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The South African Reserve Bank's mandate to promote and maintain financial stability in terms of the Financial Sector Regulation Act 9 of 2017

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SUMMARY

A stable and resilient financial system contributes substantially to balanced and sustainable economic growth. Financial stability instils confidence in the economy by reducing systemic risks, facilitating effective fund intermediation, and preventing the fallout from failing financial institutions. The 2008 Global Financial Crisis (GFC) was a watershed moment in financial regulation, highlighting the challenges posed by large, complex, and highly interconnected financial institutions, as well as intricate financial instruments like derivatives. The crisis emphasised the need for robust regulatory frameworks to prevent similar future crises. Key regulatory responses included raising bank capital requirements, intensifying supervision, and improving bank resolution and deposit protection mechanisms. Together, these measures emphasised financial stability as a primary focus in the post-GFC regulatory landscape.

The South African Reserve Bank (SARB) is central to maintaining financial stability as mandated by the Financial Sector Regulation Act 9 of 2017 (FSRA). The SARB is responsible for monitoring the financial landscape and mitigating systemic risks that could disrupt the stability of the financial system. This research assesses the SARB's effectiveness by comparing its financial stability tools to those used in the United States (US), which was the financial system of origin of the GFC. The study also examines how these US tools were applied during the 2023 banking turmoil. By analysing these comparisons, this research aims to identify specific improvements that could strengthen the SARB's financial stability framework.

In an era of interconnected financial systems, ineffective financial stability management can lead to far-reaching consequences, impacting key economic indicators such as gross domestic product (GDP) growth, unemployment, and public trust. Effective financial regulation is crucial for maintaining financial stability, especially in South Africa's economy. This research examines the tools and strategies employed by the SARB to fulfil its mandate of ensuring financial stability to uncover insights that can enhance the resilience of South Africa's financial system in times of stress or systemic crises such as pandemics or other large-scale economic shocks.

Key Words: Financial Stability, Systemic Risk, Global Financial Crisis, South African Reserve Bank, Financial Sector Regulation Act.

LIST OF ABBREVIATIONS

Basel Committee on Banking Supervision	**BCBS**
Bank of International Settlements	**BIS**
Corporation of Deposit Insurance	**CODI**
Financial Action Task Force	**FATF**
Financial Intelligence Centre	**FIC**
Financial Sector Conduct Authority	**FSCA**
Financial Sector Contingency Forum	**FSCF**
Financial Sector Counsel of Regulators	**FSCR**
Financial Sector Inter-Ministerial Council	**FSIMC**
Financial Sector Oversight Committee	**FSOC**
Financial Sector Regulation Act	**FSRA**
Financial Stability Committee	**FSC**
Financial Stability Department	**FSD**
Gross Domestic Product	**GDP**
Global Financial Crisis	**GFC**
Group of 20	**G20**
Global Financial System	**GFS**
International Monetary Fund	**IMF**
Lender of Last Resort	**LOLR**
Monetary Policy Committee	**MPC**
National Credit Regulator	**NCR**
Prudential Authority	**PA**

South African Reserve Bank	**SARB**
Systemically Important Financial Institutions	**SIFIs**
Too Big To Fail	**TBTF**
Total loss-absorbing capacity	**TLAC**
United States	**US**
United States Federal Reserve	**US FED**
United States Financial Sector Oversight Committee	**US FSOC**

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CHAPTER 1: INTRODUCTION

1.1 Background to the Study

What is financial stability and why is it important? The answer to this question is the precursor to the ultimate goal of determining what the South African Reserve Bank's (the SARB's) legislative mandate is in maintaining financial stability. Perhaps the best source of a basic definition of financial stability would be to look at how the SARB itself defines it. The SARB indicates that a stable financial system is one where risks affecting it are mitigated, and that should systemic events occur, these events should not affect economic growth to the point that public confidence in the financial system is lost.[1]

At the core of this definition is of course the very architecture of a financial system that has to be kept stable. A financial system is the conduit for economic production, distribution of goods and services, and in a stable environment should allow consumers to engage in activities that foster economic development and growth. A financial system is made up of several sectors, financial services being one of an economy's most important ones. These financial services are broad in range and can include specific activities such as banking, investing, and insurance.[2] In financial markets with underdeveloped bond and equity markets, financial intermediation is mostly carried out through the banking system.[3] Banks play a major role in the financial infrastructure of most markets, for example, as lenders not just to the public in general, but also to governments.

Central banks serve a regulatory role as part of the financial infrastructure. In most financial systems, they monitor the services offered by financial institutions and are responsible for managing the macroeconomic risks that a financial system could be exposed to.[4] In the case of the banking sector, central banks would be responsible for the supervision of these banks, and to a certain extent an ancillary consumer

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[1] The South African Reserve Bank *Financial stability* available at https://www.resbank.co.za/en/home/what-we-do/financial-stability (accessed on 23 February 2023).

[2] Mohamed, S *The South African Financial System* 2017 27 available at https://www.researchgate.net/publication/332670332 (accessed on 11 March 2023).

[3] Ozkan et al "The banking sector, government bonds, and financial intermediation: The case of emerging market countries" 2010 *Emerging Markets Finance & Trade* 55.

[4] Ugeux *International Finance Regulation: The Quest for Financial Stability* (2014) 3.

protection role. Stable financial markets require market participants that do not engage in conduct that impacts those markets negatively.[5] This can only be achieved through a rules-based system of regulation.[6] The SARB is the central bank of South Africa[7] and is regulated in terms of the South African Reserve Bank Act.[8] The primary object of the SARB is to protect the value of the currency in the interest of balanced and sustainable economic growth in South Africa. It has also subsequently become the primary custodian for maintaining financial stability in South Africa on the date of commencement of the FSRA, which was on 01 April 2023.[9]

The 2008 Global Financial Crisis (the GFC) was perhaps the most important watershed moment for financial regulation.[10] The Great Recession as it was colloquially referred to was initially a crisis with its origins in the United States (the US) financial system, primarily in its banking sector.[11] Many banks in the US engaged in risky lending practices to mortgage borrowers, who from a financial suitability test perspective, would not have qualified for the loans, and who were further unlikely in a downturn to be able to repay these loans. These non-performing loans were the genesis of the crisis.[12]

The interconnectedness of the global financial system could no longer be ignored, given the contagion[13] that spread throughout the system, from what in the past would

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[5] The National Treasury *Explanatory Policy Paper accompanying the Conduct of Financial Institutions Bill* 2019 2 available at https://www.treasury.gov.za/twinpeaks/cofi%20bill%20policy%20paper.pdf (accessed 30 May 2023).

[6] Goyal "Regulatory structure for financial stability and development" 2010 *Economic and Political Weekly* 51.

[7] Section 11 of the Constitution of the Republic of South Africa Act 108 of 1996.

[8] The South African Reserve Bank Act 90 of 1989.

[9] Section 11 of the FSRA.

[10] The National Treasury *A Safer Financial Sector to Serve South Africa better* 2011 11 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf (accessed 30 May 2021).

[11] Mishkin, FS "Over the Cliff: From the Subprime to the Global Financial Crisis" 2011 *Journal of Economic Perspectives* 49.

[12] Bernanke, B "The Real Effects of Disrupted Credit: Evidence from the Global Financial Crisis" 2018 *Brookings Papers on Economic Activity* 271.

[13] Contagion is the risk that the failure of one financial institution will lead to the failure of other financial institutions because of the linkages between them through financial structures such as the payment system / interbank markets etc. See The OECD Competition Committee *Competition and the financial crisis* 2009 5 available at https://www.astrid-online.it/static/upload/protected/OECD/OECD_Competition_and_Financial_Crisis_febbraio09.pdf (accessed on 23 February 2023).

have been reduced to the US financial system.[14] Financial regulators had to deal with the complexities of the changes wrought by globalisation, such as the rise of major conglomerates[15] whose turnover dwarfed that of some small countries, and whose complex financial products[16] raised the risk that consumers of those products were exposed to.[17] Securitization in the subprime market and trading in over-the-counter derivatives led to frozen credit markets, bankruptcies, unemployment, burst property bubbles, and large national debts.[18]

How countries around the world dealt with the GFC was largely dependent on the nature of their financial regulatory frameworks, as well as nature and complexity of their financial systems.[19] The structure of the chosen financial regulatory framework determines how best that system is able to deal with the inevitable economic shocks that will be experienced and that affect financial stability.[20]

Before the GFC, financial stability was not a concept seen as one to be considered purely on its own footing.[21] Financial stability was seen as being just another facet of central banks conducting their overall monetary policy, mostly through a standard

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[14] Mishkin, FS "Over the Cliff: From the Subprime to the Global Financial Crisis" 2011 *Journal of Economic Perspectives* 49.

[15] Conglomerates are large and complex financial institutions whose risk is difficult to accurately evaluate given the nature of financial services they provide. They provide a mix of financial services that incorporate new services such as investment banking with traditional services such as commercial banking, which results in the creation of giant financial conglomerates that dramatically increase the share of the financial sector industry and make them "TBTF". See Crotty "Structural causes of the global financial crisis: a critical assessment of the new financial architecture" 2009 *Cambridge Journal of Economics* 563–580.

[16] Hossain and Kryzannowski "Global financial crisis after ten years: A review of the causes and regulatory reactions" 2019 *Managerial Finance* 906. Securitisation is an example of a complex financial product that allows banks to repackage and sell bad debt, including loans and mortgages, to third-party investors in the form of a security. Although initially designed to enhance the resilience and stability of the financial system by redistributing risk efficiently, it ended up triggering the GFC when the housing bubble burst driven by the opportunistic behaviour by banks. This behaviour created complex, opaque and lower quality financial assets, which caused investors significant losses with an ancillary loss in confidence in securitisation itself.

[17] Baily, Litan and Johnson "The Origins of the Financial Crisis" (2009) EliScholar.

[18] Bernanke "The real effects of disrupted credit: Evidence from the Global Financial Crisis" 2018 *Brookings Papers on Economic Activity* 251-342.

[19] Botha and Makina "Financial regulation and supervision: Theory and practice in South Africa" 2011 *International Business & Economics Research Journal* 31.

[20] Sydow et al *Shock amplification in an interconnected financial system of banks and investment funds* ECB Working Paper Series, No 2581 / August 2021 4 available at https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2581~63c8ffb7dc.en.pdf (accessed 30 May 2023).

