Financial Sector Regulation Bill 2013

Implementing Twin Peaks – Phase 1

Roy Havemann and Katherine Gibson | National Treasury | January 2014
Consultation process

• Process
  – **December 2013** Bill published for public comment
  – **January – February 2014** Initial consultation with stakeholders
  – **7 March 2014** Comments deadline
  – **March – April 2014** Individual stakeholder consultations, based on comments received
  – **Post Election** Tabling

All documentation is available at [www.treasury.gov.za/twinpeaks](http://www.treasury.gov.za/twinpeaks)
Contents

• Background and Outline of Phased approach

*Phase 1*

• Structure of regulators
• Market conduct and prudential peak
• Regulatory action
• Licensing
• Rule making
• High-level Resolution Powers

*Phase 2*

• Giving legislative backing to *Treating Customers Fairly*
• Gaps in current market conduct legislation
• Gaps in prudential legislation
• Resolution Bill
Background - Cabinet has approved four policy objectives

- Need to improve **market conduct**:
  - Financial services firms (banks, insurers etc) continue to charge high fees and have complex terms and conditions that do not meet the needs of customers. South Africa’s current *approach to market conduct is fragmented* and needs to be improved.

- Need to combat **financial crime**:
  - Recent cases (e.g. Fidentia) have highlighted we have gaps in our system that need to be resolved.

- Need to strengthen **financial stability**
  - Financial crises can impose enormous costs on the taxpayer and on society – need to ensure we have a system on par with best in the world.

- Need to widen access to **financial services**
  - Access is important for inclusive economic growth.
### In South Africa reform proposals in four priority areas for a safer financial sector

#### Financial Stability / Prudential
- Reserve Bank to lead on macro-prudential (systemic stability) and micro-prudential (safety and soundness of institutions)
- Financial Stability Oversight Committee

#### Market conduct
- Comprehensive market conduct regime reflecting interconnected nature of financial services
- Treating customer fairly
- Fit and proper requirements
- Ombud schemes
- Financial literacy

#### Access to financial services
- Treasury to lead
- Financial sector code
- Co-operative and dedicated banks, and Postbank
- Introduce a microinsurance framework
- International co-operation

#### Combating financial crime
- Enforcement agencies to lead
- Investigating and prosecuting abuses
- Continued work with international partners

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*It is vital to ensure coordination and information sharing between regulators particularly in the face of an event that threatens systemic stability*

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“A safer financial sector to serve South Africa better” policy document is available at [www.treasury.gov.za/twinpeaks](http://www.treasury.gov.za/twinpeaks)
Recap: What does twin peaks attempt to achieve?

<table>
<thead>
<tr>
<th>Prudential Authority</th>
<th>Market Conduct Authority</th>
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<tbody>
<tr>
<td>• Enhanced oversight of micro-prudential regulation for banks, insurers, financial markets, <em>special focus on conglomerates</em></td>
<td>• Regulatory laws that are <em>complete, harmonised, integrated, proportionate</em> - all financial services, incl. banking i.e. 2013 Banks Act amendment</td>
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<td>• <em>Increased focus on outcomes</em>, esp. fair “Treating customers fairly” and focus on contract terms &amp; costs</td>
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<td>• <em>Targeted interventions to market failures</em> - retirement reform, Jali Commission recommendations, insurance protection, FAIS</td>
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### Financial Services Tribunal and Enforcement

- Regulators will have clear internal policies & procedures for enforcement, enhanced transparency & accountability, strong appeal mechanism

### Financial Stability

- Inter-agency co-ordination of financial stability issues
‘Twin peaks’ will be implemented in a phased manner

**Phase 1**
- Establish two new regulators
- FSOC
- Enforcement

**Phase 2**
- New laws underpinning twin peaks
  - New consolidated market conduct law
  - Extension of prudential law (MMFs, Shadow Bank, Narrow Banks)

**WHO REGULATES?**

2014 2015 2016

**HOW DO THEY REGULATE?**

**WHAT DO THEY REGULATE?**

Phased approach reduces risks and simplifies implementation
Current regulatory architecture...

Before.....

- SARB Act / Banks Act
- Mutual/Co-op Banks Act

- FSB ACT
  - LT & ST Insurance Act
  - CIS Control Act
  - Pension Funds Act
  - FAIS Act
  - Other

- Inspection of Financial Institutions Act, etc
Proposed regulatory architecture...

