# IN PURSUIT OF FINANCIAL STABILITY: A CLOSER LOOK AT TWIN PEAKS

by

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## DEDICATION

I dedicate this dissertation to the memory of my late brother, Sizwe. You are loved and deeply missed.

**ACKNOWLEDGEMENTS**

In God, With God, Through God.

To my supervisor, Prof. C Van Heerden, I am hugely indebted to you for your patience, persistence and understanding. Always willing to assist with a smile. May God bless you always.

To Margie, I have no words to express my gratitude to God for you. You turned the whole course of my life around and for that I will always be deeply grateful. From you I have learned the value of selflessness, humility and love. I will do unto others as you have done unto me.

My family have all been a blessing. Your love and support have been nothing short of amazing. Without each one of you I would not have achieved any of what has been achieved to date. May God protect and keep all of you always.

## SUMMARY

The 2008 Global Financial Crisis ("GFC"), brought the global financial system to its knees. This Crisis, however, showed the world how critically important the maintenance of financial stability is. After the Crisis the pursuit of financial stability became a core goal of financial regulation. Various countries sought to reform their approach to financial regulation in order to ensure the stability of their financial systems.

A regulatory model that emerged in the 1990s, the Twin Peaks model, conceptualized by Michael Taylor, gained favour with some countries. This model seeks to provide both systemic protection and financial consumer protection by two peak regulators responsible for systemic and prudential regulation and supervision, on the one hand, and conduct of business regulation and supervision, on the other.

Although South Africa escaped the GFC relatively unharmed, it committed itself as G20 member to the post-GFC reform agenda. This, inter alia, entailed the decision to overhaul its approach to financial regulation and switch to a Twin Peaks model. This dissertation accordingly looks at the models of financial regulation and interrogates the specific structure of the Twin Peaks model adopted by South Africa. It further looks at the Dutch Twin Peaks model that was adopted by the Netherlands before the GFC to consider whether there are lessons that can be leant from the Dutch Twin Peaks model.

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## Chapter One: Background to the Study

### 1. Introduction

A stable financial system is the bedrock of a prosperous economy. This fact has been demonstrated by the 2008 Global Financial Crisis (GFC), that had its epicentre in the subprime mortgage crisis in the USA and spread like wildfire through the interconnected global financial system, destabilizing domestic financial systems across the globe and resulting in wide-scale financial decline.[1] One of the main lessons from the GFC was consequently that financial regulation should seek to maintain financial stability.

But what is meant by the concept "financial stability"? If a country wants to adopt a regulatory approach that is optimal for promoting and maintaining financial stability it is most certainly necessary to have a good idea of the nature of this regulatory pursuit. Unfortunately, financial stability is not an easy concept to define. Allen and Wood indicate that "defining" financial stability is a "thorny issue". In their opinion the best approach is to define the characteristics of an episode of financial *in*stability and then to simply define financial stability as "a state of affairs in which episodes of instability are unlikely to occur".[2] Borio and Drehmann also refer to the "fuzziness" of the concept of financial stability and their conclusion is that "[F]inancial stability is the converse of financial instability".[3] Gadanecz and Jayaram are, however, of the view that financial stability can be defined as a "condition in which the financial system - comprising financial intermediaries, markets and market infrastructure - is capable of withstanding shocks and the unravelling of financial imbalances, thereby mitigating the likelihood of disruptions in the financial intermediation process which are severe enough to significantly impair the allocation of savings to profitable investment opportunities".[4]

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[1] Mishkin "Over the Cliff: From the Subprime to the Global Financial Crisis" (2011) *Journal of Economic Perspectives* 49.

[2] Allen & Wood "Defining and achieving financial stability" (2006) *Journal of Financial Stability* 2006.

[3] Borio & Drehmann "Towards an operational framework for financial stability: 'fuzzy' measurement and its consequences" BIS Working Papers No. 284 (June 2009) https://www.bis. org/publ/work284.htm (accessed 3 March 2020).

[4] Gadanecz and Jayaram "Measures of financial stability – a review" Bank for International Settlements – Proceedings of the IFC Conference (26 – 27 August 2008) https://www.bis.org/ifc/ publ/ifcb31ab.pdf (accessed 3 March 2020) 365, hereinafter Gadanecz & Jayaram 2008.

Llewellyn argues that a well-structured regulatory regime contributes to the efficiency and stability of the financial system.[5] The question then subsequently arises as to what the optimal regulatory model would be by means of which to ensure the promotion and maintenance of financial system stability?

### 1.2 The optimal model for financial regulation

There are generally four main models of financial regulation to consider in this regard: the institutional model; the functional model; the single regulator–model and the Twin Peaks model.[6]

#### 1.2.1 The institutional approach

The institutional approach (also known as the traditional approach) focuses on the form of a legal entity under regulation and subsequently a particular regulator is assigned to it.[7] Institutions are consequently regulated with reference to the sector in which they operate or the products or business that they are involved in, for example banks will be regulated and supervised separately from insurance companies. With the institutional approach, each regulator would be responsible for both prudential and market conduct and consumer protection issues in relation to the specific financial institutions under its jurisdiction.[8]

The Group of Thirty observed that the institutional approach is based on a business model that, to a large extent, no longer exists. This is because many large financial institutions have moved away from businesses that operate in one specific financial area and have diversified their businesses across various products and services.[9] Schmulow also points out that this model is regarded as least capable of dealing with

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[5] Llewellyn "Institutional Structure of financial regulation and supervision: the basic issues" Paper presented at World Bank Seminar - Aligning Supervisory structures with country needs - Washington DC (6 and 7 June 2006) (accessed 3 March 2020 5, (hereinafter Llewellyn 2006).

[6] Llewellyn (2006). See also Schmulow "The four methods of financial system regulation: an international comparative survey" 2015 *Journal of Banking and Finance Law and Practice* 152 (hereinafter Schmulow 2015).

[7] Schmulow (2015) no. 1 153.

[8] Schmulow (2015) no. 1 152 – 154.

[9] Group of Thirty (2008) 34 and also: The Institutional Approach potentially suffers from not having a single regulator with a 360-degree overview of a regulated entity's business or of the market as a whole. It also suffers from not having a single regulator that can mandate actions designed to mitigate systemic risk; See also discussion in 4.2 below regarding the move in the Netherlands from the sectoral model, of which the institutional model is a product, to a functional model, reflected in the Twin Peaks model.

financial conglomerates, where the activities blur the boundaries between different types of financial firms.[10] The fragmented nature of this model therefore does not make it an optimal model for the promotion and maintenance of financial stability because it basically regulates and supervises financial institutions in silos.

#### 1.2.2 The functional approach

The functional approach entails regulating activities across functional, as opposed to legal-entity, lines and it is determined by the type of business or transactions or products that are regulated. This means that one firm that engages in multiple types of transactions will be subject to multiple regulators. The benefit of this approach is that the regulator will apply consistent rules to the same activity regardless of the entity in which the activity is conducted. Each regulator will supervise the safety and soundness of a specific financial institution as well as the business conduct of that institution. Regulatory arbitrage will thus be avoided.[11]

The disadvantages of this model are, however, that financial institutions have to deal with multiple regulators, which could be costly in terms of time and effort. Another big drawback is that no regulator has sufficient information concerning all the activities of any particular entity or entities to monitor for systemic risk.[12] This also means that the functional model is not an optimal model for promoting and maintaining financial-system stability.

