Two takes on Twin Peaks: A comparative appraisal of the models of financial regulation in the Netherlands and South Africa

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OPSOMMING

Twee benaderings tot "Twin Peaks": 'n Vergelykende beoordeling van die modelle van finansiële regulering in Nederland en Suid-Afrika

ʼn Land se model van finansiële regulering is bepalend tot die vermoë om finansiële stabiliteit in ʼn bepaalde finansiële stelsel te bevorder en in stand te hou. Die "Twin Peaks"-model van finansiële regulering, wat in 1995 deur Michael Taylor gekonsep-tualiseer is, word wyd beskou as ʼn optimale institusionele struktuur, waar sistemiese en prudensiële regulering en toesighouding in een regulatoriese piek gelokaliseer is, terwyl die ander regulatoriese piek verantwoordelik is vir regulering en toesighouding van finansiële instellings se besigheidsgedrag. Elke piek het ʼn sisteemwye mandaat wat in beginsel alle finansiële instellings in ʼn gegewe finansiële stelsel dek. Die Twin Peaks-model is in 1998 in Australië ingelei en het sedertdien in gewildheid toegeneem. Nederland was die eerste Europese lidland om hierdie model aan te neem (in 2002) en in werking te stel (in 2007). Suid-Afrika het in 2017 die eerste ontwikkelende land geword wat van ʼn sektorale model van finansiële regulering na ʼn Twin Peaks-model oorgeskakel het. Hierdie bydrae stel na die Twin Peaks-modelle in Nederland en in Suid-Afrika ondersoek in. Dit bied ʼn oorsig oor die onderskeidende kenmerke van elke model en die basiese institusionele opsigte waarin die modelle verskil. Kritiese aspekte van regula-toriese modelle met betrekking tot die vraag of die sentrale bank se mandaat sisteemwye finansiële stabiliteit, sowel as prudensiële regulering en oorsig moet insluit, word bespreek, asook die noodsaaklikheid van ʼn omvattende netwerk vir samewerking en uitruiling van inligting. Nederland se ervaring met hul Twin Peaks-model tydens die 2008 Wêreldwye Finansiële Krisis bied ʼn besonder insiggewende gevallestudie en hierdie bydrae wys verskeie lesse wat Suid-Afrika by Nederland, as voorloper met die invoering van die Twin Peaks model in Europa pas voor die krisis, kan leer uit.

1 INTRODUCTION

In 1995, Michael Taylor caused a paradigm shift in the approach to financial regulation by proposing a radical new approach referred to as the "Twin Peaks" model of financial regulation by objective. The essence of the Twin Peaks model proposed by Taylor is that financial regulation should be objectives-driven and localised in two separate regulators. One of the regulators should be responsible for ensuring the stability of the financial system as a whole, primarily through the application of prudential regulation, and the other should be responsible for regulation and supervision of the conduct of business by financial institutions (a market conduct regulator).[1] The Twin Peaks model has since been adopted, with country-specific modification, in a number of jurisdictions. In particular, Australia pioneered the model in 1998 and in 2002 the Netherlands became the first European Union Member State to adopt a Twin Peaks model, which was implemented in 2007.

Two issues that have featured prominently in the design of individual Twin Peaks models pursuant to Taylor's original conceptualisation are whether the overall financial stability mandate should be entrusted to the central bank[2] and, if so, whether the central bank should then be the prudential regulator as well.[3] There appears to be general agreement that the central bank is best suited to fulfil the overarching financial stability mandate given the combination of roles that central banks have fulfilled over the years, among others, implementation of monetary policy, supervision of the payments, settlement and clearing system; bank supervision and acting as Lender of Last Resort (LOLR).[4] Some are of the opinion that it would not be appropriate to burden a central bank, that is tasked with a comprehensive financial stability mandate, with the additional mandate of

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* This contribution is based on research conducted by the second author for her doctoral thesis titled *The role of the central bank in promoting and maintaining financial stability in South Africa* (LLD thesis UP 2018), completed under supervision of the first author with input from the third author.

1 See Taylor "'Twin peaks': A regulatory structure for the new century" December 1995 Centre for the Study of Financial Innovation 2 and 3. See also Taylor "Financial regulation in the United Kingdom: A structure for the 21st century" 1996 *Futures and Derivatives Law Review* 7. Taylor conceptualised these two twin regulators as a "Financial stability commission" and a "Consumer protection commission" respectively.

2 Goodhart "The past mirror: Notes, surveys, debates – The changing role of central banks" 2011 *Financial History Review* 145; Llewellyn "Institutional structure of financial regulation and supervision: The basic issues" paper delivered at the World Bank Seminar Washington DC United States of America (6 and 7 June 2006) 28 available at researchgate.net/publication/255585648_Institutional_structure_of_financial_regulation_and_supervision_the_basic_issues (accessed on 4-10-2020). See also Bordo "A brief history of central banks" December 2007 Federal Reserve Bank of Cleveland Research Department available at www.ec%2020071201%20a%20brief%20history%20of%20central%20banks-%20pdf.pdf (accessed on 26-09-2020). Traditionally, the central bank's role of maintaining financial stability included the broader encouragement of financial development. This financial stability role was not one of the central bank's initial core roles and, as indicated by Bordo, developed only at a later stage, notably around 1914.

3 See also Goodhart and Schoenmaker "Should the functions of monetary policy and banking supervision be separated?" 1995 *Oxford Economic Papers* 540–541.

4 Goodhart 2011 *Financial History Review* 135; Freixas *et al* "Lender of last resort: What have we learned since Bagehot?" 2000 *Journal of Financial Services Research* 63 define "lender of last resort" more comprehensively as the institution that provides liquidity to an individual financial institution (or the market as a whole) in reaction to an abnormal increase in demand for liquidity that cannot be met from an alternative source.

bank supervision, because such a heavy workload may not only harness conflict of interests between the objectives of financial stability and the objectives of prudential supervision, but may also dilute regulatory energy. However, others argue that combining the overall financial stability mandate and bank supervision in the mix of tasks to be exercised by the central bank often yields economies of scale, which means savings in resources, which can be especially beneficial in developing jurisdictions.[5]

Although "financial stability" is a notoriously fuzzy concept, which escapes exact universal definition,[6] recognition of the importance of financial stability significantly (but unfortunately not sufficiently or timeously enough) increased in the years leading up to the 2008 Global Financial Crisis (GFC). Notably, the trend pre-GFC was *not* to capture the financial stability mandate of central banks expressly in legislation and to infer it from the combination of their other roles.[7] Thus, pre-GFC central banks generally exercised *de facto* financial stability mandates, which were often implied from their cumulative roles in a country's financial system.[8]

However, the 2008 GFC was a watershed event that impacted profoundly on the landscape of financial regulation.[9] It exposed many shortcomings in financial regulation and yielded crucial lessons, such as the need for a holistic macro-prudential[10] approach to financial regulation; the need for prudential regulation and market conduct regulation to operate in tandem; the failure of light touch regulation; and the need to limit the unprecedented growth of "Too Big To Fail"-financial institutions, which engaged in excessive risk taking due to increased

5 Llewellyn (2006) World Bank Seminar 19.

6 Borio and Drehmann "Towards an operational framework for financial stability: 'Fuzzy' measurement and its consequences" June 2009 *BIS Working papers* available at https://www.bis.org/publ/work284.htm (accessed on 07-08-2019).

7 Goodhart "A framework for assessing financial stability" 2006 *Journal of Banking and Finance* 3415.

8 Goodhart 2011 *Financial History Review* 146.

9 Group of Thirty Consultative Group on International Economic and Monetary Affairs Inc *Financial reform – A framework for financial stability* (2009) available at http://group30.org/images/uploads/publications/G30_FinancialReformFrame-workFin-Stability.pdf (accessed on 26-09-2020) 36:

> "Where not already the case, central banks should accept a role in promoting and maintaining financial stability. The expectation should be that concerns for financial stability are relevant not just in times of financial crisis, but also in times of rapid credit expansion and increased use of leverage that may lead to crises."