[21] Group of Thirty Working Group on Financial Reform *Financial Reform, A Framework for Financial Stability* 15 January 2009 10 available at https://policydialogue.org/files/events/background-materials/G30_Framework_for_Financial_Stability.pdf (accessed 26 September 2023).

short-term interest rate within an inflation targeting framework.[22] Alternatively, financial stability was seen to be within the purview of silo specific regulators, exercised through the micro-prudential supervision of financial institutions, by consideration of these financial institutions' accounting books.[23]

Post GFC it was accepted that central banks' aim of price stability or the basic accounting exercise by silo specific regulators of individual financial institutions did not guarantee financial stability.[24] Financial stability is now seen as also requiring macroprudential regulation, such regulation – which has its eye on the financial stability of the financial system as a whole. [25] Such regulation usually can only be achieved by a central authority like a country's central bank. Some of the macroprudential tools[26] at a central bank's disposal are its ability to create liquidity in a market or be a lender of last of resort.[27]

The GFC, as with any situation of trauma to any system, has led regulatory authorities across the world to review and reconsider their supervisory models. Before the GFC, most supervisory authorities used what was referred to as a "light touch" approach to

[22] Jordan "Debating the Mandate of the Reserve Bank" New Agenda 2017 7-10 available at https://www.ajol.info/index.php/na/article/view/160366/149942 (accessed 16 March 2024).

[23] Micro-prudential regulation is regulation that focuses on a bank's individual solvency represented by its minimum capital adequacy requirements. The Board of Governors of The Federal Reserve *Consolidated Supervision Framework for Large Financial Institutions* 2012 available at https://www.federalreserve.gov/supervisionreg/srletters/sr1217.htm (accessed 08 October 2023).

[24] Gadanecz and Jayaram *Measures of financial stability - a review* IFC Bulletin Chapters, in: Bank for International Settlements (ed) In: Proceedings of the IFC Conference on "Measuring financial innovation and its impact" Basel, 26-27 August 2008, 2009 365 available at https://ideas.repec.org/h/bis/bisifc/31-26.html (accessed on 13 November 2023).

[25] Macro-prudential regulation is a system-wide approach to regulating the financial system that not only considers the optimisation of the market conduct on the part of individual financial institutions, but also explicitly takes account external factors that exist across financial institutions to asses systemic risk, the objective being to assess resilience of the financial system as a whole to absorb shocks and to continue the financial intermediation process during the occurrence of systemic events. See Nisha and Rajoo Reform of the Dodd-Frank Act and its Implications 2016 *Review of Banking & Financial Law 60*5.

[26] Goodhart *The changing role of central banks* BIS Working Papers No 326 November 2010 9 available at https://www.bis.org/publ/work326.pdf (accessed 25 September 2023).

[27] Central banks act as lenders of last resort through the provision of liquidity insurance, usually to the banking system or to other financial institutions, which then in turn provides liquidity insurance to the rest of the economy i.e. households and businesses. Central banks, in this instance act as liquidity *re*-insurers. In the lender of last resort role, central banks in times of crisis, usually make it clear that they stand ready to lend early, freely and without limit to financial institutions, against collateral and at rates that are dependent on prevailing market conditions. The benefits of central banks playing the lender of last resort role are that banks' short-term creditors would be less inclined to conduct runs on the banks, as well as reduce the need for a forced sale of assets that could cause avoidable insolvencies and financial instability. See Tucker *The lender of last resort and modern central banking: principles and reconstruction* BIS Papers No. 76 2014 12 available at https://www.bis.org/publ/bppdf/bispap79b_rh.pdf (accessed 23 November 2023).

financial regulation,[28] which was believed to free entrepreneurs to generate astonishing wealth.[29] Light touch regulation in certain financial systems such as the US and Ireland meant, relative to other developed systems, nearly no regulation at all.[30] Government authorities were blamed during this time for the regulatory and financial system failures that occurred during the GFC as the interests of bankers were considered more than the required protection of consumers.[31] Many people were angered when highly paid bankers caused extensive job losses and brought the economy to its knees, yet faced no jail time nor had to give back their past bonuses. This led to protests like the Occupy Wall Street movement.[32] As with any system when role players are not subjected to the necessary checks and balances, this leaves little ability to take adequate corrective measures when crisis strikes.[33] Light touch regulation also involves a reluctance on the part of an individual jurisdiction to collaborate and participate in international oversight initiatives such as those offered by the International Monetary Fund (the IMF).[34] Countries badly affected during the GFC by this form of light touch regulation were the US, Greece, Iceland, Spain, and Ireland.[35]

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[28] Keynote address by Mr Lesetja Kganyago, Governor of the South African Reserve Bank, the Financial Sector Conduct Authority Industry-wide Conference 2024, Johannesburg, 13 March 2024 available at https://www.resbank.co.za/content/dam/sarb/publications/speeches/speeches-by-governors/2024/Keynote%20address%20by%20Lesetja%20Kganyago%20Governor%20of%20the%20South%20African%20Reserve%20Bank%20at%20the%20Financial%20Sector%20Conduct%20Authority%20Industry-wide%20Conference%202024.pdf (accessed 27 July 2024).

[29] Clarke and Hardiman *Crisis in the Irish Banking System* UCD Geary Institute Discussion Paper Series Geary WP2012/03 February 2012 30 available at https://www.ucd.ie/geary/static/publications/workingpapers/gearywp201203.pdf (accessed 28 July 2024).

[30] Ibid 30.

[31] Dagher *Regulatory Cycles: Revisiting the Political Economy of Financial Crises* IMF Working Papers 2018 37 available at https://www.imf.org/en/Publications/WP/Issues/2018/01/15/Regulatory-Cycles-Revisiting-the-Political-Economy-of-Financial-Crises-45562 (accessed 11 November 2023).

[32] Keynote address by Mr Lesetja Kganyago, Governor of the South African Reserve Bank, the Financial Sector Conduct Authority Industry-wide Conference 2024, Johannesburg, 13 March 2024 available at https://www.resbank.co.za/content/dam/sarb/publications/speeches/speeches-by-governors/2024/Keynote%20address%20by%20Lesetja%20Kganyago%20Governor%20of%20the%20South%20African%20Reserve%20Bank%20at%20the%20Financial%20Sector%20Conduct%20Authority%20Industry-wide%20Conference%202024.pdf (accessed 27 July 2024).

[33] Dagher *Regulatory Cycles: Revisiting the Political Economy of Financial Crises* IMF Working Papers 2018 49 available at https://www.imf.org/en/Publications/WP/Issues/2018/01/15/Regulatory-Cycles-Revisiting-the-Political-Economy-of-Financial-Crises-45562 (accessed 11 November 2023).

[34] The National Treasury *A Safer Financial Sector to Serve South Africa better* 2011 11 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf (accessed 30 May 2021).

[35] Clarke and Hardiman *Crisis in the Irish Banking System* UCD Geary Institute Discussion Paper Series Geary WP2012/03 February 2012 10 available at

The lessons from the GFC forced authorities in the global financial system to reconsider their regulatory frameworks, especially with respect to financial stability. This required a reconsideration of the objectives of financial regulation, and to place the mitigation of systemic risk as the key objective. The focus became the use of macroprudential tools that could be used to address the build-up of systemic risks.[36] The two overarching philosophies of financial regulation that predated the GFC were institutional regulation, whose wanted outcome is only the safety and soundness of financial institutions; and functional regulation, whose focus is on the actual activities that financial institutions engage in.[37] Two further models of financial regulation also commonly considered are the integrated or unified agency approach, where the prudential regulation of different sectors of the economy such as banking, securities, and insurance is handled by one agency, and the Twin Peaks approach.[38]

The Twin Peaks approach or model of financial regulation involves two different agencies, each with its specific mandate.[39] There is a prudential regulator whose main aim is to maintain and enhance the safety and soundness of financial institutions, as well as a market conduct regulator whose main aim is to protect the consumers of those financial services.[40] The advantages of this model are that each agency will have its dedicated clear objectives. There is a reduced risk of reputational damage as operations and goals are separated, and the opportunity for accountability is greater as the public can approach the two respective agencies with different problems.[41] Accountability will also result in any possible conflicts between the agencies being dealt with publicly – which can ensure a reasonable settlement. There is less

https://www.ucd.ie/geary/static/publications/workingpapers/gearywp201203.pdf (accessed 28 July 2024).

[36] Nier *Financial Stability Frameworks and the Role of Central Banks: Lessons from the Crisis* IMF Working Papers WP/09/70 2009 3 available at https://www.imf.org/external/pubs/ft/wp/2009/wp0970.pdf (accessed on 12 November 2023).

[37] Llewellyn *Institutional Structure of Financial Regulation and Supervision: The Basic Rules* World Bank Seminar: Aligning Supervisory Structures with Country Needs 2006 3 available at https://www.researchgate.net/publication/255585648 (accessed on 23 February 2023).

[38] Godwin, Howse and Ramsay "A jurisdictional comparison of the twin peaks model of financial regulation" 2017 *Journal of Banking Regulation* 131.

[39] The Financial Regulatory Steering Form Committee *Implementing a Twin Peaks model of Financial Regulation in South Africa* 2013 7 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%203%20roadmap.pdf (accessed 30 May 2021).

[40] Schmulow "The four methods of financial system regulation: An international comparative survey" 2015 *The Journal of Banking and Finance Law and Practice* 165.

[41] The Financial Regulatory Steering Form Committee *Implementing a Twin Peaks model of Financial Regulation in South Africa* 2013 7 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%203%20roadmap.pdf (accessed 30 May 2021).

concentration of power than in an integrated or unified system, and each agency can develop its own culture.[42] The perceived disadvantages[43] of the Twin Peaks model are that it may create regulatory arbitrage between two separate regulators that have two separate sets of regulations and may also create additional compliance burdens on regulated financial institutions that are regulated by dual entities.[44] Risk in the financial system can be caused by a lack of cooperation and coordination between the regulators.[45] Conflict of interest can also arise within a central bank if it is responsible for both prudential regulation and monetary policy; thus, a central bank that is responsible for preventing systemic risk is more likely to loosen monetary policy in circumstances of financial instability.[46]

In 2011, the Group of 20 (G20) members[47] undertook – after the 2008 GFC – to implement the Basel III standards,[48] known commonly as the international regulatory framework for banks. These are an internationally agreed set of measures developed by the Basel Committee on Banking Supervision (BCBS)[49] in response to the GFC.

