The Twin Peaks model of financial regulation was introduced by the Minister of Finance in the 2011 Budget. It forms part of the proposed financial services sector reform which aims to create a stable financial services sector that is accessible to all. National Treasury’s document, “Implementing a Twin Peaks model of financial regulation in South Africa” outlines the proposals made by the South African Reserve Bank (SARB), the Financial Services Board (FSB) and National Treasury for implementing the Twin Peaks model, and is open for public comment until 8 March 2013.

What is the Twin Peaks model of financial regulation?

The Twin Peaks model of financial regulation will create two regulators for the financial services sector:

- A prudential regulator regulating the solvency and liquidity of the financial services sector; and
- A market conduct regulator regulating how financial services institutions conduct their business, design and price their products and treat their customers.

It is proposed that the SARB will be responsible for prudential regulation and the FSB for market conduct regulation.

This is different from the current financial services regulatory and supervisory framework where:

- The SARB is responsible for the setting of monetary policies and financial stability (including the prudential regulation of the banks); and
- The FSB is responsible for the prudential regulation of insurance and other financial services institutions (including pension funds and collective investment schemes) and ensuring the fair treatment of financial services customers.

The Twin Peaks model has the following broad objectives:

- To strengthen South Africa’s approach to market conduct regulation in order to improve customer confidence and to create a sustainable financial services sector;
- To create a more resilient, stable financial system that will help prevent crises from developing and more easily resolve those crises that occur, at a lower cost to consumers and tax payers;
- To expand access to the financial services sector through financial inclusion; and
- To combat financial crime.

Why move towards a Twin Peaks model?

The following are the key motivations for a Twin Peaks model of financial regulation:

- The need for regulation to deal with market abuse and ensure adequate investor and consumer protection in the financial services sector;
- The need for legislation when financial services institutions experiences capital, liquidity or solvency pressures;
- Consistent regulatory standards for all financial services institutions; and
- Coordination between regulators.

Initial assessments of the economic costs of implementing a Twin Peaks model indicate that costs are expected to be relatively minimal. The overall economic benefits of a safer and more financially sound and stable financial services sector are expected to outweigh the costs.

The proposed Twin Peaks model is not expected to cause major disruptions in the financial services sector as it would be able to leverage off the existing strengths of the SARB and FSB.

A Twin Peaks model of financial services regulation has already been successfully implemented in Australia and the Netherlands. Both these countries had this system in place during the 2008 global financial crisis and are generally seen to have weathered the financial crisis better than other countries where this was not in place.

Governance and accountability framework

The Twin Peaks model will be based on a regulatory and supervisory framework that will aim to be
transparent, comprehensive, consistent and appropriate to the South African financial services sector. Results should be outcomes-based, risk-based and proportional, preemptive and proactive. The model will be a credible deterrent to non-compliance and aligned with international standards.

The governance framework of the prudential and market conduct regulators will ensure that the regulators have the necessary operational independence in order to perform their duties impartially. The governance and accountability of the prudential regulator will be based on the SARB’s current governance system. The prudential regulator will operate within the control of the SARB, comprising departments that will report to a deputy governor. The FSB will be transformed into a dedicated market conduct regulator. A full-time commissioner and executive management team appointed by the Minister of Finance will govern the market conduct regulator. Various governance committees, including an audit, remuneration and risk committee, will exercise oversight over the executive team.

The two regulators will be funded through retaining the current levy-based system of funding for the market conduct regulator and considering options such as a formula-based levy model for the prudential regulator.

**Prudential regulation and supervision**

The prudential regulator’s strategic objective will be to maintain and enhance the safety and soundness of regulated financial institutions. This includes micro- and macro-prudential regulation and supervision.

The prudential regulator will therefore be responsible for assessing and addressing systemic risks across the financial services industries and for the prudential regulation of insurers, banks and exchanges.

**Market conduct regulation and supervision**

The market conduct regulator’s strategic objective will be to protect consumers of financial services and to promote confidence in the South African financial services sector.

