160824SC FINANCE

'Twin Peaks'
The Financial Sector Regulation Bill

Presentation to Select Committee on Finance I 24 August 2016

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Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

The shift to Twin Peaks: process to date

- **2011** – Policy paper *'A safer financial sector to serve South Africa better'*, approved by Cabinet (Red Book)
- **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 **2017**)

All documentation is available at www.treasury.gov.za/twinpeaks

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Why do we regulate the financial sector?

- A financial system should work **in the interests of financial customers** and **support balanced and sustainable economic growth**
- All households & companies should be able to **transact, borrow, save, and manage their day-to-day risks** efficiently and effectively
- From a regulatory and supervisory perspective:
  - Regulators must be able to **identify and manage risks** emerging in the sector that could compromise customer & economic outcomes
  - Three main risk categories: **Conduct, Stability, Prudential**

The regulatory architecture - our universe today

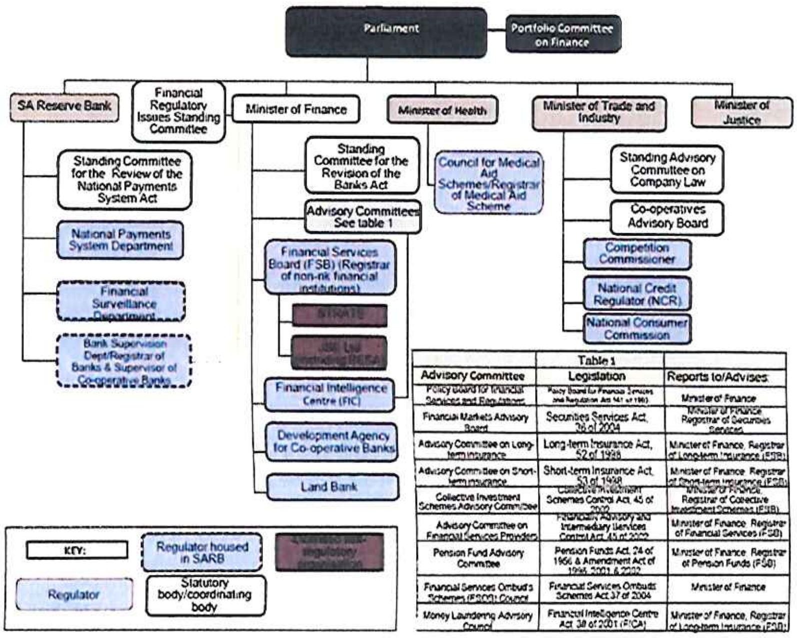


	Table 1	
Advisory Committee	**Legislation**	**Reports to/Advises**
Policy Board for Financial Services and Regulation	Policy Board for Financial Services and Regulation Act 141 of 1993	Minister of Finance
Financial Markets Advisory Board	Securities Services Act, 36 of 2004	Minister of Finance, Registrar of Securities Services
Advisory Committee on Long-term Insurance	Long-term Insurance Act, 52 of 1998	Minister of Finance, Registrar of Long-term Insurance (FSB)
Advisory Committee on Short-term Insurance	Short-term Insurance Act, 53 of 1998	Minister of Finance, Registrar of Short-term Insurance (FSB)
Collective Investment Schemes Advisory Committee	Collective Investment Schemes Control Act, 45 of 2002	Minister of Finance, Registrar of Collective Investment Schemes (FSB)
Advisory Committee on Financial Services Providers	Financial Advisory and Intermediary Services Control Act 45 of 2002	Minister of Finance, Registrar of Financial Services (FSB)
Pension Fund Advisory Committee	Pension Funds Act, 24 of 1956 & Amendment Act of 1996, 2001 & 2002	Minister of Finance, Registrar of Pension Funds (FSB)
Financial Services Ombud's Schemes (FSOS) Council	Financial Services Ombuds Schemes Act 37 of 2004	Minister of Finance
Money Laundering Advisory Council	Financial Intelligence Centre Act 38 of 2001 (FICA)	Minister of Finance, Registrar of Long-term Insurance (FSB)

What events triggered a major change in regulating financial sector in SA?

