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**THE SOUTH AFRICAN TWIN PEAKS MODEL AS MECHANISM TO PROMOTE AND
MAINTAIN FINANCIAL STABILITY**

BY

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DECLARATION OF ORIGINALITY

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Declaration:

1. I declare that this mini dissertation is my own original work. Where other people's work has been used (either from a printed source, Internet, or any other source), this has been properly acknowledged and referenced in accordance with departmental requirements.

Signature of student:

A handwritten signature in black ink, appearing to be 'David Fourie', written in a cursive style.

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SUMMARY

It is an undeniable fact that the 2008 Global Financial Crisis (GFC) shocked the financial world, as the world slumped into one of the worst recessions and everybody was affected by this crisis. The Crisis led to deep reflection regarding the appropriate approach to financial regulation among economists and financial experts who failed to foresee the Crisis and regulators who did not heed the warning signs. The Crisis resulted in the world to this day still being in pursuit of financial stability in order to anticipate and prevent another similar financial crisis.

Prior to the GFC, regulation was based on sound monetary policy and micro-prudential supervision which was considered as sufficient in maintaining financial stability. This was, however, proven to be inadequate during the GFC which showed that promoting and maintaining financial stability requires a holistic macroprudential approach supported by sound microprudential regulation and supervision as well as conduct of business regulation and supervision, and also clear governance structures and principles. The GFC emphasized the importance of implementing various mechanisms in order to promote and maintain financial stability. South Africa was not as severely impacted by the GFC as some other countries, at least not to the extent of financial collapse. Nevertheless, it did suffer some serious implications such as nearly one million job losses. The GFC also caused South Africa, as a member of the G20, to commit to align its approach to financial regulation with various international reforms. Prior to the GFC the South African financial system was characterized by a silo and fragmented approach to financial regulation. The South African Government, however, realized that this approach posed many gaps and in 2017 replaced it with a Twin Peaks model of financial regulation. The Twin Peaks model was introduced by the Financial Sector Regulation Act 9 of 2017.

This dissertation focuses on the reasons why it was necessary to implement the Twin Peaks model in South Africa by looking into the causes of the GFC, and interrogating the role of the Twin Peaks model as a mechanism to promote and maintain financial stability. In particular it considers the Twin Peaks model and whether the institutional framework it creates is likely to contribute to the promotion and maintenance of financial stability in the country.

TABLE OF CONTENTS

DECLARATION OF ORIGINALITY	1
ACKNOWLEDGEMENTS	2
SUMMARY	3
CHAPTER 1: BACKGROUND	5
1.1 THE GLOBAL FINANCIAL CRISIS	5
1.1.1 LESSONS FROM THE GLOBAL FINANCIAL CRISIS	6
1.1.2 FINANCIAL STABILITY AS CORE OBJECTIVE	8
1.2 THE FOUR APPROACHES TO SUPERVISION	12
1.2.1 THE INSTITUTIONAL APPROACH	12
1.2.2 THE FUNCTIONAL APPROACH	13
1.2.3 THE INTEGRATED APPROACH	13
1.2.4 THE TWIN PEAKS MODEL	14
1.2.5 THE TWIN PEAKS MODEL IN SOUTH AFRICA	15
1.3. NATURE AND SCOPE OF DISSERTATION	17
1.4 THE SELECTION OF AUSTRALIA AS A COMPARATIVE JURISDICTION	18
1.5 METHODOLOGY	18
1.6. CHAPTER LAYOUT	18
 CHAPTER 2: THE TWIN PEAKS MODEL IN SOUTH AFRICA	 19
2.1 INTRODUCTION	19
2.2 THE FINANCIAL SECTOR REGULATION ACT	20
2.3 SARB'S FINANCIAL STABILITY MANDATE	21
2.4 THE PA'S ROLE IN FINANCIAL STABILITY	25
2.5 THE FSCA'S ROLE IN FINANCIAL STABILITY	27
2.6 CO-OPERATION AND COLLABORATION	28
2.7 CONCLUSION	30
 CHAPTER 3: TWIN PEAKS MODEL IN AUSTRALIA	 32
3.1 INTRODUCTION	32
3.2 THE AUSTRALIAN TWIN PEAKS FRAMEWORK	34
3.2.1 THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY	34
3.2.2 THE AUSTRALIAN SECURITIES AND INVESTMENT COMMISSION	36
3.2.3 THE RESERVE BANK OF AUSTRALIA	38
3.2.4 CO-OPERATION AND COLLABORATION	40
3.3 CONCLUSION	43
 CHAPTER 4: SOUTH AFRICAN TWIN PEAKS MODEL AS MECHNISM TO PROMOTE AND MAINTAIN FINANCIAL STABILITY	 45
4.1 FINAL REMARKS REGATING THE TWIN PEAKS MODEL	45
4.2 SOUTH AFRICAN TWIN PEAKS MODEL DOES IT PROMOTE AND MAINTAIN FINANCIAL STABILITY	46
 BIBLIOGRAPHY	 49

CHAPTER ONE: BACKGROUND

1.1 THE GLOBAL FINANCIAL CRISIS

The Global Financial Crisis (GFC) began in 2007 as a deep shock to the financial world, and the Crisis subsequently prompted much soul-searching among economists and financial experts who failed to anticipate it, or whose warnings were not taken seriously by regulators and investors.¹

The crash of the real estate sub-prime mortgage bubble in the United States precipitated the 2008 GFC resulting in capital and asset market failures across the globe.² The main cause of the GFC was ultimately the collapse of the US sub-prime mortgage market, which was caused by granting loans to low income households at a low cost in order to enable everyone to become homeowners. The problem was, however, that de facto these persons who were granted subprime mortgages could not afford to repay them. In the US large numbers of these risky subprime mortgage loans were securitized and cast into collateralized debt obligations (CDOs). These CDOs were subsequently sold to various investors. Accordingly, financial institutions could off-load these risky mortgage loans onto others and get them off their books. Some US banks would even acquire mortgages with the mere aim to securitize them and later sell them off. Loans were written off from the balance sheets of banks in order for the banks to comply with their prudential obligations but the underlying debt, however, remained with the banks.³

At first the mortgage loans offered to low income household were attractive, and the monthly repayments were low and affordable. This, however, did not last long and between 2004 and 2006 the interest rate in the USA increased from 1% to 5%, meaning that subprime borrowers could no longer afford the repayment of the mortgage loans and

¹ Layna Mosley & David Andrew Singer “*The Global Financial Crisis: Lessons and Opportunities for International Political Economy*”, 2009 35:4, 420-429 available at <https://doi.org/10.1080/03050620903328993> (hereinafter referred to as Layna Mosley & David Andrew Singer).

² Hellwig “*Systemic Risk in the Financial Sector: An Analysis of the Subprime-Mortgage Financial Crisis*”, Max Planck Institute for Research on Collective Goods 37 2008.

³ Crotty “*Structural Causes of the Global Financial Crisis: a critical assessment of the ‘new financial architecture’*” 2009 Cambridge Journal of Economics 563.

this ultimately led to foreclosures.⁴ The interbank lending rates increased, and in response investors in banks withdrew equity and depositors withdrew cash from the banks. This caused the banks to run into solvency and liquidity problems. Many of the institutions that became distressed during the GFC were also so-called “Too-big-to-fail” otherwise known as Systemically Important Financial Institutions or SIFIs. Due to their systemic importance many of these SIFIs were bailed out by governments using taxpayers’ money.⁵ “Too-big-to-fail” is a major issue. When a bank takes big risks and it is successful in doing so it naturally gains profits in taking these risks. However if it fails then taxpayers will have to pay for those losses.⁶ As suggested by Andrew Lo, financial institutions that are considered “too-big-to-fail” should be broken up into smaller entities that are no longer “too-big-to-fail”.⁷

As pointed out by Van Heerden and Van Niekerk, the 2008 GFC was a global game changer that caused a shift in the regulatory paradigm geared at the pursuit of financial stability as apex objective. Although South Africa escaped the GFC relatively unscathed in comparison to other jurisdictions such as the US, it has nevertheless been recognized that many of the lessons learnt from the GFC are also equally applicable in the South African context and that a well-considered and comprehensive reform of its approach to financial regulation was imperative.⁸

1.1.1 Lessons from the Global Financial Crisis

According to the South African National Treasury a number of key lessons were learnt from the GFC of 2008, namely:

⁴ Ibid.

⁵ Ibid.

⁶ Stiglitz JE “*Lessons from the Global Financial Crisis of 2008*” 2010 Seoul Journal of Economic 23 (3), 321–339 324.

⁷ Lo. A W “*Regulatory reform in the wake of the financial crisis of 2007-2008*”, Journal of Financial Economic Policy, Vol 1, 4-43 available at <https://doi.org/10.1108/17576380910962376> 7.

⁸ Van Heerden and Van Niekerk “*Twin Peaks in South Africa: a new role for the Central Bank*” 2017 Law and Financial Markets Review v11 n4 154-162.

(a) The need for a holistic view of financial sector regulation: It became apparent that it was necessary for financial regulatory reform to focus on ensuring that authorities and regulators adopt a macroprudential approach (system-wide systemic stability) towards supervision as opposed to a purely “micro prudential” one (that focuses only on the safety and soundness of individual institutions).

(b) The failure of “light-touch” regulation of the financial sector at the global level: The idea that the financial sector can successfully regulate itself has lost credibility in the aftermath of the GFC. Thus, even if individual financial institutions are able to improve risk management practices, the lesson in this regard is that regulators must proactively monitor changes in systemic risk.

(c) The importance of regulating market conduct to support prudential regulation: The GFC has proven that it is poor policy to force banks to lend to consumers who cannot afford to repay their loans. The inappropriate subprime lending practices in the US and the resultant fall-out of the subprime mortgage crisis demonstrated the need to balance the socio-economic objectives of increased access to credit and homeownership with the imperative of financial stability. The lesson here was that the regulation of market conduct must eliminate lending malpractices in order to both protect consumers and reduce systemic risk.

(d) Global cooperation in preventing macroeconomic imbalances: The macroeconomic imbalances in savings and consumption that contributed to the GFC have shown no signs of disappearing and the sentiment that emerged post the Crisis was that the global community must act together to find a sustainable solution to this problem.

