

Twin Peaks: The role of the South African central bank in promoting and maintaining financial stability

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OPSOMMING

Twin Peaks: Die rol van die Suid-Afrikaanse sentrale bank in die bevordering en handhawing van finansiële stabiliteit

Ingevolge die Wet op die Suid-Afrikaanse Reserwebank 90 van 1989 en soos daarna bevestig in die Grondwet, 1996 is die primêre doelwit van die Reserwebank as Suid-Afrika se sentrale bank die beskerming van die waarde van die geldeenheid van die Republiek in die belang van gebalanseerde en volhoubare ekonomiese groei in Suid-Afrika. Alhoewel die Reserwebank ook *de facto* verantwoordelik was vir finansiële stabiliteit in Suid-Afrika word daar nêrens in voormelde wetgewing uitdruklik gemeld dat die bevordering en handhawing van finansiële stabiliteit 'n doelwit van die Reserwebank is nie. Die wêreldwye finansiële krisis (WFK) van 2008 het egter 'n paradigmaskuif ten opsigte van finansiële regulering meegebring wat die bevordering en handhawing van finansiële stabiliteit na die voorgrond geskuif het as regulatoriese doelwit. Alhoewel Suid-Afrika die 2008 WFK met relatiewe welslae trotseer het in vergelyking met onder andere die VSA, het Suid-Afrika as lid van die G20 hom nietemin verbind tot hervorming van sy huidige sektorale benadering tot finansiële regulering. Die gevolg was 'n besluit om die bestaande regulatoriese model te vervang met 'n aangepaste weergawe van die *Twin Peaks*-model wat redelik byval gevind het in verskeie ander G20-lande. Die eerste fase van infasering van *Twin Peaks* in Suid-Afrika word gefasiliteer deur die Finansiële Sektor Reguleringswet 9 van 2017 wat die argitektuur vir die Suid-Afrikaanse *Twin Peaks*-model in plek stel. In hierdie nuwe reguleringsbedeling word 'n uitdruklike en omvattende finansiële stabiliteitsmandaat aan die Reserwebank verleen. Hierdie bydrae ondersoek hierdie omskrewe finansiële stabiliteitsmandaat van die Reserwebank en die bevoegdhede en funksies van die sentrale bank in hierdie verband asook die maatreëls ten opsigte van samewerking met ander reguleerders en staatsorgane ten einde hierdie mandaat effektief uit te voer.

1 INTRODUCTION

The South African Reserve Bank (SARB) is the fourth-oldest central bank outside Europe.¹ It is a non-profitable and non-competitive bank that operates

¹ Rossouw "A selective reflection on the institutional development of the South African Reserve Bank since 1921" 2011 *Economic History of Developing Regions* S3 ("Rossouw (2011)").

like most other central banks in the interest of the general public. It has served as South Africa's central bank since its inception in 1921,² during which time there were many circumstances affecting, changing and internationalising the banking and financial sector of the country. As pointed out by De Jager, factors like South Africa's political liberation, acceptance of a modern Constitution, the fading of boundaries between institutions and a new concept of companies has caused various changes to the legislative framework within which the SARB operates.³

With the enactment of the South African Reserve Bank Act⁴ in 1989 the primary objective of the South African Reserve Bank was embodied in legislation for the first time.⁵ In terms of section 3 of the Reserve Bank Act the primary objective of the SARB is stated as the protection of the value of the currency of the Republic in the interest of balanced and sustainable economic growth in the Republic. Subsequently, the status of the SARB as central bank of South Africa was given recognition in section 223 of the Constitution⁶ when the latter was enacted. The Constitution, like the Reserve Bank Act, also provides that the primary objective of the SARB is to protect the value of the currency in the interest of balanced and sustainable economic growth in the Republic.⁷ The Constitution further specifies that the powers and functions of the SARB are those customarily exercised and performed by central banks, which powers and functions must be determined by an Act of Parliament and must be exercised or performed subject to the conditions prescribed in terms of that Act.⁸ The autonomy of the SARB is entrenched in the Constitution⁹ which provides that the SARB must, in the pursuit of its primary objective, perform its functions independently and without fear, favour or prejudice but that there must nevertheless be regular consultation between the SARB and the Minister of Finance.¹⁰

In so far as the maintenance and promotion of financial stability are concerned, it should be noted that the SARB Act, prior to the enactment of the Financial Sector Regulation Act, did not explicitly state that financial stability is an objective of the SARB. As indicated above, the primary objective of the SARB, being the responsibility for monetary policy, was stated in section 3 of the Reserve Bank Act but no secondary objective was provided for anywhere else. The policy followed by the South African government since 2010 however,

2 The SARB was established in Pretoria with the enactment of the Currency and Banking Act 31 of 1920.

3 De Jager "The South African Reserve Bank: An evaluation of the origin, evolution and status of a central bank (Part 1)" 2006 *SA Merc LJ* 159 ("De Jager (2006 1)").

4 Act 90 of 1989.

5 Schoombee "The Stals era of monetary policy in South Africa" 2003 *SA J of Economic History: The South African Economy in the 1990s* 31 33.

6 The Constitution of the Republic of South Africa, 1996 ("the Constitution"). The Constitution was promulgated on 18 December 1996 and came into operation on 4 February 1997. Rossouw (2011) S7 remarks that the Constitution has to some extent superseded the SARB Act by providing for a central bank with a strong constitutional mandate.

7 S 224(1) of the Constitution.

8 S 225 of the Constitution.

9 De Jager "The South African Reserve Bank: An evaluation of the origin, evolution and status of a central bank (Part 2)" 2006 *SA Merc LJ* 274 284 ("De Jager (2006 2)").

10 S 224(2) of the Constitution.

reflects that the SARB has financial stability and macro prudential mandates, but the International Monetary Fund (IMF) indicated in its Country Report No. 14/340 that for the legal underpinning of these mandates, amendments to the Reserve Bank Act would be required that should clearly state that financial stability is an objective of the SARB and also to provide powers to the SARB to realise that objective.¹¹

As discussed hereinafter, South Africa's move to a Twin Peaks model of financial regulation will have the effect that the previously underplayed financial stability mandate of the SARB will now occupy the centre stage within this new regulatory dispensation. The purpose of this contribution is accordingly to provide an overview of and comment on salient features of the SARB's "new" comprehensive financial stability mandate as set out in the Financial Sector Regulation Act¹² that, once fully implemented, will formally introduce the Twin Peaks model of financial regulation into South African law.

2 NEW REGULATORY PARADIGM

South Africa, as a member of the G-20,¹³ is continually involved in worldwide financial integration and development and accordingly it must observe the trends and influences of international financial markets. The landscape of financial regulation has however in recent years become a shifting landscape as some conventional theories with regard to *inter alia* supervisory structures are being challenged, especially since the 2008 Global Financial Crisis (GFC).¹⁴ The 2008 GFC proved to be a watershed event in the context of financial regulation giving rise to a quest for the most appropriate approach to financial regulation. The central question that arose globally, is whether there should be a single mega-regulator enveloping all the facets of financial regulation and supervision or whether financial regulation and supervision should be done by different institutions, of which the central bank might or might not be part.¹⁵ In this context, the Twin Peaks model of financial regulation attracted the attention of the South African Treasury as a regulatory approach that would serve South Africa better in the financial landscape post the 2008 GFC.