- **Fidentia fraud** against 47 000 widows and orphans exposed in Feb 2007 - intrusive supervision needed to prevent fraud and protect customers
- **Competition Commission Banking Enquiry Panel** (Jali) launched in 2006 and reported mid-2008
  - Recommendations to ensure greater competition in the retail banking sector to achieve real benefits for customers through lower costs and greater access
- Minister of Finance at the time requested a **review of gaps and weaknesses** in our financial regulatory system, particularly as it affects customers
- **2008 Global Financial Crisis** triggered after 15 Sept 2008 insolvency of Lehman Brothers - raised questions on light-touch approach to prudential and conduct regulation. Exposed how one bank failure can undermine financial stability and pose risk to entire banking system, and to economic growth
- More recently the problem of **household over-indebtedness** highlights need for closer supervision of risks and earlier corrective action
- **African Bank curatorship** shows the importance of a holistic view of risks facing an institution, and better coordination between regulators involved

International assessments by the G20 and the IMF also highlighted some weaknesses in SA's regulatory system

Since the financial crisis, G20 members have agreed a framework to assess their domestic financial systems:

- **IMF Financial Sector Assessment Programmes (FSAP):** Every 5 yrs
- **G20- Financial Stability Board Peer Reviews (FSB):** In-between FSAPs

SA G20 Peer Review (2013)- main findings	SA FSAP (2014)- main findings
1. **Poor interagency coordination and regulatory structure.**	1. **Poor coordination** between and among regulators.
2. **Inadequate OTC Derivatives reforms.** SA needs to create a framework for centrally clearing OTC derivatives where possible.	2. **Deep interconnection within the financial sector without a consolidated approach to supervision.** (i.e. Medical Insurance (schemes), insurance firms , asset managers and banks within the same financial conglomerate.)

What is Twin Peaks?

What is prudential and market conduct risk?

Need to ensure that the financial institution can meet its obligations, i.e. pay its depositors back, pay out insurance policies, etc. This is dependent on:

- A "prudently-run" business - sustainable business model and prudent investments

1. **"Prudential" regulation and supervision** is concerned with the safety and soundness of an individual firm, and aims to ensure the financial firm is run prudently

Need to ensure that the financial institution designs, markets and distributes its products appropriately, discloses costs, "fine print", and meets customer needs

2. **"Market conduct regulation"** is concerned with how the individual firm behaves in treating its customers, other firms; i.e. how it conducts itself in the market

What is the Twin Peaks system?

1. **PRUDENTIAL OVERSIGHT**
   - Prudential regulator will be a unit within the SARB – called the **Prudential Authority**
   - The current FSB will shift its prudential regulators (for insurance, securities etc) to the PA at the SARB
   - Mandate across the financial sector

2. **CONDUCT OVERSIGHT**
   - The FSB will cease to exist. A new **Financial Conduct Authority (FSCA)** with a dedicated focus on conduct of business and market integrity will be established.
   - Mandate across the financial sector

- **SYSTEMIC STABILITY OVERSIGHT**
  - SARB responsible for overseeing financial stability, in accordance with a framework agreed with the Minister of Finance
  - An advisory body of regulators chaired by the Governor (FSOC) will advise the Governor and facilitate co-ordination

What is the Twin Peaks system?

Prudential Authority

- promote and enhance the safety and soundness of financial institutions that provide financial products and securities services;
- promote and enhance the safety and soundness of market infrastructures;
- protect financial customers against the risk that those financial institutions may fail to meet their obligations; and
- assist in maintaining financial stability

Financial Sector Conduct Authority

- enhance and support the efficiency and integrity of the financial system; and
- protect financial customers by—
  (i) promoting fair treatment of financial customers by financial institutions;and
  (ii) providing financial customers and potential financial customers with financial education programs, and otherwise promoting financial literacy; and
- assist in maintaining financial stability

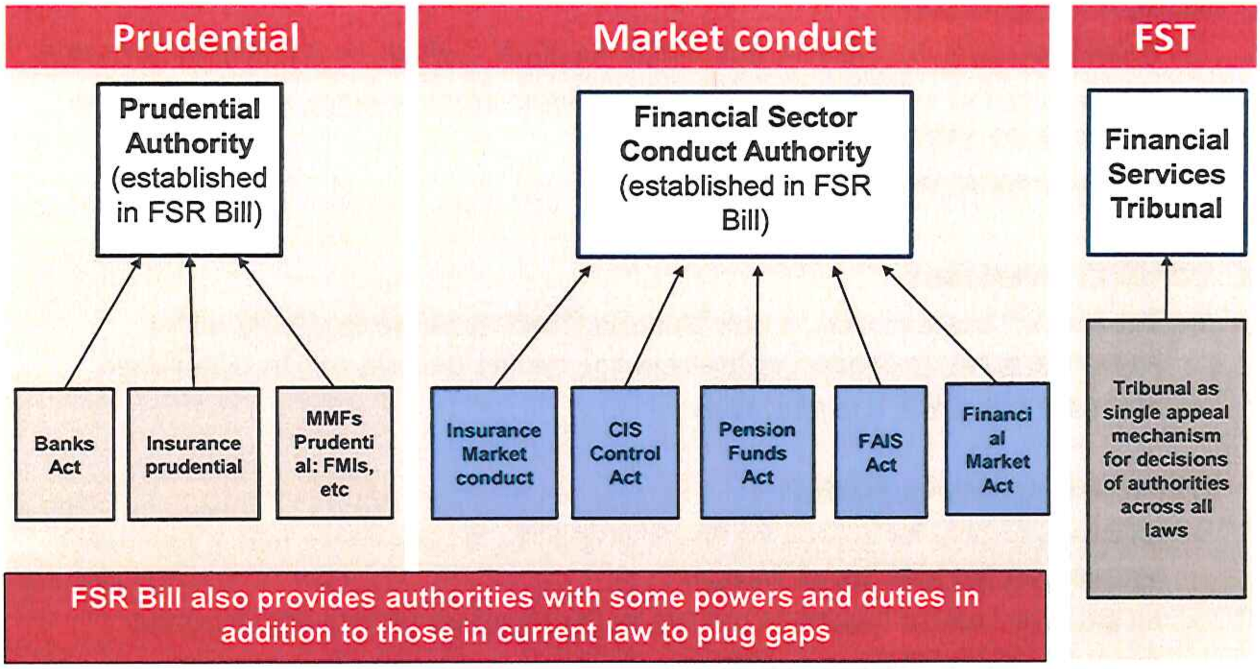
Financial Services Tribunal and Enforcement