(e) The importance of swift regulatory action to prevent contagion: The GFC grew from a prudential crisis at a few institutions to a liquidity crisis across global markets in 2008 and 2009. By 2010, the Crisis had turned into a sovereign crisis in several fiscally weak European economies. It also spilled into political crises in countries which have suffered from extended unemployment. The key lesson in this regard was that regulatory action

needed be swiftly taken to prevent the spread of contagion. Consequently, a regulatory framework is needed that is better equipped to supervise a sophisticated financial sector and pays more attention to systemic risk.⁹

The South African government deemed it important to take heed of these lessons to prevent financial crises from rearing their ugly heads in the South African financial sector and economy. As a first comprehensive step towards better financial regulation a more appropriate regulatory model than the silo, fragmented model that prevailed in South Africa pre-GFC, needed to be found.¹⁰

1.1.2 Financial stability as core objective

Roles of central banks in maintaining and promoting financial stability magnified during and after the GFC, evidencing a need to critically rethink various aspects of financial regulation. In particular central banks were criticized for not having developed sufficient tools to prevent or to foresee the GFC.¹¹

Prior to August 2007 it appeared that Central Banks had almost perfected the conduct of monetary policy. It was accepted that the role of the Central Bank was that it was operationally independent and could vary the official short-term interest rate in order to achieve an inflation target. This target was mandated either in general terms or in specific numerical terms by the democratically elected government. Currently it has been realized that the achievement of price stability by this procedure does not guarantee financial stability.¹² Goodhart questions whether this procedure should be radically altered to which he answers in the negative. He states that it is rather necessary that a separate set of

⁹ National Treasury “A Safer Financial Sector to Serve South Africa Better” 2011
<http://www.treasury.gov.za>.

¹⁰ National Treasury 13.

¹¹ Van Heerden and Van Niekerk “*The Financial Stability Mandate of the South African Central Bank in the Post-crisis Landscape*” 2018 33 J.I.B.L.R., Issue 11.

¹² Goodhart “*The Past Mirror: Notes, Surveys, Debates – The changing role of central banks*” 2011 Financial History Review 145.

macro-prudential regulatory instruments be developed for the specific purpose of maintaining financial stability.¹³

The idea that sound monetary policy and sound micro-prudential supervision was sufficient in order to achieve and maintain financial stability thus proved to be insufficient as the GFC shocked the world into a recession. The lesson in this regard was that monetary policy by itself does not guarantee financial stability and the GFC further showed that the build-up of macro-economic risks (such as high household debt levels) may pass unnoticed by the micro-prudential regulators in instances where they only focus in silos on regulation and supervision of individual institutions.¹⁴

As observed by Schinasi, the problem that regulators face is, however, that financial stability is a very difficult concept to define. There is no widely accepted model or analytical framework for assessing financial stability.¹⁵ According to Schinasi, financial stability can be broken up into five principles, which are as follows:¹⁶ The first is that financial stability is a broad concept, encompassing the different aspects of finance, infrastructure, institutions and markets which both private and public persons are continuously participating in. Governments also play a part in the financial system and they are also dependent on the private sector; hence there is a strong interlinkage between various role players in any given market. They depend on one another and any instability could be caused by the actions of either the private or public sector, or both.¹⁷ The second principle is that financial stability does not only imply that finance adequately fulfills its role, but it should also imply that the systems of payment in the economy function smoothly. This entails that the central bank monies (fiat currency) must be able to fulfill its role universally as accepted means of payment. The third principle mentioned by Schinasi is that a financial system needs to have the ability to limit, contain, and deal with

¹³ Ibid.

¹⁴ Van Heerden and Van Niekerk "The Financial Stability Mandate of the South African Central Bank in the Post-crisis Landscape" 2018 33 J.I.B.L.R., Issue 11.

¹⁵ G Schinasi "Defining Financial Stability" October 2004 IMF Working Paper International Monetary Fund 3.

¹⁶ Ibid 6 - 7.

¹⁷ Ibid.

the emergence of any imbalances even before they become a threat to financial stability. The rationale in this regard is to ultimately prevent systemic risk and, in the event that a systemic risk does materialize to ensure that remedial options such as liquidity injections are available.¹⁸ Notably there is no clear consensus on a definition for systemic risk. According to De Bandt and Hartman it can be defined as risk of experiencing systemic events where institutions affected in the second round or later actually fail as a consequence of the initial shock, although they have been fundamentally solvent ex ante.¹⁹ Systemic risk arises when shocks spread beyond their direct economic impact, resulting in diffused distress and disruption of the real economy.²⁰ Another view of systemic risk starts from the point that the origin of financial instability does not lie so much in contagion but in the exposures to the evolution of systemic risk through time, which is intimately linked to the business cycle.²¹ As observed by Galati and Moessner this view of systemic risk is fundamentally endogenous; it reflects the mutual interaction between the financial system and the real economy that results in overextension in booms which sows the seeds of the subsequent downturn and financial strains.²²

The fourth principle identified by Schinasi is that financial stability should be couched in terms of the potential consequences for the economy. In this regard Schinasi insists that at times the closing of financial institutions and the sharp and turbulent corrections in the financial market may be the result of competitive forces and may be the economy's self-correcting and self-disciplining mechanisms. Schinasi states that this can be viewed as "welcoming" to a healthy financial stability perspective.²³ Finally, the fifth principle that Schinasi mentions entails that financial stability be seen as occurring along a continuum. What he means by this is that we cannot require that each financial system or institution perform at its peak continuously, it is sometimes important that a financial system

¹⁸ G Schinasi "Defining Financial Stability" October 2004 IMF Working Paper International Monetary Fund. He states "financial stability entails both preventive and remedial dimensions." 7.

¹⁹ De Bandt, O and Hartmann, P, "Systemic Risk: A Survey", ECB Working Paper No. 35 2000 10.

²⁰ Perotti E and J Suarez (2009b) "Liquidity insurance for systemic crises", Testimonial at the Select Committee on Economic Affairs for Banking Regulation and Supervision, House of Lords, February 24.

²¹ Borio, C "Towards a macroprudential framework for financial supervision and regulation?" 2003 BIS Working Paper No. 128 8.

²² Galati and Moessner "Macroprudential policy: a literature review" 2011 BIS working paper No 337 available at <https://www.bis.org> 14.

experiences poor results or shocks as this will only lead to a “more experienced” financial system. When a financial system experiences a shock of some sort the regulators of that system will have gained experience and can possibly create policies to prevent it in the future.²⁴ Schinasi states that this concept of a “continuum” is very relevant in finance because the financial system involves uncertainty; it is dynamic and is composed of many interlinked networks, markets and institutions. It can thus be said that financial stability is dependent on many parts of the system working well, and at some point the market will be stable but at another point in time that same market will be less stable and this will depend on the interaction between various aspects of the economic system. Financial stability, accordingly, “can be seen as being consistent with various combinations of conditions of its constituent parts, such as the soundness of financial institutions, financial market conditions, and effectiveness of the various components of the financial infrastructure”.²⁵

Borio names a few areas of action which will assist in strengthening the financial system which include: strengthening transparency; addressing liquidity risks; encouraging improvements in risk management systems; reflecting on how to promote more prudent compensation schemes; strengthening the macroprudential orientation of prudential frameworks; and refining monetary policy frameworks so to take better account of both the build-up and unwinding of financial imbalances which include effective liquidity management operations at time of stress.²⁶ Borio’s view is that working along these lines holds out the promise of helping to limit the incidence of serious episodes of financial distress in the future.²⁷

Ultimately, however, it remains a fact that financial stability cannot be defined and looked at in a linear way, and that it needs to be holistically viewed as a concept that is always evolving and adapting. As observed by Schinasi, the definition of financial stability as a

²⁴ Ibid 19.

²⁵ Schinasi “*Defining Financial Stability*” IMF Working Paper 7.

²⁶ Borio “*The Financial Turmoil of 2007–?: A Preliminary Assessment and Some Policy Considerations*”, 2008 BIS Working Papers No 251 21.

²⁷ Ibid 22.

concept will continue to develop as regulators and scholars gain more experience from past as well as future mistakes.²⁸

1.2 THE FOUR APPROACHES TO SUPERVISION

Llewellyn emphasizes the role of an optimal institutional approach in the context of financial regulation and posits that it is critical to the success of an efficient model of financial regulation.²⁹ Accordingly it is necessary to consider the main approaches to financial regulation in order to benchmark the Twin Peaks model that South Africa has recently adopted.

At the outset though, note should be taken of two important questions that feature in the debate about institutional structure. The first is whether the central bank should be the prudential supervisor of banks and whether there should be a single, integrated prudential agency for all institutions.³⁰ As stated by Llewellyn, there may be a case for the central bank to regulate and supervise banks. On the other hand, there may also be a case for having integrated or unified regulatory agencies. This causes a dilemma as it can be argued that central banks should regulate and supervise banks, but it may be hazardous for the central bank to regulate all aspects of the financial system and all types of financial institutions. A safety net can be extended to the full range of financial institutions, but a choice will have to be made between the optimal agency to supervise banks and the advantages of having an integrated agency for all institutions.³¹

1.2.1 The Institutional Approach

The first approach to financial regulation that will be briefly interrogated is the Institutional Approach which is a legal-entity-driven approach. In this model an institution's status will determine which regulator will be tasked with overseeing the activity of that institution

²⁸ Schinasi *"Defining Financial Stability" IMF Working Paper 7.*

²⁹ Llewellyn "Institutional Structure of Financial Regulation and Supervision: The Basic Issues" – paper presented at World Bank Conference on Aligning Supervisory structures with Country Needs 2006 7.

³⁰ Llewellyn "Institutional Structure of Financial Regulation and Supervision: The Basic Issues" – paper presented at World Bank Conference on Aligning Supervisory structures with Country Needs 2006 7.

³¹ Ibid 7.

from a safety and soundness perspective as well as from a business-conduct perspective. Therefore, this model contemplates that different legal entities may be permitted to operate in the same business activities but that they will be regulated by different regulators. This model has, however, become outdated in the modern financial system where the boundaries are blurred between the range of activities that a financial institution may engage in.³²

1.2.2 The Functional Approach

The second model entails the functional approach, where supervisory oversight is determined by the business that is being conducted by the institution and does not have regard to the legal status of that institution. The separate institutions will thus each have its own regulator. The challenge, however, is that the specific institution's activities must fall into categories that are clear enough for the regulator to oversee.³³ The result is that regulatory arbitrage is increased by this model as different types of institutions may be regulated differently and by different agencies. Alternatively, different functions may be regulated differently and by different agencies irrespective of which institutions are performing those functions. The issues that may arise are consequently that the different regulatory agencies may apply a different type and intensity of regulation which may give rise to issues of competitive neutrality. As observed by Llewellyn, focusing upon functions means that a given firm will be subject to many different types of regulation and under the authority of different regulatory agencies, dependent upon the number of business areas in which it is operating.³⁴

1.2.3 The Integrated Approach

The third model entails the integrated approach that comprises of a universal single regulator that will conduct both safety and soundness oversight as well as conduct of

³² Frenkel "The structure of financial supervision approaches and challenges in a global marketplace" https://group30.org/images/uploads/publications/G30_StructureFinancialSupervision2008 13.

³³ Frenkel 24.

