Stakeholder consultation workshop: Second draft of the Financial Sector Regulation Bill

Jan-Feb 2015
Twin Peaks reform process to date

— **Budget 2011** – Policy paper – ‘A safer financial sector to serve South Africa better’

— **July 2011** – Approved by Cabinet

— **February 2013** – Roadmap – ‘Implementing a twin peaks model of financial regulation in South Africa’

— **December 2013** – **First** draft of the FSR Bill published

— **January – February 2014** Initial consultation with stakeholders

— **7 March 2014** Comments deadline

— **December 2014**– **Second** draft of the FSR Bill (with response doc & draft MCPF)

— **January – February 2015** Initial consultation with stakeholders

— **2 March 2015** Comments deadline (6 April for draft MCPF)

All documentation is available at www.treasury.gov.za/twinpeaks
Why do we need the twin peaks system?

Financial Stability / Prudential

Need to strengthen financial stability
- Reserve Bank to lead on macro-prudential (systemic stability) and micro-prudential (safety and soundness of institutions)

Market conduct

Need to improve market conduct
- Much wider regulatory net, higher standards applied consistently across sector
- Focus on outcomes incl. Treating Customers Fairly

Access to financial services

Need to widen access to financial services
- Treasury to lead
- Financial sector code
- Co-operative and dedicated banks, and Postbank
- Introduce a microinsurance framework

Combating financial crime

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

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

“A safer financial sector to serve South Africa better” policy document is available at www.treasury.gov.za/twinpeaks
### What are the ‘peaks’?

<table>
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<tr>
<th>Prudential Authority</th>
<th>Financial Sector Conduct Authority</th>
<th>Financial Services Tribunal and Enforcement</th>
<th>Financial Stability (FSOC)</th>
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<tbody>
<tr>
<td>• Enhanced oversight of micro-prudential regulation for banks, insurers, financial markets, special focus on conglomerates</td>
<td>• Regulatory laws that are complete, harmonised, integrated, proportionate - all financial services, incl banking</td>
<td>• Regulators will have clear internal policies &amp; procedures for enforcement, enhanced transparency &amp; accountability, strong appeal mechanism</td>
<td>• Inter-agency co-ordination of financial stability issues</td>
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<td>• Increased focus on outcomes, esp. treating customers fairly, focus on contract terms &amp; costs</td>
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<td>• Targeted interventions to market failures - retirement reform, Jali Commission recommendations, insurance protection, FAIS, etc</td>
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Key changes to 2nd draft of FSR Bill (Dec 2014)

- Close to 300 pages of comments received on first draft of Bill. The following key changes have been made in the second draft:

  - **Widens scope of application** to minimise potential for regulatory gaps. Read definitions for “financial institution” with “financial product” (cl. 2) and “financial service” (cl. 3). Also the objectives of FSCA and PA
  
  - **Empowering regulators to best achieve their mandate** by providing powers in addition to sectoral law so they are able to supervise and enforce the law in pursuit of their objectives, incl. by *setting and supervising prudential/conduct/joint standards* (cl. 74, 94, 95, 96)

  - **Improved legal enforceability of the Bill.** In particular many definitions have been reconsidered e.g. “financial customer” and “systemic risk”/”systemic event”, and additional areas have been added to improve legal application e.g. SIFI designation

  - **Address inconsistencies and confusions** associated with the concepts of “mono-regulated” and “dual-regulated” entities. The new draft does not distinguish between these two concepts. The approach to licensing and supervising all institutions on a **full dual basis** is set out in further detail (risk-based approach NB)
Key changes to 2\textsuperscript{nd} draft of FSR Bill – (cont’)

- **Better align the governance arrangements** for the new regulatory agencies, including clarifying the institutional form of the PA operating within the SARB (cl. 30 – 44 and cl 55 – 70)

- **Clarify the role of other financial sector regulators** under Twin Peaks. The role of the National Credit Regulator (NCR) was not explicitly explained in the first draft. Numerous stakeholders noted that as a key player, their role should be clarified. This has been done through explicit coordination and cooperation requirements (chp 6)

- **Align the Reserve Bank powers for systemic oversight** with its mandate for financial stability, and provide greater clarity about these powers and how these may be used in fulfilling this mandate (cl. 8 – 16)

- **Introduce a legal framework for regulating and supervising financial groups**, from both a prudential and a conduct perspective (cl. 121 – 129)

- **Streamline the ombuds system** in line with a consolidated approach to financial sector regulation. This includes creating a stronger central coordinating role for the Financial Services Ombuds Council (chp 16)

