Changing the domestic financial services supervisory architecture

Twin Peaks

Financial Sector Regulation Act

CENTRE *for*
REGULATORY STRATEGY
EMEA AFRICA DESK

The proposed Twin Peaks supervisory model for regulating the financial sector is designed to make the financial sector safer and to better protect financial customers in South Africa

1 A shift towards a 'Twin Peaks' supervisory model

The global financial crisis has acted as a catalyst for a number of countries to propose radical changes to their domestic supervisory architectures. In these cases the trend has been to move towards what is generally referred to as a 'Twin Peaks' supervisory model. These 'structural' changes were also in many cases accompanied by a significant shift in supervisory approaches.

The Twin Peaks supervisory model, due to be implemented in South Africa, has been designed to address perceived weaknesses in the current model of financial services supervision following the global financial crisis.

Through participation in the International Monetary Fund (IMF), G20, Financial Stability Board (FSB), Basel Committee, International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS), South Africa has committed to implement higher global financial standards to make the financial services sector safer and better.

The Financial Sector Regulation Act, (the "FSR Act", referred to as "Twin Peaks"), was signed into law by the President on 21 August 2017. The FSR Act provides for the Minister of Finance to determine the commencement date, of the FSR Act, by notice in the Government Gazette. The Commencement Notice will also be published by the National Treasury, and will detail the commencement of different provisions of the FSR Act, as well as repeals and amendments of other laws.

Different sections of the FSR Act will come into effect on different dates, to coincide with the establishment of the two regulators - the Financial Sector Conduct Authority (FSCA) and Prudential Authority (PA). It is anticipated that the authorities will be established during 2018.

2 Key objectives of the FSR Act

Promote financial stability

Promote the safety and soundness of financial institutions

Promote the fair treatment and protection of financial customers (improve market conduct)

Promote the efficiency and integrity of the financial system

Widen access to financial services (financial inclusion)

Promote the prevention of financial crime

Transformation of the financial sector

Promote confidence in the financial system

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3 Rules of the Game and Key Players

Prudential Authority (PA)

- **Promote and enhance the safety and soundness** of financial institutions and market infrastructures
- **Supervision and designation** of financial conglomerates
- **Resilience** of financial institutions

Consultation on certain matters & Transitional arrangements

Financial Sector Conduct Authority (FSCA)

- Enhance and support **efficiency and integrity** of financial markets
- **Protect customers** of financial institutions
- Promote **financial education and literacy**

Market infrastructure
(incl. Strate, JSE, Central Clearing and Trade Repositories)
Financial markets infrastructure will be **supervised** by **both the PA and FSCA** – the FSCA will remain the primary authority administering the Financial Markets Act, and the PA will draft, issue and enforce standards relating to safety and soundness.

Payment System
The payment system **remains the responsibility of the Reserve Bank under the National Payment System (NPS) Act**. However, the FSCA and PA may draft and issue standards with regards to payment system operators and participants in the payment system. These must be issued jointly with the Reserve Bank (e.g. capital requirements for pre-settlement risk if not exchange traded)

Medical Schemes
The responsibility for the supervision of medical schemes will **remain with the Council of Medical Schemes (CMS) as per the Medical Schemes Act.** However the PA and FSCA will co-operate with the CMS on matters of mutual interest.

Conduct of Credit Providers
The FSCA regulate and supervise the conduct of financial institutions, except when it relates to the **provision of credit under a credit agreement regulated by the National Credit Act (NCA)**. The **National Credit Regulator (NCR) shall regulate and supervise the conduct** of credit providers as it pertains to the provisions of the NCA.