³⁴ Llewellyn "Institutional Structure of Financial Regulation and Supervision: The Basic Issues" – paper presented at World Bank Conference on Aligning Supervisory structures with Country Needs 2006 16.

business for financial institutions.³⁵ An integrated agency enables a group-wide picture of the risks of an institution which allows for the intuition to be more clearly observed and supervised. This is the case when financial conglomerates themselves adopt a centralized approach to risk management and risk taking. According to Llewellyn there is thus merit in having an institutional structure of supervision that mirrors the practice of regulated institutions. This results in a more rapid response to emerging group-wide problems. A single, integrated supervisor will be able to monitor the full range of institutions more effectively and will be able to detect solvency risks emanating from different parts of the financial institution under its supervision.³⁶

There are, however, a number of disadvantages inherent in a model that comprises a single prudential agency. Notably, as financial firms have increasingly diversified over the years, the traditional functional distinctions between institutions have been eroded. Llewellyn observes that the nature of the risks posed by this “blurring of the boundaries” may be sufficiently different to warrant a differentiated approach to prudential regulation. He, however, cautions that there is a danger within a single agency that the necessary distinctions between different products and institutions will not be made. A potential moral-hazard problem thus arises.³⁷

1.2.4 The Twin Peaks Model

The Twin Peaks Model was first introduced in 1996 by Michael Taylor in a paper titled “‘Twin Peaks’: A regulatory structure for the new century”.³⁸ The proposal by Taylor entailed that financial regulation should be done with two goals in mind, which are to

³⁵ Frenkel 24.

³⁶ Llewellyn “Institutional Structure of Financial Regulation and Supervision: The Basic Issues” – paper presented at World Bank Conference on Aligning Supervisory structures with Country Needs 2006 18.

³⁷ Mishkin “*The economics of money banking and financial markets*” 2016 296 defines “moral hazard” as “the risk that one party to a transaction will engage in behavior that is undesirable from the other party’s point of view”.

³⁸ 1995 London, Centre for the Study of Financial Innovation, 1995 – Financial Service Industry (DSFI) series issue 20 December 1995 1–18.

protect the stability and integrity of the financial system and to ensure that the interests of individual depositors, investors and policy holders are protected.³⁹

Instead of being structured around the traditional tripartite distinction of banking, securities and insurance, Taylor proposed that there should be two peak regulatory agencies in this model, a Financial Stability Commission and a Consumer Protection Commission. The first regulator would be responsible for ensuring the stability of the financial system as a whole, primarily through the application of prudential regulation. The second regulator would have the task of ensuring that firms deal with their customers in a fair and transparent manner. Taylor envisaged that these two Commissions would be responsible for discharging their mandates irrespective of the legal form of the firms which they regulated.⁴⁰

The two regulatory bodies would, however, both still be accountable to answer to the Treasury, and in situations where a conflict arises between them it will be resolved by political bodies.⁴¹ According to Taylor the benefits of the Twin Peaks are clear: the structure of the Twin Peaks would eliminate any duplication and overlaps of regulation. The regulatory bodies would each have a clear and precise remit, and the model would further establish mechanisms to resolve any conflicts between the objectives of financial services regulation. In addition, the regulatory process would be open and transparent and also be publicly accountable.⁴²

1.2.5 THE TWIN PEAKS MODEL IN SOUTH AFRICA

The 2008 GFC was a shocking reality check illuminating that there needs to be better monetary and fiscal policies present in financial regulation and that more focus should be

³⁹ Van Niekerk, Gerda and Van Heerden, C. M., “*Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability*” 9 November 2017 Vol. 80, p. 636-656, Available at SSRN: <https://ssrn.com/abstract=3175789>.

⁴⁰ M. W. Taylor, ‘*Twin Peaks*’: *A Regulatory Structure for the New Century*, no. 20, Centre for the Study of Financial Innovation, No. 20 December 1995.

⁴¹ Ibid.

⁴² M. W. Taylor, ‘*Twin Peaks*’: *A Regulatory Structure for the New Century*, no. 20, Centre for the Study of Financial Innovation, No. 20 December 1995.

placed on the prevention as well as the management of systemic risks. As indicated, South Africa heeded the lessons of the GFC, and post-GFC it set its system of financial regulation on a totally new trajectory by embarking on a regulatory journey towards a Twin Peaks model of financial regulation by objective.⁴³

South Africa's journey towards Twin Peaks kicked off in February 2011 when the South African National Treasury issued a policy paper entitled "A safer financial sector to serve South Africa better" (the Red Book). This policy document reviewed the then current status of the South African financial system and the silo way in which it was regulated. It also considered the lessons learnt from the GFC and assessed the structure and characteristics of South Africa's financial sector to determine any gaps and weaknesses. The aforesaid review revealed that the existing model of regulation and supervision of South Africa's financial sector on a micro-prudential basis was inadequate and that inadequate measures were in place to foresee risks that could lead to instability in the financial sector. The policy document indicated that South Africa was in need of a macro-prudential system-wide approach to achieving financial stability. It contemplated that to best achieve appropriate financial regulation South Africa needed to adopt a Twin Peaks model as it would be the optimal financial regulatory approach for the country.⁴⁴

The move to a Twin Peaks model was approved in July 2011. In February 2013 another policy document was issued by National Treasury, entitled "*Implementing a Twin Peaks model of financial regulation in South Africa*" (the "roadmap").⁴⁵ After many draft bills that sought to refine the specifics of the South African Twin Peaks model, the model was eventually introduced by the Financial Sector Regulation Act 9 of 2017 (hereinafter FSRA). The main features of the South African Twin Peaks model is that the South African Reserve Bank (SARB) as central bank, serves as the apex peak that is mandated with a

⁴³ Van Heerden and Van Niekerk "*Twin Peaks in South Africa: a new role for the Central Bank*" 2017 Law and Financial Markets Review v11 n4 154-162.

⁴⁴ National Treasury "A Safer Financial Sector to Serve South Africa Better" 2011 <http://www.treasury.gov.za>.

⁴⁵ Van Heerden and Van Niekerk "*Twin Peaks in South Africa: a new role for the Central Bank*" 2017 Law and Financial Markets Review v11 n4 154-162.

comprehensive and expanded financial stability mandate. The Prudential Authority is established as the new systemwide prudential supervisor of financial institutions and will assist the SARB in maintaining financial stability and looking out for and addressing any systemic risk that may arise. The Financial Sector Conduct Authority is the new systemwide conduct regulator that has been established by the FSRA and is mandated with protecting financial consumers, improving financial literacy and promoting confidence in the South African financial system.⁴⁶

1.3 NATURE AND SCOPE OF DISSERTATION

The 2008 GFC had most of the world economies rethink their approach to financial regulation and specifically how to achieve and maintain financial stability. As indicated, it is, however, difficult to define in exact terms what financial stability is, and it is also difficult to place every single economy with its own challenges under the same umbrella of financial regulation. The best regulatory approach for a particular jurisdiction will thus have to be determined by considering a number of factors such as the structure of its financial system and the resources available to devote to financial sector regulation. Even though one may be of the view that the Twin Peaks model is the optimal model for financial regulation it should nevertheless be appreciated that it might not be the best model for every country as each country has its own peculiar economy and regulatory and fiscal challenges. The Twin Peaks model however seems to be a relatively flexible model and where countries do decide to adopt this model it can be adapted to their country-specific needs.

South Africa has chosen to transition to its own unique adaptation of the Twin Peaks model. Accordingly, this dissertation will consider the South African Twin Peaks model and its specific characteristics and how the model, as captured in the FSRA, seeks to facilitate the achievement of the objective of a stable financial sector.

⁴⁶ Ibid.

1.4 THE SELECTION OF AUSTRALIA AS A COMPARATIVE JURISDICTION

The Australian Twin Peaks Model was selected as a comparative jurisdiction as Australia pioneered the Twin Peaks model in 1998. The Australian model has since been used by various other countries, including South Africa, to benchmark their transition to Twin Peaks models.

1.5 METHODOLOGY

The proposed research will include a critical literature study of books, reports, journal articles, web sites, legislation, draft legislation, media statements and discussion documents.

1.6 CHAPTER LAY-OUT

Chapter 1: Introduction and overview of study: This chapter introduces the study; it explains the causes of the 2008 GFC and the lessons learnt. It introduces the concept of financial stability and explains how it became the core regulatory pursuit after the GFC. It further provides an overview of the different approaches to financial regulation, focusing in particular on the Twin Peaks Model. The chapter further provides the research question, research methodology and chapter lay-out.

Chapter 2: The South African Twin Peaks Model: This chapter introduces the South African Twin Peaks Model of financial regulation. It deals with the main objectives of the Financial Sector Act as well as the framework of the South African Twin Peaks Model. It also takes a look at specific bodies that facilitate coordination and cooperation within this framework.

Chapter 3: The Australian Twin Peaks Model: This chapter considers the features of the Australian Twin Peaks model that was implemented in 1998, long before the GFC.

Chapter 4: Conclusions and recommendations: The South African Twin Peaks Model as a mechanism to promote and maintain financial stability: This chapter concludes the study regarding the South African Twin Peaks Model as a mechanism to promote and maintain financial stability after the GFC of 2008 as well as makes some recommendations.

CHAPTER TWO: THE TWIN PEAKS MODEL IN SOUTH AFRICA

2.1 INTRODUCTION

As discussed above, the 2008 GFC was an awakening for the financial world in which almost every country came to the realization of the importance of regulating as well as maintaining financial stability. South Africa escaped the GFC relatively unscathed although approximately one million job losses were reported. A few of the reasons why South Africa was protected were that there was generally a sound framework in place for the regulation of financial institutions; there were appropriate and conservative risk management practices by domestic banks; the financial sector had limited exposure to foreign assets; a robust monetary policy framework was in place; a proactive approach to dealing with bank credit risks existed; and there was sufficient focus on reducing household vulnerability.⁴⁷

The South African government understood that it would not be prudent to become complacent about the fact that South Africa weathered the GFC relatively well and that more needed to be done in order to create a more robust financial market. South Africa also paid close attention to the lessons from the GFC which showed that the South African financial market, like other financial markets, also needs a holistic view of financial regulation to cover all regulatory gaps that may arise from taking a too dim micro-prudential view only. It was further realized that “light touch” regulation was inadequate to guard against financial instability and that it was important to ensure that there is appropriate regulation of market conduct in order to support prudential regulation; and also that it was of extreme importance that there be swift regulatory action that would prevent contagion in the financial system.⁴⁸

After much deliberation, as pointed out in Chapter One, it was finally agreed in 2011 that South Africa would move to a Twin Peaks Model of financial regulation. The essence of South Africa’s shift towards a Twin Peaks model is the objective that the financial sector

⁴⁷ National Treasury “A safer financial sector to serve South Africa better” (2011).
<http://www.treasury.gov.za/twinpeaks/20131211%20%20Item%20%20A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better>¹³. Hereinafter referred to as “A safer financial sector to serve South Africa Better 2011”.