#### 1.2.3 The integrated model

The integrated model (also called the single-regulator or mega-regulator or super-regulator model) creates a single mega regulator to regulate both the conduct of business and the prudential soundness of financial institutions.[13] It is thus a single regulator that is responsible for regulation and supervision of all financial institutions

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[10] Schmulow (2015) no. 1 152 and 154: This, however, is not always the case. For example in Mexico, where the institutional approach is followed, there are various regulators for different entities as well as a National Commission for the Protection of Financial Services Users that is in charge of protection of consumers of financial services. Its main objectives, according to Schmulow, are to "promote, advise, protect and defend the rights of people who use financial services offered by institutions operating within Mexico".

[11] Schmulow (2015) no. 1 154; National Treasury Red Book 2011 29.

[12] Group of Thirty (2008) 13 and 35.

[13] Schmulow (2015) no. 1 155. Schmulow mentions that the integrated model differs from the Twin Peaks model in that it combines both stability and business conduct oversight, whereas stability and market conduct oversight is separated in the Twin Peaks model.

that operate in the financial system and regulates and supervises their safety and soundness as well as their market conduct. The Group of Thirty indicates that the integrated model provides the advantage of a clarity of focus on regulation and supervision without confusion or conflict over jurisdiction as can happen under both the institutional approach and the functional approach. It also provides an all-inclusive holistic view of the business of the entities that fall under its regulatory and supervisory remit.[14] This means the mega-regulator can more easily assess the risks in the financial system.[15] The disadvantages of the integrated approach are, however, that there is only a single point of failure. If an integrated regulator fails to spot a problem, there is no other agency to offer support. No system of checks and balances exists. Another drawback is that in a very large market, an integrated regulator may be too large to be managed effectively or there may just be too many institutions to ensure that the single regulator regulates and supervises them all effectively.[16] It thus also appears that the single regulator model suffers from inadequacies that compromise its ability to serve as an optimal regulatory model for the promotion and maintenance of financial stability.

### 1.2.4 The Twin Peaks model

The Twin Peaks model was conceptualised by Michael Taylor, formerly with the Bank of England, in a paper entitled "'Twin peaks': A regulatory structure for the new century". [17] He proposed that when financial services are regulated, it should be done with two goals in mind, namely to protect the stability and integrity of the financial system ("systemic protection") and to ensure that the interests of individual depositors, investors, and policy-holders are protected ("consumer protection"). Taylor argued that to ensure efficient and effective financial regulation and supervision a Twin Peaks model comprising of systemic protection, located in the one peak, and consumer protection, located in the other peak, should be adopted.[18] He thus proposed a Twin Peaks model of financial regulation with only two "peaks": a systemic risk regulator

[14] Group of Thirty (2008) 36.
[15] National Treasury Red Book (2011) 29. Schmulow (2015) no. 1 155: This model is often referred to as the "FSA Model", as the former Financial Services Authority in the UK was this model's most prominent example.
[16] Group of Thirty (2008) 14, 36 and 37.
[17]hereinafter Taylor (1995). See also Schmulow A "Financial regulatory governance in South Africa: the move towards Twin Peaks" (2017) 25 *African Journal of International and Comparative Law* 393, hereinafter Schmulow (2017) at 394.
[18] Taylor (1995) 1.

which is integrated in the central bank and which is also responsible for prudential regulation on a systemwide basis; and a market conduct regulator that oversees business conduct by financial institutions on a systemwide basis.

Taylor indicated that the benefits of these "twin peaks" are clear in that this model would to a large extent do away with replication and overlap of regulatory actions and would ensure that regulatory bodies with a dedicated purpose will be created; that mechanisms for clearing up of clashes between the regulation of financial services would be encouraged; and that an open and transparent regulatory process would be established.[19] Llewellyn indicates that the advantages of the Twin Peaks model are that the two regulators responsible for prudential and market conduct regulation respectively have their own dedicated objectives and clear mandates to which they are exclusively committed; accountability is clear because of the clearly defined objectives and mandates of each regulator; and there is no danger that one of the areas of regulation will come to dominate the other.[20]

Due thereto that the twin peaks model ensures that there is systemwide systemic regulation as supervision as well as systemwide prudential regulation and supervision together with systemwide market conduct regulation and supervision that is undertaken by at least two regulators with clear objectives and mandates, it is submitted that it can be regarded as the optimal financial regulatory model for the promotion and maintenance of financial stability.

It should, however, be noted that a question which frequently arises in the context of the Twin Peaks model is whether it is appropriate for the central bank to have both the overall financial stability mandate as well as the mandate for prudential regulation. The problem in this regard is that where a central bank has both these mandates, they may give rise to conflict between the objectives of financial stability and prudential regulation. Llewellyn takes the view that where the central bank is both responsible for systemwide financial stability as well as prudential regulation, there are potentially

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[19] Taylor (1995) 16.

[20] Llewellyn (2006) 28. Schmulow (2015) no. 3 28: The single objective of each regulator minimizes overlap and turf wars between them. He mentions that over time overlap can diminish if clear lines are drawn for responsibilities and if key parties are determined to cooperate.

powerful synergies to be gained, particularly information synergies. He states that having prudential supervision, oversight of the payments system and monetary policy tasks “under one roof” makes it easier to access information and achieve cooperation and collaboration between the monetary policy and financial stability functions and the supervision of institutions.[21] Arguments against the central bank in the Twin Peaks model being both responsible for overall financial stability as well as prudential regulation and supervision are that it may lead to the concentration of excessive power in a single agency; failures in prudential regulation may compromise the authority of the central bank of its activity; and the possibility exists that the central bank itself may compromise its own monetary policy objectives due to conflict with objectives related to ensuring the safety and soundness of banks. [22]

It is, however, Llewellyn’s view that: “[I]n practice no bank regulator could or should ever be totally independent of the central bank. The central bank is the monopoly provider of the reserve base and the lender of last resort. Any serious banking problems are bound to lead to calls to the central bank to use its reserve creating powers. Moreover, the central bank in its macro-policy operational role, must have a direct concern with the payments and settlement system and the development of monetary aggregates. Any serious problem with the health of the banking system will touch on one or more of these concerns. So, there is bound to be, and there must be, very close relationships between the bank regulator and the monetary policy authority.”[23]

### 1.3 Research statement

South Africa has recently become the first emerging market and the first African country to adopt a Twin Peaks model of financial regulation with the adoption of the Financial Sector Regulation Act 9 of 2017. This dissertation will seek to interrogate the main features of the South African Twin Peaks model to determine whether it is an

[21] Llewellyn (2006) 30.
[22] Llewellyn (2006) 31. I.e. by loosening monetary policy to save financial institutions by failure.
[23] Llewellyn (2006) 32. According to Llewellyn the bottom line is that banking realities will force there to be considerable coordination and interaction between the senior official dealing with monetary policy and bank supervision.

optimal model for the promotion and maintenance of financial stability in the Republic. In order to do so it will benchmark the South African model against the Twin Peaks model that was adopted in the United Kingdom in 2012.

