FSCA

Financial Sector
Conduct Authority

UPDATE ON TWIN PEAKS REGULATORY REFORM PROCESS

IFN FORUM SOUTH AFRICA

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FSCA

Learning the lessons from 2008 Global Financial Crisis

- **Key reforms led by G20 and co-ordinated by Financial Stability Board**
  - **More intrusive, intensive and effective supervision, particularly of SIFIs**
  - Making derivatives market more transparent
  - Aligning incentives better, including remuneration incentives in the banking sector
  - Better sharing of info between home and host regulators from different countries
  - Improving resolution mechanisms, and forcing living wills
  - Growing recognition of need to deal with market conduct practices (eg preventing LIBOR and forex benchmark rigging, better market conduct practices)

- Cabinet concurred in 2011 and again on 19 November 2014 that **there is a need for more intrusive and intensive financial regulatory system in line with international lessons after GFC**
  - Financial sector is global in nature, but regulated nationally. Need international standards, which are legislated and regulated nationally
  - Dealing with Systemically Important Financial Institutions (SIFIs) to end ‘Too Big To Fail’
  - Regulating shadow banks, over-the-counter derivatives, and manipulation of key indices

Regulatory challenges within SA

- Within SA, there are **too many regulators** involved with the financial sector

- Most financial firms are regulated by a number of financial regulators
  - *Major banks in SA were regulated by SARB, FSB, FIC, NCR. This is because most banking groups do banking, credit, insurance, asset management etc*
  - *But each "activity" like deposit taking, lending, insurance, investment management regulated separately, each with own law → fragmentation means unlevel playing field, silos, gaps, regulatory coordination compromised*
  - *Nature of regulation has not kept pace with dynamic operation of financial sector*

- **Need for regulators to co-ordinate** and ensure that they do not contradict or work against each other

- How do we **prevent regulatory (forum) shopping?**

- **Tick box approach** to regulation – poor outcomes even if letter of law is followed

What is the Twin Peaks system?

- **ENHANCED OVERSIGHT OF PRUDENTIAL RISK**
  - ***What is prudential risk?***
  - ***What changes under Twin Peaks:***
    - Prudential regulator a unit within the SARB – called the **Prudential Authority**
    - Headed by deputy governor
    - Previous FSB shifted insurance prudential regulators to the PA

- **ENHANCED OVERSIGHT OF CONDUCT RISK**
  - ***What is conduct risk?***
  - ***What changes under Twin Peaks:***
    - Creation of a new Financial Sector Conduct Authority (FSCA) with a dedicated focus on conduct of business and market integrity, spanning across the financial sector

- **ENHANCED OVERSIGHT OF SYSTEMIC STABILITY**
  - ***What is systemic stability and what can place it at risk?***
  - ***What changes under Twin Peaks:***
    - SARB responsible for overseeing financial stability, in accordance with a framework agreed with the Min 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

- Clear internal policies & procedures for administrative actions, including enforcement
- Enhanced transparency & accountability
- Tribunal will hear and decide appeals and reviews