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[42] Llewellyn *Institutional Structure of Financial Regulation and Supervision: The Basic Rules* World Bank Seminar: Aligning Supervisory Structures with Country Needs 2006 16 available at https://www.researchgate.net/publication/255585648_Institutional_structure_of_financial_regulation_and_supervision_the_basic_issues (accessed on 23 February 2023).

[43] Godwin, Howse and Ramsay "A jurisdictional comparison of the twin peaks model of financial regulation" 2017 *Journal of Banking Regulation* 3.

[44] Ibid 3.

[45] The OECD Competition Committee *Competition and the Financial Crisis* 2009 3 available at https://www.astrid-online.it/static/upload/protected/OECD/OECD_Competition_and_Financial_Crisis_febbraio09.pdf (accessed on 23 February 2023).

[46] Llewellyn *Institutional Structure of Financial Regulation and Supervision: The Basic Rules* World Bank Seminar: Aligning Supervisory Structures with Country Needs 2006 29 available at https://www.researchgate.net/publication/255585648_Institutional_structure_of_financial_regulation_and_supervision_the_basic_issues (accessed on 23 February 2023).

[47] The G-20 is a collaborative forum between the finance ministers of the world's 20 largest economies, that was created in the wake of the Asian economic crisis in the 1990s, for the purpose of fostering international economic cooperation. It is a major role player in shaping and strengthening global financial architecture and governance structures. Beeson and Bell "The G-20 and international economic governance: hegemony, collectivism, or both?" 2009 *Global Governance* 67.

[48] Basel Committee on Banking Supervision *Basel III: A global regulatory framework for more resilient banks and banking systems* December 2010 revised June 2011 1 available at https://www.bis.org/bcbs/basel3.htm (accessed 26 September 2023).

[49] The BCBS is a body that has been created to be the primary global standard setter for the prudential regulation of banks and to provide a collaborative forum for regular cooperation on banking supervisory matters. The 45 members comprise central banks and bank supervisors from 28 jurisdictions. The preceding measures were the Basel I and Basel II standards. Basel I, known as the Basel Capital Accord, introduced a minimum ratio of capital to risk-weighted assets for banks. Basel II, known as the New Capital Framework Accord, amended the minimum capital ratio while introducing the supervisory review of an institution's capital adequacy and internal assessment process, as well as the effective use of disclosure as a lever to strengthen market discipline and to encourage sound banking practices. See Basel Committee on Banking Supervision *History of the Basel Committee* available at https://www.bis.org/bcbs/history.htm (accessed 26 September 2023).

These measures include stricter requirements for the quality and quantity of regulatory capital, restrictions placed on the participation by banks in system-wide credit booms to reduce their losses in credit busts, a leverage ratio or a minimum amount of loss-absorbing capital relative to all of a bank's assets, a minimum liquidity ratio requirement intended to provide enough cash to cover funding needs over 30 days of stress, as well as additional requirements for systemically important financial institutions (SIFIs).[50] The measures aim to implement minimum requirements for internationally active banks in the members' jurisdictions, to strengthen the regulation, supervision, and risk management of these banks.[51]

The main regulatory measure taken by the US government in response to the GFC was the passing of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act).[52] The Dodd-Frank Act restructured an antiquated US financial system that, due to its federal system, was fragmented and lacked the proper oversight.[53] The Dodd-Frank Act sought to meet these goals by ending the principle of "Too Big To Fail" (TBTF)[54] in not guaranteeing taxpayer-based bailouts in future crises, as well as stopping the risky lending and trading activities that had caused the crisis.[55] The US regulatory system has now enhanced regulators' ability to monitor and

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[50] Basel Committee on Banking Supervision *Global systemically important banks: assessment methodology and the additional loss absorbency requirement* 2011 1 available at https://www.bis.org/publ/bcbs207.pdf (accessed 26 September 2023). Systemically important financial institutions are large, usually complex and highly interconnected financial institutions that can be disproportionate in size in relation to domestic, or even the global financial system. These financial institutions are seen as being too big to be allowed to fail messily, given that due to their size, complexity and interconnectedness they would not be able to exit the financial system without causing major disruption and eroding financial stability. See Toniolo The evolution of the financial stability mandate: from its origins to the present day NBER Working Paper Series No. 20844 2015 available at https://www.nber.org/system/files/working_papers/w20844/w20844.pdf (accessed 11 April 2024).

[51] *Ibid* 1.

[52] The Dodd-Frank Act, Public Law 203, U.S. Statutes at Large 124 (2010): 1376-2223.

[53] The Congressional Research Service *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework* 2023 2 available at https://crsreports.congress.gov/product/pdf/R/R44918/8 (accessed on 23 February 2023).

[54] Too-Big-To-Fail was a bailout policy that implied that governments had the responsibility to financially bail out certain large interconnected financial institutions when they were in financial distress, because the failure of these institutions could cause the financial system as a whole to fail. The Too-Big-To-Fail bailout policy post-GFC was widely seen as creating the moral hazard of taxpayers bearing the cost of the excessive risk-taking of financial institutions. The bailouts of financial institutions across the world during the GFC resulted in the outrage amongst taxpayers that led to the regulatory reform discussed in this paper, such as the provisions in the Dodd-Frank Act aimed at addressing the TBTF principle. See Gao, Liao and Wang "Capital markets' assessment of the economic impact of the Dodd-Frank Act on systemically important financial firms" 2018 *Journal of Banking and Finance* 205.

[55] Baily, Litan and Johnson "The origins of the financial crisis" (2009) EliScholar.

address threats to financial stability, strengthening both the prudential oversight and resolvability of SIFIs and improved the capacity of financial institutions to absorb shocks.[56]

In contrast to some other countries at the time of the GFC, South Africa did not engage in light-touch regulation (which had the most traction in the advanced economies). Although South Africa had a strong financial regulatory framework (during the GFC) that regulated its financial institutions to not engage in the risky lending practices that other financial systems engaged in, South Africa still suffered disproportionately in one metric as compared to other G20 countries. This was with regard to job losses that totalled 1 million jobs due to the resultant recession.[57] This showed that whilst South Africa was spared the direct effects of the GFC, it is still closely connected to global financial markets and its financial sector could not and cannot now completely weather global financial crises. In light of these facts as well as South Africa's G20 membership, the country adopted the Twin Peaks model of financial regulation through the promulgation of the FSRA.

The rationale for adopting the Twin Peaks model was that the South African financial sector was and is highly interconnected and dominated by a few large financial institutions, typically comprised of at least a bank and insurance company grouping.[58] These large financial institutions result in a lack of competition between financial institutions that sell complex products with opaque fee structures at uncompetitive prices.[59] The regulatory landscape for financial services was also considered fragmented and based on different sectoral legislation. This resulted in a silo, sector-

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[56] Gao, Liao and Wang "Capital markets' assessment of the economic impact of the Dodd-Frank Act on systemically important financial firms" 2018 *Journal of Banking and Finance* 207.

[57] The National Treasury *A Safer Financial Sector to Serve South Africa better* 2011 4 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf (accessed 30 May 2021).

[58] The National Treasury *Twin Peaks in South Africa*: *Response and Explanatory Document Accompanying the Second Draft of the Financial Sector Regulation Bill* 2014 6 available at https://juta.co.za/media/filestore/2015/03/2014_12_12_Response_document.pdf (accessed 3 August 2023).

[59] Crotty and Epstein "Regulating the US financial system to avoid another meltdown" 2009 *Economic and Political Weekly* 92

specific approach to regulation, which in turn led to different industry standards and allowed for regulatory arbitrage.[60]

Under the Twin Peaks model, the SARB assumed responsibility for macro-prudential regulation, while micro-prudential regulation was delegated to a prudential regulator within the SARB, and additionally, market conduct regulation was entrusted to a separate entity.[61] This shift marked significant development, emphasising an explicit focus on financial stability and the formulation of systemic crisis resolution principles, which additionally had the effect of aligning South Africa with international best practices.[62]

The then South African Minister of Finance, Mr Pravin Gordhan, was the executive member tasked with expanding the mandate of the SARB to include the maintenance and enhancement of financial stability.[63] This initial step laid the groundwork for the subsequent planned enactment of the FSRA on 21 August 2017.[64] The FSRA brought about major financial sector reforms, in line with post-GFC global standards, with a primary emphasis on financial stability in supervision and regulation. The Twin Peaks model resulted in SARB playing a central, though not exclusive role in maintaining financial stability.[65]

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60 The National Treasury *Twin Peaks in South Africa*: *Response and Explanatory Document Accompanying the Second Draft of the Financial Sector Regulation Bill* 2014 7 available at https://juta.co.za/media/filestore/2015/03/2014_12_12_Response_document.pdf (accessed 3 August 2023).

61 *Ibid* 7.

62 The Financial Regulatory Steering Form Committee *Implementing a Twin Peaks model of Financial Regulation in South Africa* 2013 19 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%203%20roadmap.pdf (accessed 30 May 2021).

63 *Ibid* 7.

64 The National Treasury *Response and Explanatory Document: Accompanying the 2nd draft of the Financial Sector Regulation Bill* 2014 4 available at https://juta.co.za/media/filestore/2015/03/2014_12_12_Response_document.pdf (accessed 03 August 2023).

65 Financial stability cannot be maintained in normal times or restored in times of crisis by the SARB alone. The SARB also relies on other authorities such as the National Treasury, the Financial Intelligence Centre, the National Credit Regulator, the Prudential Authority, and the Financial Sector Conduct Authority. Coordination between these institutions occurs through cooperative bodies such as the Financial Sector Oversight Committee and the Financial Sector Contingency Forum. Keynote address by Mr Lesetja Kganyago, Governor of the South African Reserve Bank, the Financial Sector Conduct Authority Industry-wide Conference 2024, Johannesburg, 13 March 2024 available at https://www.resbank.co.za/content/dam/sarb/publications/speeches/speeches-by-governors/2024/Keynote%20address%20by%20Lesetja%20Kganyago%20Governor%20of%20the%20South%20African%20Reserve%20Bank%20at%20the%20Financial%20Sector%20Conduct%20Authority%20Industry-wide%20Conference%202024.pdf (accessed 27 July 2024).

