

**Presentation to the Standing Committee of Finance on
funding considerations for the FSR Bill**

September 2016



national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



**Considerations in funding new regulatory
model**

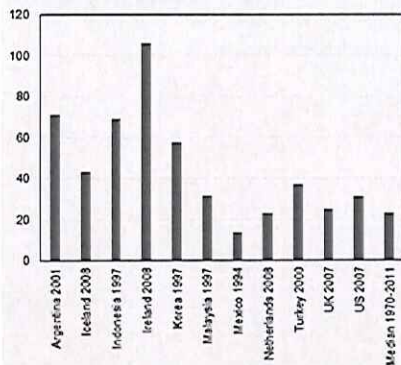


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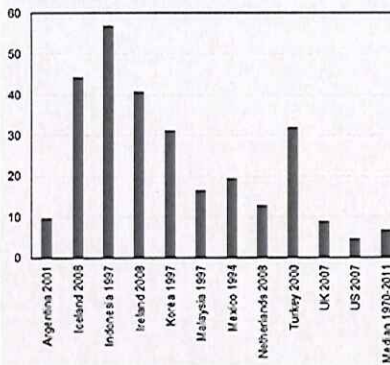
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Banking crises can impose huge economic costs

Selected systemic banking crises:
Cumulative output losses, % of GDP



Selected systemic banking crises:
Fiscal costs, % of GDP



Source: Data from Laeven, L and F Valencia (2012), "Systemic Banking Crises Database: An Update", IMF Working Paper WP/12/16, International Monetary Fund, June 2012

Cumulative output losses are calculated as the sum of the difference between actual and trend real GDP over the period T to T+3 (where T is the first year of the crisis), as % of trend real GDP.

Fiscal cost captures the gross fiscal costs related to the restructuring of the financial sector, mainly in the form of bank recapitalisations, asset purchases and loans.



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Costs of crises

- Bank of England in 2010 estimated that the financial crisis cost the British economy up to **£7.4trillion** in lost output
- Hidden cost to the taxpayer of the implicit support offered to the big UK banks at more than **£50bn**
- IMF estimated in 2009 that globally **\$11.9 trillion** had been spent dealing with the effects of the global financial crisis
- In the USA, *Better Markets* in 2015 released an extensive Cost of the Crisis Report detailing how the 2008 financial crash and the economic catastrophe it caused will cost the United States more than **\$20 trillion**.



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UK costs related to Twin Peaks implementation

- Pre global financial crisis, the cost of the FSA (single regulator) was £269mn in 2006/07, increasing to £335mn in 2008/09
- UK estimates on moving to a Twin Peaks model¹:
 - The estimated cost to the BoE and the FSA of creating the PRA: £100 million - £150 million
 - The estimated cost of creating the FCA: £15 million - £25 million
 - Anticipated that the FCA's and PRA's combined ongoing running costs not materially different (in real terms) in aggregate from FSA budget of about **£500 million** in 2012
- Actual Annual Funding Requirements of PRA and FCA in first year of operation:
 - **Combined requirement of £646.3 million** for FCA and PRA in 2013/14, an increase of 15% on the FSA funding requirement in 2012/13



1. HM Treasury, "A new approach to financial regulation: the blueprint for reform", June 2011 5

UK costs and consumers

- How is this felt by consumers?
 - **£262 million** paid back to consumers by June 2016 through **redress for PPI** (other redress schemes underway)
 - Single redress agreement this week: CFO Lending to pay back **£34 million to 97000 customers** for predatory lending practices

*A more balanced and proportionate approach: firms who do wrong must compensate
Can only identify "bad" firms/practices by intensive regulatory monitoring and scrutiny*

- Note that the FCA also collects levies for the Financial Ombuds Scheme and Money Advice Service, based on budgets submitted to the FCA