⁴⁸ A safer financial sector to serve South Africa Better 2011 12.

will be made safer through a comprehensive financial stability framework operating in conjunction with a stronger prudential and market conduct framework. As indicated by the South African Treasury, which drove the shift to a Twin Peaks model, the Twin Peaks system of regulation recognizes that the two objectives of financial soundness and treating customers fairly are better done by two regulators, dedicated to each objective and that this model will also serve to minimize regulatory arbitrage that is otherwise occasioned by conflicting objectives.⁴⁹

2.2 THE FINANCIAL SECTOR REGULATION ACT

The 2008 GFC pushed financial stability to the top of the post-GFC regulatory agenda. The maintenance and promotion of financial stability is accordingly also the main aim of the Financial Sector Regulation Act 9 of 2017 (FSRA) which describes “financial stability” to mean that:⁵⁰

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

In particular the stated objective of the Act as encapsulated in section 7 is to “achieve a stable financial system that works in the interests of financial customers and that supports balanced sustainable economic growth in the Republic, 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, the fair treatment and protection of financial customers, the efficiency and integrity of the financial

⁴⁹ Van Niekerk, Gerda and Van Heerden, C. M., “Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability” 9 November 2017 Vol. 80, p. 636-656, Available at SSRN: <https://ssrn.com/abstract=3175789>.

⁵⁰ S1 read with Section 4 of the Financial Sector Regulation Act.

system, the prevention of financial crime, financial inclusion, transformation of the financial sector and confidence in the financial sector.” The FSRA further provides that when seeking to achieve the object of this Act, the SARB and financial sector regulators must not be constrained from achieving their objectives and responsibilities as set out in sections 11, 33 and 57.⁵¹

To provide for the promotion and maintenance of financial stability the FSRA has assigned various powers and functions to the SARB, the Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA), respectively. It further requires extensive collaboration by various bodies. The SARB still functions as the South African central bank in the new Twin Peaks dispensation, but, whereas its mandate for financial stability was previously never captured in legislation, it now has an express and expanded financial stability mandate as captured in section 11 of the Act. In terms of this expanded financial stability mandate the SARB is required to monitor the financial system closely and to also act pre-emptively in order to prevent any disruption of financial stability. If any disruption does occur the SARB is tasked to manage such incident to restore financial stability.⁵² In executing this expanded financial stability mandate the SARB is supported by the Financial Stability Oversight Committee (FSOC) and the Financial Sector Contingency Forum (FSCF) as discussed below. The Act also requires specifically that there be co-operation between the SARB, the PA, the FSCA, the National Credit Regulator, the Competition Commission, the Financial Intelligence Centre and the Council for Medical Schemes.⁵³

2.3 SARB’S FINANCIAL STABILITY MANDATE

Van Heerden and Van Niekerk point out that section 11 of the FSRA sets the tone for the SARB’s expanded financial stability mandate by providing that the SARB is responsible

⁵¹ S7 (1) & (2) of the FSRA.

⁵² Van Niekerk, Gerda and Van Heerden, C. M., “*Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability*” 9 November 2017 Vol. 80, p. 636-656, Available at SSRN: <https://ssrn.com/abstract=3175789>.

⁵³ Ibid.

for protecting and enhancing financial stability; and, if a “systemic event” has occurred or is imminent, for restoring or maintaining financial stability.⁵⁴ The FSRA states that the SARB, when exercising its mandate with regards to financial stability, must have regard to the roles and functions of other organs of state exercising powers that affect aspects of the economy. As indicated by Van Niekerk and Van Heerden the Act envisages that the SARB will take an integrated approach to the exercise of its financial stability mandate, operating within the parameters of a clear policy framework and making comprehensive use of all the powers in its regulatory toolkit.⁵⁵ The SARB has the broad mandate of keeping a lookout for any risks to financial stability - meaning that it should also focus on risk that may seem small or not serious but that has the potential to grow into systemic risks if left unchecked..⁵⁶ Given the ability of systemic events to erode financial stability, Van Niekerk and Van Heerden point out that the SARB has been given specific crisis management powers in relation to systemic events. In particular the Governor of SARB may, after consultation with the Minister of Finance, determine that certain circumstances constitute a “systemic event” and after consultation advise the financial sector regulators accordingly and require them to take specific action as discussed below.⁵⁷ Thus the determination that a specific event constitutes a systemic event triggers certain crisis management powers that the FSRA bestows on the SARB.

A “systemic event” is broadly defined in section 1 of the Act 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”.

⁵⁴ Van Heerden and Van Niekerk “*The Financial Stability Mandate of the South African Central Bank in the Post-crisis Landscape*” (2018) 33 J.I.B.L.R., Issue 11.

⁵⁵ Van Niekerk, Gerda and Van Heerden, C. M., “*Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability*” 9 November 2017 Vol. 80, p. 636-656, Available at SSRN: <https://ssrn.com/abstract=3175789>.

⁵⁶ Ibid.

⁵⁷ Ibid.

In terms of section 15 of the Act, the SARB must take all reasonable steps to prevent systemic events from occurring. If a systemic event has occurred the SARB must then swiftly mitigate the adverse effects of the event on financial stability and henceforth manage the systemic event and its effects. When the SARB acts in terms of section 15(1), it is obliged to have regard to the need to minimize adverse effects on financial stability and economic activity, and it must further “protect, as appropriate, financial customers, and contain the costs to the Republic of the systemic event and the steps taken”.⁵⁸

It is further important to note that the FSRA provides that the SARB may not, except with the Minister’s approval, take a step in terms of section 15 that “will or is 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 a contingent liability for the National Revenue Fund”.⁵⁹ This makes it clear that the SARB does not, under the guise of seeking to maintain financial stability, have a carte blanche to extend bail-outs to failing financial institutions by using taxpayers money. When a systemic event is imminent or has occurred the FSRA also requires all the financial sector regulators to work together in an attempt to guard financial stability. Accordingly, if the Governor of the SARB has determined that a systemic has occurred or is imminent, each of the financial sector regulators must provide the SARB with any information in their possession, which may be relevant for the Bank to manage the systemic event. The regulators are further also required to consult with the SARB before exercising any of their powers in a way that may compromise steps taken or proposed in terms of section 15 to manage the systemic event or its effects.⁶⁰

In terms of section 18 of the Act, the Governor may direct that any information that is in the possession of a financial sector regulator be provided to the SARB or the Governor as may be necessary for the exercise of the SARB’s powers in terms of sections 14 or 15.⁶¹ The Governor, upon determining that a systemic event has occurred or will occur,

⁵⁸ S15 (1) & (2) of the FSRA.

⁵⁹ S16 (2) of the FSRA.

⁶⁰ S17 (a) & (b) of the FSRA.

⁶¹ S18 (1) of the FSRA.

may then direct a financial sector regulator to assist the SARB in complying with section 15 by acting in accordance with the directive when exercising its powers. The directives that may be issued in this regard include directives 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 the financial institution to risk, weakness or disruption.⁶²

As part of its financial stability mandate the SARB is required by section 13 of the FSRA, to publish a financial stability review twice a year, which review must also be tabled in Parliament. Thus, the SARB must make an assessment at least every six months of the stability of the financial system. The Act provides the parameters of this review by requiring the SARB to address specific important issues, namely:⁶³ its assessment of financial stability in the period under review; its identification and assessment of the risks to financial stability in at least the next 12 months; an overview of steps taken by it and the financial sector regulators to identify and manage risks; weaknesses and disruptions in the financial system in the period under review and steps that are envisaged to be taken during at least the next 12 months; and an overview of recommendations made by it and the FSOC during the period under review and progress made in implementing those recommendations. The Act thus lays down the legislative requirements that the financial stability review must meet as a tool for communicating the SARB's views on risks to financial stability in South Africa.

The approach required for purposes of the financial stability review entails that the SARB will exercise both a current and forward-looking macroprudential “surveillance approach”, skimming the financial system for build-up of future risk.⁶⁴ The Act expressly provides that “information which, if published may materially increase the possibility of a systemic event” only needs to be published in review after the risk of a systemic event subsides,

⁶² S18 (2) of the FSRA.

⁶³ S13(2) of the FSRA.

⁶⁴ Van Niekerk, Gerda and Van Heerden, C. M., “*Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability*” 9 November 2017) Vol. 80, p. 636-656, Available at SSRN: <https://ssrn.com/abstract=3175789>.

or has been addressed.⁶⁵ As observed by Van Niekerk and Van Heerden, this prohibition was enacted to prevent the financial stability review report itself from becoming a trigger or conduit for the occurrence of a systemic event as a result of publishing sensitive information that may for instance trigger a “bank run” that can drain the financial system of liquidity.⁶⁶

2.4 THE PA’S ROLE IN FINANCIAL STABILITY

Van Heerden and Van Niekerk point out that banking supervision is no longer a mandate of the SARB, as in the Twin Peaks dispensation this mandate has been now given to the PA. The PA is a separate juristic person and is located in the SARB’s building and is mandated with system-wide prudential regulation and supervision of financial institutions.⁶⁷ Even though the PA is in the same building as the SARB, it remains operationally independent. Van Heerden and Van Niekerk observe that it makes sense for the PA to be located in the same building as the SARB as South Africa is an emerging market and has limited resources and costs could thus be saved given the fact that many of the necessary systems for prudential supervision were already in place due to the presence of the Bank Supervision Department (BSD) that was previously part of the SARB. The PA has been given a clear mandate to promote and enhance the safety and soundness of financial institutions that provide any sort of financial products and securities services as well as the safety and soundness of market infrastructures.⁶⁸ It further makes sense from a financial stability perspective for the SARB to have the prudential regulator close at hand as such an arrangement would facilitate ease of information-sharing and co-ordination in times of crisis.⁶⁹

⁶⁵ S13(3) of the FSRA.

⁶⁶ Van Niekerk, Gerda and Van Heerden, C. M., “*Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability*” 9 November 2017 Vol. 80, p. 636-656, 2017. Available at SSRN: <https://ssrn.com/abstract=3175789>.

⁶⁷ See S32 of the FSRA with regards to the establishment of the Prudential Authority and S34 of the FSRA with regards to functions of the Prudential Authority.

⁶⁸ Van Heerden and Van Niekerk “*The Financial Stability Mandate of the South African Central Bank in the Post-crisis Landscape*” 2018 33 J.I.B.L.R., Issue 11.

⁶⁹ Ibid.

