Twin Peaks, improved market conduct and implications for credit regulation

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16 February 2017

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What events triggered a major change in regulating financial sector in SA?

- **Fidentia fraud** against 47 000 widows and orphans exposed in Feb 2007
- **Competition Commission Banking Enquiry Panel** (JALI) Report launched in 2006 and reported mid-2008
- Minister of Finance at the time requested a **review of gaps and weaknesses** in our financial regulatory system, particularly as it affects customers
- **2008 Global Financial Crisis** triggered after 15 Sept 2008 insolvency of Lehman Brothers
- **Regulatory siloes**; how do we **prevent regulatory (forum) shopping?**
- **Tick box approach** to regulation – poor outcomes even if letter of law is followed

Twin Peaks reform process to date

— **2011** – Policy paper '*A safer financial sector to serve South Africa better*', approved by Cabinet. **Proposed a move to a Twin Peaks model of regulation**

— **February 2013** – Roadmap '*Implementing a twin peaks model of financial regulation in South Africa*'

— **December 2013** – First draft of the FSR Bill published , consulted on

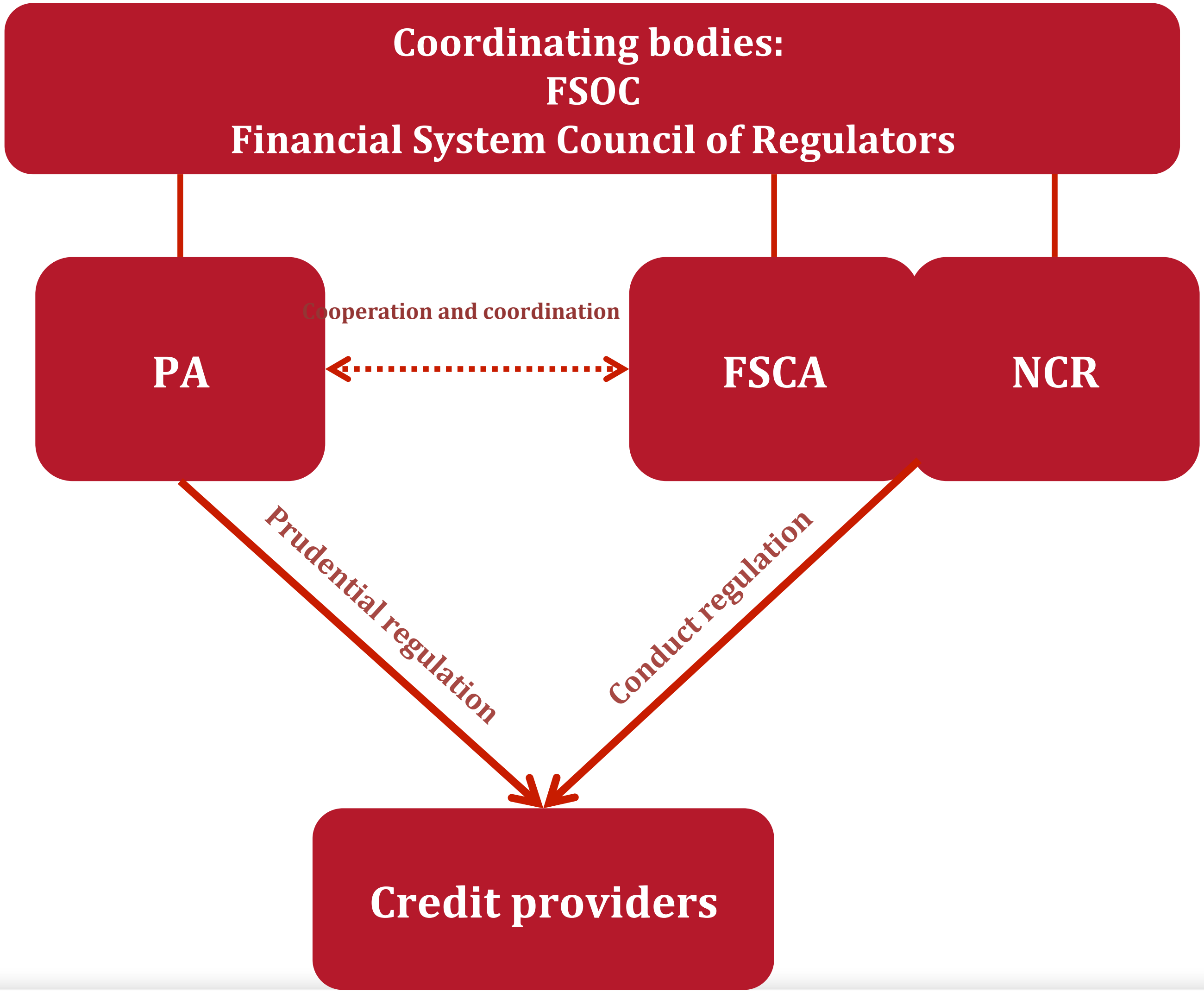
— **December 2014–** Second draft of the FSR Bill (with response doc & draft MCPF) published, consulted on

