the existing legal framework, as part of the overall responding strategy. Priority areas in the short to medium term include improving savings (especially for retirement), addressing over-indebtedness, promoting better customer outcomes for bank depositors, and dealing with poor industry practices relating to insurance.

Chapter 5 – Cross-sector interventions: implementing the TCF framework

While the sub-sector interventions above are necessary, steps are increasingly being taken to implement conduct interventions that apply across the financial sector as a whole, to reduce regulatory arbitrage opportunities presented by fragmentation and complexity. In particular, the TCF initiative of the FSB will continue to drive better outcomes for customers across the product life cycle and across the financial sector. Projects already underway to improve industry practices relate to disclosure, distribution, advice, and complaints management.

Chapter 6 – An integrated ombud system

An effective market conduct framework requires customers who are empowered to hold financial institutions to account. The approach to improving market conduct should therefore aim at improving customer recourse mechanisms, ensuring that dispute resolution mechanisms - in particular the ombud system - are easily accessible and effective.

Chapter 7 – Strengthening financial literacy and capability

An empowered financial customer is one who is informed and appropriately educated about his or her financial needs, and the benefits and risks of the financial services and products on offer. Financial education initiatives are as a result important to build customer capability. These initiatives should to the extent possible be coordinated across stakeholders and have feedback mechanisms to assess effectiveness, in turn guiding policy interventions in future years.

Chapter 8 – Enhancing the efficiency and integrity of financial markets

The FSCA will be responsible for ensuring integrity in the financial markets, working towards markets that are fair and efficient. Two options are being considered for exercising this mandate under a revised legal framework for conduct, namely: combining the conduct of business and financial market integrity elements of the existing laws into a single piece of legislation, or combining the conduct of business elements of the current laws into one Act, and the market integrity elements of the current laws into another.

Chapter 9 – Implementation of the new regulatory framework

Implementing the new market conduct framework will follow a phased approach to limit disruption for the regulators, ombud schemes and regulated entities. Phase 1 will involve the creation of the new conduct authority, as per the FSR Bill, while the proposed new legal framework is envisaged in Phase 2.

1
The problem statement

South Africa's financial sector withstood the global financial crisis, and yet the sector could be delivering better outcomes for financial customers and the economy, in particular to foster savings, facilitate transactions, balance the availability of credit with responsible lending practices, and protect customers against costly unforeseen events (like loss of household or business items through theft, or the untimely death of the primary breadwinner). How well these market segments work in the interests of customers is an important benchmark, and these are the outcomes on which Treasury is focusing. Unfortunately market conduct challenges continue to erode sector value. Government initiatives undertaken within the current regulatory framework to address conduct failures have highlighted broader structural factors within the regulatory framework which result in these failures persisting. The legislative framework is fragmented and institutionally focused, allowing for inconsistent application of standards and presenting opportunities for regulatory arbitrage. This is further compounded by financial customers who are not sufficiently empowered to hold financial institutions to account.

Persistent market conduct challenges in South Africa's financial sector

"Market conduct" considers how persons involved in the financial sector conduct themselves and their businesses in relation to clients, customers, and each other, with a focus on fairness and integrity. Many financial firms have made significant progress in improving their market conduct practices. Such firms have recognised the business opportunities for those ahead of the curve. Some positive initiatives that have been undertaken include: increased strategic focus on meeting customer needs by the executive and senior management, working with the Financial Services Board (FSB) to embed Treating Customers Fairly (TCF) principles within the organisation, and increasingly focusing on more effective communication with their customers (for example issuing disclosure documents in plain English).

However, there remain many firms that still have to change their practices, and their culture, when dealing with their customers. Table 1.1 sets out typical poor practices observed across the sector, drawn from a range of inputs including amongst others the FSB, customer complaints to ombuds, retail customer surveys and investigative media reports, and of course Government's own engagement with industry and its customers.

Table 1.1 – Current market conduct challenges in South Africa[4]

Sub-sector	Market conduct challenges
Transactional banking – non-credit	• Opaque and complex fee structures undermine product comparisons and competitiveness, particularly fees relating to account transactions, penalties and ATM charges • Incentives and inducements reduce customer scrutiny of core product features and distort decision making • Unfair debit order practices (e.g. penalties on dishonoured debit orders and double debit orders) • Other payment system issues relating to competition, pricing transparency and poor outcomes for end-users • Lack of regulatory oversight of market conduct practices has slowed reforms e.g. implementing Jali Enquiry recommendations • Insufficient focus on new customer channels emerging through new technologies, e.g. mobile banking and closed-loop payment systems (esp. domestic remittances) • Fraud risk, particularly through electronic channels
Savings and investment	• Opaque, high and sometimes inappropriate investment charges (like rebates), especially in multi-layered products (e.g. a retirement fund backed by an insurance policy invested through a Linked Investment Service Provider into a collective investment scheme) • Product design features may weaken returns (e.g. asset based fees or causal event charges), and competition (e.g. through restricted portability on account of causal event charges, esp. in legacy products). • Large gaps in regulatory net allow for structuring of investment vehicles to avoid regulation, especially with regard to the selling of potentially “bad” debt to uninformed purchasers and property syndication • Money market funds – lack of clarity between these funds and money market accounts offered by banks means that investors assume that they are invested in a bank deposit and do not know that they may lose the capital invested (in other words are exposed to market and not just credit risk) • Poor disclosure of risk of securitised assets in the wholesale market
Credit (banking and non-banking)	• Reckless lending practices that lead to over-indebtedness, especially payday lending • The sale of unsuitable, incorrectly targeted credit products • Poor sales incentives that drive unfair lending practises • A multiplicity of fees and commissions that are often high and opaque, compounded by inadequate or poor disclosures to customers • Abuse of the payments system to collect debt, including abuse of suretyships • Abuse of emolument attachment (garnishee) orders • Abusive debit order practices e.g. abuse of NAEDO system • Poor conduct practices in extending CCI linked to loans, aggravated by the ability to exploit captive (often vulnerable) customers through mandatory cover, bundled products, interconnected business models and conflicted distribution models

[4]FinScope SA 2012 Survey, FinScope SA 2013 Survey, media reports, past National Treasury policy documents, Jali Commission of Enquiry into Banking, Reports of the Financial Services Ombuds.

Risk insurance (asset and life)	• Poor disclosure of product terms, weak understanding by customers of technical policy language • Weak governance in outsourcing arrangements • Conflicted commission-based remuneration structures of intermediaries or service providers (esp. upfront commission on life risk, and remuneration for outsourcing asset risk) • Claims handling practices, esp. repudiations and non-transparency of exclusions, unreasonable excesses on asset cover, "underwriting at claim stage" • Too much focus on premium price rather than value (where costs to the consumer are displaced to higher excesses), esp. on asset (short-term insurance) cover • High incidence of illegal operators in the funeral insurance market
Sales and distribution	• Market structures leading to conflicts of interest, esp. around remuneration and outsourcing (see above); complicated relationships compromise accountability between product provider and intermediary, often leaving customer unclear on the true cost of advice and on who intermediary represents • Selling is incentive driven (product provider focused), rather than advice driven (customer focused) • Regulatory framework unclear for non-advice selling; uneven playing field • 'Tick box' compliance approaches which do not fulfil the intent of financial sector policy e.g. risk assessment tools support regulatory compliance but not necessarily fair client outcomes; disclosure documentation designed to meet regulatory requirements but does not meaningfully address customer information needs • Intermediaries structure themselves to avoid the law, including through "juristic representative"[5] structures which in effect allow the same intermediary entity to act in multiple capacities for different product suppliers – leading to regulatory arbitrage and consumer confusion.

These practices are not without consequence. Lerato's frustrations with the retirement industry for example, explained in Box 1.1 over the page, show the effects of exorbitant management fees hidden in a "quantity over quality" disclosure environment. In a paper on charges in the retirement industry Treasury has shown[6] how members of retirement funds are in most instances unaware that a 3% per annum charge on their pensions, even if it is disclosed, could reduce their pensions by half. In a simple scenario over 40 years a regular saver who faced charges on his retirement account of 0.5% of assets annually, as opposed to 2.5%, would all else being equal receive a benefit 60% greater at retirement. Alternatively, he or she could get the same retirement benefit by making contributions over his lifetime that are around 40% lower.

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[5] A representative is a person (including a natural or a juristic person) who renders a financial service to a client on behalf of a provider (the licensed FSP) by virtue of an employment contract with the provider or by virtue of a mandate from the provider. While the practice is not in itself necessarily unacceptable, market conduct risks enter where it is used to circumvent the existing laws and regulations, for example where an FSP may use the option on a "rent a license" type basis and not practice proper oversight of their juristic representative.

[6] See Charges in SA Retirement Funds (11 July 2013) available at http://www.treasury.gov.za/publications/RetirementReform/Charges%20in%20South%20African%20Retirement%20Funds.pdf

Box 1.1 – Lerato's experience of high costs in the retirement industry

When Lerato started working as a young professional 25 years ago, she decided to save for her retirement. Her boss referred her to a financial adviser who sold her a Retirement Annuity (RA) policy invested in a "stable bonus fund".[7] Her annual premiums rose by 15% to counter the effects of inflation on her retirement investment. Lerato recently decided to review her retirement planning, realising that she was moving into the last phase of her professional career. By now she understood considerably more about investments and retirement planning than when she first started off. The RA stood out as a poor performing investment, and she decided to obtain more information from the policy provider. She was not too sure how to evaluate the performance of the RA but was hoping to compare its performance with other similar investments.

What features of the policy were disclosed to Lerato, and how? Did she understand how different charges might affect the growth of the investment? Why did Lerato not receive sufficient ongoing information during the life of the investment to enable her to judge sooner whether it would deliver on her expectations?

Lerato asked the insurer for a full breakdown of the portion of premium contributions spent on costs, and a breakdown of these costs, over the past 25 years. Instead she received a schedule showing administrative fees and how much the broker received since the inception of the policy, as well as a marketing brochure describing the "fund" in which the investment portion of her premiums was being invested. This brochure contained general information about the composition of the fund, the management fee rate, the performance bonus rates for which the fund manager was eligible, and a table listing the various benchmarks against which the bonus would be evaluated.

Is the insurer understanding and responding to Lerato's needs? Is it fair for the insurer/broker to charge broker fees after 25 years with the broker no longer around? Why is the fund management and performance fee not disclosed? What other charges are being hidden?

Lerato was not sure that the figures provided explained the poor growth of her investment, and asked the insurer for a better explanation. The insurer offered for her to meet with their actuaries, but advised that she would need a sound working knowledge of actuarial science in order to make sense of their explanations.

Is it fair that ordinary consumers need to be actuaries to be able to evaluate their policies?

An actuarial friend showed Lerato that the real fee "killing" her investment was not the administrative fees charged by the insurance company, or even the commission paid to the broker, but the fee charged by the manager of the fund investing the balance of her annual premium after costs. This management fee amounted to an annual charge of almost 3% of the accrued value of her investment account and had devoured more than 30% of her investment - the investment did no better than the inflation linked (and tax free) government retail bonds. When Lerato tried to move the poor performing policy to a more competitive provider, she discovered that doing so would incur even more financial loss, due to the early termination penalties.

What steps can be taken to promote financial customers holding institutions accountable for poor treatment? How can disclosure better support policyholder capability? Should disclosure of charges be standardised? Can increased portability support increased competition and drive better value retirement products?

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[7] A stable bonus fund is also known as a "smoothed bonus portfolio", and is marketed to investers to assist with stabilising returns from more volatile investments like the equities market, thereby helping investors to achieve a more predictable return over time. In practice the policy works to guarantee a minimum return each month when the markets fall, but will pay less than the return actually earned by the underlying assets when the market performs exceptionally well.

Customer abuse has not gone unnoticed or unpunished. Over the past decade, regulatory action to better protect financial customers has been strengthened through industry laws like the Long-term and Short-term Insurance Acts, and Pension Funds Act, and activity based laws like the Financial Advisory and Intermediary Services (FAIS) Act and the National Credit Act (NCA). The FSB, National Credit Regulator (NCR) and more recently the Reserve Bank,[8] have worked to improve customer focus, in particular with respect to governance, product features (like terms and conditions) and disclosure. Appendix 1 outlines the nature of some of these regulatory interventions.

Unfortunately Table 1.1 illustrates that despite regulatory interventions already taken:

- Many financial sector participants appear **insufficiently focused on customer needs and interests**. This can be seen for example in the prevalence of reckless lending and unconscionable debt collection practices, as well as low value, high cost insurance products, or high causal event charges for long term contractual savings.
- **Many market conduct challenges are common across the sub-sectors**, for example issues relating to poor product design, and the disclosure of costs and charges (including the level, composition and impact of these). However **certain challenges are unique to specific sub-sectors**, for example claims handling practices by insurers. This suggests that a common approach to conduct standards may enhance regulatory effectiveness by minimising the potential for regulatory arbitrage, supported by more specialised approaches where industry differences render this appropriate.
- Some issues, like those pertaining to costs and charges between product providers, intermediaries and customers, **may require structural intervention** in the market to correct the underlying causes of poor customer outcomes, as problems may not be resolved merely by achieving greater transparency, through more disclosure. A key example of such a structural issue was initially highlighted by the 2005 Statement of Intent[9] and consequent discussion paper[10] on contractual savings in the life-insurance industry, which found problems with the "triangular association" model used in this sector. In this model the intermediary provides advice to a policyholder but is remunerated (often through sales incentives) by the insurer. Disclosure in this instance will not address the inherent conflicts of interest in the structure of the product and its distribution. The RDR proposals discussed later in this document seek to implement structural remedies to address this.
- **Abusive practices exist even where there is already regulatory coverage**, for example over-indebtedness in the credit sector and the continued selling of inappropriate retirement products, suggesting that in some instances regulation may not be achieving its intended outcomes.

[8] The Reserve Bank's interest in conduct has tended to relate to developing a work programme informed by the BIS, for example with respect to benchmarks (like the Johannesburg Inter-Bank Agreed Rate – JIBAR - South Africa's equivalent to the London Inter-Bank Overnight Rate - LIBOR).

[9] Focused analysis of the cost and fairness of retirement annuity funds and other savings products offered by the insurance sector, such as endowment policies culminated in the signing of the *Statement of Intent by the long-term insurance industry and the Minister of Finance as to the measures that will be implemented in respect of retirement annuity fund member policies and other savings products offered by the long-term insurance industry* (available at http://www.treasury.gov.za/comm_media/press/2005/Statementintent.pdf) in December 2005.

[10] *Contractual Savings in the Life Insurance Industry: Discussion Document. available at* http://www.treasury.gov.za/publications/other/Contractual%20savings%20in%20the%20life%20insurance%20industry.pdf

Figure 1.1 – Applicable market conduct law

Financial Sub-sector

Product Cycle[15]

	Transactional banking	Retail/ SMME credit	Insurance	Financial Markets	Investments[13]	Payment clearing/ settling	Pension Funds	Friendly societies/Co-operative banks
Governance	Banks Act		LTIA[4] / STIA[5]	FMA[14]/ MI rules[12]	CISCA[6] (collective investment schemes) FAIS[1] (investment managers & platforms)	NPSA[7] (payment systems) FMA[1] (CSDs[11])	PFA[8]	FSA[16] (limited)
Issuing products		NCA[3]		FMA[14]/ Listing requirements	CISCA[6] (collective investment schemes)		PFA[8] FAIS1 LTIA4 CISCA6	FSA[16] (limited; most products unregulated)
Sales & Distribution	FAIS[1] (intermediary deposit services)		LTIA[4] / STIA[5] (commission/ direct marketing) FAIS[1] (intermediary services)	FMA[14]/ JSE rules	FAIS[1]		FAIS[1] (Pension Fund trustees excluded)	FAIS[1] (if service providers market friendly society business)
Advice	FAIS[1]	NCA[3] (debt counselors)	FAIS[1]				FAIS[1]	
Disclosure[15]	FAIS[1] (advice, intermediary deposit services)	NCA[3]	LTIA[4] / STIA[5] (direct marketing; advertising & marketing standards) FAIS[1] (intermediated)	FMA[14]/ MI rules[12]/ Listing requirements	CISCA[6] (collective investment schemes) FAIS[1]	NPSA[7] (payment systems) FMA[1] (CSDs[11])	PFA[8] FAIS[1] (intermediaries)	
Post-sale service	FAIS[1] (ongoing advice on deposits)		LTIA[4] / STIA[5] (ongoing advice) FAIS[1] (ongoing advice)	FMA[14]/ MI rules[12]	CISCA[6] (collective investment schemes) FAIS[1] (investment mgrs, platforms, advisers)		PFA[8] FAIS[1] (ongoing advice)	
Outsourcing and 3rd party management	Banks Act (limited to general governance controls)		LTIA[4] / STIA[5]	FMA[14]	CISCA[6] (collective investment schemes) FAIS[1] (investment managers, platforms)	NPSA[7] (payment systems) FMA[1] (CSDs[11])	PFA[8] (benefit administrators) FAIS[1] (investment administrators)	LTIA[4] (where the friendly society is underwritten)
Claims & complaints	FAIS[1] (Ombud, re advice/ intermediary services) FSOS[2] (indirect – voluntary scheme)	NCA[3] (Tribunal)	LTIA[4] / STIA[5] (claims) FSOS[2] (indirect – voluntary scheme) FAIS[1] (Ombud re advice/ intermediary services)	FSOS[2]	FAIS[1] (Ombud re investment managers, platforms, advisers) FSOS[2] (collective investment schemes)		FAIS[1] (Ombud re advice/ intermediary services) PFA[9] (Adjudicator)	

1 Financial Advisory and Intermediary Services
2 Financial Services Ombuds Scheme
3 National Credit Act
4 Long-term Insurance Act
5 Short-term Insurance Act
6 Collective Investment Schemes Act
7 National Payments Systems Act
8 Pension Fund Acts
9 Pension Fund Adjudicator
10 Excludes ancillary services related to financial products (e.g., creditratings services)
11 Central Securities Depository
12 Market Infrastructure rules which will include depository as well as exchange rules
13 Includes investment managers, collective investment schemes, other types of investment administration (e.g., LISPs)
14 Financial Markets Act (includes references to the rules of the self-regulatory organisations concerned)
15 Includes marketing; 'Disclosure' refers to both customer-level disclosure on products/ services as well as disclosure to financial markets generally
16 Friendly Societies Act

Much more is therefore required of government, regulators and the industry, to find pragmatic solutions to improve financial sector conduct, with an emphasis on increasing regulatory effectiveness whilst minimising compliance burden (the costs of which are generally passed on to customers). Developing a course of action goes beyond identifying and naming harmful practices, and requires understanding the drivers of these practices, including the role of the regulatory architecture and supervisory approaches, and customer responsibility, as reflected on below.

Regulatory silos impede reform

Figure 1.1 on the previous page reflects the extent to which South African financial institutions are subject to an incomplete and inconsistent legal framework for market conduct, creating opportunities for regulatory arbitrage, and meaning that the level of customer protection depends on the industry and distribution channel.[11] Within this fragmented system financial customers tend to be easily overwhelmed across the product cycle. Figure 1.2 shows how customers struggle to identify which product best suits their needs and circumstances, are often unable to compare product value or understand the disclosures made about a product's key characteristics (especially terms and conditions that ultimately effect the extent to which it lives up to its marketed promises), and do not not know about complaint and ombud channels available to them should the product disappoint. These effects are heightened by regulatory requirements that tend to focus on sub-sector rules rather than consistent, cross-sectoral outcomes.

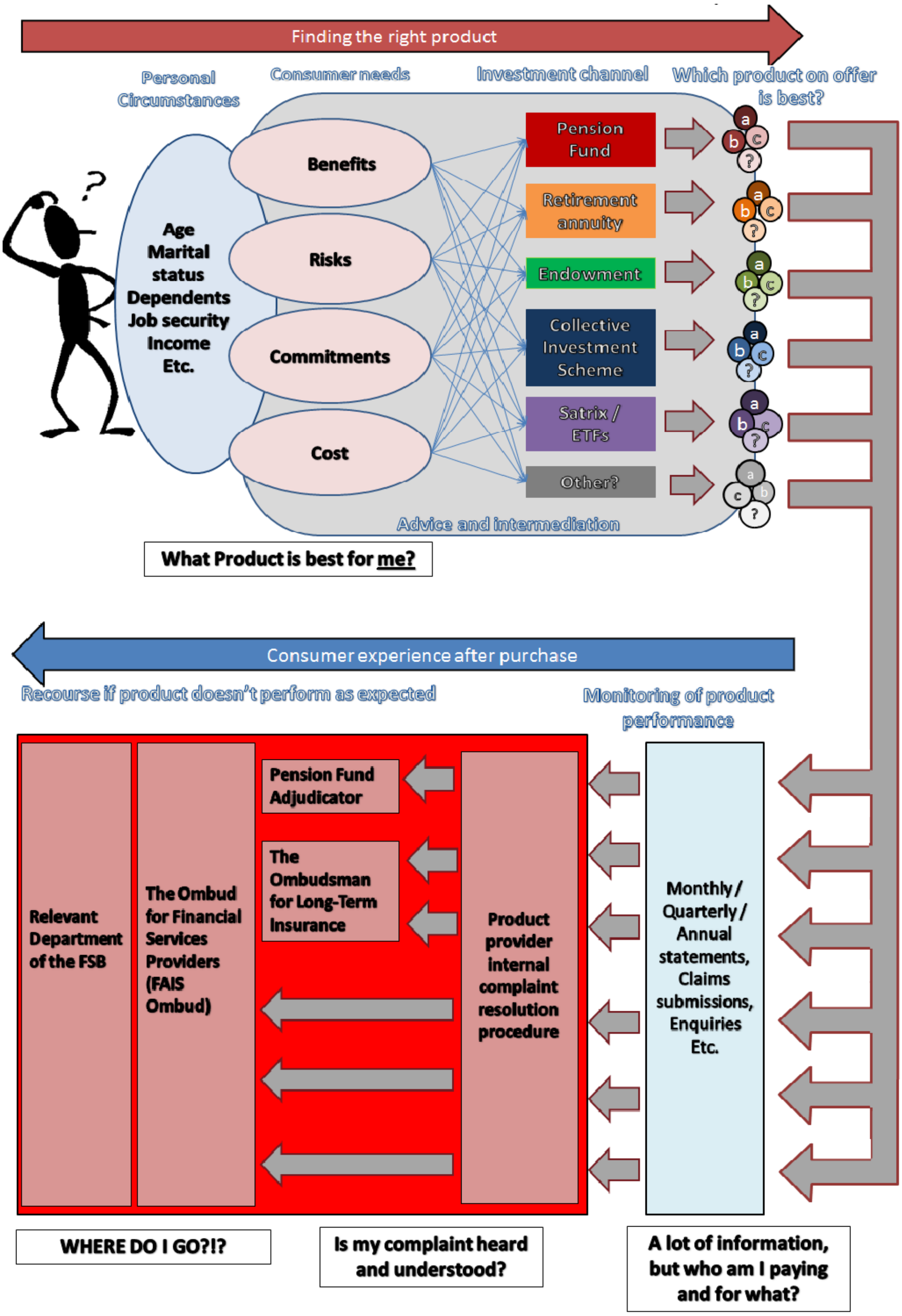
Financial institutions find this regulatory structure cumbersome and costly, requiring multiple licenses and being subject to multiple Registrars which typically each operate in a different way, with different and at times competing objectives. A silo approach to financial sector regulation – with each sub-sector governed by a separate and distinct piece of legislation – has naturally led to fragmented supervision and regulatory arbitrage, and often it is the more customer-focused and law abiding institutions that bear the highest cost of regulatory compliance, relative to those trying to skirt the system. With this level of legal complexity, full harmonisation of regulatory and supervisory standards remains compromised, impeding the FSB's best efforts to strengthen conduct holistically across the sector.

Financial customers are not sufficiently empowered

Ultimately it is the customer who best knows whether his or her needs and expectations are being realised, and yet as illustrated in Figure 1.2, in too many cases financial customers are not able to hold their product providers, sales persons, and advisers accountable for poor treatment. National Treasury's document "*A safer financial sector to serve South Africa better"* observed the need for a comprehensive review of the ombud schemes to ensure a speedy and affordable redress for consumers that is independent, impartial, transparent and effective. But empowering consumers goes much wider than the ombud system, encompassing complaints procedures within financial institutions on the one hand, and improved financial literacy and capability of financial customers on the other. On this latter point, retail customers should be educated and informed about financial products and services, their own financial needs, as well as steps to take to enforce their rights, in order to ensure their effective and protected participation in the sector. Although many South Africans have become more financially savvy, examples of endemic exploitation suggest that deeper and more innovative interventions may be required.

[11] For example, different requirements for disclosing charges will apply for the same or similar investment products offered under a long-term insurance versus a CIS license. Whereas insurers rely on a forward-looking cost disclosure measure (i.e. the Reduction in Yield), a CIS will use a backward looking or historical measure (i.e. the Total Expense Ratio). This makes it impossible for a financial customer to compare the value proposition on what can be the exact same underlying investment assets.

Figure 1.2 – Why a common regulatory framework is important



2

What is market conduct regulation? How does it better protect financial customers?

Market conduct regulation recognises that ordinary consumer protection laws do not go far enough when dealing with the financial sector, which needs much higher and tailored standards than generic legislation. Prioritising fair outcomes for customers, it is concerned not only with the customer experience of a financial product or service, but also with how a financial institution manages its conduct risk. It aims to prevent conduct failures through pre-emptive, risk-based interventions, and empowers the regulator to take strong and decisive action where abusive practices are detected, often requiring the regulator to make judgment calls within an increasingly principles-based law.

The financial sector needs higher standards tailored for its complexity

The National Development Plan sets out key objectives for the development of South Africa, including increasing growth and the number of jobs, reducing poverty and income inequality, improving household food and nutrition, and broadening ownership of assets. These cannot be realised without a well-functioning financial sector, in particular one that pays attention to customer needs and expectations. In fact the financial sector's importance to the economy far exceeds its 10.5% direct contribution to GDP, as households, businesses and government are dependent on it to buy and sell, borrow and invest to grow wealth, and insure against unforseen losses.