The objectives of the PA as stated in the Act are not only to promote the safety and soundness of financial institutions and market infrastructures, but also to protect financial customers against risks in the event that financial institutions fail to meet their obligations, and to assist in maintaining financial stability.⁷⁰ To achieve these objectives the PA will have to regulate and supervise financial institutions in accordance with financial sector laws, cooperate and assist the SARB and the FSOC, the FSCA, the National Credit Regulator (NCR) and the Financial Intelligence Centre (FIC). It must also support financial inclusion.⁷¹ The Act further seeks to entrench the independence of the PA by stipulating that the PA should act independently and conduct and perform its functions without fear, favour or prejudice.⁷²

Notably section 41 of the Act introduced the Prudential Committee as the governing body of the PA. This committee consists of the Governor of the SARB, the Chief Executive Officer (who is a Deputy Governor of the SARB other than the Deputy Governor tasked with financial stability) and the remaining Deputy Governors of the SARB.⁷³ The Prudential Committee is tasked to generally oversee the management and administration of the PA to ensure that it is efficient and effective. It must act for the PA in authorizing the CEO to sign on behalf of the PA, a section 27 or section 77 memorandum of understanding (MoU) and any amendment to such a memorandum; delegating powers of the PA to the FSCA in terms of a section 77 memorandum of understanding; adopting the regulatory strategy of the PA, and any amendment to that strategy; adopting the administrative action procedures of the PA, and any amendments to those procedures; appointing members of subcommittees of the PA required by a law, and giving instructions regarding the work of any subcommittee; and also in making prudential standards, joint standards and other regulatory instruments in terms of financial sector laws; making determinations of fees in terms of a financial sector law and any other matter assigned in terms of a financial sector law to the Prudential Committee.⁷⁴

⁷⁰ S33(a) – (d) of the FSRA.

⁷¹ S34(1)(a) – (g) of the FSRA.

⁷² S34(5) of the FSRA.

⁷³ S41 of the FSRA.

⁷⁴ S42 of the FSRA.

The PA has wide enforcement powers and a regulatory toolkit which is used to execute its systemwide prudential mandate. The prudential toolkit includes the authority to make prudential standards,⁷⁵ issue prudential directives,⁷⁶ enter into enforceable undertakings,⁷⁷ issue debarment orders,⁷⁸ impose administrative penalties,⁷⁹ and it also has wide investigative powers.⁸⁰ It is therefore clear that the PA plays a vitally important role in the prudential regulation of the South African financial system and will be a regulator that will feature prominently in achieving and maintaining financial stability .

2.5 THE FSCA'S ROLE IN FINANCIAL STABILITY

Section 56 of the FSR Act established the Financial Sector Conduct Authority (FSCA) and its powers as well as its functions are set out in Chapter Four of the FSRA.⁸¹

The objectives of the FSCA are to:⁸²

- (a) enhance and support the efficiency and integrity of financial markets;
- (b) protect financial customers by promoting fair treatment of financial customers by financial institutions; and providing financial customers and potential financial customers with financial education programs. It also seeks to promote financial literacy and the ability of financial customers and potential financial customers to make sound financial decisions; and
- (c) assist in maintaining financial stability.

The FSCA is a twin regulator that is separate from the PA, it operates independently as a juristic entity and is located in a separate building outside the central bank. It is tasked with regulation and supervision of conduct of business activities and the market practices

⁷⁵ S105 of the FSRA.

⁷⁶ S143 of the FSRA.

⁷⁷ S151 of the FSRA.

⁷⁸ S153 of the FSRA.

⁷⁹ S161 of the FSRA.

⁸⁰ S131-139 of the FSRA.

⁸¹ S 56 read with section 60 of the FSRA.

⁸² S 57 of the FSRA.

of financial institutions on a system-wide basis.⁸³ As indicated above, the duty to assist in the maintenance of financial stability is expressly written into the objectives of the FSCA.⁸⁴ The FSCA must cooperate and give assistance to the SARB, FSOC, the PA, the NCR and the FIC. It is required to promote financial inclusion as well formulate and implement strategies and programs on financial education for the general public.⁸⁵ The FSCA also has a comprehensive regulatory toolkit. The tools that the FSCA have at its disposal include the making of conduct standards,⁸⁶ issuing conduct directives,⁸⁷ entering into enforceable undertakings, debarment orders and administrative penalties.⁸⁸ The FSCA also has wide investigative powers to enable the proper execution of its mandate.⁸⁹

2.6 CO-OPERATION AND COLLABORATION

Proper functioning of the Twin Peaks model to achieve the objective of promoting and maintaining financial stability depends fundamentally on extensive and well-considered co-operation and collaboration between the various role-players in the model. As remarked by Van Heerden and Van Niekerk, a proper structure for cooperation and collaboration is essentially the bedrock of an effective and efficient Twin Peaks model which will serve in enabling a regulatory environment for the promotion and maintenance of financial stability.⁹⁰

Van Heerden and Van Niekerk point out that the FSRA contains various provisions which are aimed at achieving co-operation and collaboration on two levels: first, at the level of measures aimed at promoting and maintaining financial stability; and, secondly, at the level of measures aimed at the effective and efficient operation of the South African Twin Peaks model in general.⁹¹ In terms of section 26 of the Act all financial sector regulators

⁸³ Van Heerden and Van Niekerk “*The Financial Stability Mandate of the South African Central Bank in the Post-crisis Landscape*” 2018 33 J.I.B.L.R., Issue 11.

⁸⁴ S33 & S57 of the FSRA.

⁸⁵ S58(1)(a) – (j) of the FSRA.

⁸⁶ S 106 and 108 of the FSRA.

⁸⁷ S 144 of the FSRA.

⁸⁸ Ss 151, 153 and 161 of the FSRA.

⁸⁹ S 131-139 of the FSRA.

⁹⁰ Van Heerden and Van Niekerk “*The Financial Stability Mandate of the South African Central Bank in the Post-crisis Landscape*” 2018 33 J.I.B.L.R., Issue 11.

⁹¹ Ibid.

are required to give any assistance and information necessary to the SARB and the FSOC to maintain or restore financial stability. Thus, it is not only the mandate of the PA and the FSCA to do so. In the event that any financial sector regulator obtains any information which they have become aware of that may pose risk to financial stability they must report it to the SARB.⁹² The SARB, upon receiving any information from the financial sector regulators or any views expressed by them, must take these views into account as well as any recommendations of the FSOC, as discussed below.⁹³ If there is any information pertaining to a systemic event or information that a financial institution is failing to meet any requirements that may result in a systemic event, this must be reported to the SARB.⁹⁴ It is the duty of the SARB and financial regulators to continuously provide support to each other in order to achieve their common goals and to develop consistent regulatory policies and strategies.⁹⁵

Various committees have been established by the FSRA for purposes of the promotion and maintenance of financial stability and for the broader operation and objectives of the Twin Peaks model. The FSOC is arguably the apex committee and is comprised of the Governor of the SARB, the Deputy Governor responsible for financial stability matters, the CEO of the PA, the Commissioner of the FSCA, the CEO of the National Credit Regulator, the Director-General of Treasury, the Director of the Financial Intelligence Centre and a maximum of three additional persons appointed by the Governor.⁹⁶ The FSOC has various functions which include the following: to serve as a forum for representatives of the SARB and each of the financial sector regulators to be informed of, and exchange views about, the activities of the SARB and the regulators regarding financial stability; to make recommendations to the Governor on designation of Systemically Important Financial Institutions (SIFI); to advise the Minister of Finance and the SARB on steps taken to promote, protect or maintain, or to manage or prevent risks to financial stability; and matters relating to crisis management and prevention. The FSOC

⁹² Section 26(1)(a)–(d) of the FSRA.

⁹³ Section 26(2) of the FSRA.

⁹⁴ Section 17(a)–(b) of the FSRA.

⁹⁵ Section 76(1) of the FSRA.

⁹⁶ Sections 20 and 22 of the FSRA.

must also make recommendations to other organs of state regarding appropriate steps to assist with promoting, protecting or maintaining or managing or preventing risks to financial stability.⁹⁷ The SARB has to provide administrative support, and other resources, including financial resources, for the effective functioning of the FSOC and must ensure that minutes of the FSOC are kept in a manner determined by the Governor.⁹⁸

To assist the FSOC, the Financial Sector Contingency Forum has been established to identify potential risks that systemic events will occur and to attend to the coordination of appropriate plans, mechanisms and structures to mitigate such risks.⁹⁹ The Act has also further established a Financial System Council of Regulators, for purposes of facilitating co-operation and collaboration and consistency of action between the institutions represented on the council. It does so by providing a forum for senior representatives of those institutions to discuss and inform themselves about matters of common interest.¹⁰⁰ Further included in the committees is the Financial Sector Inter-Ministerial Council. The purpose of this committee is to facilitate co-operation and collaboration between cabinet members responsible for administering legislation relevant to the regulation and supervision of the financial sector. It does so by providing a forum for discussion and consideration of matters of common interest.¹⁰¹

2.7 CONCLUSION

South Africa implemented a solid framework with dedicated prudential and market conduct regulators with the introduction of the FSRA. The Act has introduced a Twin Peaks Model that is robust and clear in its objectives to promote as well as maintain financial stability. It has established two twin regulators being the PA and the FSCA, each of which are independent juristic persons with their own mandate, namely prudential and market conduct regulation. The SARB on the other “third hand” has acquired a new

⁹⁷ Section 21 of the FSRA.

⁹⁸ Section 23 of the FSRA.

⁹⁹ Section 25 of the FSRA.

¹⁰⁰ Section 79 of the FSRA.

¹⁰¹ Section 83 of the FSRA.

expanded and comprehensive stability mandate, which is entrenched legislatively for the first time since the SARB was established nearly a century ago.

The institutional framework created by the FSRA and the objectives it seeks to achieve will, however, be ineffective without proper structures and measures for cooperation and collaboration between the SARB and the regulators and between the regulators themselves. Extensive and well-coordinated cooperation and collaboration is essential in order to achieve a Twin Peaks Model that is effective and efficient. Communication between the regulators and the SARB and between the regulators themselves is also essential for achieving financial stability, and the regulators must clearly understand the extent of and the jurisdictional boundaries of their respective mandates. The FSRA has thus created the necessary network for cooperation and collaboration to facilitate the promotion and maintenance of financial stability in South Africa.