**1.4 Methodology**

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

**1.5 Selection of Comparative jurisdiction**

For purposes of benchmarking the South African Twin Peaks model in terms of its architecture pertaining to enabling the promotion and maintenance of financial stability, the South African model will be compared to the Twin Peaks model adopted in 2007 by the Netherlands. The Netherlands moved from a tripartite institutional (sectoral) to a Twin Peaks model in 2007 just before the GFC. The two-peak Dutch model comprising of DNB, the central bank, as systemic and prudential regulator and AFM, the market conduct regulator, took the Netherlands through the GFC. Accordingly, it may yield valuable lessons to a country with a young Twin Peaks model like South Africa.

**1.6 Chapter Lay-out**

Chapter One above has given the introduction to the paper and serves as a roadmap for the rest of the dissertation. It also provides the scope and nature of the dissertation, the delimitations, methodology and structural lay-out.

Chapter Two considers the structure of the South African Twin Peaks model and interrogates the ability of the model to ensure the promotion and maintenance of financial stability.

Chapter Three provides an overview of the Netherlands's adaptation of the Twin Peaks model with specific regard to the ability of this model to aid the promotion and maintenance of financial stability in the Netherlands.

Chapter Four is the final chapter of the study and contains conclusions drawn from the aforementioned chapters as well as recommendations regarding lessons to be learnt from the Dutch and South African Twin Peaks models.

## Chapter Two: Twin Peaks in South Africa

### 2.1 Introduction

Before it moved to a Twin Peaks model South Africa regulated its financial system also in accordance with an institutional (sectoral) model. The SARB, as central bank in the pre-Twin Peaks dispensation had traditional central banking roles such as being responsible for the implementation of monetary policy; oversight of the payments, clearing and settlement system; bank supervision; acting as lender of last resort and being *de facto* responsible for the maintenance of financial stability.[24] In this sectoral model the Financial Services Board was the supervisor of insurance companies and of fund managers and exchanges. It shared the responsibility for supervision of market intermediaries with the Johannesburg Stock Exchange. The National Credit Regulator supervised the credit sector. As pointed out by Van Heerden and Van Niekerk this was a very fragmented approach to financial regulation.[25]

The sectoral model was still in place when the GFC occurred. Fortunately, South Africa did not suffer too severely from the GFC. According to the National Treasury this was mainly because of South Africa's well-regulated financial sector, appropriate and conservative risk management practices at domestic banks, limited exposure to foreign assets and its subsidiary structure and listing requirements for registered banks as well as a robust monetary policy framework, countercyclical monetary policy, a proactive approach to dealing with bank credit risks and a focus on reducing household vulnerability.[26] Nevertheless because South Africa is a G20-country the Government made a commitment at the G20 Seoul Summit in 2010 where it was considered how to deal with the gaps in financial regulation exposed by the GFC, that

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[24] In terms of section 3 of the South African Reserve Bank Act 90 of 1989 (SARB Act) the primary objective of the SARB was the protection of the value of the currency of the Republic in the interest of balanced and sustainable economic growth in the Republic. This objective was subsequently entrenched by s223 of the Constitution of the Republic of South Africa, 1996. See further s10 of the SARB Act regarding the SARB's other functions. See further Van Niekerk *The Role of the Central Bank in Promoting and Maintaining Financial Stability in South Africa* (LLD Thesis, University of Pretoria, 2018) Chap 2.

[25] Van Heerden and Van Niekerk "Twin Peaks in South Africa : a New role for the central bank" (2018) Law and Financial Markets Review 1 (hereinafter Van Heerden and Van Niekerk (2018) *Law and Financial Markets Review*).

[26] National Treasury "A safer financial sector to serve South Africa better" available at https://www.treasury.gov.za>twinpeaks>20131211 (accessed 14 April 2020)(Hereinafter Treasury safer financial sector (2011).

it would overhaul and improve the country's approach to financial regulation. The move to a new model of financial regulation was further motivated by a need to protect financial consumers and combat financial crime.[27]

The journey to a Twin Peaks model started when National Treasury issued a comprehensive policy document titled "A Safer Financial Sector to serve South Africa better " (the "Redbook").[28] After the Redbook another policy document titled "Implementing a Twin Peaks System of Financial Regulation in South Africa" (the "Roadmap")[29] was issued to explain how the Twin Peaks model was planned to be implemented. The South African Twin Peaks model eventually became a reality a few years later with the enactment of the Financial Sector Regulation Act 9 of 2017 (FSRA) in August 2017.[30]

As stated by Van Heerden and Van Niekerk the South African model is not a two peak-model as the name suggests but it is in fact a three peak model: [31] The South African Reserve Bank (SARB), as central bank, is the apex peak with an express and comprehensive financial stability mandate. A new entity, the Prudential Authority (PA) was established as one of the two twin regulators and is responsible for systemwide prudential supervision of financial institutions (including banks). The other new twin regulator, the Financial Sector Conduct Authority (FSCA) is a new entity that was established to oversee market conduct of financial institutions on a systemwide basis. In this Twin Peaks model bank supervision is removed from the SARB's regulatory remit and is exercised by the PA.

### 2.2 The role of the South African Reserve Bank (SARB)

Important to note is that the objective of the FSRA, in alignment with financial stability as the main pursuit of financial regulation after the GFC, is stated in section 7 as

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[27] Ibid.
[28] Treasury safer financial sector (2011).
[29] Ibid.
[30] Section 8 of the Financial Sector Regulation Act. Further amendments to sector specific laws from time to time will ensure that the Twin Peaks model is reflected in all necessary legislation.
[31] Van Heerden and Van Niekerk (2018) *Law and Financial Markets Review* 1. See also Godwin & Schmulow "The Financial Sector Regulation Bill in South Africa, Second Draft: Lessons from Australia" (2015) *SALJ* 756 (hereinafter Godwin and Schmulow (2015)); Schmulow "Financial Regulatory Governance in South Africa: The move towards Twin Peaks" (2017) *African Journal of International and Comparative Law* 393.

follows: “The object of this Act is to achieve a stable financial system that works in the interests of financial customers and that supports balanced and sustainable economic growth in the Republic by establishing, in conjunction with the specific financial sector laws, a regulatory and supervisory framework that promotes-
(a) financial stability;
(b) the safety and soundness of financial institutions;
(c) the fair treatment and protection of financial customers;
(d) the efficiency and integrity of the financial system;
(e) the prevention of financial crime;
(f) financial inclusion;
(g) transformation of the financial sector; and
(h) confidence in the financial system.”

The main purpose of the FSRA thus is the maintenance of financial stability.[32] As pointed out by Van Heerden and Van Niekerk, pre-twin Peaks the SARB’s financial stability mandate was a de facto mandate that was not captured in legislation. In the new Twin Peaks model the SARB still has the financial stability mandate but it is now expanded and stated expressly in the FSRA.[33] The Act now gives the SARB an express statutory mandate for protecting and enhancing financial stability; and if a systemic event[34] has occurred or is imminent, for restoring or maintaining financial stability.[35]

