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National Credit Amendment Bill

Presentation to the Portfolio Committee on Trade and Industry

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Objectives of Treasury presentation

- First objective of this presentation is to provide broader perspective of the overall policy framework adopted by Cabinet to reform the regulation of the financial sector, following the 2008 Global Financial Crisis (GFC)
  - Lessons from 2008 GFC and what it means for SA in terms of G20 commitments by the President
  - Financial Stability objective and macroprudential powers
  - Twin peak micro-regulators
    - Micro-prudential regulator – Prudential Regulatory Authority
    - Market Conduct Regulatory Authority
- Second objective of presentation is to provide government policy to deal with problem of over-indebtedness households
- Third aim is to situate NCA Amendment process within above two objectives
  - What problems are we trying to solve with current amendments?
  - How do we deal with potentially conflicting objectives? (prudential, conduct, access)

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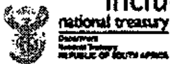
National Treasury supports the direction of amendments to the NCA

- Credit is important for the economy, for both growth and jobs
  - But SOME credit is BAD for both households and the economy
- Efforts to define and limit **reckless lending**
- The introduction of **affordability criteria**
- Introduction of **fit and proper standards** for debt counsellors
- Removal of certain bottlenecks, loopholes and unintended consequences from the **debt counselling** process
- Registration and supervision of **payment distribution agencies.**
- Key question is whether the above reforms should not go further, and be more intrusive, given the lessons learnt after the 2008 Global Financial Crisis (GFC)?
  - Do the amendments protect customers more effectively from reckless lending practices?
  - Will the amendments allow us to set tougher standards for payday lenders?
  - Will licensing be subject to tougher fit and proper requirements that include capital adequacy requirements?



How do NCA Amendments fit into broader reform package?

- NCA was passed in 2005, BEFORE the 2008 Global Financial Crisis (GFC)
  - Ahead of its time when enacted
- Following 2008 GFC, G20 countries have led attempts to make the financial sector safer, and shifted away from light tough regulation of fin sector
- New global standards (eg Basel 3) to regulate financial sector are much tougher and more intrusive
  - Toughest standards apply to global SIFIs (systemically important fin inst)
- South Africa has also moved to tougher regulation, including shift to Twin Peaks system of regulation approved by Cabinet in 2011
  - Twin Peaks Bill published for comment in Dec 2013
  - Macroprudential regulator to oversee financial stability
  - Creation of two super-regulators, one prudential, other for market conduct
- How does NCA relate to the coming Twin Peaks system of regulation?
- How do the NCA amendments deal with household indebtedness?

Twin Peaks Reform

What are the key lessons after 2008 GFC?

- The Global Financial Crisis has forced a changed in the regulatory paradigm, from light-touch regulation to a more intrusive and effective system of regulation
- Financial sector is globally integrated, but regulated nationally, hence need for global standards
  - G20 leaders set standards via Fin Stability Board and IMF
- Key lesson of GFC is need to deal with TBTF (too big to fail) banks, that pose a risk to the stability of the fin system as a whole, and to the economy and jobs
  - Focus on how to maintain financial stability
  - Classification of SIFIs, both G-SIFIs and D-SIFIs (global and domestic SIFIs)
- Key initiatives include:
  - Global standards like Basel 3, OTC derivatives, shadow banking
  - Peer review of all G20 members
  - Reducing the scope for regulatory arbitrage
  - Regulators to work together and share information

Financial Stability Board

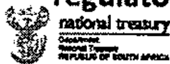
- The Financial Stability Board was set up by the G-20
- The financial crisis highlighted that different rules in different countries lead to enormous problems. As a result, the Financial Stability Board has been tasked with:
  - **Setting standards** for financial regulation, together with Basel Committee, the International Organisation of Securities Commissioners (IOSCO) and the International Association of Insurance Supervisors (IAIS)
  - **Monitoring implementation of those standards**. G-20 members have committed to regular evaluation of their standards and financial systems.
  - **Peer reviews**. Countries are assessed on their regulatory systems by their peers. South Africa was reviewed in 2013 by a team drawn from international regulators. (See next slide).
  - **Ensuring co-ordination between countries**. There are a number of international committees on a variety of topics, including regulatory coordination and vulnerabilities

What is SA committed to doing from G20 commitments?