CHAPTER 3 THE TWIN PEAKS MODEL IN AUSTRALIA

3.1 INTRODUCTION

The reforms that introduced the Twin Peaks model in Australia in 1998 were driven by the Financial System Inquiry (also known as the Wallis Inquiry), which was established in 1996 to review the Australian financial system and the approach to financial regulation in Australia.¹⁰² The Wallis Inquiry was tasked with the following: to provide a stock take of the results arising from financial deregulation that occurred in previous years, to analyse the forces that drove further change to the financial landscape with particular focus on technology change, to recommend the best framework for efficient regulation in Australia and to provide recommendations which would improve the then current regulatory arrangements.¹⁰³

In the Australian model that was adopted subsequent to the Wallis Inquiry, the twin regulators, are the Australian Prudential Authority (APRA), tasked with prudential regulation and supervision, and the Australian Securities and Investments Commission (ASIC), tasked with market conduct regulation and supervision. In addition the Reserve Bank of Australia (RBA) functions as the third peak of the Australian Twin Peaks model and is tasked with the responsibility for overall financial stability, a mandate that it shares with APRA.¹⁰⁴ The Wallis Inquiry envisaged that both ASIC and APRA would have operational autonomy to pursue their legislated objectives in the most efficient and cost-effective manner possible. Although the Wallis Inquiry recommended that APRA and ASIC should finance their operational costs through levies upon the institutions under

¹⁰² A Godwin & I Ramsey “*Twin Peaks –the legal and regulatory anatomy of Australia’s system of financial regulation*” 2015, SSRN: <https://ssrn.com/abstract=2657355> or <http://dx.doi.org/10.2139/ssrn.2657355> 1-46 2 CIFR Paper No.074/2015; U of Melbourne Legal Studies Paper No. 725. Hereinafter referred to as “Godwin & Ramsey 2015”.

¹⁰³ The Wallis Report on the Australian Financial System: Summary and Critique No 16 of 1996 https://parlinfo.aph.gov.au/parlInfo/download/library/prspub/D2G30/upload_binary/D2G30.pdf;fileType=application/pdf#search=%221990s%201997%20publications%22.

¹⁰⁴ A Godwin, S Kourabas & I Ramsey “*Twin peaks and financial regulation: the challenges of increasing regulatory overlap and expanding responsibilities*” 2016 <https://poseidon01.ssrn.com/delivery.php?ID=047093101091070107065116091097087067010037073076067052094083125127028026113087014126099054038127042010098068090113099007071089098048031000085087002109014064103076051016084126084029089089072075005086025120096000081019007100069110067003072125009103004&EXT=pdf> (accessed 22 March 2020) 1-26 9. Hereinafter referred to as “Godwin, Kourabas & Ramsey 2016”.

their supervision, this recommendation was only taken up by the government in relation to APRA and not in relation to ASIC.¹⁰⁵

Notably the Wallis Inquiry did debate the possibility of allocating prudential regulatory authority to the RBA instead of locating it in a separate prudential regulator as the combination of the mandate for financial stability and prudential regulation and supervision under the auspices of the central bank is common in some jurisdictions. It was, however, decided that the responsibility for prudential regulation and supervision should rather be allocated to an independent regulatory authority, APRA, that would supervise banks as well as non-bank financial institutions. This arrangement would enable the RBA and APRA each to focus on its clear primary responsibilities and would clarify the lines of accountability for their regulatory tasks. It would also remove potential conflict of interest for the RBA and APRA in cases where institutions require emergency liquidity and APRA as the prudential regulator would be able to provide such assistance with liquidity in order to boost its reputation in preventing institutional failure.¹⁰⁶ The view was that it would in any event be difficult for the RBA as central bank to deal with a combination of deposit taking, insurance and superannuation regulation and supervision in an effective and flexible manner as the central bank's primary operational relationships pre-Twin Peaks were with banks only.¹⁰⁷ The RBA accordingly functions within the Australian Twin Peaks model as the lender of last resort¹⁰⁸ and for ensuring financial

¹⁰⁵ Godwin, Kourabas & Ramsey 2016 8.

¹⁰⁶ The Wallis Report on the Australian Financial System: Summary and Critique No 16 of 1996 12 https://parlinfo.aph.gov.au/parlInfo/download/library/prspub/D2G30/upload_binary/D2G30.pdf;fileType=application/pdf#search=%221990s%201997%20publications%22.

¹⁰⁷ J Cooper "The integration of financial regulatory authorities –the Australian experience" 2006 <https://asic.gov.au/media/1339352/integration-financial-regulatory-authorities.pdf> (accessed 22 March 2020) 4 - 5.

¹⁰⁸ "Central banks provide liquidity insurance to the banking system, which in turn provides liquidity insurance to the rest of the economy (households and businesses). Thus, central banks are liquidity re-insurers. In each case, their capability to provide insurance stems from their liabilities being money. The central bank acts as a liquidity re-insurer: as a general matter, it does not provide liquidity insurance directly to everyone in the economy but rather to the private sector liquidity insurers, the banks. If a bank is faced with a surge of withdrawals, it may have to sell assets at discounted prices; either because it is straining the liquidity of asset markets or because it is treated as a forced seller. That will impair its solvency position" Tucker, P "The Lender of Last Resort and Modern Central Banking: Principles and Reconstruction", 2014 BIS Papers No 79.

stability whilst, as indicated, the responsibility for prudential regulation and supervision is allocated to APRA.¹⁰⁹

As observed by Godwin and Ramsey, ASIC and APRA need to work cooperatively to deal with regulatory overlap. Consequently, they comment that there are certain elements that are critical to making the Australian Twin Peaks model work properly. They point out that three critical elements that go to the heart of the effectiveness of the regulatory model are clear responsibilities and objectives, operational independence, and effective regulatory coordination.¹¹⁰

The roles of the different regulators in the Australian Twin Peaks model are discussed in more detail below.

3.2 THE AUSTRALIAN TWIN PEAKS FRAMEWORK

3.2.1 The Australian Prudential Regulation Authority (APRA)

As indicated above, the Wallis Inquiry suggested that APRA be set up as an independent prudential regulator. It recommended for APRA to operate under a charter that balanced the safety objectives of prudential regulation with efficiency, competition, contestability, and competitive neutrality considerations.¹¹¹

Godwin and Ramsey observe that it was envisaged that APRA would be able to provide “flexible, efficient, coordinated and consistent” regulation across the financial sector, particularly for financial service conglomerates.¹¹² APRA was thus established in 1998, in terms of the Australian Prudential Regulation Authority Act of 1998 (APRA Act).¹¹³ In the Australian Twin Peaks model APRA features very prominently as a pro-active regulator.

The functions of APRA are primarily to regulate and supervise aspects relating to the safety and soundness of financial institutions with the aim of ensuring that financial promises made by regulated entities are met within stable, efficient and competitive

¹⁰⁹ Godwin, Kourabas & Ramsey 2016 8.

¹¹⁰ Godwin & Ramsey 2015 9.

¹¹¹ Ibid.

¹¹² Godwin & Ramsey 2015 4.

¹¹³ Australian Prudential Regulation Act 50 of 1998.

financial markets.¹¹⁴ In terms of section 8 of APRA Act the main objectives of APRA entail regulating bodies in the financial sector in accordance with other laws of the Commonwealth that provide for prudential regulation or retirement incomes standards, administering financial claims schemes provided for in the Banking Act 1959 and the Insurance Act 1973, and developing the administrative practices and procedures to be applied in performing that regulatory role and administration. In performing and exercising its functions and powers, APRA is obliged to balance the objectives of financial safety and efficiency, contestability and competitive neutrality and, in balancing these objectives, to promote financial system stability in Australia.¹¹⁵

In terms of section 9 of APRA Act it has the following functions: functions which are conferred on it by or under APRA Act or any other law of the Commonwealth; functions conferred on it by or under any law of a State or Territory in accordance with subsection 9A(1); and functions providing regulation or advice services under agreements entered into in accordance with Subsection 9A(2).¹¹⁶ In terms on Section 9A functions or powers may be given to APRA by or under a law of a State or Territory if those powers or functions are in accordance with provisions of an agreement entered into by the Commonwealth and the State, which have been approved by the Minister of Finance for purposes of subsection 9A or an approval given by the Minister for purposes of section 9A. APRA may, with the approval of the Minister, enter into agreements under which APRA agrees to provide prudential regulation or advice services for a fee.¹¹⁷

Section 10 of APRA provides that APRA must advise the Minister of Finance if it considers that an institution regulated by it is in financial difficulty and must do so as soon as possible. If the Minister requests advice APRA must provide advice on matters that would improve financial safety and efficiency, competition, contestability, or competitive neutrality of the sectors in which the institutions regulated by APRA operate. APRA must further advise the Minister regarding any changes to the framework of the law pertaining

¹¹⁴ J Cooper "The integration of financial regulatory authorities –the Australian experience" 2006 <https://asic.gov.au/media/1339352/integration-financial-regulatory-authorities.pdf> (accessed 22 March 2020) Hereinafter referred to as "Cooper 2006" 5.

¹¹⁵ Section 8 (1) and (2) of APRA Act 50 of 1998.

¹¹⁶ Section 9 of APRA Act 50 of 1998.

¹¹⁷ Section 9A of APRA Act 50 of 1998.

to prudential regulation that APRA considers would overcome or assist in overcoming any problems that APRA has identified.¹¹⁸ Section 10 states that the Australian Parliament intends that APRA, in performing and exercising its functions and powers, should have regard to the desirability of APRA cooperating with other financial sector supervisory agencies, and with other agencies specified in regulations for the purposes of subsection 10.¹¹⁹

APRA applies a risk-based approach to regulation and supervision. It identifies measures and manages various risks that financial institutions may experience and will act swiftly in order to prevent any risk that may occur. If failure of a financial institution nevertheless does occur APRA will maintain public confidence by assisting the entity to make an orderly exit from the market.¹²⁰ Godwin and Ramsey also point out that APRA acts as an economic regulator, and that its focus is on protecting customers of prudentially regulated institutions, such as bank depositors and insurance policy holders, from institutional failure.¹²¹

APRA has three main types of powers with regards to the regulation of financial institutions, namely: authorization or licensing powers;¹²² supervision and monitoring powers;¹²³ and powers to act in circumstances of financial difficulties to protect depositors, policy holders and superannuation fund members, including powers relating to taking control of entities and/or winding up insolvent entities.¹²⁴ APRA makes use of direct contact with financial institutions through onsite visits, consultations and tripartite meetings, including meetings with APRA's external auditor.¹²⁵

3.2.2 The Australian Securities and Investment Commission (ASIC)

ASIC, upon its establishment as market conduct regulator (in terms of the ASIC Act 51 of 2001) in the Australian Twin Peaks Model, was tasked to regulate market integrity and

¹¹⁸ Section 10 of APRA Act 50 of 1998.

¹¹⁹ Section 10A of APRA Act 50 of 1998.

¹²⁰ Cooper 2006 5.

¹²¹ Godwin & Ramsey 2015 12.

¹²² See Section 9 of Banking Act 1959.

¹²³ See Section 61 of Banking Act 1959.

¹²⁴ See Section 62 of Banking Act 1959.