11 IMF Country report no 14/340 on South Africa's financial system stability assessment (2014) 11.

12 Bill B34B-2015 as amended.

13 Denters "Regulation and supervision of the global financial system. A proposal for institutional reform" 2008–2009 *Amsterdam Law Forum* 63 65: In 2009 the G-20 world leaders had implemented a plan where they met to discuss financial reforms. Their objective was to change the system of international financial governance in such a way that a system would be developed wherein it could issue early warning signs internationally in order to diminish financial risks that could occur in the future. These leaders were given the responsibility to develop standards of oversight and regulation that would be accepted internationally so that oversight of big international firms could be done over borders of countries. They also had to look for implementing ways where different countries can cooperate and work together in the case of a financial crisis.

14 See Dept of National Treasury *A safer financial sector to serve South Africa better* (2011) ("National Treasury (2011)"), also with regard to the lessons learnt from the global financial crisis. See also Schmulow "The four methods of financial system regulation: An international comparative survey" 2015 (26) *JBFLP* 151.

15 De Jager (2006 2) 279.

The idea of a Twin Peaks system of financial regulation was introduced in 1996 by Michael Taylor, formerly with the Bank of England, and at that time director of a course in financial services regulation at London Guildhall University, with a paper entitled “‘Twin peaks’: A regulatory structure for the new century”.¹⁶ Taylor proposed that when financial services are regulated, it should be done with two goals in mind, namely to protect the stability and integrity of the financial system (“systemic protection”) and to ensure that the interests of individual depositors, investors, and policy-holders are protected (“consumer protection”). Systemic protection implies that prudential measures will be designed to ensure the financial soundness of institutions. These measures comprise of capital adequacy and large exposure requirements and measures taken relating to systems and controls and provisioning policies as well as making sure that senior managers possess appropriate levels of experience and skill. On the other hand, consumer protection is mainly furthered by conduct of business measures to make sure that individual consumers do not suffer from fraudulent actions or incompetence and abuse of market powers by big institutions. The measures taken in this regard consist of rules regarding advertising, marketing and transactions in financial products and will also include that salespeople will have to be trained to meet certain minimum standards of integrity and competence and then be registered as being adequately qualified.¹⁷

Accordingly, Taylor suggested that to ensure efficient financial regulation and supervision, a twin peaks model integrating systemic protection, on the one hand, and consumer protection, on the other hand, should be implemented and that each of these areas should be regulated and supervised by two separate bodies. The two separate regulatory bodies would have overlapping staff and governing boards, all answerable to the Treasury. If a conflict arose between the two regulators, this would be clarified politically at ministerial level in the Treasury.¹⁸

Taylor made a strong case for the transfer of power for the financial soundness of the entire financial landscape (thus not only banks but also other financial institutions) to a single office which would be responsible for the protection of the whole financial system from disruption (that is, a macro prudential financial stability mandate). In this regard, he listed four considerations in favour of moving prudential supervision of banking, securities and insurance to the sphere of a single regulatory department, namely: a vast spectrum of financial businesses will be considered as systemically important; current regulatory requirements query the opposing uniformity between types of financial businesses; because of the increase of financial conglomerates, it is crucial to have a view of financial groups as a whole, with the inclusion of the banking, security and insurance sectors, and lastly, it was necessary to put together all the skills and competencies that were needed to supervise sophisticated financial businesses.

Taylor also pointed out that formerly banks were seen as the essential systemically important establishments. However, other non-bank financial businesses also developed systemic problems, for instance important non-bank financial businesses

16 1995 London, Centre for the Study of Financial Innovation, 1995 – Financial Service Industry (DSFI series issue 20 December 1995) 1–18.

17 *Idem* 3.

18 *Idem* 1.

like security houses, insurance companies, trusts and businesses in the over-the-counter derivatives market.¹⁹ When financial regulatory systems were developed, the banking, securities and insurance companies were not yet interlinked in such ways as happened subsequently and that provided a strong impetus for changing the division of responsibility in order to promote prudential soundness.²⁰

The traditional Twin Peaks model of regulation proposed by Taylor thus has only two “peaks”, that of a systemic risk regulator which is integrated in the central bank and that of a market conduct regulator. In this model the systemic risk regulator is accountable for prudential regulation of all potentially systemic financial institutions and oversight of systemically important payment and settlement systems and the maintenance of financial safety, soundness and solvency of the financial sector. The market conduct regulator is accountable for the conduct of business regulation across all sectors of financial services, like banking, insurance and securities and focuses on the behaviour of financial institutions toward customers in the market.²¹

Taylor argued that the benefits of Twin Peaks are clear in that this regulatory structure would to a large extent do away with replication and overlap of regulatory actions and would ensure that regulatory bodies with a specific purpose would be created; that mechanisms for clearing up of clashes between the regulation of financial services would be encouraged; and that an open and translucent regulatory process would be established.²²

The Twin Peaks approach accordingly regulates the financial sector in an all-inclusive way: by establishing separate institutions tasked with prudential and market conduct supervision respectively, the focus of Twin Peaks is balanced between the two aforementioned authorities. Each authority is dedicated to one of these objectives of prudential and market conduct and the two authorities are simultaneously focusing on financial stability.²³

3 SOUTH AFRICA’S MOVE TOWARDS A TWIN PEAKS MODEL OF FINANCIAL REGULATION

The regulation of the financial sector in South Africa was in the past mainly modelled on countries that it was historically linked to, specifically the United Kingdom and other former British colonies such as Australia and Canada. Following the 1993 Melamet Commission,²⁴ South Africa chose an approach to financial regulation which has resulted in various regulators practising silo regulation in respect of the different roleplayers in the South African financial markets.²⁵

19 *Idem* 4.

20 *Idem* 5. He pointed out that the previous financial regulatory systems commenced by dividing function and risk with the result that many regulatory bodies over the spectrum of the financial system might have had an interest in systemically important businesses.

21 De Jager “The South African Reserve Bank: Blowing winds of change (Part 2)” 2013 *SA Merc LJ* 492 508.

22 Taylor 16. He argued that these advantages were aligned with the philosophy of creating greater transparency, efficiency and specific functions of responsibility in the duties of governmental departments.

23 Dept of National Treasury *Twin Peaks in SA: Response and explanatory document* (2014) (accompanying the second draft of the FSR Bill) 5 (“*Explanatory document* (2014)”).

24 *The report and recommendations of the Melamet Commission of Inquiry 1994*, appointed on 6 August 1993.