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[32] Financial stability is defined in s4 of the FSRA to mean that:
“(a) financial institutions generally provide financial products and financial services, and market infrastructures generally perform their functions and duties in terms of financial sector laws, without interruption;
(b) financial institutions are capable of continuing to provide financial products and financial services, and market infrastructures are capable of continuing to perform their functions and duties in terms of financial sector laws, without interruption despite changes in economic circumstances; and
(c) there is general confidence in the ability of financial institutions to continue to provide financial products and financial services, and the ability of market infrastructures to continue to perform their functions and duties in terms of financial sector laws, without interruption despite changes in economic circumstances.
[33] Van Heerden and Van Niekerk (2018) *Law and Financial Markets Review* 1 at 3.
[34] A systemic event is defined in s1 as “an event or circumstance, including one that occurs or arises outside the Republic, that may reasonably be expected to have a substantial adverse effect on the financial system or on economic activity in the Republic, including an event or circumstance that leads to a loss of confidence that operators of, or participants in, payment systems, settlement systems or financial markets, or financial institutions, are able to continue to provide financial products or financial services, or services provide by a market infrastructure.”
[35] Section 11(1)(a) and (b) of the Financial Sector Regulation Act. In executing its financial stability mandate the SARB must act within a policy framework agreed between the Governor of SARB and the Minister of Finance and may utilise any power vested in it as central bank or conferred on it in terms of the FSR Bill or any other

The SARB's financial stability mandate means it has to take measures to enhance and maintain financial stability and to prevent, deal with, and mitigate risks to financial stability. It must therefore act *ex ante* to prevent risks to financial stability and *ex post* to deal with such risks.[36] In terms of the FSRA the SARB has to do the following for the execution of its financial stability mandate: it must monitor and keep under review the strengths and weaknesses of the financial system and any risks to financial stability, and the nature and extent of those risks, including risks that systemic events will occur.[37] The SARB must take steps to mitigate such risks by advising the financial sector regulators, and any other organ of state, of steps to be taken to deal with those risks.[38] The SARB must also make an assessment of the observance of principles in the Republic developed by international standard setting bodies for market infrastructures and report about it to the financial sector regulators and the Minister of Finance.[39]

A very important task of the SARB is to do a financial stability review about the position regarding financial stability in South Africa every six months. The FSRA lays down the following requirements that this review must meet: the SARB must set out its assessment of financial stability in the period under review; its identification and assessment of 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 or disruptions in the financial system during the period under review and that are envisaged to be taken during at least the next 12 months as well as an overview of recommendations made by SARB and the Financial Stability Oversight

legislation. It is further obliged to have regard to the roles and functions of other organs of state exercising powers that affect aspects of the economy. Notably the SARB's primary objective of price stability and its new financial stability objective are now on par as s3 of the SARB Act has been amended by Schedule 3 of the FRSA to this effect.

[36] Van Heerden and Van Niekerk (2018) *Law and Financial Markets Review* 1 at 3.

[37] Section 12(a)(i) and (ii) FSRA. It must also monitor and keep under review any other risks contemplated in matters raised by members of the FSOC (as discussed below) or reported to SARB by a financial sector regulator.

[38] Section 12(b) of the FSRA.

[39] Section 12(c) of the FSRA.

Committee (FSOC) during the period under review together with progress made in implementing those recommendations.[40]

Regarding actual or imminent systemic events Van Heerden and Van Niekerk point out that the FSRA gives the SARB specific "emergency powers" in section 15:[41] it must take all reasonable steps to prevent systemic events from occurring; and if a systemic event has occurred or is imminent, SARB must swiftly mitigate its adverse effects on financial stability and manage the systemic event and its effects.[42] It must have regard to the need to appropriately protect financial consumers but also to contain the cost to the Republic of the systemic event and the steps taken.[43] SARB also does not have a carte blanche to burden public funds and, must not, without the approval of the Minister of Finance, take a step that would be likely to bind the National Revenue Fund to any expenditure; have a material impact on the cost of borrowing for the National Revenue Fund; or create a future financial commitment or contingent liability for the National Revenue Fund.[44]

The SARB can also impose obligations on the financial sector regulators to help with financial stability. In fact, the FSRA states that part of the mandate of the PA and FSCA is specifically to assist with the maintenance of financial stability.[45] The SARB may issue directives to the financial regulators requiring information and/or assistance. It can also give them directions aimed at supporting the restructuring, resolution or winding up of any financial institution; preventing or reducing the spread of risk, weakness or disruption through the financial system; or increasing the resilience of financial institutions to risk, weakness or disruption.[46] Where the Governor of SARB has determined that a systemic event has occurred or is imminent, the FSRA states that an organ of state which is exercising powers in respect of a part of the financial system may no*t*, without the approval of the Minister of Finance, acting in consultation

[40] Section 1 (2)(a) to (d) FSRA. It is expressly provided (s 13(3)) that a financial stability review may not include information which, if published, may materially increase the possibility of a systemic event.
[41] Van Heerden and Van Niekerk (2018) *Law and Financial Markets Review* 4.
[42] S15 (1) of the FSRA.
[43] S 15(2)(b) and (c) FSRA.
[44] S 16(2) FSRA.
[45] See section 33 FSRA for the objectives of the PA and section 57 FSRA for the objectives of the FSCA.
[46] S17 FSRA. See further s 26 which sets out the collaboration and co-operation obligations of the financial sector regulators in detail.

with the Cabinet Minister responsible for that organ of state, exercise its powers in a way that is inconsistent with a decision or steps taken by the Governor or the SARB in order to manage the systemic event or its effects.[47]

The SARB is supported in the exercise of its financial stability mandate by two specific committees established in terms of the FSRA: the FSOC is established in section 20 of the FSRA as the apex committee that supports the SARB in relation to its financial stability and has the following functions: Van Niekerk and Van Heerden state that it is clear that the FSOC is the forum where the main decisions regarding the exercise of the SARB's financial stability mandate will be taken, and that the Governor will act in accordance with decisions taken by the FSOC. They state that by creating such a forum for representatives of the SARB and the financial sector regulators to come together and discuss matters affecting financial stability, the FSOC will significantly contribute to top-level cooperation and collaboration between those entities.[48]

The other committee that is important for purposes of financial stability is the Financial Sector Contingency Forum (FSCF). The FSCF is established by section 25 of the FSRA and must assist the FSOC in the identification of potential risks that systemic events will occur and must assist with the co-ordination of appropriate plans, mechanisms and structures to mitigate those risks.[49]

Van Heerden and Van Niekerk also point out that the FSRA is also aligned with the important goal of financial regulation after the GFC to regulate "Too Big to Fail" financial institutions more intrusively.[50] Accordingly the FSRA gives the Governor of SARB the power to designate Systemically Important Financial Institutions (SIFI). The SARB can then direct the PA to apply heightened prudential regulation and supervision to SIFIs to enhance their loss absorbing capacity.[51]

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[47] S 19 of the FSRA. See further s 28 regarding the roles of other organs of state in relation to financial stability.
[48] Van Niekerk and Van Heerden "The importance of a legislative framework for cooperation and collaboration in the Twin Peaks model of Financial Regulation" (2020) *South African Law Journal* 108.
[49] S25 FSRA. For the composition of this committee see s25(3) FSRA.
[50] Van Heerden and Van Niekerk (2018) *Law and Financial Markets Review* 1 at 5.
[51] Van Heerden and Van Niekerk (2018) *Law and Financial Markets Review* 1 at 5. S30 FSRA provides that for purposes of promoting and maintaining financial stability the SARB may further mitigate risks that systemic events occur, by directing the PA to issue prudential standards or directives to a SIFI in relation to any of the following matters: solvency measures and capital requirements (which may include requirements in relation to