The 2008 global financial crisis demonstrated that the failure of even one major company like Lehman Brothers can trigger the near-collapse of not only the financial system, but also of the broader economy, and not just in its home country but the rest of the world as well. One million jobs were lost in South Africa as a result of the global economic instability that followed, even while the domestic financial sector remained sound. Unfortunately the knock-on effects of the crisis continue to be felt throughout South Africa's economy, as the economic slow-down combined with reckless lending practices have in too many instances compromised borrowers' ability to repay loans, bringing risks back into the banking sector as illustrated with the recent near-collapse of African Bank – rescued by the curatorship put in place. This reinforces global lessons learnt that supervision of the financial system needs to be *intensive, intrusive and more effective.*

As one of the most powerful economic sectors in the world, the financial sector asserts its power over customers and often even governments. Financial customers generally do not have the bargaining power to ensure that agreements they conclude with the providers of those products and services are of fair value and deliver on expectations. This and the particularly complex and sometimes long completion times of financial products, as well as the high cost of conduct failure across society, necessitates a higher standard of regulatory intervention compared to other sectors (Box 2.1). Generic national consumer protection law is therefore not sufficient to protect financial customers – to be effective, regulatory protection must be designed to respond specifically to financial customer vulnerabilities.

Generally, more complicated products and more vulnerable customers (with less financial expertise) warrant more regulatory protection. The concentrated nature of South Africa's financial sector increases interconnectedness and market power, making the need for strong regulators even more pronounced. The establishment of a powerful market conduct regulator through the Financial Sector Regulation (FSR) Bill is therefore aimed at regulating the powerful financial sector more effectively, in the interests of customers.

The coming Twin Peaks system of regulation recognises that the two objectives of financial soundness and treating customers fairly are better done by two separate regulators dedicated to each objective. [12] This is because the prudential regulator and market conduct regulator often have conflicting remedies when pursuing their objectives. The prudential regulator for example generally prioritises the financial institution (to the indirect benefit of its customers), meaning that in the banking and insurance sectors higher profitability through higher prices may be seen as a regulatory advantage in order to build a solid capital buffer. Conduct regulators on the other hand prioritise the customer of the financial institution directly, and in most cases will favour lower prices (and enhanced value) as a result. South Africa's history is replete with examples of regulators favouring the prudential objective at the cost of the market conduct objective, while in other parts of the world like the UK, increased focus on conduct in a single regulator model came at the expense of prudential and stability oversight, and played a contributing role in the financial crisis. Later in this chapter we return to the opportunities presented by Twin Peaks for improved market conduct regulation.

Why market conduct, why now?

A financial sector that conducts itself with integrity, in the interests of [real] customer needs rather than just those of management or shareholders, promotes confidence in the sector by delivering better outcomes for customers and the economy. The more that customers believe they can cost-effectively save, transact, borrow and manage their risks through the financial sector, so they will endeavour to do so. Better customer experiences therefore encourage a stronger sector, which translates into broader economic participation and growth. Conversely,

[12] This is also in line with the Tinbergen rule of economics, which states that for each and every policy target there must be at least one policy tool.

poor conduct practices inevitably compromise customer and economic outcomes, hurting confidence and trust, and limiting the potential for sustainable sector growth.

Box 2.1 – Features of the financial sector that necessitate higher standards

For the typical individual consumer and smaller business, the following factors highlight the need for robust market conduct regulation:[13]

- **Financial products and services are intangible**, making it difficult for customers to assess their value and suitability, and increasing the risk of hidden charges or unfair terms and conditions
- The **quality or appropriateness** of some financial products, such as retirement savings products or insurance, may only become apparent some time after purchase or when a disaster occurs
- The **concentrated and interconnected nature of the sector** may allow financial institutions to act in their own (or shareholder) interests at the expense of customers
- The **underperformance or failure of financial products**, particularly long-term savings products, may cause considerable and sustained hardship for customers
- Products that carry **high fees or are of low value** (for example insurance products with very low claim ratios) erode disposable income, and can be particularly harmful in the case of vulnerable groups, like lower income households or the elderly
- **Losing deposits or savings imposes immediate costs** on customers and their dependents
- Retail customers generally **lack the sophistication and level of information possessed by financial services institutions**, increasing their vulnerability to exploitation
- Many customers **do not know how, or may not have the means, to hold financial institutions accountable** for mistreatment, further increasing their vulnerability

For the wholesale market, the following factors make robust market conduct regulation necessary:

- The **underlying risk profile of complex and opaque instruments**, for example securitisations and structured products, are not always evident and may lead to ill-informed decisions and adverse outcomes for the institutional market
- In the event of conduct failure, **market confidence and stability can be compromised** due to the size and systemic importance of larger corporates and the wholesale market. Such occurrences usually affect the entire economy and are not just confined to participants in the financial sector
- **Activities in retail and wholesale markets are connected**, such that effects caused by poor conduct in either segment can be transmitted rapidly to the other. There is significant risk that failures in the wholesale market will have a knock-on effect on the retail market, so affecting individuals. On the other hand endemic mistreatment of retail customers on a grand scale can compromise the safety and soundness of financial institutions and therefore also financial stability
- **Anti-competitive practices** such as collusion can lead to poor price formation and thus the erosion of economic value and efficiency for all participants in the economy.

The risk of poor market conduct and the impact on the end customer will differ across the retail and wholesale markets. However, conduct oversight is needed for the sector in its entirety, with approaches to regulation tailored to address inherent differences between the market segments. While the focus of this paper is on the retail customer, principles of fairness and product appropriateness apply to all customers including those in the wholesale segments, and the policy framework should evolve to reflect this.

[13] These factors could apply equally to 'not for profit' institutional investors such as retirement funds and medical schemes, the boards of which include people who are not experts in financial matters. This carries the risk of ill-informed investment decisions, made by trustees who often do not have the knowledge or expertise required to exercise effective oversight over the conduct of the business of the institutions they invest with.

This connection between how the financial sector treats customers and South Africa's economic health necessitates Government paying close attention to how the sector behaves, thinking carefully about what interventions - including regulatory – can be taken to minimise the potential for customer abuse, and optimise customer value. The pervasive conduct challenges highlighted in Chapter 1 show that too few firms are embracing the cultural change in attitude necessary to serve South Africa better. A comprehensive market conduct policy framework is therefore being prioritised.

In thinking about an optimal framework for South Africa, it is necessary to better understand the root causes and implications of poor customer outcomes in critical pockets of the financial sector. Government is therefore asking questions like:

Are bank accounts meeting customer needs?

In 2008, the Jali Enquiry considered, among others, the promotion of competition in retail banking to support real benefits for bank customers through lower costs and charges, better service, and greater access to transactional and savings products for lower income communities. The global financial crisis impacted on the world economy at the same time as the report was published, emphasising the need to balance the objective of better conduct and financial soundness. It led to the acknowledgment that a banking prudential regulator should have a dedicated focus on prudential objectives, and that a separate and dedicated regulator is required to promote better customer outcomes, and deal decisively with abuse where it emerges. There have been significant improvements in the industry since the recommendations were implemented, but further improvements are needed to support comparability and competitiveness across transactional accounts, improve debit order practices, and introduce conduct oversight of electronic platforms like mobile services.

Are households discouraged from saving by an inefficient, customer-unfriendly retirement industry?

Government has embarked on a retirement reform programme aimed at improving household savings and better protecting individuals, especially the elderly, from severe financial hardship and poverty. Steps are being taken to incentivise people to save more and for longer terms. Causal event charges[14] are a prime example of policy terms that can have a large detrimental impact on customers. While the Statement of Intent signed between the then Minister of Finance and the life insurance industry in December 2005 took steps to deal with extreme causal event charges linked to early termination, more needs to be done to ensure good value for savers.

A number of proposal papers have been published supporting retirement reform including improved preservation, competition (through improved portability and disclosure of charges) and governance. An approach to market conduct that promotes regulatory consistency, for example regarding point-of-sale disclosure of terms and conditions and charges across the investment sector, should further foster a more competitive environment, while recent RDR proposals aim to better align advisor and client interests and propose banning commissions on investment products (meaning that commission driven causal event charges will no longer be applicable).

[14] Causal event charges have both direct effects on the policyholder, such as significantly eroding investment value, and indirect effects, for example by penalising a policyholder for migrating a poor performing policy to a different provider, which compromises competition.

Why are households burdened with high levels of debt?

Cabinet in 2013 announced its intention to implement steps necessary to deal with household over-indebtedness in South Africa, which stood at 74% of disposable income in June 2014, sharply up from an average of 55% in 2003, having grown significantly between 2003 and 2008. It should be noted however that this is down from its peak of 83% in March 2009; the economic slowdown after the 2008 global financial crisis resulted in many households falling into arrears and/or defaulting on loans.

In June 2014, 45% of the 22 million credit-active consumers had impaired records (they were 3 or more months in arrears, had adverse listings or judgments and administration orders against them) and a further 12.8% were 1 to 2 months in arrears. Only 42% were regarded as being ‘current’.

Many abuses have been identified in the credit sector, including illegally obtained garnishee orders, gaming of the debit order system, and poor practices in the sale of consumer credit insurance (CCI). Box 2.2 tells how Edward and Thabina are entrapped into a debt spiral, a tragic but all too familiar South African story, which in most cases could be avoided with the right help offered at earlier signs of financial distress. Tougher licensing conditions and regulations, matched with strong enforcement actions, must apply to reckless lending that burdens ordinary South Africans, including in relation to pay-day lenders, balloon payments in vehicle finance and extended payment periods designed to circumvent interest rate caps (especially in the unsecured and motor car lending segments). Debt relief mechanisms should be available to all, and not just those with means.

Edward and Thabina’s experience raises important questions as to why our system failed to stop or reverse this trend earlier. This despite the fact that four regulators were involved; the NCR regulated the credit component (after its establishment in 2007, as credit was not regulated before then), the FSB regulated the insurance component, the Council for Debt Collectors oversaw debt-collection practices, and the Reserve Bank regulates banks for prudential soundness. A key question to consider is whether the four regulators could have coordinated and cooperated better, even if each was successfully supervising within its own “silo”. Another question is whether government and other stakeholders did not over-focus on making unsecured credit more accessible, without taking adequate steps to ensure that such loans were not only for consumption purposes. At the very least it is clear that a higher level of debt has come at a cost of much lower savings.

Is the insurance industry doing enough to help the average South African manage day-to-day risk?

Poor conduct outcomes identified for insurance policyholders include poor product design features, for example, low-value or inappropriate credit insurance products (like a retrenchment cover option for people who are self-employed) and so-called “comprehensive” short-term insurance products sold by motor dealers which may exclude cover for relatively common events (like hail damage). Persistent poor practices centre around policies that do not live up to expectations, in particular claims being rejected due to poorly communicated (and poorly understood) terms and conditions, aggravated by complex and confusing terminology of what is covered and when. Examples in the short-term insurance industry include denying claims on the basis that the policyholder has not reported a previous minor incident, has multiple policies (even though the insurer has been taking many months of premiums), or applying multiple and layered excess provisions that result in pay-outs of only a fraction of losses incurred.

Box 2.2 – A downward spiral into over-indebtedness

Edward is married with two children and employed in the security industry. His wife Thabina works as a clerk. Edward received an RDP house in 2001. To earn additional income, Edward borrowed R70 000 from a bank, backed by his pension fund, to construct two rooms for rent. But instead of building the rooms, he used the money to buy appliances, pay school fees and put down a deposit for a car.	***Should there be mechanisms to ensure pension-backed loans are spent on houses and home improvements?***
He is very comfortable with his ability to afford the instalments because the car dealer offered a great deal, including a 55% balloon payment and a loan term of 7 years. The dealer also organised the loan from a bank to pay for the car.	***Balloon payments and longer terms reduce the instalment amount but increase the overall cost of the credit to the consumer. At the end of the term the balloon payment due may exceed the value of the car. Consumers may not be able to repay or refinance the balloon payment and may lose their cars. Should these matters be better regulated? Should the relationship between car dealers and banks be regulated to ensure fair competition and treatment of financial customers?***
Edward and Thabina spend the major part of their joint income paying off these loans and servicing their retail store accounts of which they have two.	***Do retailers properly assess the credit worthiness of customers before issuing store cards?***
In addition Thabina has a credit card, which she draws down to its limit every month, making only the minimum payment and allowing the rest to revolve.	***Should limits on credit cards be increased if holders only make minimum payments? What "triggers" could be developed to help financial institutions better monitor their customers' financial well-being?***
In spite of their relatively large debt obligations, Edward and Thabina were managing to scrape by on their income. Edward was retrenched and due to a fall in stock market values the value of his pension was now insufficient to pay off his pension-backed loan. Edward and Thabina are no longer able to repay their loans and cover their expenses from their income.	***Where will the over-indebted consumer get advice? Is there a need for a government-sponsored financial wellness centre to assist consumers with generic advice?***
Edward and Thabina avoided all attempts at communicating their problems when they struggled to make repayments and found themselves deeper and deeper in arrears. It also does not occur to them to find out if the credit insurance they were paying for would cover the debt after he was retrenched.	***Should credit providers provide well-known and less hostile mechanisms for customers to approach them and make arrangements to settle their debt? Why are so many consumers unaware of their credit insurance cover?***

Edward and Thabina are highly stressed about their inability to make ends meet. They hear that debt review may be a solution and decide to enter a debt review process to get immediate relief and some breathing space from aggressive debt collectors. They approach a debt counsellor registered with the NCR, however she is not able to assist them because their income is insufficient to repay her fees on top of the debt.	***Should major lenders be permitted to provide free voluntary debt mediation to distressed borrowers?***
In desperation they apply for a payday loan to make at least minimum credit card payments. It was easy for them to obtain the loan because no affordability assessment was done. However the payday lender insisted on a bank account number against which to apply their early debit orders. They then need another payday loan to pay for the payday loan that was paying for the credit cards. Edward and Thabina are now in a debt spiral and dependent on payday loans to put food on the table.	***Should action be taken against payday lenders as is the case in the UK and the US (where some states like New York have prohibited payday lending)? Has effective and sufficient action been taken against reckless lenders such as payday lenders? Should reckless lenders be given access to debit order facilities?***
When they default on the eighth payday loan, the payday lender obtains an emolument attachment order against Thabina's salary placing the couple in an even more desperate situation as debit order after debt order is returned. Thabina resigns from her job to access her pension. She uses the money to pay for school fees and spends the balance on paying down some of their loans… the debt spiral worsens…	***Should emolument attachment orders be allowed for credit? Should reckless lenders be allowed to collect their debt using emolument attachment orders or debit orders? Should emolument attachment orders be given?***

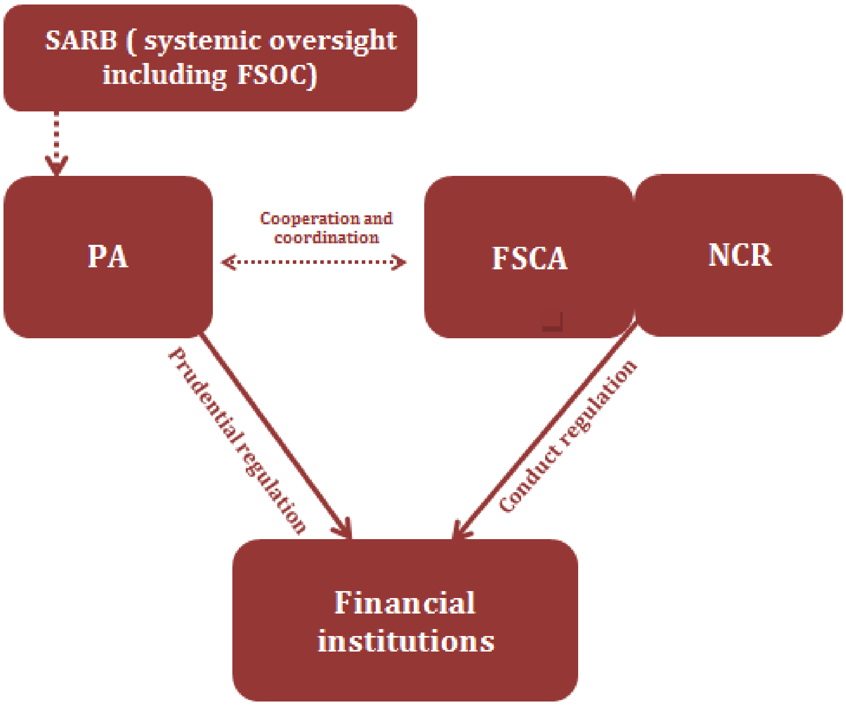
Long-term insurance risk products may also carry provisions that mean benefits are denied when they are most needed. Examples here include poorly communicated exclusion clauses which customers may not be aware of until they are used to reject a death or disability claim, or premium guarantee reviews which trigger unaffordable premium hikes, forcing customers to forfeit life cover despite many years of payment. The National Treasury and FSB are engaging the industry through the TCF framework on ways to remedy such practices, especially through improved product design and disclosure.

Twin Peaks the foundation for better conduct, better outcomes

In grappling with the issues raised above, Government is also grappling with how best to respond in support of change, with much greater focus on market conduct regulation. Market conduct regulation aims to minimise the potential for financial institutions to exploit or unfairly treat their customers (known as conduct risk), and prioritises a positive customer experience and outcomes aligned to that customer's needs and expectations. The Twin Peaks reform is therefore an important opportunity to modernise South Africa's market conduct regulatory framework. In particular, a dedicated market conduct authority – seen in Figure 2.1

- will underpin stronger and more effective customer protection for the financial services sector.

Figure 2.1 – Proposed new regulatory architecture



The FSR Bill sets out primary objectives for a newly-created Financial Sector Conduct Authority (FSCA) to best ensure that market conduct regulation works together with prudential regulation to support financial stability and protect financial customers. These objectives are:

- Fair treatment of financial customers
- Efficiency and integrity of the financial system
- Financial literacy and capability.

Government envisages a broad scope for the FSCA's mandate. Guided by the eight principles laid out in Treasury's 2013 document *"Implementing a Twin Peaks model of financial regulation in South Africa"* (Box 2.3), the FSR Bill defines financial products and services widely, provides extensive, flexible, and where necessary intrusive powers to the FSCA, and embeds within the FSCA an outcomes-focused supervisory approach. More generally, the FSR Bill places a strong emphasis on coordination and cooperation of financial sector regulators, in line with the overall intention of consolidating and streamlining regulation. Fully implemented, the Twin Peaks system should reduce the scope for regulatory arbitrage and forum shopping.

Box 2.3 – Principles for South Africa's market conduct framework

- **Transparent**: The regulator will act transparently with regard to its decisions, actions and approaches and will follow a consultative approach
- **Comprehensive and consistent**: The framework will aim to limit regulatory arbitrage by ensuring consistent principles and rules for similar activities. It will also ensure comprehensive coverage and consistent supervisory intensity based on identified risks
- **Appropriate, intensive and intrusive**: The framework must be appropriate to the sub-sector or activity concerned (i.e. not "one-size-fits-all"). Sufficient intensity and intrusiveness will ensure the rigour of regulation and supervision
- **Outcomes-based**: Regulated institutions should be evaluated on customer outcomes rather than just through a 'tick-box' compliance approach. This means that customer protection regulation will require financial institutions to comply with both principles- and rules-based standards. These should be legally binding and enforceable. The regulator should gather the information necessary to evaluate the extent to which customer outcomes are improving and should report findings to stakeholders
- **Risk-based and proportional**: Regulatory requirements will be proportional to the risk of poor outcomes. So, financial institutions that consistently comply with market conduct obligations by delivering TCF outcomes and acting in the interests of market integrity will attract less regulatory scrutiny than those which show less regard for fair customer treatment or the integrity of the market
- **Pre-emptive and proactive**: The regulator should pre-emptively respond to emerging conduct risks and intervene to prevent or limit material damage that might result in negative customer outcomes
- **A credible deterrent to misconduct**: Both customers and regulated entities should be confident that the regulator will detect and take meaningful action against misconduct and deceptive customer treatment
- **Aligned with applicable international standards:** The framework must adhere to applicable and appropriate international standards. South Africa will continue to play an active role in shaping such international standards

A new breed of market conduct regulator

The sources of conduct risk are generally different to the sources of prudential risk (although the two may be closely related), and therefore generally requires different supervisory approaches and toolkit. For example poor internal governance of prudential matters may lead a financial institution to suffer financial strain, which in turn is more likely to foster an environment of customer abuse like mis-selling. Notwithstanding this connectivity between prudential and conduct risk, market conduct supervisors need to understand and analyse risk indicators that are different from, and sometimes broader than, those considered for prudential supervision. Although material failure to manage conduct risks will expose a financial institution to reputational, legal and regulatory risks that could ultimately threaten its solvency and sustainability, in many cases poor customer treatment will not necessarily trigger financial soundness concerns, or at least not until significant customer detriment has occurred (the sources and consequences of conduct risk are more fully reflected in Figure 2.2). The regulatory regime for market conduct should therefore provide for the explicit identification and management of conduct risk, complementing the regulatory regime addressing prudential risk, and ensuring that all risks are holistically managed, often through a careful balancing act guided by the overarching stability framework.

Figure 2.2 – Sources and impact of conduct risk

Sources of conduct risk	Typical poor financial sector practises	Economic impact
Inherent factors: • Information asymmetry • Low financial literacy	• Customers sold inappropriate and low-value products • Failure to meet and manage expectations • Barriers to exercising customer rights • Focus on price rather than product value	• Low levels of savings compromises economic growth • Lack of customer confidence, mistrust • Low levels of financial inclusion impedes economic inclusion and poverty alleviation • Low financial literacy perpetuated
Environmental factors: • Cash-strapped consumers • New technologies	• Reckless and predatory lending • High lapse rates in the retirement and insurance sectors • Product push through online channels with inadequate disclosure • Fraudulent practices, privacy breaches	• Over-indebted customers, lower income households especially vulnerable • Insufficient preservation • Inability to supervise and monitor risks of new channels
Structural factors • Concentrated market, dominant players • Interconnected business models • Conflicted incentive structures • Regulatory burden limiting access • Regulatory gaps	• Price fixing and market manipulation • Exploiting "captured" financial customers • Low substitutability • Bundled offerings with unsuitable benefit components • Inappropriate sales incentives • Illegal operations • Products designed to escape regulatory net	• Ineffective competition • Increased contagion risk • Poor price formation • Wholesale risks passed to retail customers • Transition from informal to formal sectors compromised • Increased financial crime risk
Institution-specific factors: • Poor governance and controls • Poor product design practices • Inappropriate distribution models • Poor customer service	• Conduct risks not detected early enough • Inappropriate advice, mis-selling • Barriers to complaints, poor complaints management • Unduly complex products with opaque risks and costs • Unfair terms, hard to compare and understand • High cost, low value products	• Consumer mistrust and dissatisfaction due to individual bad experiences • Weak individual institutions – with possible contagion risk • Poor price formation, pricing of risk undermined, introduces systemic risk

To mitigate conduct risk the modern conduct regulator focuses on customer outcomes rather than tick-box compliance, and increasingly applies its judgement to ascertain "fairness." To promote a financial sector that works in the interests of customers, regulators scrutinise the relationship between a financial institution and its customers (including the end customer), as well as relationships between that financial institution and other sector participants that may impact on customers. This type of regulation is commonly referred to as "conduct of business" regulation, and is the foundation of the modern market conduct regulator. A summary of international learnings related to market conduct reform is given in Box 2.4, while the full survey can be found in Appendix 2.

Box 2.4 – Lessons from the international review[15]

The international review points to a general global convergence towards activity-based, proactive and outcomes driven regulation, strictly enforced by regulators increasingly making judgement calls of whether a customer has been treated fairly, and supported by empowered financial customers. Typically this has been implemented through an overarching reform of the legislative conduct framework (such as in the UK, Australia, Peru, Indonesia and the US), in most instances complimented by targeted interventions (as highlighted in Table A2.1 of Appendix 2). Although specific approaches may differ across jurisdictions, there is growing international emphasis on aspects such as:

- Principles-based conduct requirements, which underpin traditional rules-based requirements
- Assessing the organisational culture and values of institutions in relation to customer treatment
- The obligations of boards and senior leadership of institutions to drive fair customer outcomes, including through appropriate incentive and reward structures
- The extent to which fair customer treatment is embedded in governance and risk frameworks
- The extent to which customer needs and suitability are taken into account in product development and service design processes
- Customer outcomes throughout the financial product life cycle, from product design through advice, marketing and distribution, sale and servicing
- Ensuring fair customer outcomes where functions are outsourced
- The quality, suitability and relevance of product disclosure, over and above its accuracy and completeness
- Enhancing competition and minimising conflicts of interest, including through reviewing conflicted distribution models
- A growing recognition that poor market conduct in wholesale markets has contagion effects for retail customers
- Complaints-handling processes, including how complaints are analysed to improve customer outcomes
- Accessible and efficient alternative dispute resolution mechanisms

These provide useful lessons for South Africa to consider in developing a conduct framework that is suitable for the domestic financial sector, while also in line with international standards. As a member of the G20 and other standard setting bodies, South Africa is committed to incorporating these principles into its legal, regulatory and supervisory frameworks. With this mind two recent international peer reviews of South Africa's financial sector regulatory system, undertaken by the G20 and the International Monetary Fund (IMF) in 2013 and 2014 respectively, have also provided valuable insights for the reform process underway.

Looking at the broader regulatory framework, it is notable that the reviews commended South Africa for moving towards the Twin Peaks model of regulation, which seeks to address some of the identified weaknesses observed and reflected upon in earlier chapters. Both reviews identified the need to deal more decisively with deficiencies in inter-agency coordination and the overall regulatory structure applicable to the financial sector. For example, the IMF raised concerns about the uneven and uncoordinated supervision of retail credit with the Reserve Bank responsible for the deposit taking side of the balance sheet and the NCR responsible for the lending side.