See also Goodhart 2006 *Journal of Banking and Finance* 3415–3422; Allen and Wood "Defining and achieving financial stability" 2006 *Journal of Financial Stability* 152; Buiter "The role of central banks in financial stability: How has it changed?" 2002 *Discussion paper International Macroeconomics Centre for Policy Research* available at http://www.cepr.org (accessed on 26-09-2020).

10 See Galati and Moessner "Macroprudential policy – A literature review" February 2011 *BIS Working papers* 4 available at https://www.bis.org/publ/work337.pdf (accessed on 26-09-2020), where it is explained that "macro-prudential refers to a systemic orientation of regulation and supervision linked to the macroeconomy" and entails "policy aimed at supporting the safety and soundness of the financial system as a whole as well as payments mechanism." This contrasts with microprudential supervision, which focuses on the safety and soundness of individual institutions – see Wall "Stricter microprudential supervision versus macroprudential supervision" 2015 *Journal of Financial Regulation and Compliance* 354.

moral hazard.[11] These lessons drove a shift post-GFC towards interventionist hard core financial regulation in pursuit of financial stability as apex objective.[12]

Noting developments in financial regulation internationally, South Africa commenced with a review of its approach to financial regulation in 2007, shortly before the GFC erupted in full force. This review process gained momentum when South Africa, as a member of the G-20, committed itself as the first emerging market and the first country in Africa to migrate from a system of silo sectoral regulation to a functional Twin Peaks model of financial regulation by objective.[13]

The purpose of this contribution is to provide an overview of the Twin Peaks models in the Netherlands and in South Africa and to reflect on some similarities and differences in these two models, especially insofar as the role of the central bank is concerned. Consideration is given to some of the experiences of the Netherlands while steering its Twin Peaks model through the GFC and thereafter, and pertinent reforms undertaken by the Netherlands in this context. It is hoped that South Africa can take lessons from the Dutch experience and avoid some of the pitfalls experienced with the Twin Peaks model in the Netherlands.

2 TWIN PEAKS IN THE NETHERLANDS

2 1 Background

Prior to adopting a Twin Peaks model, the Netherlands followed a sectoral approach to financial regulation.[14] The Dutch central bank, *De Nederlandsche Bank* (DNB),[15] 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.[16] DNB, as central bank, derived its position as supervisor of banks from section 4 of the *Bankwet* of 1998, which imposed the following functions:

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11 National Treasury *A safer financial sector to serve South Africa better* 2011 available at https://www.treasury.gov.za>twinpeaks>20131211 (accessed on 26-09-2020). See also Stiglitz "Lessons from the Global Financial Crisis of 2008" 2010 *Seoul Journal of Economics* 321. Regarding the "Too Big To Fail"-phenomenon see Strahan "Too Big to Fail: Causes, consequences and policy responses" 2013 *Annual Review of Financial Economics* 43; Barth "Too Big to Fail and Too Big to Save: Dilemmas for banking reform" 2016 *Journal of Banking Regulation* 265.

12 See Levine "The governance of financial regulation: Reform lessons from the recent crisis" November 2010 *BIS Working papers* available at http://www.bis.org (accessed on 26-09-2020); Borio "The financial turmoil of 2007: A preliminary assessment and some policy considerations" (March 2008) *BIS Working papers* available at bis.org/publ/work251.pdf (accessed on 4-10-2020).

13 G20 *Seoul Summit declaration* (2010) available at fsb.org/wp-content/uploads/g20_leaders declaration seoul_summit_2010.pdf (accessed on 4-10-2020).

14 Busch *et al Onderneming en financieel toezicht* (2010) 23.

15 DNB is one of the oldest central banks in Europe, having been established in 1814. For a detailed historical overview, see Mooij and Prast "A brief history of the institutional design of banking supervision in the Netherlands" October 2002 *Research memorandum research series supervision* available at researchgate.net/publication/4879365 A Brief_History of the Institutional Design of Banking Supervision in the Netherlands (accessed on 04-10-2020); De Nederlandsche Bank "History of DNB" (undated) available at dnb.nl/en/about-dnb/organisation/history/index.jsp#:~:text=History%20of%20DNB,of%20the%20entire%20-financial%20sector (accessed on 5-10-2020).

16 Bierman *et al Hoofdlijnen Wft* (2015) 3.

"(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*."

Although not expressly mentioned in the *Bankwet* at the time, DNB was *de facto* responsible for the maintenance of financial stability in the Netherlands and also acted as LOLR.[17] Pre-Twin Peaks co-operation and collaboration between the Dutch supervisors were facilitated by a co-ordinating body, the *Raad van Financiele Toezichthouders* (RFT), comprising of representatives from DNB, STE and PVK and chaired by the President of DNB.[18]

However, DNB's role as central bank within the Dutch Twin Peaks model cannot be viewed in isolation from central banking developments that occurred on European Union level late in the 1990s. Notably, the establishment of the Eurozone and the common monetary area in 1999 in terms of the European Union Treaty[19] led to the creation of the European System of Central Banks (ESCB) in which the then newly established European Central Bank (ECB) acted as supranational central bank with the national central banks of the various Member States participating in the ESCB. An important consequence of the establishment of the ESCB was that the primary responsibility for monetary policy moved from the national banks to the ECB.[20] In 1998, amendments to the *Bankwet* were effected specifically to address the "expanded" role of DNB as part of the ESCB in accordance with the Treaty on the Functioning of Europe (TFEU).[21] Thus, the 1998 *Bankwet* catered for DNB's role as central bank in the

17 Mooij and Prast October 2020 *Research memorandum* 20 remark about the role of DNB in this period that

"[t]he choice of the Netherlands to maintain a structure in which the central bank is responsible for the prudential supervision of banks has to do with stability considerations. In view of the high degree of concentration in the banking sector systemic and prudential supervision are appropriately placed close at the hand of the central bank."

18 *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.*

19 Scheller *The European Central Bank: History, role and functions* (2004) available at https://www.ecb. europa.eu/pub/pdf/other/ecbhistoryrolefunctions2004en.pdf (accessed on 26-09-2020) 21.

20 Padoa-Schioppa "EMU and bank supervision" Lecture at the London School of Economics to the Financial Markets Group 24 February 1999 available at ecb.europa.eu/press/key/date/1999/html/sp990224.en.html (accessed on 5-10-2020).

21 In terms of s 2 of the *Bankwet* 1998, the primary objective of DNB, in implementation of the Treaty, was to maintain price stability (in execution of its monetary policy objective). In terms of section 3(1) it was stated that, in implementation of the Treaty, within the framework of the ESCB, DNB contributes to the following tasks: Defining and implementing monetary policy; conducting foreign exchange operations consistent with the provisions of art 219 of the Treaty; holding and managing the official foreign reserves; providing for the circulation of money as far as it consists of banknotes; and promoting the smooth operation of payment systems. S 3(2) provided that, in implementation of the Treaty within the framework of the ESCB, DNB "contributes" to the pursuit of sound policies by the competent authorities relating to the prudential supervision of banks and the stability of the financial system. S 3(3) stipulated that DNB may, in implementation of the Treaty and in carrying out its tasks and duties under s 3(1) and (2), seek and take instructions exclusively from the ECB.

Netherlands and also for its role as one of the many national central banks within the broader context of the ESCB.

2 2 Adoption of the Dutch Twin Peaks model

Mooij and Prast point out that the final decades of the twentieth century saw a distinct change in the financial landscape in the Netherlands. Globalisation; conglomeration; the blurring of distinctions between banking, insurance and securities activities; the single market for financial services in the European Union; the birth of the euro; and a growing awareness of the importance of financial integrity and consumer protection were challenging existing regulatory and supervisory policy and affected the institutional structure of financial supervision in the Netherlands in various ways. The lifting in 1990 of the prohibition on combining banking and insurance activities in one financial institution, paved the way for mergers between banks and insurance companies, resulting in large financial conglomerates.[22] The emergence of these large, complex conglomerates and increasingly complex financial products resulted in a greater emphasis being placed on efficient and comprehensive systemwide (as opposed to silo) supervision of the financial sector in the Netherlands.[23] Consequently, the sectoral approach to financial regulation came under scrutiny.