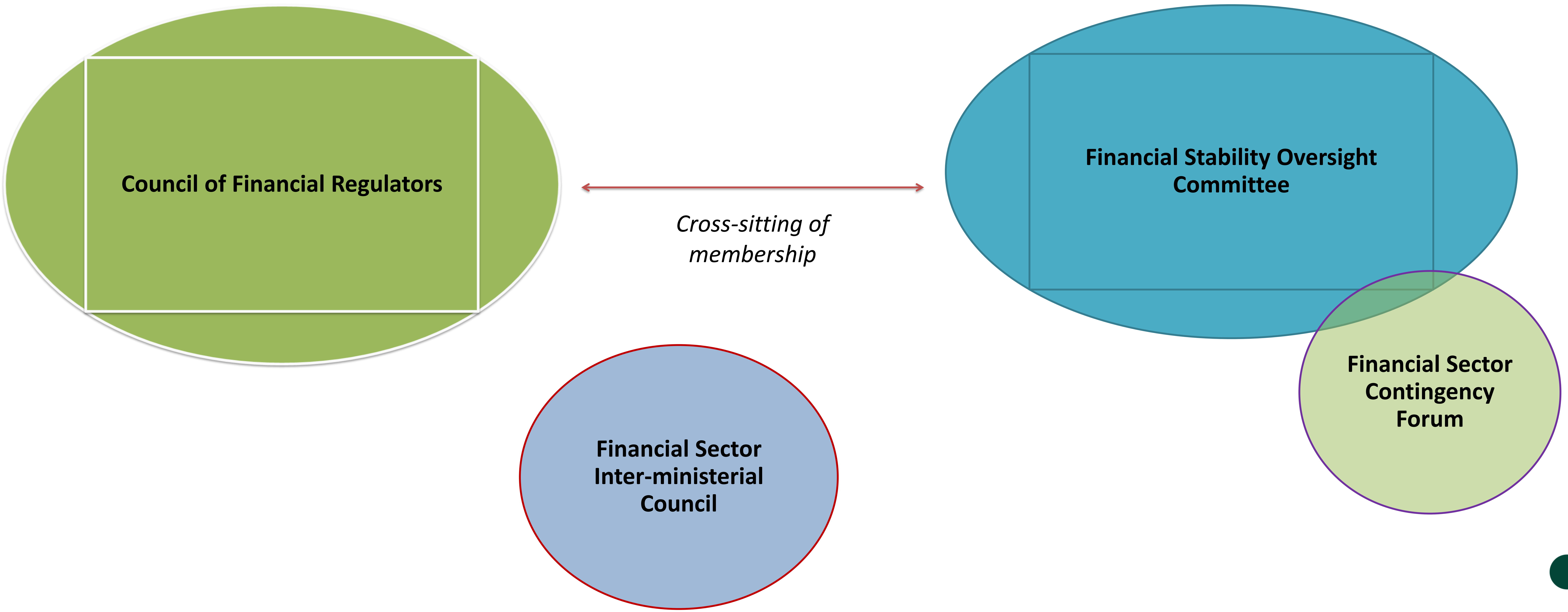
Financial Stability

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

Goals of the Twin Peaks reforms

- **Increased regulatory coverage**, minimising potential for regulatory gaps (can designate new products and services in financial sector)
- **Dedicated and equal emphasis** on monitoring stability, prudential and conduct risks in financial sector
- Enhanced oversight of **micro-prudential regulation**, special focus on conglomerates
- **Increased focus on outcomes**, especially fair customer treatment
- **More efficient use of supervisory capacity,** strengthen risk-based approach. Empowered with tools to fulfill mandate (e.g. standard setting)
- **Strong and swift action** for contraventions
- Regulatory laws that are **complete, harmonised, integrated, proportionate**

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



Improved market conduct in South Africa

- A crucial driver of the Twin Peaks reform is the need for **stronger market conduct regulation**, so that the financial sector produces **better customer outcomes** and **treats customers more fairly**.

- The 2014 discussion document "*Treating Customers Fairly in the Financial Sector: A Draft Market Conduct Framework for South Africa*" noted that creating a new market conduct regulator would not be sufficient to improve customer outcomes:

  - *The number of different financial sector laws causes **fragmentation** in regulatory requirements, **regulatory arbitrage**, a **silo approach to regulation**, and a compliance-focused, **tick-box** regulatory focus. This has contributed to **persistent poor customer** outcomes in the financial sector, in some instances even while the letter of the law is followed.*
  - *The legislative environment is also not all-encompassing (e.g. banking conduct not covered) and had not kept pace with the **dynamic and increasingly interconnected** operation of the financial sector in South Africa*

- The document proposed creating a **single law for market conduct regulation** of **all financial institutions** – the **Conduct of Financial Institutions** Act. This law would provide for a **consistent**, **activity-based** and **proportionate** approach to conduct regulation, ensuring proper customer outcomes

COFI Bill Principles

- The COFI Bill is designed to be:

  - **Activity-based:** The Bill shifts away from institutional to activity based regulation. Licensing schedule sets out financial activities requiring license. Same regulation will apply to similar activities, regardless of the institution performing the activity.

  - **Principles and outcomes focused:** Provisions have been drafted setting principle requirements in law; will allow regulator to monitor and enforce the achievement of outcomes rather than compliance with the letter of the law

  - **Risk-based and proportionate:** Proportionality will affect the regulator’s supervisory approach, the standards it sets, and the enforcement action it takes. Chapter 1 of the COFI Bill sets out guidelines for what the FSCA should consider in applying a proportionate approach

COFI Bill Principles (cont)

- **Supportive of transformation:** Financial institutions will be required to have policies in place to comply with the B-BBEE Code, and the supervision of institutions' implementation of policies in that regard will be undertaken by the FSCA

- **Supportive of inclusion:** The protection of customers in the financial sector, and meaningful financial inclusion are mutually reinforcing objectives. An explicit objective of the Bill is to support financial inclusion

- **Supportive of competition and innovation:** The Bill will allow for different licensing and supervisory requirements to be applied to different types of companies, meaning that smaller/new entrants that pose less risk will not be required to bear similar compliance burdens as larger and more complex businesses. Proportionate implementation of the regulatory and supervisory framework will encourage level playing fields, innovation and competition.

Proposed revised legal landscape

Figure 3.2. of 2014 discussion document. *Note credit services, debt collectors and forex dealers not reflected in 'Current' legislation, but will be captured for conduct regulation in terms of FSR Act definitions*

Subordinate law

Note: repealing provisions in existing sectoral laws, or the laws themselves, will not result in subordinate regulation issued under those laws falling away.

A careful transitional process will be followed to ensure that required subordinate legislation remains effective under the COFI Bill framework until migrated into conduct standards.

The FSCA’s new approach

The COFI Bill should be read in the context of FSCA’s new regulatory and supervisory approach (set out in its *Regulatory Strategy)*:

- Adopting a set of guiding principles including (among others) being pre-emptive, proactive, risk-based, **proportional**, intensive, intrusive, transparent, and **outcomes-focused**
- Embedding TCF outcomes in regulatory and supervisory frameworks
- Outcomes-focused regulation entails developing conduct standards that combine principles and rules in a way best designed to achieve desired outcomes – not relying only on rules and “box ticking”
- Moving from an “industry silo” structure to an activity-based structure
- Building capacity for new functions – e.g. overseeing banks, payments, aspects of credit, conglomerates, etc.
- Using the new FSR Act toolkit to strengthen regulatory, supervisory and enforcement processes – including customer redress

Particular considerations for Islamic finance activities

Market Conduct

- FSCA engagement with banks as part of holistic conduct mandate
  - *Draft bank conduct standard out for comment*
- Shift toward activity-based approach under the COFI Bill framework
  - *What does this mean for Islamic finance activities?*
  - *Careful consideration of existing requirements (including outside of financial sector)*
- Joint standards with PA on matters of joint relevance – in particular governance requirements

Particular considerations for Islamic finance activities

Prudential requirements

- Governance – in collaboration with FSCA
- Risk management
  Credit risk
  Operational risk
  Market risk, Liquidity risk insofar as the bank engages in those activities
- Capital requirements as per Banks Act (Basel)
- Resolution and orderly exit from market

THANK YOU

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