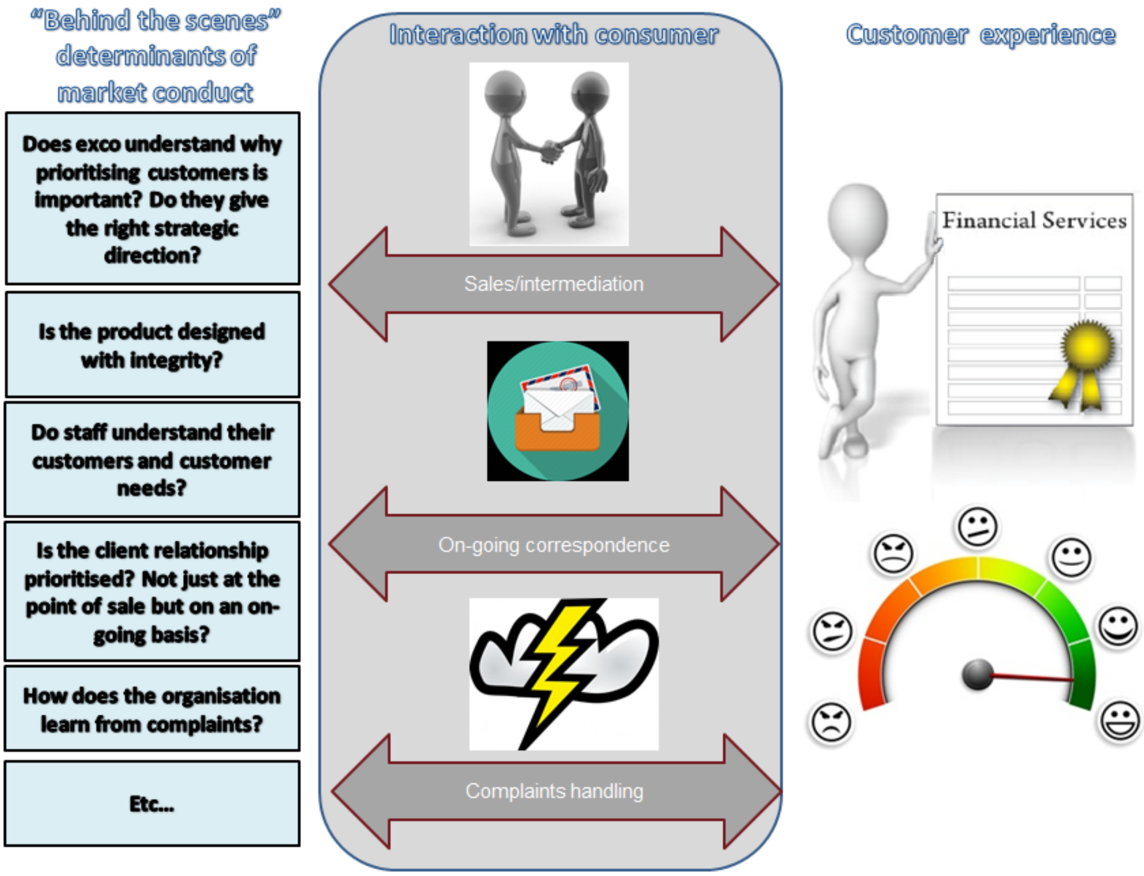
Protecting financial customers is now understood to go well beyond a regulator responding to customer complaints. While this remains important (and we should strive to perform better in

[15] The full review is given in Appendix 2.

this regard as regulators and financial institutions), it is also important to be forward-looking, and deal with poor practices that customers are often not even aware of. This was well illustrated by the Chapter 1 discussion on charges in the retirement industry. Similarly, insurance customers are generally not aware of the claims ratio for an insurance product that they purchase (see Box 5.2 in Chapter 5 on Thandi's experience of motor vehicle insurance), and like Edward and Thabina, desperate borrowers who take their first short-term loan from a payday lender do not factor in that they will be forced in most instances to renew such loans several times at very high interest rates and charges, forcing them into indebtedness as their debt grows bigger while their income does not.

The supervisory focus for conduct should therefore shift from one that scrutinises only a financial institution's interface with its customers and the related customer experience (which in the main takes place through the sales process, correspondence between the financial institutions and customer over the lifetime of the product, and complaint mechanisms). While important, in many instances interventions at this stage may be too late. Conduct regulators are therefore increasingly looking at the integrity of the product offering in the first place, which in turn will rely heavily on the governance structures and customer-centricity within the financial institutions, and in particular the strategic direction on these matters afforded by the executive (Figure 2.3). The TCF framework already recognises that true and meaningful change in financial sector conduct can only come from strong corporate leadership; the proposed policy framework must further embed this approach.

Figure 2.3 – A new approach to conduct for financial regulators and institutions



How can market conduct regulation better protect financial customers?

A good example that demonstrates how the FSCA could work if adequately empowered and capacitated, can be seen in the case of a customer of motor car insurance who puts in a claim after an accident where there is damage to his or her vehicle. This example demonstrates the much closer monitoring and intensive responses expected of the "new-breed" market conduct regulator.

In the background, though not looking at a specific claim, the PA will have ensured that the financial institution has sufficient capital to pay for any claims that it receives, and that it can meet its promises to the customer from a financial soundness perspective (to ensure that it always has sufficient funds to meet its liabilities today and in future).

The FSCA on the other hand should generally (and not on each claim) consider whether the terms and conditions of motor vehicle insurance policies are fair and readily understood by the customer before entering into an insurance policy, as well as over the life of the policy.[16] It should therefore be considering questions like:

- What is the claims ratio on the motor car insurance product? If the claims ratio is low, is this because the company has a strong bias to turn down reasonable claims? Has the customer been made sufficiently aware of the limitations of the insurance product, or his or her obligations in respect of the policy (like a duty to report minor accidents even if these are privately repaired and no claim is made)?
- Is the insurance for motor cars competing on product or on price? How standardised is the car insurance? Is it easy for the customer to understand any differences from the expected "standard" insurance policy for a car?
- Does the company and [where there is one] broker, continue to service the customer after the product has been purchased or paid for? Does the company automatically adjust the premiums at the start of every year to take account of the accepted depreciation in value of the car?
- More fundamentally, why is it that only one-third of motor car vehicles are insured? Is the industry providing appropriate and affordable products to the mass retail market? How can the insurance industry increase coverage to all vehicles on the road?

The FSCA should also have a close relationship with other watchdog bodies. This includes assessing from the relevant ombud – currently being that for short-term insurance[17] - whether any regular problems in market conduct can be identified from the ombud process, whether companies have the right culture and response to customer complaints received, and what type of regulatory interventions may be necessary. It also includes working with other financial regulators like the NCR, and non-financial regulators like the Competition Commission and National Consumer Commission. Together with the NCR it might examine loan features which have an indirect impact on the cost or take-up of insurance products for motor vehicles, asking questions like:

- Should a loan for a car go beyond four years given that it is a depreciating asset? Why should balloon and delayed payments be allowed for a car loan?

[16] These laws combine to instil market confidence and support financial stability; this means that either prudential or conduct weakness can compromise customer confidence and threaten financial stability, and by implication the broader economy.

[17] See Chapter 6 for further discussion of the future ombud framework.

Together with the Competition Commission and the National Consumer Commission, the FSCA could ask:

- Why do car manufacturers insist on original parts as a condition to maintain any warranty? Is this a reasonable limitation to impose? Does it not impose undue costs on insurance products?
- Should motor car insurance be made compulsory? If it is, how do we ensure that the industry provides significantly cheaper and standardised “Mzansi” type products?

Lastly, the FSCA should set regulatory standards on motor car insurance products (as a combination of principles and rules), and take a risk-based approach to closely monitor the more “risky” providers on a continuous basis, in order to ensure that all contracts are in line with such standards. Where they are not, the contract may be deemed to be illegal; the regulator should respond strongly to compel the institution to take corrective action, penalise the financial institution in breach and offer redress to customers where appropriate to do so.

We revisit this example in Chapter 5, to unpack it in more detail from a TCF perspective.

3

A strategy underpinned by a consolidated and harmonised market conduct law

To respond to the market conduct challenges observed, and in the context of the Twin Peaks reform underway, it is proposed that the legal framework for market conduct in the financial sector be consolidated, simplified and harmonised into a Conduct of Financial Institutions (CoFI) Act. This forms part of a multi-pronged approach to improving market conduct for the sector. Regulatory interventions already underway will continue (reviewed in Chapters 4 and 5), and the strategy will be further supported through more empowered financial customers (summarised in Chapters 6 and 7).

A multi-pronged approach to improving market conduct

International evidence and local experience suggests that no single response, on its own, will effectively confront pervasive conduct challenges. A multi-pronged policy approach is therefore proposed, as reflected in Figure 3.1 below. Implementation of elements of this approach is already underway (as shown in green).

First is to **establish strong and accountable market conduct supervisors for financial institutions,** each with a clearly defined mandate, supported by flexible and intrusive administrative and enforcement powers. To the extent that there is more than one supervisor for market conduct – as will be the case in South Africa with both the FSCA and the NCR - strong coordination mechanisms are necessary to ensure policy and supervisory consistency and cohesion. As described in the opening sections of this document, this will be effected through the FSR Bill, which establishes the FSCA and provides for clear coordination between it and the Prudential Authority (PA), Reserve Bank and NCR.

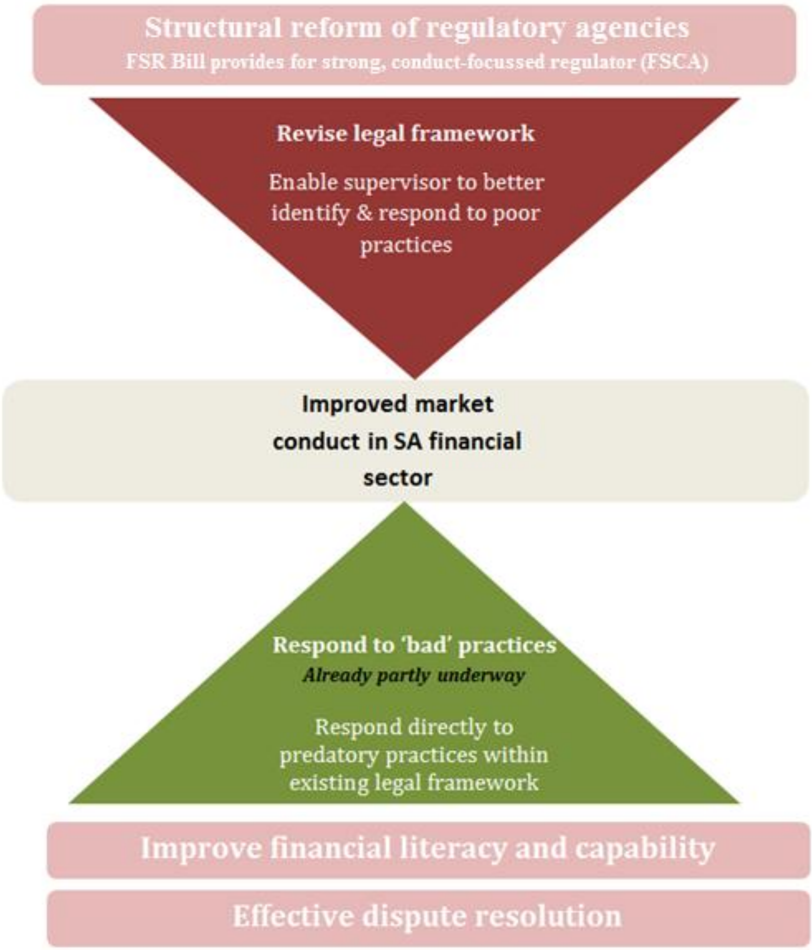
Second, **the law should be strengthened and rationalised to fully implement the TCF approach to supervision on a cross-cutting basis, through the proposed Conduct of Financial Institutions (CoFI) Act.** The law should entrench a consistent and complete approach to market conduct across the financial sector, focus on customer outcomes, and empower the supervisor to monitor and respond proactively and pre-emptively to poor conduct practices observed, taking intrusive steps where necessary to change the cultural attitude of financial institutions towards greater customer-centricity. This element of the approach is discussed further in this chapter.

Third, **the National Treasury and FSB/new FSCA should continue to respond directly to damaging industry and cross-sector practices, especially those practices that cause the most harm to consumers.** These projects are already underway, as set out in chapter 4 (that considers industry interventions) and Chapter 5 (that considers cross-sector "bridging" interventions), in support of the CoFI Act. Regulatory solutions will be accommodated for the time being through the existing sectoral laws, and in coming years through the revised law as it is reformed.

Lastly, efforts to **improve financial literacy and capability, as well as to reform the complaints and dispute resolution regimes,** should further empower financial customers in a way that rebalances customer/financial institution asymmetries. Chapter 6 (dealing with ombuds) and Chapter 7 (addressing financial literacy and capability) set this out in further detail.

These approaches are collectively reinforcing, each considered a necessary component to support structural and behavioural reform.

Figure 3.1 – Pathway to improve market conduct in the financial sector



A simplified and strengthened legal framework for market conduct

Under the Ministry of Finance, ten Acts govern financial sector activities that fall within the scope of conduct of business regulation. Figure 3.2 shows the plan to merge and harmonise these sectoral laws into a consolidated "conduct of business" framework.

Figure 3.2 – Transition towards the new regulatory framework[18]

The proposed legislative framework should comprise the following key components:

a) **Clear definition of the regulatory perimeter** – in other words, the scope of conduct regulation should be well understood, and should minimise the potential for regulatory arbitrage or avoidance

b) **Licensing and authorisation of all persons providing financial products and/or services**

c) An **outcomes focussed** approach to regulation and supervision

d) **Flexible and broad subordinate regulatory powers** (subordinate regulation instruments made by the FSCA are referred to as "conduct standards" in the FSR Bill)

e) **Powers for gathering regulatory information** that support pre-emptive, outcomes-driven supervision

f) **Strong enforcement and administrative action powers**.

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[18] The National Credit Act is anticipated to remain alongside the financial sector laws depicted here.

Consolidation and streamlining will not just aid the supervisory authority, but should also bring significant benefits to the industry, reducing the costs associated with compliance related to three different regulators doing on-sight visits, requiring different reporting requirements and the likes. As government we are mindful of the potential impact of regulation and regulatory change, and look forward to engaging stakeholders on how best to implement these proposals in a way that minimises cost and maximises regulatory effectiveness.

The proposed approach to each of these key components is set out below:

a) The regulatory perimeter for conduct regulation

The FSR Bill establishes a regulatory perimeter for conduct that spans all financial products, and all services provided in relation to those products, whether offered by traditional financial institutions or not. This principle should be reinforced in the market conduct legislation. The complexity and impact of the financial sector necessitates governing legislation that can respond to *all* sources of conduct risk, in a way that is flexible, proportionate, complete and consistent, and necessarily proactive and intrusive. A broad scope for the CoFI Act will place financial institutions, and other corporates or persons providing financial products or services, on a level playing field, helping to ensure the protection of financial customers by reducing the potential for regulatory arbitrage or avoidance.

As a result, all financial institutions that are regulated by the PA will also need to be authorised by the FSCA. Moreover, financial product or service providers that are already regulated by other entities – including credit providers (regulated by the NCR) and debt collectors (by the DoJ) – may be subject to additional higher regulatory requirements through the FSR and CoFI Acts.

For the sake of clarity, it is not proposed that all financial institutions are subject to the same form and intensity of oversight. The law should be applied proportionately to the potential conduct risk and impact of the financial institution, based on (at a minimum) product complexity, customer vulnerability and customer market share. In order to minimise regulatory burden and other unintended consequences but without compromising customer protection, careful consideration should be given to different categories of product or service providers - for example retail versus wholesale operations, and formal versus informal markets (including stokvels and burial societies), which may each bring very different conduct risk, and therefore warrant different regulatory attention.

b) Licensing and authorisations

The FSR Bill proposes an activity-based system of authorisations for regulated entities with tough fit and proper standards for authorised activities. Irrespective of the scope or size of a financial institution's business, that entity must be authorised to carry out the regulated activities concerned.

It is proposed that the FSCA will issue each provider with a single licence that authorises them to:

- Perform one or more specified financial **services**
- In respect of one or more specified classes of financial **products**
- To one or more specified types of **customers**

The initial authorisation categories will provide for all known types of financial services, financial products and customers. Classes of customers will need to be clearly defined. The new licensing model will be function- and activity-based, replacing the current institution- or sector-based model.

This means, for example, that rather than being licensed by the FSCA as a "bank" (as per the institutional approach to licensing), an entity acting as a typical retail bank will be licensed as a financial services provider, authorised to issue and provide services in relation to specific products (for e.g. savings or transactional accounts), to retail customers. An example of a typical license is provided in Appendix 3.

To the extent possible broad, cross-cutting authorisation criteria will be applied, for example more consistent, cross-sectoral fit-and-proper criteria for management and control functions. However the legislation should also empower the FSCA to apply tailored authorisation criteria for the various authorisation categories, and develop additional authorisation categories or sub-categories as informed by evolving national policy objectives, supervisory experience, emerging conduct risks, product and business model innovation and international standards.

c) Outcomes based supervision

The market conduct legislation will complement the FSR Bill to ensure that the FSCA has the optimal supervisory toolkit to satisfy its mandated functions and responsibilities. These powers should therefore provide for proactive and pre-emptive outcomes-based supervision, applied consistently and proportionately across the sector.

In practice this means doing away with the Registrar model and the related regulatory and supervisory silos of the current landscape. The FSR and CoFI Acts (and any other relevant legislation) should work together in order to provide complete, when necessary intrusive, and flexible powers. These powers should be balanced by enhanced transparency in decision-making and consultation to support accountability of the FSCA to the Minister of Finance, parliament and the general public.

Outcomes-focused supervision will aim not only to test financial institutions on their delivery of the TCF outcomes (in the case of conduct of business), or on their pricing efficiency and transparency (in the case of market integrity). It is intended also to focus on financial sector policy outcomes more broadly, testing the financial sector's effectiveness in supporting the real economy.

The FSCA may therefore be required to consider macro-economic questions, for example whether market and regulatory structures are supporting the average South African in saving enough to meet his or her needs over the short, medium and longer terms. Where such enquiries identify problems, the FSCA would need to analyse the root causes, particularly those related to the behaviour of regulated entities or the supporting regulatory environment.

The FSR Bill thus requires the FSCA to build capacity to research trends and continuously monitor the extent to which the financial sector is working for financial customers. The FSR Bill also envisages a sub-committee of the Council of Financial Regulators as a consultative and coordinating forum in relation to these market and regulatory outcomes.

d) Setting regulatory standards (conduct standards)

The FSR Bill provides that the FSCA may set conduct standards for providers of financial products and services, to promote the objectives of fair treatment of customers; enhancing the efficiency and integrity of the financial system; and to support the Reserve Bank in maintaining financial stability. Further, the FSR Bill provides that such conduct standards may make provision with respect to (and not limited to) any of the following:

- Standards of business conduct for financial institutions
- Fit and proper person requirements for financial institutions and key persons
- Governance of financial institutions

- Risk management and compliance arrangements for financial institutions
- Promotion, marketing, distribution-of or access-to financial products, financial services, market infrastructures or payment systems
- Disclosures in relation to financial products, financial services, market infrastructures or payment system services provided or offered to financial customers
- Giving advice, recommendations or guidance to financial customers
- Ensuring that financial products or financial services, provided or offered to financial customers are suitable to their circumstances
- Remuneration practices
- Outsourcing and insourcing arrangements
- Custody, separation and protection of client funds
- Disclosure and reporting requirements for financial institutions
- Preventing abusive market practices

In effect, conduct standards are the rule-making instrument created through the FSR Bill to give effect to legislative powers delegated to the FSCA i.e. they will apply generally to the industry, sub-sector or category of financial institution or regulated activity concerned.[19] The power to issue conduct standards will over time effectively replace existing FSB powers to issue Notices, Board Notices and Rules, and are to be consolidated into a single handbook, similar to that published in the UK.[20]

It is proposed that that the FSCA's powers to develop conduct standards are underpinned by a statement of binding conduct principles that regulated entities are obliged to adhere to, over and above any specific rules-based conduct standards that may apply to them i.e. the conduct principles set out in the CoFI Act would align to the six TCF outcomes (see Chapter 5 in this regard). The CoFI Act would specify these conduct principles – and, if necessary, additional principles relating to specific categories of authorisations – so laying the foundation for outcomes-focused regulation and supervision. It follows that that the legislation should be flexible enough to allow for a finding of non-compliance with the principles without a finding that one or more specific conduct standards have been breached; in other words the law must support judgement-based decision making by the regulator

The new regulatory powers proposed in the FSR Bill are an important development towards enabling the FSCA to achieve the comprehensive consumer protection framework described in this document. To complement these strengthened regulatory powers, the various accountability measures proposed for the FSCA in the FSR Bill – including measures relating to Parliamentary and National Treasury reporting, transparency and consultation, and appeals and reviews - provide important checks and balances.

e) Information gathering

Greater emphasis will be placed on understanding business models, drivers of decision-making, incentives, conflicts of interest, and other sources of conduct risk within financial institutions and across financial services groups and value chains. This means that there will be a review of the types of information collected from regulated entities, to enable the FSCA to obtain earlier insight into conduct risk indicators[21], in addition to the more traditional reporting on compliance with specific prescribed processes. The FSCA will also need to draw on broader

[19] See the FSR Bill in this regard.

[20] UK Conduct of Business Sourcebook, as published on the Financial Conduct Authority (FCA) website: http://www.fca.org.uk/firms/being-regulated/meeting-your-obligations/cobs

[21] As an initial step, consultation with industry is already underway on a detailed Conduct of Business return for insurers. A review of conduct reporting in other sectors will follow.

sources of information regarding conduct of business than relying almost exclusively on an institution's own evidence of its conduct, as is currently the case. Enhanced information gathering powers in the FSR Bill will support this approach.

f) Enforcement and administrative actions

The FSCA requires an enhanced enforcement framework to effectively deter misconduct and impose tough and meaningful sanctions in cases of wrongdoing. The FSR Bill therefore builds on the existing tools available to the FSB, such as directives to financial institutions, entering into enforceable undertakings, appointment of statutory managers to financial institutions, suspension or withdrawal of licenses, registrations or authorisations, and declaration of practices as irregular or undesirable. The Bill also introduces several new administrative action mechanisms, including:

- The ability to issue interpretation rulings on the interpretation of a financial sector law, to facilitate the consistent and uniform application of the law. A financial institution *must* adhere to an interpretation ruling, unless or until such time as a court attaches a different interpretation to the subject matter of that interpretation ruling.
- The ability to issue directives to key persons and representatives of financial institutions.
- Allowing the FSCA to enter into leniency agreements whereby, in exchange for a person's cooperation in an investigation, certain actions will not be taken against that person in relation to conduct that contravenes or may contravene a financial sector law.
- Allowing the debarment of persons that have contravened a financial sector law, a directive, or an enforceable undertaking, from providing financial products or financial services, acting as a key person or a representative of a financial institution, or being involved in the management or ownership of a financial institution.

In keeping with its proactive and pre-emptive approach, the new authority will increasingly focus not only on breaches of specific rules-based conduct standards, but also on transgressions of principles-based conduct standards – including failure to deliver TCF outcomes for customers. As highlighted in the section on conduct standards, this in turn means that the regulatory and supervisory framework must support judgment-based decision making by the FSCA, with appropriate checks and balances to minimise the potential for an uncertain and inconsistent application of the law, especially requirements in the FSR Bill relating to the proposed administrative actions procedures, administrative actions committee and the appeal tribunal.

Complexities of regulating the wholesale market for conduct

National Treasury acknowledges that considerably more work must be done to clarify how this law should apply to the wholesale sector. A challenge with the wholesale market is that the "customer" in a transaction changes across transactions; in other words an asset manager may be a product or service provider in one transaction (for example relative to a retail client) and itself be a customer in another (for example relative to a bank providing prime broking services or selling securitised investments). In any event it must be clear that the nature of regulatory intervention should be different to that for the retail segment, taking into account the level of sophistication and knowledge of the corporate, significantly reduced vulnerability and different policy objectives (noting that poor conduct in this instance could nonetheless introduce systemic risk, as witnessed in the US household mortgage market).

4

Accelerating and intensifying industry interventions

This chapter sets out regulatory interventions that the National Treasury, FSB and Reserve Bank are undertaking over the short- to medium-term, in order to achieve better outcomes for ordinary South Africans. Already underway, these projects must be accelerated and intensified to bring much needed relief to customers.

Prioritising high impact conduct interventions

As Twin Peaks and the market conduct regulatory framework evolve, the following work programme should be accelerated and intensified:

- Targeting poor conduct practices that compromise savings, especially saving over the long term for retirement
- Confronting unscrupulous lenders, relieving over-indebted households
- Introducing conduct regulation of retail banking (including payment system effects)
- A strategy towards insurance risk products that better protect policyholders

A discussion of each of these programmes, and the project plan for taking these forward in the short- to medium-term, is set out below:

Targeting market conduct practices that compromise savings

Government is working towards a fair and sustainable social security system that provides pension, life insurance and disability benefits. In support of this strategy, a retirement reform programme is underway, aimed at improving household savings in order to better protect individuals, especially the elderly, from severe financial hardship and poverty.

Box 4.1 – Incremental retirement reform policy proposals

Encourage preservation of accumulated savings, especially during job changes

- Unless a member of an employment-based fund decides otherwise, on termination of a member's employment, accumulated retirement savings should be retained in the fund unless and until transfer is requested into the member's new chosen fund, whether it is employment based or not
- Employment-based funds should be required to accept transfers from former funds of new employees
- New contributions subject to new rules that restrict lump sum benefits in favour of annuity benefits

Enhance governance of funds

- FSB/FSCA to assess whether members of the boards of funds are "fit and proper" for that office in that
    - Each is able, and is seen to be able, to exercise an independent discretion, free from undue influence by providers of products and services, participating employers, unions and others who might have an interest in the business of the fund
    - Each is diligent and ethical
    - Together, they have the knowledge, skills, experience and attributes (such as familiarity with the profile of the membership and an ability to communicate well with members on behalf of the fund) required for the proper and effective governance of the fund
- The current Trustee Toolkit may be elevated into a basic, independent, compulsory training tool for board members who may then be required to demonstrate their knowledge by means of a credible, independent assessment mechanism
- New requirements likely to be prescribed by the registrar to promote better compliance by fund boards with their fiduciary obligations towards both the fund and members

Provide guidance to members exercising choice, facilitating the payment of pensions by the funds in which retirement savings have accumulated and requiring default annuity provision at retirement

- Boards of retirement funds should ensure that members have access to sound advice whenever they have choices to make, including choices, if any, in relation to the investment of their retirement savings and the providers of retirement benefits including annuity policies
- The annuity market should be opened to more providers to promote competition and better value for money
- To promote the use of economies of scale and bargaining power by retirement funds, consideration should be given to finding ways to encourage them to pay pensions themselves even if it means relieving employers of underwriting responsibilities towards those they no longer employ.

Simplify the taxation of retirement contributions

- The tax treatment of contributions to, and benefits from, pension and provident funds (and retirement annuity funds) should be harmonised to reduce complexity
- Greater equity in the tax system should be achieved by rationing tax exemptions
- Higher rates of retirement savings should be encouraged by increasing the base and rate of contributions

Encourage non-retirement saving through tax free saving plans

- As has happened in some OECD countries, tax-free savings products will be introduced that will facilitate more investment by lower-income earners in bank deposit accounts, retail bonds, money market instruments, CISs

Encourage good value retirement products and services

- Structural reforms as highlighted above
- Tougher market conduct regulation and supervision including new prescribed requirements to:
    - Promote simplicity, harmonisation and comparability in the wording of retirement fund rules
    - Encourage mergers of retirement funds to achieve stronger bargaining power, economies of scale and more effective governance, management and administration;
    - Discourage funds from buying financial services on "bundled" basis that allow unsound business models (such as under-resourced fund administration services sold "cheap" to procure more lucrative investment and/or insurance business) resulting in poor customer outcomes;
    - Require better disclosures of fund costs and charges to promote comparison and competition
    - Promote product simplicity and portability
    - Prescribe requirements relating to the remuneration of intermediaries to better align their interests with those of their financial customers and thus promote more effective intermediation.