The FSRA is the basis of the legislative framework in South Africa that regulates the financial system. It confers a statutory mandate on the SARB to protect and enhance financial stability. It divides South Africa's regulatory system into different components,[66] each assigned with different tasks for the framework's effective implementation. The SARB takes the lead in ensuring overall financial stability. The specific regulatory aim to strengthen the safety and soundness of financial institutions is conducted through the Prudential Authority (the PA), which is a body that is housed within the SARB.[67] The Financial Sector Conduct Authority (the FSCA) oversees the protection of customers by regulating market conduct.[68]

This interplay between these regulatory peaks is important to SARB's overarching mandate of maintaining financial stability.[69] The safety and soundness of financial institutions are intimately linked to the market conduct of the financial system's participants, as a system rife with misconduct will also become unstable.[70] A functioning regulatory environment fosters a stable financial system that can self-correct in crisis, thus preventing adverse effects on the real economy in times of crisis.[71] Confidence in a financial system is paramount to its success, and it can only be achieved through financial stability.[72]

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66 The National Treasury *A Safer Financial Sector to Serve South Africa better* 2011 8 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf (accessed 30 May 2021).

67 The South African Reserve Bank *The Prudential* Authority Annual Report 2022/23 27 June 2023 61 available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/2023/Prudential-Authority-Annual-Report-2022-2023 (accessed 29 March 2024).

68 The Financial Sector Conduct Authority *Regulatory Strategy of The Financial Sector Conduct Authority: October 2018 to September 2021* 2018 4 available at https://www.fsca.co.za/Documents/FSCA_Strategy_2018.pdf (accessed 30 May 2021).

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

70 Keynote address by Mr Lesetja Kganyago, Governor of the South African Reserve Bank, the Financial Sector Conduct Authority Industry-wide Conference 2024, Johannesburg, 13 March 2024 available at https://www.resbank.co.za/content/dam/sarb/publications/speeches/speeches-by-governors/2024/Keynote%20address%20by%20Lesetja%20Kganyago%20Governor%20of%20the%20South%20African%20Reserve%20Bank%20at%20the%20Financial%20Sector%20Conduct%20Authority%20Industry-wide%20Conference%202024.pdf (accessed 27 July 2024).

71 Schinasi *Defining Financial Stability* IMF Working Paper No. 2004/187 October 2004 5 available at https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Defining-Financial-Stability-17740 (accessed 14 May 2023).

72 Calomiris and Carlson *Restoring confidence in troubled financial institutions after a financial crisis* Finance and Economics Discussion Series Working Paper No 2022-044 Washington: Board of Governors of the Federal Reserve System July 2022 34 available at https://doi.org/10.17016/FEDS.2022.044 (accessed 01 June 2023).

1.2 Research Problem

The interconnected nature of global financial markets has made it evident that the shocks and crises experienced over the last 15 years are likely to persist. To effectively navigate these challenges, resilient regulatory frameworks and tools are imperative to attain and sustain financial stability. The impact of an unstable financial system will be even more acutely felt in an emerging market economy such as South Africa. An unstable macroeconomic environment can lead to major distortions to the real economy, and once a shock to the financial system takes hold, this results in a systemic crisis.[73] Financial instability is even more acutely felt in circumstances wherein there is a lack of adequate macroeconomic regulation.

This research seeks to explore the concept of financial stability and the financial stability mandate vested in the SARB by the FSRA. This investigation is conducted within the framework of the South African Twin Peaks model of financial regulation, with specific focus on understanding the ramifications of the GFC on South Africa's approach to financial stability. The primary concern is to examine the regulatory toolkit at the disposal of the SARB, the primary guardian of financial stability in South Africa, to determine whether it can withstand the many forms of risks the financial system faces today.

In the SARB's most recent 2023 Financial Stability Review[74] the latest major risks globally that were identified were the fears of a global recession, globally systemic risk due to further global monetary policy tightening, persistently high inflation, nervousness about the resilience of the global banking system, volatile financial markets and downward revisions of growth projections, both for major economies and South Africa. In the local context, the country-specific vulnerabilities that were identified were an unreliable electricity supply, deteriorating South African rail and port infrastructure networks and the diplomatic fallout resulting from the comments by the US Ambassador to South Africa on the Russian-Ukraine war, which led to a sharp sell-

[73] The Bank of International Settlements *Financial Stability in Emerging Market Economies* 2 available at https://www.bis.org/publ/gten02.pdf (accessed on 13 November 2023).

[74] The South African Reserve Bank *Financial Stability Review* Second edition 2023 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2023/financial-stability-review/second-edition-2023-financial-stability-review/Second%20Edition%202023%20Financial%20Stability%20Review1.pdf (accessed 16 March 2024).

off in the South African rand and its worst-ever level against the US dollar.[75] South Africa's non-aligned stance in the war between Russia and Ukraine was said to be a risk to the future participation of South African financial institutions in the global financial system and increased the likelihood of sanctions being imposed on South Africa.[76] The Financial Action Task Force (FATF)[77] grey-listing was also mentioned as a material factor.[78] South Africa having one of the highest ratios of state-owned enterprise debt among emerging markets was also identified as a risk.[79] The failure of Silicon Valley Bank and the ensuing turmoil faced by US regional banks was said to be indicative that a high level of exposure to government debt by financial institutions

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75 Ibid

76 Address by Mr Lesetja Kganyago, Governor of the South African Reserve Bank at the 103rd annual ordinary general meeting of the SARB shareholders, Pretoria, 28 July 2023 available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/speeches/speeches-by-governors/2023/Anaddress-by-Lesetja-Kganyago-Governor-of-the-South-African-Reserve-Bank-SARB-at-the-103rd-annual-Ordinary-General-Meeting-of-the-SARB-shareholders (accessed 25 March 2024).

77 The FATF is an organization that tackles money laundering, terrorist and proliferation financing. The FATF researches how money is laundered and terrorism is funded, promotes global standards to mitigate the risks, and assesses whether countries are taking effective action. The Financial Stability Oversight Council Annual Report 2023 available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf (accessed 25 August 2023). Global bodies in the financial sector like the FATF, the IMF, and the BCBS use peer reviews through a mutual evaluation process to assess compliance with internationally agreed standards by member countries. The FATF conducts the evaluation to ensure adherence to FATF's standards which consist of 40 Recommendations against money laundering, terrorist financing, and proliferation financing. The results of the mutual evaluation exercise identify deficiencies and countries strengthen their financial systems by addressing these deficiencies, thereby enhancing the integrity of not only the country's financial system, but that of the global financial system as well. FATF grey listing is the FATF's practice of publicly identifying countries with strategic Anti- Money Laundering and Countering the Financing of Terrorism (AML/CFT) deficiencies. The FATF maintains two such lists, one wherein jurisdictions under increased monitoring are actively working with the FATF to address strategic deficiencies, and another wherein high-risk jurisdictions subject to a call for action are not actively engaging with the FATF. The most significant implication to a country that is grey-listed is the reputational damage to the country, as its effectiveness in combatting financial crimes like corruption and money-laundering as well as terror financing are deemed to be below international standards. The second and related implication arises from consequential action taken with regard to cross-border transactions, particularly possible action taken by foreign banks that provide correspondent banking services. The National Treasury *Fact Sheet: What Does FATF Grey-listing Mean For A Country?* 2023 2 available at https://www.treasury.gov.za/comm_media/press/2023/2023022501%20FATF%20Grey%20Listing%20Fact%20Sheet.pdf (accessed 23 March 2024).

78 The South African Reserve Bank Financial Stability Department *An event-window assessment of the impact of FATF grey-listing on the South African stock market and financial stability consequences* 2023 2 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/topical-briefing---november-2023/TB%20%20An%20event-window%20assessment%20of%20impact%20of%20FATF%20grey-listing%20on%20SA%20stock%20market%20and%20financial%20stability%20consequences.pdf (accessed 25 March 2024).

79 The South African Reserve Bank *Financial Stability Review* First edition 2023 1 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2023/financial-stability-review/First%20Edition%202023%20Financial%20Stability%20Review.pdf (accessed 25 March 2024).

represents a potential risk.[80] However, the domestic soundness of financial institutions in the prudentially regulated financial sector was said to be still strong, as measured by these institutions' aggregate ability to maintain adequate capital and liquidity buffers to absorb the impact of shocks.[81] The conclusion of the report was that the South African financial system continued to function without interruption despite the global banking sector turmoil. The major future risk identified that could affect this would be slow domestic economic growth.[82]

The genesis of the regulatory changes implemented in the US and South Africa in the face of the challenges faced was the 2008 crisis. However, financial stability after 2008 has faced new threats, even with the new legislation and international instruments that have been promulgated to address financial stability. Contemporary challenges to financial stability have included the impact of events like the Covid-19 pandemic,[83] the increased possibility of conflict given geopolitical developments amongst global military powers,[84] and post-GFC collapses of financial institutions[85] that have indicated that engagement with financial stability mandates remains relevant and necessary today.

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80 Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 5 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

81 The Banking Association South Africa *Submission on Transformation in the Financial Sector* 2017 6 available at https://www.banking.org.za/wp-content/uploads/2019/04/submission-on-transformation-in-the-financial-sector-10-03-2017.pdf (accessed 23 March 2024).

82 The South African Reserve Bank *Financial Stability Review* First edition 2023 1 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2023/financial-stability-review/First%20Edition%202023%20Financial%20Stability%20Review.pdf (accessed 25 March 2024).

83 Covid-19, also called coronavirus disease 2019, is an illness caused by the virus called severe acute respiratory syndrome coronavirus 2, or SARS-CoV-2. It started spreading at the end of 2019 and became a pandemic disease in 2020. The virus spreads most commonly through the air in tiny fluid droplets between people in close contact. The Mayo Clinic *Coronavirus disease 2019 (COVID-19)* available at https://www.mayoclinic.org/diseases-conditions/coronavirus/symptoms-causes/syc-20479963 (accessed on 11 October 2024). The Covid-19 pandemic led to a severe global recession that ravaged financial systems around the world, with after-effects that have persisted to this day, which is consistent with the history of deep recessions often leaving damage to economic productivity. Financial instabilities and medium-term output losses although anticipated to be lower than after the GFC, were still substantial, and the degree of future expected damage is dependent on the structure of the relevant economies and the size of the policy response from their lawmakers. Emerging markets and developing economies are expected to suffer more than advanced economies. Barrett et al *After-Effects of the COVID-19 Pandemic - Prospects for Medium-term Economic Damage* IMF Working Paper No. WP/21/203, July 2021 2 available at https://www.imf.org/en/Publications/WP/Issues/2021/07/30/After-Effects-of-the-COVID-19-Pandemic-Prospects-for-Medium-Term-Economic-Damage-462898 (accessed 24 February 2024).

