Treating Customers Fairly in the Financial Sector: A draft Market Conduct Policy Framework for South Africa

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Market conduct – what’s that?

- ‘Market conduct’ in the financial sector is not a new concept. We have all come across market conduct issues in some way or another:

REGULATION
FSB and NCR regulate aspects of financial sector market conduct in South Africa

HIGH PROFILE MARKET CONDUCT FAILINGS
International: Subprime mortgage loans; PPI mis-selling; forex rigging; etc
Local: Fidentia; Jali commission inquiry into banking; statement of intent in long-term insurance, etc.

GLOBAL BUZZWORD
Spotlight on market conduct post GFC. E.g. G20 principles on financial consumer protection; tough action being taken for conduct failings by big global financial institutions, including large fines

INCREASED FOCUS IN SA
FAIS; Treating Customers Fairly initiative; Twin Peaks reform and new market conduct regulator
... as financial customers, we have experienced market conduct failings too!

Opaque, complex fee structures

Focus on premium price rather than value

Sale of unsuitable, incorrectly targeted products

Overly technical policy language

High, inappropriate investment charges

Conflicts of interest in remuneration structures

Investment vehicles structured to avoid regulation

Unfair debit order practices

Inadequate or poor disclosures

A multiplicity of fees and commissions

Multi-layered products

Poor sales incentives

Reckless lending practices
What’s happening to market conduct regulation in South Africa?

- Comprehensive reform of financial sector regulation underway – **Twin Peaks**

- Aims to make financial sector safer AND ensure customers are fairly treated

- Creates new authorities – **Prudential Authority** and **Financial Sector Conduct Authority**

- Opportunity to **overhaul market conduct regulation** in SA:
  - Build on good (eg TCF) and address bad (eg regulatory inconsistency, arbitrage)
  - Take into account local context and international developments

- Put in place a **strong, complete and comprehensive** market conduct framework for the FSCA to fulfill its mandate

**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.
What’s already working? What’s not?

- SA financial sector is well-developed, stable, resilient, and a crucial sector for the economy. However is it best delivering on outcomes?

  Are bank accounts meeting customer needs?
  
  Are households being discouraged from saving by an inefficient, customer-unfriendly retirement industry?
  
  Why are households burdened with high levels of debt?
  
  Is the insurance industry doing enough to help the average South African manage day-to-day risk?
  
  Is regulatory fragmentation impeding policy interventions to achieve the best customer outcomes?
  
  Are customers sufficiently empowered to hold financial institutions to account?

What outcomes should the financial sector be delivering? From an economic and customer perspective?

Is the list of current market conduct challenges complete, and described correctly? (Table 1.1) What challenges are we missing?
The strategy: a multi-pronged approach to improving market conduct

- Direct interventions both from ‘top-down’ and ‘bottom-up’
  - **Top-down:** Twin Peaks reform and legislative overhaul
  - **Bottom-up:** direct conduct interventions, initiatives to improve financial literacy and customer dispute resolution mechanisms

Is this strategy sufficiently comprehensive and complete?

Do elements need clarification?
What the strategy seeks to achieve

- **Increased regulatory coverage**, minimising potential for regulatory gaps

- A more level playing field, where regulatory requirements are **based on the financial activity** performed

- Shift regulator and industry to **proactively focus on outcomes** and the **spirit of the law** rather than mere compliance

- More **principles-based law**, supported by rules, with **structural intervention where necessary**

- A more **flexible supervisory toolkit** for regulator, which should mean working with industry to contain abuse where identified → **preemptive** regulation, increasingly judgment based

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What the strategy seeks to achieve

- **Strong and swift enforcement** for contraventions, **increased emphasis on remedial action** i.e. not just fines – poor customer treatment will expose management/shareholders

- Strong, easily accessible **dispute resolution channels** with consistent approaches to resolving customer disputes

- Focus on **consumer redress** – enforceable undertakings & ombud judgments already provided for. Consider compensation scheme (e.g. US, UK). Should regulator be able to initiate cases on behalf of customers (e.g. Australia)?
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<th>Topic</th>
<th>Question</th>
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<td>Regulatory perimeter</td>
<td>How should the regulatory perimeter be defined?</td>
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<td>What about the wholesale market?</td>
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<td>Licensing and authorisations approach</td>
<td>How can a shift to an activity-based approach be implemented with minimal disruption/confusion?</td>
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<td>Outcomes-based supervision</td>
<td>On a practical level, how can supervision take place to ensure best outcomes for customers?</td>
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<td>What are the legal implications?</td>
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<td>Setting conduct standards</td>
<td>Are there any concerns with the approach to subordinate legislation? When should existing rules/board notices etc be amended?</td>
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<td>Information gathering</td>
<td>Are there sources of information that have not been identified? How could the FSCA best use information once gathered? Eg. publication?</td>
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<td>Enforcement and administrative actions</td>
<td>Should the law be more principles or rules based? What implications does this have for actions taken by the regulator? Will FSCA be strong enough?</td>
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Accelerated, intensified industry interventions now