### 2.3 The Role of the Prudential Authority (PA)

The PA is established as a separate juristic person operating within the administration of SARB.[52] Godwin and Schmulow indicate that this may have been done to achieve synergies and costs saving that can be derived if both the central bank and the prudential regulator are "housed under the same roof".[53] The PA regulates and supervises prudential compliance by financial institutions that provide financial products and securities services and also regulates and supervises market infrastructures.[54] The objective of the PA is to promote and enhance the safety and soundness of financial institutions to provide financial products and securities services; to promote and enhance the safety and soundness of market infrastructures; protect financial customers against the risk that those financial institutions may fail to meet their obligations; and to assist in maintaining financial stability.[55]

The functions of the PA are to co-operate and assist the SARB, the FSOC, the FSCA, National Credit Regulator and Financial Intelligence Centre and to co-operate with the Council for Medical Schemes and the Competition Commission.[56] It must also support financial inclusion, regularly review the perimeter and scope of financial sector regulation; take steps to mitigate risks; and conduct and publish relevant research.[57] The PA is managed by a prudential committee consisting of the Governor and Deputy Governors of SARB with one of the Deputy Governors as the CEO of the PA.[58]

The PA has an extensive regulatory toolkit: It licences financial institutions that fall within its regulatory remit;[59] makes prudential standards for financial institutions,

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counter cyclical capital buffers);leverage ratios; liquidity; organisational structures; risk management arrangements (including guarantee arrangements); sectoral and geographical exposures; required statistical returns; recovery and resolution planning and any other matter in respect of which a prudential standard may be made.

[52] S32 FSRA.

[53] Godwin & Schmulow (2015) 760.

[54] S 34(1)(a) FSRA.

[55] S 33 FSRA.

[56] S 34(1)(b) to (d) FSRA.

[57] S 34(e) to (g) FSRA.

[58] S 36 and 41 FSRA.

[59] S113 FSRA read with Schedule 2 FSRA.

market infrastructures and key persons of financial institutions aimed at ensuring the safety and soundness of those financial institutions and/or reducing the risk of engagement in conduct that amounts to, or contributes to, financial crime; and may make standards that assist in maintaining financial stability.[60] The PA may also issue directives to financial institutions and key persons of financial institutions requiring certain actions to be taken, inter alia to reduce risk and cease the contravention of financial sector laws.[61] It can further issue guidance notices[62] and interpretation rulings;[63] enter into enforceable undertakings with financial institutions;[64] make debarment orders[65] and impose administrative fines. It also has wide investigative powers.[66]

### 2.4 The role of the Financial Sector Conduct Authority (FSCA)

The FSCA is established in terms of section 56 of the FSRA. It is a separate juristic person and is located outside the SARB. The FSCA is managed by an executive committee comprising of a Commissioner and Deputy Commissioners.[67] The FSCA is the market conduct regulator for all financial institutions, including banks.. The FSCA's objective is to enhance and support the efficiency and integrity of financial markets; protect financial customers by promoting their fair treatment by financial institutions

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[60] S 105(2 FSRA). Standards may accordingly be made in respect of fit and proper requirements; governance; appointment, duties, responsibilities, remuneration, reward, incentive schemes and suspension and dismissal of members of governing bodies and of their substructures; the operation of, and operational requirements for, financial institutions; financial management; risk management and internal control requirements; control functions of financial institutions and outsourcing thereof; record-keeping and data management; reporting to a financial sector regulator; outsourcing; insurance arrangements, including reinsurance; amalgamation, merger ,acquisition, disposal and dissolution of financial institutions; recovery , resolution and business continuity and requirements for identifying and managing conflicts of interest. The PA and FSCA can also issue joint standards in terms of s 107 FSRA.

[61] Section 143(2) and (3) FSRA. Action that may be specified in a directive for example includes the following: that the financial institution cease to offer or provide a specific financial product; or modify a specific financial product or the terms on which it is provided; removing a person from a specified position or function in relation to the financial institution and that the financial institution must remedy the effects of a contravention of a financial sector law.

[62] S141 FSRA.

[63] S142 FSRA.

[64] S151 FSRA.

[65] S53 FSRA.

[66] S129 -140 FSRA.

[67] SS 60 and 61 FSRA.

and providing financial education programs and otherwise promoting financial literacy and the ability of financial customers and potential financial customers to make sound financial decisions; and to assist in maintaining financial stability.[68] Its functions are to co-operate with and assist the SARB, FSOC, PA, National Credit Regulator and Financial Intelligence Centre and the Council for Medical Schemes and the Competition Commission.[69]

Other functions of the FSCA are to promote financial inclusion; regularly review the perimeter and scope of financial sector regulation, and take steps to mitigate risks; administer the collection of levies and the distribution of amounts in respect of levies; conduct and publish relevant research; monitor the extent to which the financial system is delivering fair outcomes for financial customers and formulate and implement strategies and programs for financial education of the general public.[70]

The FSCA's regulatory toolkit is similar to that of the PA: it has wide investigative powers;[71]it may make conduct standards[72] and issue directives; [73] issue guidance notices and interpretation rulings;[74] issue debarment orders; enter into enforceable undertakings with financial institutions and impose administrative fines.[75]

[68] S 57 FSRA.
[69] S 58(1)(b) to (d) FSRA.
[70] S 58(1)(e) to (j) FSRA.

[71] S143-140 FSRA.
[72] S106 FSRA. Conduct standards may be made on: efficiency and integrity requirements for financial markets; measures to combat abusive practices; requirements for fair treatment of consumers (such as design and suitability of financial products and services as well as their marketing); design, suitability, implementation and monitoring of financial education programs.
[73] S144 FSRA. These directives may deal with stopping the contravention of financial sector laws; ensuring compliance with enforceable undertakings; stopping involvement if financial crime; reducing the risk that a systemic event may occur and remedying the effects of contravention of a financial sector law or a person's involvement in crime.
[74] Ss141 and 142 FSRA.
[75] SS 151,153 and 167 FSRA respectively.

## 2.5 Cooperation and collaboration

Van Niekerk and Van Heerden point out that cooperation and collaboration in the South African model is facilitated on two levels:[76] First, for the narrow purpose of promoting and maintaining financial stability, as described above, and, second, for the broader effective working of the Twin Peaks model. The two other committees, namely the Financial System Council of Regulators[77] and the Financial Sector Inter-Ministerial Council assist with cooperation and collaboration. The objective of the Financial System Council of Regulators in terms of section 79 of the FSRA is to facilitate cooperation and collaboration between and consistency of action between the financial institutions that are represented on this Council by providing a forum where senior representatives can discuss and be informed about matters of common interest.

The Financial Sector Inter-Ministerial Council facilitates cooperation and collaboration between the cabinet members responsible for legislation relevant to the regulation and supervision of the financial sector by providing them with a forum for discussion and to be informed about matters of common interest.[78] The regulators must enter into memoranda of understanding to work out their cooperation and collaboration. The SARB and the PA and FSCA, and also the FSCA and PA, have entered into memoranda of understanding in 2018.[79] The FSRA further requires independent evaluations to be carried out of the effectiveness of co-operation and collaboration between the regulators.[80]

[76]Van Niekerk and Van Heerden "The importance of a legislative framework for cooperation and collaboration in the Twin Peaks model of Financial Regulation" (2020) *South African Law Journal* 108.
[77] S 79 FSRA. For the composition of this committee see s79(3).
[78] S83 and 84 FSRA. For the composition of this committee see s83(3).
[79] S26 and s77 FSRA. See further SARB/PA MOU 'Memorandum of Understanding between the South African Reserve Bank and the Prudential Authority' 26 September 2018 paras 2.1–2.4 available at *https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/8792/PA-SARB%20Memorandum%20of%20Understanding.pdf*, accessed on 15 March 2019; SARB/FSCA MOU 'Memorandum of Understanding between the South African Reserve Bank and the Financial Sector Conduct Authority' 28 September 2018 para 2.1.1 available at *https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/8828/Signed%20MOU%20-%20SARB%20and%20FSCA.pdf*, accessed on 15 March 2019; PA/FSCA MOU 'Memorandum of Understanding between the Prudential Authority and the Financial Sector Conduct Authority' 28 September 2018 paras 2.1.1–2.1.4 available at *https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/8804/PA-FSCA%20Memorandum%20of%20Understanding.pdf*, accessed on 15 March 2019.
[80] S86(1)(b) FSRA mandates such evaluations to be undertaken every two years.

