

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

*Jan-Feb 2015*



**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

# 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 )



# 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*

# What are the 'peaks'?

## Prudential Authority

- Enhanced oversight of micro-prudential regulation for banks, insurers, financial markets, special focus on conglomerates

## Financial Sector Conduct Authority

- Regulatory laws that are *complete, harmonised, integrated, proportionate* - **all** financial services, incl banking
- *Increased focus on outcomes*, esp. treating customers fairly, focus on contract terms & costs
- *Targeted interventions to market failures* - retirement reform, Jali Commission recommendations, insurance protection, FAIS, etc

## Financial Services Tribunal and Enforcement

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

## Financial Stability (FSOC)

- Inter-agency co-ordination of financial stability issues



# Key changes to 2<sup>nd</sup> 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<sup>nd</sup> draft of FSR Bill – (cont')

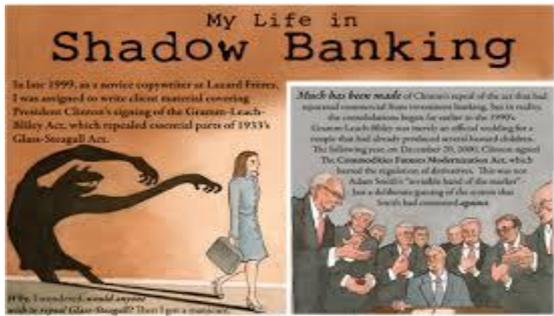
- ***Better align the governance arrangements*** for the new regulatory agencies, including clarifying the institutional form of the PA operating within the SARB **(cl. 30 – 44 and cl 55 – 70)**
  - ***Clarify the role of other financial sector regulators*** under Twin Peaks. The role of the National 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



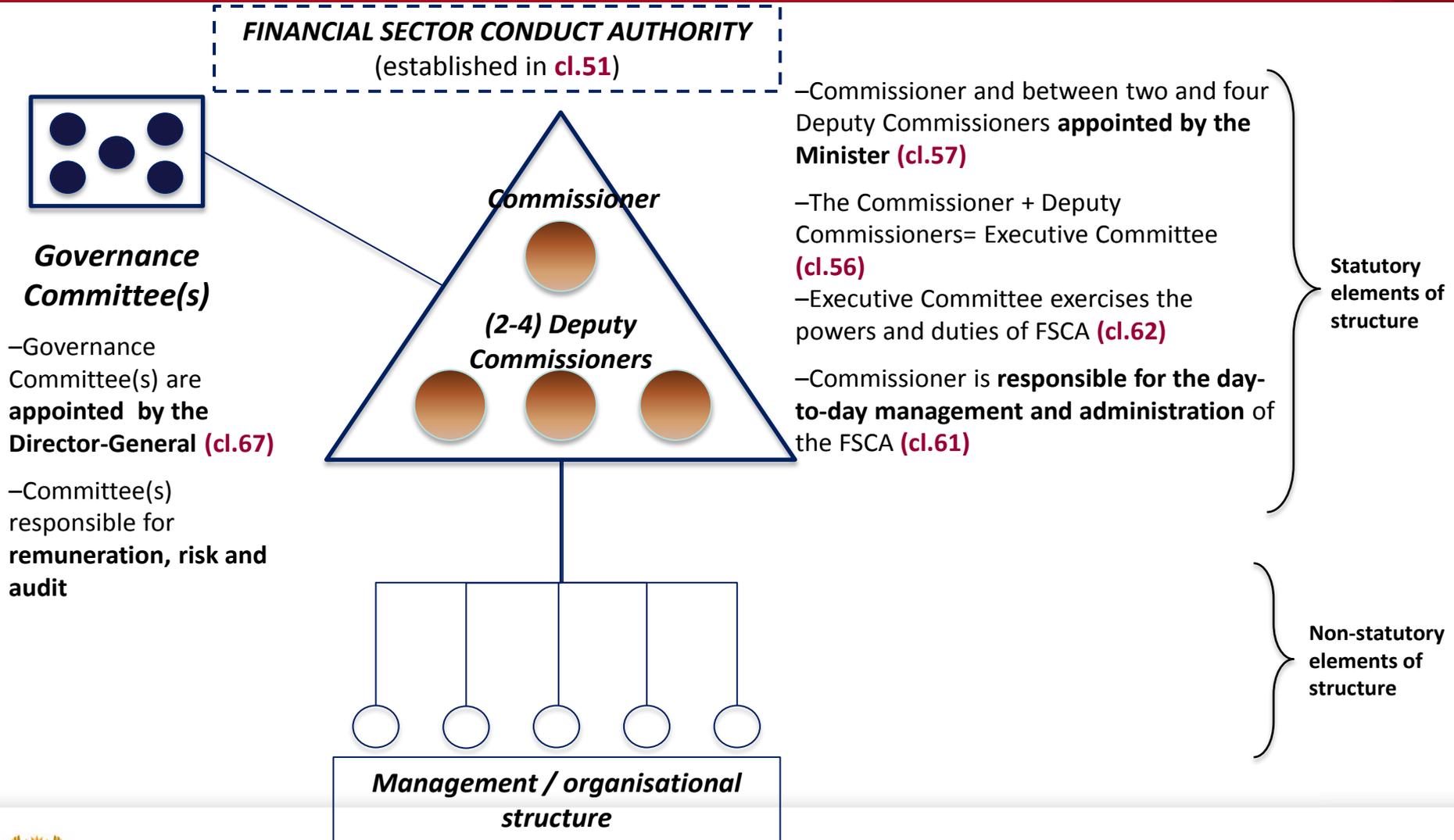
- PA responsible for supervising safety and soundness of financial institutions that provide **financial products, market infrastructures or payment systems (cl.27 – 29)**
- Linked to products, prudential oversight required so institutions meet financial obligations to customers ('promises').
- **Financial 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

