“An appraisal of the Twin Peaks model of Financial Regulation in South Africa”

by

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SUMMARY

The 2008 Global Financial Crisis proved to be a landmark event in the context of financial regulation to the extent that it gave rise to questions of which approach would best suit financial regulation in the pursuit of financial stability. As such the question followed whether there should be a single mega regulator covering all the basis of financial regulation and supervision or whether the mandate should be covered by different institutions of which the central bank should be part thereof. It was within this context that the Twin Peak model attracted the attention of the South African national treasury as a regulatory approach to follow which would serve South Africa better on the whole. This dissertation investigates this model as the way forward having enacted the Financial Sector Regulation Act to give effect to it.

The purpose of this dissertation is to consider the specific Twin Peaks model adopted as the new approach to financial regulation in South Africa. The main components of this model will be interrogated in order to determine whether this model is an appropriate regulatory model that caters for the main aspects of financial regulation. This includes the promotion and maintenance of financial stability, safety and soundness of financial institutions and appropriate business conduct regulation. It will be shown that through this model South Africa has augmented its approach to financial regulation to the South African Reserve Bank as the central bank through an advanced and pronounced financial stability mandate via the legislative framework of the Financial Sector Regulation Act that will enable the efficient execution of this mandate.

The dissertation will also delve into a comparative investigation which will focus on the Twin Peaks model which was first pioneered in Australia in 1998 to comparatively benchmark the South African model. The lessons learnt from the failure of the model to work efficiently in Australia will also be discussed. The dissertation is concluded with recommendations for the effective implementation of Twin Peaks in South Africa.
**TABLE OF CONTENTS**

**Chapter One: Background to the Study**

1.1 Introduction ........................................................................................................... 5-6  
1.2 The Global Financial Crisis.................................................................................. 7-9  
1.3 The Main Approaches to Financial Sector Regulation...................................... 10  
1.3.1 Institutional Approach (Sectoral/Silos)......................................................... 10  
1.3.2 Functional Approach...................................................................................... 10-11  
1.3.3 Integrated Approach...................................................................................... 11  
1.3.4 The Twin Peaks Approach............................................................................ 12-13  
1.4 Scope and Nature.............................................................................................. 14  
1.5 Methodology...................................................................................................... 14  
1.6 Chapter Lay-Out................................................................................................. 14-15

**Chapter Two: The South African Twin Peaks Model of Financial Regulation**

2.1 Introduction........................................................................................................... 16-19  
2.2 The Financial Sector Regulation Act.................................................................. 19-20  
2.3 The SARB’s Financial Stability Mandate............................................................. 20-23  
2.3.1 Designations of Systemically Important Financial Institutions...................... 23-24  
2.4 The role of the Prudential Authority................................................................. 25-27  
2.5 The role of the Financial Sector Conduct Authority........................................... 27-30  
2.6 Cooperation and Collaboration for purposes of financial stability.................... 30-31  
2.7 Cooperation and Collaboration on a broader Twin Peaks level.......................... 31-33  
2.8 Conclusion........................................................................................................ 34-36

**Chapter Three: The Australian Twin Peaks Model: Comparative Analysis**

3.1 Introduction........................................................................................................... 37-39  
3.2 Twin Peaks legal framework of financial regulation in Australia...................... 40-41  
3.3 APRA and its role within the Twin Peaks regulatory framework......................... 42-43  
3.4 ASIC and its role within the Twin Peaks regulatory framework.......................... 44-45  
3.5 The RBA and its role within the Twin Peaks regulatory framework..................... 45-46  
3.6 Cooperation and Collaboration of the regulatory authorities in Australia............. 47-49  
3.7 Conclusion........................................................................................................ 49-50

**Chapter Four: Conclusions and Recommendations**

4.1 Introduction........................................................................................................... 51-52  
4.2 Final Remarks..................................................................................................... 53-54  
4.3 Recommendations............................................................................................. 55  
4.4 Conclusion........................................................................................................ 55-56

5. Bibliography.......................................................................................................... 57-61
Chapter one:  
Background to the Study  

1.1 Introduction  

Prior to the 2008 Global Financial Crisis (GFC), central banks had three functional roles.¹ This included price stability, maintenance of financial stability which included financial development, and lastly to provide a financial support structure to the State in times of need but also ensuring that government would not misuse their financial muscle or power.² The monetary policy paradigm before the Global Financial Crisis according to Jurgen Stark³, an executive member of the Central Bank in the United Kingdom (Bank of England or BoE), that would not be discredited by the Financial Crisis, included two features of the pre-Crisis paradigm, namely central bank independence and centralizing price stability.⁴ Notwithstanding that the financial role players ignored the role of money and credit indicators within the financial system, liquidity proved to be the strength which some of the banks in Europe relied on.⁵

Before the Crisis, many policymakers and academic writers were of the view that monetary policy caused macroeconomic stability to be achieved through the lens of inflation targeting and a small role for discretionary fiscal policy. ⁶ The central banks performed this role by controlling the short-terms interest rates via three channels namely: inflation, asset pricing and long-term interest rates.⁷

If one considers the aforementioned roles that central banks played prior to the 2008 Global Financial Crisis, the clear down-side to this was that the focus on price stability

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² Ibid.  
³ Speech by Jurgen Stark sharing his thoughts at a European Central Bank talk eluding to how the GFC could shape central banking in the future held in Hong Kong on 12 April 2011.  
⁵ Ibid.  
⁷ Ibid.
caused these banks to limit themselves to a micro-prudential approach in terms of regulation and supervision. This is turn created a full focus on individual institutions, which caused a blind eye to be cast to the stability of the system as a whole. This approach certainly needed change post the Global Financial Crisis and a reconsideration of the role of central banks but particularly also the role of the South African Reserve Bank required some in-depth attention.

The regulatory position prior to moving to a Twin Peaks model of financial regulation in South Africa was a traditional legal entity driven, sector-by-sector approach (i.e. a silo sectoral approach) through a multiplicity of regulators each regulating a specific legal entity. The downside of this silo approach was that it caused South African financial regulation to be complicated, fragmented and subjected to regulatory arbitrage. One of the key pitfalls of this approach was that market conduct regulation of banks went unnoticed as it was not within the regulatory ambit of the South African Reserve Bank (SARB) nor any of the other financial regulators. In view of this, inadequacies were recognized within the silo approach in the context of risks for financial instability occasioned by major interconnectedness between financial conglomerates. Therefore the GFC revealed that microprudential regulators only focused on individual institutions, having allowed macroeconomic risks such as assets bubbles, interconnectedness of financial conglomerates and high household debt levels to go unnoticed, hence there was a need for a macroprudential and holistic approach to financial stability and oversight of the safety and soundness of financial institutions.

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8 Ibid.
12 Ibid.
1.2 The Global Financial Crisis and the need for a shift in the regulatory paradigm

The 2008 GFC proved to be a landmark event in the context of financial regulation and gave rise to the question regarding which approach would most suit financial regulation post GFC. The cause of the GFC was inter alia attributed to global imbalances in savings and consumptions between different parts of the world and inadequate financial sector regulation which were characterized by large savings in emerging markets such as China and industrialized economies such as the United States, Eurozone and the United Kingdom. The biggest trigger causing the GFC was however the collapse of the subprime mortgage markets in the USA which resulted in asset and capital market failures throughout the world. The credit crisis therefore was the direct cause of the failure of the mortgage market in the U.S. The failures of “light touch” regulation by financial regulators further contributed to the veracity of the effects of the GFC by allowing household debts to rise to unscrupulous levels. The problem with subprime mortgages began when the Federal Reserve of America (FED) decided to lower interest rates to 1% in 2001 to negate the effect of the terrorist attacks on 9 September 2001. Housing prices in the U.S subsequently spiraled upwards by 2006 and soon thereafter dropped with more than 30% creating major declines. During the last period of the credit boom, sub-prime mortgage lending targeted vulnerable households which created a situation of excessive default rates and repayments that were based on assumptions that house prices and income growth

14 Ibid.
17 “A safer financial sector to serve South Africa better” (2011).
would continue.\textsuperscript{20} The subsequent effects were that the markets experienced ripple effects as property values decreased substantially and interbank lending rates increased.\textsuperscript{21} Securitization was used as a process through which financial institutions repackaged mortgage products into securities which they then sold to investors.\textsuperscript{22} At the time the housing bubble exploded, the total toxic assets written off involved for all financial institutions rose from the period of 2007 to 2010 to US $2.3 Trillion. \textsuperscript{23} At the summit of the financial crisis with the fall of Lehman Brothers in 2008, panic and uncertainty ensued.\textsuperscript{24} Governments were coerced into providing financial backup by acquiring debts worth hundreds of billions of dollars and bailing out financially distressed companies.\textsuperscript{25} Major credit agencies further downgraded or placed large number of collateralized debt obligations (CDOs) that relied on mortgages as collateral under review. The biggest indication of the fall was when the markets were shocked by the withdrawals of its investments by BNP Paribas, a large French bank, for the failure of fairly valuing its company holdings.\textsuperscript{26}

The GFC has revealed a number of lessons that led to some major changes in financial regulation internationally and also in South Africa as a G20-member. As pointed out above, prior to the GFC, there was the view that microprudential supervision would sustain and maintain financial stability. The GFC has further shown that complex and largely interconnected financial institutions (not only banks) were given the chance to become too big and consequently became major regulatory concern due to the risk they posed to the financial system. These systemically important financial institutions were known as “Too-Big-To-Fail” (TBTF)\textsuperscript{27}, due to their complexity, size and interconnectedness. These features meant that in the event of failure they would not be able to exit the financial system without causing widespread disruption and threatening financial stability. The influence these TBTF institutions

\begin{itemize}
  \item \textsuperscript{20} “A safer financial sector to serve South Africa better” (2011) at page 10.
  \item \textsuperscript{22} “A safer financial sector to serve South Africa better” (2011) at page 10.
  \item \textsuperscript{23} Ibid.
  \item \textsuperscript{24} Ibid.
  \item \textsuperscript{25} Ibid.
  \item \textsuperscript{26} Ibid.
  \item \textsuperscript{27} Farrell, “Too important to fail: legal complexity in planning for the failure of the financial market infrastructure” 2014 (29) Journal of International Banking Law and Regulation at page 469.
\end{itemize}
had also meant that any trigger of a collapse of a whole financial system led to them being bailed-out by the Government inter alia using tax payers money. This regulatory response was not only criticised for its use of taxpayers money but also because it rise to moral hazard.28 The reason for this was that these TBTF institutions were further incentivized for taking risky strategies and having a “nothing to lose” mind-set as they knew that someone else would be paying for their risky behaviour.29

The Crisis further exposed the adverse effects the TBTF institutions created in the financial system. The failure of “light touch” regulation by regulators who did not impose sanctions to admonish reckless lending and who failed to make proper use of their enforcement powers was also exposed. The postmortem of the GFC thus indicated that a holistic approach to financial regulation was needed, comprising of a macroprudential approach within a regulatory regime where prudential regulation is to be supported by coherent market conduct regulations.30 As much as there was a need for financial stability prior to the GFC major criticism was levelled at central banks for not creating sufficient macroprudential instruments to address the various vulnerabilities that the financial system would be exposed to. In this regard De Jager is of the view that the responsibility of financial stability was not well explained and the instruments to ensure maintenance of financial stability were not developed well enough prior the GFC.31

The GFC thus emphasised that a new approach to financial regulation was required wherein macroprudential supervision has to be enforced and operate side by side with microprudential supervision and conduct of business supervision, to ensure the maintenance of financial stability.32 This means that regulators must proactively

30 “A safer financial sector to serve South Africa better” (2011) at page 12.
observe changes in systemic risks. Ultimately South Africa committed itself at the 2010 Seoul Summit of the G20, to reform its approach to financial regulation.