This is to be achieved by taking steps that incentivise people to save more and for longer periods, and make sure that hard-earned savings accumulated over a lifetime are not unduly eroded by the inefficient management of retirement assets or unfair business practices. Proposals to give effect to these objectives are summarised in Box 4.1 above.[22] Steps have already been taken in some areas to legislate these proposals, such as the proposed tax-free savings accounts.

There are around 12 million individual accounts invested in approximately 3 500 pension, provident or retirement annuity funds, totalling accrued savings of over R1337bn. The high personal cost to a South African saving for retirement, of a pre- or post-retirement product failing to deliver on expectations, exposes him or her to significant conduct risk. Mitigating this risk must therefore be prioritised. Proposals in Box 4.1 that relate to market conduct – governance and "good-value" products – are informed by the following considerations:

Improved governance of retirement funds

The proposed governance framework aims primarily to give effect to the principle of independence of the board of management, so that trustees take decisions solely in the best interests of fund members, free of undue influence from the sponsor or service providers. An effort is therefore being made to restore an appropriate balance of power, between the boards of management of retirement funds on the one hand, and the service providers that provide the expertise and administration that funds rely on to achieve their objectives on the other.

Good-value retirement products

Table 1.1 highlighted pervasive market conduct problems in the contractual savings environment, relating in the main to:

- "Unfair" product design (especially penalties, for example with respect to penal charges on early termination)
- Conflicted commission-based remuneration structures
- No standardised approach to the calculation and disclosure of fees and charges (compromising comparability and, together with restricted portability, quelling competition).

These issues are not unique to retirement funds, and to varying degrees relate across the investment space to include investment insurance policies and other investment vehicles like CISs. What makes remedial action more complicated is strong interconnectedness amongst these products (and product providers). For example a retirement fund could be wholly or partly underwritten by an insurance policy, with or without a guarantee, which invests in underlying assets through a CIS. Alternatively, a CIS could be accessed through a Linked Investment Service Provider (LISP)[23], bringing layering of a different kind (and frequently with a layering of complexity and charges as well). An approach that promotes regulatory consistency across these vehicles, in particular with respect to disclosure of terms and conditions and charges, will go a long way towards fostering a more competitive environment.

[22] These proposals are fully described in a series of papers released for public consideration over 2012-14, which papers are referenced in Appendix 4.

[23] A LISP is an independent investment administration company that offers investors access to collective investment schemes across a number of different management companies. It acts purely as an administrator and does not manage fund assets nor does it provide investment advice.

Investment funds

Important to promoting a more competitive and value-driven savings sector – with more than R2075bn in assets according to the latest available figures – investment funds i.e. non-insurance investment products, merit attention.[24] Statutory requirements for how a CIS is structured afford protection to investors through the prescribed ring-fencing of investor assets held in trust, with management of the assets under the strict oversight of a trustee. This mitigates the risk of fraudulent misuse of those assets (as was unfortunately seen in the cases of Fidentia,[25] Tannenbaum and Sharemax). Some market conduct concerns do however relate to the unlevel regulatory playing field, such that products may be "under"-regulated (like private equity funds or real estate investment trusts – REITs), or lie outside the financial regulatory net altogether (like property syndications and factoring 'investments'). Some products, like securitisations, lie within the regulatory scope – in this case, they fall under the Banks Act – but are not subject to conduct-specific requirements or supervision, for example around disclosure of the underlying assets. These weaknesses may impact the retail and wholesale markets.

Within the CIS environment specifically, money market funds bring a unique set of risks related to these vehicles behaving very much like banks, performing large-scale maturity transformation.[26]They therefore bring additional conduct concerns, especially relating to disclosure insofar as whether investors understand that they may lose some or all of their initially invested capital.[27]Lack of investor understanding on this point may introduce systemic risk, as observed recently in the failure of African Bank, where even so called "sophisticated" institutional and corporate investors were caught off-guard on their exposure to money market funds.

Project action plan to promote better outcomes for savers

Consistent with the retirement reform proposals highlighted in Box 4.1, over 2015-16 the National Treasury and FSB/FSCA is aiming towards:

The better governance of stand-alone retirement funds, through steps to promote:

- A strong, representative and independent board of management of the fund, that is properly trained and capacitated

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[24] Investment funds here include CISs and alternative investments (like Real Estate Investment Trusts, private equity funds and hedge funds).

[25] On 1 December 2014 the Supreme Court of Appeal, recognising the severity of the crime and the impact that it had on mostly pensioners, upheld an application by the National Prosecuting Authority to overturn the sentence imposed on Fidentia's then CEO J Arthur Brown. The original sentence of a fine of R75 000 for each of two fraud charges was set aside and replaced with 15 years' imprisonment on each charge, to run concurrently.

[26] In 2011 National Treasury determined that money market funds (MMFs) held the equivalent of 13% of bank liabilities in 2010 but was growing faster (at 24% per annum) than bank deposits (at 16% per annum), suggesting that by 2018 MMF assets would equal 22% of bank deposits. This figure has been estimated at 17% for 2014.

[27] Disclosure concerns relate specifically to:

Branding of MMFs: Many investors in bank branded funds confuse the fund with the bank itself, believing that the bank would stand behind the fund in times of liquidity or solvency pressure, when in fact there is no legal requirement to do so.

Misinterpreting fund objectives: Marketing material may create the impression that these funds offer commitments or guarantees. Liquidity risk is poorly understood or communicated.

Reported constant NAV of "R1 per price unit": It should be more explicitly disclosed that this price is not guaranteed and that it could even decrease under certain circumstances.

- Clear fiduciary duties for the board of management, including mechanisms to avoid conflicts of interest
- A strengthened regulatory framework for retirement fund service providers, including clear fiduciary duties and mechanisms designed to avoid possible conflicts of interest.

The better governance of multi-employer funds, such as commercial umbrella funds and union funds, through steps to:

- Improve member representation
- Prohibit fund rules that make use of a specified service provider compulsory
- Strengthen governance and reporting requirements in cases where the board of management utilises the services of the sponsor or related company, so as to address potential conflicts of interest
- Require periodic independent expert evaluation of the governance function.

Enhanced comparability and value of investment products across the sector by:

- Incentivising product simplification and portability, for example through developing minimum product standards for the tax-free savings account scheduled to be implemented in 2015; rules should prohibit terms and conditions considered by the FSB/FSCA as inherently "unfair" e.g. causal event charges may be banned (consider the RDR proposals in Chapter 5).
- Introducing standardised point-of-sale disclosure documents for all investment products, including long-term insurance products, CISs, and retirement funds.
- Working with industry to introduce a standardised measure for calculating and disclosing charges for investment products and the impact of those charges on benefits.

Generally promoting distribution models that better serve the interests of consumers:

- Proposals for new regulatory requirements governing remuneration practices form part of the RDR (Chapter 5).

Specific to the investment funds sector, National Treasury is also working together with the FSB to introduce a consolidated prudential framework for investment funds, incorporating elements of CISCA and sitting alongside the proposed conduct framework. Policy proposals will be released for public comment over 2015-16. The structural law reform envisaged through the Twin Peaks reform and discussed later in this document will further support a consistent and coherent approach to the investment sector.

Confronting unscrupulous lenders, relieving over-indebted households

The economic slowdown after the 2008 global financial crisis resulted in many households falling into arrears and/or defaulting on loans. There are a variety of journeys a consumer can take into over-indebtedness. These depend on a number of variables including financial capability, life stage, lack of self-discipline, a desire to keep up with friends and neighbours and the availability of support networks as well as life events such as the death of a partner, disability and retrenchment. Irrespective of the path, government has recognised that reckless lending practices and abuses in payday loans have aggravated this problem, causing many over-indebted households to become trapped in a debt cycle.

Notwithstanding government efforts to reverse the effects of endemic abuse in the retail credit market, over-indebtedness remains a major challenge facing many South Africans today. Household indebtedness in South Africa stood at 74% of disposable income in June 2014 (sharply up from 55% in 2003) and of the 22 million credit-active consumers in South Africa, 10 million having impaired credit records. However the growth in unsecured loans and instalment sales (or vehicle loans) has generally slowed, and at 7.5% year-on-year in September, is well below growth rates in excess of 30% year-on-year at the beginning of 2013.

Following Cabinet's 2013 announcement to implement steps necessary to deal with present and future household over-indebtedness, the Ministers of Finance and Trade and Industry, together with other relevant government departments, began work on a detailed implementation framework, and engagement is on-going with major lenders, debt-collection firms, insurers and employers to consider steps that may be taken to assist currently over-indebted households.

Project action plan to promote better outcomes for borrowers and alleviate over-indebtedness

As part of the Cabinet process discussed above, proposals under consideration by the dti, National Treasury, Department of Justice, Reserve Bank, FSB and NCR that can be effected through the current regulatory framework and over the short term to assist currently over-indebted consumers include:

- Employers, including public sector employers, are to investigate the Emolument Attachment Orders (EAOs or garnishee orders) they are deducting from their employees' pay and deal with those that are illegitimately or incorrectly issued.
- Employers, including public sector employers, should make financial wellness mechanisms available to their employees.
- Enabling willing lenders to provide appropriate relief to distressed borrowers including through free voluntary debt relief mediation, restructuring their loans and reducing their instalment burden, without additional cost to the borrowers.

There are also a number of measures that will be implemented in the short-term to prevent consumers from becoming over-indebted in the future:

- Clear affordability criteria are to be set that all lenders have to adhere to, and more clearly define reckless lending. In August 2014 the dti issued draft regulations for comment and finalisation.
- Standards for the future use of EAOs, especially for small loans, will be determined.

Proposals to be effected over the longer term include:

- Extending and strengthening the debt collection law to apply to legal firms and ensuring that debt collectors are fit and proper
- Setting standards for access to the payment system, including for debit orders. Persistent reckless lenders should be denied access to the payments system
- Ensuring the provision of credit is not only affordable but suitable to customer needs
- Reviewing the level and composition of pricing caps under the NCA to ensure that current levels of caps are appropriate, especially for pay-day loans.
- Investigating simpler and lower-cost insolvency arrangements for lower- and middle-income individuals.

Widespread and sustained abuse within the credit insurance sector has prompted the FSB and National Treasury to investigate market conduct practices in the consumer credit insurance market, where poor market practices can significantly increase the cost of credit, and allow for a circumventing of the interest rate cap. A technical paper setting out the findings of this review was released in July 2014, notably including comprehensive recommendations intended to complement the envisaged NCA premium cap. Specifically the paper highlights weaknesses in the current CCI market structure that undermine fair customer outcomes, and invites comment on key focus areas regarding CCI pricing, a range of non-price-related market conduct regulatory enhancements, and a possible shift to self-insurance against CCI related risks by credit providers. The outcome of engagement on these proposals will likely be translated into conduct standards.

Retail banking – including the payments system

Despite strongly growing participation by the previously “unbanked” in the banking sector, deposit taking and transactional services remain largely outside of the regulatory net for market conduct, exposing consumers to risks of unfair treatment. While it is true that South African banks comply with the sector’s voluntary Code of Banking Practice, no statute governs the conduct of business activities of these institutions (barring coverage of their advice and intermediation activities under FAIS and limited coverage by the Consumer Protection Act).

The Jali Enquiry highlighted market conduct challenges associated with South Africa’s retail banking landscape, especially related to the market power of the four largest banks, which was observed to create the potential for poor customer focus and outcomes. Considerable progress has been made in implementing the Panel’s recommendations (see Box 4.2. below).

Box 4.2 - Progress with Banking Enquiry Panel recommendations

Recommendation 1: Penalty fees on rejected debit order should be capped

- On low-income accounts, penalty fees have been reduced to between zero and R9.50.
- On other accounts fees have been reduced but to a lesser extent
- Banks are educating customers about debit orders and the impact rejected ones have on customers’ creditworthiness.
- To bring down rejections, banks warn customers by SMS of pending debit orders

Recommendation 2: Customers should be empowered to cancel their debit orders at any time

- Banks provide systems that allow customers to stop payment of debit orders.
- Coherent abbreviated short names and unique contract reference numbers have been introduced to facilitate stop payments.
- A “Debit Order Abuse” list has been created to detail debit-order users that misuse or abuse debit orders or process fraudulent transactions against consumers’ accounts. If listed, the debit-order user will be denied access to the national payment system.
- Telephone debit-order mandate requirements are being reviewed as the majority of fraudulent debit orders processed originate from Call Centres.
- Fit and proper requirements for debit-order users are being implemented.

Recommendations 3 to 7: The direct charge model should be used for off-us-ATM transactions

- Research to date shows that it is not advisable for South Africa to adopt a direct charge model (DCM).
- To improve disclosure, fees for off-us-ATM withdrawals are separately reported on monthly account statements.
- Banks also display a pre-transaction message warning customers that their bank may charge additional fees for using the off-us- ATM. Customers can opt-out of the transaction.

Recommendations 8, 13, 14: Interchange (set up independent, objective and transparent regulatory process for determining interchange, including the necessity of interchange, and establishing rules)

- The Reserve Bank-led project to set an interchange fee per payment stream is complete for critical payment streams - ATMs and payment cards.
- Interchange rates implementation for ATMs commenced in the first quarter of 2014 and for payment cards, commencement will be in the first quarter of 2015.

Recommendations 9 to 11: Card schemes should abolish restrictive rules

- All card-rules related recommendations have been implemented.

Recommendations 15 to 19: Access should be given to the NPS for nonbanks and other unregulated payment service providers. Non-bank financial institutions and non-clearing banks should be permitted to clear and settle.

- Non-bank financial institutions and non-clearing banks are allowed to clear but permitting them to settle could cause potential systemic risk and should not be allowed.
- The Reserve Bank has made amendments to the NPS Act and issued directives to give access to the NPS as recommended.

Recommendations 20 to 22, 26, 28: Code of Banking Practice to include minimum standards for product and price disclosure, and a switching code.

- Revised Code of Banking Practice includes established standards for product and price information disclosure by banks. Includes a switching code that allows customers to easily switch banks.
- The code became effective on 1 January 2012. Implementation extends the scope within which the Ombud for Banking Services is empowered to mediate, make binding determinations or recommendations.
- The Code of Banking Practice and the Switching Code are available on Banking Association South Africa's website; and on websites and in braches of all the banks.

Recommendation 23: Banking fee calculators should be established.

- The banks provide banking fee calculators.
- Many banks pro-actively advise their customers of cheaper product offering within the bank.
- Independent centralised fee calculators on websites such as "JustMoney" and "ThinkMoney" are in place.

Recommendation 24: Permit comparative advertising.

- This recommendation falls outside of the scope of financial sector regulation.

Recommendation 25: Competition Commission may consider it necessary to oblige the banks to provide simpler products

- National Treasury is encouraging the introduction of simpler products through the Financial Sector Charter Council process and TCF initiative.

Recommendation 27: The National Treasury should establish a central FICA hub

- An investigation is being undertaken to establish a workable solution to financial identification.

The FinScope survey shows interesting trends with regard to banking behaviour. The 2014 survey findings show that 33% of bank account holders withdrew all money as soon as it was deposited, while the 2013 survey showed that only 26% of adults agree that they find banking easy to understand, and perceptions of high costs continue with 28% of all respondents saying that bank fees were too expensive.[28]

An independent 2014 review of the Banking Enquiry and progress made with respect to recommendations noted that there remains considerable scope for reforms in the banking sector that will facilitate more competition and better outcomes for financial customers. Such reforms, as set out in the review, would address many of the issues identified in Table 1.1 above, particularly from a payment system perspective. They include for example greater access to the payments system, changes to approaches on interchange particularly in terms of transparency, and better governance of the self-regulatory body managing payment system operators (the Payments Association of South Africa),[29] including increased independence from the banks. The Reserve Bank is already undertaking a strategic review of the neutrality and effectiveness of the national payment system. Further recommendations set out in the review include regulating the timeframes for switching banks, indemnifying consumers from interest, penalty fees and other charges incurred as a result of delays in switching bank accounts, and regulator developed tools to enable better product comparison.

Project action plan to promote better outcomes for bank depositors

With the implementation of Twin Peaks through the FSR Bill, the market conduct framework will be extended to banks offering transactional and savings products, and related services. The immediate focus in doing so will be on:

- Exploring ways to better disclose account fees and charges to prospective and own customers, in ways that promote product comparability and competition, not only through the point-of-sale Key Information Documents (KIDs), but possibly also through product simplification and/or system changes e.g. pre-transaction fee disclosure on ATMs
- Exploring ways to improve contestability, for example by disallowing off-us transaction "penalty" fees, when using another bank's ATM infrastructure
- Developing conduct standards in order to apply the TCF principles to retail banks, with a particular focus on debit order practices
- Monitoring retail banks' delivery against financial literacy, capability and inclusion targets as set out in the Financial Sector Code.

The FSR Bill also takes a step toward improving conduct oversight of payment services provided through the National Payment System. Due to the crucial importance of the payment system to financial stability, standards applied on users will be done in agreement with the Reserve Bank.

[28] FinScope SA 2014 Consumer Survey, 4 November 2014 and FinScope SA 2013 Consumer Survey, 5 November 2013.

[29] "Review of the Competition Commission Banking Enquiry", 10 March 2014. Published by the Centre for Competition, Regulation and Economic Development in the University of Johannesburg

A strategy towards risk products that better protect policyholders

A number of poor conduct outcomes have been identified in the insurance sector. Persistent poor practices identified include the practice of "underwriting at claims stage" (for example where a consumer's credit history or previous medical history is only checked at the claims stage and used as a reason to repudiate the claim), poor disclosure and misleading marketing practices. Weaknesses have also been identified in the claims handling process, and the manner in which certain services are outsourced by insurers to third parties. Customers often do not have recourse to effective complaints management processes.

The implementation of the SAM Pillar II standards will place more stringent governance requirements on insurers, and will include conduct risk governance requirements in addition to prudential requirements. In addition, many of the interventions discussed elsewhere in this paper, for example in relation to disclosure and distribution, will also be applicable to the insurance sector, and work has begun on addressing some of these.

Project action plan to promote better outcomes for policyholders[30]

The National Treasury and FSB will work together with the industry to address the weaknesses identified and improve on outcomes for policyholders. It is anticipated that interventions will target:

- **Improved product design**
  In addition to addressing unfair and inappropriate product terms and conditions and low claim ratio products, work will also begin to identify the possibility of introducing standardised product features, offered across insurers, to make product comparisons easier and make the value of products easier to identify and evaluate. This work will in particular seek to address the current concern that insurers and advisers place excessive focus on price ("super cheap insurance") rather than value and quality. As part of this focus, the role and conduct of price comparison websites is to be reviewed.

  Particular areas of work aimed at ensuring insurance products are appropriately designed for their target markets relate to CCI[31], the development of the micro-insurance framework, and health insurance. Other product features being scrutinised for fairness are extended motor warranty and other "add on" products sold by motor dealers and retailers, as well as legal expense insurance

- **Improved disclosure, advertising and marketing**
  Work already underway in this area includes the KIDs (to be discussed in the next chapter), and further collaboration with industry on the standardisation of terminology. A draft information letter has also been issued that will impose requirements to ensure insurers' advertising and marketing is not misleading

- **Non-conflicted distribution models**
  The cross-cutting retail distribution review, discussed elsewhere in this paper, has particular implications for the insurance sector's commission-based distribution model. Although commission will continue to be a component of intermediary remuneration for risk insurance, the RDR contains specific recommendations to minimise the conflicts of interest inherent in the current framework.

[30] These initiatives will also apply to the CCI market already discussed as part of the "credit" workstream.

[31] See the Technical Report on the Consumer Credit Insurance Market in South Africa

- **Responsible outsourcing**
  Existing initiatives aimed at improving the governance of outsourcing arrangements will also be built upon. These are designed to improve accountability of the insurer for proper risk management – including risks to fair treatment of customers – where they operate through partners or service providers. Focus areas here include insurance “binder” arrangements and the use of cell captive models.

- **Improved claims and complaints handling**
  As part of the FSB’s broader planned enhancement of complaints management requirements and reporting under the TCF banner, the FSB has also undertaken a thematic review of insurers’ complaints handling practices, the findings of which will inform the final complaints management framework. Work has also begun on a thematic review of claims handling practices, with a view to developing standards on fair practices in claims handling.

- **Holding insurers to account more effectively for their business conduct**
  Customers are not adequately empowered to identify “good” insurers that treat customers fairly from “bad” insurers that consistently fail to deliver on fair outcomes. The FSB is in the process of finalising a “Conduct of Business” reporting template for insurers – which will include statistics on claims ratios, complaints ratios, and so on – for reporting to the FSB. Public reporting of key fair treatment indicators is also planned.

5

Cross-sector interventions: implementing the TCF framework

In addition to the industry interventions discussed in the preceding chapter, cross-cutting approaches to cross-sector conduct challenges should continue being implemented through conduct standards, thereby laying the basis for the CoFI law. With this in mind, The TCF approach of the FSB aims to entrench principles of fair treatment of financial customers and has led to projects on disclosure and distribution that seek to give effect to these principles.

Treating customers fairly[32]

The TCF framework is transforming the way in which the supervision of market conduct happens. Being implemented by the FSB, TCF is an activities-based, cross-cutting and outcomes-driven approach to regulation and supervision, designed to ensure that regulated financial institutions apply specific standards of fairness to all financial customers. Institutions are expected to demonstrate that they deliver specified outcomes to their customers – as summarised in Box 5.1 – across the product value chain, from design and promotion, to advice and servicing, claims handling and complaints. "Activities-based" means that requirements will apply depending on the financial service being offered, irrespective of the type of institution offering it, thereby levelling the regulatory playing field. This means that all institutions providing the same sort of financial service will be regulated in the same way, regardless of what type of financial institution they are. As explained in earlier chapters, an "outcomes focus" for financial institutions and their regulators aims to ensure that the regulatory framework supports a financial sector that serves South Africans better. It guides regulation in a way that should result in meaningful positive outcomes, through applying standards that affect institutional behaviour.

[32] The TCF Roadmap published by the FSB in March 2011 sets out the rationale, structure, key features and high level implementation plans for the TCF framework – see http://www.fsb.co.za

Box 5.1 –TCF outcomes developed to support a good customer experience

- Customers can be confident they are dealing with firms where TCF is central to the corporate culture
- Products and services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly
- Customers are provided with clear information and are kept appropriately informed before, during and after point of sale
- Where advice is given, it is suitable and takes account of customer circumstances
- Products perform as firms have led customers to expect, and service is of an acceptable standard and as they have been led to expect
- Customers do not face unreasonable post-sale barriers imposed by firms to change product, switch providers, submit a claim or make a complaint.

The FSB is embedding TCF in its regulatory and supervisory frameworks on an incremental basis, and the approach will form an important foundation for the new FSCA. For regulated entities the general principles of TCF have been consistently communicated for a number of years, and the FSB already expects these entities to be applying fair treatment principles in their overall business processes.[33] Although there will be explicit inclusion of TCF principles in future overarching market conduct legislation, existing legislative and regulatory frameworks already allow the application of TCF principles. In addition, the FSB is in the process of identifying opportunities to enhance and align existing subordinate legislation to further support TCF delivery. For example, there are dedicated efforts underway to ensure that sales and distribution practices work in the interests of financial customers. Such efforts include:

a) Implementing a harmonised disclosure framework
b) The Retail Distribution Review
c) Improving internal complaints mechanisms
d) A revised competency framework for intermediaries.

a) Implementing a harmonised disclosure framework

The high degree of information asymmetry between financial institutions and their customers is a significant source of conduct risk. In order for a consumer to make an informed decision, it is necessary that they be provided with certain essential information, and that the information is not misleading, deceptive or confusing. Many financial products are by their nature complex and their performance uncertain, and even with all available information, comparison across products may be difficult. It is therefore imperative that key information is provided in such a way that consumers can easily locate, compare and understand the information needed to make an informed decision. One of the explicit outcomes of TCF is that “Customers are provided with clear information and kept appropriately informed before, during and after point of sale.” Thandi’s story in Box 5.2 considers how the various regulatory actions proposed in this chapter, especially relating to disclosure within the TCF framework, may support greater customer-focus, attention and ultimately fairer outcomes in the short-term insurance sector.

[33] A recent TCF baseline study conducted by the FSB over the period December 2012 to August 2013 provided a snapshot of how customer treatment practices in the financial services industry measure up against the 6 TCF outcomes. The study entailed requiring a broad spectrum of different types of financial institutions, using the FSB’s published TCF self-assessment tool, to rate their own TCF delivery. Without exception, all categories of financial institutions in the sample rated themselves lowest on TCF Outcome 1 – the requirement that customers can be confident they are dealing with firms where TCF is central to the corporate culture. In particular, the extent to which reward, remuneration and recognition practices are linked to TCF objectives, scored generally low self-ratings.

Box 5.2 – How can a TCF approach facilitate change?

Thandi recently bought her first car and is the first in her family to take up insurance cover. She wanted a simple insurance product that would cover her in the event of an accident, theft or damage. She expected the policy to pay out in her time of need with no problems.	***Will TCF promote a more customer-centric approach, especially in product design and claims practices?***
She received the policy contract setting out the terms and conditions only after she agreed to take out the insurance cover. The contract was full of small print and legal terms which didn't make sense, and did not seem to correspond to telesales commitments. Terms like "primary driver" and "trade/book value" were not explained. Her claim for hail damage was rejected on the basis of policy exclusions, even though the policy was described as "comprehensive".	***What more can be done to make consumers aware of the different types of material disclosures and any other significant conditions which could affect the insurance contract? Would more simple and standardised disclosure documentation, with standardised policy wording, have assisted making comparisons with other products?***
When someone reversed into her parked car, her entire claim for accident damage was rejected because she had scratched her car 6 months previously and did not know that the insurer required even minor incidents to be reported.	***Will insurers take more trouble to verify information upfront during the sales process to determine the customer's risk profile, rather than making a quick sale and only assessing risk at claims stage?***
She did not know who to complain to about the claim rejection, or how. The internal complaints process upheld the original claim rejection on a strictly legal basis given the terms of the policy contract.	***Will publishing claims ratios promote competition and aid customers in selecting good-value products? Will the new complaints framework support a more customer-friendly and fair mechanism? What more can be done to promote the visibility and effectiveness of the ombud system?***
Thandi's insurance premium was never adjusted despite her dealer advising that the insured value of her vehicle had depreciated. When she called the insurer and threatened to switch to a competitor, her premium was immediately lowered.	***Will TCF motivate insurers to focus on how to proactively offer better value over the life of a policy?***
When she bought the car she was also sold credit life insurance but she didn't realise that she was even covered for death, disability or retrenchment. She found out that she was paying ten times more for what she would pay for an ordinary funeral policy (and already had a life policy).	***Will stricter requirements around pricing, product design and disclosure of product features and claims ratios support CCI products that better serve borrowers?***

Although this source of risk is particularly prevalent in the retail market, inadequate disclosure and opaque product and cost structures also undermine fair outcomes in wholesale markets – in particular where risk is passed on to end customers such as retirement fund members and retail investors in product "wrappers".

