

Presentation to the Standing Committee of Finance on the Financial Sector Regulation Bill

November 2015



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

- Representatives:
 - Ismail Momoniat, DDG: Tax and Financial Sector Policy
 - Roy Havemann, CD: Financial Stability and Markets
 - Katherine Gibson, CD: Market Conduct
 - Petula Sihlali, DD: Financial Markets and Competitiveness
- Previous presentations in 2015
 - **2 June 2015:** Twin Peaks Regulatory Reform: Making the financial sector safer and better for customers
 - **11 August 2015:** Update on Twin Peaks and Financial Sector Regulation Bill
 - **15 October 2015:** Visit from Dutch and UK conduct representatives
- This presentation follows the formal tabling of the Bill

Twin Peaks reform process to date

- **2011** – Policy paper ‘*A safer financial sector to serve South Africa better*’, 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 , consulted on
- **December 2014**– **Second** draft of the FSR Bill (with response doc & draft MCPF) published, consulted on
- **November 2015** – FSR Bill tabled in Parliament
- **Next steps:** Establish new regulatory authorities (target **2016**)
- **Next steps:** Conduct framework – draft legislation in **1H 2016**



Aim of Twin Peaks regulatory model in SA

- **Increased regulatory coverage**, minimising potential for regulatory gaps
- Regulatory laws that are **complete, harmonised, integrated, proportionate**
- **Dedicated and equal emphasis** on monitoring stability, prudential and conduct risks in financial sector
- Enhanced oversight of **micro-prudential regulation** for banks, insurers, financial markets, special focus on conglomerates – **Prudential Authority**
- **Increased focus on outcomes**, especially fair customer treatment – **FSCA**
- **More efficient use of supervisory capacity**, strengthen risk-based approach
- **Strong and swift action** for contraventions

Reforms are guided by a set of principles

- **Principle 1:** Financial service providers must be appropriately licensed or regulated.
- **Principle 2:** There should be a transparent approach to regulation and supervision.
- **Principle 3:** The quality of supervision must be sufficiently intense, intrusive and effective.
- **Principle 4:** Policy and legislation are set by government and the legislature, providing the operational framework for regulators.
- **Principle 5a:** Regulators must operate objectively with integrity and be operationally independent, but must also be accountable for their actions and performance.
- **Principle 5b:** Governance arrangements for regulators and standard-setters must be reviewed, so that boards perform only governance functions

Reforms are guided by a set of principles

- **Principle 6:** Regulations should be of universal applicability and comprehensive in scope in order to reduce regulatory arbitrage.
- **Principle 7:** The legislative framework should allow for a lead regulator for every financial institution that is regulated by a multiple set of financial regulators.
- **Principle 8:** Relevant ministers must ensure that the legislation they administer promotes coordination and reduces the scope for arbitrage.
- **Principle 9:** The regulatory framework must include responsibility for macroprudential supervision.
- **Principle 10:** Special mechanisms are needed to deal with systemically important financial institutions (SIFIs).
- **Principle 11:** Market conduct oversight must be sufficiently strong to complement prudential regulation, particularly in the banking sector.