25 National Treasury (2011) 28.

Prior to the Financial Sector Regulation Act, the regulatory and supervisory structure in respect of the financial system was thus multi-layered. The SARB was responsible for banking regulation and supervision, and the Financial Services Board (FSB) was responsible for insurance regulation and supervision. The FSB also supervised fund managers and exchanges, and shared the responsibility for supervision of market intermediaries with the Johannesburg Stock Exchange (JSE). The National Credit Regulator, which has a consumer credit regulation mandate, oversees lending and reports to the Department of Trade and Industry. Because of this silo structure, financial regulation in South Africa was fragmented and complex and susceptible to regulatory arbitrage.²⁶

It is, however, to be noted that the South African financial services industry functions in an international environment where there is significant interconnectedness between financial institutions and accordingly a crisis in one economy can spread to another at a disastrous speed as a result of contagion. As pointed out by the South African National Treasury, this increases the risk of financial instability and heightens the need for supervision of the financial sector. The 2008 GFC has emphasised the need for better co-ordination of monetary and fiscal policies in financial regulation as well as the need to focus on prevention and management of systemic risks.²⁷ Systemic risk is the risk that systemic events can occur: serious events that can significantly impact on a domestic or even global financial system and, through contagion due to interconnectedness between financial institutions, produce a domino effect that can erode the stability of that financial system.²⁸

Although the financial sector in South Africa has withstood the 2008 GFC relatively successfully, the South African government nevertheless undertook to rethink the financial regulatory system and in the G20, South Africa committed to a global financial reform agenda in order to strengthen financial stability.²⁹ The South African National Treasury subsequently embarked on a formal review of the financial regulatory system and issued a policy paper entitled “A safer financial sector to serve South Africa better”³⁰ in February 2011. This document, commonly known as the Red Book, considered the lessons learnt from the 2008 GFC and assessed the structure and characteristics of South Africa’s financial sector for gaps and weaknesses. It voiced the realisation that there were inadequacies in the (then) existing supervision of the South African financial sector on a micro-prudential basis *inter alia* regarding the risks for financial instability from interconnections between different establishments in the financial sector. It also expressed the need for a macro-prudential system-wide approach to financial stability and financial regulation³¹ and identified the Twin Peaks model of financial regulation as the appropriate regulatory approach that South Africa should embrace in future.³²

26 *Idem* 4. The National Credit Regulator (NCR) obtained a “carve-out” (see s 58(2)) in that it has not been assimilated into the FSCA but still oversees lending by credit providers in the new Twin Peaks system. However, the co-operation of the NCR in the context of financial stability is fully facilitated by the Financial Sector Regulation Act. See, eg, ss 22(e) and 26.

27 *Idem* 5.

28 Schwarcz “Systemic risk” 2008 *Georgetown LJ* 193 198, available at <http://bit.ly/2pbrK-DC>, accessed on 11 May 2017.

29 De Jager 2013 *SA Merc LJ* 498.

30 National Treasury (2011) 1–93.

31 De Jager 2013 *SA Merc LJ* 499.

32 *Explanatory document* (2014) 6.

Following the approval in July 2011 of a shift to an “expanded” Twin Peaks model of financial regulation which included the SARB as an “extra (apex) peak” with an express and comprehensive financial stability mandate, a detailed follow-up document was published by the Treasury on 1 February 2013, entitled *Implementing a Twin Peaks model of financial regulation in South Africa*. This document set out the process going forward, and highlighted important policy choices in the area of prudential and market conduct supervision.³³

The essence of South Africa’s shift towards a Twin Peaks model for financial regulation is that the financial sector will be made safer through a comprehensive financial stability framework and a stronger prudential and market conduct framework. The envisaged Twin Peaks system of regulation recognises that the two objectives of financial soundness and treating customers fairly are better done by two regulators, dedicated to each objective and that this model will also serve to minimise regulatory arbitrage due to conflicting objectives.³⁴ Accordingly, the South African model does away with the Bank Supervision Department in the SARB as regulator of banks and establishes a separate juristic person, the so-called Prudential Authority, located within the SARB, as system-wide prudential regulator. It further replaces the current Financial Services Board with a new system-wide market conduct regulator, the Financial Sector Conduct Authority.³⁵ The South African Twin Peaks model will thus comprise of three prominent regulators: The SARB is assigned as primary guardian of financial stability; the Prudential Authority will be the entity responsible for prudential supervision of the wider spectrum of regulated financial institutions, such as banks, long-term and short-term insurers, and will assist the SARB in maintaining overall financial stability and overseeing systemic risk that may arise from key financial markets infrastructures; and the Financial Sector Conduct Authority will be responsible for protecting consumers of financial services and promoting confidence in the South African financial system by regulating and supervising the market conduct of financial services providers, including banks, insurers, financial advisers, financial intermediaries, investment institutions and the broader financial markets.³⁶ The 2008 GFC has revealed the importance of business conduct

33 Also referred to as “the Roadmap”.

34 *Explanatory document* (2014) 8. Such regulatory arbitrage is usually characteristic of a system of silo regulation where one regulator is tasked to oversee prudential as well as market conduct of financial institutions, as was the case under the system of silo regulation that prevailed in South Africa pre-Twin Peaks.

35 De Jager 2013 *SA Merc LJ* 499. Initially it was envisaged that the Financial Services Board (FSB) would be restructured to serve as the market conduct authority but in later drafts of the Financial Sector Regulation Bill, discussed below, the establishment of a new market conduct authority, the Financial Sector Conduct Authority (FSCA), as a new juristic entity, was introduced.

36 De Jager 2013 *SA Merc LJ* 509. In the *Explanatory document* (2014) 10 it is stated that the industry-specific legislation that is currently valid, will remain in place and will be revised over time. However, with the creation of the new regulators, the responsibility for the existing Acts will change. For example, the responsible authority for the prudentially-focused provisions of the Banks Act and prudential aspects of the Long-term and Short-term Insurance Acts will shift from the Registrar of Banks and Registrars of Long-term and Short-term Insurance to the Prudential Authority. For most other pieces of legislation, the primary responsibility for the law will shift to the FSCA. The authority responsible for the legislation will also become the licensing authority for financial institutions licensed or authorised in terms of that law (see Sch of the Financial Sector Regulation Act.).

supervision to support prudential supervision and accordingly the FSCA through its conduct supervision mandate will also assist the SARB in maintaining financial stability.³⁷

This new comprehensive financial stability mandate of the SARB entails oversight of systemic macro prudential aspects of the financial system by establishing a framework for macro prudential supervision. This will include identifying systemic risks in the financial system, monitoring and analysing market and other financial and economic factors that may increase systemic risks and result in systemic crises, formulating and implementing appropriate policies, and assessing how these policies may impact on the financial system. It further includes dealing with systemically important financial institutions in order to reduce the probability of using tax-payer funds to bail out failing financial institutions.³⁸

The first stage of South Africa's move towards a Twin Peaks system of financial regulation is encapsulated in the Financial Sector Regulation Act, which puts the regulatory architecture for this new approach to financial regulation in place and which underwent a formidable number of drafts in an attempt to refine the proposed regulatory model. After the first draft of the Bill was published, close to 300 pages of comments were received on the draft Bill, and various communications between stakeholders followed.³⁹ Early in 2014 the National Treasury published the second draft of the Financial Sector Regulation Bill⁴⁰ as a revised version of the first draft of the Bill for further public consultation.⁴¹ Treasury summarised some of the responses and comments from stakeholder engagements with members of the public and various government departments received on the first draft of the Bill. It gave detailed explanations of the proposals in the document that accompanied the second draft of the Bill, named "Twin Peaks in SA: Response and explanatory document".⁴² The introduction of a Twin Peaks system of regulating the financial sector gained further momentum when the Revised (Third) Draft of the Financial Sector Regulation Bill was tabled in parliament on 27 October 2015. The tabled version of the Bill was amended in July 2016⁴³ and in November 2016 a further slightly amended draft of the Bill served before the National Assembly. On 21 August 2017, the President signed the Bill into law but it will only be implemented incrementally on future dates yet to be determined.