Project action plan to implement a more harmonised disclosure framework

National Treasury and the FSB have established a disclosure workgroup with industry representation within the broader TCF structures, tasked with reviewing and reforming the current disclosure framework across the retail sector. Policy proposals emerging from this workstream will form the basis for a policy discussion document due for public release over 2015. This will inform both detailed conduct standards for disclosure issued by the FSCA as well as the overarching conduct legislation envisaged for the financial sector. The workgroup has begun work in three areas:

- **Alignment and completeness of disclosure across retail market segments**

  The aim is harmonisation of disclosure requirements, for both product provider and intermediary across market segments, and the filling of identified gaps within the existing regulatory framework. The workgroup is developing standardised templates for Key Information Documents to be provided before the sale of any retail financial product or service, which will allow easy comparison of that product's benefits, costs, commitments, risks and suitability (see Box 5.3 below). It is anticipated that consumer testing of these templates will begin in 2015, for phased-in implementation over 2015-16 (with an initial focus on long-term and short-term insurance products and retail savings products).

Box 5.3 – Key Information Documents

National Treasury, the FSB and industry stakeholders have prioritised the development of pre point of sale documents known as "Key Information Documents" or "KIDs". These are being specifically designed to give financial consumers important information about the product that is:

- In language they can easily understand (and is, as far as possible, free from jargon and technical language)
- Succinct enough to be readable
- In a standardised format that aids comparability
- Given at a time that is relevant to the consumer's decision.

KIDs will be compulsory across the entire range of retail financial products, and extensive work has already gone into developing the KIDs for a range of products including long term Insurance products, short term Insurance products, CIS's, and Pension funds, with transactional banking and securities products to follow.

- **Alignment and completeness of the law that supports and gives effect to these disclosure instruments, identifying regulatory principles and rules necessary to support the desired TCF outcome**

  This includes addressing identified disparities in disclosure standards currently applicable to different market sectors at different stages of the product life cycle.

- **Identifying ways to enhance the disclosure toolkit, and thereby improve the effectiveness of disclosure**

  Work in this area includes collaboration with industry associations on the standardisation of key terminology. Included in this area is the development of a standardised method for the disclosure of costs and charges for all investment products, including standardised disclosure of the impact of such charges on investment returns (implementation is envisaged to take place under the current law, scheduled for 2015).

b) Retail Distribution Review (RDR)

Significant progress has been achieved since the FAIS Act was introduced in terms of raising intermediary professionalism, improving disclosure to clients and addressing certain conflicts of interest in the advisory and intermediary sector. However, concerns remain about poor customer outcomes, as practices of inappropriate advice and product mis-selling continue. As part of the broader TCF implementation, the FSB has undertaken its RDR, aimed at clarifying and improving the manner in which financial products are sold, advice is provided, and intermediaries are remunerated. The primary aim of the RDR is to ensure that financial products are distributed in ways that support the delivery of TCF outcomes - in particular, to promote advice that is appropriate, affordable and fair. It will also ensure that financial products in the retail market are appropriately distributed through sustainable business models. Similar distribution model reviews have been undertaken in other countries, including the UK and Australia.

As with the TCF initiative, the RDR approach is a further example of uniform, activity-based regulation across the financial sector. It advocates a consistent cross-sectoral approach to regulating the distribution of financial products and the provision of advice. The RDR will therefore also complement the retirement reform process underway, by addressing the impact of intermediary remuneration models on benefits delivered by contractual savings products, such as retirement annuities.

The RDR paper released in November 2014 sets out a number of proposals to support fair customer outcomes – with an emphasis on retail financial customers, who are most vulnerable to the risks of unfair and conflicted advice and sales practices. In particular it seeks to ensure that distribution models:

- Support the delivery of **suitable products** and provide **fair access to suitable advice** for financial customers
- Enable customers to **understand and compare** the nature, value and cost of advice and other services intermediaries provide
- Enhance **standards of professionalism** in financial advice and intermediary services to build consumer confidence and trust
- Enable customers and distributors to benefit from **fair competition** for quality advice and intermediary services, at a price more closely aligned with the nature and quality of the service, and
- Support **sustainable business models** for financial advice that enable adviser businesses to viably deliver fair customer outcomes over the long term.

The paper highlights the complex distribution landscape for financial products in South Africa. It proposes a number of measures to rationalise this. Proposals are grouped according to three main themes:

- **The types of services provided by intermediaries to customers and product suppliers respectively**

  An activity-based approach to categorising these services is proposed, in particular to clarify when an intermediary is providing services for a client, or a product provider.

- **Rationalisation of the range of relationships between product suppliers and intermediaries**

  Proposals address the responsibility of product suppliers for advice and intermediary/outsourced services provided.
- **The types of intermediary remuneration models** that should apply to the revised sets of services and relationships outlined in the preceding proposals.

Project action plan to better align retail distribution with customer interests

Interim steps will be implemented to address specific concerns relating to potential conflicted remuneration giving rise to incentive-driven product churn and inappropriate arbitrage between tied and independent distribution models.

Regulatory standards developed for the distribution of financial products through the RDR process will be integrated into the future market conduct legislative architecture under Twin Peaks, specifically for products that are marketed and sold to retail customers.

c) Improving internal complaints mechanisms

A customer's first port of call when resolving a complaint should be to the financial institution concerned. TCF Outcome 6 states that customers should not face unreasonable post-sale barriers imposed by firms to change product, switch providers, submit a claim or make a complaint. To demonstrate commitment to this TCF Outcome, it would be necessary for a financial institution to develop, implement, monitor and report on, an appropriate and effective internal process to manage customer complaints. In addition, firms are expected to use customer complaint information as an important source of management information to measure and improve their delivery of the full set of TCF Outcomes.

The regulatory framework should therefore set consistent obligations for all firms to develop and implement complaints management processes (CMPs), and set consistent standards which those processes should meet. As with many of the current regulatory standards, the financial services regulatory framework in relation to complaints management is inconsistent, with different levels of responsibility placed on different types of entities.

Project action plan to improve internal complaints mechanisms

In November the FSB made public its proposal for a revised regulatory framework for CMPs. This proposal is the outcome of a series of consultations, going back to February 2013, with the multi-stakeholder TCF Regulatory Framework Steering Committee. International standards and practices in relation to complaints management were also reviewed. The main features of the framework are:[34]

All regulated financial institutions should have a CMP with the following components:

- A detailed description of the CMP which makes it clear to customers and employees how the system works and how, and by whom, it is maintained and overseen by the firm.
- A simplified outline of the CMP that makes it quick and easy for consumers to understand who to contact, what is required from them, what the firm will do and any waiting periods.

[34]To avoid unnecessary duplication, what follows below is confined to a synopsis of the TCF Complaints Management Discussion Document, available on http://www.fsb.co.za.

- Standards for record keeping and reporting, to make sure complaints are captured correctly and reported correctly. This will enable the conduct regulator to exercise oversight, and to require publication of complaints data in a manner that makes it possible for the financial sector to learn from customer feedback obtained through the CMPs.
- Standards whereby financial institutions have to be able to demonstrate how they are monitoring, and learning from, customer complaints, including not only those captured by their own system but also from data published by the regulator on complaints handling throughout the financial sector.

Basic principles governing the relationship between the CMPs of individual firms and ombud schemes are that:

- Firms have to make information available to their clients at all stages of the service relationship, about the ombud scheme (s) to which the client has recourse in the event of a dispute not being resolved internally to a customer's satisfaction
- Firms should be able to demonstrate that their CMP includes a mechanism to analyse, and learn from, ombud rulings.

The framework proposes ways in which complaints management can be embedded in the current regulatory framework for different types of institutions, until the FSR law is in place, for e.g. through the Policyholder Protection Rules (PPRs) for insurers. Industry engagement on the proposals will inform the finalised approach.

d) A revised competency framework for intermediaries

While the FAIS Act has introduced a level of professionalism into the financial intermediation industry, this can be enhanced to ensure that financial customers get the best financial advice taking into account their individual needs and circumstances. The plan to achieve this is to ensure that in addition to adequate knowledge of their regulatory obligations (through the existing regulatory exam), intermediaries should also demonstrate that they have adequate knowledge of their line of business and the specific products they distribute.

Project action plan to enhance FAIS requirements relating to professionalisation

The FSB initially intended to implement a "product knowledge" exam, to be set and administered by the FSB in a similar way to the regulatory knowledge exam. This thinking has shifted and, in line with the TCF objective of ensuring that responsibility for fair customer outcomes is appropriately shared between product suppliers and other parts of the value chain, it is now proposed that product suppliers should take the responsibility of ensuring that anyone they authorise to sell or give advice on their products should be competent to do so. This product knowledge will be tied in with a requirement of continuous professional development. In consultation with the financial services sector, the FSB will propose frameworks for ensuring that this product knowledge requirement is implemented and assessed at the appropriate levels to ensure good customer outcomes.

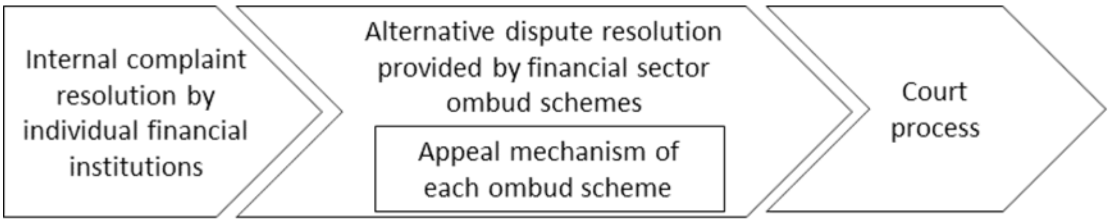
6

An integrated ombud system

Improved market conduct in the financial sector requires empowered customers who are able to hold financial institutions to account. In addition to reforming the legal framework for regulating financial institutions, and in support of the various interventions proposed in preceding chapters, the approach to improving market conduct will include improving customer recourse mechanisms.

A fundamental component of an effective consumer protection framework is appropriate customer recourse channels. Customers should have access to affordable, effective and independent mechanisms to address complaints, resolve disputes, and secure a fair outcome when broader customer protection frameworks have failed. An overview of these mechanisms is shown in figure 6.1 below.

Figure 6.1 – Customer recourse mechanisms



Having already discussed the internal complaints framework being developed under TCF in Chapter 5, we focus here on the alternative dispute resolution (ADR) mechanism provided by the ombudsman schemes.

The role and functioning of ADR channels

Customers may take their disputes to court if they cannot resolve them directly with their financial services providers. However few customers do so, as access to the courts can be costly and court processes slow, cumbersome and intimidating to the ordinary person. It is therefore important that there are ADR mechanisms in financial services that customers can access cheaply, easily and expeditiously.

There are different options for ADR methods – for example, negotiation, mediation, conciliation and arbitration. However the most common ADR mechanism in financial services is the ombud scheme. Such schemes can be either voluntary or statutory[35].

An ombud scheme is an alternative to, rather than a substitute for, the courts. Such schemes are generally free for the customers entitled to access them. Customers are not required to use the scheme nor be bound by a decision made by the ombud, and may at any time withdraw from the process and take their dispute to court. Ombuds may base decisions on what is considered fair and reasonable rather than the strict legal position. Financial institutions, unlike their customers, are generally bound by the decision of an ombud.

An effective ombuds system will ensure that:

- Customers have more confidence in using financial services as they know disputes can be fairly and independently heard and adjudicated speedily at reasonable or no cost
- Financial institutions will be assisted to resolve disputes with customers they are unable to resolve themselves
- Unscrupulous and abusive financial institutions that do not treat customers fairly will be held to account
- Feedback from ombuds schemes to policymakers and regulators will indicate where regulation needs to be strengthened and when regulators are not intrusive enough

South Africa's existing ombuds system is an important redress mechanism in the hands of customers. However, as the system of financial sector regulation in South Africa is being consolidated and strengthened through the Twin Peaks process, additional work will also be required to improve and streamline the ombud scheme architecture, so that it efficiently delivers quality outcomes for customers and is a strong pillar in the reformed regulatory system.

The current framework

South Africa has a mix of voluntary and statutory ombuds, generally organised on a sectoral basis.[36] The Financial Services Ombud Schemes (FSOS) Act was introduced in 2004 and governs all ombud schemes, statutory and voluntary. Voluntary schemes are recognised by the Financial Services Ombud Schemes (FSOS) Council in terms of the FSOS Act.

This Act provides the foundations of an ombud system based on:

- Independence
- Impartiality
- Confidentiality
- Openness and transparency
- Accountability
- Integrity
- Clarity of purpose

[35]Voluntary ombud schemes are set up voluntarily through an industry initiative. Statutory ombuds derive their powers directly from the provisions of statute and their powers are set out in such statute.

[36] The Ombudsman for Long-term Insurance was the first to be established in 1984, followed by the Ombudsman for Banking Services in 1997, the Pension Fund Adjudicator and Ombudsman for Short-term Insurance in 1998, the FAIS Ombud in 2002, the Credit Ombudsman in 2004 and the JSE Ombudsman in 2007. The Pension Fund Adjudicator and FAIS Ombud are created through legislation i.e. are statutory schemes, whereas the rest are voluntary schemes created by their respective industries.

- Effectiveness

The FSOS Act provides for setting minimum standards with which ombud schemes must comply, and promotes consumer education on the role and functioning of the ombuds.

The ombuds have played a valuable role in dispute resolution, and have worked to improve turnaround times for dealing with the increasing number of cases, partly brought about through an increasing awareness among customers of the schemes themselves. However, recent reviews and assessments of the ombuds schemes have pointed to weaknesses in the current system. For example in 2007 the FinMark Trust identified certain shortcomings in the present ombudsman structure in its report “Landscape for Consumer Recourse in South Africa’s financial services sector”. Problems which have been identified with the operation of the ombuds schemes include:

- A general lack of knowledge by consumers about ombud schemes
- Inadequate transparency and accountability of ombuds
- Jurisdictional boundaries of the various ombuds and customer confusion
- The need for greater coordination and consistency between ombuds.

From a customer perspective, trying to access the current fragmented ombuds system for an increasingly interconnected financial sector can be very confusing. As just one example, a customer mis-sold an insurance product through a bank distribution channel could complain to the FAIS ombud, banking ombud or an insurance ombud. A central call centre has been established to try and address this issue, directing complaints from a central point to the relevant ombud office, but more can – and should – be done.

The matter of customer uncertainty is further illustrated when considering the role of other dispute resolution mechanisms in the economy more broadly, as financial transactions may be linked to more general transactions – for example the purchase of a car or house through bank financing. The story of Thando and Ayanda in Box 6.1 illustrates this. The role of other dispute resolution channels – which may not necessarily be an ombud – also highlights the differing approaches to resolution that customers may encounter.

Box 6.1 – Coordination between regulators and between ombuds

Thando and Ayanda are a newly married couple, wanting to buy a family car and move out of their rented flat into their own property. These represent the biggest financial purchases they will have made.

Thando visits a car dealer to purchase a new sedan. The motor dealer arranges for the financing of the car through a loan from a bank as well as the required insurance. Thando deals directly with the vehicle dealer throughout the transaction.

A few months after the purchase, the car breaks down and Thando has to take it for repairs. When trying to assess the problem so he may claim for the repairs, he discovers that the fault was due to poor repairs done on the car previously, and is therefore excluded by his insurance policy. Thando realises that he was not sold a new car, as the dealer had indicated, but rather a refurbished car sold to him as new. He complains to the dealer but despite several attempts, the dealer does not acknowledge the complaint. Not knowing how to take the matter further, Thando leaves the vehicle at the dealer's premises and cancels his monthly debit order to service his vehicle loan, refusing to pay for a refurbished car. When the bank approaches him about his lapsed payments, he refers them to the motor dealer who arranged the loan. The bank informs Thando that he remains responsible for the loan and that he runs the risk of being blacklisted if he doesn't service his loan.

At the same time, the couple find a house they want to purchase. The estate agent offers to arrange a home loan for the purchase through a mortgage originator, and assures them that she will be able to facilitate the required insurance for the loan and household contents too. Wary of their experience with the motor dealer, the couple decide instead to approach a bank directly to arrange for their mortgage and insurance requirements. To do so however, they need to ensure that their vehicle loan is current and are unsure where to turn to get the matter resolved.

Although three parties are involved in the sale of the car – the motor dealer, lender and insurer – the customer deals only with one party. Is the role of the motor dealer in facilitating the financing and insurance of the vehicle clear to the customer?

There are three regulators responsible for elements of the transaction – the National Consumer Commissioner for the car sale, the National Credit Regulator for the vehicle finance and the FSB for the insurance. How do the regulators each assess whether the motor car dealer is fit and proper in terms of their specific legislation? How is the lender/ insurer accountable for the activities of their agent?

Is it clear to the customer which ombud to approach to resolve the dispute – should the lender be held accountable for extending the loan against a car that was not new? Would any ombuds involved co-ordinate actions to make it easy for the customer to resolve?

When it comes to the sale of property, are there adequate controls to ensure that estate agents or mortgage originators meet fit and proper standards, and properly take into account affordability criteria? Is there coordination among the regulators involved – including the Estate Agency Board – to ensure customers are properly protected throughout the transaction?

A consolidated approach to ombuds schemes under Twin Peaks[37]

Going forward, the role and effective functioning of the ombud schemes will need to be considered within the Twin Peaks framework. As the landscape for financial sector regulation is consolidated, consideration must be given to how best develop a streamlined, efficient and coordinated system for ombuds. To strengthen the ombud system, current FSOS Act provisions are brought into the overarching FSR Bill, and additional provisions create a much stronger, independent FSOS Council, intended to take over many of the functions currently assigned to the FSB.[38]

Once the FSOS Council is established through the FSR Bill, and as the consolidated market conduct policy framework is developed and entrenched, the stronger FSOS Council is intended to start addressing weaknesses in current ombud arrangements. In particular, these are:

- **The need for greater coordination and consistency between ombuds**

  The current ombuds system has not had strong oversight and coordination, and has resulted in differing approaches to ADR mechanisms in different sub-sectors (e.g. banking, insurance, pensions etc.). In line with the approach to streamline financial sector regulation, and in particular put in place a more consolidated overarching market conduct policy framework, one of the main functions of the FSOS Council will be to ensure that the ombuds system is similarly reformed. A key focus of the council will therefore be to ensure better coordination and strengthened oversight of ombud activities, and a more unified approach to external dispute resolution across the financial services sector.

- **Accessibility and the state of consumer awareness**

  The FinMark Trust study found a lack of knowledge or awareness among consumers about the existence of the ombudsmen and a lack of knowledge about which channel to use for specific complaints. This finding is further supported by more recent statistics – for example, in 2013 it was found that only 43% of the complaints received by the FAIS ombud fell within the jurisdiction of that ombud, suggesting that consumers still have a poor understanding of how best to direct their complaints. The FinMark study concluded that there was work to be done by both the ombud schemes and the FSOS Council to improve consumer awareness and their ability to use ombud facilities.

  Since then the ombuds have agreed on the centralised helpline mentioned above – 0860 OMBUDS (662 837) – but not to much more. The voluntary ombuds and industry participants have on an individual basis implemented measures to improve knowledge and awareness among consumers. For example the various industry codes of conduct require institutions to advise customers to escalate their complaints to the relevant ombud if they are not satisfied with the results of their institutions' internal complaint process.

  The FSOS Council, working with the FSCA and financial institutions, will need to drive greater awareness among financial customers of the ombud schemes, their jurisdiction, and their purpose.

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[37] As informed by the FSBs stakeholder engagement on its 2011 policy paper relating to reform of the ombud system.

[38] An implication of the Twin Peaks reform is that the FSB will need to be replaced as the agency responsible for administratively supporting the FSOS Council and the statutory ombuds.

- **Transparency and accountability**

  Transparency and accountability enhance the independence of an ombud. Ombuds should publish clear details about their powers and procedures, and the type and impact of their decisions. It is also considered good practice for ombud schemes to publish case studies that illustrate how the ombud approaches typical disputes, and an annual report setting out the work done by the ombud and the number and subject matter of such disputes. In line with a growing international trend to promote transparency, the current FSOS Council has recommended that recognised financial ombud schemes publicise industry performance including statistics and information related to the disputes of individual financial institutions (a 'name and shame' approach). Many ombuds do produce an annual report, and the strengthened FSOS Council will be encouraged to drive greater transparency of the ombuds schemes through these and other innovative mechanisms like websites or the media.

  Due to the nature of work they perform, ombuds are able to quickly identify trends in specific industries such as product features that undermine fair outcomes, inadequate or misleading disclosure, and undisclosed or inadequately-disclosed fees and charges. Ombuds should therefore also have a broader role in working with the FSCA and other consumer agencies, using information gathered to identify and report market conduct abuses that impact on broad groups of financial customers, beyond the parties to the dispute.

- **Jurisdictional boundaries of the various ombuds**

  As mentioned, while provisions have been made in legislation to clearly delineate the jurisdictions of the various ombud schemes, the interconnected nature of the financial services sector means that it is not always immediately apparent which ombud would have jurisdiction over a specific complaint. The FSOS Council will need to ensure that there is an effective central point of entry into the ombuds system for financial services. In this way, complaints can be directed to the correct office.

Under this framework, the FSOS Council should also have the responsibility to be the final arbiter in jurisdictional uncertainties when the ombuds have not been able to resolve the issue by agreement.

Revising the framework for ombud schemes

Revising the framework for ombud schemes to address the identified shortcomings will be done as part of the gradual implementation of the twin peaks regulatory framework. As mentioned, the FSR Bill proposes to establish a stronger FSOS Council[39], but questions remain relating to an optimal ombud structure over the longer-term, for example whether a "chief ombud" would support greater consistency in approach. As the market conduct policy framework proposed in this document is evolved and measures put in place to consolidate conduct regulation in the financial sector, it is anticipated that the FSOS Council can begin putting in place measures to similarly consolidate the ombuds system, and ensure it is an effective pillar in the reformed market conduct framework.

[39] The explanatory document, *Twin Peaks in South Africa: Response and Explanatory Document*, which accompanies the second draft of the FSR Bill as well as this discussion document, also discusses the ombuds arrangements in some detail.

7

Strengthening financial literacy and capability

Financial education and awareness programmes aim to reduce information asymmetries between financial institutions and ordinary customers. Improving financial literacy and capability forms part of a wider policy approach toward market conduct regulation and supervision and the protection of individual consumers against abusive practices in the financial services industry. Various government departments and institutions have already been given mandates related to financial education, and the National Consumer Financial Education (NCFE) Committee was established in 2012 to foster coordination and consistency between stakeholders.

Poor practices and customer outcomes in the financial services industry, highlighted throughout this document, have added a sense of urgency to the need to strengthen customer financial education, literacy and capability. One of the core objectives of the FSCA provided in the FSR Bill is consequently:

> "providing financial customers and potential financial customers with financial education programs, and otherwise promoting financial literacy and financial capability."|

Box 7.1 – Defining customer financial education, literacy and capability

The OECD defines consumer **financial education** as the process by which financial consumers/investors improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being.

Financial literacy is defined as people's ability to understand finance and financial services thereby allowing them to make informed and effective decisions about their financial matters. It includes people taking part in economic life, making the most of life's opportunities and enabling them to lead fulfilling and happy lives.

Financial capability is defined as people's knowledge and skills to understand their own financial circumstances, along with the motivation to take action. Financially capable consumers plan ahead, find and use information, know when to seek advice and can understand and act on this advice, leading to greater participation in the financial services market". Financial capability is a broader concept than financial literacy.

The backdrop: the National Consumer Financial Education (NCFE) Strategy

Financial consumer education is one of the critical components of a comprehensive solution for protecting consumers of financial services. Consumers who are financially literate and financially capable are relatively less vulnerable to poor conduct practises than those who are not. In support of this, the objectives of the NCFE strategy are to provide a framework for collaboration and co-ordination of financial sector stakeholders in consumer financial education; and to provide data and measurement of financial education programmes and determine whether strategy and programme objectives are being achieved[40].

The strategy seeks to improve consumers' financial well-being by improving their financial literacy in the dimensions of financial control, financial planning, product choice and financial knowledge. It aims to help consumers to:

- Understand financial management and thus take good decisions that are tailored to their personal circumstances
- Monitor the market conduct of financial institutions through their decisions and use of recourse facilities
- Manage their ever-increasing responsibilities as a result of the growing complexity of financial products and the transfer of financial risk to consumers
- Know where to look for important information, objective advice or access to recourse facilities

The achievement of these objectives rests on four principles:

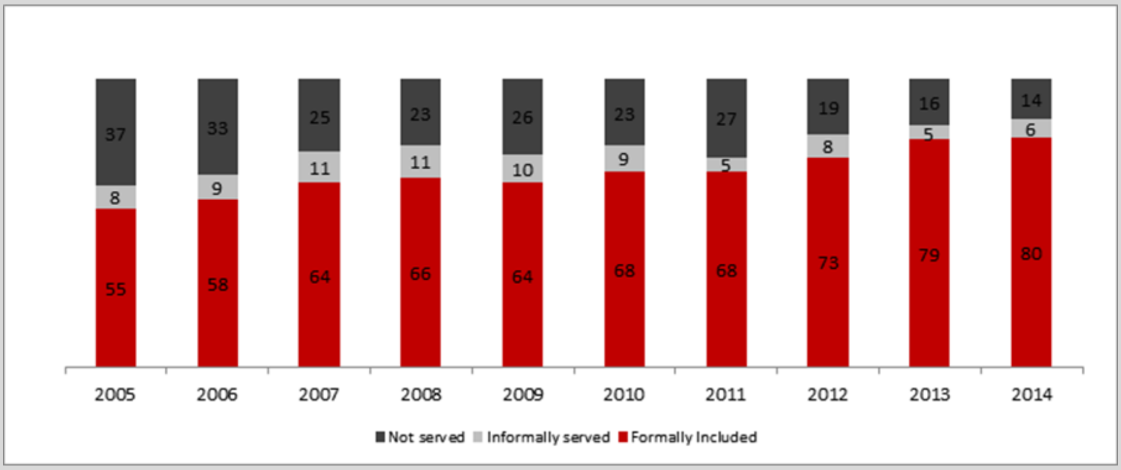
- **Consumer financial education is part of a wider market conduct and customer protection policy approach**. It is not seen as a substitute for effective customer protection and market conduct regulation. Instead it should be taken into account in the broader customer protection and market conduct regulatory framework, including the regulation of financial information and advice. In this vein, Box 7.2 considers the interface between conduct, literacy and financial inclusion, specifically the importance of strong market conduct oversight and financial education programmes in an environment of increasing inclusion.