- These are explained in further detail below. Note also the change of the name of the market conduct authority to the Financial Sector Conduct Authority
New draft also takes into account SA G20 commitments made

• Cabinet concurred on 19 November 2014 that **there is a need for more intrusive and intensive financial regulatory standards in line with G20 agreed principles** at the 2014 Brisbane Summit

Dealing with SIFIs to end ‘too Big to Fail’

Regulating shadow banks, over-the-counter derivatives, and manipulation of key indices such as LIBOR and possibly exchange rates

• The proposed Financial Sector Regulation Bill takes steps to ensure that our financial regulatory framework continues to be stronger in line with the international system, and where appropriate, our regulators can work with their counterparts in other jurisdictions.
Definitions: financial products

- No longer refer to ‘mono and dual’ regulation by authorities. Instead financial product providers will be regulated and supervised by the PA and financial service providers by the FSCA.

- PA responsible for supervising safety and soundness of financial institutions that provide financial products, market infrastructures or payment systems (cl.27 – 29).

- Linked to products, prudential oversight required so institutions meet financial obligations to customers (‘promises’).

- Financial product is defined in cl.2 to mean:
  - a participatory interest in a collective investment scheme
  - an interest, subscription, contribution, or commitment in a pooled fund
  - a long-term or a short-term policy (Long/Short-term Insurance Act)
  - a benefit provided by– a pension fund organisation (Pension Funds Act); or a friendly society (Friendly Societies Act)
  - a deposit (Banks Act)
  - a health service benefit provided by a medical scheme
  - a credit agreement; etc

- FSR Bill allows Finance Minister to designate new financial products.
Definitions: financial services

• FSCA responsible for fair treatment, integrity and education, and will supervise services performed in relation to financial products, foreign financial product, securities, market infrastructure or the payment system as applicable (cl.3):
  – promotion, marketing or distribution
  – providing advice, recommendations or guidance
  – dealing or making a market
  – operating or managing, or providing administration services
  – services provided in relation to credit agreements, including legal services
  – services provided by payment system participants

• Financial services also include (cl. 3):
  — providing an intermediary service as defined in section 1(1) of FAIS
  — securities services provided by a regulated person as defined in section 1(1) of the FMA
  — providing credit rating services as defined in section 1(1) of the CRS Act
  — the calculation of a financial benchmark
  — services related to an interest, subscription, contribution, or commitment in a pooled fund
  — services related to the buying and selling of foreign exchange
  — dealing with trust property, as defined in s1 of the Financial Institutions (Protection of Funds) Act, as a regular feature of business

• FSR Bill allows Finance Minister to designate new financial services
Two Authorities: Key characteristics - FSCA

FINANCIAL SECTOR CONDUCT AUTHORITY
(established in cl.51)

Commissioner

(2-4) Deputy Commissioners

Governance Committee(s)

– Governance Committee(s) are appointed by the Director-General (cl.67)
– Committee(s) responsible for remuneration, risk and audit

Statutory elements of structure

– Commissioner and between two and four Deputy Commissioners appointed by the Minister (cl.57)
– The Commissioner + Deputy Commissioners= Executive Committee (cl.56)
– Executive Committee exercises the powers and duties of FSCA (cl.62)
– Commissioner is responsible for the day-to-day management and administration of the FSCA (cl.61)

Non-statutory elements of structure

Management / organisational structure
Two Authorities: Key characteristics - PA

**PRUDENTIAL AUTHORITY** (established in cl.27)

- CEO appointed by the Governor with the concurrence of the Minister (cl.31)
- CEO is responsible for the day-to-day management and administration of the PA (cl.35)
- Oversight Committee for the PA consists of the Governor, CEO of PA and other Deputy Governors (cl.36)
- Oversight Committee responsible for overseeing the management and administration of the PA (cl.36)

**Governance Committee(s)**
- Governance Committees are established by the Oversight Committee (cl.41)
- Committees responsible for remuneration, risk and audit
- These responsibilities may be performed by the corresponding committee of the Reserve Bank

**Oversight Committee**

**CEO**

**Management / organisational structure**
Licensing in FSR Bill

- Under phase 1, responsibilities for licensing under the current Acts allocated to one of the two licensing authorities **(see Schedule 2)**, including in certain instances for a 3 year transitional period **(cl. 231)**

- Medical Schemes Act (subject to s.231)
- National Credit Act
- Banks Act
- Mutual Banks Act
- Long-term Insurance Act
- Short-term Insurance Act
- Co-operative Banks Act
- Friendly Societies Act
- Financial Supervision of the Road Accident Fund Act
- Financial Advisory and Intermediary Services Act
- Financial Markets Act
- Credit Rating Services Act
- Pension Funds Act (subject to s.231)
- Collective Investment Schemes Control Act (subject to s.231)
Licensing (cont..)