In Part 2 of Chapter 1 of the Financial Sector Regulation Act, the objectives of the Act are set out, namely to "achieve a stable financial system that works in the interests of financial customers, and supports balanced and sustainable economic

37 National Treasury (2011) 6.

38 *Explanatory document* (2014) 7. See also Godwin and Schmulow "The Financial Sector Regulation Bill in South Africa, second draft: Lessons from Australia" 2015 *SALJ* 756; Schmulow "Financial Regulatory Governance in South Africa: The move towards Twin Peaks" 2017 *African J of Int and Comp L* 393.

39 *Idem* 4.

40 "FSR 2014".

41 IMF *Country report no 14/340 on South Africa's financial system stability assessment* (2014) 56.

42 *Explanatory document* (2014) 4.

43 Financial Sector Regulation Bill, 2016. July 2016 draft accompanying response matrix for submissions made in respect of the tabled version of the FSR Bill 2015, available at <http://bit.ly/2pwyPhm>, accessed 1 August 2016.

growth in the Republic, by establishing, in conjunction with the other financial sector laws, a regulatory and supervisory framework that promotes financial stability; the safety and soundness of financial institutions; the fair treatment and protection of financial customers; the efficiency and integrity of the financial system; the prevention of financial crime; financial inclusion and confidence in the financial system”.⁴⁴

The FSR Act generally applies to financial institutions rendering financial services⁴⁵ and providing financial products⁴⁶ in the South African financial system.⁴⁷ For purposes of the Act, “financial institution” means a financial product provider; a financial service provider; a market infrastructure; a holding company of a financial conglomerate; or a person licensed or required to be licensed in terms of a financial sector law.⁴⁸

4 SARB’S FINANCIAL STABILITY MANDATE

4.1 Introduction

As indicated, the 2008 GFC exposed the threat of systemic risk to financial systems as one of the main problems that warrant regulatory attention. Since the

44 Explanatory Summary of the Financial Sector Regulation Bill, 2015, published in GG 39127 on 21 August 2015 in terms of rule 241(1)(c) of the Rules of the National Assembly.

45 S 3 of the Act provides that “financial service” means – “(a) any of the following in relation to a financial product, a foreign financial product or a financial instrument: (i) Offering, promoting, marketing or distributing; (ii) providing advice, recommendations or guidance; (iii) dealing or making a market; and (iv) operating or managing, or providing administration services; (b) dealing or making a market in a financial product, a foreign financial product, a financial instrument or a foreign financial instrument; (c) a service provided by a financial institution, being a service regulated by a specific financial sector law; (d) a service related to the buying and selling of foreign exchange; (e) a service, including a debt collection service, provided to a financial institution through an outsourcing arrangement, being a service provided in relation to the provision by a financial institution of a financial product, a foreign financial product, a financial instrument or a financial service; and (f) a service related to the provision of credit, excluding the services of a debt counsellor, payment distribution agent or alternative dispute resolution agent, each as defined or referred to in the National Credit Act”.

46 S 2 of the Financial Sector Regulation Act provides that “financial product” means – “(a) a participatory interest in a collective investment scheme; (b) a long-term policy as defined in section 1(1) of the Long-term Insurance Act; (c) a short-term policy as defined in section 1(1) of the Short-term Insurance Act; (d) a benefit provided by – (i) a pension fund organisation, as defined in section 1(1) of the Pension Funds Act, to a member of the organisation by virtue of membership; or (ii) a friendly society, as defined in section 1(1) of the Friendly Societies Act, to a member of the society by virtue of membership; (e) a deposit as defined in section 1(1) of the Banks Act; (f) a health service benefit provided by a medical scheme as defined in section 1(1) of the Medical Schemes Act; (g) credit, as defined in section 1 of the National Credit Act, provided in terms of a credit agreement as defined in that section; (h) a warranty, guarantee or other credit support arrangement as provided for in a financial sector law; (i) a facility or arrangement designated by Regulations for this section as a financial product; and (j) a facility or arrangement that includes one or more of the financial products referred to in paragraphs (a) to (i)”.

47 “Financial system” is defined in s 2 of the Act to mean “the system of institutions and markets through which financial products, financial instruments and financial services are provided and traded, and includes the operation of a market infrastructure and a payment system”.

48 S 1(1) of the Act.

2008 GFC, the regulatory focus has therefore extensively been on the maintenance of “financial stability” as the core pursuit of the new regulatory paradigm.⁴⁹ This is also the main focus of the Financial Sector Regulation Act which describes the concept of “financial stability” to mean that:⁵⁰

- “(a) financial institutions generally provide financial products and financial services without interruption;
- (b) financial institutions are capable of continuing to provide financial products and financial services without interruption despite changes in economic circumstances; and
- (c) there is general confidence in the ability of financial institutions to continue to provide financial products and services without interruption despite changes in economic circumstances.”⁵¹

In order to provide for the promotion and maintenance of financial stability the Act assigns various powers and functions to the SARB and requires broad collaboration by various bodies. The SARB’s “new” express financial stability mandate is a comprehensive mandate that requires SARB to monitor the financial system closely and act pre-emptively to prevent disruption of financial stability and, if such disruption occurs despite efforts to prevent it, to manage such situation in an attempt to eventually restore financial stability in the South African financial system.

In exercising its financial stability mandate the SARB will primarily be supported by the Financial Stability Oversight Committee (FSOC) established in terms of section 20 of the Act and the Financial Sector Contingency Forum (FSCF) established in terms of section 25 of the Act and discussed in more detail below. The Act further provides for co-operation between the SARB and the other regulators such as the Prudential Authority, the Financial Sector Conduct Authority, the National Credit Regulator (NCR), the Competition Commission, the Financial Intelligence Centre (FIC) and the Council for Medical Schemes. The co-operation and collaboration of other organs of state in maintaining financial stability is also provided for in the Act as it is clear that ensuring stability in the South African financial system is a holistic exercise that requires the co-operation and collaboration of all role-players.