84 The War between Russia and Ukraine, and possible conflict between Israel and Iran.

85 The collapse of Silicon Valley Bank, which will be discussed in a later chapter.

1.3 Research Objectives

The objectives of the research are:

1.3.1 To determine the meaning of the concept of financial stability, setting a foundation for further analysis, particularly in the context of potential financial crises.

1.3.2 To consider the powers conferred on the SARB regarding financial stability, as outlined in the FSRA, and to determine how these powers are exercised in preserving financial stability within South Africa's financial sector.

1.3.3 To assess the effectiveness of the powers conferred on the US regulatory authorities regarding financial stability, as outlined in the Dodd-Frank Act, in preserving financial stability within the US financial sector after the GFC.

1.3.4 To enable a better assessment of the effectiveness of the powers conferred on the SARB regarding financial stability, and to draw valuable insights and lessons from the regulatory landscape of the US. This comparative analysis aims to consider whether or not the necessary lessons have been learned and absorbed into South Africa's financial stability framework after the GFC.

1.3.5 To consider the contemporary understanding of the concept of financial stability, in the context of the contemporary challenges that have been experienced in the post-GFC regulatory landscape.

1.4 Literature Review

There are general understandings of what embodies financial stability, irrespective of the jurisdiction in which the concept is applied. Llewellyn defines financial stability in reference to the risks to the financial system as a whole and the integrity of the payments system.[86]

According to Houben, the main components of what financial stability is composed of are the avoidance of systemic events that cause a financial system (or significant parts of it) to fail to function (crisis), the ability of a financial system to absorb shock and still continue to operate, as well as the ability of the financial system to efficiently allocate resources, monitor and address financial risks, and maintain adequate employment levels.[87]

Chandavarkar deals with how the definition of financial stability and the role of central banks have expanded over the years.[88] Central banks are, in most countries, the core foundational piece in the maintenance of financial stability. This role has traditionally been seen as being centred around the adoption of policies that have to do with the maintenance of price stability and the prudential regulation of banks.

Chittedi indicates that financial instability and the resultant crises that occur can lead to economic recession, cause capital flight, lower exchange rates, and destroy the infrastructure built to allow for financial intermediation. This can result in taxpayer bailouts of SIFIs and/or collapse of these institutions, the financial shock of which as a result of contagion, can cross over into other financial sectors and national borders.[89]

The aims of financial stability must be intricately linked to the policy goals of the specific regulatory framework in which it operates. Gohari and Woody state that, in general, the main goals of financial stability are the prevention of systemic shocks to the financial system, the regulation and supervision of financial institutions to prevent negative risk-taking conduct, the provision of prudential buffers to enable financial

[86] Llewellyn *Institutional Structure of Financial Regulation and Supervision: The Basic Rules* World Bank Seminar: Aligning Supervisory Structures with Country Needs 2006 6 available at https://www.researchgate.net/publication/255585648_Institutional_structure_of_financial_regulation_and_supervision_the_basic_issues (accessed on 23 February 2023).

[87] Houben, Kakes and Schinasi *Toward a framework for safeguarding financial stability* IMF Working Paper No. WP/04/101 June 2004 6 available at https://www.imf.org/external/pubs/ft/wp/2004/wp04101.pdf (accessed 13 November 2023).

[88] Chandavarkar *Promotional Role of Central Banks in Developing Countries* IMF Working Paper No. 87/20, 27 March 1987 1 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=884635 (accessed 04 August 2023).

[89] Chittedi "Global Financial Crisis and Contagion: Evidence for The Bric Economies" 2014 *The Journal of Developing Areas* 43–64.

institutions to absorb shocks (conservation buffers), and the enabling of financial institutions to be able to have plans in place based on proper risk assessments to take self-corrective measures in the face of crises (countercyclical measures).[90]

Barra and Zotti argue that the importance of financial stability of the market is that it provides the framework in which economic transactions such as savings and investments can take place, these transactions which then can be steered in certain directions by monetary policy. This is usually done with the end goal of fostering economic growth.[91]

In the South African context, the Financial Regulatory Reform Steering Form Committee (which was the South African body tasked with implementing the post-GFC financial regulatory model), has stated that there is said to be financial stability if payment systems, settlement systems and financial institutions generally provide financial products and financial services without interruption and are capable of continuing to do so, and there is general confidence in their ability to continue to do so.[92]

In the US context, policymakers such as the Chairman of the US Federal Reserve (the US Fed) at the time of the GFC, Ben Bernanke, have subsequently indicated that the momentousness of the crisis has caused a comprehensive reconsideration and remodelling of financial regulation in the US.[93] The core objectives of these policymakers, which have come to define financial stability in the US, are embodied in the Dodd-Frank Act. The US Fed now defines financial stability as a financial system wherein banks, other lenders, and financial markets are able to provide households, communities, and businesses with the financing they need to invest, grow, and

[90] Gohari and Woody "The new global financial regulatory order: Can macroprudential regulation prevent another global financial disaster?" 2015 *Journal of Corporation Law* 403.

[91] Barra and Zotti "Financial stability and local economic development: the experience of Italian labour market areas" 2022 *Empirical Economics* 1952.

[92] The Financial Regulatory Steering Form Committee *Implementing a Twin Peaks model of Financial Regulation in South Africa* 2013 26 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%203%20roadmap.pdf (accessed 30 May 2021).

[93] Testimony by Mr Ben S Bernanke, Chairman of the Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, US Senate, Washington DC, 21 July 2011 1 available at https://www.bis.org/review/r110722a.pdf (accessed 10 July 2023).

participate in a well-functioning economy, in circumstances where they do so without making the system more vulnerable to sharp downturns.

1.5 Research Methodology

This research uses a desktop research methodology to critically analyse various sources regarding the SARB's mandate to promote and maintain financial stability under the FSRA. The sources include legislation, case law, secondary sources of law – such as books and journal articles, publications from international standard-setting bodies – such as the BCBS and the IMF, reports, speeches, media statements, policy documents, and internet sources.

The main focus of the research is to critically analyse the SARB's mandate to protect and enhance financial stability as outlined in the FSRA. This involves assessing the effectiveness, strengths, and weaknesses of the current regulatory framework and its implementation by the SARB. Additionally, the research includes a comparative study on relevant aspects of financial stability regulation. It references international principles and guidelines, particularly focusing on the different regulators responsible for financial stability in the US under the Dodd-Frank Act. The research aims to identify potential improvements and best practices that could enhance the SARB's financial stability regulatory toolkit, thereby improving its capacity to address the diverse risks faced by the financial system today.

1.6 Comparative Jurisdiction

The most important factor in the adoption of the US as the comparative jurisdiction in this study was that it was the epicentre of the GFC, and as such, the US took the lead in the implementation of the G20 financial stability reforms. The new core objectives of the financial stability mandate in the US regulatory framework, as laid out in the Dodd-Frank Act, would be a good comparative litmus test for the regulatory changes adopted in the South African financial system post-GFC.

A developed economy with complex financial markets like the US could be useful in determining what the best model for an emerging market economy like South Africa is, as there can be few shocks and crises that the US economy has not experienced. In fact, besides the Covid-19 pandemic that was experienced all over the world, the US has experienced bank failures as recently as in 2023 caused by government bond holdings, which are normally considered safe assets, contrary to the risky assets that caused the GFC years ago. Determining whether or not emerging economies have developed to the point of being able to implement systems of regulation and supervision that can adequately maintain financial stability to prevent instability caused by the global financial system is important in determining the future economic potential of emerging markets such as South Africa.[94]

The US Fed is also the central bank in the most important economy in the world and could be an important example to the SARB as to whether or not it should consider policy changes in exercising its financial stability mandate. The policy changes adopted by US regulators after the GFC and beyond could be significant for the SARB to consider, especially if additional financial stability tools could be incorporated.

1.7 Limitations to the Study

Attention in this study is on defining financial stability, locating its meaning in the regulatory framework that underpins the SARB's financial stability mandate, as well as on the regulatory tools at its disposal in the execution of this mandate. An in-depth mathematical analysis of the specific microprudential and macroprudential tools of regulation is not the focus of the study,[95] the tools are largely referred to how they are formulated in the policy instruments they are embodied in, and as executed by the regulatory role players in their financial stability regulation frameworks.

The financial data and modelling that is the basis for the theories underlying the writings of some of the authors considered is beyond the scope of this research.[96] Instead, the focus will be on the laws, regulations and standards that form part of the SARB's legislative financial stability mandate.

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94 Coman and Lloyd "In the face of spillovers: Prudential policies in emerging economies" 2022 *Journal of International Money and Finance* 2.

95 Such as capital or liquidity buffers, balance sheet restrictions, and an in-depth analysis of the inflation targeting frameworks of the respective comparative jurisdictions.

96 Mathematical models such as balance sheet composition/dynamics that are used to test the stability of a financial system.

The study furthermore focuses on the institutional operation of the financial stability mandate and the statutory duties imposed on the bodies tasked with its implementation. The overall political stability of the comparative jurisdictions and how this may affect financial stability is not a factor that is taken into account in this study.

The focus of this study is also on making policy recommendations to the SARB on how it can better promote and maintain its financial stability mandate, and not on developing a new financial stability regulatory framework.

1.8 Structure and Outline of Chapters

Chapter 1 serves as the foundational framework for this study, outlining the background of the study, the research problem, and the research objectives. It sheds light on the evolving regulatory focus of financial regulators regarding their financial stability mandates. This chapter underscores the pivotal role of financial stability within monetary policy, emphasising its need for robust support from regulatory authorities through the implementation of comprehensive regulatory policies. In addition to these aspects, this chapter provides an introductory overview of the key functionaries in the South African and US jurisdictions entrusted with the financial stability mandate, and examines how their roles have been fundamentally transformed by the crises of the past decade and a half. This chapter also encompasses a literature review, a discussion of the research methodology employed, the rationale behind the selection of comparative jurisdictions, the study's limitations, as well as the structure and outline of chapters.

Chapter 2 defines financial stability using insights from various sources, establishing a guiding definition for the study. It explains why financial stability is crucial to a functioning economy and explores how crises have shaped this definition.

Chapter 3 delves into the regulatory framework in South Africa, exploring the model of financial regulation and the tools and methods employed by the SARB, the authority entrusted with safeguarding and improving financial stability in the country. Additionally, the chapter examines how the SARB executes its financial stability mandate collaboratively with other financial sector regulators and stakeholders to ensure the protection of financial stability.