- President has committed SA to meet with global standards at G20 Leaders Summits
- Cabinet approved shift to Twin Peaks in 2011, following policy doc "A safer financial sector to serve SA better"
- Cabinet approved publication of new Twin Peaks legislation for comment at meeting of 4 Dec 2013
  - Financial Sector Regulations Bill available on Treasury website
  - Bill mandates the SA Reserve Bank to protect financial stability within agreed framework
  - Establishes the Prudential Regulator within the SA Reserve Bank
  - Establishes new Market Conduct Regulator from Fin Services Board
- Basel 3 and other standards to be implemented through new legislation
- SA fin regulatory system peer reviewed by Fin Stability Board in 2013
- SA will be subjected to FSAP by IMF in 2014

Current regulatory system in SA

- Current regulatory system is fragmented in SA
- Credit is regulated by NCR, and deposits by BSD in the SA Reserve Bank
  - So most banks have different side of balance sheet regulated by two regulators
  - Non-bank lenders only regulated by NCR
- Most major fin institutions tend to be conglomerates, and tend to do banking, lending, insurance, asset management, retirement funds etc
  - Hence regulated by BSD in SARB, NCR, Fin Services Board as well as FIC
  - In addition NPA in the SARB regulates payment systems, and FIC regulates anti-money laundering
- Key question to consider is to what extent the regulators work together, and do not cause a financial crisis when acting against a financial institution
- **A joint, co-ordinated approach across departments and regulators** is required
- Need for **better co-ordination and co-operation between all financial sector regulators** (NCR, FSB, SARB), to regulate the credit market more effectively



Cabinet has approved four policy objectives when approving Twin Peaks

- 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 (FINANCIAL INCLUSION)**
  - Access is important for inclusive economic growth

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Four main policy objectives

"Twin peaks"

Financial Stability	Consumer protection	Access to financial services	Combating financial crime
• Reserve Bank to lead • Establish a Financial Stability Oversight Committee	• Financial Services Board and National Credit Regulator to lead • New market conduct regulator for banking services in the Financial Services Board	• Treasury to lead • Further support to co-operative and dedicated banks, including Postbank • Treasury to introduce a microinsurance framework	• Enforcement agencies to lead • Investigating and prosecuting abuses • Continued work with international partners

Council of Financial Regulators
Ensures coordination where necessary

Twin Peaks is a System, with many parts

Prudential Authority

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

Market Conduct Authority

- Regulatory laws that are *complete, harmonised, integrated, proportionate* - all financial services, incl, banking i.e. 2013 Banks Act amendment
- *Increased focus on outcomes*, esp. fair "Treating customers fairly" and focus on contract terms & costs
- *Targeted interventions to market failures* - retirement reform, Jali Commission recommendations, insurance protection, FAIS

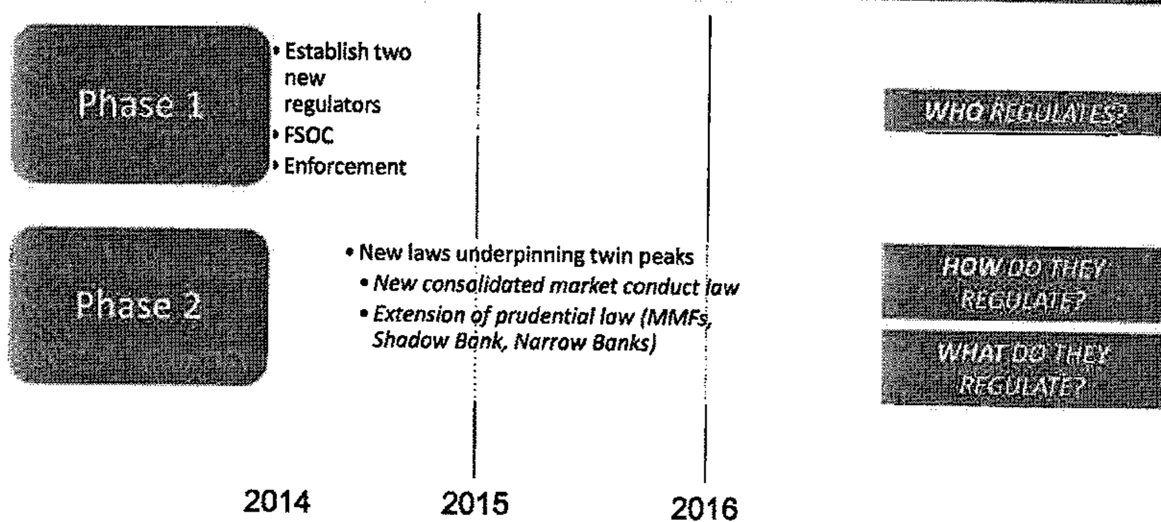
Financial Services Tribunal and Enforcement