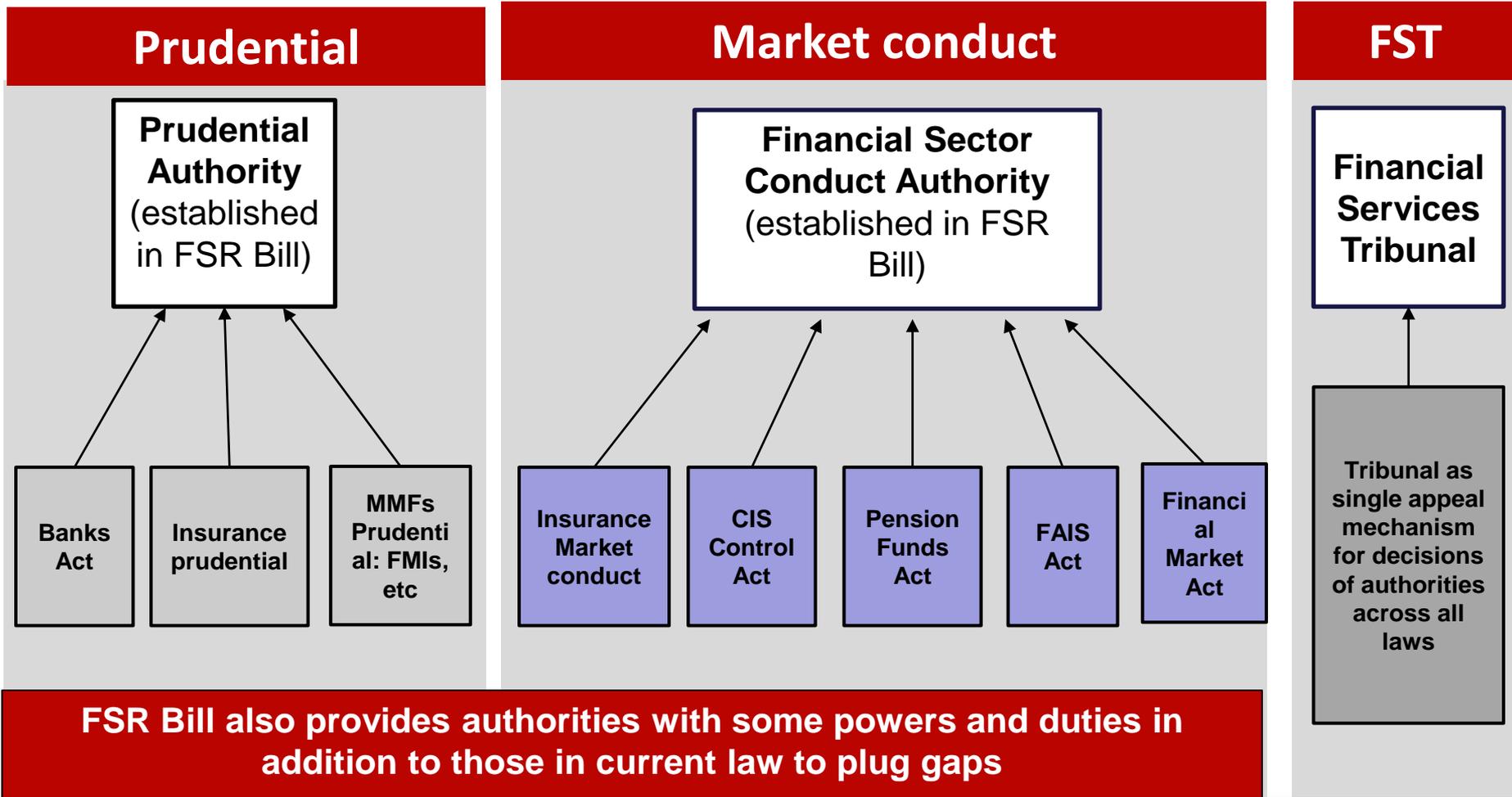
Reforms are guided by a set of principles

- **Principle 12:** Financial integrity oversight should be effective to promote confidence in the system.
- **Principle 13:** Regulators should be appropriately funded to enable them to function effectively.
- **Principle 14:** Financial regulators require emergency-type powers to deal with a systemic financial crisis, requiring strong and overriding legislative powers.
- **Principle 15:** All the above principles are reflected in international standards like Basel III and standards set by the International Association of Industry Supervisors (IAIS) and International Organisation of Securities Commission (IOSCO). To the extent that there are any contradictions or inconsistencies in the above principles, consideration needs to be given to apply those international standards taking into account local conditions. Where possible these standards should not be contradicted by the principles outlined above,

Financial services regulation needs to align to international best practice

- South Africa is committed to ensuring financial services regulation remains amongst the best in world
- Regularly subject to a variety of peer reviews and international assessments by G-20 Financial Stability Board, International Monetary Fund, World Bank, Ratings Agencies, World Economic Forum, etc.
- All highlight that financial services regulation is amongst best in world
- But complacency is a risk
 - IMF FSAP noted a number of areas that need to be improved
 - Twin Peaks
 - Key areas: Regulation of derivatives, money market funds, insolvency framework for banks