One particular problem with the sectoral model was the different regulatory approaches and cultures among the three supervisors, which inevitably resulted in regulatory arbitrage.[24] Another concerning aspect was that the efficiency of the supervisors had deteriorated because they all had unclear objectives, which resulted in misunderstandings between them, leading to various "turf wars". This problem was exacerbated by the vague boundaries that existed between financial institutions, markets and products in the financial sector. As pointed out by Kremers and Schoenmaker, the efficiency of the traditional design of financial regulation in the Netherlands had come under pressure and "had begun to lose energy".[25]

However, the emergence of financial conglomerates was the main driver behind the move in the Netherlands to a Twin Peaks model as the then prevailing sectoral model of financial regulation was unfit to address the regulatory challenges posed by these large, complex and interconnected financial giants.[26] A further driver was the realisation, which gradually dawned, that prudential and market conduct supervision were two different objectives, each requiring a different skill set, a different external profile and different decision making powers and responsibilities to do justice to both these objectives. Yet another driver was the conviction that financial system stability must be closely linked with microprudential stability (individual safety and soundness) of individual

22 Mooij and Prast October 2020 *Research memorandum* 21 point out that, in fact, the Netherlands were pioneers in "bancassurance".

23 Everdingen, Grundmann-van de Krol and Sachse *Aspecten van toezicht: Beschouwingen over het toezicht op de financiele sector: Preadviezen voor de Vereniging voor Effectenrecht* (1999) 19.

24 Everdingen, Grundmann-van de Krol and Sachse (1999) 14.

25 Kremers and Schoenmaker "Twin Peaks: Experiences in the Netherlands" December 2010 *LSE Financial Markets Group Paper series*.

26 International Monetary Fund (IMF) *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) available at imf.org/external/pubs/ft/scr/2011/cr11208.pdf (accessed on 05-10-2020).

financial institutions, especially in a concentrated financial market with a number of Systemically Important Financial Institutions (SIFIs), as was the case in the Netherlands. It was further argued that financial stability also should be closely linked with monetary policy with its decisive influence on financial market conditions.[27]

The decision to move to a Twin Peaks model of financial regulation in the Netherlands was eventually taken late in 2001.[28] In March 2002, the STE was converted into the *Autoriteit Financiele Markten* (AFM), taking on responsibility for conduct of business supervision on a cross-sectoral basis, while its previous microprudential supervisory responsibilities for securities market activities were taken over by the DNB.[29] The PVK subsequently merged with the DNB in 2004, whereafter the PVK ceased to exist as a separate regulator.[30]

Thus, the Dutch Twin Peaks model comprises of two peaks, namely the DNB and the AFM. In this model, the central bank, DNB, as the one peak, is both the systemic supervisor responsible for financial stability *and* the prudential supervisor tasked to supervise the safety and soundness of *all* financial institutions (banks, insurance firms, investment companies, pension funds and securities companies). Thus, the DNB exercises macroprudential as well as micro-prudential supervisory oversight in the Dutch financial system. The other peak in the Dutch model is the market conduct regulator, AFM, which is tasked to oversee systemwide market conduct (conduct-of-business) by *all* financial institutions. Each of these regulators regulate and supervise the Dutch financial system on a holistic macro-level in respect of the matters under their remit. The final political responsibility for the Dutch financial system rests with the Minister of Finance.[31]

After the decision to move to a Twin Peaks model, the regulators concluded a Covenant in 2002 to address co-operation and collaboration between them. This Covenant was replaced by a further Covenant in 2004. Notably, the RFT was dissolved in terms of a resolution signed on 15 November 2004. In 2007, another

27 Kremers and Schoenmaker December 2010 *LSE Financial Markets Group paper series* 2.

28 Initially, it was decided that the Netherlands would merely move to a model of amplified sectoral regulation and supervision. However, less than two years later, there was a sudden change in regulatory direction when the Minister of Finance announced that the Netherlands would switch to a Twin Peaks model. See Busch *et al* (2010) 35.

29 IMF *Country report 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 on 26-09-2020) 6. Mooij and Prast October 2020 *Research memorandum* 20–21 indicate that the reorganisation of the Dutch model of financial regulation was based on the philosophy that financial supervision should meet three criteria:

> "It should be effective, market-oriented and efficient. Effectiveness implies that supervision should meet the objectives of systemic supervision, soundness of financial institutions and proper conduct of business, including market transparency. Market-oriented implies that markets should be as undistorted as possible, and that institutions can compete in a level playing field. Efficiency requires that the overlap between the tasks of the different supervisors should be kept to a minimum and that the administrative burden of the supervised institutions should be restricted."

30 In terms of s 2 of the *Fusiewet De Nederlandsche Bank N.V. en de Stichting Pensioen- & Verzekeringskamer* of 13 October 2004, the DNB would perform all the tasks of PVK.

31 Kremers and Schoenmaker December 2010 *LSE Financial Markets Group paper series* 1.

Covenant relating to co-operation and collaboration was entered into between DNB, AFM and the Ministry of Finance.[32]

The legal framework for the Dutch Twin Peaks model was conceptualised over the course of a few years: The *Wft*,[33] which set out the Twin Peaks framework, and the *Invoerings-en aanpassingswet Wet op het financieel toezicht*,[34] which implemented the Dutch Twin Peaks model, eventually became law on 1 January 2007 – shortly before the GFC. Notably, the objective of the *Wft* was not laid down in the Act itself. However, Bierman points out that it can be derived from the parliamentary history and from sections 1:24 and 1:25 of the *Wft* as being the supervision of the soundness of financial enterprises and contribution to the stability of the financial sector; orderly and transparent financial market processes; good relationships between parties in the market; and handling of customers in a "careful" manner.[35]

The division of the prudential supervision mandate of the DNB and the market conduct supervision mandate of the AFM was addressed in the General Provisions in Part 1 of the *Wft*. The core determination for the DNB's prudential supervision mandate was contained in section 1:24(1) *Wft*, which stipulated that prudential supervision was directed at the soundness of financial enterprises and the stability of the financial system; thus, in essence, a combination of micro- and macroprudential supervision. This provision had to be read with the *Bankwet* 1998, as alluded to above, which formed the basis for the exercise of systemic supervision in the Netherlands by the DNB. However, it is to be noted that the *Bankwet*, as enabling act laying down the parameters within which the DNB functions as central bank, was not changed at the time of introduction of the Dutch Twin Peaks model to provide for an express and comprehensive domestic financial stability mandate for the DNB.[36] Section 1:24(2) *Wft* extended the role of the DNB as prudential supervisor by providing that the DNB had the task to exercise prudential oversight over financial enterprises[37] and to make rulings on whether financial enterprises may be admitted to the financial markets.

In terms of section 1:25(1) *Wft*, market conduct supervision by 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. Further, section 1:25(2) *Wft* stipulated that the mandate of the AFM was to exercise supervision of the conduct of the financial markets and to decide on the admission of financial enterprises to those markets. Thus, supervision by the AFM involved supervising market conduct in markets for investment, savings, lending, and insurance, as well as supervising the admission of businesses into this market. Van Erp points out that the objective that the AFM was set to

32 Raad van Financiële Toezichthouders *Jaarverslag 2003/2004* available at https://www.dnb.nl/binaries/RFT%20Jaarverslag%202003-2004_tcm46-146964.pdf (accessed on 05-10-2020). See also *Stichting Autoriteit Financiële Markten* and *De Nederlandsche Bank N.V. Covenant* (2004) with regards to co-operation and co-ordination in supervision, regulation, policy, (inter)national consultation and other tasks with a common interest.