1. **Saving:** Targeting poor conduct practices that compromise savings, especially saving over the long term for retirement. Action plan will work toward:
   - The better governance of stand-alone retirement funds
   - The better governance of multi-employer funds
   - Enhanced comparability and value of investment products across the sector
   - Generally promoting distribution models that better serve the interests of consumers

2. **Borrowing:** Confronting unscrupulous lenders, relieving over-indebted households. Action plan:
   - Short term: investigate EAOs, provide financial wellness training, voluntary debt mediation
   - Medium term: clear affordability criteria, standards for EAOs
   - Longer term: strengthen debt collection law, payment system standards, price caps, investigate insolvency arrangements, ensure credit suitable and affordable

3. **Transacting:** Introducing conduct regulation of retail banking (including payment system effects). Action plan:
   - Exploring ways to better disclose account fees and charges
   - Exploring ways to improve contestability
   - Developing conduct standards 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 in the Financial Sector Code.
4. **Managing risk**: A strategy towards insurance risk products that better protect policyholders. Action plan will focus on:

- Improved product design
- Improved disclosure, advertising and marketing
- Non-conflicted distribution models
- Responsible outsourcing
- Improved claims and complaints handling
- Holding insurers to account more effectively for their business conduct

• Is the list of industry interventions complete? Are the four themes correct?
• Will these interventions have the most significant impact on customers?
• Are the proposed action plans adequate? How can they be improved?
• How can the plans be developed to achieve maximum impact in the shortest time?
TCF and continued cross-sector interventions

- Existing frameworks allow the application of TCF principles. FSB identifying opportunities for existing subordinate legislation to further support TCF delivery. Focus areas, with proposed action plans:
  - Implementing a harmonised disclosure framework
  - The Retail Distribution Review
  - Improving internal complaints mechanisms
  - A revised competency framework for intermediaries

- Other areas may warrant attention – are product design issues being adequately considered? What about e-finance in South Africa?
- Is the current list correctly prioritised?
- How feasible is a cross cutting approach to these issues?
- What issues should we be aware of in implementing the TCF framework in a way that supports improved conduct law and regulatory oversight, and ultimately better conduct and customer outcomes?
Empowering customers

- Propose to **streamline ombuds system**, ensure effectiveness in resolving customer disputes
  - Strengthened FSOS Council, able to set ‘ombud’ standards
  - Further discussion to take place on voluntary vs statutory, role of a chief ombud etc

- What are the main challenges in the current ombuds system? Does the proposed way forward adequately respond to these?
- Do the proposals go far enough to provide a consistent approach to dispute resolution?
- Are there areas of the current ombuds system that could be improved in the short to medium term?

- FSCA will also have mandate to drive **financial education**. Will continue work of the National Consumer Financial Education committee

- Is the consumer financial literacy strategy understood? What could be done to improve awareness of the strategy and increased participation?
- How could the FSCA be most effective in fulfilling a financial literacy mandate?
- What other options could be considered for driving financial education more strongly in South Africa, supported by both government and industry?
Issues for further development

- **Market integrity mandate**
  - Two options for incorporating this mandate under new framework – incorporating FMA or leaving separate
  - Licensing implications; implications for organisational structure at FSCA
  - Further discussion required on SRO model review

- **Wholesale market conduct regulation**
  - Considerably more work must be done to clarify how CoFI Act should apply to the wholesale sector
  - Must be clear that the nature of regulatory intervention should be different to that for the retail segment
Timelines and next steps

- **Phase 1 – Financial Sector Regulation Bill**
  - Tabled by 2\textsuperscript{nd} half 2015, enacted early 2016
  - Two new authorities established 2016
  - Will operate under FSR Act and existing industry laws

- **Phase 2 – market conduct framework**
  - Consultation on discussion document
  - Comments close 8 April
  - Further development of framework, including further engagements where required
  - Draft legislation by end 2015
  - Legislation for comment **early 2016**
Open discussion