¹²⁵ Cooper 2006 6.

consumer protection with the objectives of promoting market fairness and consumer confidence.¹²⁶

The objectives of the ASIC Act are, inter alia, “to provide for the Australian Securities and Investments Commission (ASIC) which will administer such laws of the Commonwealth, a State or a Territory as confer functions and powers under those laws on ASIC, and to provide for ASIC’s functions, powers and business”.¹²⁷ In terms of section 2, in performing its functions and exercising its powers, ASIC is required to strive to maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy. It must also: promote the confident and informed participation of investors and consumers in the Australian financial system; administer the laws that confer functions and powers on it effectively and with minimum procedural requirements; receive, process and store information provided to it under the laws that confer functions and powers on it; and is obliged to ensure that information is available as soon as practicable for access by the public. ASIC is empowered to “take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it”.¹²⁸

The powers which the ASIC board have are broad and include being able to investigate where it has reason to suspect that there may have been a contravention of the corporations legislation or a contravention of a law of the Commonwealth, or of a State or Territory in its jurisdiction. This could involve fraud or dishonesty in relation to a body corporate or managed investment scheme.¹²⁹ ASIC may prosecute persons in terms of section 49 of the ASIC Act for offences.¹³⁰ Section 50 allows a follow-on civil action for the recovery of damages for fraud, negligence, default, breach of duty, or other misconduct, committed in connection with a matter to which an investigation or examination by ASIC related, or for the recovery of property .¹³¹

¹²⁶ Cooper 2006 6.

¹²⁷ Section 1 of ASIC Act 51 of 2001.

¹²⁸ Section 1 of ASIC Act 51 of 2001.

¹²⁹ Section 13 of ASIC Act 51 of 2001.

¹³⁰ Section 49 of ASIC Act 51 of 2001.

¹³¹ Section 50 of ASIC Act 51 of 2001.

In terms of section 93AA, ASIC may accept a written undertaking given by a person in connection with a matter in relation to which ASIC has a function or power under the ASIC Act. If ASIC considers that the person who gave the undertaking has breached any of its terms, ASIC may apply to the Court for an order under subsection (4).¹³² ASIC may bring an application for a debarment order disqualifying a person from managing corporations for a specific period that the Court considers appropriate if the Court is satisfied that the person has committed, has attempted to commit or has been involved in, a contravention of a provision of Subdivision C or D.¹³³

As indicated ASIC's role is that of a conduct regulator, which means that it is mandated with ensuring that there is compliance with statutory regulation and other regulatory standards that pertain to the market conduct of deposit-taking financial institutions in Australia. ASIC has to regulate such institutions to ensure that they meet certain conduct and competency standards and have sufficient risk management mechanisms in place, and that when they fail, client funds and property are protected.¹³⁴

3.2.3 The Reserve Bank of Australia (RBA)

As mentioned above there is a third, unofficial, "pillar" in the Australian Twin Peaks model which is the Reserve Bank of Australia (RBA). In 1911 the first Commonwealth Bank Act provided that the Commonwealth bank had ordinary functions of commercial and savings banking. The Bank did not have a central banking remit and it was not responsible for the note issue. The Australian Department of Treasury at the time had the responsibility of the note issue which took it over from the private trading banks and the Queensland Government.¹³⁵

The note issue in 1920 was transferred from the Treasury to a Notes Board. The Governor of the Bank was a member of the Notes Board, and the administration of the note issue was undertaken by the Bank even though the Bank and the Notes Board were formally independent from each other. The Commonwealth Bank Act was amended in

¹³² Section 93AA of ASIC Act 51 of 2001.

¹³³ Section 12GLD of ASIC Act 51 of 2001.

¹³⁴ Godwin & Ramsey 2015 13.

¹³⁵ The Reserve Bank of Australia <https://www.rba.gov.au/about-rba/history/>.

1924 and the Commonwealth bank was given full control of the note issue. In 1945 the new Commonwealth Bank Act and the Banking Act, then formalized the Commonwealth bank powers regarding the administration of monetary and banking policy, and exchange control.¹³⁶

The Reserve Bank Act of 1959 took effect from 14 January 1960. This Act preserved the original corporate body, to carry on the central banking functions of the Commonwealth Bank as the new central bank of Australia which was now officially known as the Reserve Bank of Australia (RBA). In the Wallis inquiry into the Australian financial system in 1996, there were two major outcomes pertaining to the RBA which took effect from 1 July 1998. Notably the RBA's mandate of bank supervision was transferred to APRA as discussed above. Legislation was introduced namely the Payment System Act of 1998 and the Payment Systems and Netting Act 1998, in order to promote a new mandate which was the safety and efficiency of the Australian payments system.¹³⁷

In 2014 a further inquiry into the financial system was conducted.¹³⁸ This inquiry was triggered by the lessons from the Global Financial Crisis. The purpose of the 2014 Financial System Inquiry was, inter alia, to determine whether there were further challenges pertaining to the regulation of the financial system that needed to be addressed. The inquiry, however, found that Australia's regulatory architecture did not need a major change and that the role of the RBA remained appropriate.¹³⁹

In terms of section 10 of the Reserve Bank Act 1959, the RBA Board has power to determine the policy of the Bank in relation to any matter, other than its payments system policy, and to take such action as is necessary to ensure that effect is given by the Bank to the policy so determined. It is the duty of the RBA Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank under the Reserve Bank Act and any other Act, other than the Payment Systems (Regulation) Act 1998,

¹³⁶ The Reserve Bank of Australia <https://www.rba.gov.au/about-rba/history/>.

¹³⁷ The Reserve Bank of Australia <https://www.rba.gov.au/about-rba/history/>.

¹³⁸ Financial System Inquiry Final Report 2014 <https://treasury.gov.au/sites/default/files/2019-03/p2014-FSI-01Final-Report.pdf>.

¹³⁹ The Reserve Bank of Australia <https://www.rba.gov.au/about-rba/history/>.

the Payment Systems and Netting Act 1998 and Part 7.3 of the Corporations Act 2001, “are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to: the stability of the currency of Australia; the maintenance of full employment in Australia; and the economic prosperity and welfare of the people of Australia”.¹⁴⁰

Under Twin Peaks, as pointed out above, the RBA is tasked with, *inter alia*, overall responsibility for the financial system and to function as lender of last resort (LOLR). Schmulow states that the Australian model could, therefore, reasonably have been described as a three-peak model, with each peak created as an independent, statutory body.¹⁴¹

3.2.4 Cooperation and collaboration

Regulatory cooperation and collaboration in the Australian Twin Peaks model is described as “primarily informal, long-term, frequent, voluntary and cooperative in nature”.¹⁴² Godwin and Ramsey point out that there are four aspects to the policy framework supporting coordination that are critical to the Australian Twin Peaks model, all of which are interrelated. These aspects are proactive information-sharing between the regulators, consultation and mutual assistance between the regulators, practical measures to encourage and facilitate coordination and a coordination body.¹⁴³

Information-sharing is underpinned by the confidentiality provisions in the relevant legislation. This enables the regulators to share confidential information that assists them in performing their functions or exercising their power. APRA and ASIC have entered into a Memorandum of Understanding (MoU) on 28 November 2019.¹⁴⁴

¹⁴⁰ Section 10 of the Reserve Bank Act of 1959.

¹⁴¹ Schmulow “*Financial regulatory governance in South Africa: the move towards Twin Peaks*” 2017 (25) *African Journal of International and Comparative Law* 397.

¹⁴² Godwin & Ramsey 2015 31.

¹⁴³ *Ibid.*

¹⁴⁴ Memorandum of Understanding 28 November 2019

<https://www.apra.gov.au/sites/default/files/APRAASIC%20Memorandum%20of%20Understanding%202019.pdf>.

This is the most recent MoU, following upon previous MoUs entered into between the APRA and ASIC.¹⁴⁵ However, this MoU, like the other MoU's entered into between the Australian regulators in the course of applying the Twin Peaks model, is not legally binding between the regulators. Its purpose is merely to indicate to the public how the regulators intend to achieve effective coordination and to set out the process by which the MoUs are reviewed from time to time.¹⁴⁶

Notably the MoU between APRA and ASIC makes provision for information-sharing between the regulators as full and timely Information-sharing is a crucial element of co-ordination between APRA and ASIC.¹⁴⁷ APRA gathers a wide range of information on the entities under its prudential supervision and ASIC gathers such information during the course of its role in monitoring and promoting market integrity and extending consumer protection.¹⁴⁸ The two agencies thus agreed that when information is available to one agency, and this information is relevant to the functions of the other, then such information will be shared.¹⁴⁹ When sharing confidential information APRA and ASIC acknowledge the confidentiality and observes the secrecy of such information as required by legislation.¹⁵⁰ In order to avoid duplication of the collection of information the agencies work together to minimize the reporting burden on financial institutions.¹⁵¹ APRA and ASIC, may arrange for information relevant to their responsibilities to be collected from financial entities by the other agency.¹⁵² The MoU of 12 October 1998 between the RBA and APRA¹⁵³ which was entered into in mirrors the same provisions as the MoU between

¹⁴⁵ Memorandum of Understanding 12 October 1998 <https://www.rba.gov.au/publications/annual-reports/cfr/2002/appendix-b.html>, Memorandum of Understanding 30 June 2004. <https://www.rba.gov.au/publications/annual-reports/cfr/2002/appendix-b.html>, Memorandum of Understanding 10 May 2010 <https://www.apra.gov.au/sites/default/files/ASIC-MoU.pdf>.

¹⁴⁶ Godwin & Ramsey 2015 32.

¹⁴⁷ Godwin & Ramsey 2015 32.

¹⁴⁸ Godwin & Ramsey 2015 32.

¹⁴⁹ Godwin & Ramsey 2015 32.

¹⁵⁰ Godwin & Ramsey 2015 32.

¹⁵¹ Godwin & Ramsey 2015 32.

¹⁵² Godwin & Ramsey 2015 33.

¹⁵³ Memorandum of Understanding between the RBA and APRA 12 October 1998. <https://www.rba.gov.au/media-releases/1998/jmr-98-1210-rba-apra.html>.

APRA and ASIC, and this is also the case in respect of the MoU between RBA and ASIC.¹⁵⁴

The second aspect to the policy framework to support coordination in Australia pertains to consultation and mutual assistance between the regulators. The MoU of 18 May 2010 which was entered into between the APRA and ASIC,¹⁵⁵ contains provisions for regular meetings, consultations, proactive dialogue and liaison between the regulators.¹⁵⁶ The third aspect is to make available practical measures to encourage and facilitate coordination between the regulators. Finally, the fourth aspect of the framework for cooperation and collaboration within the Australian Twin Peaks model comprises a coordination framework, which is achieved through the Council of Financial Regulators (CFR).¹⁵⁷ The CFR is the main coordinating body within the Australian Twin Peaks model and its members are APRA, ASIC, the RBA and the Australian Treasury.