1.3 The Main Approaches to Financial Sector Regulation

Various models for financial regulation exist which South Africa had to consider in its quest for an optimal model of financial regulation, namely:

1.3.1 The Institutional Approach (Sectoral/Silos)

This approach, also known as the traditional approach, is a legal-entity driven approach followed by countries like Mexico, China and Hong Kong. In this approach an institution’s legal status (for example, an insurance company) determines which regulator is given the task of overseeing its activities from a safety and soundness and business conduct perspective as well as determines the scope of the institutions permissible business activities. There is however a view that this approach is under pressure and becoming outdated given the changes in financial markets and blurring of product lines across sectors. The institutional approach is regarded to be suboptimal however there is also the view that this problem can overcome by other coordination mechanisms.

1.3.2 The Functional Approach

The functional approach appears to work well as long as coordination amongst agencies is maintained and achieved. In terms of this approach supervisory oversight is determined by the business that is being transacted by the entity, without regard to its legal status. Thus if a single entity engages in multiple types of business

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33 “A safer financial sector to serve South Africa better” (2011) at page 13.
34 Ibid.
35 “A safer financial sector to serve South Africa better” (2011) at page 12.
36 “A safer financial sector to serve South Africa better” (2011) at page 29.
38 Ibid.
40 “A safer financial sector to serve South Africa better” (2011) at page 29.
it may have more than one regulator. This means that the functional regulator would be tasked with the responsibility of both safety and soundness oversight of every entity within its regulatory remit as well as the business conduct regulation and supervision of each such entity.\textsuperscript{41} The downside of this approach is that it is not easy to distinguish which activity comes within the jurisdiction of a particular regulator thus giving rise to inconsistencies in regulatory positions on similar activities (i.e regulatory arbitrage).\textsuperscript{42} Jurisdictions like Spain, Italy and France implemented this approach.\textsuperscript{43}

### 1.3.3 The Integrated Approach (Unified/Single Regulator)

This approach has been prominent prior to the GFC. This approach entails a single regulator that conducts both safety and soundness oversight as well as conduct of business oversight (like a mega-regulator). The integrated approach has the advantage of a streamlined focus on regulation and is flexible to the extent that there is no conflict over jurisdictional lines.\textsuperscript{44} This approach is effective in smaller markets as the single regulator can have an oversight of the wider financial market spectrum.\textsuperscript{45} The advantage of the integrated approach is that it has a consolidated focus in regulation and supervision without any misunderstanding over jurisdictional remit.\textsuperscript{46} A disadvantage of this approach is however that it may create a single point of regulatory failure. There are obstacles like lack of coordination amongst supervisors during times of unease and disturbance under this approach and therefore communication within such a large regulator may become cumbersome.\textsuperscript{47} Other arguments against the mega regulator model include that adopting a ‘one size fits all’ approach to regulation, would give such a mega regulator too much power.\textsuperscript{48} Jurisdictions which follow an integrated approach are Canada and Germany.

\textsuperscript{43} Ibid.
\textsuperscript{44} “A safer financial sector to serve South Africa better” (2011) at page 29.
\textsuperscript{46} Ibid.
\textsuperscript{47} Ibid.
1.3.4 The Twin Peaks Approach

As mentioned above the 2008 GFC was an apex event in financial history which gave rise to a pursuit for the most appropriate approach to financial regulation that would promote and maintain financial stability.\(^49\) The central question which arose was whether there should a single mega-regulator dealing with all the aspects of financial regulation and supervision or whether financial regulation and supervision should be taken upon by different institutions.\(^50\) It was against this backdrop that the Twin Peaks model of financial regulation attracted the attention of the South African National Treasury as a regulatory approach that would address the South African financial landscape positively post the 2008 GFC.\(^51\)

The Twin Peaks idea was introduced by Michael Taylor in 1995.\(^52\) This idea was initially in response to the ‘blurring of the boundaries’ phenomenon occasioned by the emergence of large financial conglomerates within the financial services in the UK.\(^53\) Although not at that stage adopted by the UK, this method of financial regulation attracted widespread attention amongst financial regulators. In essence Taylor proposed that when financial services are regulated, there should be two objectives, firstly that financial regulators should protect the stability and integrity of the financial system\(^54\) (i.e. systemic protection), and secondly to ensure that protection of consumers from unscrupulous operators in the form of a market conduct and consumer protection regulator. It would then be the responsibility of such market conduct regulator to ensure that consumers are fairly treated and that their interests

\(^50\) Ibid.
\(^51\) Ibid.
are protected against abuse of market power. In Taylors view, to ensure efficient financial regulation and supervision a twin peak model amalgamating systemic protection, on the one hand, and consumer protection, on the other hand, should be applied. He indicated that and these two “peaks” should be regulated by two different bodies that would be answerable directly to the Treasury.

Importantly Taylor further noted that previously Banks were seen as so-called “Systemically Important Financial Institutions” (SIFI’s), however other non-bank financial businesses also created systemic problems within the financial system. This in turn created a need for changing the divisions of responsibility to allow for the promotion of systemwide prudential soundness.

The conventional Twin Peaks model as advanced by Taylor envisaged the one peak integrated within the central bank to be responsible for overall financial stability and also prudential regulation of the safety and soundness of financial institutions. The other peak would be a systemwide market conduct regulator responsible for conduct of business regulation for example banking, securities and insurance. This peak would particularly focus on the behavior of financial institutions towards customers in the market.

Taylor remarks that the benefit of Twin Peaks is “uncloudy” to the extent that this regulatory structure would largely eradicate the duplication and overlap of regulatory actions and ensure that regulatory bodies are established for a specific mandate and purpose. Twin Peaks as such regulates the financial sector in an all-inclusive way. This is done by establishing distinct institutions mandated with prudential and market conduct supervision. The focus of the Twin Peaks approach is accordingly balanced between the two aforementioned authorities. This is achieved through each authority

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56 Ibid.
57 Ibid.
being dedicated to its own established objectives of prudential and market conduct respectively, however both authorities are at the same time focusing on financial stability.\textsuperscript{60}

1.4 Scope and Nature of dissertation

The Twin Peaks model of financial regulation by objective has created a legal framework within which the promotion and maintenance of financial stability is sought to be achieved. South Africa eventually transitioned to a Twin Peaks model with the enactment of the Financial Sector Regulation Act\textsuperscript{61} in 2017. The main focus of this Act is to put in place the architecture of the Twin Peaks regulatory system for the financial sector. Furthermore, it aims to ensure financial stability in South Africa through a regulatory approach that is risk--based. The focus of the South African model is therefore on systemic risks which give rise to systemic events.

The purpose of this dissertation therefore is to consider the specific Twin Peaks model adopted as the new approach to financial regulation in South Africa. The main components of this model will be interrogated in order to determine whether the South African model is an appropriate regulatory model that caters for the main aspects of financial regulation, i.e. the promotion and maintenance of financial stability, safety and soundness of financial institutions and appropriate business conduct regulation. This dissertation will importantly also consider the Twin Peaks model of financial regulation which was first pioneered in Australia in 1998 to comparatively benchmark the South African model.

1.5 Methodology

This dissertation is a desktop-based literature study comprising of journal articles, websites, legislation, media statements, reports and discussion documents.

1.6 Chapter Lay-out

\textsuperscript{60} Department of National Treasury "Twin Peaks in SA", Response and explanatory document (2014) (accompanying the second draft of the FSR Bill) 5 ("Explanatory document (2014)").

\textsuperscript{61} Financial Sector Regulation Act 9 of 2017 (hereinafter FSR Act).
Chapter One is the introduction to the study and provides a roadmap for the dissertation. This chapter provides a background to the 2008 GFC and focuses on the causes and lessons learnt from a regulatory perspective. The chapter further elaborates on the main approaches to financial sector regulation pre and post the 2008 GFC and how the need for a Twin Peak model of financial regulation has become prevalent amongst many countries. The scope and nature of the dissertation, the delimitations, methodology and structural lay-outs are also set out in this chapter.

Chapter Two deals with the salient features of the South African Twin Peaks model as envisaged by the Financial Sector Regulation Act 9 of 2017 (FSR Act). A brief background will be explored on policy documents and basic components of this regulatory model. The establishment of the Prudential Authority and Financial Sector Conduct Authority will be discussed in more detail as well the regulatory toolkit the Act empowers them each with will be looked at more closely. A closer inspection will then be made on the objectives and functions of each peak regulated in terms of the Act. This chapter will then importantly look at the South African Reserve Bank (SARB) and a discussion will be made on the financial stability mandate and its powers including those powers relating to the designation of systemically important financial institution’s (SIFI’s). The mechanisms for cooperation and collaboration between the different financial sector regulators both for the purposes of financial stability and on a broader twin peaks level will also be briefly explored.

Chapter Three deals with the salient features of the Australian Twin Peaks. It will comparatively investigate the role of the central bank in the Australian Twin Peaks model and focus on specifically how this model advances the promotion and maintenance of financial stability. It will further provide a brief overview of the establishment and role of the Australian Prudential Regulation Authority (APRA) and Australian Securities and Investment Commission (ASIC) within the Twin Peaks legal framework in Australia as well as the mechanisms for cooperation and collaboration between the financial regulators.
Chapter Four is the final chapter of the study and contains conclusions on the effectiveness and appropriateness of the South African Twin Peaks model and recommendations for the way forward.
Chapter 2:

The South African Twin Peaks Model of Financial Regulation post the GFC

2.1 Introduction

The South African financial sector largely weathered the severity of the 2008 GFC, albeit that the effects of the recession thereafter caused significant job losses in the country.\textsuperscript{62} For purposes of avoiding similar financial crisis to occur in the future, the South African government committed itself at the G20 Seoul Summit to a global financial regulatory reform agenda with the key aim to strengthen financial stability.\textsuperscript{63} The 2008 GFC inter alia highlighted that there was a necessity for improved co-ordination of monetary and fiscal policy within current financial regulation and a need to concentrate on prevention and management of systemic risk.\textsuperscript{64} In February 2011, The South African National Treasury, intent on reforming the regulation of the South African financial sector, issued a policy paper titled “A Safer Financial Sector to Serve South Africa Better” (also known as the Red Book). The Red Book illustrated the deficiencies within the structure and characteristics of South Africa’s financial sector showing that there were various gaps that needed to be addressed. The key issues addressed in the Red Book related to major shortcomings resulting from regulatory gaps and interconnections between the different financial regulators within the wider financial system. It was against this background that Government committed itself to a sturdier regulatory framework, with effective supervision, regular international assessments and crisis resolutions.\textsuperscript{65} In response to the idea of achieving financial stability, deficiencies were noted in the conduct of supervision from a micro-prudential basis. In lieu of this approach it was agreed that to be aligned with global developments, a system-wide macro-prudential approach to financial stability and


\textsuperscript{65} De Jager at page 342-361.
regulation would be implemented in South Africa.\textsuperscript{66} This resulted in the eventual shift to a ‘twin peaks’ approach to financial regulation.

