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The Chair: National Assembly Standing Committee on Finance
Hon. Yunus Carrim (MP)
Parliament of the Republic of South Africa
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Residual Comments: Financial Sector Regulation Bill (B34-2015)

With reference to the draft Financial Sector Regulation Bill currently being considered by the Portfolio Committee on Finance, and the previous public hearings of the Committee on this Bill (24 November 2015), in addition to our previous comments on the Bill (doc ref# 173219) we hereby make the following comments for consideration by the Committee in its deliberations on the Bill:

1. **Calculation of fines based on turnover: Sections 257 ("Significant owners") and 258 ("Financial Conglomerates")**

   These sections provide for certain non-compliance administrative penalties or sanctions expressed in terms of "10 (or 5) per cent of … annual turnover".

   The turnover of large financial conglomerates can be a significant number, and for banks in particular even higher as "annual turnover" is a difficult concept to determine, given that both interest received and interest paid could be classified as "annual revenue," while if "turnover" is defined to also include trading values in derivatives, foreign exchange, bonds, etc. this would add R trillions to the potential calculation of "annual turnover". Any fine based on this parameter is therefore problematic.

   The financial sector is also highly sensitive to reputation and systemic risks, where loss of trust in the sector can have critical financial and economic consequences.

   Administrative fines of "up to 10% of annual turnover" could, therefore, result in the insolvency of the financial institution, and trigger widespread financial collapse.

   The offences to which these fines relate also do not warrant the potential severity of these massive fines. It is therefore recommended that these

sections be amended to provide for capped, determined-value fines as in the rest of the Bill, e.g. "not exceeding R5 000 000". This will enable the supervisors in question to discharge their duties, without the risk of potential systemic consequences from administrative fines.

It should also be noted that in certain other jurisdictions where provision exists in law for such massive fines, and regulators/supervisors have applied appropriate (lower) fines, activists have taken the regulators/supervisors to court to enforce the higher/maximum level of fine. As noted this could have significant systemic impacts totally out of context with the underlying offence, and beyond the capacity of the supervisors to control the unintended risk consequences.

2. Risk-based approach to supervision

With reference to the comments in the National Treasury Consolidated Comments that "materiality has been included where appropriate", there are several outstanding sections where "materiality" or "significance" still need to be inserted. These are as follows:

2.1 Reference to "financial stability" – section 4(1)(a): There is no reference to materiality. We recommend the section is amended as follows:

"4. (1) For the purposes of this Act, financial stability means that—
(a) financial institutions generally provide financial products and financial services without significant interruption;"

2.2 Section 120(1)(d) - material contravention of a foreign law – this was agreed to in the Consolidated Comments, but not included in the revised version of the Bill. Accordingly, we recommend the section be amended as follows:

"120(1)(d) the licensee has in a foreign country materially contravened a law of that country that corresponds to a financial sector law;"

2.3 In addition we recommend that the references to "materiality" be included in sections 266(1) and (2) as proposed below:

"266. (1) If-
(a) a financial institution commits a material offence in terms of a financial sector law; and
(b) a member of the governing body of the financial institution failed to take all reasonably practicable steps to prevent the commission of the material offence;
the member of the governing body commits the like offence, and is liable on conviction to a fine not exceeding the fine that may be imposed on the financial institution for the offence.

(2) If -
(a) a key person of a financial institution engages in conduct relating to the provision of financial products or financial services that amounts to a material contravention of a financial sector law; and
(b) the financial institution failed to take all reasonably practicable steps to prevent the conduct;
the financial institution must be taken also to have engaged in the conduct."

2.4 Section 266 – Vicarious liability for offences and contraventions. The reference to "vicarious" in the heading of the clause must be removed, as proposed in the Consolidated Comments. The heading should therefore read as follows: "Liability for offences and contraventions"

3. Powers awarded to Regulators to issue Standards

We recommend that section 106(2) be amended by inserting the words "pertaining to principles in relation to:", as follows: "Conduct standards made in terms of subsection (1) may be made on any of the following matters pertaining to principles in relation to:"

4. Consequential amendment to Section 4 "Prohibitions and Adherence to Authorised Users, Participants and Clearing Members" in the Financial Markets Act, No 19 of 2012 (FMA)

With reference to Section 4(1)(e) of the FMA it is unclear whether a person is permitted to act as a clearing member of a recognised market infrastructure, licensed external central counterparty or an external counterparty that has been exempted from having to be licensed. Is this an oversight, or is the intention that this permission will be provided for in a Ministerial Regulation in terms of Section 5(1)(c) and (2)?

It is therefore recommended that certainty be introduced and that section 4(1)(e) of the Financial Markets Act, No 19 of 2012 be amended as follows:

"(e) act as a clearing member unless authorised by a licensed exchange, a licensed independent clearing house, **[or]** a licensed central counterparty, **a licensed external central counterparty, or an external counterparty that has been exempted from having to be licenced**, as the case may be.

We thank the Committee for the opportunity to include these comments to those previously submitted, and to again present verbally during the public hearing on 10 February 2016.

Yours sincerely

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