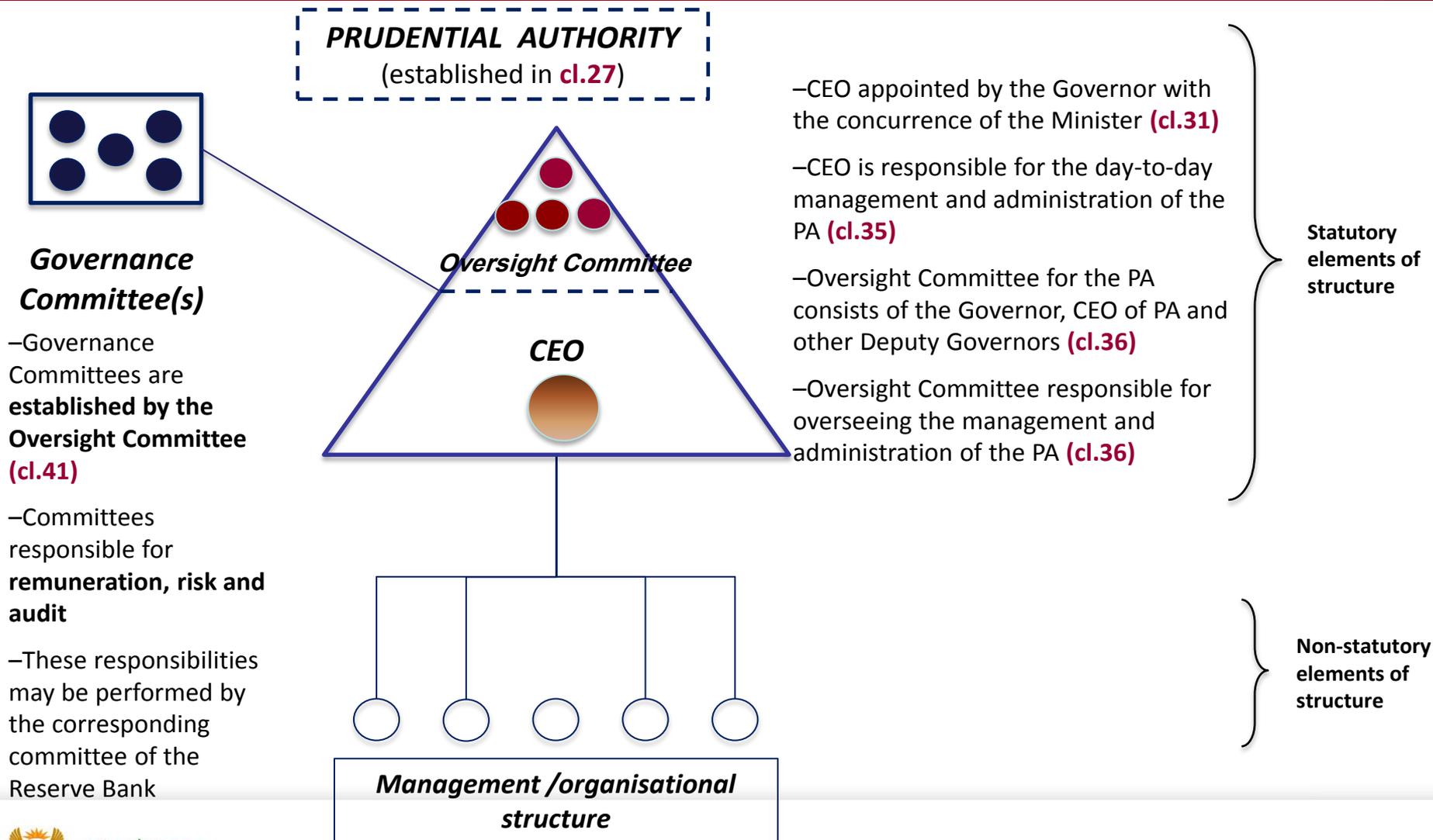


- FSCA responsible for fair treatment, integrity and education, and will supervise **services performed in relation to financial products, foreign financial product, securities, market infrastructure or the payment system** as applicable **(cl.3)** :
  - promotion, marketing or distribution
  - providing 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

# Two Authorities: Key characteristics - FSCA



# Two Authorities: Key characteristics - PA



# 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

***Prudential  
Authority***

–Banks Act  
–Mutual Banks Act  
–Long-term Insurance Act  
–Short-term Insurance Act  
–Co-operative Banks Act

***Financial Sector  
conduct Authority***

–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

|                                      | Deposit Taking (BANKS)                                 | LT & ST Insurance (INSURANCE FIRMS)   | Financial services/ Advisory                     | Retirement savings (PENSION FUNDS) | Credit Ratings Agencies (CRAs) | Pooled investments (CIS)                  | FMIs                  | Medical Schemes        |
|--------------------------------------|--------------------------------------------------------|---------------------------------------|--------------------------------------------------|------------------------------------|--------------------------------|-------------------------------------------|-----------------------|------------------------|
| Sectoral law                         | Banks Act                                              | Long-term / Short Term Insurance Acts | Financial Advisory and Intermediary Services Act | Pension Funds Act                  | Credit Rating Services Act     | Collective Investment Schemes Control Act | Financial Markets Act | Medical Schemes Act    |
| Designated Licensing Authority       | PA                                                     | PA                                    | FSCA                                             | FSCA (subject to s.231)            | FSCA                           | FSCA (subject to s.231)                   | FSCA                  | CMS (subject to s.231) |
| Setting and supervision of standards | <i>PA and FSCA, for respective standards</i>           |                                       |                                                  |                                    |                                |                                           |                       |                        |
| Enforcement of sectoral law          | <i>Primarily Designated Financial Sector Regulator</i> |                                       |                                                  |                                    |                                |                                           |                       |                        |