1. HM Treasury, "A new approach to financial regulation: the blueprint for reform", June 2011 6

Funding requirements of new authorities in UK in first year of operation

Table 4.A Combined AFR across FCA and PRA

£ million	FCA 2013/14	PRA 2013/14	FCA plus PRA 2013/14	FSA 2012/13	Change
Ongoing regulatory activity (ORA)					
FSA twelve months to 31 March 2013				535.5	
FCA twelve months to 31 March 2014	445.7		445.7		
PRA twelve months to 28 February 2014		217.6	217.6		
Total ORA	445.7	217.6	663.3	535.5	127.8
Year on year change in annual ORA					
PRA adjustment to eleven months		-18.2	-18.2		-18.2
Total ORA adjusted	445.7	199.4	645.1	535.5	109.6
Year on year change in adjusted ORA					
					21%
Additions:					
Recovery of scope change costs	3.3		3.3	2.4	0.9
FCA regulatory reform implementation	2.6		2.6	32.5	-29.9
Bank of England transition costs		14.8	14.8		14.8
Subtractions:					
Surplus in previous year ^(a)	-19.5		-19.5	-10.6	-8.9
AFR	432.1	214.2	646.3	559.8	86.5
Year on year change in AFR					
Financial penalty discount	-40.6		-40.6	-70.7	30.1
Percentage year on year change in chargeable fees taking account of financial penalties discount					
					24%

(a) To be finalised on completion of the statutory audit.

Other jurisdictions

USA

- In July 2010, Congress passed and President Obama signed the Wall Street Reform and Consumer Protection Act. The Dodd-Frank Act created the Consumer Financial Protection Bureau (CFPB). The CFPB receives a mandatory transfer of funding from the Federal Reserve System in an amount determined by the Director of the CFPB

- Total cost of CFPB operations in 2011 was \$142mn, increasing to \$329mn in 2012. The cost for 2016 is budgeted at **\$605.9mn**

AUSTRALIA

- APRA budget for 2015/16 → AU\$ 184mn
(Budgeted expenses for APRA pre-crisis in 2007/08 → AU\$ 9.3mn)

- ASIC budget for 2015/16 → AU\$ 562mn
(Budgeted expenses for APRA pre-crisis in 2007/08 → AU\$ 23.1mn)

Putting costs of regulation into perspective...

South Africa's financial regulators cost around R907m in 2015/16

This is expected to rise initially to around R1.033bn in 2016/17 under Twin Peaks

It's the direct cost to government and the financial sector of delivering a safer financial sector that works in the interests of financial consumers...

... That's less than the R1.243 billion* in combined remuneration packages in 2015 for Directors and senior executives of some of SA's largest financial sector companies.

*Based on total fees and remuneration reported for Directors and other senior executives in the following companies: Barclays Africa, FirstRand, Nedbank, Standard Bank, Discovery, MMI, Sanlam, and the JSE. Source: Annual Reports 2015

Putting costs of regulation into perspective...

South Africa's financial institutions contributed around R325 billion* to the economy in 2015...

*Gross value added (GVA) of financial corporations, SARB Quarterly Bulletin

Preliminary estimates and scenarios suggest that the total direct and indirect costs of financial regulation could be between 1.3% and 1.8% of the sector's contribution to the economy

Projections of costs at the SARB, Prudential Authority and FSCA and scenarios for compliance costs at financial institutions based on current costs reported by respondents to the questionnaire conducted for the Impact Study

Budgets for the PA and FSCA

Current prudential budgets

SARB Banking Supervision Department

- Total BSD budget 2016/2017 : **R 201m**
 - Personnel costs: R 133m
 - Operational costs: R 68m

FSB Insurance Prudential

- Total budget 2016/17: **R98mn**
 - Personnel costs: R44mn
 - Operational costs: R54mn

Prudential Authority Budget Estimate

- 2016/17 Budget (estimate)
 - Bank supervision: R201m
 - Insurance supervision: R98m
 - Additional supervisory functions: R37m
 - FSB transferring personnel alignment: R 42m
 - Total R378m**
- SARB additional indirect costs – Facilities (Office Space, Parking, IT, other support, etc.)

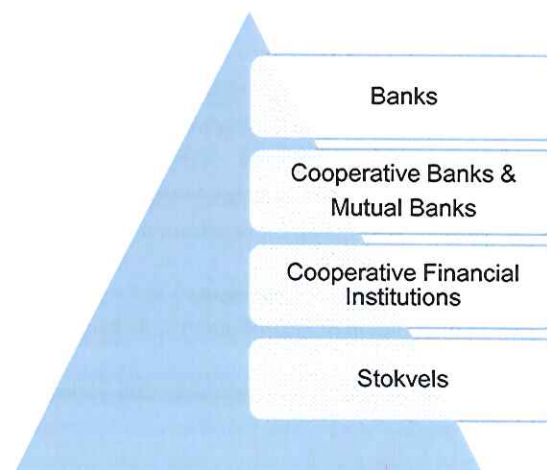
Current approach to setting charges

- Charges/fees are determined into Banks Act and Regulations, generally linked to time & effort of BSD
 - Examples
 - Review of decisions of the Registrar – S9 – R12 000
 - Granting or refusal of application for Registration – S17 – R18 000
 - Branches of foreign institutions - S18A – R18 000
 - Annual licence fee – S35 Minimum R6 000 – Maximum R300 000
 - Granting or refusal of application for registration as controlling company – S44 – R6 000
 - Amalgamations, mergers and arrangements – S54 – R40 000
 - Alteration of Memorandum of Incorporation and change of name – S56 – R4 800
 - Inspection, copies and keeping of documents – S86 Varies between R60 to R1 200