Existing laws under Twin Peaks



Aim of consequential amendments

- Currently 13 pieces of financial sector legislation (**Schedule 1**). FSR Bill intended to be overlay on current legal framework, and take steps toward final Twin Peaks framework
- Consequential amendments indicate **how current laws will operate when FSR Bill enacted** – clarifies that powers and duties in FSR Bill are **in addition to** those in current law
- Amendments ensure **common definitions and understanding across laws** – e.g. **‘Authority’** replaces **‘registrar’**, **‘regulations’** to be read as **‘standards’** etc.
- Amendments ensure **same processes followed in all laws** when undertaking actions such as inspections, investigations, consulting on legislative instruments, publishing documents on Register etc
- Amendments ensure **uniform appeal mechanism** – Financial Services Tribunal
- See **“Relationship between Act and Financial Sector Regulation Act”** in consequential amendments

Chapter 1: Definitions: financial products

- Definitions anchor the structure of the Bill and structure of regulatory architecture.
- To delineate regulatory jurisdiction - **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 and securities services (cl.33)**. Products require prudential oversight so institutions meet their financial obligations to customers ('promises').
- **Financial product** is defined in **cl.2** to mean:
 - a participatory interest in a collective investment scheme
 - 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
- **FSR Bill allows Finance Minister to designate new financial products**



Chapter 1: Definitions: financial services

- Financial services provided in relation to financial products, or on their own (e.g. advice)
- FSCA responsible for market integrity, customer education, and promoting fair treatment of financial customers by **all** institutions providing financial products and services **(cl. 57)**
- **Financial services** defined as those performed in relation to **financial products, foreign financial products, and financial instruments (cl.3)** :
 - Offering, promoting, marketing or distributing
 - Providing advice, recommendations or guidance
 - Dealing or making a market
 - Operating or managing or providing administrative services
- Financial services also include **(cl. 3)**:
 - **a payment service**
 - **a service provided by a financial institution and regulated under a financial sector law**
 - services related to the **buying and selling of foreign exchange**
 - Services provided to financial institutions through **outsourcing, and includes debt collection**
- **FSR Bill allows Finance Minister to designate new financial services**