• The relevant licensing authority will be responsible for licenses issued under the Act and supervising requirements of the Act:

  — Licensing requirements remain set by the relevant industry-specific sectoral laws (cl 97), unless designated under this Act (cl. 2(2) or 3(2))

  — The FSR Bill delinks authority powers from licensing – regardless of which authority issues the license, both authorities can apply their regulatory, supervisory and enforcement powers on all financial institutions

  — New licenses and renewal, termination or variations of existing licenses will require the licensing authority to seek the approval of the other authority in respect of matters under its jurisdiction (‘two key’) – cl. 109

• Phase 2 of Twin Peaks process will require more significant changes to licensing process as prudential and conduct frameworks develop
## Overview of the regulatory framework

<table>
<thead>
<tr>
<th>Sectoral law</th>
<th>Deposit Taking (BANKS)</th>
<th>LT &amp; ST Insurance (INSURANCE FIRMS)</th>
<th>Financial services/Advisory</th>
<th>Retirement savings (PENSION FUNDS)</th>
<th>Credit Ratings Agencies (CRAs)</th>
<th>Pooled investments (CIS)</th>
<th>FMIs</th>
<th>Medical Schemes</th>
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<tbody>
<tr>
<td>Designated Licensing Authority</td>
<td>PA</td>
<td>PA</td>
<td>FSCA</td>
<td>FSCA (subject to s.231)</td>
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<td>CMS (subject to s.231)</td>
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### Setting and supervision of standards

*PA and FSCA, for respective standards*

### Enforcement of sectoral law

*Primarily Designated Financial Sector Regulator*
May not easily fit categories of financial product or financial service. FSR Bill provides flexible regulatory structure in which both PA and FSCA responsible for regulating and supervising FMI, and assist the Reserve Bank in exercising its oversight functions relating to NPS.

<table>
<thead>
<tr>
<th>Financial Market Infrastructure</th>
<th>Exchange</th>
<th>CSD</th>
<th>Clearing House</th>
<th>CCP</th>
<th>Trade Repository</th>
<th>NPS</th>
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<td>Sectoral law</td>
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<td>Financial Markets Act</td>
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<td>Licensing authority</td>
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<td>FSCA</td>
<td>SARB</td>
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<td>Supervision of sectoral law</td>
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NPS remains responsibility of the SARB under the NPS Act. The NPS Act is not a financial sector law in terms of the FSR Bill.

- FSCA and PA may make standards with regards to payment system operators and participants in the payment system. Must be issued jointly with SARB

Users and members of FMI and the SRO model to be retained under FSCA
Standards

- FSR Bill introduces new standard-making powers, which will allow the two authorities to impose requirements (subordinate legislation) on financial institutions *(cl.94-96)*. Similar status to current rules, board notices, and other subordinate legislations.

- PA can set **prudential standards**, including to maintain financial stability, for matters such as:
  - Liquidity
  - Leverage
  - Risk management
  - Capital

- FSCA can set **conduct standards** for matters such as:
  - Product design
  - Advice
  - Disclosure
  - Transparency

- Where standards overlap, **the two authorities may set joint standards**
- A clearly defined **public consultation process is set out (cl.90)**
- SARB may, after consulting PA, impose requirements on SIFIS through prudential standards issued by PA
Enforcement

• Authorities provided with comprehensive powers in FSR Bill for undertaking administrative and enforcement action *(Chapter 12)*

• **Financial Services Tribunal** established as independent arbiter.

• **Administrative actions**
  – Authorities must adopt written administrative action procedures
  – An administrative actions committee may be established to advise the authority on appropriate action in complex cases
  – All administrative actions are subject to:

  ![The Promotion of Administrative Justice Act (the PAJA)](image)

• **Enforcement actions**
  – If there is a breach of a financial sector law, prudential or conduct standard, authority can choose to remediate the situation, including by issuing directives, entering into enforceable undertakings, declaring practices as undesirable, or applying to court for appropriate orders, imposing an administrative penalty. **Remediation aims to rectify the breach and ensure it does not recur.**
  – Authority may also institute criminal prosecutions
Accountability

- Strong powers provided along with **appropriate checks and balances**, including:
  - Authorities to develop **regulatory strategies** setting out strategic objectives and focus areas *(cl. 43, 69)*
  - Extensive **consultation process** to be followed when setting standards *(cl. 90, 92)*
  - Financial sector regulators must have arrangements in place for **consulting representatives of financial institutions and financial customers** *(cl. 87)*
  - Authorities must have written **administrative action procedures** regarding the actions it may take in terms of a financial sector law to promote a fair and consistent approach *(cl. 149)*