Chapter 4 studies the US financial stability regulatory framework under the Dodd Frank Act, which is housed with the United States Financial Stability Oversight Council in collaboration with certain other bodies. The main tenets of the US regulatory framework, which is embodied in a dual fragmented state-federal regulatory system, are discussed to later compare with those of the South African financial system.

Chapter 5 makes final observations regarding the effectiveness of the regulatory took-kit at the disposal of the SARB for its financial stability mandate. Furthermore, recommendations will be made for the SARB as the custodian of the stability of the South African financial system. The chapter will assess the SARB's financial stability toolkit in comparison with the US framework for financial stability. Additionally, the potential adoption of alternative tools for maintaining financial stability will be considered. The insights from comparisons with the role of US regulators in maintaining financial stability will be reduced into recommendations for the SARB, in order to ultimately enhance the execution of its financial stability mandate.

CHAPTER 2: DEFINING FINANCIAL STABILITY

2.1 Introduction

To understand the SARB's mandate for maintaining financial stability within the South African economy, one needs to first establish a clear definition of financial stability. Financial stability in its broad sense is the feeling of the financial institutions in the financial system, as well as the feelings of the consumers of the financial products and services that these financial institutions render, that the financial system in which they operate is resilient to the inevitable risks that the markets that make up that system would be exposed to.[90] This subjective feeling of confidence in the financial system must be underpinned by objective standards that can measure whether or not the financial system is indeed able to continue to function under adverse circumstances.[91]

Financial stability is important as it allows for financial intermediation to occur, with the resultant allocation of resources, which in turn provides the necessary liquidity in the system for further financial activity to occur.[92]

This chapter aims to define financial stability using insights from various sources to establish a guiding definition for the study. It explains why financial stability is crucial to a functioning economy and explores how crises have shaped this definition. Additionally, it examines the standard macroeconomic indicators that are used to assess economic performance and measure financial stability.[93]

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[90] Nier *Financial Stability Frameworks and the Role of Central Banks: Lessons from the Crisis* IMF Working Papers WP/09/70 2009 25 available at https://www.imf.org/external/pubs/ft/wp/2009/wp0970.pdf (accessed on 12 November 2023).

[91] Schinasi *Defining Financial Stability* IMF Working Paper No. 2004/187 October 2004 12 available at https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Defining-Financial-Stability-17740 (accessed 14 May 2023).

[92] Sydow et al *Shock amplification in an interconnected financial system of banks and investment funds* ECB Working Paper Series, No 2581 / August 2021 4, available at https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2581~63c8ffb7dc.en.pdf (accessed 30 May 2023).

[93] Gadanecz and Jayaram *Measures of financial stability - a review* IFC Bulletin Chapters, in: Bank for International Settlements (ed) In: Proceedings of the IFC Conference on "Measuring financial innovation and its impact" Basel, 26-27 August 2008, 2009 376, available at https://ideas.repec.org/h/bis/bisifc/31-26.html (accessed on 13 November 2023).

2.2 Historical perspective on financial stability

Financial stability is a concept that constantly progresses and changes over time, due to changes in our understanding of its constituent elements, such elements which include our understanding of financial intermediation, monetary policy, financial crises, macroeconomics and regulation.[94] There is no widely accepted definition of financial stability, nor is there a widely accepted model for assessing it.[95]

The fundamental changes to the global financial system in the last fifteen years brought on by crises have resulted in a new understanding of modern financial stability that is beginning to develop.[96] Given the interplay of financial stability's constituent elements, no accurate single element can be seen to be the basis for defining or assessing the attainment of financial stability.[97]

Historical definitions, or perhaps a better way of putting it, the historical understanding of financial stability, was a narrow sense of financial stability that was tied to the dynamics of the economy in which it operates, in that the economy must be one wherein finance or financial intermediation occurs without interruption.[98] This requires consumers to have confidence in the financial system's ability to accurately quantify their investment risk.[99] Financial intermediation usually has at its centre an undertaking to pay fiat money in the future, and thus, in this narrow context financial stability can

[94] Schinasi *Defining Financial Stability* IMF Working Paper No. 2004/187 October 2004 12 available at https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Defining-Financial-Stability-17740 (accessed 14 May 2023).

[95] Vredin, An *Inflation targeting and financial stability: Providing policymakers with relevant information* BIS Working Papers No. 503 2015 33 available at https://www.bis.org/publ/work503.pdf (accessed 16 November 2023).

[96] The South African Reserve Bank *Financial Stability Department A new macroprudential policy framework for South Africa* 2016 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/A%20new%20macroprudential%20policy%20framework%20for%20South%20Africa.pdf (accessed 02 June 2023).

[97] Goodhart *The changing role of central banks* BIS Working Papers No 326 November 2010 2 available at https://www.bis.org/publ/work326.pdf (accessed 25 September 2023).

[98] Vredin, An *Inflation targeting and financial stability: Providing policymakers with relevant information* BIS Working Papers No. 503 2015 27 available at https://www.bis.org/publ/work503.pdf (accessed 16 November 2023).

[99] Allen "A New Philosophy for Financial Stability Regulation" 2013 *Loyola University Chicago Law Journal* 184.

be seen as a financial system's ability to provide, through markets and financial institutions, mechanisms for pricing and allocating financial risks.[100]

The central tenant of financial stability in this type of formulation is the confidence of the market in the viability of the financial system. Instability results when this confidence is negatively affected when the financial system fails to properly allocate and price risks.[101] The definition of financial stability in these circumstances is seen in the context of how the financial system adequately allocates risks through the financial system, as well as how the applicable regulatory system can prevent risk from spreading during a crisis or can manage risk once a crisis begins.[102]

2.3 Contemporary definitions of financial stability

The increase of instances of instability in global financial markets has led to an increased shift towards the maintenance of stability being considered a key policy consideration for governing authorities.[103] Examples of the instances of financial instability that have been experienced since the GFC are, firstly, the global recession caused by the Covid-19 pandemic, which damaged economic productivity and output. The War between Russia and Ukraine has in turn, led to a recession in many European economies as a result of declining economic growth, high commodity prices, a strong dollar, unsustainable debt burdens, and persistently high inflation.[104] The global financial system also continues to experience the most common cause of global economic uncertainty, the instability caused by the collapse of financial institutions as exemplified by the failures of Silicon Valley Bank and Signature Bank in the US, and Credit Suisse in Switzerland. The definition of what financial stability is in a concurrent context would inevitably change in these circumstances.

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[100] Houben, Kakes and Schinasi *Toward a framework for safeguarding financial stability* IMF Working Paper No. WP/04/101 June 2004 6 available at https://www.imf.org/external/pubs/ft/wp/2004/wp04101.pdf (accessed 13 November 2023).

[101] Ibid 11.

[102] Aymanns "Models of Financial Stability and Their Application in Stress Tests" 2018 Handbook of Computational Economics 357.

[103] Godwin, Howse and Ramsay "A jurisdictional comparison of the twin peaks model of financial regulation" 2017 *Journal of Banking Regulation* 1.

[104] The Office of Financial Research *Annual Report* 2023 1 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

Earlier definitions of financial stability that were based purely on a financial system's ability to be a conduit for financial intermediation have been replaced by a stress test-based modelling[105] of the financial system that is aimed at ensuring that financial institutions are prudentially safe and sound enough to weather potential financial crises as well as ensuring that the necessary regulatory tools are developed that are geared to preventing crises.[106]

One such contemporary definition of financial stability is that it is the ability of the constituent elements of financial systems such as financial markets, intermediaries and infrastructures to resist financial shocks.[107] The analysis of the actual structures that make up the financial system is what is important to this definition.

Contemporary definitions of financial stability still view it through the prism of the allocation and management of financial risks in a financial system, and the efficient performance of the economy.[108] However, what has become integral to these definition is the notion that the financial institutions in that financial system need to be prudentially regulated[109] in a manner that breeds confidence that they are financially sound, safe, and stable, and that there would be limited disruptions to them that results in the distortion of the allocation and management of financial risks.[110]

Financial stability is also now defined in the context of mitigation of systemic risk[111] through regulation. In these circumstances, systemic risk can compromise macro-

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105 Aymanns "Models of Financial Stability and Their Application in Stress Tests" 2018 *Handbook of Computational Economics* 357.

106 Tayler "Macroprudential regulation, credit spreads and the role of monetary policy" 2016 *Journal of Financial Stability* 1.

107 Saha "Nexus of financial inclusion, competition, concentration and financial stability: Cross-country empirical evidence" 2021 *Competitiveness Review* 24.

108 Barra and Zotti "Financial stability and local economic development: the experience of Italian labour market areas" *2022 Empirical Economics* 1951.

109 The South African Reserve Bank *The Prudential Authority Annual Report 2019/20* 9 available at https://www.resbank.co.za/content/dam/sarb/publications/shares-correspondence/2020/10045/South-African-Reserve-Bank-Annual-Report-2019-20.pdf (Accessed 09 June 2021).

110 Kashyap, AK et al: "*Financial Stability Considerations and Monetary Policy*", International Journal of Central Banking, 231 – 266, (2020). Kashyap "Financial Stability Considerations and Monetary Policy" 2020 *International Journal of Central Banking* 243.