## Chapter 3: Twin Peaks in the Netherlands

### 3.1 Introduction

The Netherlands was the first EU member state to adopt a Twin Peaks model of financial regulation. Before it adopted the Twin Peaks model it applied an institutional (sectoral) approach where there were three main regulators: *De Nederlandsche Bank* (DNB)[81], which is the Dutch Central Bank, was the supervisor for banks; the *Stichting Toezicht Effectenverkeer* (STE) was the securities supervisor and the *Stichting Pensioen- en Verzekeringskamer* (PVK) supervised insurance and pension funds.[82] .

In this sectoral model DNB, as central bank, had various functions in addition to bank supervision in terms of the Bankwet of 1998, including supervising the payments system and acting as lender of last resort.[83] Although the Bankwet did not contain any express provision that gave DNB the mandate for financial stability the factual position was that over the years DNB had the mandate for the maintenance of financial stability in the Netherlands.[84] In this financial model the body that was responsible for cooperation and collaboration was the *Raad van Financiele Toezichthouders* (RFT). The RFT was chaired by the President of DNB and its membership was made up by representatives from DNB, STE and PVK.[85]

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[81] DNB is one of the oldest central banks in Europe having been established in 1814.See Mooij & Prast "A brief history of the institutional design of banking supervision in the Netherlands: Research Memorandum Wo no. 703/ Research Series Supervision No. 48 (October 2002) available at https://www.dnb.nl/binaries/ot48_tcm46-146058.pdf (accessed 22 May 2020) (hereinafter Mooij &Prast (2002); De Nederlandsche Bank "History of DNB" (undated) available at https://www.dnb.nl/en/binaries/History%20DNB_tcm47_144511.pdf?2018021115 (accessed 22 May 2020).

[82] Bierman, Silverentand, Eerden, Reijmer, Sprecher & Wit *Hoofdlijnen Wft* (2015) 3 (hereinafter Bierman *et al* (2015).

[83] Section 4 of the Bankwet of 1998 provided that: "(a) the Bank has the task of supervising financial institutions on the basis of dedicated legislation;
(b) it has the task to promote the efficient working of the payment system;
(c) it must gather statistical data and compile statistics in accordance with dedicated legislation;
(d) it can after approval by virtue of a royal decision, in the general (public) interest, conduct other tasks than those mentioned in the *Bankwet*. "

[84] Van Niekerk Thesis (2018) 278.

[85] *Wet van 22 November 2001 tot het voorzien in bepalingen ter introductie van een niet-sectorspecifieke toezichtsdimensie in de Wet toezicht beleggingsinstellingen, de Wet toezicht natura-uitvaartverzekeringsbedrijf en de Wet toezicht verzekeringsbedrijf 1993*.

### 3.2 The Twin Peaks model in the Netherlands

The sectoral model in the Netherlands comprising of the DNB, STE and PVK came under pressure due to problems in the model itself and also because of many changes that occurred in the financial system. A big problem was that each of these three regulators had different regulatory cultures which lead to regulatory arbitrage and "turf wars". Kremers and Schoenmaker remark that the efficiency of the traditional design of financial regulation in the Netherlands had come under pressure and "had begun to lose energy".[86]

The many changes in the Dutch financial system towards the end of the 20th century also challenged the Dutch sectoral model of regulation. These changes included increased globalisation; financial institutions that grouped themselves into financial conglomerates; a blurring of distinctions between banking, insurance and securities activities; the establishment of the single market for financial services in the European Union; and the adoption of the euro as common EU currency. These developments posed great regulatory challenges and had a significant impact on the institutional structure of financial supervision in the Netherlands. One of the main reasons for the move to a Twin Peaks model in the Netherlands was therefore because the institutional model of financial regulation proved unfit to adequately deal with the regulation of financial conglomerates with their diversified range of activities.[87]

The decision to move to a Twin Peaks model in the Netherlands was made in 2001. Thereafter the STE was converted into the *Autoriteit Financiele Markten* (AFM), and became the systemwide conduct-of-business supervisor, and its previous micro-

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[86] Kremers & Schoenmaker "Twin Peaks: Experiences in the Netherlands" December (2010) *LSE Financial Markets Group Paper Series – Special Paper number 196* 1 (hereinafter Kremers and Schoenmaker (2010).

[87] International Monetary Fund Country Report 11/208 *Kingdom of the Netherlands - Netherlands: Financial Sector Assessment Program Documentation – Technical Note on Financial Sector Supervision: The Twin Peaks Model* (July 2011) https://www.imf.org/external/country/NLD/index. htm?pn =3 (accessed 22 May 2020 (hereinafter IMF 11/208).

prudential supervisory responsibilities for securities market activities were taken over by DNB.[88] The PVK and DNB merged in 2004 and the PVK became part of the DNB.[89]

The Dutch Twin Peaks model is therefore a traditional Twin Peaks model with two peaks as originally conceptualized by Michael Taylor, namely DNB and the AFM. The DNB is responsible for financial stability and prudential regulation (safety and soundness) and supervision of banks, insurance firms, investment companies, pension funds and securities companies. It therefore has a macro-prudential and micro-prudential outlook on the financial system. The AFM is the market conduct regulator and supervisor for all financial institutions. The final political responsibility for the Dutch financial system lies with the Minister of Finance. [90]

In 2002 the DNB and AFM entered into a Covenant to arrange how they would cooperate and collaborate. In 2004 they entered into a new Covenant to replace the previous one and it was then also decided to dissolve the RFT so that cooperation and collaboration between the regulators would be conducted on the basis of the Covenant. A further Covenant was made in 2007 between DNB, AFM and the Ministry of Finance.[91]

After approximately 5 years the legislation containing the Dutch Twin Peaks model was introduced through the *Wet op het financieel toezicht* (Wft)[92] (framework Act for the Dutch Twin Peaks model) and the *Invoerings-en aanpassingswet Wet op het financieel toezicht*[93] (implementation Act for the Dutch Twin Peaks model) on 1 January 2007. The Netherlands thus had adopted a Twin Peaks model just a few months before the GFC started.

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[88] International Monetary Fund Country Report No. 04/311 *Kingdom of the Netherlands-Netherlands: Technical Note: The Netherlands Model of Financial Sector Supervision* (September 2004) available at https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Kingdom-of-the-Netherlands-Netherlands-Technical-Note-The-Netherlands-Model-of-Financial-17755 (accessed 23 May 2020) (hereinafter IMF 4/311) at 6.