- Regulators held accountable through clear internal policies & procedures for administrative actions, including enforcement
- Enhanced transparency & accountability
- Tribunal will hear and decide appeals and reviews

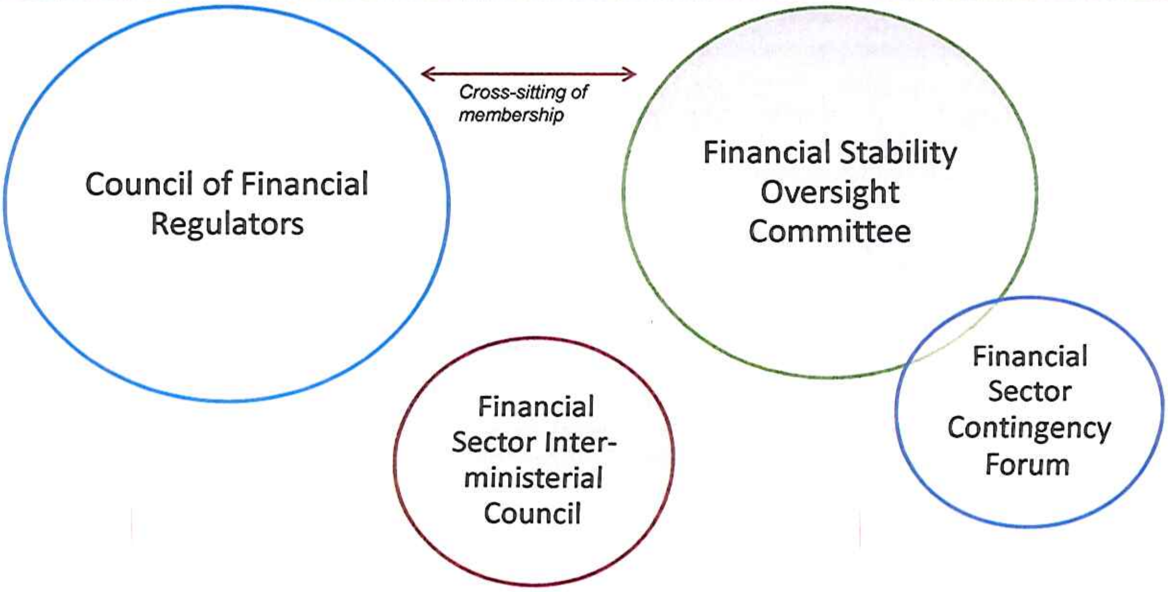
Financial Stability

- Powers to SARB – stability standards, SIFIs, managing systemic risk/events
- FSOC - Inter-agency co-ordination of financial stability issues

Existing laws under Twin Peaks



Better co-operation and co-ordination between financial sector regulators



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 **Ombud Council as a statutory body that will establish a single point of entry** into the ombud system
  - Requiring **all ombuds schemes to be registered** with the Council
  - Strengthening **mechanisms for Ombud 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 to be phased

Phase 1
- Establish two new regulators
- FSOC
- Enforcement

Focus on ***WHO*** REGULATES

Phase 2
- New laws underpinning twin peaks
  - *New consolidated market conduct law*
  - *Extension of prudential law (MMFs, Shadow Bank, Narrow Banks)*

Focus on ***HOW THEY*** REGULATE

2016 2017 2018

Phased approach reduces risks and simplifies implementation

Questions

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,

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