- 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



Phased approach reduces risks and simplifies implementation

Outcomes of 2013 Fin Stability Board Peer Review

- South Africa was assessed in 2013 by peer countries in the Fin Stab Board, which identified weaknesses (eg in co-ordination) in current regulatory system, and also assessed coming Twin Peak system proposals.
- Team comprised regulators from Germany, Australia and Saudi Arabia; supported by FSB Secretariat from Switzerland
- Peer Review Recommendations (Full report www.treasury.gov.za/twinpeaks)
  - welcomes the planned reforms and agrees that a shift to a Twin Peaks model provides a good opportunity for South Africa to streamline responsibilities and elevate the importance of market conduct regulation, which has historically played a less prominent role in certain financial sub-sectors (e.g. banking)
  - To ensure effective market conduct regulation and to avoid regulatory overlaps or gaps, the team made specific proposals on how NCR should relate to the Twin Peaks System
- Government considering the recommendations, no final decisions until after receiving public comments on Twin Peaks Bill

Key area of concern at G20 and Fin Stab Board is the need to regulate Shadow Banking

- Shadow banks are institutions that act like banks but are not subject to banking regulation. Key concern is that shadow banks are not regulated PRUDENTIALLY
- Currently there are more than 5 500 credit providers
- Only 32 credit providers are banks that are prudentially regulated
  - Only banks registered with the SARB may legally take deposits
  - Large non-bank lenders get funding from the bond market, often through securitisation
- Large sophisticated non-bank lenders pose 3 interconnected risks, which require prudential supervision
  1. Credit extension (NCR regulated)
  2. Maturity transformation (unregulated)
  3. Leverage (unregulated)

Key test for NCA Amendments is to give effect to new prudential regulatory objectives

- How can the Bill recognise the need for **financial stability as a policy priority?**
  - No regulator should act in a way that can cause a systemic crisis
- How does the Bill force regulators to work more co-operatively and share info?
- How does the Bill reduce the scope for regulatory arbitrage?
- How does the Bill give effect to international commitments to make the financial sector safer?
- How do the NCA Amendments deal with regulating the shadow banking sector

PROTECTING CUSTOMERS: Household Indebtedness and Market Conduct

How do NCA amendments protect the customer better?

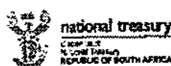
- Market conduct reforms aim to protect the customer better, and to regulate HOW fin institutions conduct their business
- Financial sector must be held to higher standards that in other markets, hence the need for specific approach different from more generic consumer protection legislation
- New approach follows on Jali enquiry into bank charges, and recent work on charges and costs in retirement industry
- Financial sector must be pushed to compete on price, and not on products, which are very difficult to compare.
- Key challenge is how the Bill will enable NCR to deal with the abuses in the retail credit industry
- Bill provides for the National Credit Regulator to register (deregister) and accredit **alternative dispute resolution agents** (ADRAs) even though a regulatory framework already exists for ombud schemes
- Bill silent on a regulatory framework for **voluntary debt mediation.**

How does the Bill deal with potential conflicts?