[89] Section 2 of the *Fusiewet De Nederlandsche Bank N.V. en de Stichting Pensioen- & Verzekeringskamer* act of 13 October 2004.

[90] Kremers & Schoenmaker (2010) 1.

[91] Jaarverslag 2003/2004 Raad van Financiële Toezichthouders https://www.dnb.nl/binaries/RFT%20Jaarverslag%202003-2004_tcm46-146964.pdf (accessed 23 May 2020) at 5.

[92] *Wet op het financieel toezicht, Wet van 28 September 2006*.

[93] *Invoerings-en aanpassingswet Wet op het financieel toezicht, Wet van (20 November 2006)*.

The DNB's mandate for prudential supervision was contained in section 1:24(1) of the Wft. This section provided that prudential supervision by the DNB was directed at the soundness of financial enterprises *and* the stability of the financial system. Section 1:25(1) of the Wft provided for the conduct of business supervision by the AFM. It provided that the AFM had to focus on orderly and transparent market processes, integrity in relations between market parties and due care in the provision of services to clients. The Wft, however, did not contain a framework of provisions to set out the main functions of the DNB in executing its financial-stability mandate.

The Wft recognised that cooperation and collaboration between the two peak regulators was essential to the success of the Dutch Twin Peaks model. This issue was address by Chapter 1.3 of the Wft. In terms of section 1:46 Wft it was stated that the DNB and AFM must collaborate closely with a view to laying down generally binding regulations and policy rules, so that these rules and policies were equivalent wherever possible insofar as they related to matters that were both subject to prudential supervision and supervision of conduct of business. The section specified various instances in respect of which it gave detailed prescriptions on how such cooperation and collaboration had to occur. Examples of this are that the one supervisor had to provide the other supervisor with a reasonable term to submit its view before taking any measures such withdrawal of a financial institution's licence,[94] or before imposing certain prohibitions on a financial institution.[95]

The Wft provided the DNB and AFM with an extensive regulatory toolkit: Section 1:74 Wft provided that DNB and AFM could request information from any party for purposes of supervising compliance with the Act. The regulators could, for example, issue an "instruction" to a financial institution requiring it to act in a manner as specified.[96] DNB could also issue an instruction to a financial institution in terms of section 1:75(2) Wft where it detected signs of a development that "might jeopardize the equity capital, solvency or liquidity" of the financial institution. If a financial institution failed to comply with the Wft the regulators could appoint a custodian for that institution.[97] Failure to

[94] Section 1:104 Wft.
[95] Sections 1;58; 1:59(2); 1:67(1); 4:4 Wft.
[96] Section 1:75 Wft.
[97] Section 1:76 Wft.

comply with an instruction issued to a financial institution in terms of the Wft could have the effect that the financial institution would be prevented from conducting its business from a branch office or from providing services in another Member State.[98] The regulators could also issue orders for incremental penalty payments for certain violations under the Wft;[99] impose administrative fines;[100] and issue public warnings.[101]

### 3.3 The impact of the Global Financial Crisis

The Netherlands did not escape the impact of the GFC even though it had switched to a new model of financial regulation just before the GFC. Many big financial institutions in the Netherlands such as ABN AMRO, Fortis, ING and SNS Reaal encountered problems.[102] There were also some problematic bank failures that showed the lack of proper supervision by DNB. In the failure of the Icelandic Bank Ice Save there was a problem because depositors were not sure whether they would have protection for their deposits in accordance with the Dutch deposit protection system. Eventually DNB compensated them from the Dutch Deposit Guarantee system but DNB could not later recover the money that was used for compensation from Iceland.[103] The De Wit Commission was appointed to investigate the Ice Save matter and it severely criticised the fact that the decision to grant access to the deposit guarantee scheme was not raised timeously at the highest level within DNB as the bank and systemic supervisor.[104] In the GFC the failure of another bank Dirk Scheringa Beheer (DSB) also exposed weakness in DNB's approach to prudential regulation and in the cooperation mechanisms of the Dutch Twin Peaks model. The Scheltema

[98] Section 1:77 Wft.
[99] Section 1:79 Wft.
[100] Section 1:80 Wft.
[101] Section 1:94 Wft.
[102] Bierman et al (2015) 1.
[103]Report of Special Parliamentary Commission on Financial Crisis Issued (11 May 2010) http://www.loc.gov/law/foreign-news/article/netherlands-report-of-special-parliamentary-commission-on-financial-crisis-issued/ (accessed 24 May 2020).
[104] Committee of Parliamentary Inquiry into the financial system "Conclusions and Recommendations" (11 May 2010) https://www.houseofrepresentatives.nl/sites/default/files/news_items/the_committee_of_parliamentary_inquiry_into_the_financial_system_conclusions_and_recommendations.pdf (accessed 21 June 2019) 17 – 18.

Commission[105] that was appointed to investigate the failure of DSB found that cooperation between DNB and AFM was completely lacking at the time and that this contributed to the failure of DSB. DNB was heavily criticised by the Scheltema Commission for the manner in which it handled the supervision of DSB and for the failure of DSB.[106]

Kremers and Schoenmaker indicate that in the GFC a many problems experienced in the Twin Peaks model were caused by DNB's long tradition of a laid back supervision where they did not give public warnings to financial institutions and relied on "moral suasion" to obtain regulatory compliance by financial institutions.[107] This laid-back regulatory approach by the DNB was not conducive to safety and soundness of financial institutions and financial stability.

Despite these problems the Twin Peaks model, however, seemed to be working well. In 2011 the IMF conducted a Financial Sector Assessment Plan (FSAP) on the Netherlands. In the FSAP Report[108] the IMF indicated that generally the Dutch Twin Peaks model worked well during the GFC. It was found that decisions were generally able to be made timeously to contain the Dutch banking crisis during the GFC, because of information sharing between DNB and AFM, and also between DNB and the Ministry of Finance in the context of crisis management. The IMF FSAP 2011 Report referred to the Covenant concluded in 2007 between the Ministry of Finance and DNB, and pointed out that in terms of this Covenant DNB acted as crisis manager and could take measures it deemed necessary if the urgency of the situation required it.[109] It further indicated that DNB and the AFM collaborated well together in practice (apart from instances like the DSB failure) and especially during the GFC, which was largely attributable to the 2007 Covenant.[110] The Report, however, highlighted the need for even closer cooperation between DNB and the AFM, indicating that although

[105] Scheltema Commission *Rapport van de Commissie van Onderzoek DSB Bank* (23 June 2010) available at https://www. zoek.officielebekendmakingen.nl/blg-70732.pdf (accessed 23 May 2020).
[106] Ibid.
[107] Kremers & Schoenmaker (2010) 7..
[108] International Monetary Fund Country Report No. 11/208 *Kingdom of the Netherlands - Netherlands: Financial Sector Assessment Program Documentation – Technical Note on Financial Sector Supervision: The Twin Peaks Model* (July 2011) https://www.imf.org/external/country/NLD/index. htm?pn =3 (accessed 24 May 2020) (hereinafter IMF 11/208).
[109] IMF 11/208 at 9.
[110] IMF 11/208 at 8.

the Covenant between these two entities set out general guidelines that the lead supervisor would defer to the opinions of the other supervisor, it fell short in specifying a formal procedure for resolving differences in opinions.[111]

### 3.4 The Dutch Twin Peaks model after the GFC

After the GFC the Netherlands took steps to improve the working of their Twin Peaks model. The IMF, inter alia, mentions the following changes that the Netherlands made to further improve financial regulation and supervision.[112] It created an enforcement department in DNB for corrective actions and sanctions, thereby reducing reliance on moral persuasion to ensure compliance. It also introduced the VITA-project "From Analysis to Action" to encourage supervisors to make more use of their formal powers and to bring supervisory tools more in line with supervisory best practice and to ensure their more consistent application.