33 *Wet op het financieel toezicht, Wet van 28 September 2006.*

34 *Invoerings-en aanpassingswet Wet op het financieel toezicht, Wet van 20 November 2006.*

35 Bierman *et al* (2015) 6. See also Busch *et al* (2010) 41.

36 Busch *et al* (2010) 10 and 15.

37 S1:1 *Wft* defines "Financial enterprise" to include the following: A management company; a collective investment scheme; an investment firm; a depositary; a clearing institution; a financial service provider; a financial institution; a credit institution; and an insurer.

achieve was to establish financial market processes that were transparent and where the facts and information circulated by and among financial establishments are dependable. Furthermore, it would supervise the integrity of the financial markets by preventing unfair trade practices or insider trading and would be instrumental in ensuring impeccable relations between customers and financial institutions.[38]

Co-operation and collaboration between the DNB and AFM were dealt with in Chapter 1.3 of the *Wft*.[39] Section 1:46 *Wft*, among others, obliged the DNB and the AFM to collaborate closely with a view to laying down generally binding regulations and policy rules, to ensure that these were equivalent wherever possible insofar as they related to matters that were subject to prudential supervision and to supervision of conduct of business. In addition, various instances were explicitly mentioned wherein the nature of such co-operation and collaboration was prescribed in detail. For example, it was required that the one supervisor had to provide the other supervisor with a reasonable term to submit its view before taking any measures, such as the appointment of a custodian for a failing financial institution,[40] withdrawal of a licence,[41] imposition of certain prohibitions[42] and the designation under section 1:75 intended to dismiss a person determining or co-determining the policy of a financial institution, or intended to dismiss a person belonging to a body responsible for supervising the policy and general affairs of a financial institution.[43] Given that the Netherlands is part of the broader European Union structure, Part 1.3.2 of the *Wft* further dealt with collaboration between the DNB and the AFM and supervisors in other Member States in general, where such collaboration was required for the performance of supervisory duties. As indicated above, covenants were entered into between the regulators to streamline co-operation and collaboration.

The *Wft* also provided the Dutch supervisors with an extensive regulatory toolkit, comprising of the power to request information from any party for purposes of supervising compliance with the Act[44] and of the power to issue "instruction" (directive) requiring specific actions to be taken.[45] Also, DNB and AFM were given the more intrusive discretion to appoint a custodian for a financial institution that failed to comply with the provisions of the *Wft*.[46] Further, the supervisors could issue an order for incremental penalty payments for certain violations under the *Wft*,[47] could impose an administrative fine,[48] and

38 Van Erp "Regulatory disclosure of offending companies in the Dutch financial market: Consumer protection or enforcement publicity?" 2010 *Law and Policy, The University of Denver/Colorado Seminary* 415.

39 See also Busch *et al* (2010) 48 regarding collaboration between the DNB and the AFM.

40 S 1:76 *Wft*.

41 S 1:104 *Wft*.

42 S 1:58; 1:59(2); 1:67(1); 4:4 *Wft*.

43 S 1:47 *Wft*.

44 S 1:74 *Wft*.

45 S 1:75 *Wft*.

46 S 1:76 *Wft*. A custodian could be appointed in the following instances: After the institution failed to comply with an instruction in terms of s 1:75(1) within the specified period; if the aforesaid violation seriously jeopardised the adequate operation of the institution; if the violation seriously jeopardised the interests of consumers or clients; or if the DNB detected signs of a development that might jeopardise the equity capital, solvency or liquidity of that financial institution.

47 S 1:79 *Wft*.

48 S 1:80 *Wft*.

could issue public warnings.[49] DNB in particular, could apply to a court to declare emergency regulations applicable to a financial institution if the institution showed signs of a "dangerous development" that compromised its safety and soundness and where no reasonable improvement could be expected.[50]

2 3 Twin Peaks in the Netherlands during the GFC

Given that the Dutch Twin Peaks model was introduced shortly before the GFC, it meant that the model was almost immediately confronted with various challenges occasioned by the CFC. National players in the Netherlands that had big financial problems during the GFC were ABN AMRO, Fortis, ING and SNS Reaal, to name but a few.[51] Some issues of unco-ordinated supervision surfaced in a couple of spectacular banking failures during the GFC: In 2008, Icesave, an internet branch of an Icelandic bank that conducted business in the Netherlands, went bankrupt, raising pertinent issues relating to financial consumer protection, specifically whether the Dutch deposit guarantee system was applicable to Dutch consumers that deposited their money in a foreign bank. Affected Dutch consumers were eventually granted access to the Dutch deposit guarantee scheme and the Netherlands tried – in vain – to recover damages from Iceland. In 2010, the De Wit Commission was appointed to, among others, examine DNB's performance as supervisor in relation to the Icesave matter.[52] The De Wit Commission found that the guarantee of Icesave deposits was a responsible risk taken by the Minister of Finance, but criticised the fact that the decision to grant access to the deposit guarantee scheme was not raised timeously at the highest level within the DNB as bank and systemic supervisor.[53]

Another notable bank failure during the GFC was that of Dirk Scheringa Beheer (DSB). This bank targeted low-income groups with dubious payment protection insurance, high interest rates and aggressive trading practices. Scheringa, the founder of the DSB, also saw the bank as donor to his personal hobbies, which included a soccer team and a museum. After critical reports in the media, the DSB faced a bank run, which led to its demise, because neither the DNB nor one of the other big Dutch banks was willing or able to save the DSB. In the inquiry *ex post* the DSB failure by the Scheltema Commission[54] in 2010, it became clear that co-operation between the DNB and the AFM was completely lacking at the time and that this contributed to the failure of the DSB. Specifically, the DNB openly overruled a decision of the AFM regarding the appointment of a former Finance Minister as Chief Financial Officer of the DSB.

49 S 1:94 *Wft*.

50 S 3:160 *Wft*.

51 Bierman *et al* (2015) 1. Denters "Regulation and supervision of the global financial system. A proposal for institutional reform" 2008–2009 *Amsterdam Law Forum* 63 and 64.

52 De Wit Commission *Report of special parliamentary commission on financial crisis* (11 May 2010) (hereinafter De Wit Commission *Report*) available at http://www.loc.gov/law/foreign-news/article/netherlands-report-of-special-parliamentary-commission-on-financial-crisis-issued/ (accessed on 27-09-2020). The De Wit Commission was a Dutch parliamentary group set up in 2009, among others, to examine the cause of the credit crisis and structural problems and subsequent measures taken to deal with the crisis.

53 De Wit Commission *Report* 17–18.

54 Scheltema Commission *Rapport van de Commissie van Onderzoek DSB Bank* (23 June 2010) available at https://www. zoek.officielebekendmakingen.nl/blg-70732.pdf (accessed on 29-08-2019).

The Scheltema Commission severely criticised the DNB for its handling of the supervision and subsequent failure of the DSB.[55]

It transpired that much of the problems relating to prudential supervision in the early days of the Dutch Twin Peaks model were occasioned by the fact that the DNB had a long tradition of a laid back "hands off" style of supervision. For many years, the presidents of the DNB prided themselves that they never had to give a public warning to a bank, because all disagreements could be solved amicably in the "old boys network". Thus, the DNB did not take a strict enforcement approach, but rather relied on "moral suasion" to obtain regulatory compliance by financial institutions.[56] In contrast with the DNB's lax approach to prudential supervision, the AFM fortunately proved to be a more strict supervisor.[57] However, the effectiveness of the Dutch Twin Peaks model during the GFC was clearly impeded especially by the DNB's *laissez faire* approach to enforcement at a time when stricter regulatory and supervisory action would have been appropriate.

Nevertheless, the 2011 IMF *Financial sector assessment plan* (FSAP) report[58] of the financial system of the Netherlands indicated that generally the Dutch Twin Peaks model worked well during the GFC. It was found that decisions were generally made timeously to contain the Dutch banking crisis during the GFC, because of information sharing between the DNB and the AFM and also between the DNB and the Ministry of Finance in the context of crisis management. The IMF FSAP report of 2011 referred to the Covenant concluded in 2007 between the Ministry of Finance and the DNB and pointed out that in terms of this Covenant the DNB acted as crisis manager and could take measures it deemed necessary if the urgency of the situation required it.[59] It further indicated that the DNB and the AFM collaborated well in practice (apart from instances like the DSB failure) and especially during the GFC, which was largely attributable to the 2007 Covenant.[60] However, the report highlighted the need for even closer co-operation between the DNB and the AFM, indicating that although 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 opinion.[61]

2 4 Dutch Twin Peaks model after the GFC

The Netherlands heeded the lessons from the 2008 GFC. The IMF indicated that by the time it brought out its report in 2011, the Netherlands had taken various measures to further improve financial regulation and supervision, including the following:[62]

55 *Ibid.*

56 Kremers and Schoenmaker December 2010 7; Busch *et al* (2010) 40.

57 Van den Niewenhuijzen *Financial law in the Netherlands* (2010) 24.

58 IMF *Country report 11/208.*

59 *Idem* 9.