— **November 2015 –** FSR Bill tabled in Parliament

— **December 2016** – FSR Bill passed in the National Assembly

All documentation is available at www.treasury.gov.za/twinpeaks

Twin Peaks and credit providers



A harmonised system of regulation

- Twin Peaks is a comprehensive and coherent system going beyond the setting up of the "twins"

PRUDENTIAL REGULATOR/ MARKET CONDUCT REGULATOR

Deposit Taking (BANKS)

LT & ST Insurance (INSURANCE FIRMS)

Securities (FMIs)

Retirement savings (PENSION FUNDS)

Financial services/ Advisory

Pooled investments (CIS)

NCR

Credit (CREDIT PROVIDERS)

Harmonised system of licensing

SIFIs

Co-ordinated supervision

Enforcement

Information sharing

Consumer recourse (including ombuds system)

Appeal mechanism (tribunal)

Coordination, cooperation, collaboration (licensing ,inspections, investigations ,enforcement, etc)

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Twin Peaks and improved financial sector regulation

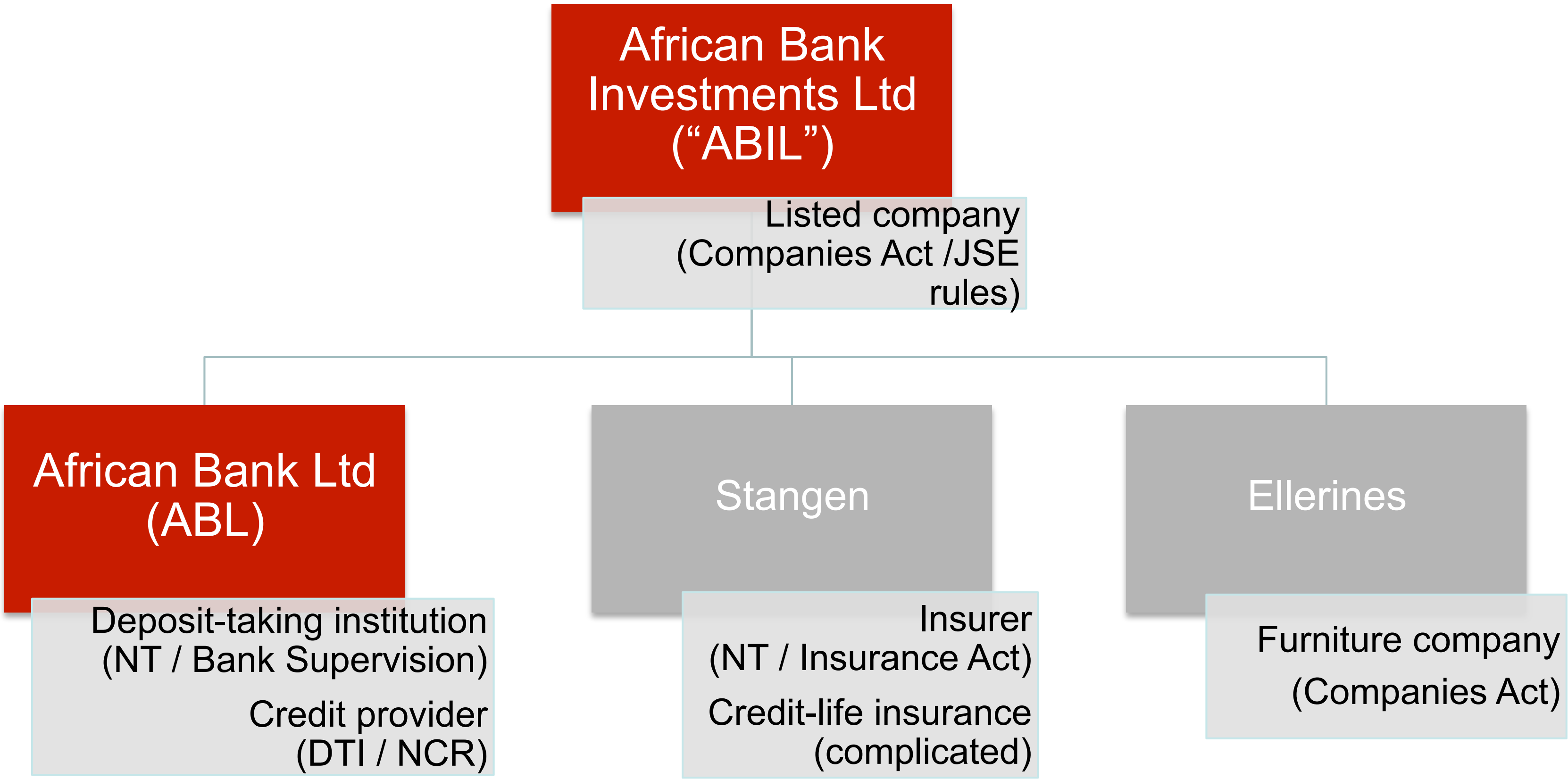
- **Dedicated and equal emphasis** on monitoring stability, prudential and conduct risks in financial sector
- **Increased regulatory coverage**, minimising potential for regulatory gaps (can designate new products and services in financial sector)
- Regulatory laws that are **complete, harmonised, integrated, proportionate, flexible**
- 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

