Submission on the Financial Sector Regulation Bill
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By way of introduction, we are currently engaged in a research project that examines Australia's Twin Peaks model of financial regulation and whether it might serve as a template for reform in the People's Republic of China. The project is funded jointly by the Centre for International Finance and Regulation and Melbourne Law School. For further details, please visit the following link: http://www.cifr.edu.au/project/Australia_twin_peaks_approach_for_China_and_Asia.aspx.

We are pleased to have this opportunity to submit our comments on the Financial Sector Regulation Bill (the "Bill"') to the National Treasury. We would be delighted to answer any queries in relation to our comments or assist further with the proposed move towards a Twin Peaks model in the Republic of South Africa.

Our comments are set out below:

1. Section 1 – definition of "**financial customer**": we query whether the word "other" before "financial institutions" is necessary as this could be construed as (1) limiting "corporates" to financial institutions; or (2) referring to another financial institution that is not expressly identified in the definition.

2. Section 1 – definition of "**financial stability**": we query whether the word "key" before "financial institutions" is necessary as the concept of a "key financial institution" is not defined in the Bill (we note that the term "systematically important financial institution" is defined) and this might introduce an element of uncertainty into the definition. Perhaps the intention is that the reference should be to "financial institutions as a whole" or that "key" should be replaced with "systematically important"?

   In addition, we suggest amending the last line to read "shocks in the economy, both endogenous and exogenous". This will enable the regulatory authority to extend its authority over financial institutions in respect of issues external to the Republic and in the process better avert crises and manage contagion.

3. Section 1 – definition of "**systemic**", paragraphs (d) and (e): in light of the experience gained from the Global Financial Crisis, we are of the view that these are highly pertinent and their inclusion is a sensible step on the part of the South African authorities.

4. Section 3 – **Purpose of this Act**: we would suggest that subsection (b) be amended to read: "the safety, efficiency and soundness of financial institutions;" The reference to "efficiency" would introduce the elements of cost-effectiveness and competitiveness into the purpose of the Act, which we believe are important elements of a properly functioning financial system. We note that the concept of "efficiency" appears in section 14(2)(b).

5. Section 3(1)(e) – we recommend that consideration be given to defining "financial inclusion". We assume that it refers to the inclusion of disadvantaged persons who previously did not enjoy access to the financial system or its basic consumer products.

6. Section 12 – **Objectives and scope of responsibilities of Market Conduct Authority**: we would suggest that subsection (1)(a) be amended to read as follows:

   The objective of the Market Conduct Authority is (1) to strengthen the protection of financial customers by promoting their fair treatment by financial institutions, the performance and integrity of the financial system, and financial awareness and literacy; and (2) generally to promote the purpose of this Act as referred to in section 3.

   We believe that the insertion of "performance" would enhance the objectives of the MCA. In addition, the second insertion would make it clear that the objectives of the MCA are not limited to the protection of financial customers but extend to promoting the purpose of the Act generally. We would make the same suggestion in relation to section 13 – **Objectives and scope of responsibilities of Prudential Authority**.

   In addition, we query whether section 12(1)(b)(i) should be amended to read "of all financial institutions and persons carrying our mono-regulated activities…" to align with the wording in the introductory paragraph to Schedule 2 and to reflect the reality that the regulatory remit of the Market Conduct Authority will extend beyond simply regulating "financial institutions."

   We note that the Market Conduct Authority appears to have a much narrower regulatory ambit than its counterpart in other jurisdictions such as Australia.

7. In respect of s 14(2)(a) and 14(2)(b)(i) and (b)(ii), we note the absence of a similar provision in Australia, and commend the South African authorities on the inclusion of such a sensible and timely provision.

8. In respect of s 16(1)(c) we note a minor conflict in tenses, and suggest that the provision be re-worded as follows: "the adoption of a risk-based approach to supervision."

9. Section 22(2)(a) – **Vacation of office**: we query whether the Minister should have the power to remove the Commissioner of Deputy Commissioner of the MCA on the ground of "poor performance". We believe that this concept is vague and could detract from the actual or perceived operational independence of the regulatory authority, even with the requirement under section 22(2)(b) for an independent enquiry to make a finding to this effect beforehand. We also note this in relation to section 29(2) as it applies to the Chief Executive Officer of the Prudential Authority.

10. Section 24 – **Management and administration of Prudential Authority**: we note that in Australia the prudential regulator is separate from the Reserve Bank. In the United Kingdom, on the other hand, the Prudential Regulation Authority is part of the Bank of England. Accordingly, there is no standardised approach to this question internationally. There is, however, research to the effect that a stand-alone regulator is preferable, and we would welcome an opportunity to provide any further input into this question.