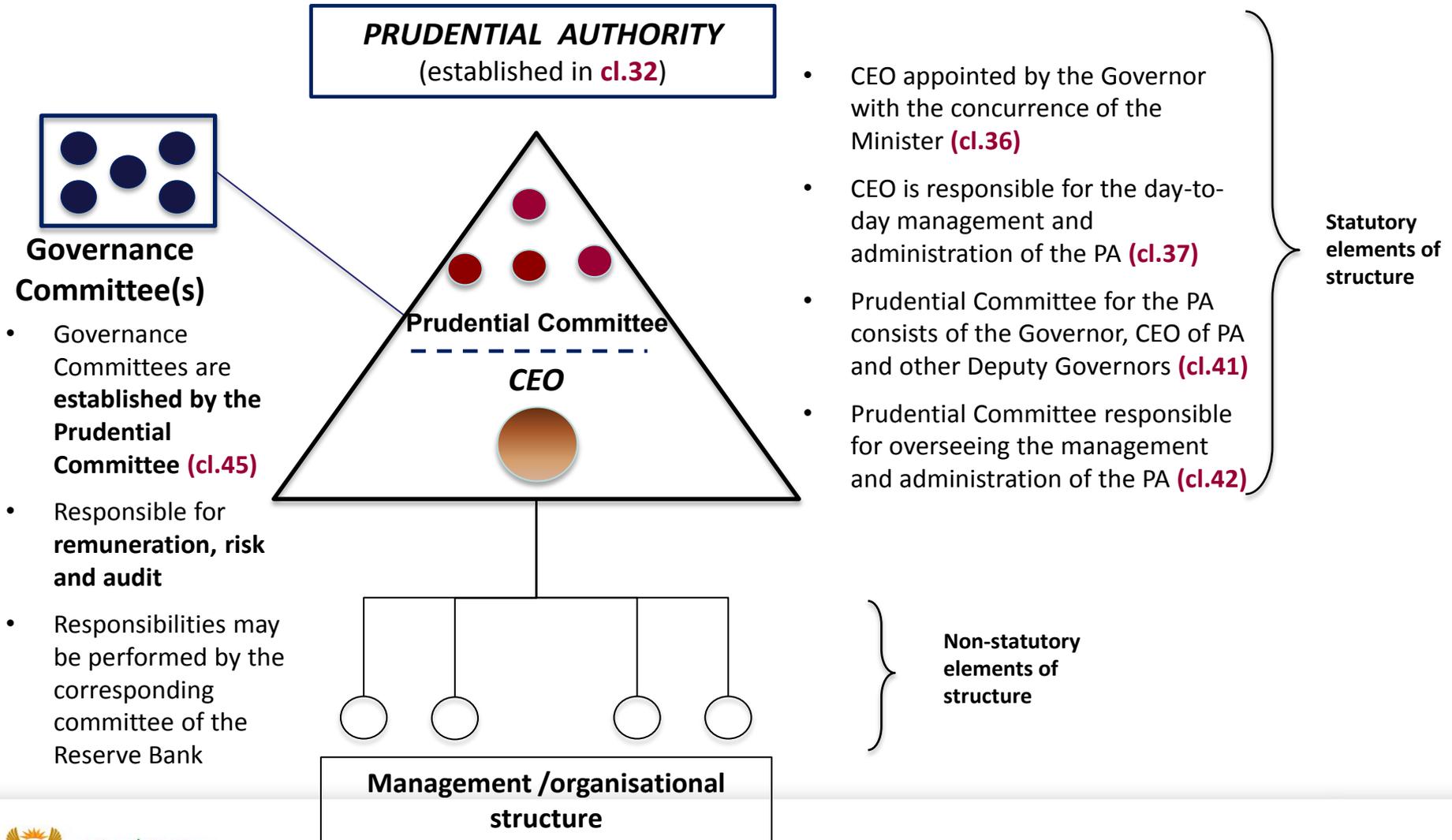


Chapter 2: Financial Stability

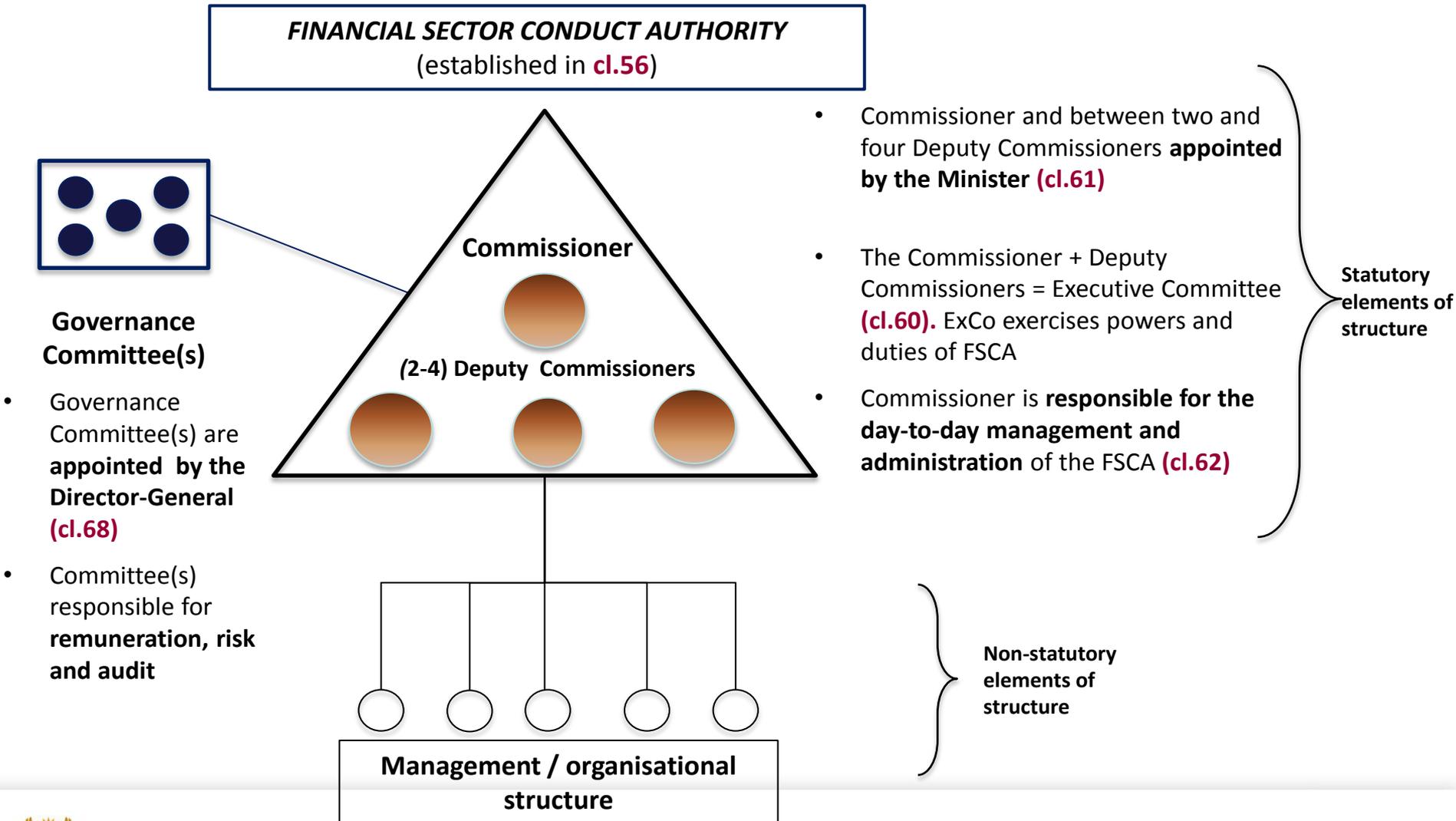
- **Chapter 2 sets out mandate, role and powers of SARB in relation to financial stability :**
 - Must monitor financial system for potential systemic risks **(cl. 12)**
 - If a systemic event occurs/ is imminent, must inform the Minister and propose actions, and can give directions to other authorities i.e. PA, FSCA, NCR **(cl. 14-19)**
 - Can designate SIFIs according to a clearly set out process **(cl. 29)**
 - In consultation with the PA, can set enhanced prudential standards for SIFIs, to be supervised by the PA **(cl. 30)**
 - Provisions related to winding up of SIFIs set out **(cl 31)**
 - Produces annual Financial Stability Review **(cl. 13)**
- **Role of the FSOC:**
 - Plays an **advisory** role to the Reserve Bank to support it in fulfilling its financial stability mandate **(cl. 20-24)**
 - Supported by Financial Sector Contingency Forum **(cl 25)**
- **The Bill also provides for Conglomerate (group) supervision** and allows authorities to regulate and supervise groups in their entirety, rather than only at holding company level **(ch. 12)**