60 *Idem* 8.

61 *Idem* 12. See also Kremers and Schoenmaker December 2010 7.

62 IMF *Country report 11/208* 13. See also Dutch initiatives such as DNB *Supervisory strategy 2010–2014* (April 2010) available at dnb.nl/en/binaries/DNB%20Supervisory%20-Strategy%202010-2014_tcm47_238092.pdf (accessed on 5-10-2020) and De Nederlandsche Bank *From analysis to action* (21 September 2010) available at dnb.nl/en/binaries/-From%20Analysis%20to%20Action_tcm47-239499.pdf (accessed on 05-10-2020).

(a) It created an enforcement department in the DNB for corrective actions and sanctions, thereby reducing reliance on moral persuasion to ensure compliance.

(b) The "From analysis to action" (VITA) project was introduced to encourage supervisors to make use of their formal powers more regularly and to bring supervisory tools in line with supervisory best practice and to ensure their consistent application.

(c) The department for macro-prudential supervision in the DNB was expanded to further improve the monitoring of macro-prudential risks.

(d) Expertise was enhanced in areas relating to investment and innovative financial products and specific knowledge was improved in the fields of risk, fair value reporting, governance, and strategy.

(e) Risk analysis was strengthened and the risk analysis tool, Financial Institutions Risk Analysis Method (FIRM),[63] was improved to provide more scope for linking macro-prudential risks with the assessment of individual institutions.

(f) Co-operation and knowledge sharing between different departments in the DNB were promoted, by setting up knowledge networks.

(g) Group supervision for banks and insurance companies with large cross-border operations were intensified through establishing closer ties with host country supervisors. A daily communication tool was set up to enable fast and safe sharing of supervisory information between supervisors.

(h) The Netherlands also supported the move towards a consistent European Union-wide supervisory network, as discussed below.

(i) The quality of financial supervision in the Netherlands was further strengthened through peer reviews and random auditing.

As to future reforms in the context of the Dutch Twin Peaks model, the IMF, among others, suggested that macro-prudential supervision be strengthened by *introducing financial stability as an explicit mandate for DNB* and by expanding the macro-prudential regulatory toolbox accordingly to enable the DNB to take swift action against any emerging systemic risks without first having to resort to legislative changes.[64] The IMF report concluded on a positive note that, although the GFC impacted the Dutch financial sector to a great extent and although a high percentage of the Gross Domestic Product had to be applied to support distressed financial institutions, the Twin Peaks model was still regarded as the best regulatory approach for the Netherlands.[65]

Pursuant to the IMF FSAP, the Financial Stability Committee (FSC) was established in November 2012, comprising of the DNB, the AFM and the Ministry of Finance. Its purpose 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-prudential tools to deal with systemic risks.[66] Another regulatory reform occurred

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63 See the FIRM manual available at http://www.toezicht.dnb.nl/en/binaries/51-212099.pdf (accessed 27-09-2020).

64 Author's emphasis. The IMF welcomed the steps taken by the DNB toward a more proactive and decisive approach including timely on-site inspections and corrective actions that rely less on moral persuasion.

65 IMF *Country report 11/208* 4.

66 DNB *Annual report* (2014) available at dnb.nl/en/binaries/jv2014%20uk_tcm47-319635.pdf at 100 (accessed on 5-10-2020).

on 13 June 2012, through the introduction of the *Interventiewet*,[67] that authorised the DNB or the Minister of Finance to intervene in the failure of a bank or an insurance company that operates in the Netherlands to ensure its orderly resolution.[68]

In line with the suggestions by the IMF, article 4 of the *Bankwet* 1998[69] was amended as of 1 January 2014, to provide 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*;[70] and to gather statistical data and compile statistics in accordance with dedicated legislation. Thus, the 2014 amendment of the *Bankwet* eventually introduced an express financial stability mandate for the DNB, aligning the mandate of the bank with the regulatory paradigm post-GFC and providing a sound basis for a more invasive approach to macro-prudential supervision by the central bank.

Finally, note should be taken of certain developments that took place in the broader European Union context during and after the GFC, which impacted on the role of especially the DNB in the Dutch Twin Peaks model. In response to the 2008 GFC, the European Union developed a new overarching supervision model, the European System of Financial Supervisors (ESFS), which was implemented on 1 January 2011. This model introduced four new supervisory bodies on European Union level. These are the European Systemic Risk Board (ESRB), which is tasked with macroprudential supervision,[71] and three other supervisory bodies, namely the European Supervisory Authorities (ESAS), which are tasked to oversee microprudential supervision of individual institutions. This microprudential supervision, which includes conduct supervision on the European level, is divided sectorally; supervision on the banking sector is overseen by the European Banking Authority (EBA), supervision on the pensions and insurance sector is overseen by the European Insurance and Occupational Pensions Authority (EIOPA) and supervision on the securities market and securities services is overseen by the European Securities and Markets Association (ESMA).[72]

The ESRB has the power to issue warnings on risks and recommendations on steps to mitigate or manage the effects of those risks.[73] In 2014, a set of

67 *Wet bijzondere maatregelen financiële ondernemingen* (*Interventiewet*) STB 2012. The Intervention Act came into force retroactively as of 20 January 2012.

68 Hermans, Schlingmann and Vriesendorp "Netherlands: Dutch Intervention Act in force" 2012 available at http://www.mondaq.com/x/183050/Insolvency+Bankruptcy/ Financial+Markets+Newsletter+Dutch+Intervention+Act+In+Force; (accessed on 27-09-2020).

69 Busch *et al* (2010) 6See s 4 of the *Bankwet* as amended by article II of *Wijzigingswet financiële markten* 2014.

70 Author's emphasis.

71 The ESRB is responsible for the detection and prevention of system risks in the European financial system. See the reports of the Advisory Scientific Committee *The consequences of the single supervisory mechanisms for Europe's macro-prudential policy framework* (September 2013) available at https://www.esrb.europa.eu>pub>pdf>asc>Reports ASC 3 1309 (accessed 27-09-2020).

72 Joosen *Roos & Van der Heijden Instituut & Vereniging voor Financieel Recht*: *Vijf Jaar Wet op het Financiaal Toezicht: Preadvies Vereeniging voor Financieel Recht* (2013) 36. Joosen significantly stated as follows at 39:
"After an evaluation of the functioning of the ESA's by the European Commission on 2 January 2014, it was clear that the European Commission was not making any plans to change from the current sectoral model to the functional supervising model."

73 For more information on the ESRB, see their website available at https://www.esrb.europa.eu (accessed 25-09-2020). See also Ehrmann and Schure "The European Systemic Risk Board – Governance and early experience" 2019 *Journal of Financial Policy Reform* 12.

macroprudential instruments became available to regulatory authorities across the European Union through the implementation of the Fourth Capital Requirements Directive (CRD IV) and accompanying Regulation (CRR).[74] Further, the ESRB set out *guiding principles for core elements of national macroprudential mandates*,[75] which seek to balance the need for consistency in national approaches across the European Union with flexibility to accommodate national specificities. The recommendation indicated that Member States should set out clearly that the objective of macroprudential policy was to safeguard systemic stability and to ensure a sustainable contribution of the financial sector to economic growth. Member States were asked to designate, in national legislation, an authority with responsibility for the conduct of macroprudential policy, with the central bank playing a leading role.