111 Systemic risk is the probability that cumulative financial losses that occur from an event ignite a series of successive losses along a chain of financial institutions or markets that make up that financial system. It is the risk that the failure of a participant to meet its contractual obligations may in turn cause other participants to default, with the chain reaction leading to broader financial instability. Because financial institutions such as banks are closely intertwined financially with each other through lending to and borrowing from each other, holding deposit balances with each other, and the payments clearing system, a failure of any one bank will more likely spill over to other banks

systemic risk – which occurs when a financial system is exposed to the aggregate risk of many financial institutions, which in turn results in the weakening of a financial system due to a reduction of credit.[112] Alternatively, systemic risk can also compromise of micro-systemic risk, which occurs when a single SIFI fails, resulting in negative consequences for the entire financial system such as instability for other financial institutions that are reliant on the failing institution to provide credit.[113]

Financial stability in South Africa is now defined in the FSRA,[114] as the ability of financial institutions to generally provide financial products and financial services, and for market infrastructures to generally perform their functions and duties in terms of financial sector laws without interruption, despite changes in economic circumstances, coupled with consumers' general confidence in the ability to do so.[115] It is further indicated that the definition of the maintenance of financial stability includes the restoring of financial stability in circumstances where it has been adversely affected.[116] The SARB defines financial stability by referring to it as a financial system that inspires confidence, through its resilience to systemic risks, and its ability to efficiently intermediate funds.[117]

The US Fed defines financial stability as a financial system wherein banks, other lenders, and financial markets are able to provide households, communities, and businesses with the financing they need to invest, grow, and participate in a well-functioning economy, in circumstances where they do so without making the system

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and do so more quickly. Thus, the banking system is seen as being more susceptible to systemic risk. The risk is that one bank's default may cause a chain reaction of failures and even threaten the solvency of other financial institutions in the system, as one bank's obligation to another bank may adversely affect that other bank's ability to meet its obligations to other banks, and so on down the chain of banks and beyond. Five reasons cause contagion in banking to be more serious than in other parts of the financial system, namely that (1) it occurs faster, (2) it spreads more widely within the industry, (3) it results in a larger number of failures (4) it results in larger losses to creditors (depositors) at failed firms (5) it spreads more beyond the banking industry to other sectors, the macro economy, and to other countries. Kaufman "Bank Failures, Systemic Risk, And Bank Regulation" 1996 *Cato Journal* 17.

112 Nier *Financial Stability Frameworks and the Role of Central Banks: Lessons from the Crisis* IMF Working Papers WP/09/70 2009 25 available at https://www.imf.org/external/pubs/ft/wp/2009/wp0970.pdf (accessed on 12 November 2023).

113 Ibid.

114 Act No. 9 of 2017.

115 Section 4(1) of Act No. 9 of 2017.

116 Section 4(2) of Act No. 9 of 2017

117 The South African Reserve Bank, "Financial Stability", available at https://www.resbank.co.za/en/home/what-we-do/financial-stability (accessed on 23 February 2023).

more vulnerable to sharp downturns.[118] Financial instability would thus be a financial system wherein an economic shock is likely to have much larger effects, disrupting the flow of credit and leading to larger-than-expected declines in employment and economic activity.

2.4 Challenges and ambiguities in defining financial stability

The major challenge faced by regulators in defining financial stability is that there are many economic metrics that could be used in describing financial stability.[119] The prudential safety and soundness of SIFIs could be the main focus; alternatively, the stability of market infrastructures could be used as the main indicator, or the presence or absence of instability could be another barometer that could be used to measure stability.[120]

In most capitalistic economies, the tension in financial stability regulation lies between allowing the private sector and the market to determine developments in the financial system, or whether there should be more intervention by the public sector and regulators.[121]

As indicated above, there is no single widely accepted definition of financial stability. Financial stability is multi-layered, as it can be defined in terms of the stability and prudential safety of financial institutions, or the stable operation of market

[118] The United States Federal Reserve: "Financial Stability", available at https://www.federalreserve.gov/financial-stability/what-is-financial-stability.htm. (accessed on 16 April 2024).

[119] Schinasi *Defining Financial Stability* IMF Working Paper No. 2004/187 October 2004 4 available at https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Defining-Financial-Stability-17740 (accessed 14 May 2023).

[120] Gadanecz and Jayaram *Measures of financial stability - a review* IFC Bulletin Chapters, in: Bank for International Settlements (ed) In: Proceedings of the IFC Conference on "Measuring financial innovation and its impact" Basel, 26-27 August 2008, 2009 1, available at https://ideas.repec.org/h/bis/bisifc/31-26.html (accessed on 13 November 2023).

[121] Credit extension in the private sector, as seen in the US Housing system before the 2008 GFC, demonstrates how market forces can drive risk-taking behavior. The lack of effective regulation during this period allowed these risks to escalate, ultimately requiring massive liquidity injections from regulators to stabilize the financial system. This response, while necessary, created challenges for public finances, including sovereign debt crises in European countries such as Greece and Ireland, which faced severe repercussions during the GFC. Ciumasa "Implications of Private Sector Behavior on Public Finance Sector" 2012 *Procedia Economics and Finance* 153.

infrastructures such as payment settlement systems.[122] This is further complicated by the fact that financial stability has, in many important ways, evolved since the GFC.[123] Financial stability is now usually defined in the context of the systemic risk and financial volatility or crisis that a financial system is experiencing at a particular moment.[124]

The policy objectives of regulators and governments tasked with maintaining financial stability can also be determinative in defining financial stability.[125] For example, one of the US Fed's primary policy objectives within its mandate is the attainment of maximum employment, and so its interpretation of what constitutes financial stability may include the conditions it deems necessary to attain maximum employment.[126]

Challenges in determining the different elements that define financial stability also arise because different financial systems around the world have differing constituent elements, as well as methods of how financial intermediation occurs.[127] In South Africa, the main economic activity is concentrated around financial institutions such as banks.[128] The US financial system, on the other hand, is stock-market based and is made up of a complex network of traditional financial institutions, private credit markets as well as large investment houses that offer complex financial products.[129]

Although the difficulties mentioned above are real, we must still attempt to come up with generally accepted parameters of what constitutes financial stability, given the interconnectedness of global financial markets. This has been attempted in most

122 Schinasi *Defining Financial Stability* IMF Working Paper No. 2004/187 October 2004 4 available at https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Defining-Financial-Stability-17740 (accessed 14 May 2023).

123 Hollander *A Review of the South African Reserve Bank's Financial Stability Policies* Stellenbosch Economic Working Papers: WP11 2019 9 available at https://www.ekon.sun.ac.za/wpapers/2019/wp112019/wp112019.pdf (accessed 19 March 2023).

124 Aymanns "Models of Financial Stability and Their Application in Stress Tests" 2018 *Handbook of Computational Economics* 357.

125 Kashyap "Financial Stability Considerations and Monetary Policy" 2020 *International Journal of Central Banking* 231.

126 *Ibid* 231.

127 Calice Concentration in the Banking Sector and Financial Stability: New Evidence Stellenbosch Economic Working World Bank Policy Research Working Paper No. 8615 2018 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3267682 (accessed 11 March 2023).

128 Mohamed, S *The South African Financial System* 2017 39 available at https://www.researchgate.net/publication/332670332 (accessed on 11 March 2023).

129 Ndikumana *Financial Development, Financial Structure, and Domestic Investment: International Evidence* Economics Department Working Paper Series 92 2003 5 available at https://doi.org/10.7275/1072549 (accessed on 27 February 2024).

financial systems through the codification of the concept of financial stability in their respective regulatory frameworks.[130]

2.5 The important role of financial stability in an economy

Financial stability is crucial because instability can damage the real economy, particularly when crises cause information asymmetry that erodes the financial system's ability to allocate risk or funds to productive investment opportunities.[131] The interconnectedness of modern financial systems means that failure of a SIFI can lead to the failure of other financial institutions, disrupt other market infrastructures in the wider economy, and cause systemic risk.[132] This can occur even if the other financial institutions are financially sound, due to information asymmetry.[133]

One of the primary benefits of financial stability regulation is that it prevents taxpayers from having to fund government bailouts of failing financial institutions.[134] The FSRA was recently amended by the Financial Sector Laws Amendment Act (FSLAA)[135] to provide for the establishment of a framework for the resolution of designated institutions[136] to ensure that the impact or potential impact of a failure of a designated institution on financial stability is managed appropriately. The Act also introduced a deposit insurance scheme to further protect consumers and boost confidence in the financial system. The SARB has been designated as the resolution authority, tasked with exercising the resolution powers over all designated institutions. These powers

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130 Ullah "Role of Regulatory Governance in Financial Stability: A Comparison of High and Low Income Countries" 2020 *Journal of Central Banking Theory and Practice* 207-226.

131 Houben, Kakes and Schinasi *Toward a framework for safeguarding financial stability* IMF Working Paper No. WP/04/101 June 2004 6 available at https://www.imf.org/external/pubs/ft/wp/2004/wp04101.pdf (accessed 13 November 2023).

132 Nier *Financial Stability Frameworks and the Role of Central Banks: Lessons from the Crisis* IMF Working Papers WP/09/70 2009 25 available at https://www.imf.org/external/pubs/ft/wp/2009/wp0970.pdf (accessed on 12 November 2023).

133 Tucker *The lender of last resort and modern central banking: principles and reconstruction* BIS Papers No. 76 2014 12 available at https://www.bis.org/publ/bppdf/bispap79b_rh.pdf (accessed 23 November 2023).

134 Allen "A New Philosophy for Financial Stability Regulation" 2013 *Loyola University Chicago Law Journal* 184.

135 Act 23 of 2021.

136 A designated institution is one that in the opinion of the SARB is or will likely be unable to meet its obligations, irrespective of whether or not the designated institution is insolvent, and it is necessary to ensure the orderly resolution of the designated institution to maintain financial stability, or in the case of a bank or a member of a group of companies of which a bank is a member to protect depositors of the bank. The SARB may then recommend to the Minister of Finance that the designated institution be placed in resolution. Section 166J(1) of the FSRA.

include innovative measures such as the statutory "bail-in", which enables the absorption of losses by shareholders of financial institutions to protect taxpayers and bridge banks.[137]

A financial crisis can also undermine the confidence of financial participants in the system's ability to continue providing credit.[138] Resolution tools such as bail-in and bridge banks provide consumers the confidence that financial intermediation can continue to occur, even in the midst of instability. An unstable economy is often marked by reduced employment rates.[139] This can negatively impact the usual social benefits of a stable economy and lead to wider consequences, such as the need for unpopular austerity measures or political instability.[140]

Regulatory financial stability measures have positively impacted economic growth by increasing efficiency. New requirements[141] and standards for leverage ratios, capital buffers, stress testing, and liquidity requirements, especially for SIFIs, have made financial systems safer.[142] Financial stability cannot be assessed in isolation from

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[137] Section 166S and 166F of the FSLAA. There are two types of bail-in-tools that are used, that is an "open-bank" bail-in and a "closed-bank" bail-in. In an open bank bail-in, the failed financial institution is recapitalised and returned to the market through a direct write down and conversion of equity and debt. In a closed-bank bail in, the majority of assets and some of the liabilities of the failed financial institution in resolution are transferred to a successor entity (a bridge institution), while shareholders' equity and TLAC liabilities are left behind in the failed entity to absorb losses. In this instance, shareholders and creditors are not formally written down and/or converted, but are simply left behind in the old entity with the expectation of recovering whatever is the value of the assets left behind in liquidation. The economic effect of the two approaches is the same, namely loss absorption and recapitalisation using internal resources (equity and debt), while the implementation approach varies. Single Resolution Board *The 2023 Banking Turmoil* 2024 22 available at https://www.srb.europa.eu/system/files/media/document/2024-07-02_Staff-Paper-4_The-2023-Banking-Turmoil.pdf (accessed 22 February 2024).