**Prudential**
- SARB Act / Banks Act
- Banks Act
- Insurance prudential
- MMFs Prudential: FMIs, etc

**Market conduct**
- “Super-regulator”
- Insurance Market conduct
- CIS Control Act
- Pension Funds Act
- FAIS Act
- Financial Market Act
- Inspection of Financial Institutions Act, etc

**FST**
- “Super-tribunal”
- Financial Services Tribunal
- Current system of enforcement is fragmented - need a Tribunal with powers to hear major cases
Financial Stability is delegated to the Reserve Bank within an agreed policy framework

- entrench the primary role of the Reserve Bank (s4)
  - to promote financial stability and
  - implementing steps towards restoring financial stability in the event of a crisis
- establish the Financial Stability Oversight Committee (FSOC) (s5)
  - to assist the Reserve Bank to maintain financial stability and
  - to respond to financial crises while maintaining the operational independence of financial regulators
  - shall consist of (s6): the Governor (chair), CEO and DGs of SARB, Commissioner and two (min) DCs of MCA, DG of NT
Authorities with enhanced accountability, coordination & operational independence

- A stand-alone **Market Conduct Authority** (s12, ch3)
  - to strengthen financial customer protection
  - to promoting the integrity of financial markets, consumer education and financial inclusion
  - lead regulator of financial institutions carrying out *mono-regulated activities*
  - joint regulator of financial institutions carrying out *dual-regulated activities*

- **Prudential Authority** within the SARB (s13, ch3)
  - to regulate the safety and soundness of individual financial institutions carrying out *dual-regulated activities*
  - lead regulator of financial institutions carrying out *dual-regulated activities*
Enhanced coordination and co-operation between regulators

- a legal framework for enhanced coordination and co-operation when exercising respective powers and performing their respective duties:
  - between the PA and MCA
    - including a memorandum of understanding (s44)
    - Co-operation into, e.g. licensing, rule-making, etc.
  - between regulatory authorities and other financial regulators
    - through Council of Financial Regulators (“CFR”) (s56) and
    - establishment of Subcommittees of CFR (s58)
Balance operational independence and accountability of regulators

The Bill

• Strengthens the operational independence of regulators, while ensuring accountability

• Provides a governance framework that will provide clarity on the policy objectives of Government

• Ensures the necessary operational powers and independence of regulators to perform duties impartially
Financial crisis management and resolution

- identifies the SARB as **the resolution authority** in South Africa
- outlines action the governor must take where FSOC detects any risk, weakness, development or disruption in the financial system that may give rise to a financial crisis (s63)
- outlines **crisis management responsibilities**
  - of the Minister which may have impact on public finances (s64)
  - Reserve Bank (s65)
  - The regulatory authorities (s67)
- powers to the Minister to make **Emergency regulations** for the management and mitigation of an impending or actual financial crisis (s68)
Administrative actions and appeals

- to promote a **consistent and harmonised approach** by the regulators for all regulatory decisions, incl. licensing through to the imposition of penalties
- to outline **enforcement mechanisms** aimed at encouraging compliance with all aspects of the new regulatory regime and to help combat financial crime
- to provide for the use of **administrative penalties, referrals** to an administrative decision-making body, and referral of **matters for criminal prosecution**
- to enable **supervisory actions** such as suspension or withdrawal of licences and approvals, orders to take or cease particular actions, and debarments
- to establish a **Financial Services Tribunal** to serve independently from the regulatory authorities and hear administrative appeals against decisions taking by the PA or the MCA
- a **two-phased** approach to shift to “twin peaks”
Phase 1:
Governance, structure and accountability of the two regulators
MARKET CONDUCT AUTHORITY

**Governance Committee**
- Single committee
- At least 5 members, appointed by Minister
- Must cover: risk, audit & remuneration

**THE AUTHORITY**
- Power vested collectively in Head & Deputies
- Head has override power if outvoted
- Head & Deputies appointed by Minister
- Authority is juristic person and PFMA accounting body
- Funding through levy

**Management / organisational structure**
- Authority has power to delegate responsibility to staff / management
- Structure / appointments at discretion of the Authority

**Statutory elements of structure**

**Non-statutory elements of structure**
**PRUDENTIAL AUTHORITY**

- Authority established within the SARB
- Power of the Authority vested in office of Head
- Head = a DG, appointed by Governor in consultation with Minister
- Authority is juristic person under the management & control of SARB
- Self-funded (mechanism tbd)

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**Statutory elements of structure**

- Chaired by Governor
- At least 5 members from SARB directors (non-DGs)
- Chosen by Governor i/c with Minister
- Must cover: risk, audit & remuneration
- Governor may add additional responsibilities

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**Non-statutory elements of structure**

- Authority has power to delegate responsibility to staff / management
- Structure / appointments at discretion of the Head of the Authority

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**THE AUTHORITY**

- Head
- Management / organisational structure

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**SARB board**

- Governor
- PA governing body

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**RESERVE BANK**

- Governor
- SARB board
FINANCIAL STABILITY OVERSIGHT COMMITTEE

Statutory elements of structure:

- Statutory committee of SARB, with objective to contribute to financial stability mandate
- Meetings at least quarterly
- Chaired by Governor – casting vote
- Ex officio members:
  - Head PA + 1 DG
  - Head MCA + 1 DH
- NT member – participates in meetings but cannot vote
- Governor may appoint external (voting) members i/c with Minister
- Others may attend at invitation of Governor

Non-statutory elements of structure:

- Other FSOC attendees may, at discretion of the Governor, form an informal cadre of non-voting members
- Standing secretariat with staff from all 3 authorities to support meetings, gather data, commission analysis etc

Standing Secretariat
Non-voting “members”
INSTITUTIONAL LINKS: influence / accountability

**Other regulators / organisations**
- FSOC recommendations (non-binding)
- Governor may refer non-compliance to Minister
- Minister to discuss with relevant colleague