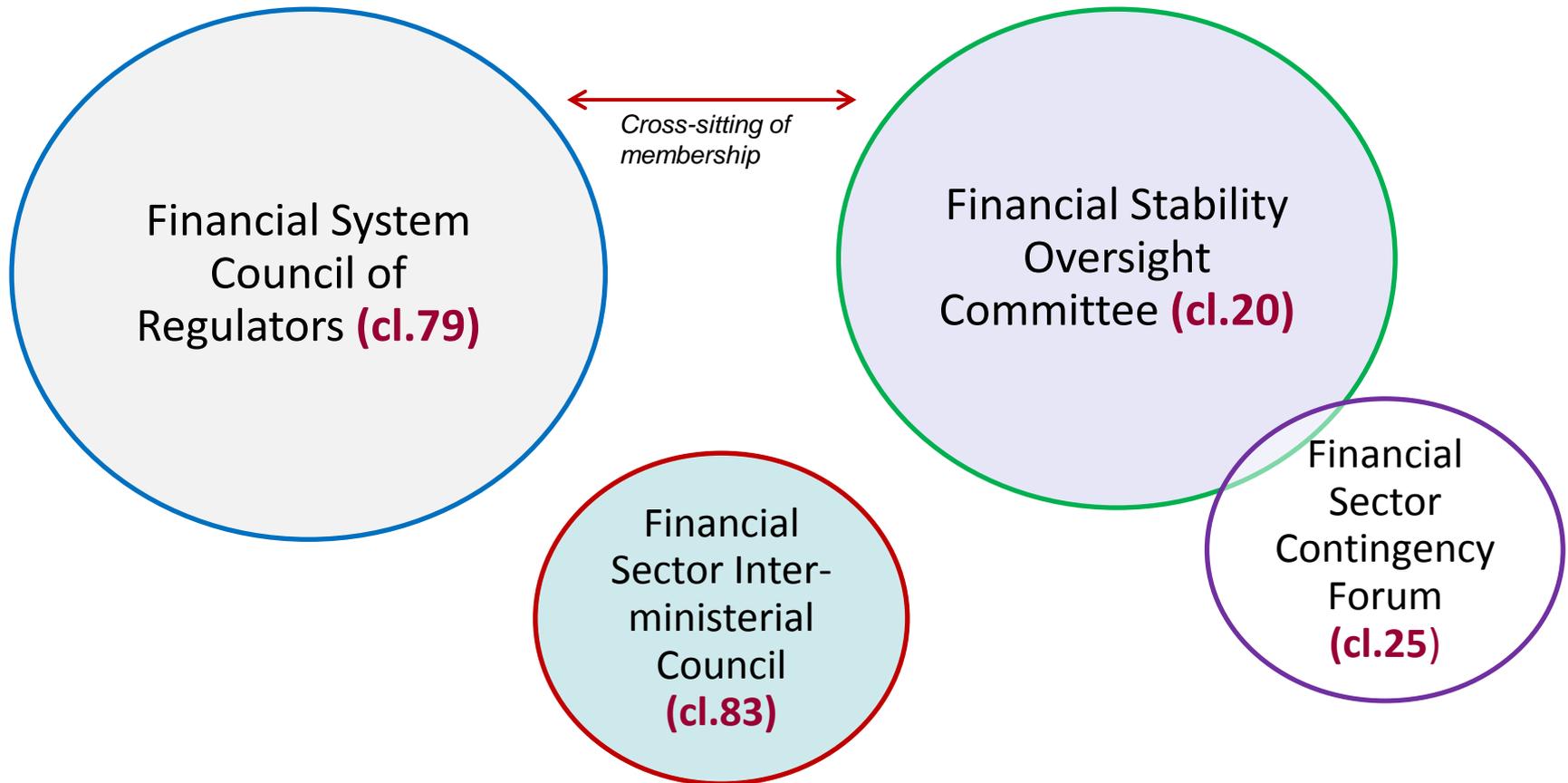
Chapter 3: Key characteristics - PA



Chapter 4: Key characteristics - FSCA



Chapter 5: Co-operation and co-ordination between financial sector regulators



- FSCA and the PA have an obligation to co-operate with all key regulators **(cl.76)**
- Required to enter in MoU agreements that will be submitted to relevant Ministers and published **(cl 77)**

Chapter 6: Administrative Actions

- 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. 92)**

- Provisions of **PAJA** still apply

The Promotion of Administrative Justice Act (the PAJA)

- Administrative action procedures must be consulted on before being determined **(cl. 93)**
- Regulators may establish **administrative action committees** to consider and make recommendations on administrative actions referred to it by relevant authority **(cl 87)**

Chapter 7: Regulatory Instruments

- In addition to provisions in current legislation, two authorities can impose **standards** (subordinate legislation) through FSR Bill on financial institutions (**cl.105 - 106**). Similar status to current rules, board notices etc
- 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