- Strong appeal mechanism also provided for – **Financial Services Tribunal** *(chp 15)*
The FSR Bill establishes a Financial Services Tribunal (cl.153)

The function of the Tribunal is to hear and decide appeals by persons aggrieved by a decision of a regulator or any other person in terms of the financial sector law (cl.154)

Members of the Tribunal are appointed by the Minister (cl.155)

The Tribunal consists of as many members as the Minister considers necessary, including, at least two advocates or attorneys with a minimum of 10 years’ experience, or retired judges; and at least four persons who have experience and expert knowledge of financial products or financial services.

The Tribunal is chaired by a retired judge, an advocate or an attorney

All of the members of the Tribunal must be independent

An order by the Tribunal has legal force and may be enforced as if it were issued in civil proceedings in the division of the High Court

Decisions of the Tribunal are made public

All administrative actions are appealable to the Tribunal and reviewable to the Courts (cl.166 & 167)
Financial Stability

- **Role and powers of SARB clarified in relation to financial stability mandate (ch. 2, ch. 5).** The SARB:
  - Must monitor fin system for potential systemic risks *(cl. 8-9)*
  - Can designate SIFIs according to a clearly set out process *(cl. 73)*
  - In consultation with the PA, can set enhanced prudential standards for SIFIs, to be supervised by the PA *(cl. 74)*
  - If a systemic event occurs/ is imminent, must inform the Minister and propose actions, and can give directions to other authorities i.e. PA, FSCA, NCR *(cl. 11-16)*

- **Role of the FSOC clarified:**
  - Plays an *advisory* role to the Reserve Bank to support it in fulfilling its financial stability mandate *(cl. 17-18)*
  - Membership more balanced and decisions made on a consensus basis *(cl. 19)*
  - Produces annual Financial Stability Review *(cl. 22)*

- **The Bill provides for Conglomerate (group) supervision** and allows authorities to regulate and supervise groups in their entirety, rather than only at holding company level *(ch. 11)*
Role of the NCR

- Twin Peaks is a comprehensive and coherent system going beyond the setting up of the “twins”

| PRUDENTIAL REGULATOR/ MARKET CONDUCT REGULATOR | NCR
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- **Harmonised system of licensing**
- **Consumer recourse (including ombuds system)**
- **Appeal mechanism (tribunal)**
- **Enforcement**
- **Co-ordinated supervision**
- **Information sharing**

**Coordination, cooperation, collaboration (licensing, inspections, investigations, enforcement, etc)**

Financial Stability- NCR is a member of the FSOC and CoFR
Platforms for co-operation and co-ordination between financial sector regulators

- FSCA and the PA have an obligation to co-operate with all key regulators (cl.29 & 53)
- Financial sector regulators must have arrangements in place for consulting representatives of financial institutions and financial customers (cl.87)
Ombud scheme system

• Revised **FSR Bill proposes to repeal the FSOS Act**, and integrate provisions into the FSR Bill, to align ombud system to evolving Twin Peaks regulatory system, in keeping with a **unified** regulatory approach and move away from the range of industry specific legislation *(Chapter 16)*

• The FSR Bill proposes:
  – Establishing the **FSOS Council as a statutory body that will establish a single point of entry** into the ombud system
  – Making it **compulsory for financial institutions to belong to an ombud** scheme
  – Requiring **all ombuds schemes to be registered** with the FSOS Council
  – Strengthening **mechanisms for FSOS Council to ensure a consistent framework for external dispute resolution mechanisms** across the financial services industry, including increasing awareness of ombuds, advising on jurisdictions, and prescribing council standards

• An important question for public consultation is whether the approach taken in the Bill is sufficient for an effective ombuds system in the financial sector

• Improvements to the ombuds system also discussed in the market conduct framework discussion document
Implementation Phases

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
A framework within which FSCA will ultimately operate is being drafted and *first draft was released with the FSRB in December for comments*

*Framework sets out key considerations for strengthening and improving market conduct under twin peaks model*, including significantly streamlining current industry facing legislation and consolidated view of many projects underway in various financial sub-sectors

*Separate consultation process will be followed for feedback on draft framework*, longer period for consultation than for second draft of FSR Bill

*Draft legislation for conduct regulation likely in 2016*
Next steps

- **Process**
  - **January – April 2015** Individual stakeholder consultations, and processing of comments received, in revising the Bill
  - **2015 Tabling**
Questions