This regulator will be mandated to:

- Promote the fair treatment of financial services customers;
- Promote the financial awareness and financial literacy amongst South Africans;
- Protect and enhance the efficiency and integrity of South Africa’s financial markets; and
- Contribute to the financial sector’s policy objectives of financial stability, financial inclusion and combating financial crime.

The market conduct regulator will therefore fulfill market conduct and prudential regulatory functions in respect of micro-insurers, collective investment schemes, financial advisory and intermediary services, credit rating agencies and pension funds.

There will be reliance on a mix of traditional and new supervisory tools. Traditional supervisory tools include site visits, regular compliance and other reporting, ad hoc information requests, reviews and analyses of independent reports and other information. New tools will include “mystery shopper” techniques, sourcing information from 3rd parties such as intermediaries, and revised and enhanced regulatory reporting.

**Conglomerate supervision**

Coordinated conglomerate supervision is key to a twin peaks model of financial regulation and supervision, especially where a financial group includes both banking and insurance business. This is also embodied in the objectives of insurance groups’ supervision under the FSB’s proposed Solvency and Assessment Management (SAM) regime.

Conglomerate supervision will be developed as a financial stability function of the prudential regulator and coordinated with the market conduct regulator to address market conduct risks in conglomerates.

**Cooperation and coordination**

The legislative framework of the Twin Peaks model will facilitate coordination and allocation of supervisory responsibilities between the prudential and market conduct regulators.

Appropriate mechanisms will be put in place to ensure cooperation and synchronization of efforts between the two sub-regulators.

The National Credit Regulator (NCR) plays an important role in the market conduct regulation of credit extension for banks and non-financial institutions. National Treasury will therefore engage with the Department of Trade and Industry (currently governs the NCR) to assess the current arrangements and the impact of having two separate regulators governing different aspects of market conduct.
Anti-money laundering and combating financial terrorism

Compliance with anti-money laundering (AML) and the combating of financial terrorism (CFT) will be supervised as part of regulated institutions’ enterprise wide risk management processes. The prudential regulator will supervise AML and CFT of institutions that falls under its authority (banks, insurers and exchanges), while the market conduct regulator will carry out AML and CFT supervisions for the other financial services institutions.

Crisis management and resolution

It is important to have mechanisms in place to prevent disruptions and to deal with crises when they occur in the financial markets.

The prudential regulator has been identified as the resolution authority in South Africa due to its financial stability mandate, its responsibility for both macro- and micro-prudential supervision and its role in managing money-market liquidity. Decisions to use fiscal resources will however be taken by the Minister of Finance.

Implementation

The Twin Peaks model will be implemented in two phases:

- The first phase will include the development of legislation and the transfer of resources and staff that are currently responsible for prudential regulation in the FSB to the SARB during 2013/2014; and
- The second phase will be implemented over the next several years and will consist of the broader harmonisation process of specific financial sector regulatory and supervisory systems and frameworks.

Public consultation will be followed for both the development of legislation and the coordination of specific financial sector regulatory frameworks.

Close interaction with the evolving regulatory structures is an important strategy to be adopted by financial institutions. This will ensure that changes implemented in realistic time frames for industry are considered, the implications and extent of change management required for the regulator is understood and the consequences on reporting defined. A key challenge facing the regulator during the transition will be the preservation of skills particularly as the insurance industry itself is going through a significant change facing SAM and TCF in difficult and trying economic conditions. The evolution of Twin Peaks will change the regulatory landscape and will be an interesting development over the months to come.

We encourage financial institutions to engage with the various regulatory structures to provide views on legislative changes and ensure that the changes do not have unintended consequences on organizations or the financial services industry as a whole.

Enforcement

The proposed enforcement options include:

- Administrative penalties;
- Referrals to an enforcement forum; and
- Criminal prosecution.

Supervisory actions will include:

- Suspending or withdrawing licenses and approvals;
- Issuing orders to take or cease particular actions; and
- Debarments.