[40]The document can be found at: http://www.fsb.co.za.

Box 7.2 –Financial inclusion in South Africa

It is important to pay close attention to market conduct when broadening access to financial services, as the previously un-served segment of the market may be especially vulnerable to market conduct abuses.

Financial Inclusion Landscape (% adult South Africans)



Source: FinScope SA Survey

FinScope data shows that in 2013, 79% of the 36 million South Africans participated in the financial sector, up from 55% in 2005. Factors that have contributed to this improvement include the introduction of the Mzansi basic bank account in 2004, the rapid increase in unsecured lending, technological innovation in the provision of financial services, as well as the implementation of the new system of distributing social grants via a bank account rather than cash disbursements to beneficiaries. New and innovative access channels support financial inclusion, but tend to bring new conduct risk, especially as these channels frequently lie beyond the reach of traditional market conduct regulation.

Financial Product Usage Levels (% adults using a particular service)

	2009	2010	2011	2012	2013	2014
Transactional account	54	64	62	67	75	75
Insurance	45	40	34	30	38	38
Credit active consumers	55	55	57	56	55	55
Savings	20	24	24	22	21	20

Source: FinScope Survey and NCR credit market report (2009 to 2014)

Product usage data suggests that financial inclusion efforts have stalled, and that there is little movement across the products. This is itself concerning, as international evidence has shown that a positive customer experience in one market segment motivates the customer to try other products. That this is not happening in South Africa suggests possibly that transactional banking customers are just too poor to migrate onto a full product suite, that financial education programmes may not be bridging the knowledge divide, or that the customer experience is so negative customers are reluctant to try new products or service.

Issues for policymakers to consider include:

- How can more and better products be provided to the consumers?
- How can better products be provided for small businesses?
- How can costs be reduced in providing access to products and services?
- Is the financial sector open to the financial needs of the youth?
- Is there enough being done to develop human capital and up-skill in the sector itself?

- **Consumer financial education is a shared responsibility among many stakeholders** who all have a powerful and legitimate role to play: government, schools, financial institutions, industry associations, employers, trade unions, community organisations, and NGOs. A centrally coordinated committee – the National Consumer Financial Education Committee – is required to secure the active involvement of all such stakeholders and reduce fragmentation in different approaches
- The achievement of consumer financial education **requires a broad public national consumer financial education strategy** and associated tools and programmes. The national strategy strives to establish high-level guidance for stakeholders' consumer financial education strategies. Since the resources available for consumer financial education are limited, the national strategy should be risk-based, i.e., it should focus on high-priority issues.
- **Consumer financial education has a common focus and direction for a wide group of consumer education initiatives.** National strategy developed will not attempt to replace existing consumer education interventions or even suggest less emphasis be placed on such interventions. Rather they aim to leverage current resources by encouraging their alignment with a national strategy.

To date, various government departments and institutions have been given mandates to promote and/or implement financial education programmes for consumers. These include the FSB, the NCR, the FSOS Council, the National Consumer Commission and the dti. The FSB for example has a dedicated Consumer Education Department which provides and promotes financial education in two targeted areas, - through educational institutions in the formal education system, and through community education initiatives. A variety of methods are used in targeting financial customers and potential financial customers, including workshops, developing educational and informative material, exhibitions, training programmes, and developing a dedicated consumer education website.

Given the number of agencies involved, and the potential for fragmentation, the NCFE Committee was established in 2012 to foster coordination and consistency across these programmes. This committee is mandated to:

- Develop the NCFE strategy including defining target groups; using a risk-based approach to decide which target groups to focus on; and setting up appropriate action plans and key performance indicators indicating comparisons to international standards to measure achievement
- Oversee the implementation of the strategy by monitoring performance
- Review the NCFE strategy on an annual basis to ensure its relevance and effectiveness

Key to crafting the strategy and monitoring its implementation is the South African financial literacy baseline study, first completed in 2010, which provides guidance on priorities and targets and enables the assessment over time of whether consumer financial education objectives are being achieved.

The baseline study focuses on four domains: financial control, financial planning, product choice, and financial knowledge and understanding. These terms are defined in Box 7.3. The study is updated annually to evaluate improvements (or otherwise) in financial literacy levels in South Africa. The total overall score observed for South Africa in the 2011/2012 baseline study was, as expected, decidedly low at 54, which is the average of the four domains, namely 58 for financial control, 53 for financial planning, 45 for product choice and 56 for financial knowledge. The Committee is tasked with raising these scores, and developed the NCFE Strategy in July 2013 with strategic objectives, as explained above, aligned to the baseline line study.

Box 7.3 – Financial literacy baseline study measurements

- **Financial control – managing current expenditure**

  Financially capable consumers (i) exercise a high level of control and restraint over their finances; (ii) save rather than spend money; (iii) live in a household that budgets; (iv) are able to make ends meet and; (v) are involved in daily household financial decision-making.
- **Financial planning – managing future income and expenditure**

  Consumers who do financial planning (i) set financial goals and commit to meeting them (ii) prefer to save for the long-term and (iii) have emergency funds in place.
- **Product choice – choosing the right financial product**

  Consumers who make good product choices have: (i) a broad awareness of different types of bank, loan, savings, investment, and insurance products; (ii) a clear understanding of their product needs and undertake detailed research before choosing a product and (iii) no regrets about recent financial product decisions and who have not taken an unsuitable product in the past.
- **Financial knowledge and understanding**

  Consumers with good financial knowledge and understanding are familiar with most or all of the following basic concepts: basic mathematical division, effects of inflation, interest paid on loans, interest on deposits, compound interest, risk of high return investments, effects of inflation on cost of living and risk diversification.

Priority target groups for consumer financial education programmes and initiatives were derived from the baseline studies, based on scores that were below the national average for various dimensions such as age, race, gender, education levels and location. For instance, the study identified the aged (70 years and older) as highly vulnerable with regard to financial knowledge. While this group had higher than average financial control and financial planning domain scores, it scored lower than average on product choice and financial knowledge. These results infer that this group is more likely to make poor decisions about financial products and services, rendering them more vulnerable to scams and fraud. Given the vulnerability of this group, it is necessary to incorporate them into financial consumer education programmes with a focus on financial knowledge and correct product choice.

The baseline study includes South Africans from the age of 16. As a result children below the age of 16 are not prioritised in national strategy. However, it is recognised that consumer financial education should start at school, as South Africans should be educated about financial matters as early as possible in their lives. To this end, the committee is working on embedding financial literacy in the school curriculum.

Since the inaugural baseline study in 2010, two full studies were conducted in June 2011 and June 2012, and a smaller checkpoint study in 2013. There was relatively little change in overall financial literacy over this short period, although the financial planning domain has shown a distinct, moderate downward tendency with each successive round of measurement, which may be cause for some concern. This aspect of financial literacy relates to medium- to long-term provisioning, and a declining trend suggests increasing difficulties in terms of savings. The results also showed changes in attitude, with a fall in the share of South Africans who are able to set and actively pursue long-term financial goals. There is also an early indication that financial knowledge has begun to fall, with an increase in those who fail to demonstrate an understanding of basic financial concepts such as inflation, interest rates, and compound interest.

Given the importance of financial literacy in ensuring that South Africans exhibit the kind of behaviour and make the kind of choices and decisions that will ultimately promote their financial well-being, it is critical that the annual monitoring of developments relating to the core indicators continues. This in turn will assist us in tailoring existing and future programmes according to needs and behaviour.

How private sector financial literacy initiatives are expected to be funded[41]

Funding for consumer financial education initiatives will likely come from various sources, including as an outcome of the Financial Sector Code. The Financial Sector Code was gazetted as a sector code in terms of the Broad-Based Black Economic Empowerment Act, on 26 November 2012. The origins of the Code are the Financial Sector Charter, a voluntary transformation charter implemented through the Financial Sector Charter Council. It came into effect in January 2004 as a result of agreements reached at the NEDLAC Financial Sector Summit in August 2002.

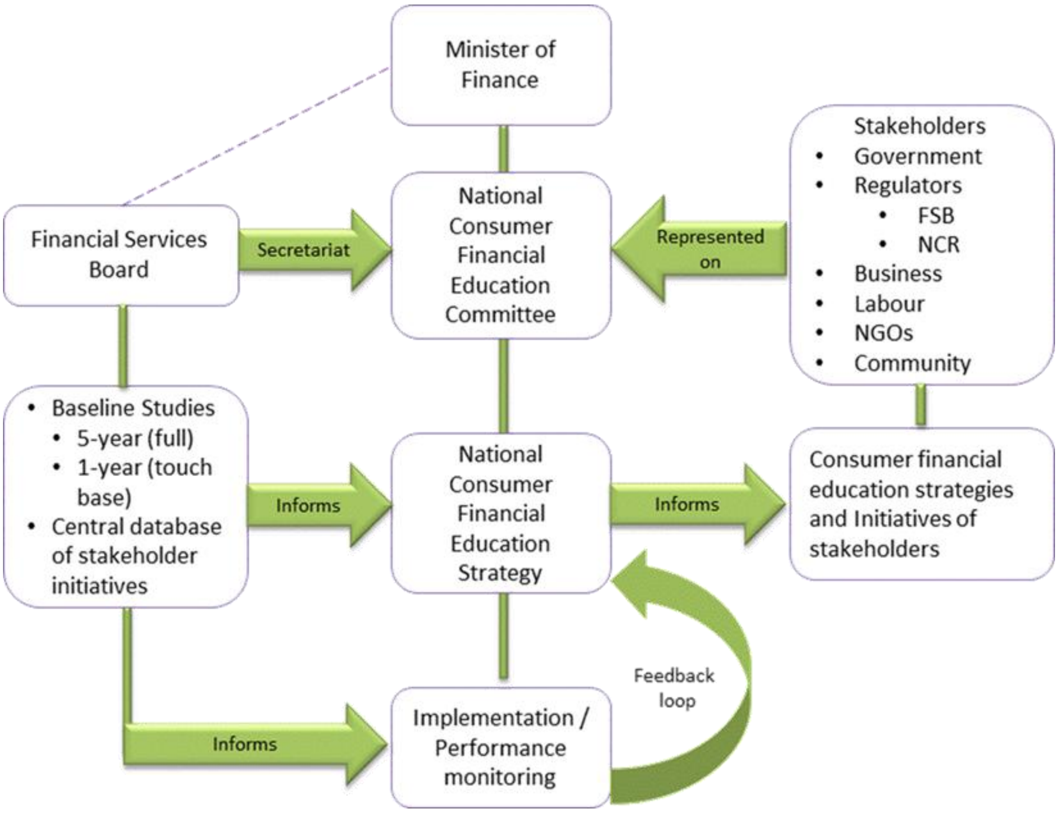
The Financial Sector Code provides for all financial services firms to apply 0.30% in 2013 and 0.40% in 2014 of their net profit after tax from retail business to consumer financial education.

Governance and performance monitoring of the financial literacy strategy

The NCFE Committee is chaired by the National Treasury and reports to the Minister of Finance. The FSB serves as secretariat. It develops and maintains the central database to which stakeholders capture their education initiatives and oversees the baseline studies (Figure 7.1). This responsibility will be taken over by the FSCA in due course.

[41] Consumer education initiatives currently undertaken by the FSB are funded through the FSB discretionary fund. Enforcement penalties and fines levied against financial services providers for contraventions are paid into the discretionary fund and this is dedicated to funding consumer education and protection initiatives. In addition the FSB was, by virtue of a deed of Trust dated 29th October 2004, the Founder of the Financial Services Consumer Education Foundation. The Foundation raises funding for consumer education initiatives, is supported by financial service providers and offers tax benefits to donors.

Figure 7.1 – Governance of the national financial literacy strategy



In terms of the Committee's governance system, stakeholders:

- Develop and implement individual consumer financial education strategies that are in line with national strategy
- Capture the consumer financial education programmes and initiatives they have undertaken to the central database to enable the performance monitoring of national strategy.

The baseline study will be repeated every five years with a touch-base assessment every year. The results of the studies together with the information on the central database of stakeholder initiatives will inform the crafting of the strategy, its annual review and the monitoring of its implementation.

In practise, the individual financial education strategies implemented by stakeholders comprise a wide variety of delivery channels, tailored to meet the needs of specific target audiences. This could include initiatives to reach specific age groups, or specific geographic areas (urban versus rural). The overarching national strategy then provides a useful mechanism against which such methods can be assessed and benchmarked. Internationally, similar efforts are underway to develop and assess the most suitable channels of delivery of financial education initiatives. Appendix 2 provides useful examples in this regard.

Strengthened civil advocacy for financial customers

Financial literacy and education aims to ensure better empowered financial customers. In addition to stakeholders such as the FSCA, organs of state and the financial services sector, civil society advocacy groups can also play a strong role in better empowering customers and potential customers. Consumer rights bodies are a common feature across many industries, including the financial services sector. Such bodies provide an independent voice for customer interests and in some instances try to reduce information asymmetries between powerful institutions and their target market through education and literacy initiatives.

An independent advocacy agency in South Africa with a financial literacy mandate could have many benefits. Such an agency would be empowered to drive financial literacy more strongly, as this would be its sole mandate. It would be likely to react quickly to emerging customer trends that need to be addressed – for example, running an awareness campaign on poor lending practices of financial institutions, and driving stronger education around this topic. The agency would be able to maintain close links to other financial customer interest groups, and is likely to be able to tailor its approach to financial literacy in a more efficient way than a regulator would be able to. It would extend the achievement of financial literacy beyond regulatory measures, although coordination and cooperation measures could also be put in place to ensure it operates within the broad regulatory architecture for financial services, without hampering its independence.

The UK has taken the approach of establishing a standalone financial literacy agency, funded through industry levies. The agency, the Money Advice Service, has been successful in creating awareness among the public about its role, and in providing advice to consumers facing financial difficulty. It is increasing its focus on providing general financial information to consumers to prevent financial difficulties from arising. Similar options may be explored in South Africa.

Way forward

The NCFE and other agencies currently working on financial education initiatives will explore how best to merge and co-ordinate activities, learn from practical experiences of those involved, and to expand participation to all key stakeholders. The task of educating financial customers is a challenging one, even where there are pooled resources. Innovative mechanisms should also be further explored, including the use of social media and digital platforms.

8

Enhancing the efficiency and integrity of the financial markets

The FSCA will be responsible for ensuring financial markets are fair and efficient and that market integrity is enhanced. Two options are being considered for exercising this mandate under a revised legal framework – incorporating market integrity requirements into the proposed conduct law, or designing a complementary but separate integrity framework alongside a focused conduct of business framework.

Financial markets play a critical role in mobilising savings towards investment in households, businesses and government. They channel capital from those who can supply it to those who need it, supporting sustained growth and development. In addition to raising capital, individuals and entities also use the financial markets to manage their risk and invest their savings. This happens – whether directly through trading on a market or indirectly through another investment product like a CIS – through the listed and unlisted debt and equity markets, including the spot and derivatives markets.

Financial markets, also known as capital or securities markets, comprise market infrastructures[42] and related securities services (including that of trading, clearing and settlement), the provision of intermediary services (like brokering or standing as nominee for an investor) and market users (namely investors, be it on their own account or on the account of others).[43] In considering these three categories of market participation, the last category of investors should be protected through the appropriate regulation of the first two categories - market infrastructure and the provision of securities services, including securities intermediation. Investors should also be protected in their dealings with each other.

[42] IOSCO defines a financial market infrastructure as a multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives, or other financial transactions. Consistent with IOSCO, South Africa's FMA defines a market infrastructure to include: an exchange, a clearing house, a central securities depository and a trade repository.

[43] National Treasury policy documents prepared in support of the FMA in 2012, http://www.treasury.gov.za/legislation/bills/2012/FMB/

Broadly speaking, this is achieved by regulation that seeks to achieve financial market integrity. Under the twin peaks model, the close relationship between investor and customer protection means that the responsibility for ensuring financial market integrity is being given to the FSCA. An important consideration is how this mandate will be implemented alongside the conduct of business framework being developed.

Financial markets should not unduly favour some market users over others. In particular, regulation should ensure the highest practicable levels of transparency and efficiency, and should ensure that investors are given fair access to market facilities, market information and price information[44]. Regulation should also detect, deter and penalise market manipulation and other unfair trading practices, and should be based on the following principles to underpin market integrity:

- Regulated entities should have a sound and effective corporate governance structure in place
- Internal controls of regulated entities should be documented and adhered to and be subject to review as part of the risk management function
- Disclosure and transparency should facilitate better understanding by consumers
- Entities must have a sound legal and accounting system in place
- A body of professional accountants, auditors and lawyers should be developed to assist in market integrity regulation
- The regulator should be independent and not prone to political interference in the carrying out of its mandate
- An efficient fit and proper vetting mechanism of key individuals and officers of regulated entities
- An effective enforcement regime
- An efficient judicial system for the criminal prosecution of infractions of integrity-related laws
- An effective whistleblowing program

The existing financial market regulatory framework

In South Africa, financial market integrity is promoted through the Financial Markets Act of 2012 (FMA) and the Credit Ratings Services Act of 2012 (CRS Act).[45] These laws generally

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[44] Transparency may be defined as the degree to which information about trading (both for pre-trade and post-trade information) is made publicly available on as close to a real-time basis as is practicable for the characteristics and liquidity of the market/product. Pre-trade information concerns the posting of firm bids and offers as a means to enable investors to know, with some degree of certainty, whether and at what prices they can transact. Post-trade information is related to the prices and the volume of all individual transactions actually concluded. Efficiency on the other hand requires that the dissemination of relevant information is timely and widespread and is reflected in the price formation process. Transparency and efficiency, through the promotion of liquidity, can therefore be mutually reinforcing.

[45] The National Payments Systems Act provides for the management, administration, operation, and (to a lesser extent) regulation and supervision of payment, clearing and settlement systems, including a wide variety of payment channels, like debit cards, cheques, EFTs, and participants, which include licensed institutions such as banks, non-regulated payment services providers such as online websites, and non-banks such as retailers.

Due to the systemic importance of the payments system, the market integrity of the system is key to managing stability risk. Supervising the integrity elements of the payment system is therefore most appropriately located under the domain of the new PA and the Reserve Bank. Where aspects of the payment system, such as payment services and its interface with payment system operators, impact on financial customers, the FSCA will have a role to play through it conduct of business mandate.

apply a combination of stability, prudential and market conduct regulatory requirements in support of market integrity and confidence.

Financial Markets Act (FMA)

The FMA is a relatively new piece of legislation for regulating the financial sector, enacted in 2013 to replace the Securities Services Act of 2004. It aims to achieve markets that are fair,[46] efficient and transparent. Fairness in the trading environment is important to support price formation and curb market abuse practices like insider trading and front-running[47].

As discussed above, markets that are fair and efficient are typically described as having integrity. Fair and efficient markets help ensure that those who trade in them can do so with confidence. Regulation for market integrity typically involves setting and enforcing rules governing disclosure and price formation, rules promoting orderly and efficient trading, rules to avoid market abuse, and rules for supervising the operation of exchanges and market infrastructure.

To achieve this objective, the FMA applies standards consistent with the IOSCO Objectives and Principles of Securities Regulation[48]. These include principles relating to a strong, independent and accountable regulator, principles for good governance for models of industry "self-regulation" (explained below), principles for secondary markets that promote liquidity and stability, and principles relating to specific categories of regulated person including issuers and market intermediaries, dealing with issues like good governance, transparency and fairness.

Besides setting minimum standards for efficient price formation, through for example requirements governing a listed company's prospectus and trading rules for bond, equities and other listed or over-the-counter (OTC) instruments, the FMA also sets standards to maintain financial stability through robust and reliable trading, clearing and settlement systems.

The law provides for a self-regulatory organisation or "SRO" approach to regulation. This means that the market infrastructure – namely the Johannesburg Stock Exchange (JSE) and Strate – set, monitor and enforce regulatory standards for their members, and authorise participants, on behalf of and under the stewardship of the FSB.

The FMA seeks to increase confidence in the South African financial markets by requiring that securities services be provided in a fair, efficient and transparent manner; and by contributing to the maintenance of a stable financial market environment. The Act also promotes the protection of regulated persons, clients and investors who invest in listed securities on a regulated market against three forms of market abuse: insider trading, market manipulation, and false and misleading reporting.

The FMA introduced provisions that align the regulation of securities services in the South African financial markets with international best practices. These provisions strengthen the

[46] "Fairness" in the financial markets has a different meaning to when the term is applied in conduct of business. In the financial market context it refers to investors, when buying and selling securities, having access to the same information at the same time, so that they may assess the risk-weighted value of that asset. Investors who have more information than others will have an unfair advantage, and can unfairly "game" the system.

[47] Orders by a financial services provider on a security for its own account while taking advantage of advance knowledge of pending orders from its customers

[48] https://www.**iosco**.org/library/pubdocs/pdf/**IOSCO**PD154.pdf

principles of investor protection, monitoring systemic risk, and managing conflicts of interest in respect of the regulatory and business functions of market infrastructures.

In line with the recommendations of the G20, the FMA also makes provision for the regulation of the previously unregulated over-the-counter (OTC) derivatives markets. Draft Ministerial regulations prescribed in terms of the FMA in 2014 extend the scope of application of regulation to unlisted securities, in particular the OTC derivatives market, and include provision for the authorisation of central clearing counterparties as well as trade repositories.

Key projects taking place currently include: reviewing the SRO model of regulation; reform of the OTC derivatives markets; improved transparency in the government bond market; regularising the affairs of all unlicensed exchanges; and the global legal entity identifier update. An additional project being considered on the advice of a recent IMF Financial Sector Assessment Program (more commonly referred to as the FSAP), is to review requirements for the unlisted investment sector.

Credit Rating Services (CRS) Act

Fair and reliable credit ratings are important to the integrity of the financial system, assisting financial institutions to understand the credit risk associated with the range of financial products that they invest or trade in. The CRS Act seeks to give effect to G20 and IOSCO recommendations that credit rating agencies should be subject to regulatory oversight, including registration and ongoing supervision.

Given the role that credit rating agencies tend to play in a financial institution’s monitoring and mitigation of credit risk, strong regulatory oversight is necessary to ensure that all persons performing credit rating services are registered and adhere to the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies. The Code is based on the following principles:

- The quality and integrity of the rating process
- The independence of the credit rating agency and the avoidance of conflicts of interest
- Responsibilities to the investing public and issuers

This implies that credit rating agencies are held to strict standards when issuing credit ratings, and may be subject to strong enforcement action taken against breaches, including suspension or deregistration. In particular, these organisations should be required to introduce governance arrangements that support fair, unbiased and accurate ratings, which as far as possible reasonably estimate the risk associated with the entity or activity being rated.

Market integrity within the revised conduct framework

As the twin peaks reform progresses and the legislation in respect of conduct of business is streamlined and consolidated, a key question is how to accommodate the similarly evolving market integrity framework. Two options are being explored:

Option 1

Combine the conduct of business and financial market integrity elements of existing laws into a single piece of legislation – the CoFI Act.

Advantages

This option achieves maximum harmonisation by reducing the risk of diverging approaches across separate Acts, and readily facilitates a single, activity-based licence for all elements of market conduct.

Option 2

Combine the conduct of business elements of the current laws into the CoFI Act, and the market integrity elements of the current laws into a separate Act. In effect, this would mean retaining the current FMA and integrating provisions of the CRS Act into the FMA. This option could also be considered as a transitional option, pending a longer term shift to Option 1.

Advantages

This option avoids the complexity of integrating laws intended for very different purposes, and provides time for the structural reviews of the SRO model to take place (discussed in box 8.1 below). It will allow regulatory resources to focus on implementing the new FSR Bill, the proposed CoFI Act, as well as the 2013 FMA and CRS Acts.

Considerable work needs to be done to better understand the implications, costs and benefits of these alternative approaches. Such work should be guided by lessons learnt over Phase 1 of implementation of the twin peaks model i.e. establishing the FSCA.

Box 8.1 – Reviewing the SRO model

South Africa's SRO model introduces additional complexity to the law reform programme underway. Under this model a number of regulatory functions are divested to the SROs - including licensing of their members, issuing rules and directives, performing market surveillance, and conducting investigations into alleged regulatory breaches - and it remains to be resolved how exactly SROs will be positioned under the twin peak authorities. In Phase 1 the role of the Registrar of Securities Services will be replaced by the FSCA and PA, with the FSCA as licensing authority.

Although subject to substantial fiduciary and reporting requirements, the aspect of SRO operations that is receiving on-going international and local attention, is the management of actual and perceived conflicts of interest within an SRO, particularly conflicts between its commercial and regulatory functions. The nature of the conflicts of interest encountered within SROs and the mechanisms with which SROs have dealt with those conflicts are diverse. They depend on aspects such as the individual characteristics of the SRO, its business focus and operations, its corporate governance structure, the composition of its shareholders, the nature and intensity of oversight by its regulator and the regulatory duties entrusted to it.

In South Africa, provisions dealing with conflicts of interest have been included in the FMA particularly in respect of the market infrastructure which is now required to take the necessary steps to avoid, eliminate, disclose and manage possible conflicts of interest between its regulatory functions and commercial interests. This includes implementing appropriate arrangements which must comply with the requirements prescribed by the registrar, be documented and be publicly available. The market infrastructure is also required to conduct an annual assessment of these arrangements, the results of which must be published.

Globally, pressures on self-regulatory frameworks have increased and the value of self-regulation is being debated anew. Forces such as commercialisation of exchanges, development of stronger statutory regulatory authorities, consolidation of financial services industry regulatory bodies, and globalisation of capital markets are affecting the scope and effectiveness of SROs, and in particular the traditional role of securities exchanges as SROs. In addition, the effectiveness of all financial regulatory systems is being re-examined in the aftermath of the international financial crisis of 2008 - 09. The crisis has again put issues of governance of both regulators and financial intermediaries at the forefront. There has been a reduced reliance on SROs (especially in Europe) and exchange SROs' roles are being cut back due to conflicts.

There is currently an initiative underway to review the SRO model of regulation in South Africa, to inform the scope of regulation of market infrastructures going forward, and with a firm intention of more robust and intrusive supervision by the regulators. Preliminary lessons learnt suggest that a complete reversal of the SRO model, with the statutory regulators assuming all the regulatory and supervisory functions, may not be feasible at this stage, with capacity constraints possibly bringing detrimental effects to the markets. Consideration is being given to the relative "power" of supervision between the statutory regulators and SROs, exploring which powers should be drawn back to the statutory authorities over time.