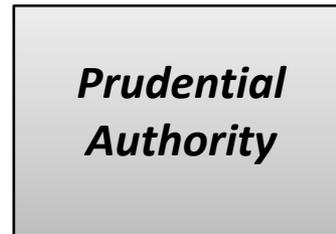
Transparency

- Where standards overlap, **the two authorities may set joint standards**
- Harmonise process for issuing regulatory instruments by setting same minimum consultation requirements (**cl. 97 - 104**)

- FSCA may not set standards on credit agreement services without consulting NCR (**cl. 106(4)**) and on payment service providers without concurrence of SARB (**cl. 109**)

Chapter 8: Licensing

- Under phase 1, responsibilities for licensing under the current Acts allocated to one of the two responsible authorities (**see Schedule 2**), including in certain instances for a transitional periods (**cl. 281 - 282**)



–Medical Schemes Act
(subject to s.231)

–National Credit Act

–Banks Act
–Mutual Banks Act
–Co-operative Banks Act
– Financial supervision of
RAF Act

–Friendly Societies Act
–Financial Advisory and
Intermediary Services Act
–Financial Markets Act
–Credit Rating Services Act
–Pension Funds Act
–Collective Investment
Schemes Control Act

–Long term Insurance Act
Prudential aspects

—Short term Insurance Act
Prudential aspects

–Long term Insurance Act
Conduct Aspects

–Short term Insurance Act
Conduct Aspects

Chapter 8: Licensing

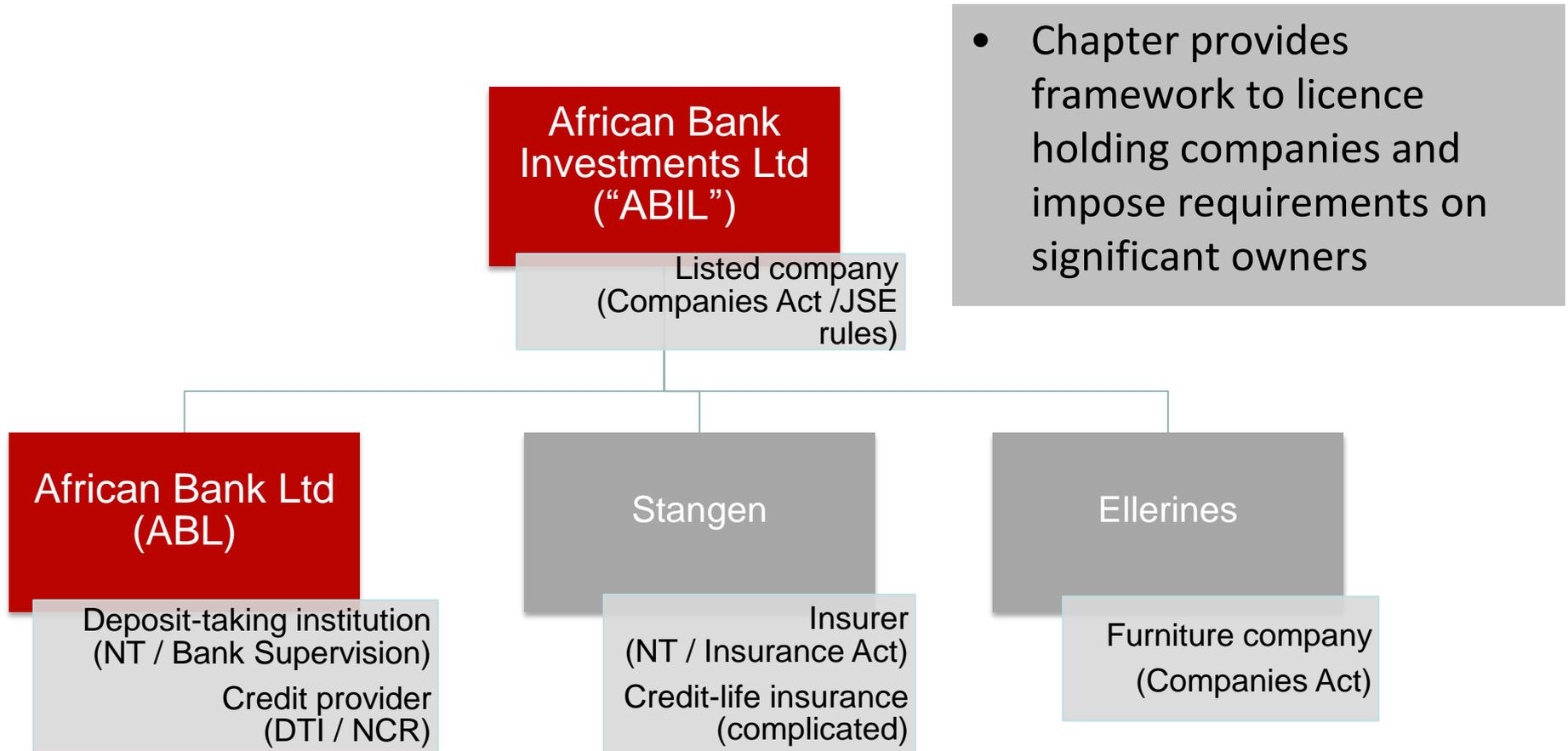
- The relevant licensing authority will be responsible for licenses issued under the Act and supervising requirements of the Act:
 - Licensing requirements remain set by the relevant industry-specific sectoral laws (**cl 111**). FSR Bill sets out licensing requirements only for newly designated product/service (**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. 126**
- Phase 2 of Twin Peaks process will require more significant changes to licensing process as prudential and conduct frameworks develop