The Red Book outlined four main policy objectives which required to be addressed:

1. Financial stability - the financial crisis showed that there was a need for better co-ordination with fiscal, monetary and other economic policies coupled with taking systemic risks into account.\textsuperscript{67}

2. Consumer Protection – this aspect addresses the issue that our financial sector is one which is depicted as costly and opaque in respect to fees and at times privy to treating customers unfairly.\textsuperscript{68} In addressing these challenges, Treasury proposed firstly to create a retail banking services market conduct regulator and also provide for the implementation of a ‘Treating Customers Fairly’ initiative which would ensure that there are consistent standards applied in respect to consumer protection.\textsuperscript{69}

3. Expanding access through financial inclusion – this entailed that Government aimed to provide financial service for the poor, especially those in rural communities. It would also include the education of the un-educated and financially distressed individuals avoiding situations like the promotion of reckless credit practices.\textsuperscript{70}

4. Combating Financial Crime – these initiatives are important as Treasury would address issues such financial crimes and abuses, the stealing of beneficiary funds, money laundering through amendments to applicable money laundering legislation and addressing the financing of terrorist activities.\textsuperscript{71}

Pursuant to the aforementioned reform initiatives, the South African Twin Peaks model was introduced comprising of the SARB as longstanding central bank and two twin regulators, namely the Prudential Authority (PA) and Financial Sector Conduct Authority (FSCA,) that were newly established. The SARB was included as an “extra

\textsuperscript{66} Ibid.
\textsuperscript{67} Ibid.
\textsuperscript{68} Ibid.
\textsuperscript{69} Ibid.
\textsuperscript{70} Ibid.
\textsuperscript{71} Ibid.
peak” with an explicit and expanded financial stability mandate. Bank supervision was removed from the SARB’s regulatory remit and moved over to the Prudential Authority. On 1 February 2013, Treasury published a follow-up document to the Red Book entitled, “Implementing a Twin Peaks model of financial regulation in South Africa”, hereinafter referred to as the “Roadmap”. This document detailed important policy decisions moving forward in respect to prudential and market conduct supervision as well as setting out the process going forward with the implementation of Twin Peaks in South Africa.

As such, the crux of South Africa’s transition to a Twin Peaks model of financial regulation is to ensure that the financial sector is made safer via a far-reaching financial stability structure with a stringent prudential and market conduct supporting framework, each placed within a separate regulator. One of the key issues Twin Peaks addresses is that the system acknowledges that the objectives of treating customers fairly and financial soundness are better regulated by dedicating them to two different regulators which in turn minimizes regulatory arbitrage due to conflicting objectives.

Notably the South African Twin Peaks model created a distinct juristic person, the Prudential Authority (PA), located within the SARB, as the new system-wide prudential regulator. Another notable change is the replacement of the Financial Services Board (FSB) with a new system-wide market conduct regulator, the Financial Sector Conduct Authority (FSCA).

In essence therefore the South African Twin Peaks model encompasses a three peak regulatory structure, where the SARB is the primary guardian of financial stability; the FSCA is responsible for protecting consumers of financial services and promoting

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73 Ibid.


confidence in the South African financial system by overseeing and supervising the market conduct of financial service providers which includes financial advisors, banks, insurers and broader financial markets; and the PA is responsible for the prudential supervision of the wider range of regulated financial institutions such as short-term insurers, long-term insurers and banks. The PA will assist the SARB by overseeing and dealing with systemic risk that may arise in financial markets as well as maintaining overall financial stability. Likewise the FSCA will assist with the maintenance of financial stability by ensuring greater consumer protection for financial consumers.

2.2 The Financial Sector Regulation Act

It is within this context that as a first step toward a Twin Peaks system of financial regulation, the Financial Sector Regulation Act 9 of 2017 (FSR Act) was encapsulated and modelled in a manner which would put the Twin Peaks architecture in place. On 21 August 2017, the President signed the Bill into law and the FSR Act subsequently came into effect in April 2018 with the creation of the PA and FSCA. The FSR Act ensures that the newly legislated regulators are equipped with enforcement and supervisory powers in addition to the authority given to the relevant regulators under the current industry specific legislation, which also includes a broader mandate to issue new standards and directives under the industry specific legislation. This shift is regarded as necessary in light of the experiences this country has seen following the curatorship of African Bank in 2014, the recent allegations of misappropriation in relation to VBS Mutual Bank and the Steinhoff scandal.  

In terms of section 7, the object of the Act is to achieve a stable financial system by promoting financial stability through a regulatory and supervisory framework that promotes safety and soundness of financial institutions, fair treatment and protection

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76 De Jager at page 342-361.
of financial customers, prevention of financial crimes and transformation of the financial sectors amongst others.\textsuperscript{78}

It is therefore deduced from the above that the FSR Act aims to achieve extensive promotion and maintenance of financial stability within financial markets. The Act also provides a definition of the concept of “financial stability”\textsuperscript{79}to the effect that it refers to the ability of financial institutions to continue providing financial products and services to the general public and therefore creating public confidence, without major interruptions, notwithstanding that there are constant changes in economic circumstances.

The Act, in a nutshell, assigns an extensive financial stability mandate to the SARB, which is a comprehensive mandate that requires the SARB to oversee the financial system closely, with a view to act pre-emptively to avoid disturbances to financial stability, and should any disturbances do occur, the SARB is required to manage the issue with the end goal of restoring financial stability within the South African financial system. How exactly the SARB is mandated to achieve its financial stability goal will be discussed below.

2.3 The SARB’s financial stability mandate

Pre-Twin Peaks SARB had a diverse mandate. SARB’s primary mandate was set out in section 3 of the Reserve Bank Act, and reiterated again in section 224(1) of the Constitution\textsuperscript{80} as the protection of the value of the currency of the Republic in the interest of balanced and sustainable economic growth in the Republic. SARB’s application of monetary policy by pursuing price stability through inflation targeting coupled with its traditional roles, meant that SARB had an implied financial stability mandate and was \textit{de facto} responsible for maintaining financial system stability.\textsuperscript{81}

\textsuperscript{78} Section 7 of the FSR Act 9 of 2017.
\textsuperscript{79} Section 1 read with section 4 of the FSR Act.
\textsuperscript{81} De Jager at page 342-361.
Section 11 of the FSR Act caters for a broader additional primary mandate for the SARB, by indicating that the SARB is responsible for “protecting and enhancing” financial stability and in the event of a systemic event occurring or being imminent, the SARB holds the responsibility for “restoring and maintaining” financial stability in the South African financial system. Further it is to be noted that section 3 of the SARB Act was amended to the extent that the mandate for promotion and maintenance of financial stability is given equal importance and standing, as compared to the price stability objective and therefore both objectives are now regarded as primary objectives of the SARB.  

In achieving and fulfilling its responsibility in respect of this mandate of promoting and maintaining financial stability the SARB must act within a policy framework agreed between the Minister of Finance and the Governor of SARB. Notwithstanding that the Minister of Finance is responsible for the administration of the FSR Act, further extensive collaboration is needed between the SARB and National Treasury for the effective functioning of the Twin Peaks model. In terms of the new legislative framework, the SARB must now proactively work towards achieving, promoting and maintaining financial stability. Furthermore, the broadly worded provisions of section 11(2)(b) of the Act mandates the SARB to utilize any power vested in it as the central bank, referring to the SARB’s role and powers in relation to monetary policy, lender of last resort and other functions as mentioned in the Constitution.

The promotion and maintenance of financial stability post GFC requires that the central bank is afforded certain emergency type power(s) to cope with systemic crises and a robust legislative framework is therefore required. The FSR Act sets out the parameters of the SARB’s financial stability mandating by indicating that SARB has to monitor and keep under review strengths and weaknesses of the financial system; and any risks to financial stability; as well as the nature and extent of those risks; including risks that systemic events will occur. In the event that the SARB does identify any risk to the overall financial stability of the country, it is obligated to take steps to mitigate

82 Schedule 4 of the FSR Act.
83 Section 11(2)(a) of the FSR Act.
84 ‘A Safer Financial Sector to Serve South Africa Better’ at page 27.
85 Section 12(a) of the FSR Act.
those risks.\textsuperscript{86} This includes, but is limited to, advising the financial sector regulators and organs of state to take specific steps to mitigate those risks.\textsuperscript{87} The SARB is explicitly empowered to issue directives directing compliance by organs of state and financial sector regulators in a coordinated manner to achieve and promote financial stability.\textsuperscript{88}

Notably the SARB as part of its obligation\textsuperscript{89} to promote and maintain financial stability must at least every six months make an assessment of the stability of the financial system and set it out in the form of a ‘financial stability review’. This review applies both in respect of the period covered as well as the future 12 month period running from the date of the review. The issues dealt with in this review must contain SARB’s 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 SARB and the Financial Stability Oversight Committee (FSOC) during the period under review as well as progress made in implementing those recommendations.\textsuperscript{90} In essence therefore the financial stability review is a mirror for the rest of the country to see what the state of financial stability in the South African financial system is, and also to keep the central bank accountable.

Probably the most noteworthy power assigned to the SARB in the context of financial stability is its power to determine that certain events qualify as “systemic events”.\textsuperscript{91} Section 14 and 15 of the FSR Act accordingly create a basis for emergency \textit{ex ante} intervention and also \textit{ex post} management of a systemic event. Section 14(1)  

\textsuperscript{86} Section12(b) of the FSR Act.  
\textsuperscript{87} Ibid.  
\textsuperscript{88} Section 18 of the FSR Act.  
\textsuperscript{89} Section 13 of the FSR Act.  
\textsuperscript{90} Section 13(1) and 13(2) of the FSR Act.  
\textsuperscript{91} A systemic event is defined in section 1 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 system or financial markets, or financial institutions, are able to continue to provide financial products or financial services, or services provided by a market infrastructure”.  