On 20 November 2013, the Treasurer released a draft term of reference for an envisaged 2014 Financial System Inquiry (the Inquiry). The Committee that was subsequently appointed to conduct the 2014 Financial System Inquiry was tasked to determine how the financial system could be positioned to best meet Australia's evolving needs and support Australia's economic growth.¹⁵⁸

Notably the RBA in its submission to the 2014 Financial System Inquiry argued against formalizing the coordination mechanism of the CFR by capturing it in legislation. The RBA was of the view that capturing the CFR in a formal legislative framework with explicit responsibilities and policy tools would involve transferring "agency constituent powers" to the CFR. The RBA's view was, however, that this would be a risk, due to the possibility of "blurring the lines of responsibility" between the various regulators and the CFR that

¹⁵⁴ Memorandum of Understanding between the RBA and ASIC 18 March 2002 <https://www.rba.gov.au/media-releases/2002/mr-02-08.html>.

¹⁵⁵ Memorandum of Understanding 10 May 2010 <https://www.apra.gov.au/sites/default/files/ASIC-MoU.pdf>.

¹⁵⁶ Ibid.

¹⁵⁷ Ibid.

¹⁵⁸ Financial System of Inquiry November 2014 vii.

have worked well over the years since the Australian Twin Peaks model was implemented.¹⁵⁹

3.3 CONCLUSION

It goes without saying that Australia took a leap, built a bridge, and paved the way when it decided to implement the Twin Peaks Model in 1998 which it had done long before the 2008 Global Financial Crisis.

According to Schmulow, the Australian Twin Peaks Model has the following six particular advantages: First, by assigning to each regulatory agency a single objective, there is maximum regulatory focus by each regulator.¹⁶⁰ Second, there are significant potential synergies that result from bringing together all regulators of a particular market. Schmulow indicates that APRA was also one of the first agencies to apply a broad risk-based supervisory approach to all prudentially regulated sectors of the financial system. Similarly, he points out that Australia was one of the first countries in the world to introduce a single licensing regime for market participants, by bringing all markets under ASIC's purview.¹⁶¹ The third advantage is that bringing all prudentially regulated entities under one roof is conducive to eliminating regulatory arbitrage.¹⁶² The fourth advantage is that bringing all prudentially regulated institutions under one roof should facilitate a more consistent and effective approach to regulating financial conglomerates.¹⁶³ The fifth advantage mentioned by Schmulow is that when a single objective is allocated to each regulator it minimizes any overlap between regulators' objectives and their functions.¹⁶⁴ The sixth advantage, is that the allocation of a single objective to each agency should minimize cultural clashes.¹⁶⁵

The overview provided in this chapter demonstrated that the RBA and APRA are both mandated with sharing a responsibility to achieve, as well as maintain, financial stability,

¹⁵⁹ Ibid.

¹⁶⁰ Schmulow "Twin Peaks: An Analysis of the Australian Architecture" 2016 61 – 63.

¹⁶¹ Ibid.

¹⁶² Ibid.

¹⁶³ Ibid.

¹⁶⁴ Ibid.

¹⁶⁵ Ibid.

and they are consistently cooperating and collaborating with one another for the benefit of the Australian financial market. It is also clear that the RBA and APRA need the market conduct regulation support rendered by ASIC in order to enable the promotion and maintenance of financial stability in Australia. There is a strong system of collaboration and cooperation in place between the regulators in the Australian Twin Peaks model, as facilitated by the CFR, which contributes to the effectiveness of the Australian approach to financial regulation. As pointed out this system for cooperation and collaboration is, however, informal as the regulators have preferred that it should not be captured in legislation but rather in informal non-binding MoU's between them.

It is clear that the success of the Australian Twin Peaks model has contributed thereto that the Twin Peaks model as a method of financial regulation gained popularity, to such an extent that other countries have followed suit. As such the Australian model serves as a benchmark for other jurisdictions who seek to introduce a similar model albeit with country-specific adaptation.

CHAPTER 4 CONCLUSIONS AND RECOMMENDATIONS

4.1 FINAL REMARKS REGARDING THE TWIN PEAKS MODEL

The 2008 Global Financial Crisis resulted in a major rethink with regards to rules and assumptions which underpin the regulation of financial systems across the globe. Although various opinions exist as to the causes of the GFC, it was nevertheless clear that many countries did not capture the risks that banks and other financial institutions were exposed to and that regulation that focused only on micro-prudential aspects was too narrow.¹⁶⁶ As the global economy grew financial products became more complex and an increasing challenge to regulate large financial conglomerates which were engaged in a range of financial activities comprising complex financial products and services, arose. The GFC, however, yielded valuable lessons and made effective regulation of the financial system a key priority. The one identified trend is that there has been a significant departure from the sectoral or institutional model of regulation as this model became inadequate to provide effective regulation of the increasingly complex and interconnected financial system.¹⁶⁷

Consequently other approaches to regulation were considered and adopted in various countries across the globe, the main aim being to provide holistic supervision of the financial system through an appropriate institutional network and to provide regulators with appropriate tools in order to detect and mitigate the build-up of systemic risk.¹⁶⁸ As discussed in Chapter Three Australia was a pioneer in developing an effective and efficient regulatory model that eventually also was able to withstand the dire impact of the GFC and that could serve as a benchmark for countries that wanted to transition to a Twin Peaks model of financial regulation.

The many advantages of the Twin Peaks model were highlighted in this dissertation. Chief among these advantages is that the two peak regulators are more likely to have dedicated objectives and clear mandates to which they are exclusively committed. Secondly, it will

¹⁶⁶ Godwin, Kourabas & Ramsey 2016 1.

¹⁶⁷ Godwin, Howse & Ramsey "A Jurisdictional Comparison of the Twin Peaks Model of Financial Regulation" 2017 1 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2905458 (accessed 28 March 2020) Hereinafter referred to as "Godwin, Howse & Ramsey 2017".

¹⁶⁸ Godwin, Kourabas & Ramsey 2016 2.

be highly unlikely that the one aspect of regulation will dominate the other aspect of regulation; thus one can expect prudential regulation and market conduct regulation in such a model to each receive the regulatory attention that it requires.¹⁶⁹ As noted by Godwin, Howse and Ramsay the Twin Peaks model will be better adapted at keeping up with the growing complexity of financial markets and the continuing rise of financial conglomerates.¹⁷⁰

It would, however, be prudent to also take note of some disadvantages of the model in order to ensure that pitfalls are avoided. First, the model may in some ways create regulatory overlap with dual regulated entities. If this is not carefully managed then it could place a burden on regulated entities and lead to poor information-sharing and coordination.¹⁷¹ Secondly, Godwin, Howse and Ramsay observe that a general risk may arise that the regulators do not practice proper or sufficient cooperation and coordination, and they caution that this should be managed through robust coordination and liaison channels.¹⁷² Finally, they observe that there may be a conflict of interest within the central bank in versions of the Twin Peaks model where the central bank is responsible not only for financial stability but also for both prudential regulation and monetary policy. Therefore, countries that are considering adopting such a version of the Twin Peaks model need to think carefully about whether they should leave prudential regulation and supervision to the central bank.¹⁷³

4.2 THE SOUTH AFRICAN TWIN PEAKS MODEL: DOES IT PROMOTE AND MAINTAIN FINANCIAL STABILITY?

South Africa must be given some credit for the fact that prior to and during the GFC it did not experience the financial upheaval experienced in some other economies across the globe. This is due to the fact that South Africa already had a sound framework for financial

¹⁶⁹ Godwin, Howse & Ramsey 2017 3.

¹⁷⁰ Godwin, Howse & Ramsey 2017 3.

¹⁷¹ Ibid 4.

¹⁷² Ibid 4.

¹⁷³ Ibid.

regulation and well-regulated institutions, appropriate and conservative risk management practices at domestic banks, and a robust monetary policy framework to name a few.¹⁷⁴

As pointed out in this dissertation South Africa nevertheless heeded the lessons from the GFC and embarked on a comprehensive overhaul of its approach to financial regulation. South Africa was fortunate that it could refer to the extensive experience of a jurisdiction like Australia with the Twin Peaks model of financial regulation.¹⁷⁵ The move towards the South African Twin Peaks model was carefully considered and crafted over a number of years taking these lessons into account in devising a model that is tailor-made for South Africa.¹⁷⁶ The Twin Peaks approach is regarded as the optimal means of ensuring that, in addition to the focus on financial stability and sound prudential regulation, transparency, market integrity, and consumer protection also receive equal and sufficient priority. In particular the South African model appears to be based on an institutional model comprising of three peak regulators who will work together with other regulators and organs of state to promote and maintain financial stability in South Africa. In this regard the comprehensive and expanded financial stability mandate imposed on the Reserve Bank together with the proper execution of the objectives and functions assigned to the PA as prudential regulator and the FSCA as market conduct regulator who are both tasked to assist in maintaining financial stability, bodes well for the future of financial stability in South Africa. The existence of a separate prudential and market conduct regulator will further create a system of checks and balances, which will avoid vesting too much power in a single agency.¹⁷⁷

This does not mean that South Africa must now become complacent about its new optimal model of financial regulation. This model will only work effectively and efficiently and contribute to the promotion and maintenance of financial stability if there is swift and appropriate information sharing and cooperation and coordination between the various

¹⁷⁴ National Treasury "A Safer Financial Sector to Serve South Africa Better" 2011
<http://www.treasury.gov.za>.

¹⁷⁵ Van Heerden and Van Niekerk "*Twin Peaks in South Africa: a new role for the Central Bank*" 2017. Law and Financial Markets Review v11 n4 154-162.

¹⁷⁶ Ibid.

¹⁷⁷ National Treasury "A Safer Financial Sector to Serve South Africa Better" 2011
<http://www.treasury.gov.za>.

bodies that function within the model. Accordingly, such cooperation and collaboration must be a priority both for purposes of promoting and maintaining financial stability and also for making sure the model as a whole operates effectively and efficiently. It is evident that the promotion and maintenance of financial stability will not be a goal that the Reserve Bank can achieve without the assistance of other regulators and role players in the financial system. Therefore, the twin regulators as well as the other institutions and organs of state that are role players in the financial system have to accept and act on the responsibilities imposed on them for purposes of assisting the Reserve Bank with this mammoth task.

At the time of writing this dissertation the world is currently facing a pandemic in which most countries have been forced to essentially lockdown the country as a result of COVID-19. This means that economies across the globe are experiencing a rapid decline as a result of this pandemic. It will certainly test the Twin Peaks model that has been implemented in South Africa and it is hoped that this new model of financial regulation will prove its worth by assisting to appropriately address the shock that the economy is currently facing and to promote and maintain financial stability in the country during the course of this systemic crisis.

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