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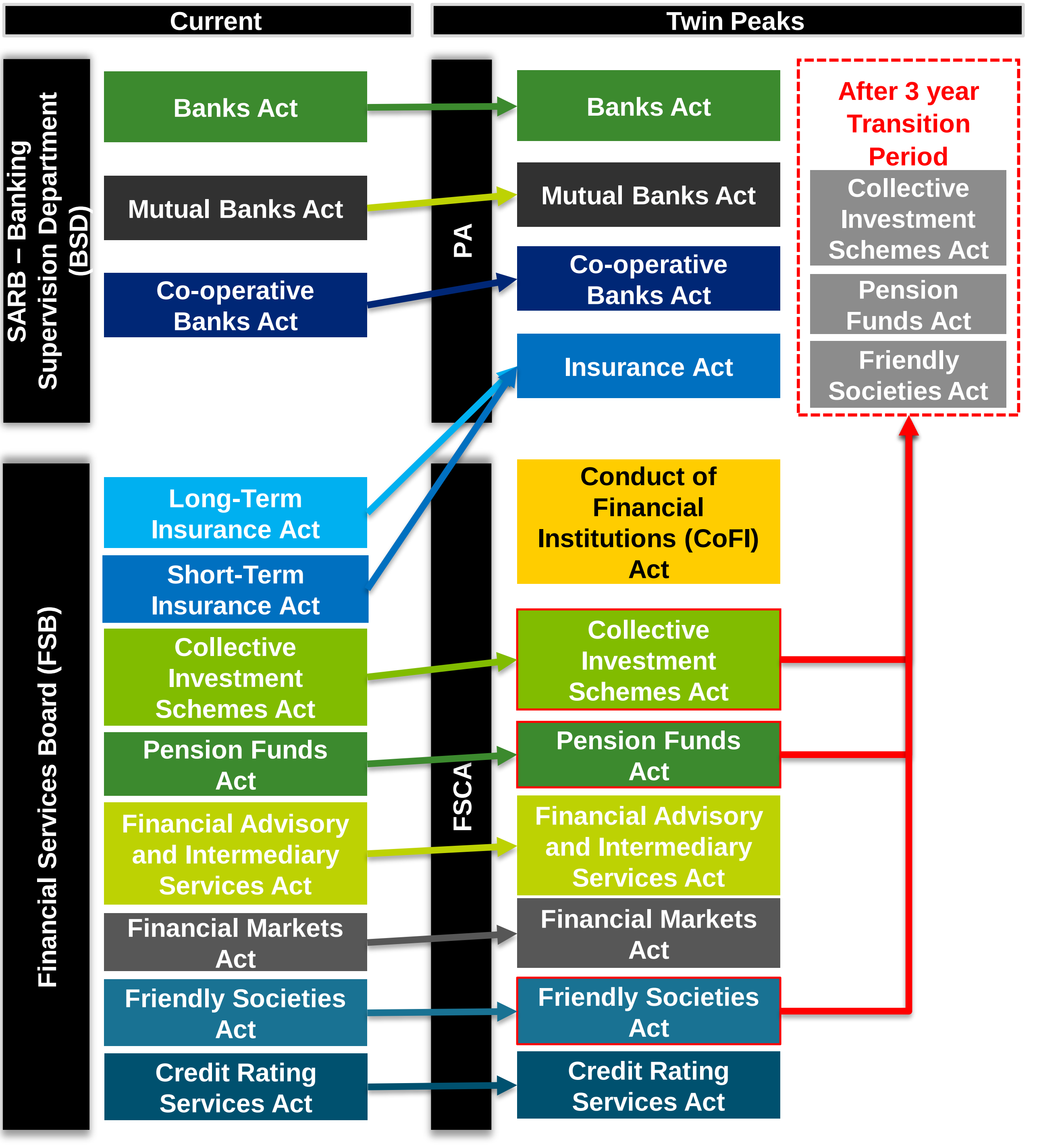
4 Shift in primary Supervisor



The diagram above depicts the shift in primary Supervisor in accordance with the FSR Act.

Transitional arrangements to the FSR Act - The power of the PA to make prudential standards with respect to safety and soundness of financial institutions is to be exercised by the FSCA for a period of three years, as it relates to the following institutions: Collective Investment Schemes (CIS), Pension Funds (PF) and Friendly Societies.

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5 Potential implications of the new Twin Peaks supervisory model, based on global observations…

A. Implementation challenges

As a consequence of the changing supervisory architecture, firms must not only be ready to adapt to the new environment themselves but also recognise that the new bodies are also likely to go through an adjustment period.

B. Dual focus, different perspectives

Both the PA and FSCA will focus on business model assessments, particularly to ensure that the business model will be viable in normal and stressed conditions. The required information set will be similar, but this will be assessed and viewed from very different perspectives.

C. Balancing expectations

The PA and FSCA will expect firms to give equal priority to each of their separate actions and requirements and firms must be prepared for adjacent (if not overlapping) PA and FSCA regulatory visits - putting additional pressure on firms' already strained resources.

D. Supervisory challenge

Firms will need to be prepared for a much more intrusive and challenging style of supervision (ready to provide answers to detailed business model / financial questions and provide data to back them on an ad-hoc basis). Increased reporting and data requirements may require enhancements to reporting systems and data infrastructure.