In brief, the SARB’s stability mandate as per the Financial Sector Regulation Act requires it to keep the scales of financial stability hanging in balance. In order to comprehend the scope of this mandate and exactly how it is envisaged to be exercised, the various provisions of the Act will be unpacked and analysed below.

4.2 Parameters of the SARB’s financial stability mandate

Section 11 of the Act provides that the SARB is responsible for protecting and promoting financial stability in South Africa. Additionally, if a systemic event

⁴⁹ However, it should be noted that despite “financial stability” being hailed as the holy grail of financial regulation, Allen “What is financial stability? The need for some common language in international financial regulation” 2014 *Georgetown J of Int L* 929 points out that the international standard-setting bodies responsible for elevating financial stability as the core pursuit of financial regulation fail to provide a proper definition of this elusive concept.

⁵⁰ S 1 read with s 4 of the Financial Sector Regulation Act.

⁵¹ It is important to note that s 4(2) expressly provides that a reference to “maintaining” financial stability includes, where financial stability has been adversely affected, a reference to “restoring” financial stability.

has occurred or is imminent, the SARB has the responsibility to restore and maintain financial stability. In terms of Schedule 4 to the Financial Sector Regulation Act an amendment has also been effected to section 3 of the Reserve Bank Act to reflect that in addition to its objective of protecting the value of the currency, the SARB is also responsible for protecting and maintaining financial stability as envisaged in the SARB Act. In fulfilling its financial stability mandate the SARB is required to act within a policy framework agreed between the Minister of Finance and the Governor of the SARB,⁵² thus signifying extensive collaboration between the SARB and National Treasury. SARB may further utilise any power vested in it as South Africa's central bank or conferred on it in terms of the Financial Sector Regulation Act or any other legislation. However, in exercising its financial stability mandate it is expressly obliged to have regard to, amongst other matters, the roles and functions of other organs of state exercising powers that affect aspects of the economy.⁵³ The Act thus envisages that the SARB will take an integrated approach to the exercise of its financial stability mandate, operating within the parameters of a clear policy framework and making comprehensive use of all the powers in its regulatory toolkit.

4.3 Monitoring of risks by SARB

As a first step in exercising its financial stability mandate, the SARB is required in terms of section 12 of the Act, to monitor and keep under review strengths and weaknesses of the financial system; and any risks to financial stability, and the nature and extent of those risks, including risks that systemic events will occur and any other risks contemplated in matters raised by members of the FSOC or reported to the SARB by a financial sector regulator.

This clearly is a continuing duty, covering systemic risk as well as non-systemic risk, which requires in-depth scrutiny of the operations of the various financial institutions that participate in the financial system. In essence, the SARB has to keep a look-out for *any* risks to financial stability hence this is a broad mandate which requires SARB to not only focus on risks of great magnitude such as the risk that a systemic event may occur but that it should also be vigilant of smaller apparently non-systemic risks that may build up and eventually weaken or erode the stability of the financial system.

If the SARB identifies any risks to financial stability it is obliged to take steps to mitigate such risks. These steps include (but are not limited to) advising the financial sector regulators and any other organ of state of steps to be taken by such regulator or organ of state to mitigate the risks to financial stability identified by SARB.⁵⁴ The SARB is thus specifically empowered to issue directives mandating compliance by the regulators and organs of state in a co-ordinated effort to promote and maintain financial stability.⁵⁵

⁵² S 11(2)(a).

⁵³ S 11(2)(b) and (c). An example of such an organ is the Department of Trade and Industry which, by means of determining interest rates pertaining to credit agreements governed by the National Credit Act 34 of 2005, exercises a power that may significantly impact on the economy.

⁵⁴ Ss 17 and 18.

⁵⁵ S 18.

At this point, it is apposite to note that the financial system has especially in recent years seen a spate of international standards and guidelines being churned out by international standard setting bodies in an attempt to effect some form of top-down regulatory crackdown on financial institutions seeking to align and improve financial regulation in the interests of global financial stability.⁵⁶ G20 member states, such as South Africa, are obliged to observe standards and guidelines issued by bodies such as the Basel Committee on Banking Supervision, the Financial Stability Board (FSB) and the International Monetary Fund (IMF). Accordingly, the Financial Sector Regulation Act requires the SARB, in the exercise of its financial stability mandate, to regularly assess the observance of principles in the Republic developed by international standard setting bodies, and reporting its findings to the financial sector regulators and the Minister of Finance. In doing so, it must have regard to the circumstances and context within the Republic. It is thus apparent that in order for the SARB to exercise its financial stability mandate effectively it must have the “buy-in” of the other role-players in the financial system towards observing international standards and maintaining a stable financial sector in South Africa.

4.4 SARB’s duties regarding the Financial Stability Review

The SARB is held accountable for the due and continuous exercise of its financial stability mandate by the requirement in section 13 of the Act that it must, at least every six months, make an assessment of the stability of the financial system in the form of a “financial stability review” that is required to be published for public notification and input. The SARB is required to address a closed list of important issues in every financial stability review, namely:⁵⁷ its assessment of financial stability in the period under review; its identification and assessment of the risks to financial stability in at least the next 12 months; an overview of steps taken by it and the financial sector regulators to identify and manage risks; weaknesses and disruptions in the financial system in the period under review and steps that are envisaged to be taken during at least the next 12 months; and an overview of recommendations made by it and the FSOC during the period under review and progress made in implementing those recommendations.

The Financial Stability Review thus entails that the SARB will exercise both a current and forward-looking macroprudential “surveillance” approach, skimming the financial system for build-up of future risk.

It is also important to note that the Act expressly provides that “information which, if published may materially increase the possibility of a systemic event” only needs to be published in the review after the risk of a systemic event subsides, or has been addressed.⁵⁸ Obviously, this prohibition was enacted to

56 Eg, Basel I, II and III and the *Basel core principles of effective banking supervision* available at <http://www.basel.org> and the Financial Stability Board’s *Key attributes of effective resolution regimes* available at <http://www.fsb.org>.

57 S 13(2). The SARB is required in terms of s 13(4) to follow a consultative process prior to publication of the financial stability review. In this regard it is required to submit a copy of each review to the Minister of Finance and the FSOC and allow them at last two weeks to comment thereon, should they wish to do so. Only thereafter may the review be published, with SARB being obliged (“must”) to take into account any comments by the Minister of Finance and the FSOC before the review is published.

58 S 13(3). An example of such information would probably be if it is reported that a systemically important bank is experiencing serious liquidity problems but no indication is

prevent the financial stability review report itself from becoming a trigger or conduit for the occurrence of a systemic event as a result of publishing sensitive information that may for instance trigger a “bank run” that can create a severe liquidity crisis in the financial market.

4.5 Determination of systemic events

As explained above, systemic events are events that have the potential to trigger the collapse of a whole financial system and accordingly they pose the most significant threats to financial stability. In section 1 of the Act “systemic event” is broadly defined as

“an event or circumstance, including one that occurs or arises outside the Republic, that may reasonably be expected to have a substantial adverse effect on the financial system or on economic activity in the Republic, including an event or circumstance that leads to a loss of confidence that operators of, or participants in, payment systems, settlement systems or financial markets, or financial institutions, are able to continue to provide financial products or financial services, or services provided by a market infrastructure”.