Other notable developments in the context of prudential regulation were the Single Supervisory Mechanism (SSM), which came into operation in November 2013, and the *Single rulebook*,[76] regarding material prudential supervision of banks. As a result of the SSM, significant Dutch banks are no longer primarily supervised by the DNB, but by the ECB.[77] A bank is classified as a significant bank if the total value of the assets of the bank is more than €30 billion.[78] Although the ongoing supervision of less significant banks is still done by the DNB, the ECB is empowered to include some less significant banks under its supervision, if it perceives that such (less significant) bank may pose a threat to financial stability. Thus, the establishment of the ESCB has impacted significantly on the role of the DNB as systemic and prudential supervisor in the Dutch Twin Peaks model, with the effect that the DNB operates domestically on a functional Twin Peaks level, whereas its participation in the ESCB occurs within a sectoral milieu.

3 TWIN PEAKS IN SOUTH AFRICA: THE FINANCIAL SECTOR REGULATION ACT

3 1 Background

South Africa has been fortunate to have largely weathered the GFC, mainly because of its well-regulated financial sector, conservative risk management practices at banks, limited exposure to foreign assets, subsidiary structure and listing requirements for registered banks, robust monetary policy framework,

74 Financial Stability Board *Peer review of the Netherlands* (11 November 2014) available at https://www.fsb.org?2014/11/peer-review-of-the-netherlands/ (accessed 27-09-2020) 11.

75 ESRB *Recommendation of the European Systemic Risk Board on the macro-prudential mandate of national authorities ESRB/2011/3* (22 December 2011) available at http://www.esrb.europa.eu/pub/pdf/ESRB_Recommendation_on_National_Macroprudential Mandates.pdf?87d545ebc9fe76b76b6c545b6bad218c (accessed on 27-09-2020).

76 Bierman *et al* (2015) 31. The European Commission strived therewith not to have any differences in implementation in the different Member States. They tried to reach that with the *Single rulebook*, wherein all technical capital rules for the Member States are laid down. In the CRR, the more technical, prudential rules from Basel 3 are laid down.

77 Bierman *et al* (2015) 18.

78 In the Netherlands, the following groups were classified as significant banks: ABN AMRO Group N.V.; ING Bank N.V.; Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.; SNS Reaal N.V.; N.V. Bank Nederlandse Gemeenten; Nederlandse Waterschapsbank N.V. and RFS Holdings N.V.

countercyclical[79] monetary policy, proactive approach to dealing with bank credit risks and focus on reducing household vulnerability.[80] As indicated, South Africa as G-20 member was not complacent, but aligned itself with the international reform agenda post-GFC and undertook a wholesale overhaul of the existing regime of fragmented silo regulation of the financial system which it, among others, described as a concentrated market, lacking sufficient competition and financial inclusion. The regulatory shift was further motivated by a need to protect financial consumers as well as to combat financial crime.[81]

In 2011, National Treasury released a comprehensive policy document titled *A safer financial sector to serve South Africa better* (the "Redbook"), which marked the commencement of the move towards a Twin Peaks model.[82] This was followed by another policy document titled *Implementing a Twin Peaks system of financial regulation in South Africa* (the "Roadmap"),[83] setting out the way forward in transitioning to a Twin Peaks model. After extensive consultation, resulting in a number of draft bills, the Financial Sector Regulation Act[84] was signed into law in August 2017 as framework law implementing the first phase of the South African Twin Peaks model.[85] The object of the Act, as stated in section 7, is to achieve a stable financial system that works in the interests of financial customers and that supports balanced and sustainable economic growth in South Africa. It seeks to do so by establishing, in conjunction with the specific financial sector laws, a regulatory and supervisory framework that promotes financial stability, the safety and soundness of financial institutions, fair treatment and protection of financial customers, the efficiency and integrity of the financial system, the prevention of financial crime, financial inclusion, transformation of the financial sector, and confidence in the financial system.

The main features of the Twin Peaks model, as introduced by the FSRA, are the following: The South African Reserve Bank (SARB), as central bank, is given a pronounced and comprehensive financial stability mandate with a systemwide macroprudential focus; a new supervisory body, the Prudential Authority (PA) was established and is responsible for systemwide prudential supervision of financial institutions (including banks). The other new "twin" regulator, the Financial Sector Conduct Authority (FSCA), was established to oversee market conduct of financial institutions on a systemwide basis.[86]

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79 A countercyclical monetary policy is aimed at reducing spending during a boom period and increasing spending during a recession; see IMF *Monetary policy: Stabilizing prices and output* (February 2020) available at imf.org/external/pubs/ft/fandd/basics/monpol.htm (accessed on 5-10-2020).

80 Treasury *Safer financial sector* (2011) 14.

81 *Ibid.*

82 *Ibid.*

83 *Ibid.*

84 9 of 2017 (hereafter the "FSRA").

85 S 8 FSRA. Further amendments to sector specific laws over time will ensure that the Twin Peaks model is reflected in all necessary legislation.

86 See also Godwin and Schmulow "The Financial Sector Regulation Bill in South Africa, second draft: Lessons from Australia" 2015 *SALJ* 756; Schmulow "Financial regulatory governance in South Africa: The move towards Twin Peaks" 2017 *African Journal of International and Comparative Law* 393.

Thus, in effect, the South African Twin Peaks model comprises of three peaks. Other financial regulators, such as the National Credit Regulator[87] and the Financial Intelligence Centre,[88] operate within the Twin Peaks model, but outside of the peaks established by the model. As with any regulatory model comprising of various regulators, the effectiveness of the South African Twin Peaks model critically hinges on the statutorily mandated co-operation of the various financial sector regulators and other organs of state that directly or indirectly participate in the financial system, as discussed in more detail below.

3 2 Role of the South African Reserve Bank regarding financial stability

In line with the core regulatory paradigm that emerged post-GFC, the main priority of the FSRA is the maintenance of financial stability[89] and the prevention of systemic events[90] that may erode such stability. Pre-Twin Peaks, SARB had traditional central banking roles, comprising of responsibility for monetary policy; oversight of the payments, clearing and settlement system; bank supervision; LOLR; and being *de facto* responsible for the maintenance of financial stability.[91] However, in the Twin Peaks model, bank supervision is removed from SARB's regulatory remit and is now undertaken as part of the systemwide prudential supervision mandate of the newly established PA. In contrast with the position pre-Twin Peaks, SARB now has an express legislative

87 Established in terms of s 12 of the National Credit Act 34 of 2005 to oversee the regulation of the South African credit market.

88 Established in terms of s 2 of the Financial Intelligence Centre Act 38 of 2001 to combat money laundering activities and the financing of terrorist and related activities.

89 Financial stability is defined in s 4 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."

90 A systemic event is defined in s 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 systems or financial markets, or financial institutions, are able to continue to provide financial products or financial services, or services provided by a market infrastructure."

91 In terms of s 3 of the South African Reserve Bank Act 90 of 1989 (hereafter "SARB Act"), the primary objective of 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 s 223 of the Constitution of the Republic of South Africa, 1996. See further s 10 of the SARB Act regarding SARB's other functions. See further Van Niekerk (LLD thesis UP 2018) Ch 2. SARB's price stability mandate and its financial stability mandate are now on par in the Twin Peaks model.

mandate for protecting and enhancing financial stability; and, if a systemic event has occurred or is imminent, for restoring or maintaining financial stability.[92]

The promotion and maintenance of financial stability by its nature entail taking proactive steps and having mechanisms in place to deal with risks or threats to financial stability and to manage the effects of systemic events. Accordingly, the FSRA sets out the main functions of SARB for purposes of executing its financial stability mandate. These functions are of an *ex ante* as well as an *ex post* nature and entail that SARB 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.[93] SARB must also take steps to mitigate risks by, among others, advising the financial sector regulators, and any other organ of state, as to steps to take to mitigate risks.[94] SARB must further assess the observance of principles in the Republic developed by international standard setting bodies for market infrastructures and has to report its findings to the financial sector regulators and to the Minister of Finance.[95]

SARB must issue a financial stability review every six months, which is especially valuable as a tool through which it communicates its assessment about financial stability to the public and which contributes to public confidence in the financial system. In the review, SARB must set out its assessment of financial stability in the period under review; its identification and assessment of risks to financial stability for at least the next 12 months; an overview of steps taken by it and by 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 over the next 12 months; and an overview of recommendations made by SARB and the Financial Stability Oversight Committee (FSOC) during the period under review together with progress made in implementing those recommendations.[96] The financial stability review must be tabled in Parliament, which ensures the accountability of SARB to appropriately execute its mandate in this respect.