11. Section 40 – **Governance committees for Market Conduct Authority**: we note the establishment of these governance committees with approval, and commend the South African authorities for their far-sightedness in establishing them, especially the committee as contemplated by s40(1)(b), which, if operated effectively, could provide far-ranging insights into current trends and research internationally.

12. Section 43(1) – **Co-operation between regulatory authorities**: we query whether an absolute obligation to co-operate ("must co-operate with each other") is appropriate and whether it might be better – and more realistic – to amend the subsection as set out below. This would also be consistent with the drafting of section 14(1).

    (1) When exercising their respective powers and performing their respective duties in terms of this Act and the regulatory laws, the regulatory authorities must take all reasonable steps within the means at their disposal to co-operate with each other in accordance with subsection (2) and any other requirements of this Act.

    (2) For purposes of complying with subsection (1), the regulatory authorities must strive to do the following - …

13. Section 43(2)(c): we query whether it would be clearer to amend this to read as follows: "consult each other when required by this Act to do so as a formal requirement". Otherwise, it would not appear to be clear when consultation is required "as a formal requirement".

14. Section 45(1)(a) – we query whether the reference to "section 105" should be replaced with "section 104".

15. Section 47(2) – **Co-operation in making of rules relating to dual-regulated activities**: consistent with our comments in paragraph 7 above, we query whether this subsection should be prescriptive about the need for the MOU to include "detailed provisions for co-operation in the making of rules…" Although it would be good for the regulatory authorities to agree on the detailed procedures, we are concerned that an overly prescriptive approach in the MOU might reduce the flexibility that is necessary to enable the regulatory authorities to achieve appropriate co-operation on a case-by-case basis and whether this might lead to a sub-optimal result in specific cases.

    We raise the same query in relation to subsections 48(3) and 53(1).

16. Section 50(2) – **Consultation with National Treasury and promulgation**: we commend the South African authorities on the wording of this section, and note with approval the flexibility it provides in the event of a crisis.

17. Section 59(b) – **Assistance to Financial Stability Oversight Committee**: we suggest that this provision ("promptly report to the Financial Stability Oversight Committee any relevant matters detected in the financial system, whether of a specific or systemic nature") is vague and therefore creates compliance difficulties for the regulatory authorities. Perhaps it was intended that this should be linked to (a) as set out below?

    (b) promptly report to the Financial Stability Oversight Committee any relevant matters detected in the financial system in terms of subsection (a), whether of a specific or systemic nature:…

18. Section 60(3)(a) – **Recommendations by Financial Stability Oversight Committee to regulatory authorities**: we query whether the drafting of this provision is appropriate, given that the section does not expressly require agreement between the Financial Stability Oversight Committee and a regulatory authority and does not make it clear when these bodies will be deemed to "fail to agree on the implementation of a recommendation". Is it when the Financial Stability Oversight Committee responds to a written explanation from the regulatory authority under subsection (2)(b) to confirm that it disagrees, or is it on some other basis? This is likely to be more of an issue for the MCA than the Prudential Authority as the other is part of the Reserve Bank and, presumably, its decisions can be internally overridden.

We also raise this query in relation to section 61(4)(a).

19. Section 65(2)(b) and (c) - we note the potential for conflict between these two sections, especially as concerns mitigating the costs of a crisis versus continuation of a systemically important bank. We point out that the costs of a crisis could be lower in the event that a systemically important bank is deemed to have failed and should exit. We point out that a bank exit policy may therefore conflict with mitigating the costs of a crisis where that bank is deemed systemically important, and therefore under s 65(2)(c) is required to be recapitalised. In such an event it would be preferable to include a provision determining which section should prevail over the other in the event of a conflict.

20. Part 3 – **Hearing of appeals by Financial Services Tribunal**: we would be interested to know whether it is possible to appeal from a decision of the Financial Services Tribunal and, if so, whether this should be expressly stated.

21. Schedule 2 Part 1 – **REGULATED ACTIVITIES**: we query whether the reference to "(a) to (f)" in paragraph (h) should instead read "(a) to (g)".

22. Schedule 2 Part 2 – **REGULATED ACTIVITIES**: we query whether the referent to "(a) to (i)" in paragraph (i) should instead read "(a) to (h)".

23. We note the extensive academic and professional literature that points strongly to the need to indemnify financial regulators personally in the pursuance of their work, and we note that such provisions are absent from the Bill. We strongly recommend that indemnity for regulators be included in the Draft Bill.

24. We note that in Australia the costs of maintaining and operating a prudential authority are covered by a levy on financial institutions, and we recommend that a similar arrangement be considered in South Africa.

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