**Public accountability through transparency**

**FSOC**
- FSOC formal power of recommendation to PA/MCA (comply or explain)
- PA/MCA duty to inform FSOC of potential risks to fin stab

**PA**
- PA/MCA statutory duty to coordinate (including MoU)

**MCA**

**MINISTER / NATIONAL TREASURY**
- Minister’s “statement of expectation” sets out policy priorities for PA/MCA
- PA / MCA “statement of intent” approved by Minister and published
- PA / MCA annual report submitted to Minister, tabled in Parliament
- Minister power to request ad hoc reports from PA/MCA (eg on regulatory failures)
- Minister sets Head’s performance agreement (PA: Governor i/c with Min)
- Standard PFMA accountability for finances

**FSOC must publish quarterly statements**
- FSOC annual report submitted to Minister, tabled in Parliament
- Minister power to request ad hoc report on any FSOC action
- Governor may take PA/MCA deadlock to Minister for decision
Other issues

- **Funding of regulatory authorities** (s. 36)
  - Role & determination of industry levies

- **Licensing of regulated entities** (def, s. 3(2)(c), s. 54)
  - New concept of authorisations & entitlements, move to streamline procedures
  - Dual key in & out, st. joint rules (see below)

- **Rule making powers** (s. 45-52, s. 104)
  - Levelling of subordinate regulation – existing instruments now rules, st. rule making provisions in this Act
  - New concept of “joint rules”
  - Enhanced & standardised cooperation & consultation requirements (incl. Minister Regulation on “process for consultation on rules”)
  - Additional resolution powers to be contained in Resolution Bill
Prudential peak
## Main components of Prudential Peak

<table>
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<tr>
<th>Category</th>
<th>Description</th>
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<tr>
<td><strong>Bank prudential</strong></td>
<td>• Basel 3</td>
</tr>
<tr>
<td><strong>Insurance prudential</strong></td>
<td>• SAM</td>
</tr>
<tr>
<td><strong>Collective Investment schemes</strong></td>
<td>• “Implicit or explicit guarantee”</td>
</tr>
<tr>
<td><strong>Financial Market Infrastructure Prudential</strong></td>
<td>• Safety and soundness of the FMIs (operational risk, market risk etc.)</td>
</tr>
<tr>
<td><strong>Financial Markets Act prudential</strong></td>
<td>• Safety and soundness of authorised users, clearing members, settlement members etc. Risk-based approach</td>
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Phase 2 focus for prudential peak

- Conglomerate supervision
- Resolution
- Current anomalies:
  - Banks are regulated by Bank Supervision through Banks Act
  - Clearing and settlement members are regulated through the Financial Markets Act, with frontline supervision delegated to JSE / Strate
  - Large broker dealers are not directly regulated by Bank Supervision
  - Transitional arrangements will need to be considered
- ‘Shadow banking’
  - Non-banks fulfil roles previously fulfilled by banks
  - Includes both ‘deposit-taking’ and ‘lending’, e.g. BMW Financial Services provides mortgages and does securitisations
Proposed regulatory architecture...

Market conduct

“Super-regulator”

- Initially, market conduct regulator will continue to function according to existing Acts

**E.g. Previously**
Registrar of FAIS = EO of FSB
Day-to-day Head of FAIS Dept

**Transition**
Registrar of FAIS = Commissioner and Deputy Commissioners of MCA
Day-to-day Head of FAIS Dept

Future: Licensing, registration, enforcement etc. will be streamlined
Role of credit is under discussion within government
Phase 2 focus for market conduct peak (underway)

- Developing market conduct policy framework
  - More effective regulation: Conduct of Business law, supporting full implementation of TCF initiative
  - More effective supervision: Amendments to FSR Bill to enhance supervisory toolkit

- Priority targeted interventions:
  - Retail banking
  - Saving for retirement
  - Retail Distribution Review
Special Case of FMI
FMI is a complex area to delineate

A system/no balance sheet at risk (no promise)

A system with balance sheet risk (i.e. make a promise)

Prudential entity, i.e. balance sheet risk & microprudentially regulated

Other entities (non-prudential) with no balance sheet risk (generally), microprudentially regulated

End consumer

Exchange

Clearing House incl. CCP

Custodian (functions required for settlement)

CSD

NPS

Trade Repository

Authorised user member banks

Bank clearing members

Non-bank clearing members

Custodian bank

CSD Participants bank

Settlement members bank

Non-bank

Non-bank

Non-bank

End-users

End-users

Pension fund, asset managers etc.
In Phase 1 there will be minimum disruption

- During Phase 1, front-line supervision of authorised users will be undertaken by the JSE (no change)

- JSE rules are being recast into “Prudential” and “Market Conduct” rules

- JSE rules will be approved by both PA (Prudential rules) and new MCA (Market Conduct rules)

- Over time front-line supervision for large prudentially-relevant authorised users will be moved to the Reserve Bank
Issues for discussion

• Transitional arrangements
  – Minimising risks

• Schedule:
  – Activities versus institutions

• Enforcement mechanisms

• Other?
Consultation process

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