Given that systemic events are the greatest threat to financial stability, the FSRA requires SARB to firstly prevent systemic events. SARB further has the power to declare an event as systemic and to exercise certain emergency powers to deal with such systemic event. It is obliged to mitigate swiftly the adverse effects of a systemic event on financial stability and to manage the systemic event and its effects.[97] In line with the post-GFC move from a regulatory culture

92 S 11(1)(a) and (b) of the FSRA. In executing its financial stability mandate, 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 FSRA or any other 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.

93 S 12(a)(i) and (ii) FSRA. It must also monitor and keep under review any other risks raised by members of the FSOC (as discussed below) or reported to SARB by a financial sector regulator.

94 S 12(b) FSRA.

95 S 12(c) FSRA.

96 S 1(2)(a) to (d) FSRA.

97 S 15(1) FSRA.

of "bail-out" to "bail-in",[98] specific constraints apply to the exercise of SARB's power in relation to systemic events. This, among others, requires SARB to 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 in this regard.[99] Also, it may not, without the approval of the Minister of Finance, take a step that would likely bind the National Revenue Fund to any expenditure; have a material impact on the cost of borrowing for the Fund; or create a future financial commitment or contingent liability for the Fund.[100]

SARB is supported in the execution of its financial stability mandate by provisions aimed at co-operation and collaboration by all financial sector regulators. In this regard, SARB may issue directives to the financial regulators requiring information and/or assistance.[101] Organs of state are also bound to co-operate and an organ of state exercising powers in respect of a part of the financial system may *not*, without the approval of the Minister of Finance acting in consultation with the Cabinet 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 of SARB or by SARB to manage a systemic event or its effects.[102] The FSOC is the apex committee that supports SARB in relation to its financial stability functions and acts as co-ordinating forum between the financial regulators and SARB.[103] In turn, the FSOC is supported by the Financial Sector Contingency Forum (FSCF), which assists the FSOC in identifying systemic events and in co-ordinating plans to mitigate those risks.[104]

In line with the post-GFC reforms aimed at regulating "Too Big to Fail" financial institutions more intrusively, the Governor of SARB is given the power to designate SIFIs and to direct the PA to apply heightened prudential regulation and supervision to such institutions, among others, to enhance their loss absorbing capacity and resilience in times of stress.[105]

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98 A bail-in involves rescuing a financial institution on the brink of failure, by making its creditors and depositors take a loss on their holdings. A bail-in is the opposite of a bail-out, which involves the rescue of a financial institution by external parties, for instance governments using taxpayers' money; see National Treasury *Strengthening South Africa's resolution framework for financial institutions* available at http://pmg-assets.s3-website-eu-west-1.amazonaws.com/150813Resolution_Framework_Policy.pdf (accessed 30-09-2020).

99 S 15(2)(b) and (c) FSRA.

100 S 16(2) FSRA.

101 S 17 FSRA. See further s 26, which sets out the collaboration and co-operation obligations of the financial sector regulators in detail.

102 S 19 FSRA. See further s 28, which requires organs of state, in performing their functions, to have regard to the implication of their activities for financial stability and to provide information and assistance to SARB and the FSOC.

103 Ss 20–24 FSRA. For the composition of this committee see s 22 FSRA.

104 S 25 FSRA. For the composition of this committee see s 25(3) FSRA.

105 For purposes of promoting and maintaining financial stability, SARB may further mitigate risks that systemic events occur, by directing (s 30) the PA to issue prudential standards or directives to a SIFI in relation to any of the following matters: solvency measures and capital requirements; leverage ratios; liquidity; organisational structures; risk management 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.

3 3 Prudential Authority

The PA is a separate juristic person operating within the administration of SARB and is located in the same building as SARB.[106] The decision to house the PA under the same roof as SARB appears to have been driven by synergies and costs saving.[107] The PA regulates and supervises prudential compliance by financial institutions that provide financial products and securities services. It also regulates and supervises market infrastructures. Thus, it has a much broader prudential mandate than only bank supervision.[108] Its objective is to promote and enhance the safety and soundness of financial institutions that provide financial products and securities services; to promote and enhance the safety and soundness of market infrastructures; to protect financial customers against the risk that financial institutions may fail to meet their obligations; and to assist in maintaining financial stability.[109]

The PA must further co-operate with and assist the SARB, the FSOC, the FSCA, the National Credit Regulator and the Financial Intelligence Centre and co-operate with the Council for Medical Schemes and the Competition Commission.[110] 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 research relevant to its objective.[111]

A prudential committee, consisting of the Governor and Deputy Governors of SARB with one of the Deputy Governors as the CEO of the PA, is responsible for the management and administration of the PA.[112] The PA's extensive regulatory toolkit comprises of the following: Licensing of financial institutions;[113] issuing prudential standards and standards that assist in maintaining financial stability;[114] issuing directives requiring certain actions to be taken, among others, to reduce risk and to cease the contravention of financial sector laws;[115] issuing guidance notices[116] and interpretation rulings;[117] entering into enforceable undertakings;[118] making debarment orders[119] and imposing administrative fines. It also has wide investigative powers.[120]

3 4 Financial Sector Conduct Authority

The FSCA is a separate juristic person located completely outside of SARB. It is managed by an executive committee, comprising of a commissioner and deputy

106 S 32 FSRA.
107 Godwin and Schmulow (2015) 760.
108 S 34(1)(a) FSRA.
109 S 33 FSRA.
110 S 34(1)(b)–(d) FSRA.
111 S 34(e)–(g) FSRA.
112 Ss 36 and 41 FSRA. The CEO may be any other Deputy Governor than the Deputy Governor responsible for financial stability.
113 S 113 FSRA read with Sch 2 FSRA.
114 S 105 FSRA.
115 S 143(2) and (3) FSRA. However, the PA may not, without concurrence by SARB, issue a directive to a financial institution on the basis that it is causing or contributing or is likely to cause or contribute to instability in the financial system.
116 S 141 FSRA.
117 S 142 FSRA.
118 S 151 FSRA.
119 S 53 FSRA.
120 Ss 129–140 FSRA.

commissioners,[121] and is funded by levies paid by regulated financial institutions.[122] The FSCA is tasked with the market conduct regulation of all financial institutions, including banks (for which there previously were no dedicated market conduct regulator). Its objective is to enhance and support the efficiency and integrity of financial markets; protect financial customers by promoting their fair treatment by financial institutions, by providing financial education programs and by 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.[123]

As part of its functions, the FSCA must co-operate with and assist SARB, the FSOC, the PA, the National Credit Regulator, the Financial Intelligence Centre, the Council for Medical Schemes and the Competition Commission.[124] Further, it must promote financial inclusion; regularly review the perimeter and scope of financial sector regulation; 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.[125]

The FSCA's regulatory toolkit is similar to that of the PA and comprises of licensing of financial institutions;[126] issuing conduct standards;[127] issuing directives;[128] issuing guidance notices and interpretation rulings;[129] making debarment orders; entering into enforceable undertakings and imposing administrative fines.[130] Similar to the PA's powers, the FSCA also has wide investigative powers.[131]

3 5 Co-operation and collaboration in the South African model

Co-operation and collaboration in the South African model are facilitated on two levels:[132] narrowly, to of promote and maintain financial stability, as facilitated by the FSOC and the FSCF, and more broadly, for the effective functioning of the Twin Peaks model. On a broader level, co-operation and collaboration are facilitated by the Financial System Council of Regulators.[133] In addition, the Financial Sector Inter-Ministerial Council facilitates co-operation and collaboration between the various cabinet members responsible for legislation relevant

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121 Ss 60 and 61 FSRA.

122 S 56(2) FSRA.

123 S 57 FSRA.

124 S 58(1)(b)–(d) FSRA.

125 S 58(1)(e)–(j) FSRA. However, the FSCA may not regulate and supervise the conduct of financial institutions in relation with the provision of credit under a credit agreement regulated in terms of the National Credit Act, except in relation with matters listed in s 108 and regarding the provision of financial services relating to credit agreement; see s 58(2) FSRA.