General approach & factors in setting fees

- Factors taken into account when setting fees
 - International standards:
 - Capital requirements to establish and maintain a bank, linked to risks in the bank
 - Annual licence fees
 - Based on total capital and liabilities, calculated by formula in Regulation 60
 - Minimum R6 000
 - Maximum R300 000
 - Internal costs of the SARB: BSD
 - Specific fees and charges apply per task, published in Regulations Relating to Banks

Inclusion - Prudential



Going forward

- Formula = Total cost of PA X Total Liability of Bank/Total liabilities of all banks
- Example
 - R 289 million X 1 180/4610 million = R 73 million
 - Perhaps capped at R50m, minimum R100 000
- Top 5 banks will contribute 88.92%
- Top 5 insurers will contribute 57%

Current FSB budget

- **Total budget** **R 744 million**
 - Personnel costs: R 451 million
 - Operational costs: R 293 million

FSCA Budget Estimate

• Current budget:	R 744m
Less: Insurance prudential supervision	(R 98m)
• Adjusted base:	R 646m
Add: Banking conduct supervision	R 20m
Add: Proactive market/customer research	R 10m
Add: Financial inclusion focus	R 10m
Add: Specialist supervisory support	R 50m
Add: Expanded financial market supervision	R 20m
Add: More intensive conduct supervision	R 20m
Add: Expanded investigation/enforcement capacity	R 10m
• Provisional FSCA budget estimate:	R 786m

(Plus: capex on integrated regulatory system, new branding, etc.)

Proportionate approach to fees

- **Currently, annual supervisory fees set according to following criteria:**
 - Base amount: Captures cost (time spent) of basic level of supervision needed for all entities, regardless of size
 - Variable amount: Proportionate to nature, size and complexity of entity (according to variables like asset size)
 - Special dispensation to support financial inclusion/transformation: Lower annual supervisory fees for entities serving the low-income sector
- **Examples:**
 - Life insurers: R106,000 (base amount) + 0,0079% of liabilities
 - Assistance business insurers: R10,600 (base amount) + 0,0079% of liabilities
 - Friendly Societies: zero supervisory fee
- **Future approach:**
 - Proportionate approach to continue
 - Cost increases will be carried by entities subject to new regulation (e.g. banks) and larger, more complex entities which pose higher risk to the achievement of supervisory objectives

Other examples – propose to use existing system

Financial services providers (brokers, etc.)

- Category II, IIA or III financial services providers
 - Per year: R7400 + (R600 x number of brokers) + (0.0019% x total value of investments)

Collective investment schemes

- E.g. Local collective investment scheme
 - Per year: 11200 + (R6050 x number of portfolios) + (0.00031% x amount of assets)

Pension funds

- E.g. Occupational schemes
 - Per year R2000 + R14 x number of members (up to a maximum of R2.75 m)

Two areas will change – banks and financial market infrastructures

What will change?

- The only change will be to banks and financial market infrastructures

Banks

- Propose an annual fee of R50,000 + 0.0001% x assets of the bank

Financial market infrastructures

- *Currently there is a flat fee on the Johannesburg Stock Exchange. To accommodate new exchanges and other financial market infrastructure, we propose to shift it to a variable fee based on number of transactions.*

Considerations for regulator funding process

- **Transparent process** important
 - Regulators should **consult on the intended fees to be charged** and increases thereto annually i.e. apply Chapter 7; if above CPI-linked threshold require Minister approval
- **Strong oversight** required – more onerous than regulatory instruments
 - Regulators should face oversight on **how funds are raised/fees are set PLUS actual expenditure PLUS** if money spent is **achieving regulatory objectives (strategy)**
 - Oversight important on particular matters of expenditure, eg remuneration
- Differentiate between 1) costs related to holding a licence, 2) the “lesser” fees and 3) capital adequacy (reserving) requirements
- Propose consumer education, Ombud council and Tribunal included in licence fee as costs of doing business



Redrafted Chapter 16 of the FSR Bill sets out process

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