One of the main powers assigned to the SARB in the context of financial stability is its power to determine that certain events qualify as systemic events. This designation creates the basis for emergency intervention and also *ex post* management by the SARB. In terms of section 14(1) of the Act the Governor may, after having consulted the Minister of Finance, determine in writing that a specified event or circumstance, or a specified combination of events or circumstances, is a systemic event⁵⁹ and that a specified systemic event has occurred or is imminent.⁶⁰ Before making such a determination, the Governor may also consult the FSOC.⁶¹ Although this obligation is phrased in discretionary terms it is submitted that it can be expected that the Governor will, as a matter of course, consult the FSOC before such determination. It is important to note that a determination that an event or circumstance, or combination of events or circumstances constitutes a systemic event, may be made regardless of whether or not the event or circumstances or combination of events or circumstances has already arisen, thus conferring on the Governor a pre-emptive power.

Subsequent to the determination of an event as systemic, the Governor is then obliged to notify the Minister of Finance of such determination.⁶² In addition, the Governor must keep the determination under review.⁶³ Flexibility is built into this power in that the Governor may at any time, after having consulted the Minister of Finance, amend or revoke a determination in writing and notify the Minister accordingly.⁶⁴ As can be expected, the SARB must also notify the financial sector regulators of such a determination or the revocation or amendment thereof.⁶⁵

provided of an intention by SARB as lender of last resort to address such problem or to move for curatorship in order to rescue the failing bank.

59 S 14(1).

60 S 14(4).

61 S 14(2).

62 S 14(5)(a).

63 S 14(5)(b).

64 S 14(5)(c) and (d).

65 S 14(6). As per s 14(7) a determination that an event or circumstance or combination of events or circumstances constitute a systemic event or that a systemic event is imminent or has occurred, must also be published.

4 6 Functions of SARB in relation to systemic events

The functions of the SARB in relation to systemic events in terms of the Act are both of an *ex ante* and an *ex post* nature: it must take all reasonable steps to prevent systemic events from occurring and if a systemic event has occurred or is imminent, it must “mitigate without delay the adverse effects of the event on financial stability and manage the systemic event and its effects”.⁶⁶ When the SARB acts as such, it is obliged to have regard to the need to minimise adverse effects on financial stability and economic activity and protect, as appropriate, financial customers and contain the cost to the Republic of the systemic event and the steps taken.⁶⁷

Thus, the SARB does not have *carte blanche* to deal with systemic events but has to conduct some sort of cost-benefit analysis with respect to each instance of systemic event in order to determine whether for example, protecting depositors by rescuing a “too big to fail” distressed bank through bailing it out with taxpayers’ money is justified in a given situation.⁶⁸

4 7 Information to the Minister

The Minister of Finance is responsible for the administration of the Financial Sector Regulation Act and accordingly plays a central role, albeit somewhat behind the scenes, in the context of financial stability. If the Governor has determined that a systemic event has occurred or is imminent, the Governor is obliged to ensure that the Minister is kept informed of the event and any steps taken or proposed to manage the systemic event and the effects thereof.⁶⁹ This provision thus contemplates close co-operation between the SARB and National Treasury. It is further noteworthy that the SARB may not, except with the Minister’s approval, take any step in terms of section 15 that will or is likely to⁷⁰ bind the National Revenue Fund to any expenditure (thus to tie it to a “bail-out”); have a material impact on the cost of borrowing for the National Revenue Fund; or create a future financial commitment or a contingent liability for the National Revenue Fund. It appears that this provision speaks directly to the global regulatory trend to move away from a culture where bail-outs of “Too Big To Fail” financial institutions, and hence moral hazard through excessive risk-taking by these institutions, were condoned, to a post-GFC culture of condemning bail-outs and underwriting the principle that shareholders and directors should curb their risk appetite by being held accountable to contribute in the event that giant institutions encounter financial distress.⁷¹

66 S 15(1).

67 S 15(2).

68 See, with regard to bailout as a rescue mechanism, Dewatripont “European Banking: Bailout, bail-in and state aid control” 2014 *Int J of Industrial Organization* 37.

69 S 16(1).

70 S 16(2)(a)–(c).

71 Kuepper “What is a bail-in and how does it work?” 2016 *Trade online*, available at <http://bit.ly/2ouH8Ni>, accessed on 15 November 2016. A bail-in entails rescuing a financial institution on the brink of failure by making its creditors and depositors take a loss on their holdings. A bail-in is the opposite of a bail-out, which involves the rescue of a financial institution by external parties, for instance governments using taxpayers’ money. Prior to the 2008 GFC bail-outs were commonly used to rescue failing institutions.

4 8 Responsibilities of financial regulators

The SARB and the financial sector regulators are obliged to co-operate and collaborate with each other to maintain, protect and enhance financial stability.⁷² The financial sector regulators must provide such assistance and information to the SARB and the FSOC to maintain or restore financial stability, as the latter two establishments may reasonably request and must promptly report to the SARB any matter of which the financial sector regulator becomes aware of that poses or may pose a risk to financial stability; and to gather information from, or about, financial institutions that concerns financial stability.⁷³ The SARB is not entitled to proceed with its financial stability mandate in a dictatorial fashion but must, when exercising its powers in terms of Chapter 2, take into account any views expressed and any information reported by the financial sector regulators as well as any recommendations of the FSOC.⁷⁴

Clearly, the extent of collaboration envisaged by the Financial Sector Regulation Act will not be possible without memoranda of understanding between the various entities that are required to work together with the SARB in creating a stable financial sector in South Africa. The Act thus requires that the financial regulators and the SARB must not later than 6 months after Chapter 2 takes effect, enter into one or more memoranda of understanding with respect to how they must co-operate and collaborate with each other and perform their roles and comply with their duties relating to financial stability.⁷⁵ These memoranda must be reviewed and updated as appropriate, but at least once every three years.⁷⁶

The Act specifically provides that if the Governor has determined that a systemic event has occurred or is imminent, each financial sector regulator must provide the SARB with any information in their possession which may be relevant for the SARB to manage the systemic event or the effects thereof.⁷⁷ The financial regulators must also consult the SARB before exercising any of their powers in a way that may compromise steps taken in terms of section 15 to manage the systemic event or the effects thereof.⁷⁸

The SARB's stability mandate powers and functions are supported by a well-stocked regulatory toolkit, comprising *inter alia* of powers to extract information from regulators and organs of state, directing them to act in a certain manner and sanctioning them for non-compliance.⁷⁹ The Governor may accordingly direct a financial sector regulator to provide the SARB with information that the SARB

72 S 26(1). See also ss 33(c) and 57(c) which state that it is an objective of the Prudential Authority and the Financial Sector Conduct Authority respectively, to assist SARB in maintaining financial stability.