126 S 113 read with Sch 2 FSRA.

127 S 106 FSRA. See further s 108 regarding additional matters for issuing standards.

128 S 144 FSRA.

129 Ss 141 and 142 FSRA.

130 Ss 151, 153 and 167 FSRA respectively.

131 Ss 143–140 FSRA.

132 For a detailed discussion, see Van Niekerk and Van Heerden "The importance of a legislative framework for co-operation and collaboration in the Twin Peaks model of financial regulation" 2020 *South African Law Journal* 108.

133 S 79 FSRA. See s 79(3) for the composition of this committee.

to the regulation and supervision of the financial sector.[134] The practical implementation of such co-operation and collaboration is set out in memoranda of understanding and SARB, the PA and the FSCA as well as the FSCA and the PA have entered into such memoranda in 2018.[135] The FSRA further requires independent evaluations of the effectiveness of co-operation and collaboration between the regulators.[136]

4 PERTINENT LESSONS FROM THE DUTCH TWIN PEAKS MODEL

As is clear from the overview above, that the institutional structure of the Dutch and the South African Twin Peaks models differ. The Dutch model has two peaks: DNB, with its micro-and macro-prudential mandate, and AFM, with its conduct of business mandate. The South African model has three peaks: SARB, as the apex peak with its macro-prudential financial stability mandate, supported by the PA, as separate juristic person with a micro-prudential mandate, and the FSCA, as market conduct supervisor. However, the implementation of Twin Peaks models of financial regulation by objective in both countries means that each regulator is given a clear regulatory remit and their regulatory jurisdiction and objectives are clearly delineated; thus minimising the likelihood of "turf wars", like the ones that compromised financial regulation in the Netherlands prior to its move to a Twin Peaks model.

South Africa can indeed regard itself as fortunate in that it had the example of the Netherlands to turn to on its regulatory journey to replace its outdated silo regulatory approach with a Twin Peaks model. The Dutch Twin Peaks model has withstood rough tides occasioned by the fact that it was implemented in the Netherlands shortly before the GFC and did not, at that stage, have the benefit of being tried and tested before the wide-scale turmoil caused by the CFC hit the financial markets. However, sometimes being thrown in at the deep end has its advantages and this also appeared to be the case with the Dutch experience.

By having to navigate the Dutch Twin Peaks system through the GFC, the Netherlands learnt valuable lessons that it can pass on to other jurisdictions who are adopting a Twin Peaks approach to financial regulation. First and foremost, the Dutch experience yields the lesson that, to promote and maintain financial stability it is essential to have a systemwide macro-prudential approach to financial regulation. In this context, the explicit financial stability mandate eventually assigned to the DNB in the Bankwet, the augmentation of the DNB's macro-prudential supervisory radar and enforcement powers, the establishment of the Financial Stability Committee and the expansion of its regulatory toolkit serve

134 Ss 83 and 84 FSRA. See s 83(3) for the composition of this committee.

135 Ss 26 and 77 FSRA. See further SARB/PA *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 15-03-2019); SARB/FSCA *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 15-03-2019); and PA/FSCA *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 15-03-2019).

136 S 86(1)(b) FSRA mandates such evaluations to be undertaken every two years.

the objectives of promoting and maintaining financial stability well. The DNB, as macro- and micro-prudential supervisor, is clearly in a prime position to survey the financial sector for weaknesses and, armed with its augmented regulatory toolkit, it can be expected that it will take a more strict and pro-active approach to enforcement and that such swift regulatory action will prevent or at least contain and mitigate crises that may arise, especially those of a systemic nature. Given that both systemic stability and prudential supervision are within the remit of the DNB as central bank, the DNB is in a position where it can immediately detect prudential problems in financial institutions that may compromise financial stability and where it can act swiftly to contain risks without having to face the information-sharing constraints that would have been occasioned had the prudential authority been located in a separate institution. Thus, South Africa appears to have made a good decision to keep the prudential regulator close to the central bank as systemic regulator. The DNB experience during the GFC also yields the lesson that SARB as well as the PA and the FSCA should make proper use of their regulatory enforcement powers to ensure appropriate execution of their mandates, as was realised by the DNB after having experienced failings occasioned by its initial lack of an appetite for robust regulatory intervention at the beginning of the GFC.

The Dutch have further appreciated the principle that macro-prudential supervision cannot be undertaken in isolation and that such supervision will not be efficient unless supported by appropriate micro-prudential and market conduct supervision. Consequently, efficient and effective information sharing has been a critical component of the Dutch model and effort has been put into refining the mechanisms for such co-operation and collaboration by means of covenants between the regulators, which are flexible and which can be easily changed to meet new challenges. Thus, the Dutch experience has shown that collaboration between the prudential and market conduct regulators and the alignment of the manner in which they approach their supervisory functions, to minimise the perception of regulatory arbitrage, should be high on the regulatory agenda. Clearly, the covenant entered into by the Dutch regulators to iron out their working relationship was a step in the right direction, which bodes well for the various provisions in the FSRA that address co-operation and collaboration between the South African regulators and the memoranda of understanding concluded to give effect thereto.

The fact that one of the drivers for the move towards a Twin Peaks model in the Netherlands was the inability of the previous sectoral model to appropriately cater for the supervision of financial conglomerates is also significant. Holding these conglomerates to higher prudential standards and to higher market conduct standards in a model of regulation that monitors them individually and on a systemwide basis in relation to both prudential soundness and to how they conduct themselves in the market can minimise the risk associated with large complex financial institutions and decrease the opportunity for destabilising the financial system. In this regard, the designation of SIFIs by SARB and their tightened prudential regulation by the PA will extensively contribute towards minimising structural build-up of risk in the South African financial system and will thus also assist in maintaining financial stability.

Some may question the rationale for the separation of systemic and prudential supervision in the South African model. However, it is submitted that in view thereof that the PA, despite being a separate juristic person, will be located

within SARB, having a SARB Deputy Governor as its CEO, and that the Prudential Committee will consist of SARB governors, one can expect SARB to have very much the same ability as the DNB to survey the whole financial system for risk, especially given the FSRA's provision for co-operation and collaboration between SARB and the PA. However, the advantage will be that SARB's regulatory energy will not be depleted by the attention that needs to go into the constant prudential supervision of financial institutions, because this burden is being shouldered by the PA, thus affording SARB the time to maintain its regulatory focus. However, that being said, care should be taken that the PA's operational independence is respected so that appropriate prudential regulation and supervision are not compromised for the sake of financial stability by avoiding at all costs the failure of financial institutions that should actually be allowed to fail and to exit the financial system.

South Africa should also take a lesson in relation to aspects that may weaken the Twin Peaks model. In this regard it is submitted that, although the Netherlands have covenants in place to facilitate co-operation and collaboration between the supervisors, the fact that they have done away with the Council of Financial Regulators appears to be a questionable move. Most likely, the covenants between the regulators and the subsequent establishment of the Financial Stability Committee adequately plug this gap. Although one must always be mindful not to overburden a regulatory model with too many committees that have overlapping functions, it is submitted that, in principle, the structure of the South African Twin Peaks model, where four different committees, each with its dedicated but symbiotic set of functions, enable information sharing and co-operation, appears to be a well-devised network to facilitate effective co-operation and collaboration, which is the bedrock of a Twin Peaks model of financial regulation.

5 CONCLUSION

Any country seeking to transition to a Twin Peaks model would benefit from considering how this model was implemented in countries with comparable financial systems. As indicated in this contribution, South Africa can take some poignant lessons from the Netherlands on how to optimise its new regulatory model and on which pitfalls to avoid. However, the greatest lesson yielded by the experience with Twin Peaks in the Netherlands is that the Twin Peaks model of financial regulation is a dynamic, optimal regulatory model that gives appropriate priority to the pursuit of financial stability, recognising that it hinges on extensive support from prudential and market conduct regulation as the pillars that enable the attainment of this critical regulatory pursuit.