\textsuperscript{23}
specifically states that the Governor may, after having consulted the Minister of Finance, determine in writing that a specific event or circumstance, or a specified combination of events or circumstances, is a systemic event. This prior consultation is important as it serves to avoid unnecessary use of regulatory resources and other financial implications where an event is prematurely or incorrectly branded as a systemic event.

2.3.1 Designation of Systemically Financial Institutions

Yet another very important power which is bestowed on the SARB relates to the designation of Systemically Important Financial Institutions (SIFI’s). This aspect refers to those financial institutions that have grown uncontrollably large and complex as result of whereof they become “Too Big to Fail” (TBTF). The problem, from a regulatory perspective, is that these TBTF-institutions often believe that due to their size and interconnectedness, they have earned an advantageous position within the economy that implies that, should they encounter financial distress, the Government would come to their rescue in a form a bail-out using tax payers money. A key lesson learnt during the GFC was therefore that these large, complex and increasingly interconnected financial institutions (SIFI’s) need to be closely monitored to avoid a build-up of systemic risk. Paramount was the need in the first instance to prevent these financial institutions from becoming uncontrollably big to the extent that they could not be appropriately regulated. The rationale behind the regulation of SIFI’s is that it is intended to ultimately protect consumers but also to enforce market discipline.

Accordingly, the FSR Act provides that the Governor of the SARB may designate a financial institution as a SIFI. The Governor can however only designate a financial institution as a SIFI after following due process which entails that he must notify the Financial Sector Oversight Committee (FSOC) of the proposed designation and invite the FSOC to provide advice on the proposal within a reasonable period. Once a decision on the designation of a financial institution as a SIFI has been taken the SIFI

92 Section 29(1) of the FSR Act.
93 Section 29(2)(a) of the FSR Act.
is then notified and given opportunity to make submissions regarding such intended
designation within a reasonable time.\(^94\)

In deciding whether to designate a financial institution as a SIFI, the Governor must
take into account the factors as envisaged in section 29(3) of the FSR Act, namely the
financial institution’s size; the complexity of the institution and its affairs; its
interconnectedness with financial institutions inside and outside the Republic; whether
there are readily available substitutes for its financial services and products;
recommendations of the FSOC; submissions made by or on behalf of the institution
and any other matter as prescribed by Regulation.\(^95\) However, an important
emergency power given to the Governor entails that if he 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 per
the provisions set out in section 29(2) or (3) of the FSR Act.\(^95\)

In conclusion therefore, the designation as a SIFI in terms of the FSR Act provides the
SARB with additional powers and responsibilities and allows the imposition of stricter
prudential requirements on SIFIs. In terms of section 30 of the Act, the SARB after
consulting with the PA, may direct the PA to impose additional requirements on SIFI’s
either through prudential standards or regulator’s directives, to mitigate the risk that
systemic events may occur.\(^96\) These requirements relate to inter alia solvency and
capital requirements, including counter-cyclical buffers; leverage ratios; liquidity
measures; organisational structures; risk management arrangements; sectoral and
geographical exposures and recovery and resolution planning. Lastly section 31 of the
FSR Act puts constraints on regulators when dealing with SIFI’s and the consensus of
the SARB is most importantly required prior to any actions being taken in respect of
the wind-up or any of the other resolution-type steps listed in the section.\(^97\)

\(^94\) Section 29(2)(b).
\(^95\) Section 29(4)(a) of the FSR Act.
\(^96\) South African Reserve Bank, Financial Stability Department, “A methodology to determine which
banks are systemically important within the South African context”, February 2019, available at:
\(^97\) Section 31(1)(a) to (g) of the FSR Act.
2.4 The role of the Prudential Authority in the context of Financial Stability

The Prudential Authority (PA) is established in terms of Chapter 3 of the FSR Act. In terms of section 32 of the Act, the PA is a separate juristic entity, which is housed in the same premises as the SARB, and which relies for administrative support on the SARB. This is an important feature as it confirms that the prudential regulator does have a legal status that is separate from the SARB. This signals that the PA acts with its own operational independence. The CEO of the PA is one of the Deputy Governors of SARB and the PA is managed by a prudential committee comprising of such CEO as well as the Governor and other deputy governors of the SARB.

Goodhart at the Financial Stability Conference held by the SARB in 2010, made mention that there would be reputational risk if the SARB held full responsibility for prudential supervision in addition to its financial mandate as conflicts of interests could arise in such a situation. Taking this advice, the SARB opted to entrust the PA to be within the Twin Peaks structure as a separate juristic person albeit not being physically separate from the central bank.

The objectives of the PA are to promote and enhance safety and soundness of financial institutions; promote and enhance safety and soundness of market infrastructures; protect financial customers in the event that financial institutions may fail to meet their obligations; and to assist in maintaining financial stability. As part

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98 Section 31(2) of the FSR Act.
100 Section 36 of the FSR Act.
101 Section 41 of the FSR Act.
103 Section 33(a)-(d) of the FSR Act.
of its functions, the PA is tasked to regulate and supervise financial institutions in accordance with financial sector laws; to co-operate with and assist the SARB, FSCA, FSOC, FIC and the NCR and to provide for financial inclusion.\textsuperscript{104} The Act further provides the PA must perform its functions without fear, favor or prejudice.\textsuperscript{105}

The PA is further given a regulatory toolkit which provides the PA with wider enforcement powers in order to enable it to attain its regulatory objectives. This toolkit encompasses the power to issue standards and directives, to gather information, to conduct supervisory on site-inspections;\textsuperscript{106} to issue guidance notes\textsuperscript{107}, to enter into enforceable undertakings\textsuperscript{108}, to issue debarment orders\textsuperscript{109}, and to impose administrative penalties.\textsuperscript{110}

Standards and directives particularly are very significant regulatory tools. Prudential standards are the minimum prudential requirements that financial institutions ought to comply with, and directives are used to enforce compliance with these standards. In terms of Section 105(2) of the FSR Act prudential standards are aimed at ensuring the safety and soundness of financial institutions, therefore reducing any risks that financial institutions and any key individuals engage in conduct or actions that amounts to financial crime, and as such these standards importantly assist in the overall maintenance of financial stability. A financial sector regulator however may not set a standard with the aim of assisting in maintaining financial stability without the concurrence of the SARB.\textsuperscript{111} Importantly, the PA and the FSCA may also make joint standards on any matter in respect of which they both have the power to determine a standard.\textsuperscript{112}

\textsuperscript{104} Section 34(1)(a)-(g) of the FSR Act.
\textsuperscript{105} Section 34(5).
\textsuperscript{106} Section 129 -139 as contained in Chapter 9 of the FSR Act.
\textsuperscript{107} Section 141 of the FSR Act.
\textsuperscript{108} Section 151 of the FSR Act. Enforceable undertakings are whereby a person may be given a written undertaking regarding the his/her future conduct in relation to a matter regulated by a financial sector law, and therefore that undertaking then becomes enforceable upon its acceptance.
\textsuperscript{109} Section 153 of the FSR Act. A debarment order prohibits the debarred person, who has contravened a financial sector law, for the period specified in the order, from inter alia being able to provide specified financial services to a financial institution.
\textsuperscript{110} Section 167-174 of the FSR Act.
\textsuperscript{111} Section 109(2) of the FSR Act.
\textsuperscript{112} Section 107 of the FSR Act.
Notably in respect to written directives issued to a financial institution, the Act provides that the PA may issue such a directive to a financial institution that provides financial products or services, or that is a market infrastructure or a key person of a financial institution to take action as specified in the directive.\(^{113}\) This directive must be followed in the instance where the financial institution is conducting any business in a financially unsound or improper manner resulting in that financial institution not being able to comply with its obligations.\(^{114}\) A prudential directive must have the aim of achieving the objective of the PA as per section 33 of the FSR Act.\(^{115}\) Directives may thus be issued to reduce the risk of a systemic event that may occur but also to remedy the effect of an infringement of a financial sector law or any involvement in a financial crime.\(^{116}\)

Finally, as part of its regulatory toolkit, both the PA and the FSCA, may issue, suspend and revoke licenses\(^{117}\) in terms of a separate, but closely co-ordinated process.\(^{118}\) Licenses are required for financial institutions or persons to perform certain specific activities according with the current financial sector law.\(^{119}\) Licenses may further be amended by the responsible authority by removing or varying conditions, or changing categories of services, customers or products. The responsible authority for licensing also has the right to revoke or suspend a license in the event of specific contraventions.\(^{120}\)

### 2.5 The role of the Financial Sector Conduct Authority within the context of financial stability

\(^{113}\) Section 143(1) of the FSR Act.
\(^{114}\) Section 143(1)(b)(i) of the FSR Act.
\(^{115}\) Section 143(3) of the FSR Act.
\(^{116}\) Section 143(3)(a) to (f) of the FSR Act.
\(^{117}\) Chapter 8 read with Schedule 2 of the FSR Act.
\(^{119}\) Ibid.
\(^{120}\) Ibid.
As part of the Twin Peaks architecture, a market conduct authority is established as a separate juristic person known as the Financial Sector Conduct Authority (FSCA).\footnote{Section 56 of the FSR Act.} This juristic person is governed by an Executive Committee consisting of a Commissioner and several Deputy Commissioners.\footnote{Section 60 of the FSR Act.} This appointment is made by the Minister of Finance. Interestingly the SARB has no representation on the executive committee of the FSCA, unlike the position with the PA. The FSCA is given the mandate for regulating and supervising the conduct of financial institutions. As such its role is to ensure consumer protection and market conduct.