9

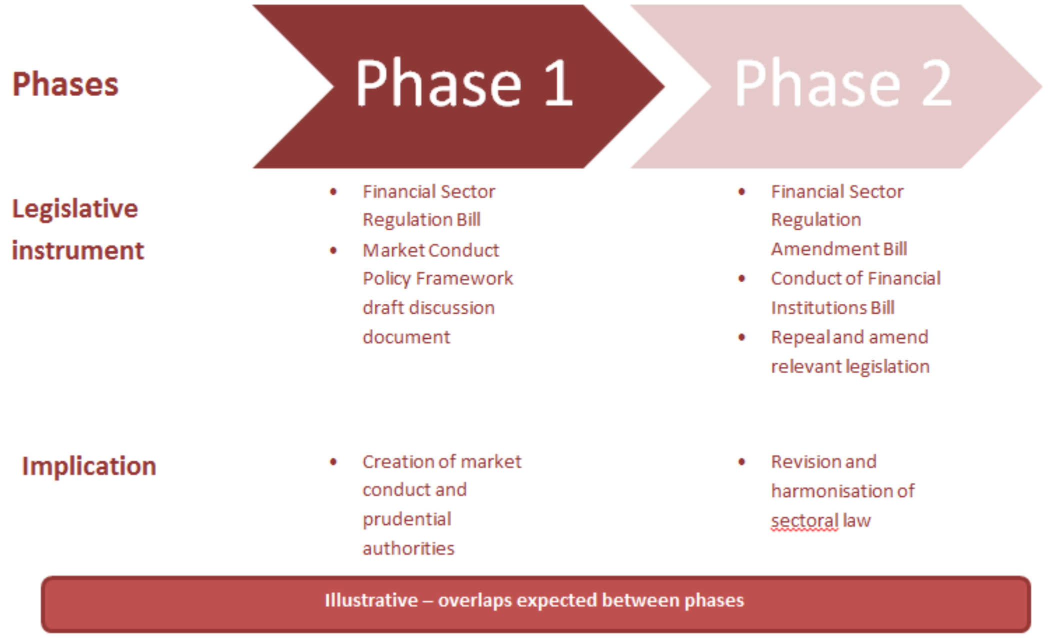
Implementation of the new regulatory framework

This chapter provides an overview of the implementation process and timeframes for the new framework. The guiding principle is that the implementation of the new regulatory framework should maximise regulatory effect while minimising market disruption. The chapter concludes by considering some of the consequences of proposals set out earlier in this paper, for regulated entities.

A phased implementation plan

The implementation plan to bring the new market conduct regulatory framework into effect involves the following phases:

Figure 9.1 –Phased implementation plan



Phase 1

The first phase is focused on finalising and enacting the FSR Bill. In this phase, existing primary sectoral laws, including the Banks Act, Long-term and Short-term Insurance Acts, Pension Funds Act, Collective Investment Schemes Act, Financial Markets Act, Credit Rating Services Act and FAIS Act, will remain largely unchanged; they will simply "plug" into the new organisational arrangements of the Reserve Bank, PA and FSCA. What this means in practice is that:

- The FSB will be dissolved and replaced by the FSCA, with a significant shift in mandated functions and powers
- The FSCA and PA will be arranged to reflect their respective mandates. This is likely to include a transfer of resources from and between the current FSB and Reserve Bank structures. The new authorities will be given requisite supervisory and enforcement powers to carry out their respective mandates through the FSR Bill.
- The FSCA and the PA will become the licensing authorities for the current Acts as appropriate, replacing the existing Registrars. For example, the responsibility for licensing banks and insurers (in those capacities) under the Banks Act and Insurance Acts will shift from the Registrar of Banks and Registrar of Insurance to the Prudential Authority. For most other pieces of legislation, the primary responsibility for licensing and authorisation lies with the FSCA.
- Entities that are already licensed will not need to apply for a new license in Phase 1. Licenses will merely shift to being administered by a new licensing authority (either the PA or FSCA). Any new licenses will still be issued under sectoral law, and will be issued by the relevant licensing authority (being the PA for insurers and banks and the FSCA for most other entities). There will be a consultation process between the authorities before a new license is issued, with no new licences issued unless and until both authorities are satisfied that the licence may be granted.
- The FSR Bill delinks the post-licensing powers of the authorities from the licensing process. This means that once a financial institution is licensed, *both* authorities will be able to apply their powers to a licensed entity, regardless of which authority issues or administers the license. So, the FSCA will be able to apply conduct standards on entities licensed by the PA (and vice versa).

Phase 2

The second phase of the implementation process will be focused on revising and consolidating the regulatory and supervisory components of the sectoral laws. Ultimately, the various market conduct and market integrity provisions in current sector laws will be repealed, and replaced with more streamlined, consistent overarching conduct legislation – the CoFI Act and any other relevant Acts as proposed in this document.

In the case of market conduct this is intended to:

- Ensure regulatory harmonisation, completeness and consistency across market segments and regulated activities
- Recognise the cross-cutting product development, distribution and customer bases that characterise a modern and sophisticated financial services sector
- Ensure that the new FSCA has the full and complete legal basis to satisfy its mandated responsibilities, including full implementation of the TCF framework.

From a licensing perspective, in the second phase all financial institutions will need to obtain a license from the FSCA, and a separate - additional - license from the PA if subject to prudential supervision. The FSCA license will authorise entities to carry out specified categories of regulated activities, for specified categories of customer.

Following the revision and consolidation of primary law, the focus will move to incrementally harmonising subordinate regulation for market conduct as the regulatory framework evolves and moves to a more standardised approach.

It is important to note that incremental changes can also be expected to continue to take place within the current framework, particularly in respect of the specific market conduct concerns and priority initiatives highlighted elsewhere in this paper. The intention will be that any such interim regulatory changes will be designed to transition as seamlessly as possible into the future overarching legislative architecture.

Impact of the proposed policy

Both regulated entities and financial customers have a strong interest in the way that this transition happens. Customers are looking for assurance that the new regulatory framework will lead to more appropriate products and services, sold in a more transparent manner, with better accountability by financial institutions should they suffer unfair treatment. Product and service providers seek assurance that the regulatory framework will be consolidated and rationalised to minimise complexity and avoid increasing their costs.

National Treasury recognises the potential challenges for the industry in transitioning to a new licensing and regulatory framework. To manage these challenges, it is proposed that the transition process for licensing in particular be mapped out in conjunction with the industry through consultation. More fundamentally perhaps, the FSCA will need to continually engage financial sector providers and consumer groups to evolve an optimal, outcomes-focussed regulatory framework. Over time financial sector providers will in many instances need to make significant improvements to the culture of their company to ensure they treat customers more fairly.

Government and regulators will also have to balance different - and at times competing - objectives, to ensure that financial providers offer good value and appropriate products for their customers, while at the same time remaining financially sound and generating sufficient returns for their investors. Affordability is a key concern that needs to be addressed. However the factors that affect affordability are widespread and are not solely market conduct related. Affordability needs to be addressed holistically and an environment created that allows for fees and charges to be more affordable.[49] Government and business needs to work together to tackle these concerns.

Furthermore, in many instances prudential policy objectives and supervisory tools may be at odds with those for conduct policy. This is because prudential risk management aims to protect a firm’s balance sheet, whereas conduct risk management is a direct reference to the fair treatment of customers. Consider for example the pricing model for retail banks. A prudential regulator may have a bias toward “higher” pricing models that would support bank profitability and therefore the soundness of the financial institution and its sustainability. A conduct regulator, thinking first of the customer before the financial institution, will in the search for better value generally favour more benefits for lower prices. As policy objectives of prudence, conduct, efficiency and inclusion may at times conflict, the regulatory framework should to the

[49] Consideration may need to be given to other initiatives related to affordability. For example, in the short-term insurance sector factors such as compulsory third-party motor insurance, road safety, unlicensed vehicles and drivers, unroadworthy vehicles on the roads, road conditions, high levels of crime, cost of motor repairs and parts (which in instances are higher than the depreciated value of the vehicle) collectively impact affordability.

extent possible be agreed between both the prudential and market conduct regulators, and must support systemic financial stability.

Process and timelines for implementation

Comments will be taken on the proposed framework until 8 April 2015. This will be followed by an updated policy document, including a response matrix to comments received, and draft legislation supporting the proposed framework. It is anticipated that the market conduct policy framework, supported by draft legislation, will be submitted to Cabinet for approval and tabling to Parliament in 2016, with implementation to follow in 2017.

Public forums will be held in Johannesburg and Cape Town to explain the policy framework and support the comment process. National Treasury welcomes engagement with civil society, industry associations and other interested stakeholders during this comment period. A number of bilateral engagements will be set up in this regard.

Appendix 1: Conduct of business requirements issued in recent years

By no means exhaustive, the following list is intended to illustrate the nature of regulatory interventions undertaken by the FSB over recent years.

Long- and short-term insurance

A range of subordinate legislation has been introduced in the insurance sector, aimed at improving various aspects of conduct.

The amendments to the regulations in 2005 and 2009 to give effect the Statement of Intent signed between the Minister of Finance and the long-term insurance industry in December 2005 assisted in rectifying certain past unfair and unreasonable industry practices, promoted fair treatment of policyholders and, more particularly, ensured that contractual savings policies are likely to perform as policyholders have been led to expect in respect of the net returns (particularly in the context of early premium reduction or cessation and other causal events). The above was further enhanced by the Directive on multiple maximum causal event charges that may be deducted from contractual savings policies issued in 2013.

The Policy Holder Protection Rules, first introduced in 2001, were strengthened in 2011. The 2011 amendments set out clearer rules relating to the rejection of claims by insurers and clarified the time limitation and disclosures by insurers relating to legal proceeding by policyholders against insurers.

In 2014, the range of matters in respect of which PPRs may be made was extended to better facilitate the implementation of the TCF principles.

The Directive on outsourcing issued in 2012 has improved insurers' management of outsourced activities that may adversely affect their ability to manage risks and meet regulatory obligations, and has resulted in the avoidance, and where this is not possible the mitigation, of conflicts of interest between the insurance business of the insurer, the interests of policyholders or the business of the person that performs the outsourcing;

Binder Regulations also issued in 2012 that build on the Outsourcing Directive, have, improved insurers' management of outsourced activities in respect of certain outsourced activities, further increased the oversight and management of certain contractual arrangements in the interests of policyholders. Further proposed amendments to the Binder Regulations were published in 2014 to address emerging undesirable practices and regulatory gaps identified after the implementation of the Regulations.

In 2014 a draft Board Notice on the intended declaration of the practice of insurers charging policyholders a fee in addition to the premium (typically referred to as an "insurer fee"), as an undesirable practice or method of conducting business was published for comment.

In 2014 a draft Board Notice on the proposed governance and risk management framework for insurers was published for comment.

Other instruments issued addressed conduct risks such as poor market practises relating to fee payment and permissible charges, and proper marketing and communication practises in the sector

List of regulatory interventions:

- 2011 - Amendments to the Policyholder Protection Rules to regulate the rejection of claims by insurers;
- 2012 – Issuing of the Binder Regulations to regulate the outsourcing of binder functions by insurers;
- 2012 – General Directive on outsourcing by insurers;
- 2012 - Information Letters on market practices relating to the payment of fees;
- 2013 – General Directive on maximum causal event charges that may be deducted by insurers in respect of certain policies;
- 2013 – Draft Information Letter on advertisements, brochures or similar communications published for comment;
- 2014 – Information Letter on conducting of insurance business in respect of assistance and life policies through administration agreements (also referred to as co-administration, profit sharing or 80/20 agreements);
- 2014 – Extension of the matters in respect of which Policyholder Protection Rules may be made by the Registrar by the Financial Services Laws General Amendment Act;
- 2014 – Release of amendments to the Binder Regulations to address emerging undesirable practices and regulatory gaps identified post implementation of the Regulations in 2012
- 2014 – Draft Board Notice on the intended declaration of the practice whereby insurers charge policyholders a fee in addition to the premium (typically referred to as an "insurer fee"), as an undesirable practice or method of conducting business published for comment.
- 2014 - Draft Board Notice on the proposed governance and risk management framework for insurers published for comment.
- 2014 – Information Letter on the Key Findings of the Complaints Management Thematic Review
- 2014 - Second Draft Demarcation Regulations made under section 72(2b) of the LTIA and section 70(2b) of the STIA: Government Gazette No. 37598.

CIS

Instruments issued under the CISCA over the past five years have sought to improve governance and market practises in the sector. The FSB has issued board notices aimed at ensuring proper conditions of registration for schemes and adequate fit and proper requirements for managers. Recently, notices have been issued clarifying arrangements for third party portfolios, and setting out disclosure requirements and conduct requirements for managers of participation bond schemes. It is anticipated that further direction will be provided regarding marketing and advertising, as well as information disclosure, for CIS products.

List of amendments:

- 2010 – Notice 910 of 2010 – Conditions of registration and fit and proper requirements for managers of CISs;
- 2011 – Notice 778 of 2011 – Third party named portfolios – addressing the use of white labelling arrangements recognised as co-named portfolios or incubator portfolios. Co-named portfolios are required to bear the names of the manager and the FSPII that manages the portfolio;
- 2014 – Board Notice 65 of 2014 – Rules for the administration of participation bond schemes including disclosure requirements and prescribing conduct of managers of CIS in participation bonds;
- 2014 – Draft Marketing, Advertising and Information Disclosure Notice will be promulgated over the next two weeks.

Retirement funds

A dedicated programme focused on reforming the retirement fund industry is underway, as discussed in further detail in Chapter 5. Some improvements have already been introduced through existing law to drive better governance and conduct of retirement funds and thus better protect the interests of pensioners.

The amendment to Regulation 28, for example, sets out good governance principles for a fund and its board, including promoting the education of the board regarding retirement fund investment. A governance framework for trustees of retirement funds has also been introduced through subordinate legislation.

Amendments to the Pensions Fund Act itself in 2014 seek to ensure that all retirement funds in South Africa are registered, so that minimum skills and training for those managing the fund can be enforced. Amendments also relate to a stronger focus on adequate disclosure to members and beneficiaries of their rights and benefits. The regulator has also been empowered to stop the publication of misleading advertising and information related to retirement funds.

Work is also underway to clarify the role of administrators toward any fund and fund members placed under their administration.

Financial advisers and intermediaries

The FAIS Act introduced a principle-based approach to regulating market conduct, supported by rules pertaining to the functions of rendering advice or intermediary services in respect of financial products. It requires that providers must at all times render financial services with due skill, care and diligence and in the interests of clients and the integrity of the financial services industry.

This principle is supported by Codes of Conduct for financial services providers which are licenced and supervised by the FSB. These Codes of Conduct, together with the Act, set out minimum disclosure requirements, conflict of interest management, requirements around needs analysis and advice, operational ability, record taking, solvency and reporting amongst others.

The FAIS Act also introduced professionalism into the industry by requiring that all representatives and key individuals of financial service providers are appropriately “fit and proper”; this means that they should meet honesty and integrity requirements and also set out specific qualification and experience criteria The minimum qualifications required were introduced incrementally building to the full qualification requirement required today; these continue to evolve, as is described in Chapter 5.

To ensure that financial services providers also understand the requirements of the FAIS Act and the Codes of Conduct, the FSB required that all representatives and Key Individuals write regulatory exams which focussed on their obligations in terms of financial advice and intermediary services. The Act introduced the ability to debar persons from the industry should they prove no longer be fit and proper.[50]

List of amendments:

- Proposed amendment to definition of “intermediary services” and proposed deletion of exclusion of product suppliers from ambit of FAIS Act when selling their own products (published 2013 in ILAB);
- Conflict of interest prohibitions and requirements (published 2010)
- Prohibition of sign-on bonuses (published 2014)
- Fit and Proper Requirements – introduction of full qualification requirements, regulatory examinations , continuous professional development and more stringent soundness requirements (published 2008)
- Investigation of alternative delivery models for regulatory examinations (published 2013)

[50] The Act gives the responsibility and administrative powers to providers to ensure that the representatives they appoint are fit and proper, and consequently, the authority to debar them from the industry should they no longer meet the fit and proper criteria. There has been some abuse of this authority and the debarment rules are being enhanced to clearly set out the duties of financial services providers in this regard.

Appendix 2: Insights and lessons from other country approaches to market conduct

Poor conduct played a central role in the global financial crisis. Mortgage loans in the US were knowingly issued to households that could not afford to pay them back. The institutional market in turn supported the sustained funding of these reckless loans through a burgeoning but opaque and weakly regulated securitisation and OTC derivative market, and credit rating agencies continued to give the highest ratings for what ultimately proved to be toxic assets.

Shortcomings in the regulatory and supervisory frameworks of most jurisdictions, including across Asia, the US, the UK and Europe, meant that sizable conduct, prudential and stability risks went unnoticed for too long. Ultimately this exposed the global financial system, financial customers and governments to massive turbulence – from which the global economy is still recovering.

International standard setting bodies

The crisis highlighted how conduct weaknesses in the financial sector can cause severe economic hardship for the man on the street, and extend more broadly to impact on financial stability and economic growth. The G20-OECD Task Force on Financial Consumer Protection has been established to support the implementation of high-level principles including through proposing effective approaches towards implementation of such principles.[51]

[51] See www.oecd.org/finance/financial-education/g20-oecd-task-force-financial-consumer-protection.htm

Box A2.1– G20 principles on consumer protection in financial services

- Financial consumer protection should be an integral part of the legal, regulatory and supervisory framework
- Financial consumer protection must be within the responsibility of key oversight bodies
- Equitable and fair treatment of consumers is imperative at all stages of the relationship with financial services providers
- Disclosure and transparency is required from financial services providers and authorised agents
- Financial education and awareness should be promoted by all relevant stakeholders
- Responsible business conduct of financial services providers and authorised agents involves, as an objective, working in the best interest of customers and upholding financial consumer protection
- Institutions must protect consumer assets against fraud and misuse
- Institutions must protect consumer data and privacy by having appropriate control mechanisms in place
- Complaints handling and redress mechanisms should be in place
- Competition should be promoted

The G20 principles highlight at least three necessary elements for an effective market conduct framework – a strong legal and regulatory regime that emphasises fair customer treatment (with a focus on conduct of business), well-known, well-functioning dispute resolution procedures, and prioritising awareness and capability by financial customers through financial literacy initiatives.

Several international bodies have also provided sub-sector guidance to regulators and supervisors. In particular:

- IOSCO has published standards on point of sale disclosure, particularly in the context of CISs[52]
- The Joint Forum (comprising the Basel Committee on Bank Supervision or BCBS, IOSCO and IAIS) published recommendations regarding point of sale disclosure for investment and savings products across the insurance, banking and securities sectors
- The IAIS has published a set of core principles and standards for supervision of the insurance industry, which include specific standards on conduct of business and fair treatment of customers in the context of consumer protection[53]. A recent application paper on approaches to conduct of business supervision will guide debate and further inform policy development.[54]
- The BCBS has been active in contributing to consumer protection standards through cooperation with the international Financial Stability Board and the G20. It has also done so via its membership of the Joint Forum, a group of senior financial sector supervisors which contributes to the international regulatory agenda where risks exist across banking, insurance and CISs.
- The World Bank has published the *Good Practices for Financial Consumer Protection* which, based on international experience from different countries, lists good practices regarding institutional and legal frameworks, disclosure requirements, business practices, dispute resolution mechanisms and financial education in all main sectors of the financial

[52] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD310.pdf

[53] http://www.iaisweb.org/__temp/Principles_for_conduct_of_insurance_business.pdf

[54] Application Paper on Approaches to Conduct of Business Supervision, http://www.iaisweb.org/Supervisory-Material/Application-papers-763

market (banking, non-bank credit, insurance, securities and pensions).[55] The World Bank has conducted over 30 diagnostic reviews in developing and emerging economies based on the Good Practices.

- FinCoNet, an international organisation of supervisory authorities responsible for financial consumer protection, has published a report on supervisory tools for responsible lending practices in the consumer credit market.
- IOPS have published a range of principles, guidelines and good practice reports regarding the supervision of private pensions, including measures related to governance of funds, the use of investment vehicles, and good practices regarding the licensing and supervision approaches of regulators.
- The European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) published a Joint Committee report on guidelines for handling consumer complaints in the securities and banking sectors.

Table A2.1 highlights a selection of financial sector conduct issues and reform programmes underway worldwide. By no means exhaustive, the table nonetheless illustrates that countries across the globe share common conduct risks, recognise the need for active regulatory interventions, and are grappling with how best to achieve this.

A cross-country review of market conduct reform

South Africa can draw valuable lessons from the experiences of other countries undertaking market conduct reform, especially other twin peak jurisdictions. These lessons span: the scope and objectives of the market conduct regulator; licensing and authorisations; the setting of regulatory standards; outcomes based supervision; information gathering; and enforcement and administrative action.

Scope and objectives of the market conduct regulator

For regulatory certainty, it is important to clearly demarcate the regulatory perimeter. There are at least three considerations: whether there should be a dedicated consumer protection regulator for financial services; objectives for such an authority; and the stretch of its regulatory net (informed by the financial activity and intended customers of financial institutions).

Many countries reviewed here have concentrated regulatory powers for market conduct in a single authority – for example, the UK, Australia and the Netherlands.

In the UK, the scope of responsibility for the conduct agency is broad. The Financial Conduct Authority (FCA) is outcomes focused and has a primary objective to ensure that the financial sector functions well and in the interests of financial customers. Retail as well as wholesale customers are included.

[55]http://responsiblefinance.worldbank.org/~/media/GIAWB/FL/Documents/Misc/Good-practices-for-financial-consumer-protection.pdf

Table A2.1 – Conduct issues and reform programmes in other countries

Country	Conduct related issues/ reforms/ actions taken by regulators
Australia	**Pension funds:** 2011 reforms to make the pension system more efficient to maximise retirement income. A new, simple, low-cost, default pension product created **Intermediation:** Reforms undertaken (the Future of Financial Advice or "FoFA" reform) to improve trust and confidence of investors, and improve access to advice **Consumer credit:** regulatory guidance published in 2013 to improve compliance with responsible lending requirements. Action taken against non-compliant pay-day lenders in 2014
Canada	**Financial literacy:** Financial Literacy Leader was created to support initiatives that strengthen the financial literacy of Canadians. **Bank fees:** Investigation into bank fees and trends undertaken to address perception that high level of concentration in Canada's banking sector means the market is not as competitive as it could be **Consumer protection framework:** Government considering implementing a stronger consumer protection framework, underpinned by standards and principles, which is more adaptable to changes in the financial sector
The European Union	**Disclosure:** Draft regulations aimed at ensuring that providers of packaged retail and insurance-based investment products produce standardised information documents **Distribution:** Markets in Financial Instruments Directive II (MiFID II) issued to improve, among others, transparency and management of conflict of interests and inducements
India	**Intermediation:** Strict rules implemented to regulate the behaviour of financial professionals and investment advisers, to protect investors and eliminate mis-selling of financial products **Complaints management:** Comprehensive customer complaints management and reporting standards introduced. **Regulatory reform:** Proposed introduction of Financial Code, to ensure complete coverage of financial sector regulation and enhance consumer protection
Mexico	**Financial inclusion:** Focus on promoting access to financial services, including compelling banks to have a simple low cost account for low income customers. **Consumer protection:** Financial Services Transparency and Organisation Law sets minimum disclosure standards that financial institutions have to comply with when sending out statements **Regulatory reform:** 2014 financial sector reforms aim to strengthen the financial system by increasing transparency and consumer protection including creating new powers for the regulator and improving the dispute resolution system

The Netherlands	**Pension funds:** Reforms to ensure greater transparency in costs and charges **Credit insurance:** Addressing hidden charges in sale of Payment Protection Insurance (PPI)[56] **Pay day loans:** Fines imposed on unlicensed entities offering pay day loans **Life insurance:** 'Woekerpolis affair' highlighted excessively priced and complex life insurance policies **Investment services:** Inducements for investment firms banned
Philippines	**Consumer protection:** In May 2014, the central bank in the Philippines adopted the Financial Consumer Protection Framework, institutionalising consumer protection as an integral component of banking supervision in the country
Singapore	**Intermediation:** The Financial Advisory Industry Review ("FAIR") aims to enhance the standards of financial advice and improve efficiency in distributing life insurance and investment products
The UK	**Pension funds:** General reform underway; focus on better disclosure of costs and charges **Pay day loans:** Criticism of the industry for fuelling debt crisis **Debt collection:** Poor debt collection practices identified, including overcharging and sending false letters of demand **Intermediation:** Retail Distribution Review addressed shortcomings with remuneration models and disclosure in the retail investment market **Credit insurance mis-selling:** Premiums excessively high and the product itself frequently mis-sold, resulting in a £22 billion redress. **Banking:** Banking Reform Act of 2013 aims to impose higher standards of conduct on the banking industry **Libor:** Following widespread manipulation of the London Interbank Offered Rate (Libor), a key reference interest rate, oversight was moved from the Banker's Association to UK regulators. Significant fines were imposed on banks found to have been involved. For example Barclays Bank was fined $360 million by the United States authorities and £59.5 million by the UK's Financial Services Authority. **Forex scandal**: Large currency trading banks colluded over a period of at least a decade to manipulate and rig daily foreign exchange rates. Fines totalling $1.7 billion were imposed by the UK's Financial Conduct Authority on five banks for failing to control business practices in their spot foreign exchange trading operations

The FCA's mandate spans business conduct, integrity of the financial system and promoting effective competition in the interests of consumers. It also regulates and supervises the financial soundness of financial institutions that do not pose a significant risk to the stability of

[56] Payment protection insurance – PPI - also known as credit insurance, credit protection insurance, or loan repayment insurance, is an insurance product (especially in the Netherlands and United Kingdom) that enables consumers to insure repayment of loans if the borrower dies, becomes ill or disabled, loses a job, or faces other circumstances that may prevent them from earning income to service the debt.

the financial sector (the Prudential Regulation Authority is responsible for prudential oversight of larger institutions whose failure may pose a systemic risk). From 1 April 2014 the FCA also took over responsibility for consumer credit regulation from the Office of Fair Trading.[57] On the same day, a Payment System Regulator was created as a subsidiary of the FCA.

Similar to the UK, the financial sector conduct authorities in Australia and the Netherlands have conduct of business and market integrity supervision mandates, covering the regulation and supervision of financial markets infrastructure and the provision of credit. These jurisdictions do not, however, have prudential oversight responsibilities as this falls under the mandate of separate financial sector authorities.