73 S 26(1).

74 S 26(2).

75 S 27(1).

76 S 27(2). It is further provided in s 27(3) that a copy of a memorandum of understanding must, without delay after being entered into or updated, be provided to the Minister and the Cabinet member responsible for consumer matters. S 27(4) states that the validity of any action taken by a financial sector regulator in terms of a financial sector law, the National Credit Act or the Financial Intelligence Centre Act is however not affected by a failure to comply with s 27 or a memorandum of understanding contemplated in this clause.

77 S 17(1)(a).

78 S 17(1)(b).

79 A detailed discussion of the SARB's regulatory toolkit is beyond the scope of this contribution.

or the Governor needs for exercising the power in terms of sections 14 and 15 as discussed above.⁸⁰ If the Governor has determined that a systemic event has occurred or is imminent, he may also in writing, direct a financial sector regulator to assist the SARB in complying with section 15 by acting in accordance with the directive when exercising its powers.⁸¹ Such a directive may include directions aimed at supporting the restructuring, resolution or winding up of any financial institution; preventing or reducing the spread of risk, weakness or disruption through the financial system; or increasing the resilience of financial institutions to risk, weakness or disruption.⁸²

4 10 Exercise of powers by other organs of state

The Financial Sector Regulation Act is also prescriptive about the role of other organs of state in the context of financial stability: If the Governor has determined in terms of section 14(4) that a systemic event has occurred or is imminent, an organ of state exercising powers in respect of a part of the financial system may not, without the approval of the Minister of Finance, acting in consultation with the Cabinet member responsible for that organ of state, exercise its powers in a way that is inconsistent with a decision or steps taken by the Governor or the SARB in terms of the Act to manage that systemic event or its effects.⁸³ Obviously, the SARB and the FSOC will provide guidance to the Minister in this regard.

4 11 Financial Stability Oversight Committee (FSOC)

The effective and efficient exercise by the SARB of its new financial stability mandate is facilitated further by the creation of dedicated supporting committees. The Financial Stability Oversight Committee (FSOC) is accordingly established in terms of section 20 of the Act to support the SARB when it performs its functions in relation to financial stability. It is also tasked with facilitating co-operation and collaboration between, and co-ordination of action among, the financial sector regulators and the SARB in respect of matters relating to financial stability.⁸⁴

The FSOC is comprised of all the regulatory “heavy-weights” and will consist of the Governor, Deputy Governor responsible for financial stability matters, the Chief Executive Officer of the Prudential Authority, the Commissioner of the Financial Sector Conduct Authority, the Chief Executive Officer of the National Credit Regulator, the Director-General of Treasury, the Director of the Financial Intelligence Centre and any additional persons appointed by the Governor.⁸⁵

It will serve as a forum for representatives of the SARB and the financial sector regulators to be informed and to exchange views about their respective activities regarding financial stability; to make recommendations to the Governor on the designation of systemically important financial institutions; to advise the

80 S 18(1).

81 S 18(2)(a).

82 S 18.

83 S 19(1). This provision does not apply to financial sector regulators. In terms of s 19(2) any unresolved issues between the Minister and that Cabinet member must be referred to Cabinet.

84 S 20.

85 S 22.

Minister and the SARB on steps to be taken to promote, protect or maintain, or to manage or prevent risks to, financial stability; matters relating to crisis management and prevention; to make recommendations to other organs of state regarding financial stability and any other function conferred on it in terms of applicable legislation.⁸⁶

From the aforementioned it is clear that the FSOC will be the forum where the main decisions regarding the exercise of the SARB's financial stability mandate will be made and that the Governor will be acting largely in accordance with decisions taken by this Committee, which in turn will rely on information provided to it by the Financial Sector Contingency Forum, discussed below.

4 12 Financial Sector Contingency Forum

Section 25 provides for the establishment of the Financial Sector Contingency Forum (FSCF) by the Governor.⁸⁷ The primary objective of the FSCF is to assist the FSOC with the identification of potential risk that systemic events will occur; and the co-ordination of appropriate plans, mechanisms and structures to mitigate those risks.⁸⁸

It thus appears that the FSCF will be the forum where the actual detection of risk that may impede or threaten financial stability and strategising upon how to address and contain or mitigate those risks will be undertaken. This information will then be fed through to the FSOC, which will take pivotal decisions that will eventually inform the SARB's actions relating to addressing the identified risks and promoting and maintaining financial stability.

4 14 Designation of systemically important financial institutions

With the emergence of universal banking⁸⁹ and financial conglomerates in the past few decades, many financial institutions have grown uncontrollably large and complex leading to the emergence of so-called "Too Big To Fail" institutions. These institutions often feel secure in the belief that their size and interconnectedness have earned them such a privileged position in the economy that should they ever encounter financial distress, the Government would not have the option to allow them to fail and go into liquidation but would be obliged to come to their rescue with a bailout funded by taxpayers' money. Accordingly, these large institutions had no incentive to tone down their appetite for risk-taking and embarked on a wild orgy of risky ventures and extravagant management bonuses that contributed to the 2008 GFC. This behaviour to "privatise profits and socialise losses"⁹⁰ by taking excessive risk because someone else will pay for losses is referred to as "moral hazard".⁹¹

⁸⁶ S 21.

⁸⁷ S 25(1).

⁸⁸ S 25(2).

⁸⁹ Universal banks participate in many kinds of banking activities and are both commercial and investment banks that also provide services such as insurance. See Benson "Universal banking" 1994) *The J of Economic Perspectives* 121.

⁹⁰ Carney "Statement to International Monetary and Financial Committee" (IMF 2013) 2 states that "[t]he expectation that systemically important institutions can *privatise profits and socialise losses* encourages excessive private sector risk-taking and can be ruinous for the public sector" (own emphasis), available at <http://bit.ly/2p9jeli>, accessed on 31 July 2016.

⁹¹ Mishkin *The economics of money banking and financial markets* (2016) 296 defines "moral hazard" as "the risk that one party to a transaction will engage in behavior that is undesirable from the other party's point of view".

One of the key lessons from the 2008 GFC is that these large, complex and heavily interconnected financial institutions (referred to as systemically important financial institutions or SIFIs) should be closely monitored for build-up of systemic risk and in principle, that no institution should be allowed to become “Too Big To Fail”.⁹² The regulation of SIFIs is intended to reinforce market discipline and protect consumers of the financial service industry. The Financial Sector Regulation Act recognises this by providing that the Governor may designate a financial institution as a SIFI,⁹³ subjecting it to heightened prudential regulation⁹⁴ and requiring the SARB’s concurrence in its rescue or resolution.⁹⁵

Before designating a financial institution as a SIFI, the Governor must notify the FSOC of the proposed designation and provide a statement of the reasons why the designation is proposed and invite the FSOC to provide advice on the proposal within a specified reasonable period.⁹⁶ If after considering the FSOC’s advice, the Governor proposes to designate the financial institution as a SIFI, he must invite the financial institution to make submissions on the matter, and allow it a reasonable period to do so.⁹⁷ In deciding whether to designate a financial institution as a SIFI, the Governor must take into account at least the following:⁹⁸

- (a) the size of the financial institution;
- (b) the complexity of the financial institution and its business affairs;
- (c) the interconnectedness of the institution with other financial institutions within or outside the Republic;
- (d) whether there are readily available substitutes for the financial products and financial services or market infrastructure that the financial institution provides;
- (e) recommendations of the FSOC;
- (f) submissions made by or for the institution; and
- (g) any other matters that may be prescribed by Regulation.