The FSR Act also sets out the objectives\footnote{Section 57 of the FSR Act.} of the FSCA as the market regulator which is to enhance and support efficiency and integrity of financial markets, to protect financial customers by promoting their fair treatment of financial customers by financial institutions and assist in maintaining financial stability.\footnote{Section 57(a) to (c) of the FSR Act.} The key functions in order for the FSCA to achieve its objectives are to regulate and supervise the conduct of financial institutions, to co-operate with and assist the SARB, FSOC, PA, NCR and FIC, as necessarily required by the FSR Act, to promote financial inclusion and to formulate and implement strategies and programs for financial education of the general public.\footnote{Section 58(4) of the FSR Act includes a provision which may regarded as an “all-inclusive”, to the extent that the FSCA may do anything else which is necessary to achieve its objective. This includes co-operation with its counterparts in other jurisdictions and partaking in relevant international regulatory, supervisory and standards setting bodies.} Section 58(4) of the FSR Act includes a provision which may regarded as an “all-inclusive”, to the extent that the FSCA may do anything else which is necessary to achieve its objective. This includes co-operation with its counterparts in other jurisdictions and partaking in relevant international regulatory, supervisory and standards setting bodies.\footnote{Section 54(4)(a) and (b) of the FSR Act.}

As illustrated above the PA is equipped with an extensive regulatory toolkit, and this position is similarly applicable to the FSCA. This means the FSCA is also empowered to make conduct standards\footnote{Section 106, 107 and 108 of the FSR Act.} and issue directives.\footnote{Section 14.} Apart from its licensing powers as alluded to above, the FSCA is also equipped with a wide range of investigative
powers and therefore, should it reasonably believe that a financial sector law is being or will be contravened, then the FSCA may carry out investigations and conduct on-site inspections.\textsuperscript{129} Like the PA, the FSCA is also allowed to issue guidance notes and interpretation rulings on the application of the financial sector law; enter into enforceable undertakings, make debarment orders and impose administrative penalties.\textsuperscript{130} 

Particularly the FSCA may make conduct standards directed towards financial institutions, representatives of financial institutions, key persons and contractors.\textsuperscript{131} However it may not make a standard that imposes requirements on providers of payment services without the go-head of the SARB.\textsuperscript{132} As alluded to above, the FSCA, in section 107 of the FSR Act, may issue joint standards together with the PA. These conduct standards must be aimed at ensuring the integrity and efficiency of financial markets, ensuring that financial customers are treated fairly, and reducing risks to financial stability by overseeing all financial stakeholders’ conduct that may pose risk or contribute to financial crimes.\textsuperscript{133}

As pointed out the FSCA may, as part of its regulatory toolkit, issue written directives to a financial institution, should the financial institution be conducting its business in a manner which poses a material risk to the efficiency and integrity of financial markets\textsuperscript{134}, or if the institution does not comply with its obligation of treating its financial customers in a fair manner or if it is failing to provide financial education in a manner which is contrary to the relevant conduct standards.\textsuperscript{135} The FSCA may also issue directives to the extent that a financial institution or key person, representative or contractor of a financial institution would contravene or is likely to contravene a financial sector law for which the FSCA is the responsible authority; or has not complied with an enforceable undertaking accepted by the FSCA or is causing or

\textsuperscript{129} Section 134 – 139 of the FSR Act.
\textsuperscript{130} Section 141 of the FSR Act.
\textsuperscript{131} Section 106(1) of the FSR Act.
\textsuperscript{132} Section 109 of the FSR Act.
\textsuperscript{133} Section 106(2) (a) to (e) of the FSR Act.
\textsuperscript{134} Section 144(1)(a) of the FSR Act.
\textsuperscript{135} Section 144, 142, 151,153 and 167 respectively.
contributing to the instability in the financial system or likely to do so.\textsuperscript{136} It is again salient to mention at this juncture that the FSCA may not issue any directive relating to financial stability unless directed to do so by the SARB.\textsuperscript{137} The actions that may be specified in a directive by the FSCA includes the financial institution ceasing to offer or provide a specific financial product or service; or directing the institution to comply with an enforceable undertaking or ceasing to be involved in financial crime or that it must reduce the risk that a systemic event may occur or that it has to remedy the effects of contravention of a financial sector law or involvement in financial crime.\textsuperscript{138} The FSCA may however not issue a directive to a SIFI without the concurrence of the PA.\textsuperscript{139}

\textbf{2.6 Cooperation and collaboration for purposes of financial stability}

Key to the effective implementation and functioning of the Twin Peaks model is the well-considered network for cooperation and collaboration between the several role-players in the financial system.\textsuperscript{140} As indicated above, the duty to assist the SARB in maintaining financial stability is expressly incorporated into the objectives of the PA and FSCA.\textsuperscript{141} This includes the duty that the financial regulators must provide such information and assistance to the SARB and the Financial Sector Oversight Committee (FSOC) to maintain or restore financial stability as they may reasonably request and further requiring a prompt reporting duty to the SARB with respect to any matter which the financial sector regulator becomes aware of that poses or may pose a risk to financial stability.\textsuperscript{142} The financial regulators are further given the responsibility to gather information about financial institutions concerning financial stability insofar as failures to comply with prudential requirements, toxic market conduct and protracted illiquidity that may place the financial system at risk, is concerned. Section 26(2) states that in exercising its powers in relation to financial stability, the SARB must take into account any views expressed and any information furnished by the

\begin{footnotes}
\item[136] Section 144(1)(a) – (d) of the FSR Act.
\item[137] Section 144(4) of the FSR Act.
\item[138] Section 144(5)(a) of the FSR Act.
\item[139] Section 144(6) of the FSR Act.
\item[141] Section 33 and Section 57 of the FSR Act respectively.
\item[142] Section 26(1)(a)-(d) of the FSR Act.
\end{footnotes}
financial sector regulators as well as the recommendation of the FSOC. Therefore, based on the reasons stated above the SARB may not in lieu of pursuing financial stability, on its own deem fit to cherry pick which views and information it will utilize, as the Act prescribes that there must be extensive cooperation and collaboration. As such the success of the model will depend largely on effective cooperation collaboration between the various financial regulators and organs of state that engage in the financial sector.

In particular section 26 provides that the financial regulators must provide information and assistance to the SARB and the FSOC to restore and maintain financial stability. It is also the duty of the financial sector regulators to be obliging and promptly report any matter they become aware of that poses a risk to financial stability, to the SARB. As mentioned above, the SARB may not pursue its financial stability mandate in a dictatorial manner and therefore must, when exercising its powers, take into account the views expressed and information reported by the financial sector regulators and any recommendations made by the FSOC. Interestingly, it should be noted that the FSOC’s recommendations do hold significant weight and that the FSOC is regarded as ultimate decision maker when it comes to issues of financial stability.

2.7 Cooperation and collaboration on a broader Twin Peaks level

Cooperation and collaboration between the SARB and other financial sector regulators is important for the SARB to pursue its financial stability mandate, but from a broader perspective, cooperation and collaboration is just as paramount for the effective functioning of the Twin Peaks model. Therefore section 76 of the FSR Act facilitates the cooperation and collaboration between the SARB and financial regulators on a more general level. As remarked by Van Niekerk and Van Heerden, South Africa has historically opted to use a hard-law approach to regulate its financial system, however

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143 Section 26(1)(b) of the FSR Act.
144 Section 26(2) of the FSR Act.
the FSR Act mandates the use of soft law by requiring that the various regulators enter into memoranda of understanding to facilitate such cooperation and collaboration.\textsuperscript{146}

The FSR Act provides that the financial regulators and SARB must no later than six months after Chapter 2 of the FSR Act takes effect, agree on how they will co-operate and collaborate, provide assistance to and each other and comply with their duties relating to financial stability.\textsuperscript{147} As such the FSR Act obligates the SARB and financial regulators to enter into memoranda of understanding (MoU’s) relating to their cooperation and collaboration with each other and with the SARB to achieve a stable financial sector. It is important to note that the provisions requiring entering into MoU’s are not prescriptive in nature. In ensuring that the MoU’s are kept up to date, they must be reviewed and updated at least once in every three years.\textsuperscript{148}

The Act also makes provision for the obligations of organs of state in the context financial stability in particular but also relating to cooperation and collaboration generally. To this extent an organ of state that has a regulatory or supervisory function in relation to financial institutions must consult the financial sector regulators and the SARB regarding the performance of that function.\textsuperscript{149} Given the fact that an organ of state has the ability to influence regulators within its jurisdictional remit and by doing so has the ability to compromise financial stability, the SARB or a financial sector regulator may, in writing, request an organ of state to provide information regarding any decision that an organ of state has taken or proposes to take in relation to a financial institution as specified in the request.\textsuperscript{150}

In furthering the enhancement of the framework for cooperation and collaboration between financial sector regulators on a broader Twin Peaks level, the FSR Act creates a Financial System Council of Regulators (FSCR) as a coordinating body.\textsuperscript{151} The FSCR comprises of the following members: the Director-General of the National Treasury; the Director-General of the Department of Trade and Industry; the Director-


\textsuperscript{147} Chapter 2 and section 76 to 82, part of Chapter 5 that took effect on 01 April 2018.

\textsuperscript{148} Section 27(2) and Section 77(4) of the FSR Act.

\textsuperscript{149} Section 78(1) of the FSR Act.

\textsuperscript{150} Section 78(2) of the FSR Act.

\textsuperscript{151} Section 79(1) of the FSR Act.
General of the Department of Health; the Chief Executive Officer of the PA; the Commissioner of the FSCA; the Chief Executive Officer of the NCR; the Chief Executive Officer of the Council for Medical Schemes; the Director of the FIC; the Commissioner of the National Consumer Commission; the Commissioner of the Competition Commission; the Deputy Governor responsible for financial stability matters; and the head, however described, of any organ of state or other organisation that the Minister of Finance may determine. The objective if the FSCR is to facilitate cooperation and collaboration and consistency of action between institutions represented on the FSCR by providing a forum for senior representatives of those institutions to discuss, and inform themselves about matters of common interest.

The broader purpose of this council is made clear in section 81 which indicates that the council’s function is to establish working groups or subcommittees in respect of the matters like enforcement and financial crimes; financial stability and resolution; and any other matters that the Director-General of the National Treasury may determine after consulting the other members of the FSCR.

Lastly, in order to facilitate decisions taken which would have an impact on financial stability, again more over on a broader Twin Peaks level, there needs to be a watchdog who overlooks decisions made at government level, and who keeps an eye on those Ministers who are responsible for the organs of state within whose jurisdiction each of the financial sector regulators are located. As such the FSR Act creates a Financial Sector Inter-Ministerial Council. The objective of the Inter-Ministerial Council is to facilitate cooperation and collaboration between cabinet members responsible for administering legislation relevant to the regulation and supervision of the financial sector by providing a forum for discussion and consideration of matters of common interest. The members of the Inter-Ministerial Council are made up of the Minister of Finance, the Cabinet members responsible for consumer protection and consumer protection.

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152 Section 79(3) (a) – (l) of the FSR Act.
153 Section 79(2) of the FSR Act.
154 Section 81(1)(a)-(h) of the FSR Act.
155 Section 83(1) of the FSR Act.
156 Section 83(2) of the FSR Act.
credit matters\textsuperscript{157}, the Cabinet responsible for health\textsuperscript{158}, and the Cabinet member responsible for economic development.\textsuperscript{159}

2.8 Conclusion

The move by South Africa to a Twin Peaks model of financial regulation has been a well-planned since 2011, taking into consideration the lessons learnt from the Global Financial Crisis. Prior to shift towards twin peaks, the South African model of financial regulation was sectoral and regulators operated in silos. The main focus for the SARB during that period was to ensure the application of monetary policy through price stability and inflation targeting in terms of section 3 of the SARB Act, but also acting as regulator and supervisor of banks, supervisor of the payment system and Lender of Last Resort. As pointed out the SARB’s financial stability mandate was not captured in legislation but was an implied de facto mandate.

As a consequence of the international financial turmoil caused by the GFC, South Africa being a member of the G-20, acted pro-actively in taking measures to align itself with international regulatory developments. National Treasury undertook an extensive financial sector review which resulted in two important policy documents being issued. Both the Redbook and Roadmap, considered the adoption of the Twin Peaks model as approach to financial regulation in South Africa. After careful consultation and a number of draft Bills considered, the Financial Sector Regulation Act was enacted in 2017, setting out a comprehensive legal framework for the implementation of the South African Twin Peaks model.