In Canada, the Financial Consumer Agency of Canada has a mandate to enforce compliance with federal conduct of business legislation and regulations, as well as voluntary codes of conduct and public commitments. It is also responsible for promoting greater financial literacy by informing consumers about their rights and responsibilities when dealing with financial entities and payment card network operators.

In some jurisdictions more than one authority may be responsible for market conduct. In the USA, for example, the Consumer Financial Protection Bureau (CFPB) is responsible for supervision of federal legislation related to conduct of business, while state authorities supervise relevant state legislation.

In the US, the CFPB protects consumers by carrying out federal consumer financial laws. Among other things, CFPB:

- Writes rules, supervises companies, and enforces federal consumer financial protection laws
- Restricts unfair, deceptive, or abusive acts or practices
- Handles consumer complaints
- Promotes financial education
- Conducts research on consumer behaviour
- Monitors financial markets for new risks to consumers
- Enforces laws that outlaw discrimination and other unfair treatment in consumer finance[58]

The CFPB is not responsible for market integrity matters. These responsibilities reside with the Securities and Exchange Commission.

Conduct supervision may not be the sole focus of financial sector regulators in other jurisdictions, but there is a notable trend toward stronger emphasis on consumer protection, even for authorities with more general mandates. In Peru, for example, market conduct supervision has been strengthened by establishing a new adjunct superintendence in market conduct and financial inclusion. This new department centrally supervises transparency and consumer protection. In India, the Reserve Bank has announced its intent to develop comprehensive consumer protection regulations and formulate a Charter of Customer Rights.

Indonesia introduced a new integrated regulator, the Financial Services Authority of Indonesia. Along with its prudential responsibility, the FSA has a specific consumer protection function and published the Financial Services Sector Consumer Protection Regulation in 2013.

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[57] This was done in order to ensure that the regulation of credit, which is a fundamental component of financial sector policy, is aligned with the rest of the sector. The OFT was reshaped into a dedicated competition authority.

[58] See http://www.consumerfinance.gov/the-bureau/.

Licensing and authorisations

Licensing is the process by which authorities register and grant permission to persons or entities involved directly or indirectly in the provision of financial products and services to customers. Conditions for granting licenses are usually based on specific criteria which aim to minimise the risk that a person or entity authorised to provide financial products and services, does so in a manner that harms the interests of users of those products or services.

Increasingly, jurisdictions require regulated entities to obtain a license or authorisation endorsed by the prudential regulator as well as the conduct regulator. The UK, Netherlands, Australia and Indonesia are examples of such countries. In the UK, a distinction is made between sole-regulated firms regulated only by the FCA, and dual-regulated firms that are regulated by the FCA for compliance with market conduct rules and by the PRA for prudential requirements. To become authorised, a dual-regulated firm must make a single application to the PRA, the lead regulator for all dual-regulated firms. The application is then assessed through a collaborative process between the PRA and FCA.[59]

Legacy licensing regimes have now generally given way to "authorisation" regimes, under which institutions are *authorised* to conduct specific types of regulated activities on conditions determined by the licensing authority – the so-called "activity-based" approach to licensing. This approach better captures the increasingly integrated nature of financial institutions, which provide a wide range of financial products and services under one roof, as well as for the larger number of non-financial institutions engaging in the provision of financial products and services. Examples of licensing activities are: authorisation of the provision of credit (considering compliance with disclosure requirements, marketing activities, or treating consumers fairly standard, among others). Other countries having adopted this approach include Singapore, which has an activity-based approach to licensing financial advisers.

Issuing subordinate regulation

Primary legislation enacted by Parliament can empower regulators with specialist expertise to issue subordinate regulation. The purpose of subordinate legislation is to set out in further detail specific legal conditions related to the primary law – for example, specific conditions for licensing – without needing to enact new primary legislation (for example a new Act) through a minister or similar member of government. International best practice principles (such as those referred to in IAIS ICP 1.2[60] and IOSCO Principle 2[61]) highlight the importance of providing regulators with this power, to ensure that regulatory authorities have a degree of operational independence and to minimise the risk of undue influence from the government.

The power to issue subordinate regulation is also important given the highly dynamic environment of financial markets driven by financial innovation. Thus, flexible regulatory intervention exercised within the limits set by primary legislation is crucial for well-functioning markets and effective supervision.

[59] See http://www.fca.org.uk/firms/about-authorisation/dual-regulated-firms.

[60] Refer to the Insurance Core Principles set by the International Association of Insurance Supervisors, available on the IAIS website (http://www.iaisweb.org). IAIS ICP 1.2 states "Primary legislation clearly defines the objectives of insurance supervision and the mandate and responsibilities of the supervisor and gives the supervisor adequate powers to conduct insurance supervision, including powers to issue and enforce rules by administrative means and take immediate action."

[61] Refer to the Objectives and Principles of Securities Regulation, published by the International Organisation of Securities Commissions, available on the IOSCO website, (http://www.iosco.org). IOSCO principle 2 states: "IOSCO principle 2: The regulator should be operationally independent and accountable in the exercise of its functions and powers"

Further policy issues that should be taken into consideration when issuing subordinate legislation – often done through setting standards – relate to: how to ensure regulatory effectiveness, minimising the potential for regulatory arbitrage, providing for proportionality and appropriateness, and transparency and accountability in how these standards are made.

Subordinate regulation in other jurisdictions has been developed to ensure regulatory effectiveness and empower the respective regulators to fulfil their mandates. In the UK, for example, the Financial Services Act of 2012 paved the way for the creation of the FCA and PRA, and specific conduct standards are laid out in the comprehensive FCA handbook.

Similarly, in the US, the CFPB has been granted wide regulatory powers to issue regulations for financial institutions to comply with[62]. The CFPB has issued regulations relating to mortgages, remittance transfers, and is working on rules related to debt collection.

Across other Twin Peaks jurisdictions, there is generally a defined set of conduct standards – whether set by the conduct regulator or other bodies – that is recognised as being applicable to all authorised institutions. Additionally, efforts are undertaken to avoid overlap or contradiction between new standards (and subordinate legislation) and existing legislation.

Outcomes based supervision

Until recently, market conduct regulators concentrated on setting conduct rules, periodically assessing financial institutions for compliance with these, and issuing fines for non-compliance. Rules were made in response to poor practices observed, which inevitably meant the regulator responded to poor conduct practices only after their relative prevalence. Moreover, institutions were only held to account once a rule was contravened, meaning that many customers had already suffered by the time of remedial regulatory action.

To remedy this weakness in the regulatory and supervisory approach, some jurisdictions have prioritised monitoring conduct risks on a continual basis, with closer scrutiny of those entities and sub-sectors that can pose the most harm to customers, in order to respond proactively to customer abuse before bad practices become endemic. These countries have also increased their attention to internal governance and risk management mechanisms of financial institutions, placing increased responsibility on the most senior leadership structure of an entity to set up the right customer centric processes for the organisation as a whole. Lastly, structural reform is increasingly being looked at as a remedial solution to mitigate conduct risk where it is observed.

In the UK, the FCA’s supervisory approach includes both reactive and pre-emptive elements. Supervision is broadly broken down into four areas:

- Diagnostic (identifying, assessing and measuring risks)
- Monitoring (tracking the development of identified risks as they arise)
- Preventive (mitigating identified risks)
- Remedial (responding to events ex-post)

The UK is also the best example of the increasing reliance by conduct regulators on principles complemented by rules - the FCA has published a regulatory handbook headlining 11 overarching principles it seeks to entrench, supported by specific rules. Similar supervisory approaches are followed in Australia, the Netherlands and New Zealand. Other jurisdictions, such as Singapore and Malaysia, which do not follow a Twin Peaks model of financial sector regulation, also have a focus on principles-based supervision.

[62]See https://www.consumerfinance.gov/regulations

Overall, supervision clearly involves pre-emptive components. This implies that extensive monitoring, risk identification and pre-emptive actions are necessary. In addition, the experience of these countries suggests that supervision should also be risk-based – that is, the greatest supervisory effort should be focused on the areas of highest risk. In developing a risk-based supervision framework, it needs to be borne in mind that sources and indicators of conduct risk differ from those for prudential risk, as discussed in Chapter 2.

Information gathering

The shift toward more pre-emptive, risk-based approaches to market conduct regulation has been supported by regulators instituting wider-ranging information gathering processes.

Traditional methods of collecting information on financial institutions remain, and include regular risk and compliance reports submitted to regulators by the entities themselves. This is typically supported by on-site inspections of financial institutions. On-site inspections may also help detect problems that may not be immediately apparent through analysing regular report submissions.

However, an increasingly important goal of supervision is to proactively identify potential conduct risks, to prevent negative customer outcomes from emerging, or at least mitigate significant damage. Regulators are therefore also focusing on gathering a broader range of information, to pre-emptively identify emerging risks both within specific institutions, as well as at an industry, market, or business model level.

In the United States, the state insurance supervisors have implemented a Market Conduct Annual Statement (MCAS) to collect and analyse market conduct data from insurers. The MCAS was initially designed as an aid in targeting inspections, as well as an alternative to on-site COB inspections[63].

Proactive information gathering tools used in various jurisdictions, including in Australia, Argentina, Belgium, Netherlands, Peru and the United Kingdom, include examining the industry environment; product approval requirements; monitoring financial innovation developments, press releases and contracts; mystery shopping; data collection, and analysis (including analysis of reported customer complaint data) to identify potential trends.

Sources of information may be institutions themselves as well as related sources. Regulators are increasingly gathering information from sources such as ombudsman services, consumer bodies and industry associations, the media, other regulatory or supervisory agencies overseeing consumer protection, court cases and their own market analysis.

Regulators increasingly need to find the appropriate balance between assessing micro conduct risks (risks arising from the conduct of specific regulated entities) and macro conduct risks (risks arising from broader market practices). This requires a mix of tools such as institution-specific supervision; thematic reviews and investigations; product review and approval processes and individual case reviews and complaint investigations.

Enforcement and administrative action

Notwithstanding the move by conduct regulators to focus increasingly on preventing poor conduct practices from occurring, where financial institutions mistreat their customers conduct authorities are taking stronger, swifter, and more severe enforcement action. These actions are taken against financial institutions that contravene not just the letter (i.e., specific rules or

[63] “Application Paper on Approaches to Conduct of Business Supervision ”, International Association of Insurance Supervisors, October 2014

binding principles) but also the spirit (e.g., intention of the law, based on purposive interpretation) of the law, requiring an enforcement strategy and toolkit that is flexible and robust to legal challenge, in particular making sure that regulators can take action against firms observed to have contravened binding governing principles, and not just specific supporting rules.

The risk-based approach has generally come to be seen as standard for market conduct supervision, with such an approach being implemented in the EU countries, as well as in Canada, India, Kenya and Peru.

In the UK, regulatory effectiveness for the FCA relies strongly on a pre-emptive, risk-based and outcomes-driven approach to regulation and supervision, relying on both governing principles and rules. There is close and continuous monitoring of companies that pose the highest conduct risk. Similarly, enforcement practices rely heavily on judgment of whether a financial institution is adhering to principle-based obligations to treat customers fairly, and action is taken for the contravention of these binding principles rather than only the contravention of specific rules. It is important that the law supports judgement-based supervision and enforcement.

The enforcement powers of market conduct supervisors by nature differ from the powers typical for prudential supervisory agencies. For example, conduct authorities in Argentina, Australia, Belgium, Germany, Netherlands, Kenya, and the UK have the power to publish warnings and issue an order to withdraw advertisements. In the UK, Argentina and Belgium, the authorities can also instruct institutions to refund excess charges to consumers.[64]

The lesson for South Africa, then, is that the enforcement powers of the new conduct authority need to be sufficiently wide to deter transgressions by financial institutions, operating within a broad regulatory framework that minimises the opportunity for unscrupulous operators to “design” their activities to avoid regulation and enforcement.

To constitute a credible deterrent, enforcement powers need to be augmented by visible, appropriate and swift enforcement and regulatory action, reinforcing the message that detection is likely and will have significant consequences. The authority should be empowered to make decisions based on judgment of unique cases against the relevant principles and rules – with such judgment supported by legislation. These wider enforcement powers need to be appropriately balanced by adequate accountability, transparency and appeal or review frameworks.

Complaints handling and redress mechanisms

Supervisors generally have a role to play with regard to customer complaints against financial institutions. This can be twofold: firstly, supervisors may have a role to play in terms of the mechanisms through which complaints are managed. Supervisors may set rules and requirements related to how financial institutions themselves handle complaints. They may also have a role to play in overseeing, establishing or in some instances operating independent dispute resolution structures such as ombud schemes.

In India, proposals have been put forward to create a unified Financial Redressal Agency (FRA), where consumers of financial products can submit complaints, providing a single entry point rather than dealing with multiple regulators across the financial sector.

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[64] See Global Survey on Consumer Protection and Financial Literacy data available at responsiblefinance.worldbank.org.

Increasingly, supervisors are also playing a more active role in monitoring trends in complaints data. Complaints provide useful information about the industry, individual firms and actual consumer concerns, including emerging issues in the marketplace. This fits into a more proactive approach to supervision, and can also help regulators identify where proportionally more focus may be required. The FCA in the UK has followed such an approach.

Some jurisdictions have required financial institutions to report either serious complaints, or an increase in specific complaints, on a regular basis to identify the potential problems.

Financial literacy

In addition to throwing a spotlight on poor market conduct practices, the global financial crisis also sharpened the focus of governments around the world on the financial empowerment of citizens, including through financial education and literacy initiatives. Many financial customers, and especially vulnerable customers, have a limited knowledge and understanding of financial products and concepts, and are not able to make long-term informed financial decisions or select financial products that are appropriate to their needs. Ultimately, this can have negative consequences, not just on individual financial well-being, but also on the long-term stability of the financial sector and economy.

The OECD in its 2013 paper on national strategies for financial education noted that "(f)inancial education has … become an important complement to market conduct and prudential regulation, and improving individuals' financial behaviour(s) has become a long-term policy priority in many countries."[65]

To ensure that resources spent on financial education are being efficiently and effectively used, there is growing attention on establishing specific national strategies for financial education, so that the impact of initiatives can be measured and monitored.

At their summit in June 2012, G20 Leaders endorsed the High-level Principles on National Strategies for Financial Education developed by the OECD and its International Network on Financial Education (INFE), which includes 110 countries and economies.

Box A2.2: The OECD/INFE High-level Principles on National Strategies for Financial Education

The High-Level Principles acknowledge that national circumstances must be fully taken into account in deciding over the scope of the strategy, its sequence of implementation, and whether financial education should be addressed as part of wider frameworks aimed at increasing financial inclusion or consumer protection. The High-level Principles centre on five sections, each addressing specific steps in the preparation and implementation of such endeavours:

- Definition, scope and purpose
- Preparation of the National Strategy: defining its scope and purpose through assessment, mapping and consultation
- Governance mechanism and the role of main stakeholders in the National Strategy

Roadmap of the National Strategy: key priorities, target audiences, impact assessment and resource Implementation of the National Strategy: delivery mechanisms and evaluation of programmes.

The number of countries with a national strategy has increased rapidly, and in August 2014, 55 countries at differing stages of development, had implemented a national strategy or was

[65] 'OECD/INFE High-Level Principles On National Strategies For Financial Education', August 2012

actively designing one[66]. The OECD defines a national strategy (NS) for financial education as:

"a nationally co-ordinated approach to financial education that consists of an adapted framework or programme, which:

- Recognises the importance of financial education – including possibly through legislation – and defines its meaning and scope at the national level in relation to identified national needs and gaps
- Involves the cooperation of different stakeholders as well as the identification of a national leader or co-ordinating body/council
- Establishes a roadmap to achieve specific and predetermined objectives within a set period of time
- Provides guidance to be applied by individual programmes in order to efficiently and appropriately contribute to the NS"

Strategies are tailored to take into account the specific characteristics of the financial sector of the country involved.

Some findings of the OECD/G20 publication on advancing national strategies for financial education were[67]:

- **Although national strategies are aimed at addressing the needs of the general public, they also often define key target audiences**. These include women (in Brazil, India, Indonesia, Saudi Arabia and Turkey), migrants (in Canada, Indonesia and Mexico), entrepreneurs (in Brazil, India, Indonesia, the Netherlands, Saudi Arabia and Spain), and the elderly (China, Korea, Turkey and the United States). Some countries are also refining their approaches to target audiences through a risk-based approach or the identification of key life stages and teachable moments in individuals' lives.
- **Dedicated governance mechanisms and bodies to develop and/or implement the national strategy are also established in most countries with a national strategy.**
- **Most countries also consider various ways to best integrate relevant private and civil stakeholders in the development and especially the implementation phase of their national strategy**. Korea, Singapore, and Turkey have developed strategic partnerships with private-sector associations (banking industry/insurance/capital markets association) to dilute the interests of each individual financial institution
- **The design and implementation of national strategies is in general supported by a mixture of public and private resources.** In the Netherlands for example, the national strategy is the responsibility of the Ministry of Finance but is developed and implemented by the broader platform Money Wise, involving the private sector and civil society. In Singapore the national strategy is led by public authorities and implemented in close co-operation with financial industry associations. In some cases, funding can come from levies on the financial services sector, as is the case in the United Kingdom
- **The implementation of financial education strategies and programmes involves the use of a wide range of delivery methods.** These aim to reach the whole population and target audiences depending on countries' circumstances and the population's preference. Almost all countries with a national strategy seek to introduce some form of financial education in schools as a way to reach the population at a young age. Most countries also develop dedicated interactive websites on financial matters, which in some cases also

[66] 'OECD/INFE Progress Report On Financial Education', September 2014

[67] 'Advancing National Strategies For Financial Education', Joint OECD and G20 publication, September 2013

allows them to provide detailed advice to consumers. Australia, the Netherlands, Singapore, Spain and the United Kingdom have such websites that have become the reference in their countries. Most of these websites are interactive and some provide detailed financial directions

- **The implementation of financial education strategies and programmes involves the use of a wide range of delivery methods.** These aim to reach the whole population and target audiences depending on countries' circumstances and the population's preference. Almost all countries with a national strategy seek to introduce some form of financial education in schools as a way to reach the population at a young age. Most countries also develop dedicated interactive websites on financial matters, which in some cases also allows them to provide detailed advice to consumers.

Appendix 3: Example of a typical license under the new regulatory regime

__Please note that the example is illustrative. Details of the final licensing, authorisation and customer categories and criteria are still in development.__

The table below sets out the possible licensing and authorisation model for a bank that provides both retail and wholesale banking services, and includes a tied advisory operation providing advice to retail customers. Its advisory operation provides advice on its own banking products, but also on long-term and short-term insurance products offered by other entities.

Authorisations:

Financial services		**Financial products**		**Customers**
Main category	**Sub-category**	**Main category**	**Sub-category**	
Advise[68]	[Possible sub-categories of advice, e.g. financial planning, financial product advice]	Deposit and payment products	[Specific classes of banking products]	Retail
		Long-term insurance	[Specific classes of long-term insurance products]	
		Short-term insurance	[Specific classes of short-term insurance products]	
Distribute	Non-advised sales execution[69]	Deposit and payment products	[Specific classes of banking	Retail

[68] As proposed in the Retail Distribution Review, the Financial Service authorisation category "Advise" may be further broken down into different types of advice.

[69] This would apply where banking products are entered into on a non-advice basis through staff at bank branches or through electronic banking channels.

			products]	
Issue financial product	N/A	Deposit and payment products	[Specific classes of banking products]	Retail Wholesale
		Foreign currency investment instruments	[Specific classes of forex products]	
		Securities and instruments	[Specific classes of instruments]	

Relationship approvals and notes: This section of the license will record any relationships requiring approvals or noting, as the case may be. The examples below are purely illustrative.

Relationship	**Details and notes**
Approved relationships with other licensees	Nominee companies for non-bank business: [Insert details]
Approved relationships with key persons / control functions	Auditor: [Insert name] Compliance officer: [Insert name]
Noted relationships	Also an authorised credit provider: [NCR License details] Payment providers

Appendix 4: Market conduct reform proposals – papers published

Twin Peaks

- A safer financial sector to serve South Africa better (Feb 2011)
- Implementing a Twin Peaks model of financial regulation in South Africa (1 Feb 2013)

Industry proposals

Retirement reform

- National Treasury discussion paper on Contractual Savings (2006)
- Strengthening Retirement Savings: An overview (May 2012)
- Enabling a better income in retirement (Sept 2012)
- Incentivising non-retirement savings (Oct 2012)
- Improving tax incentives for retirement savings (Oct 2012)
- Preservation, annuitisation, portability and governance for retirement funds (Sep 2012)
- 2013 Retirement Reform Proposals for further consultation (Feb 2013)
- Charges in SA Retirement Funds (Jul 2013)
- 2014 Budget update on retirement reforms (Mar 2014)

Insurance

- The Future of Micro-Insurance in South Africa (Apr 2008)
- Review of third-party cell captive insurance and similar arrangements (2013)
- Technical Report on the Consumer Credit Insurance Market in South Africa (3 Jul 2014)

Cross-sectoral reform

Treating Customers Fairly

- Treating Customers Fairly: The Roadmap (Mar 2011)
- TCF implementation update and baseline study feedback report (Dec 2013)
- Treating Customers Fairly: Complaints Management Discussion Document (Oct 2014)

Retail Distribution Review

- Retail Distribution Review 2014 (Nov 2014)

Appendix 5: Acronyms and abbreviations

AML	Anti-Money Laundering
ASISA	Association for Savings and Investment South Africa
BASA	Banking Association of South Africa
BCBS	Basel Committee on Banking Supervision
BIS	Bank of International Settlements
CCI	Consumer Credit Insurance
CFT	Combating the Financing of Terrorism
CIS	Collective Investment Scheme
CISCA	Collective Investment Schemes Control Act
CoFI	Proposed new Conduct of Financial Institutions Act
CPA	Consumer Protection Act
DTI	Department for Trade and Industry
ETFs	Exchange Traded Funds
FAIS	Financial Advisory and Intermediary Services
FCA	Financial Conduct Authority (UK)
FIC	Financial Intelligence Centre
FICA	Financial Intelligence Centre Act
FSB	Financial Services Board
FSCA	Financial Sector Conduct Authority
FSR	Financial Sector Regulation Bill / Act
FSOC	Financial Stability Oversight Committee
FSOS	Financial Services Ombud Schemes

G20	Group of 20
GWP	Gross Written Premium
IAIS	International Association of Insurance Supervisors
IOSCO	International Organisation of Securities Commissions
JSE	Johannesburg Securities Exchange
LIBOR	London Interbank Offered Rate
LISP	Linked Investment Service Provider
LTI	Long-term Insurance
NCA	National Credit Act
NCR	National Credit Regulator
NT	National Treasury
PA	Prudential Authority
PAJA	Promotion of Administrative Justice Act
PASA	Payment Association of South Africa
PF	Pension Fund
PUTs	Property Unit Trusts
RDR	Retail Distribution Review
REITs	Real Estate Investment Trusts
SA	South Africa
SAM	Solvency Assessment and Management
TCF	Treating Customers Fairly

Appendix 6: Questions to stakeholders to support engagement and submissions

Chapter 1 – The problem statement

- Is our list of current market conduct challenges complete and described correctly?
- As a consumer what has been your experience of the financial sector, and what would you most like to see being done differently?
- What regulatory approaches have worked most effectively to ensure a better customer focus, what are the most significant weaknesses in the current system that should be urgently remedied?

Chapter 2 – What is market conduct regulation? How does it better protect financial customers?

- In implementing Twin Peaks, what should government be most cautious or aware of in order to best support improved conduct law, regulatory oversight, and ultimately improved conduct and better customer outcomes?
- How can the relationship between the new conduct regulator and other regulators be strengthened to best support positive customer outcomes?
- Are there other international lessons that we should be mindful of? Which regulatory approach is most relevant for South Africa, and why?
- What do you see as critical features of a modern market conduct regulator?

Chapter 3 – A strategy underpinned by a consolidated and harmonised market conduct law

- Is the proposed strategy sufficiently comprehensive and complete?
- How should the regulatory perimeter be defined?
- What aspects of the proposed legal framework do you think will work best to achieve better outcomes for customers, and are there elements of the framework that concern you?
- What should Treasury be most mindful of in drafting the law?
- Are there elements of the proposed framework which are confusing or need further clarification?
- Should the law be more principles or rules based, or both, and to what degree?
- Do you have proposals relating to legislative drafting to support an outcomes-focused approach?

Chapter 4 – Accelerating and intensifying industry interventions

- Has the draft framework correctly prioritized the specialized industry projects, along the right themes (savings, etc.)? In other words, are the projects identified those that will have the most significant impact on customers? Is this list complete?
- How can we improve upon the proposed action plans?
- How do you suggest that these projects are developed in order to deliver best results in the shortest time?

Chapter 5 – Cross-sector interventions: implementing the TCF framework

- In implementing the TCF framework, what should government be most cautious or aware of in order to best support improved conduct law, regulatory oversight, and ultimately improved conduct and better customer outcomes?
- Has the draft framework correctly prioritized cross-sector interventions, and is this a complete list?
- To what extent is a cross cutting approach to each of these issues feasible and/or desirable?
- How can we improve upon the proposed action plans?
- How do you suggest that these projects are developed in order to deliver best results in the shortest time?

Chapter 6 – An integrated ombud system

- What do you see as the main challenges in the current framework, and do you think the proposed way forward adequately responds to these?
- How can the ombud system be improved to better respond to cross-sectoral complaints?
- Do the proposals go far enough to provide a consistent approach to dispute resolution in the financial sector?
- Do the proposed changes to the FSOS council go far enough?
- Are there areas of the current ombuds system that could be improved in the short to medium term to improve customer outcomes?

Chapter 7 – Strengthening financial literacy and capability

- Is the consumer financial literacy strategy understood? What could/should be done to improve awareness of the strategy and increased participation?
- What channels could be better used to drive financial education initiatives with better outcomes (i.e. school programmes, social media, point of sale programmes etc.)
- How could the FSCA be most effective in fulfilling a financial literacy mandate for South Africa?
- A standalone agency has been mooted as a possible manner of driving financial literacy and education. What would the benefits and drawbacks of such a model be in the specific context of the South African market?
- What other options could be considered for driving financial education more strongly in South Africa, supported by both government and industry?

Chapter 8 – Enhancing the efficiency and integrity of financial markets

- Is the market integrity mandate of the new conduct authority clearly explained?
- Two options have been proposed for incorporating market integrity requirements into the target conduct framework. What would the benefits and drawbacks of the options be? Does one option stand out as more beneficial than the other?

Chapter 9 – Implementation of the new regulatory framework

- Is the phased approach to implementation set out clearly enough? Does it address the concern of not unduly disrupting industry and customers while the FSCA is being established?
- Is the approach (and in particular the proposed timelines) sensible? What should the National Treasury be most conscious of across the implementation process?