# Zooming in on the approach to FMI and NPS

- 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

| Financial Market Infrastructure             | Exchange                              | CSD | Clearing House | CCP | Trade Repository | NPS         |
|---------------------------------------------|---------------------------------------|-----|----------------|-----|------------------|-------------|
| <b>Sectoral law</b>                         | Financial Markets Act                 |     |                |     |                  | NPS Act     |
| <b>Licensing authority</b>                  | FSCA                                  |     |                |     |                  | SARB        |
| <b>Supervision of sectoral law</b>          | Primarily FSCA, also PA for licensing |     |                |     |                  | SARB        |
| <b>Setting and supervision of standards</b> | PA and FSCA, for respective standards |     |                |     |                  | PA and FSCA |
| <b>Enforcement of sectoral law</b>          | Primarily FSCA, also PA for licensing |     |                |     |                  | SARB        |

- 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:
- **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

## **The Promotion of Administrative Justice Act (the PAJA)**

# 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)**



# Financial Services Tribunal



- 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)**

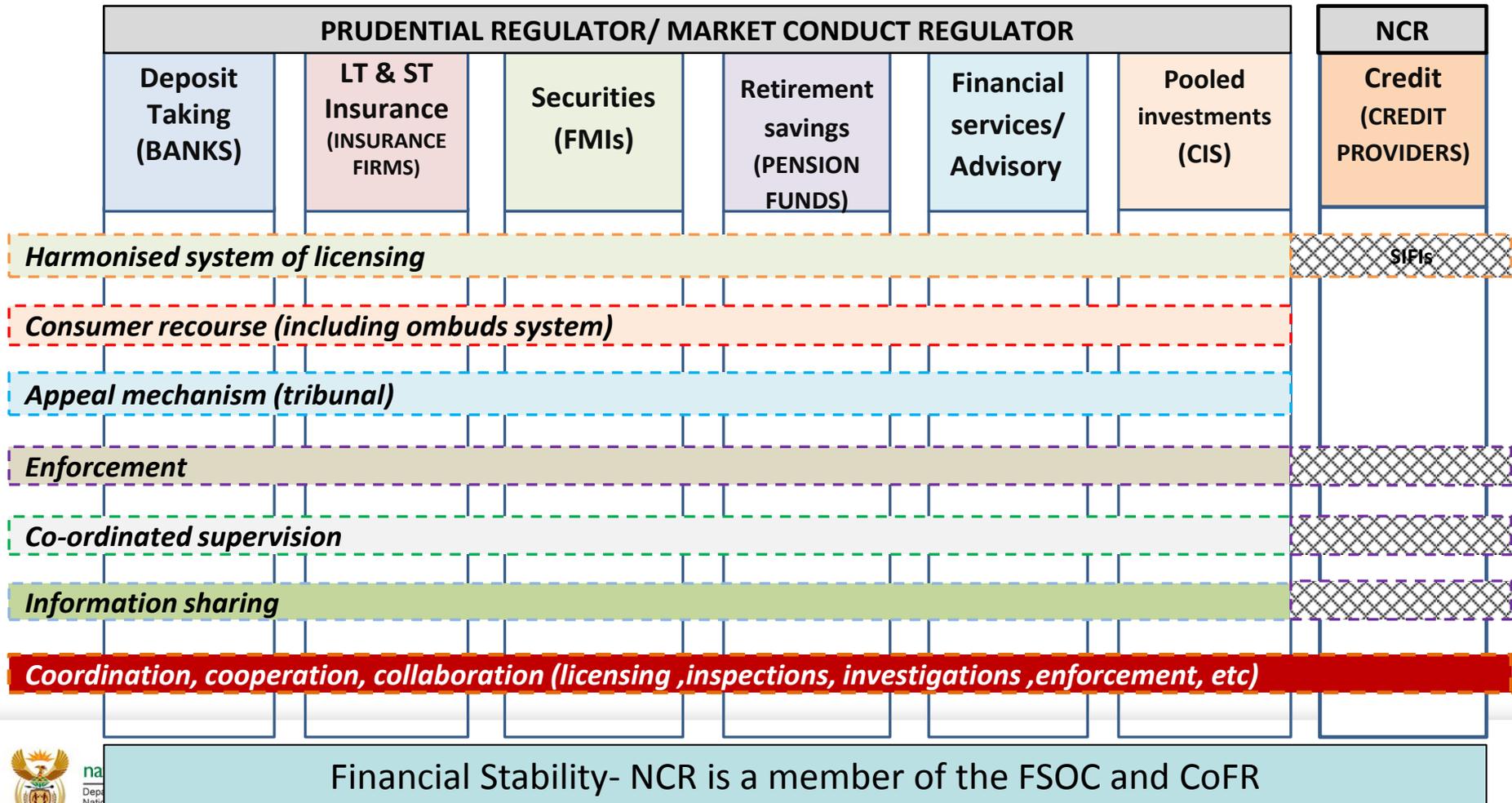
# Financial Stability

- **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)