E. Enforcement mechanisms

The two new authorities have been granted considerable enforcement power including enforceable undertakings; court orders; debarment orders; and administrative penalties which will give rise to a more intensive and intrusive supervisory regime with possibly greater administrative action and bigger fines for non-compliance.

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5 Potential implications of the new Twin Peaks supervisory model, based on global observations…continue…

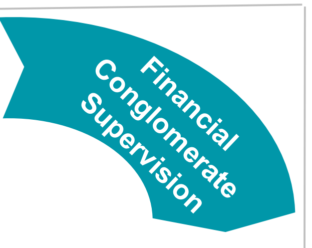
F. Change in scope of regulations

The FSR Act allows for supervision and regulation of financial conglomerates in entirety, rather than just at a holding company level. The PA has to designate a group as a financial conglomerate, define the scope of the group entities to be included in the financial conglomerate and inform the holding company. FSCA must be consulted in determining scope.

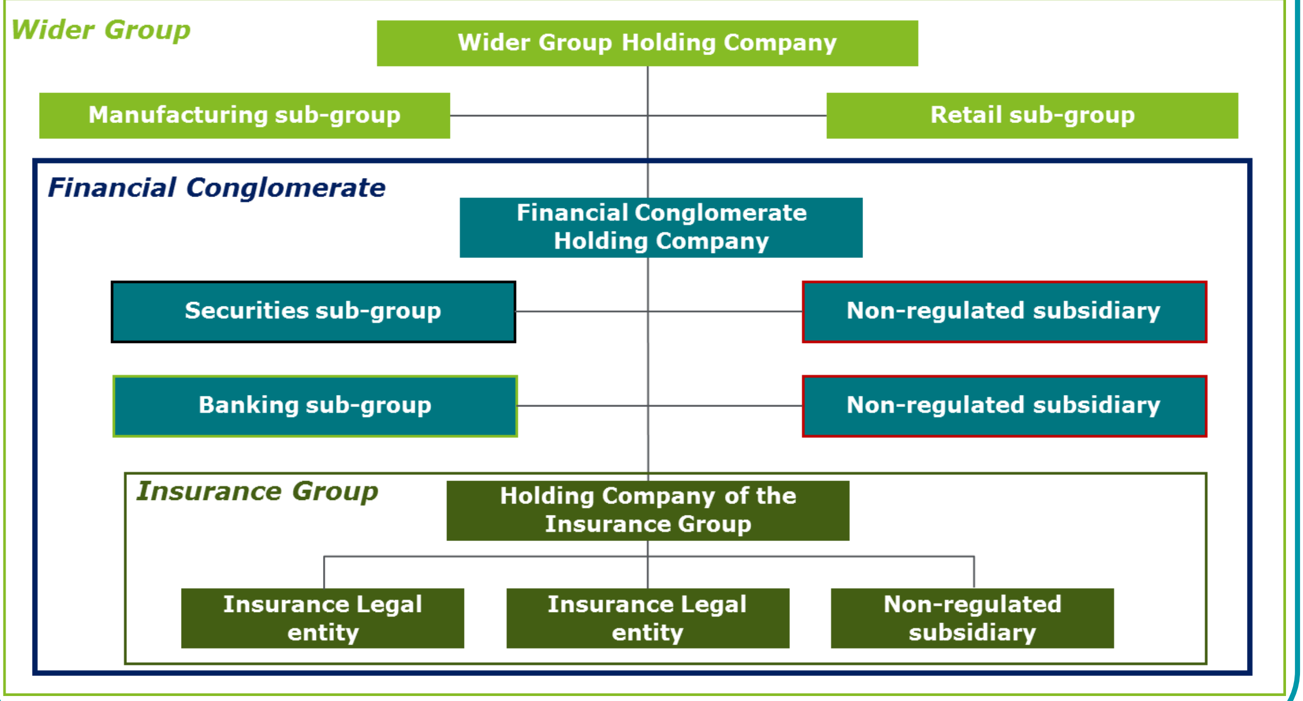
The requirements relating to financial conglomerates supervision could significantly change the regulatory compliance landscape, including requiring changes in strategy and operations of an institution, where this institution is designated as part of a financial conglomerate.

Defining the scope of a financial conglomerate

A financial conglomerate designated in terms of the FSR Act, must include both an eligible financial institution and a holding company of the eligible financial institution, but need not include all the members of the group of companies.



Example of a Financial Conglomerate structure



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