At this time the IMF, inter alia, suggested that macro-prudential supervision in the Netherlands should be strengthened by introducing financial stability as an explicit mandate for DNB and by expanding the macro-prudential regulatory toolbox accordingly to enable DNB to take swift action against any emerging systemic risks without first having to resort to legislative changes. The IMF, however, stated that although the GFC impacted on the Dutch financial sector to a great extent, and a high percentage of the GDP had to be applied to support distressed financial institutions, the Twin Peaks model was still regarded as the best regulatory approach for the Netherlands.[113]

After the IMF brought out this report the Financial Stability Committee (FSC), was established in November 2012, with membership from the DNB, AFM and Ministry of Finance. The purpose of the FSC is to deal with the main risks to financial stability in the Netherlands and to advise the Minister of Finance regarding the use of macro-

[111] IMF 11/208 at 12. See also Kremers & Schoenmaker (2010) 7.
[112] IMF Report 11/208 at 13.
[113] IMF 11/208 4.

prudential tools to deal with systemic risks.[114] The *Bankwet* 1998[115] was also eventually amended as of 1 January 2014 to give the DNB an express statutory mandate for financial stability by providing that the DNB has the task of supervising financial institutions on the basis of dedicated legislation; to promote the efficient working of the payment system; to promote the stability of the financial system.

[114]DNB Annual Report (2014) available at https://www.dnb.nl/en/binaries/jv2014%20uk_tcm47_319635.pdf (accessed 24 May 2020) at 100.

[115]Article II of *Wijzigingswet financiële markten (2014)*.

## Chapter 4: Conclusions and Recommendations

### 4.1 Conclusion

In this dissertation it was indicated that the GFC turned the goal of financial regulations towards achieving the maintenance of financial stability. It was also indicated that the Twin Peaks model appears to be an optimal model for properly regulating a financial system and maintaining financial stability. Background was further given about South Africa's journey to a Twin Peaks model and the main features of the South African Twin Peaks model was explained.

From the discussions in Chapter Two it is clear that South Africa has made great effort to design an optimal Twin Peaks model. The South African Model focuses extensively on the promotion and maintenance of financial stability and how the SARB as apex regulator must go about to exercise this mandate. It also sets out clearly what the functions are of the two twin regulators namely the PA and the FSCA. The South African Twin Peaks model further gives significant attention to putting in place structures to facilitate proper cooperation and collaboration in the model.

In Chapter Three the Twin Peaks model in the Netherlands was discussed. The Dutch Twin Peaks model was adopted long before South Africa decided to switch to a Twin Peaks model. What is notable about the Dutch model is that it was adopted just before the GFC. This means that the Netherlands were in both a bad and a good position. They had adopted a new model of financial regulation just before one of the greatest financial disasters on earth happened. In a way this was bad because they did not have enough time before the GFC to test their model. But the good part is that their Twin Peaks model took them through the GFC and they could see where it still needed to be refined to provide optimal financial regulation.

The advantage of the Dutch Twin Peaks model for South Africa with its young Twin Peaks model is that we can look at the Dutch model which has been tested by a major financial crisis and see what lessons can be learned from their experience so that we can improve our model or at least avoid some problems that the Netherlands experienced. And perhaps our model may also yield some lessons for the Netherlands.

## 4.2 Recommendations regarding lessons to be taken

The GFC has shown that the Twin Peaks model is an optimal regulatory model. It provides a focus on systemic stability and also provides for regulators to have a systemwide view of how safe and sound financial institutions are and whether they are engaged in business conduct that may put the financial system at risk.

The Dutch experience with its Twin Peaks model shows that it is indeed very important to capture the central bank's financial stability mandate in legislation because it provides the statutory basis for the functions which the central bank must execute in relation to financial stability. If the central bank's mandate for financial stability is expressly stated in legislation it places the central bank in a strong position to take steps to maintain financial stability.

As indicated the Dutch central bank is also the prudential regulator in the Dutch Twin Peaks model which is a traditional two peak-model. From the Dutch experience of the DNB as prudential regulator we can see that our prudential regulator, the PA, should not take a laid-back approach to prudential regulation. The DNB luckily was made aware of its mistake in this regard and improved its approach to prudential supervision and more extensive use of its regulatory powers after the GFC. It is submitted that our financial sector conduct regulator, the FSCA, can equally observe the lesson not to be a laid-back regulator. We can also see, like we have done, that it is prudent to keep the prudential regulator close to the systemic regulator even though they are not merged into one entity in South Africa as in the Netherlands where DNB oversees both these functions.

From the Dutch model we can also take the lesson that the objectives and jurisdiction of each regulator must be clear because this will avoid the problems that can be caused by regulatory arbitrage. The experience with the Dutch Twin Peaks model has also shown the importance of a good structure for cooperation and collaboration and that entering into Covenants or memoranda of understanding is a good way for the regulators to achieve such cooperation and collaboration. The advantage of entering into such soft law instruments is that they can be changed quickly if it appears that certain arrangements contained in them are not working well.

It is submitted that although our Twin Peaks model is very young, jurisdictions such as the Netherlands can also take lessons from our model. In particular it is submitted that we have observed the necessity to capture the financial stability mandate in legislation from the start. The FSRA also can serve as an example of how to capture the broad functions of the central bank in relation to financial stability in legislation. This serves two purposes: it indicates to the central bank what is expected from it in relation to the tasks it must carry out to fulfil its mandate. It also provides a legislative basis for the central bank to be able to tell other regulators and organs of state what they must do to assist with the maintenance of financial stability. Where systemic events occur, like the current Covid 19-pandemic that is threatening financial systems across the globe, it gives the central bank the legislative powers to deal with such a crisis and to prescribe steps to mitigate the effects of the crisis without putting the central bank in the precarious position that the regulators can question its authority to order such steps.

It is further submitted that the South African model provides a good example of a structure for cooperation and collaboration within the Twin Peaks model that involves the central bank as well as the financial regulators and organs of state. The FSRA caters for such cooperation and collaboration on two levels and each level is provided with specific committees to make sure that such cooperation and collaboration is achieved. The central bank is given legislative powers to oblige cooperation by the financial sector regulators and organs of state to assist with maintaining financial stability and provision is also made for the regulators to co-operate for the broader purpose of ensuring that the model works effectively and efficiently. The FSRA not only requires the regulators to enter into memoranda of understanding to iron out their cooperation and collaboration but has also built in a requirement for review of these measures for cooperation and collaboration to assess how well they are working and whether they are in need of amendment.

### 4.3 Final remarks

A country's financial system is a living sector that evolves as the country and its economy progresses through the years. Likewise, a model for the regulation of a financial system should be able to grow with that financial system and adapt to its peculiar challenges. From the overview provided in this dissertation, the Twin Peaks model appears to be an optimal regulatory model to take a country like South Africa through good and bad times and that can be adapted after a crisis to make it even more suitable to provide appropriate financial regulation and assist with the maintenance of financial stability.

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