- NCA has commissioned several excellent studies
  - An assessment of debt counselling in SA (1 May 2012) (Univ of Pta)
  - Literature Review on the Impact of the NCA has had on SAs Credit Mkt (June 2012)
- Papers identify problems, with some dealt with in the Bill, but others not
- NCA Amendment should clearly state that NCR is there to protect the customer over all other players who are there to serve them (credit providers, debt counsellors, PDAs)
- Need to deal with perverse incentives related to debt counselling (wider probem related also to financial advisors and commissions/fees)
- Debt counselling mainly assists consumers who are employed and earn sufficient income to pay debt counselling fees, which comprise an upfront fee of up to R6000 and up to 5% on monthly payment to a maximum of R400
- There are only 500 active debt counsellors and over 8000 consumers signing up every month
- Debt counsellors are not regulated as financial advisors even though they manage the entire balance sheet of consumers

Key problem to address is household over-indebtedness

- Cabinet is extremely concerned at over-indebtedness problem in SA
- While credit is good for the economy and consumer, it is bad for over-indebted households, especially low-income households
- South African households are indebted at 76% of disposable income
  - Lower than S Korea at 160%, UK at 165%, Denmark at 279%
  - Higher than Italy at 59%, Poland at 58%, Slovakia at 44%
  - BUT OVER-INDEBTEDNESS CONCENTRATED IN LOWER-INCOME MKT
- NCR figures at end Dec 2011 indicated that 47% of of the 19.3 mil credit active consumers have impaired records (three months or more in arrears), with a further 14.7% in arrears for one or two months
- Since highly-leveraged households are more sensitive to changes in income and interest rates, shocks to the economy have a bigger impact on the financial strength and consumption of households that are highly indebted



Why do we have the problem of over-indebtedness?

- Most countries encouraged more credit to get higher growth before 2008
- In South Africa community, government and labour all wanted more access to credit (eg Financial Sector Charter, Red October campaign etc)
- We also opened up payment systems following the Competition Commission enquiry into competition in banking (so-called Jali Commission)
- **ALL our regulators were NOT tough enough (but this is wisdom in hindsight, AFTER 2008)**
- Examples of possible actions that should have been considered:
  - We could have put up loan-to-value limits and higher capital requirements, but this would have decreased access
  - We could have limited access to payment system by smaller lenders (i.e., contrary to Jali Commission)
  - We could have put in affordability criteria
  - We could have restricted the activities of pay-day lenders and lenders targeting social grant recipients
  - We could have ensured that only a Court (and not the Clerk) issue garnishees for credit

Cabinet has approved TOUGHER measures to address the problems (4 Dec 2013)

- Cabinet has accepted that we need a JOINT approach between at least three depts and the regulators who report to them (dti, NT, DoJ)
- Ministers of Finance and of Trade and Industry should develop a programme to **assist over-indebted households** and **strengthen financial stability,** taking into consideration tougher Twin Peaks standards aimed at improved co-ordination and co-operation between all financial regulators (NCR, FSB and SARB);
- Ministers of Justice and Constitutional Development, of Finance and of Trade and Industry should take measures to limit the scope for fraudulent and abusive practices relating to **emolument attachment orders** (EAOs) for credit; and explore tougher regulation of all **debt-collection firms** (including legal firms) in line with the Twin-Peaks reform outlawing unscrupulous debt-collection practices; and
- The Minister of Finance should encourage private and public sector employers to assist **over-indebted employees** by investigating employees emolument attachment orders for validity;

Framework for the implementation of government proposals to assist over-indebted consumers

- The following proposal can be implemented quickly i.e., within the next year:
  - Affordability and suitability criteria
  - Pricing caps, particularly in respect of pay-day loans, mortgages and loans secured by direct payroll deductions
  - Consumer credit insurance reforms
  - Voluntary debt mediation
  - Unilateral relief by lenders to distressed borrowers
  - Initiatives to eliminate abuse of emolument attachment order
- The following could be fully implemented in the medium term (by 2015)
  - norms and standards for access to the payment system
  - reform of debt collectors regulatory framework
  - Improved regulatory monitoring, supervision and enforcement to shut down unregistered credit providers and ensure compliance of registered credit providers.
- Implementation of an improved solvency regime will be relatively long-term.