Though the model is labelled as a “Twin Peak” model of financial regulation, in reality it is a three peak model comprising of the SARB and the two “twin” regulators, namely the Prudential Authority and Financial Sector Conduct Authority. Given that the SARB is positioned as the apex peak, this framework appears to impart the SARB’s mandate

\textsuperscript{157} Being the Minister of Trade and Industry.
\textsuperscript{158} Being the Minister of Health.
\textsuperscript{159} Being the Minister of Economic Development. Also See Section 83(3)(a) – (d).
with a fair measure of transparency and accountability. As mentioned the Prudential Authority oversees the system-wide prudential regulation of a broad range of financial institutions, whereas the Financial Sector Conduct Authority is newly established market conduct authority tasked to oversee conduct of business of financial institutions on a systemwide basis. Both these newly established peaks have their mandates set out in the FSR Act aimed at ensuring that the prudential safety and soundness of financial institutions but also ensuring the efficiency and integrity within which these institutions conduct themselves and the fair treatment of financial consumers. The SARB’s mandate has also changed to the extent that the responsibility of prudential supervision of banks has been taken away from the SARB and given to the PA, and therefore the SARB is able to focus more fully on its expand financial stability mandate under the FSR Act. What is clear though from the amendments to section 3 of the SARB Act is that SARB is now given two primary mandates, namely price stability and financial stability.

For purposes of executing its financial stability mandate the FSR Act creates a legal framework that sets out the SARB’s obligations in relation to financial stability and gives it certain financial stability –specific powers such as designating and dealing with systemic events and designating SIFIs. The purpose of designating SIFIs is to deal better with the significant systemic risk they pose by imposing stricter prudential regulation on them. It is at the juncture important to make mention that South Africa is in the process of moving away from an implicit deposit insurance system to a system of explicit deposit insurance, which in turn will assist in facilitating the orderly resolution of SIFI’s. The FSR Act also provides the twin regulators with a regulatory toolkit which comprising of wide enforcement powers to ensure that they achieve their regulatory objectives.

Finally, it has been pointed out that for the effective implementation of the Twin Peaks model, there needs to be cooperation and collaboration between the various role-players in the financial system. The FSR Act goes as far as to include organs of state

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to this mandate. The committees that are formed indicate that they each have a specific purpose, therefore allowing for better cohesion and less regulatory overlap. For the Twin Peaks model to be effective there must be proper information sharing included in this mandate of cooperation and collaboration, entrenched within the legislative framework. Through requiring that they enter into memoranda of understanding the FSR Act ensures that the various regulators are able to streamline their cooperation and collaboration.

All things considered, it can be said that the move for South Africa to a Twin Peaks model of financial regulation taking into consideration the legislative and institutional framework established by the FSR Act, provides one with a greater assurance that regulatory mechanisms have been put in place that would enable South Africa to better guard the stability of its financial system.
Chapter 3:

The Australian Twin Peaks Model: Comparative Analysis

3.1 Introduction

Twin Peaks was introduced in Australia in 1998 pursuant to the recommendations of the Wallis Inquiry who undertook a review of the Australian financial system.\(^\text{161}\) The Wallis Inquiry identified three factors in its review of the Australian financial system which necessitated regulatory reform, namely: innovation in product design and distribution which had “blurred the boundaries” between financial institutions and instruments; increasing competition from new competitors in the financial markets; and conglomeration which was appearing within financial institutions.\(^\text{162}\) A move to the Twin Peaks model for Australia was further occasioned by the fact that the size of the banking sector being highly concentrated, meant that in this environment there was a need for the separation of market conduct regulation from prudential regulation otherwise there would be a risk of regulatory overlap and conflicts of interest arising between the two regulatory functions of prudential regulation and market conduct regulation.\(^\text{163}\)


\(^{162}\) Ibid, at page 61.

\(^{163}\) Ibid 78, at page 183.
The Wallis Committee gave recommendations regarding the most suitable overarching framework for the efficient regulation of the Australian financial system and further provided recommendations on ways to improve the then-existing regulatory arrangements. The Wallis Inquiry notably recommended that a single regulator be founded for the regulation of companies, market conduct and consumer protection. The idea behind forming this regulator was that at the time conduct and market regulation was conducted through a number of agencies. The Wallis Inquiry suggested that such arrangements were inconsistent and would cause inefficiencies, inconsistencies and regulatory gaps not conducive for the financial markets. A separate market conduct regulator was consequently established known as the Australian Securities and Investments Commission (ASIC). The ASIC would be responsible for the promoting of confidence and informed participation of investors and consumers in the financial system.

The Wallis Inquiry also recommended that a single prudential regulator be established to further prudential regulation on a systemwide basis within the financial system. The idea centered around the fact that combining prudential regulation in a single regulator would better accommodate the emergence of the wide ranging financial conglomerates and allow for a more adaptable approach to changes in the focus of prudential regulation. Notably, the Wallis Inquiry in this respect recommended that the prudential regulator should be a separate entity, but that it should cooperate very closely with the Reserve Bank of Australia (RBA) and that it should share the mandate for financial stability with the RBA. It was also recommended that rigid mechanisms should be established to ensure appropriate collaboration and coordination between

165 Ibid, at page 61.
169 Ibid.
the two agencies. As such the Australian Prudential Regulation Authority (APRA) was established as a body that operates outside the confines of the RBA. One of several reasons given for establishing a separate prudential regulator was to allow the RBA and APRA to focus clearly on their primary objectives and to clarify the lines of accountability for the regulatory task.

The overall stability of the financial system is in hands of the Australian central bank, namely the Reserve Bank of Australia (RBA). The RBA has various traditional central bank functions including supervision of the payments system and monetary policy. The RBA further has the mandate to be sole currency issuing authority and acts as banker to the federal government. These responsibilities include being responsible for the financial system’s overall financial stability and in certain limited instances, acting as lender of resort to authorized deposit taking institutions in Australia. The Wallis Inquiry inter-alia determined that the RBA should regulate the Australian payment system under a separate Payments System Board.

In terms of this financial model it is pertinent to ensure that the objectives of each regulator, the regulatory perimeters and boundaries between them are clearly clarified. There are intrinsic possibilities for conflicting priorities between the regulatory objectives of the three main actors in the Australian Twin Peaks model, as action by one regulator may conflict or undermine the objectives of the other. Accordingly this necessitates effective co-ordination that entails consultation, information sharing and cooperation in areas of enforcement and supervision, as discussed in more detail below.

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170 Australian Prudential Regulation Authority Act 1998 ("The APRA Act")
171 Ibid, 61. Recommendation 32 which states that coordination and cooperation were to be achieved by making provision for full information exchange between the RBA and APRA and for RBA participation in APRA inspection teams.
172 Ibid 61, at page 17.
174 Ibid.
175 Ibid.
176 Ibid, at page 61.
177 Ibid, at page 66.
The purpose of this chapter is therefore to consider the role of the central bank, and the two regulators within the confines of the Australian Twin Peaks model and how this model accommodates the pursuit of the promotion and maintenance of financial stability.

3.2 Twin Peaks legal framework of financial regulation in Australia

The legislative architecture of the Australian Twin Peaks model is not contained in a single legal framework, however is set out in a number of acts, more specifically the Reserve Bank Act, the APRA Act and the ASIC Act. More specifically the legislative framework which provides for the Australian Twin Peaks model comprises of the following:

1. The Banking Act\textsuperscript{181} which regulates banking and provides provisions relating to licensing of Australian Deposit-taking Institutions (ADIs), the protection of depositors, and also provides for APRA’s powers to obtain information from ADIs together with APRA’s powers to issue directions or take control of an ADI.\textsuperscript{182}

2. The Australian Prudential Authority Act\textsuperscript{183} Which established APRA as the prudential regulator which is an independent entity that operates outside the jurisdiction of the RBA. Section 8(2) of the APRA Act states that in ‘performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system

\textsuperscript{181} Banking Act of 1959.
\textsuperscript{182} The Structure of Financial Supervision: Approaches and Challenges in a Global Market Place’ Group of Thirty 2008, at page 189.
\textsuperscript{183} Act 50 of 1998.
stability in Australia’. APRA is foremost a supervisory agency and its primary aim is to see that financial promises made to consumers by regulated entities are attained within stable and competitive financial markets.

3. The Reserve Banks Act created the RBA as Australia’s central bank and gives it the powers to conduct monetary policy in line with the objectives set out in section 10(2) of the Act. Since 1998 the RBA’s mandate for prudential supervision was shifted to APRA, however the RBA still has the general responsibility to promote stability in the Australian financial system. The Reserve Bank Act was amended in 1998 to further establish the Payments System Board (PSB) within the RBA to promote the safety and soundness of the Australian payment system.

4. The Australian Securities and Investments Commission Act created the market, corporate and financial services conduct regulator (ASIC). ASIC further seeks to ensure that Australia’s capital and financial services markets are fair and transparent. It also has wider responsibilities such as consumer protection and market integrity. This includes sectors like superannuation and insurance across the financial system. ASIC interprets laws through issuing of guidelines, approvals of code of conduct and preferred practices. It further has a variety of other enforcement powers.

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186 The Reserve Bank Act 1959.
188 The Australian Prudential Regulation Authority Act 1998.
189 Ibid.
190 Section 1(2)(a) of the ASIC Act.
The Wallis Inquiry indicated that the need for coordination as envisaged in Principle 3 of the Basel Core Principles\textsuperscript{193} is vital for the twin peaks model to operate effectively, as a market participant may be regulated by both regulators. In Australia, as a result of the Wallis Inquiry recommendations and the realization of the importance of information-sharing and coordination, the Council of Financial Regulators (CFR) was established with the mandate to coordinate a broad range of activities with the aim of overseeing cooperation and collaboration between APRA, ASIC and the RBA.