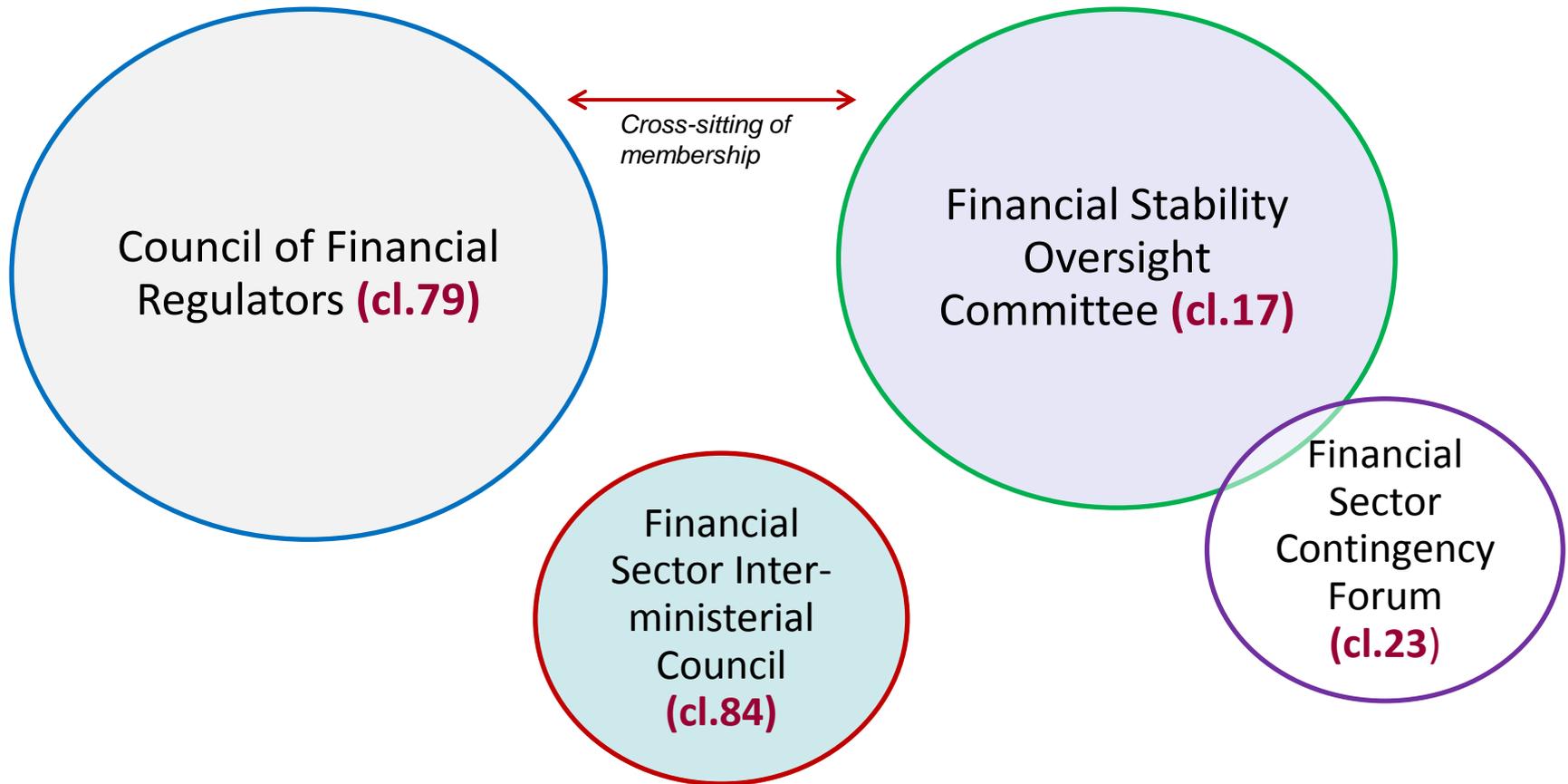


# Role of the NCR

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



# 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)**

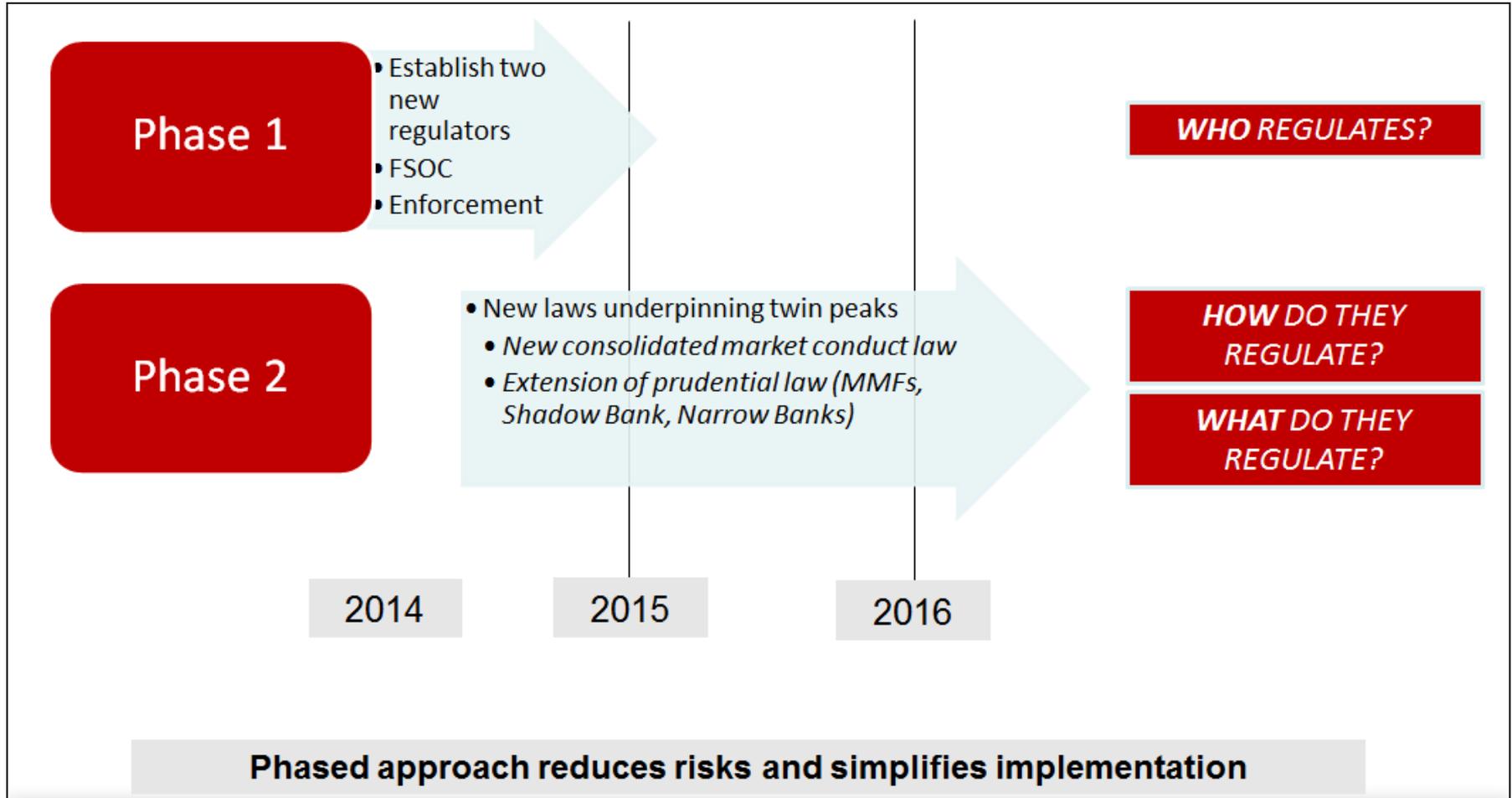
# Ombud scheme system



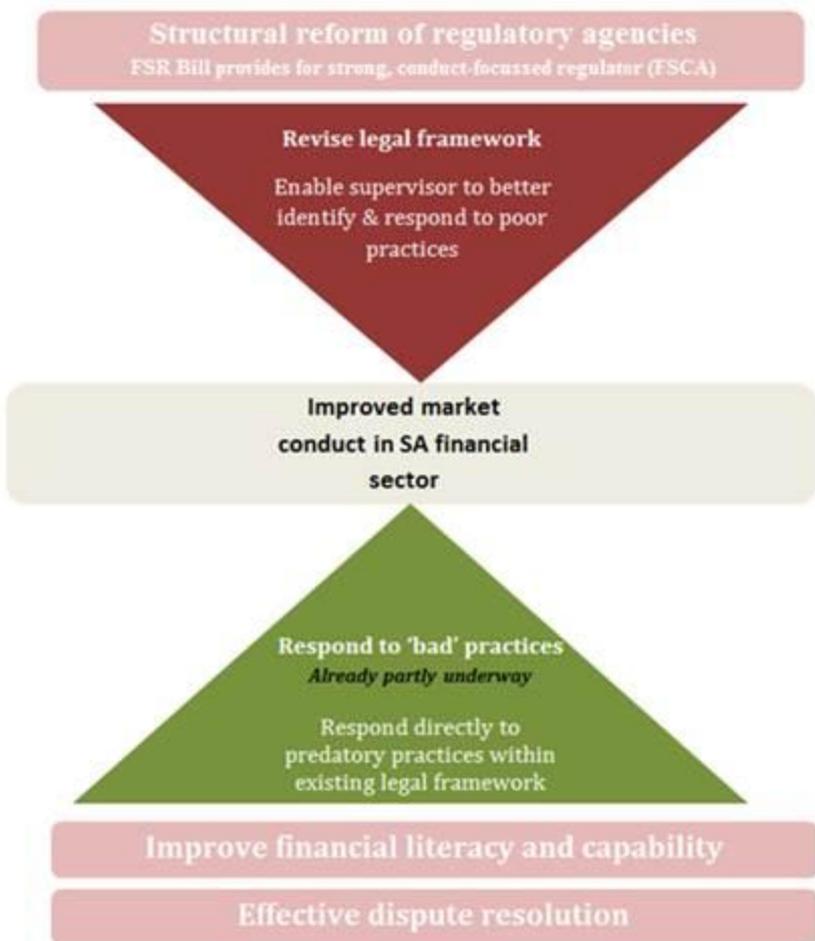
- Revised **FSR Bill proposes to repeal the FSOS Act**, and integrate provisions into the FSR Bill, to align ombud system to evolving Twin Peaks regulatory system, in keeping with a **unified** regulatory approach and move away from the range of industry specific legislation (**Chapter 16**)

- 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

# Implementation Phases



# Draft Market Conduct Policy Framework



- 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