Preventative proposals by government to minimise the risk of over-indebtedness in the future

- Set clear affordability criteria that all retail lenders have to adhere to and clearly defining "reckless lending" under the National Credit Act
- Ensure the provision of credit is not only affordable but suitable. For example it is clearly inappropriate to promote a short-term (30 day) loan as being suitable for supporting borrowing over longer periods.
- Reviewing the pricing caps under the National Credit Act to ensure that current levels of caps are appropriate, especially for pay-day loans where rates are excessive.
- Strengthen regulatory monitoring, supervision and enforcement to ensure the shutting down of unregistered credit providers and full compliance of registered credit providers.
- Review the regulatory framework for credit insurance policies that are sold with, or linked to, credit.

Government proposals to assist households that are already in a debt trap

- Engage with lenders and their industry associations to provide appropriate relief to qualifying distressed borrowers by reducing their installment burden, without additional cost to the borrower
- Enable major lenders to provide voluntary debt relief measures to distressed borrowers without charge, in addition to the current debt counseling process, subject to compliance with the National Credit Act and Financial Advisory and Intermediary Services Act
- Engage with current lenders to take steps to withdraw certain categories of existing emolument attachment orders for credit, and to use such orders for future credit only as a last resort and according to a robust code of conduct
- Regulate debt-collection firms, including legal firms, to ensure they do not indulge in unscrupulous debt-collection practices
- Encourage employers to investigate the legitimacy of all emolument attachment or garnishee orders they may be enforcing against their employees (for purposes of credit not maintenance) and to write to credit providers to reduce or even remove all onerous orders. Public sector employers will be expected to lead by example.

Preventative proposals by government to minimise the risk of over-indebtedness in the future (2)

- Set norms and standards for access to the payment system, including for debit orders. Persistent reckless lenders should be denied access to the payments system
- Set norms and standards for emolument attachment and garnishee orders issued for credit
- Extend and strengthen the debt collection law to apply to legal firms
- Regulate credit-linked deductions allowed on employer payroll systems
- Investigate simpler and lower-cost insolvency arrangements for lower- and middle-income individual persons

Prime example of market failure due to fragmented regulatory framework: consumer credit insurance

- The NT and FSB are finalising a review of the regulatory framework for Consumer Credit Insurance ("CCI") in South Africa. A discussion paper on key findings is being released
- The responsibilities of the NCR and FSB in relation to credit insurance overlap.
- In the current legislative framework, the FSB is the primary regulator of insurers and insurance business, as well as financial intermediaries.
- The National Credit Act, however, introduces elements of dual regulation in respect of CCI. Although the NCR clearly has a key interest in the operation of the credit insurance market, in view of its integral role in overall credit provision, the current framework poses risk of duplication and inconsistency in supervision by the two regulators.
- The findings of the review suggest that competition in the market is not effective, with high premiums, low claims ratios which brings into questions the overall value proposition of CCI for consumers.

Improving the functioning of the retail credit market

- Credit is critical for the economy, and it is critical that the regulatory system functions more effectively
- NCR must act decisively against reckless lending, and do so in a way that does not endanger financial stability
- It is important that credit bureaus are effectively regulated, and fair to the customer
- NT supports regular clean-up of data, but this must be done carefully, and not in a way makes it more difficult for lenders to determine whether a loan is reckless or not
- **Credit information review** proposal must be assessed to ensure that it does not worsen the problem of reckless lending and over-indebtedness for many households
- There is little sense in removing adverse info of UNPAID debtors
- Tougher regulatory standards are required to deal with pay-day lenders, and to regulate the debt-collection industry, esp legal firms that collect debt.

Conclusion

- NCA Amendments are in the right direction
- However, global standards have got tougher, and NCA needs to be tougher to keep up to new standards (including dealing with shadow banking)
- Also, NCA Amendments need to protect the CUSTOMER better, and prioritise the CUSTOMER over credit providers, advisors and debt counsellors
- We need to take care that in improving the credit info framework, we do not in fact restrict good credit to good borrowers
- We need to take a COMPREHENSIVE view of the impact of our entire financial sector regulatory framework to prevent REGULATORY ARBITRAGE and be more effective