3.3 APRA and its role within the Twin Peaks model

APRA is established under the APRA Act as a body corporate with perpetual succession\textsuperscript{194} which functions completely outside the remit of the Reserve Bank of Australia. Section 8(1) of APRA sets out its main purpose which is to regulate bodies in the financial sector in accordance with other laws of the Commonwealth that provide for prudential regulation or for retirement income standards; administering the financial claims schemes provided for in the Banking Act 1959 and the Insurance Act; and to develop administrative practices and procedures to be applied in performing that regulatory role and administration.\textsuperscript{195} APRA importantly is a joint mandate together with the RBA to promote financial stability. Section 8(2) of the APRA Act provides that whilst APRA performs and exercises its functions and powers, it is obliged to balance the objectives of financial safety, competition, contestability\textsuperscript{196} and competitive neutrality and in doing so to also promote financial system stability in Australia. Notably APRA is also a supervisory agency and its core aim is to ensure that financial pledges that are undertaken by regulated entities are complied with within competitive, efficient and stable markets.\textsuperscript{197} APRA achieves this aim by ensuring that all financial institutions various systems to mitigate risk of failure are sound. This includes the identification,

\textsuperscript{193} Basel Committee on Banking Supervision, “Core Principles for Effective Banking Supervision” (September 2012): Principle 3 – Cooperation and collaboration.
\textsuperscript{194} Section 13 of the APRA Act.
\textsuperscript{195} Section 8(1) of the APRA Act.
\textsuperscript{196} This is where new entrants to a have market have the potential to challenge the already existing entities.
\textsuperscript{197} Ibid 91 page 5.
measuring and managing adequacy of capital.\textsuperscript{198} In the event of not achieving its supervisory agency mandate, in order to hold on to public confidence, APRA assists the regulated entity by making an orderly exit from the market.\textsuperscript{199}

APRA was established originally in July 1998, with 3 types of mandated powers in regulating financial institutions, namely:\textsuperscript{200} supervision and monitoring powers; authorization or licensing powers; and powers to act in circumstances of financial difficulties to protect depositors, policy holders and superannuation fund members, including powers relating to taking control of entities and/or winding up insolvent entities.

It is important to note that APRA has the ability to exercise the main tools for macroprudential supervision in Australia.\textsuperscript{201} This means that APRA the only agency in Australia that may use financial tools available for macroprudential supervision, to alter the conduct of financial institutions.\textsuperscript{202} APRA is not responsible for dealing with institutions who are unable to meet their prudential obligations,\textsuperscript{203} but also works closely with the RBA with respect to ADIs. This means that APRA is given the power to take any action against life and general insurance companies and superannuation funds which face financial difficulties.\textsuperscript{204} In cases of failures of ADIs, depositors are protected by a first priority claim against the assets of the ADI.\textsuperscript{205} Interestingly, APRA is mainly funded by fees charged on the financial sector entities it supervises as determined by the Australian government.\textsuperscript{206}

\textsuperscript{198} Ibid.
\textsuperscript{199} Ibid.
\textsuperscript{201} Ibid.
\textsuperscript{202} Ibid.
\textsuperscript{204} Ibid.
\textsuperscript{205} Ibid.
The discussion above indicates that APRA takes a systemic, industry-wide view over the financial sector in carrying out its mandate.\(^{207}\) APRA executes its prudential and systemic mandate through its risk-based approach which ensures that more intensive supervision is cast over institutions which pose greater systemic risks.\(^{208}\) Notably, in 2002 APRA codified its risk-based approach to financial regulation by introducing the ‘Probability and Impact Rating System’, commonly known as PAIRS, and the Supervisory Oversight and Response System, commonly known as SOARS.\(^{209}\) PAIRS AND SOARS are used by APRA for a measured and risk-based approach to supervision.

### 3.4 ASIC and its role within the Twin Peaks regulatory framework

ASIC, being Australia’s market integrity and consumer protection regulator established under the ASIC Act as indicated above, seeks to regulate financial markets, financial institutions and professional people who provide services like investments, superannuation, deposit-taking and credit.\(^{210}\) It interprets the laws through issuing of guidelines, preferred practices and approved codes of conduct.\(^{211}\)

ASIC’s powers are broad-ranging and includes being able to investigate situations where a breach of its legislation might have occurred; to prosecute in a criminal court; and disqualify people from managing corporations or dealing in financial services.\(^{212}\) As a corporate regulator ASIC is given the responsibility to ensure that company directors and officers follow through with their duties in a honest and diligent manner in the best interests of their companies.\(^{213}\) As a market regulator, ASIC reports and assesses how well authorized financial markets are complying with their legal obligations to contribute to fair, transparent and orderly markets.\(^{214}\) ASIC licenses

\(^{208}\) Ibid.
\(^{209}\) RBA & APRA Financial Stability 2012, at page 17.
\(^{210}\) Ibid.
\(^{212}\) Ibid.
\(^{213}\) Ibid.
\(^{214}\) Ibid.
and monitors financial institutions to ensure that they operate efficiently and fairly.\textsuperscript{215} ASIC has general powers to protect consumers against fallacious or deceptive conduct affecting all financial products and services, including credit and administering aspects of legislation relating to insurance, retirement savings and superannuation.\textsuperscript{216}

It is relevant at this juncture to point out that there is no specific mandate given to ASIC to promote financial system stability as in the case of APRA. Section 823E of the Corporations Act of 2001 does however impute some responsibility with regards to financial stability on ASIC, in respect of decreasing systemic risk in clearing and settlement systems.\textsuperscript{217} Notably there is also no reference to competition as in APRA’s case.\textsuperscript{218} It should also be noted that the Financial Services Reform Act of 2001 has also reinforced ASIC’s powers of market conduct regulation.

3.5 The RBA and its role within the Twin Peaks regulatory framework

Financial Stability has been a well-established responsibility of the RBA.\textsuperscript{219} The RBA has the responsibility of complying with its financial stability mandate by mitigating the risk of financial disruptions with the potential of causing systemic consequences and also by responding in the event that a financial system disruption does occur.\textsuperscript{220} The RBA takes steps such as setting low and stable inflation rates and overseeing sustainable economic growth, to ensure that there the environment is conducive to better financial stability. As part of its financial stability mandate, the RBA assesses a variety of financial and economic data which assists with gauging the robustness of the financial system. The Financial Stability Review is a platform which shows the results of such analysis.\textsuperscript{221}

\begin{flushright}
\textsuperscript{215} Ibid. \\
\textsuperscript{216} Ibid. \\
\textsuperscript{218} RBA & APRA Financial Stability 2012, at page 2. \\
\textsuperscript{220} Ibid. \\
\textsuperscript{221} Ibid. 
\end{flushright}
Being part of the RBA, the Payment System Board has the express authority to ensure for payments system safety and stability and has the backing of strong regulatory powers. It must be mentioned that the RBA has an important role in so far as managing of a financial crisis is concerned. This includes advising of the Treasurer or other relevant Ministers on possible distress in the markets and systems. The RBA’s role within the Twin Peaks model as described above thus includes an overall stability mandate of the financial system which encompasses the safety and reliability of the payments system as well as responsibility for monetary policy.

As mentioned above the mandate for financial stability in Australia is shared between APRA and the RBA. The interconnection of the mandate between the APRA and RBA as far as financial stability is concerned was unpacked by the former Assistant Governor, Malcom Edey Who remarked as follows: “It is sometimes said ……that the Bank is the macroprudential authority in Australia and APRA is the micro prudential authority. The implication is that the bank looks at stability from the point of view of the system while APRA looks only at the individual institutions. I think that is at best an oversimplification and is an unhelpful way to look at the two institutional roles. It presupposes that it is possible to focus on the system as a whole without taking an interest in the individual components or, conversely, that an agency can sensibly look at parts without being interested in how they interact with the whole. The difference between the two roles, I suggest, is best understood in terms of their powers and responsibilities rather than their objectives. APRA has powers and responsibilities that relate mainly to individual institutions, but its legislative mandate includes stability of the system, and it can adjust its prudential settings to address system-wide concerns. The RBA has a broad financial stability mandate, existing in conjunction with other macro-economic objectives and attached to a very different set of powers.”

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222 Ibid.
223 Ibid.
225 Ibid.
Thus, as explained by Edey, the RBA is authorized to provide financial services to Government and to the financial system and as such is given powers to engage in financial activities in the interests of the public. These powers include the RBA to be a lender of last resort and liquidity manager for the financial system. He further indicated that at the time of the Wallis recommendations, the Bank’s supervisory powers were moved from the RBA to APRA, the RBA’s general mandate to promote financial stability was strengthened.  

It may thus be concluded that although the RBA and APRA do share the financial stability mandate in Australia, it is evident that the RBA has the final say relating to financial stability. This is shown by the actions that may be taken by the RBA to mitigate risks to the financial system but also the actions it may take in responding to any financial system disturbances as indicated above.

3.6 Cooperation and Collaboration of the regulatory authorities to facilitate general workings of the Twin Peaks Model in Australia

Australia’s financial regulatory framework has received positive reviews mainly attributed to their performances in terms of international best practice standards. However if one looks at the practical challenges faced, there seems to appear that there have been “chinks in the armor” as far as internal financial collapses are concerned. These collapses include the HIH general insurance collapse and the Trio Capital collapse which involved a superannuation fund trustee and managed investment schemes. The HIH report revealed deficiencies in terms of APRA’s response to information and the lack of coordination between APRA and ASIC. There was a further lack of clarity relating to the functions and responsibilities of each regulator. In contrast, the Trio Capital collapse showed insufficiencies in terms of poor information sharing between the two regulators and therefore showed a need for effective information sharing on a voluntary basis.

226 Ibid.
228 Ibid 78. at page 186.
229 Ibid.
Godwin et al remark that the financial collapses in Australia over the last 15 years has shown that there are two main areas where regulators have encountered regulatory challenges. First being the challenge of furnishing the effective coordination mechanisms required of a multi-agency system.\textsuperscript{230} Secondly, as much as Twin Peaks ought to assist regulators in describing their regulatory objectives, in practice they come across many challenges as increased integration has caused an overlap between functions and expected roles of the regulators. This in turn created a problem to determine what tools should be made available to regulators to carry out their functions. This also led to a tension between regulators.\textsuperscript{231}

As pointed out the Wallis Inquiry at the time recognized the need of information-sharing and coordination between regulators and recommended that the Council of Financial Regulators (CFR) coordinate a broader range of activities, with the aim of overseeing the cooperation of its members namely the RBA, APRA and ASIC.\textsuperscript{232} Following the occurrences of the HIH Insurance Limited collapse in 2001, many loopholes in coordination were identified in the HIH Royal Commission report, which recommended that the exchange of information between APRA and ASIC be strengthened in a systematic manner based on clear protocols.\textsuperscript{233} This caused the APRA Act to capture a new provision to confirm that APRA should, in exercising its powers and functions, have regard to cooperating with other financial sector supervisory agents.\textsuperscript{234} It is interesting to note that this is the only provision that categorically refers to coordination in the legislation governing APRA and ASIC.

Accordingly, there are four aspects to the policy framework supporting coordination which are critical to financial regulation in Australia namely:\textsuperscript{235}

\textsuperscript{231} Ibid.
\textsuperscript{232} Ibid 78. at page 185.
\textsuperscript{234} Section 10A of the APRA Act.
Proactive information sharing between regulators;
1. Consultation and mutual assistance between regulators;
2. Practical measures to encourage and facilitate coordination; and
3. A coordination body.