Poor customer outcomes, poor conduct practices in credit environment

- Some recent examples of poor customer outcomes in the credit environment:

  - **Poorly disclosed costs:** on many products, customers not clear what they are paying for and why, what penalty fees may apply and why
  - **Confusing products:** customers find it hard to assess what product may be best suited to their needs (overdraft vs personal loan vs credit card?)
  - **Car/home loans:** customers don’t understand why they’re declined, what insurance is for, what to do when they get into difficulties
  - **Sales practices:** staff don’t always act in the customer’s best interest
  - **Collection practices:** collecting on debts can involve confusing and at times abusive practices. On-selling loan books creates further complications
  - **Complaints practices:** who to complain to not always clear or customer-friendly

Financial conglomerates lead to regulatory challenges



Bundled products, consumer confusion

- The Credit Ombud recently dealt with a consumer who approached the ombud for assistance in understanding the balance outstanding on his statement of account – despite making payment every month the balance was not decreasing.

- When investigating the complaint the ombud noticed that the consumer made a payment arrangement to decrease his monthly payments a few years ago. The customer disclosed that he made the payment arrangement because he suffered an illness which resulted in him becoming disabled. He was unaware that he had credit life cover for precisely such an event.

- The ombud then assisted him by submitting the necessary documentation for a claim against his insurance, it was paid out and his account was settled in full.

Bundled products, consumer confusion

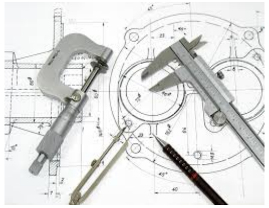
- A mystery shopping exercise at a bank found that a certain **credit provider** required their customers to obtain consumer credit insurance when being granted a loan.

- While technically the customer was free to obtain such cover from an insurer of his choice, the **credit provider** required that such cover must include “short-time cover”. This would cover situations where the number of hours worked by the customer decreased as a result of low activity periods (i.e. shift work)

- By ‘lucky coincidence’, the associated **insurer** of the credit provider offered a product where retrenchment cover was defined to also include “short-time cover”, making it de facto the insurer that the customer would have to use.

Under Twin Peaks, conduct can be addressed throughout product cycle

Products fairly designed



Sales, marketing and advice practices are fair

Proper disclosure of relevant info

Products and services meet expectations

Customers able to complain

Fair treatment part of firm's culture; customer expectations and experiences are acknowledged and included

All Financial Institutions

Agreed principles for regulating the financial sector – including credit

- Provide for a **proportionate, risk-based, system-wide approach** to regulating the financial sector, to **level the regulatory playing field** and minimise the potential for regulatory gaps, arbitrage and forum shopping.

- **Minimise fragmentation and regulatory siloes**, **support and strengthen coordination mechanisms** between the FSCA and PA, and the NCR, CMS and FIC, building on what is provided for in existing sector laws

- **Operational independence** of each regulator should be protected from interference from the executive and from each other. (Regulators must operate **within the policy direction spelt out by the governing law**)

- The achievement of the objectives of one regulator should not be at the expense of achievement of objectives of another regulator; to the extent possible **these regulators should support the achievement of each other's objectives**.

What this means for Twin Peaks regulatory model

Scope of jurisdiction for the financial sector regulators and the SARB:

- **SARB and Prudential Authority should regulate credit providers for stability and safety and soundness** respectively, with intensity of oversight determined on a **risk-basis**.

- The **NCR and FSCA should regulate credit providers for conduct** but in **different ways and with a different focus; the FSCA should complement and support the actions of the NCR**

- **NCR is the sole regulator of the credit agreement** itself, i.e. the features of the product. The **FSCA can regulate credit providers** that provide credit agreements, on a risk-basis, especially **in relation to the culture** of such providers (esp. banks), to **complement what is provided for under the NCA**.

- **FSCA** sets standards for **financial services provided in relation to credit agreements** (e.g. distribution and advice), to provide for a system-wide approach to conduct, provided that these support regulatory requirements set by the NCR under the NCA.