An important power given to the Governor in this regard entails that if the Governor has determined that a systemic event has occurred or is imminent, he may designate a financial institution as a SIFI without complying, or complying fully, with the designation process as set out in section 29(2) or (3).⁹⁹ In such an instance the relevant financial institution may make submissions on the designation to the Governor within 30 days after being notified of the designation.¹⁰⁰ The Governor must consider any such submissions and, by notice to the financial institution, either confirm or revoke the designation.¹⁰¹

92 Financial Stability Board “Policy measures to address systemically important financial institutions” (2011), available at <http://bit.ly/2oC1RiB>, accessed on 27 May 2016.

93 S 29. See also s 29(6) and (7). The Governor may, in writing, revoke a designation made in terms of this clause. A designation, and the revocation of a designation, in terms of this clause must be published.

94 S 30(1).

95 S 31.

96 S 29(2)(a).

97 S 29 (2)(b).

98 S 29(3).

99 S 29 (4)(a).

100 S 29(4)(b).

101 S 29(4)(c).

In order to limit the incidence of moral hazard that fuels excessive risk-taking by financial institutions who believe that their size and interconnectedness will guarantee them a bail-out with taxpayers' money in the event of their failure, it is expressly stated that the designation of a financial institution as a SIFI does not imply, or entitle the financial institution to, a guarantee or any form of credit or other support from any organ of state (thus, there is no guarantee of a bail-out).¹⁰²

Designation as a SIFI means that the regulators will impose stricter prudential measures on the designated institution due to it being regarded as high risk insofar as its ability to contribute to a systemic event is concerned. Accordingly, the Act provides that to mitigate the risk that systemic events may occur, the SARB may, after consulting the Prudential Authority, direct the Prudential Authority to impose, either through prudential standards or regulator's directives, requirements applicable to one or more SIFI or to such institutions generally in relation to any of the following matters:¹⁰³

- (a) solvency matters and capital requirements, which may include requirements in relation to counter-cyclical capital buffers;¹⁰⁴
- (b) leverage ratios;¹⁰⁵
- (c) liquidity;
- (d) organisational structures;
- (e) risk management arrangements;
- (f) sectoral and geographical exposures;
- (g) required statistical returns;
- (h) recovery and resolution planning; and
- (i) any other matter in respect of which a prudential standard may be made.

In view of their systemic importance the failure of SIFIs should therefore in the first place be prevented, which is what the legislature seeks to achieve by providing for the increased prudential regulation of these institutions *inter alia* by imposing requirements that could improve their ability to absorb losses. However, should it happen that a SIFI encounters financial distress the SARB, given its financial stability mandate, will have to engage in the process of either rescuing the SIFI or allowing it to fail and move on to an orderly resolution. Accordingly none of the following steps may be taken in relation to a SIFI or a

102 S 29(5).

103 S 30(1).

104 Lekatis "Basel III: Understanding the countercyclical buffer" (available at www.treasury.nl, accessed on 4 April 2017) explains that losses incurred in the financial sector can be extremely large when a downturn is preceded by a period of excess credit growth. The countercyclical buffer aims to ensure that financial sector capital requirements take account of the macro-financial environment in which financial institutions operate. It will be deployed by national jurisdictions when excess aggregate credit growth is judged to be associated with a build-up of system-wide risk to ensure that the financial system has a buffer of capital to protect it against future financial losses.

105 A leverage ratio is any one of several financial measurements that look at how much capital comes in the form of debt (loans) or assesses the ability of a financial institution to meet financial obligations. Leverage ratios measure how leveraged an institution is and an institution's degree of leverage (its debt load) is often a measure of risk, for instance if the institution has a lot of debt relative to assets. See further "Basel III leverage ratio framework and disclosure requirements", available at www.bis.org, accessed on 6 April 2017.

SIFI within a financial conglomerate without the concurrence of the SARB:¹⁰⁶ suspending or varying or cancelling a licence issued to that SIFI; adopting a special resolution to wind up the SIFI voluntarily; applying to a court for an order that the SIFI be wound up; appointing an administrator, trustee or curator for the SIFI; placing the SIFI under business rescue or adopting a business rescue plan for the SIFI; entering into an agreement for amalgamation or merger of the SIFI with another company and entering into a compromise arrangement with the creditors of the SIFI. Taking any of the aforementioned steps without the concurrence of the SARB will render such step void.¹⁰⁷

5 CONCLUSION

Since its inception, the SARB as central bank, with nearly a century of institutional expertise, has fulfilled a pivotally important function in the South African financial system and economy. In essence, it has been the guardian or custodian of the safety and soundness of banks, the overseer of the payments and settlement system, and has shaped the country's monetary policy and on a larger scale, it carefully curated the financial well-being of the South African financial system. At the core of its ability to promote and maintain the health of the South African financial system was the reality that the SARB *de facto* executed a financial stability mandate for many years although this mandate was never comprehensively expressed in either the Reserve Bank Act or Constitution.

The GFC and the new regulatory paradigm it brought about has emphasised financial stability as one of the main goals of financial regulation. In line with this global regulatory trend, South Africa has augmented its approach to financial regulation to give the SARB as central bank an advanced and pronounced financial stability mandate that aptly covers the whole financial spectrum. It has also taken the necessary measures to facilitate the move towards a Twin Peaks model of financial regulation by putting in place a legislative framework via the Financial Sector Regulation Act that will enable the efficient execution of this mandate.

As such, the regulatory toolkit provided by the Act caters for all the powers that one would expect the central bank to have in the context of financial stability: monitoring the financial system for risks, designating events as systemic events, preventing their occurrence and managing their effects, issuing financial stability reviews and keeping regulatory tabs on the business of systemically important financial institutions. The Act also creates a comprehensive collaborative and support framework comprising of the regulators, organs of state as well as the FSOC and FSCF and although instances of overlap and duplication will inevitably arise it is submitted that the proper drafting of and compliance with memoranda of understanding between the SARB and regulators and observance of the regulatory remit of each regulator can go a long way in addressing these problems.

The 2008 GFC did not bring the South African financial system to its knees *inter alia* because the SARB as central bank has served South Africa well in the past with regard to financial stability even though its powers in that context were not expressly laid down in legislation. Now in the era of Twin Peaks that is about

106 S 31(1).

107 S 31(2).

to dawn in South Africa as the first emerging market to adopt this approach, it can be expected that the SARB will continue to serve the country well in this new dispensation where it is comprehensively provided with the express mandate, instructions and tools to closely guard, promote and maintain the stability of the South African financial system.