Importantly, to facilitate cooperation and collaboration between the RBA, APRA and ASIC, Australia adopts a soft law approach by requiring the regulators to enter into memoranda of understanding (MoU) between themselves and also between each regulatory body and the RBA. These mechanisms are facilitative and enabling, rather than prescriptive.\textsuperscript{236} The RBA further has asserted the importance of pursuing a culture of co-ordination in terms of which the main priority is on regulatory performance rather than regulatory structure.\textsuperscript{237}

In closing, the existence of a proper coordinating body is also critical to the operation of the Twin Peaks model.\textsuperscript{238} In the Australian Twin Peaks model this body is the Council of Financial Regulators (CFR). The CFR has no statutory basis and also has no legal powers or functions but nevertheless fulfills a comprehensive coordinating function. Its members comprise of APRA, ASIC, RBA and the Australian Treasury. The council is operated as an informal body and contributes to the efficiency of financial regulation by providing for a high-level forum for cooperation and collaboration amongst its members.\textsuperscript{239}

\textbf{3.7 Conclusion}

Australia was the first country to move to a Twin Peaks model of financial regulation in 1998. This decision served them well as they were able to weather the storm of the Global Financial Crisis in 2008. What is of critical importance to this model firstly is the clearly demarcated responsibilities and objectives of each regulator which requires a distinct separation between the roles of the regulators and contributes to the reduction

\textsuperscript{236} Ibid.
\textsuperscript{239} Ibid.
of regulatory overlap. Secondly, a notable feature of the model is the architecture of coordination that promotes both APRA and ASIC to share information proactively and to cooperate in the supervisory and enforcement functions they perform.

The Australian Twin Peaks model also allows greater possibility of promoting and maintaining financial stability given that such mandate is not solely entrusted to the RBA but is also a core mandate of APRA.

What was further interesting to note was that within the Australian Twin Peaks model, regulatory coordination is mainly informal, voluntary and cooperative in nature, with a major emphasis on soft law rather than prescriptive legislation. The Australian Twin Peaks model is said to ensure that a culture of mutual trust exist between the regulators as both regulators may find themselves regulating the same institutions and market participants. This leads to the greater observance of the need for information sharing and cooperation between the two regulators in the performance of their functions.
Chapter Four:
Conclusions and Recommendations

4.1 Introduction

As illustrated throughout the course of this dissertation, the Twin Peaks model of financial regulation aims to a legal framework within which to actively pursue and achieve financial stability objectives. In South Africa the FSR Act which introduced the South African Twin Peaks model therefore was considered to determine whether the institutional and legislative framework it creates appropriately accommodates the pursuit of financial stability. It was also pointed out that to ensure that financial stability in South Africa through a regulatory approach that is risk-based, the focus is on systemic risks which gives rise to systemic events. The aim therefore was to demonstrate that the FSR Act does bring about the promotion and maintenance of financial stability through a comprehensive model for financial regulation which comprises of promotion and maintenance of financial stability, safety and soundness of financial institutions and appropriate business conduct regulation coupled with extensive prescribed cooperation and collaboration of all stakeholders.

As indicated in Chapter One the Twin Peaks model as conceptualized by Michael Taylor was first pioneered in Australia. The main idea centered around avoiding the so-called “blurring of the boundaries” phenomenon within the financial services market. To this extent Taylor proposed that there be a split between prudential and market conduct regulation, and therefore placing the responsibility in two distinct regulators which would oversee objectively driven, system-wide and focused financial
regulation, with a touch of proper cooperation and coordination which would contribute to financial stability.

South Africa’s membership of the G20 has caused the country to align its approach to financial regulation with regulatory the regulatory paradigm shift post GFC that is geared at the pursuit of financial stability as main objective. As part of South Africa’s commitment to the global reform agenda, it moved away from the silo sectoral approach to financial regulation where a number of sectoral regulators supervised different financial institutions, towards a functional Twin Peaks model of regulation by objective. This approach is viewed as an optimal model underscoring an enabling framework for overseeing the promotion and maintenance of financial stability.

As a result, the South African Twin Peaks model was captured in ‘hard law’ through the introduction of the FSR Act, complemented by the flexibility of a soft law approach like its Australian counterpart, which is facilitated by memoranda of understanding (MoU’s) to enable cooperation and collaboration between the parties responsible for the effective functioning of the model. One of the key motivating factors for the regulatory shift just like the position is in Australia, South Africa has a sizeable and a highly concentrated banking sector. It is said that 90 percent of banking assets are controlled by the five largest banks in South Africa. It is for this reason that in such an environment, separating market conduct regulation from prudential regulation appears a rational solution. This in turn also avoids regulatory overlap and conflicts of interest.

Against this background together with the additional mandate given to the SARB in terms of section 11 of the FSR Act, the Twin Peaks model effectively gives the PA and FSCA the responsibility for “assisting” with maintaining financial stability through rigorous prudential and market conduct supervision on a system-wide scale. Importantly, the SARB as central bank will continue to have a leading role in overseeing financial stability within the dedicated legal framework provided by the FRS Act that focuses much more on the SARB’s financial stability mandate than in the pre-Twin Peaks era.

It was also noted that as part of achieving its financial stability mandate, the Act recognizes that SIFI’s need to be closely monitored for a buildup of systemic risk and
therefore principally no institution should be allowed to become “Too Big To Fail”. Coupled with the other regulatory tools together with its designation powers it has been showed that the FSR Act empowers the SARB to execute its financial stability mandate effectively. Comparatively in Australia the APRA has also recently been granted expanded powers, including enforcement powers which helps to avoid the so-called blurring of the lines between their prudential regulation and market conduct regulation.

4.2 Final Remarks

One of the more debatable issues which arises is that of the contrasting views given for housing of the prudential authority. In Australia notably, the APRA is established under the APRA Act as a body corporate which operates entirely outside the remit of the RBA whereas in South Africa the position is different to the extent the PA is a juristic person under the administration of the SARB. This has clearly brought the independence of the PA into question. On the one hand it is argued that there are good reasons for housing the PA within the SARB, especially in light of the fact that central banks in resource-constrained emerging countries are well-placed to undertake banking supervision and distance themselves from political interreference. On the other hand, the status of the PA in South Africa has been questioned.

As mentioned the PA is a separate juristic person located within the structure of the SARB however is not a subsidiary of the SARB and its management committee is comprised entirely of SARB officials, which makes it conceivable that the PA and SARB will implement a similar way of thinking and have a similarly aligned regulatory culture. As a matter of fact it would appear that the SARB will set the tone for the PA’s regulatory approach and will be behind many of the decisions that the PA takes. These are the challenges the SARB and PA both face which can possibly compromise the proper execution of their respective mandates which may for example occur where the PA wishes to let a failing financial institution go into resolution whereas the central bank may want to keep it afloat in the interests of financial stability.

The FSCA on the other hand is established as a juristic person, which is a separate legal entity that has its own legal rights and duties and is located outside the SARB.
Notably the executive committee of the FSCA has no representation of any SARB members which indicates that the SARB may have a lesser strong-hold over the FSCA.

It has also been observed that it is extremely important for the effective implementation of the Twin Peaks model of financial regulation that there must be well-considered and intensive ongoing cooperation and collaboration and that mechanisms to facilitate such cooperation and collaboration be should put in place. If one looks at the position in Australia, they are in favor of regulatory coordination which is informal, voluntary and cooperative in nature. This coordination is typically based on a soft law approach in the form of MoU’s between regulatory bodies and between each regulatory body and the RBA. This proves that the Australian model thrives on its specific regulatory culture for the effective implementation of the Twin Peaks model. The position in South Africa is a bit different to the extent that a hard law approach with a soft law overlay is used to regulate its financial system. The use of MoU’s as mentioned above is used in South Africa relating to financial stability between various entities that are needed to work together with the SARB in creating a stable financial sector. One may however argue that the approach of hard law regulatory coordination may lead to a culture that is more concerned with compliance as opposed to achieving the required outcomes. The Australian model seems to show that a less prescriptive and formalized approach to coordination allows financial regulators to deal better with the challenges like those arising from the global financial crisis.

The importance of an inter-agency body that facilitates cooperation and coordination on a practical level within a Twin Peaks model should also be highlighted. In Australia they have a coordinating body relevant for regulatory agencies namely the Council of Financial Regulators (CFR) who operate on a high-level forum for cooperation and collaboration. In South Africa we have four significant coordinating bodies namely the: FSOC, FSCF, FSIC, FSCR. The FSCR is the closest equal to the CFR in Australia which facilitates the coordination and collaboration between agencies and the two peaks. The position in South Africa is structured differently to the extent that the members of the FSCR are all from different financial regulatory agencies and government organs. Therefore, the FSCR appears to have the most extensive government representation of the two twin peaks jurisdictions that were compared in
this dissertation. This duty unlike the position in Australia, is contained in the detailed provision provided for in section 76 of the FSR Act.

4.3 Recommendations for the effective implementation of the Twin Peaks Model in South Africa

As discussed above the issue of housing the PA within the SARB begs the question whether this will cause a so-called “regulatory capture” by the SARB of the PA. Therefore, in my view there needs to be a re-look at the composition of the PA Committee to the extent that there needs to be a balance by bringing other persons not related to the SARB onto this committee so that the PA is given independent authority to make decisions when it comes to prudential regulation which should not be in conflict to the SARB’s mandate of financial stability.

As far as the practical measures involved in terms of the collaboration and cooperation are concerned, my view is that to ensure better cohesion and learning for all three peaks, as encouraged by section 50 of the Act, the PA should be allowed to enter into secondment arrangements which allows personnel from each peak to better understand the regulatory culture of the other. The fact that the legislature has included this provision in the Act illustrates the point further that secondment arrangements can eliminate regulatory turf wars.

An important recommendation in my view also is that of having our regulatory MoU’s reviewed by international bodies such as the IMF who have an international view point which may aid South Africa better. Furthermore, consulting MoU’s of Australia and other twin peak jurisdictions will allow South Africa to understand better if their MoU’s are aligned to international best practices.

4.4 Final remarks
The South African Twin Peaks model is based on the idea ultimately to bring together all the efficiency of an effective and efficient model for financial regulation model. It will ensure that prudential supervision and market conduct supervision do not overshadow one another. It appropriately focuses on systemic stability hence the end goal of the prudential and market regulator is to enable an environment for financial regulation geared towards achieving financial stability. One may even go as far as to say that financial stability is the sum of all its parts. This means that to achieve its goal you need to have the two peaks to work in a coordinated manner. From the discussion above it can be further be said that what makes this model of financial so attractive is that each peak has very clear objectives and mandates.

Of course this does not mean that the South African model is infallible, and it is submitted that many problematic issues will likely come to light during the roll out of the model’s implementation. However notwithstanding these issues, the South African model has augmented the country’s approach to financial regulation to give the SARB as the central bank an advanced and pronounced financial stability mandate that aptly covers the whole financial spectrum and has established the PA and FSCA as twin regulators who will not only respectively oversee prudential and market conduct compliance by financial institutions but who are also actively committed to assist with the maintenance of financial stability in South Africa.

All things considered it is thus submitted that the move towards the Twin Peaks model in South Africa does offer the public the confidence that our financial system is now more robust with the ability to withstand systemic risks but also that there is a greater likelihood that it be more resilient against any future financial crisis.
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