Chapters 9 – 10: Inspections, investigations, enforcement

- **Access to correct information** will be key to ensure effectiveness of regulators. Powers of regulators in respect of information gathering to support proactive and preemptive approach to supervision (**cl. 130**)
- **Inspections** refer to on-site visits undertaken in the normal course of supervisory functions (**cl. 131 – 132**). **Investigations** undertaken when contraventions of law suspected (**cl. 133 – 138**)
- **Enforcement actions (chapter 10)**
 - 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
- Process for issues administrative penalties set out in **Chapter 13**
- Financial Services Tribunal established in **Chapter 15** to review decisions of regulators

Chapters 11 – 12: Significant owners, financial conglomerates



Chapter 14: Ombud scheme system

- **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 14**)
- The FSR Bill proposes :
 - Establishing the **Ombud Regulatory Council as a statutory body that will establish a single point of entry** into the ombud system. Replaces current FSOS Council. Will be in effect the regulator of ombud schemes in financial sector
 - **Chief Ombud** is responsible for day to day management and administration of Ombud Regulatory Council
 - Requiring **all ombuds schemes to be registered** with the Ombud Regulatory 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 rules for ombud schemes to follow
 - Ombud Regulatory Council will be able to issue **directives**, enter into **enforceable undertakings**, conduct **inspections and investigations**, issue **administrative penalties** and make **debarment orders**

Chapter 15: Financial Services Tribunal



- The FSR Bill establishes a Financial Services Tribunal **(cl.214)**
- The **function of the Tribunal is to judicially review decisions of financial sector regulators and Ombud Regulatory Council** on application by aggrieved persons
- Members of the Tribunal are appointed by the Minister **(cl.216)**
- **The Tribunal consists of as many members as the Minister considers necessary**, including, at least two retired judges or persons with suitable legal experience; and at least two persons who have experience and expert knowledge of financial products or financial services.
- All of the **members of the Tribunal must be independent**
- **Panels** are constituted for each application for review **(cl. 219)**
- 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

Roadmap of implementation

- Nov 2015 Bill presented to Parliament
- Early 2016 Parliamentary process
 - » Including first “Phase 2” Bill, the Insurance Bill, which separates out the roles of the two Authorities more cleanly
- Mid 2016 Two Authorities created
 - » Shadow authorities already have been set up

Potential stakeholders for Standing Committee to consider

- Civil society groups
 - E.g. consumer forums
- Academia
- Other countries that have implemented a similar model
- Major industry associations
 - Banking Association, ASISA, Short-term Insurance Association

Thank you