[138] Nier *Financial Stability Frameworks and the Role of Central Banks: Lessons from the Crisis* IMF Working Papers WP/09/70 2009 7 available at https://www.imf.org/external/pubs/ft/wp/2009/wp0970.pdf (accessed on 12 November 2023).

[139] Barrett et al *After-Effects of the COVID-19 Pandemic - Prospects for Medium-term Economic Damage* IMF Working Paper No. WP/21/203, July 2021 4 available at https://www.imf.org/en/Publications/WP/Issues/2021/07/30/After-Effects-of-the-COVID-19-Pandemic-Prospects-for-Medium-Term-Economic-Damage-462898 (accessed 24 February 2024).

[140] Allen "A New Philosophy for Financial Stability Regulation" 2013 *Loyola University Chicago Law Journal* 188.

[141] The Basel III standards were adopted after the 2008 GFC. These standards were implemented to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The objective of the reforms was to improve the banking sector's ability to absorb shocks arising from financial crisis whatever the source, thus reducing the risk of contagion from the financial sector to the real economy.

[142] Baily, Litan and Johnson "The origins of the financial crisis" (2009) EliScholar.

economic growth, as it is designed to yield social benefits that contribute to overall economic well-being.[143]

2.6 The impact of financial crises on the definition of financial stability and the institutions tasked with its maintenance

The need to have stability as the key determinative feature of any financial system has been brought to the fore by the two crises that have affected the world financial markets during the last 15 years; that is, the GFC and the Covid-19 Pandemic. The reason that the two events are both relevant and comparable in a discussion on financial stability is that both crises have had a global impact on international financial markets and have led to severe recessions of most national economies.[144]

The Great Recession,[145] as the GFC was colloquially referred to, had its origins in the US financial system, primarily in its banking sector.[146] Many banks in the US engaged in risky lending practices to mortgage borrowers, who from a financial suitability test perspective, would not have qualified for loans they received, and who were further unlikely in a downturn to be able to repay their loans.[147] These non-performing loans were the genesis of the crisis.

The development of a subprime mortgage bubble between 2005 and 2007 occurred when there was a housing boom in the US.[148] When housing prices started to decline in 2007, subprime mortgage-based securities suffered losses of approximately US$500 billion.[149] This caused a standard indicator of crisis in a financial system to occur, namely runs on several SIFIs.[150] This caused the credit bubble that had resulted

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143 Gadanecz and Jayaram *Measures of financial stability - a review* IFC Bulletin Chapters, in: Bank for International Settlements (ed) In: Proceedings of the IFC Conference on "Measuring financial innovation and its impact" Basel, 26-27 August 2008, 2009 366 available at https://ideas.repec.org/h/bis/bisifc/31-26.html (accessed on 13 November 2023).
144 Li "A comparative analysis of COVID-19 and global financial crises: evidence from US economy" 2022 *Economic Research-Ekonomska Istraživanja* 2428.
145 Ramlall "Understanding Financial Stability" (2018) ProQuest Ebook Central.
146 Crotty "Structural causes of the global financial crisis: a critical assessment of the new financial architecture" 2009 *Cambridge Journal of Economics* 563–580.
147 Baily, Litan and Johnson "The origins of the financial crisis" (2009) EliScholar.
148 Ibid.
149 Mishkin, FS "Over the Cliff: From the Subprime to the Global Financial Crisis" 2011 *Journal of Economic Perspectives* 49.
150 Aymanns "Models of Financial Stability and Their Application in Stress Tests" 2018 *Handbook of Computational Economics* 357.

from the housing boom to burst.[151] Contagion caused the crisis to spread from the credit markets to other parts of the US economy, and eventually also to the rest of the global financial system due to the interconnectedness that other global markets had either directly or indirectly to the US subprime mortgage market.[152] The GFC revealed that certain SIFIs had transformed into conglomerates that had assumed the traditional role of banks, including credit extension, securitization, and credit trading.[153] It also exposed a significant shift in the financial markets where these SIFIs operated, comprising a blend of centralised and decentralised markets.[154] Despite this transformation, markets remained vulnerable to the traditional risks associated with liquidity shortages.[155]

Before the GFC, the old definition of financial stability was seen in a limited sense as the allocation and management of financial risks in the financial system to produce efficient performance of the economy.[156] The GFC became the tipping point and transformed the understanding of financial stability into being the central focus of financial sector regulation, and an even greater focus was placed on prudential regulation as being a critical requirement to keeping financial institutions in a financial system stable and able to weather crises or disruptions.[157]

In 2011, the Basel III standards were developed and aimed to strengthen the regulation, supervision, and risk management of SIFIs.[158] These measures included a leverage ratio or a minimum amount of loss-absorbing capital relative to all of a bank's assets, as well as a minimum liquidity ratio requirement intended to provide enough

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151 Baily, Litan and Johnson "The Origins of the Financial Crisis" (2009) EliScholar.

152 Allen "A New Philosophy for Financial Stability Regulation" 2013 *Loyola University Chicago Law Journal* 188.

153 Hossain and Kryzannowski "Global financial crisis after ten years: A review of the causes and regulatory reactions" 2019 *Managerial Finance* 907.

154 Baily, Litan and Johnson "The Origins of the Financial Crisis" (2009) EliScholar.

155 Nelson "Banks beyond borders: Internationalization, financialization, and the behavior of foreign-owned banks during the Global Financial Crisis" 2020 *Theory and Society* 312.

156 Houben, Kakes and Schinasi *Toward a framework for safeguarding financial stability* IMF Working Paper No. WP/04/101 June 2004 6 available at https://www.imf.org/external/pubs/ft/wp/2004/wp04101.pdf (accessed 13 November 2023).

157 Ullah "Role of Regulatory Governance in Financial Stability: A Comparison of High and Low Income Countries" 2020 *Journal of Central Banking Theory and Practice* 211.

158 Ferreira et al *From Basel I to Basel III: Sequencing Implementation in Developing Economies* IMF Working paper WP/19/127 2019 2 available at https://www.imf.org/en/Publications/WP/Issues/2019/06/14/From-Basel-I-to-Basel-III-Sequencing-Implementation-in-Developing-Economies-46895 (accessed 26 September 2023).

cash to cover funding needs in periods of stress.[159] In addition to this, regulators around the world then passed legislative measures to reform financial stability supervision, such as the Dodd-Frank Act in the US and the FSRA in South Africa. The Dodd-Frank Act aimed to end the "TBTF" principle in that it did not guarantee taxpayer-based bail-outs in future crises, prevented the risky lending and trading activities that had caused the crisis, enhanced regulators' ability to monitor and address threats to financial stability, strengthened the prudential oversight and resolvability of SIFIs, and improved the capacity of financial institutions to absorb shocks.[160]

South Africa, although it did not engage in light-touch regulation and maintained a strong financial regulatory framework, still suffered disproportionately in terms of job losses during the subsequent recession.[161] This and other factors resulted in the adoption of the Twin Peaks model of financial regulation, wherein the SARB assumed responsibility for macro-prudential regulation and financial stability, while micro-prudential regulation was delegated to a prudential regulator within the SARB (the PA), and market conduct regulation was entrusted to a separate entity (the FSCA).[162] Emphasis was placed on an explicit focus on financial stability and the formulation of systemic crisis resolution principles.[163]

The GFC was perhaps the most important paradigm shift in the evolution of the modern understanding of regulators' approach to financial stability,[164] which new principles had to face their first new important test with the next major crisis that followed, the crisis caused by the Covid-19 pandemic. The Great Compression,[165] as the 2020 financial crisis is colloquially referred to, was caused by the novel

159 The Basel III Accord.
160 Implementing The Dodd–Frank Wall Street Reform and Consumer Protection Act, hearing before the Committee on Banking, Housing, and Urban Affairs, US Senate, Washington DC, 30 September 2010, available at https://www.banking.senate.gov/hearings/implementing-the-dodd-frank-wall-street-reform-and-consumer-protection-act (accessed 20 April 2024).
161 The National Treasury *A Safer Financial Sector to Serve South Africa better* 2011 4 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf (accessed 30 May 2021).
162 Ibid 5.
163 Ibid 5.
164 Nier *Financial Stability Frameworks and the Role of Central Banks: Lessons from the Crisis* IMF Working Papers WP/09/70 2009 17 available at https://www.imf.org/external/pubs/ft/wp/2009/wp0970.pdf (accessed on 12 November 2023).
165 Li "A comparative analysis of COVID-19 and global financial crises: evidence from US economy" 2022 *Economic Research-Ekonomska Istraživanja* 2428.

Coronavirus or the Covid-19 virus.[166] The virus caused countries to impose lockdowns on their citizens.[167] This meant that in certain circumstances, depending on the severity of the lockdown, the labour force could not work.[168] This had a severe effect on the labour market and millions of job losses occurred, the likes of which had not been experienced since the GFC.[169]

There have been debates about whether or not the Covid-19 pandemic rose to the level of being a crisis.[170] However, when certain macroeconomic indicators between the two crises are compared, there can be no doubt that it did meet the criteria of being a globally significant crisis. In terms of employment, for example, in the US, the GFC unemployment rate was 10%, while during the pandemic it was as high as 12%. Industrial production during the GFC fell by 9.7%, while during the pandemic it fell as much as 11.6%, and consumer spending during the GFC fell by about US$500 million, while during the Covid-19 pandemic it fell by approximately US$775 million.[171]

The data reveals that the GFC lasted for a longer period, its after-effects were more profound, and had greater implications for financial stability.[172] However, the impact of the Covid-19 pandemic cannot be underestimated. Despite its shorter duration, the pandemic's peak posed a more intense challenge to financial stability.[173] Its

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[166] See footnote 90 above on the Covid-19 virus.

[167] A lockdown was a stay-at-home order from a government to its citizens. See the Office of Financial Research *Annual Report* 2023 124 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

[168] COVID-19 had an effect on the economy through mandated closure of non-essential industries. Essential workers usually included those in the field of medicine and healthcare, telecommunications, information technology systems, defence, food and agriculture, transportation and logistics, energy, water and wastewater, law enforcement, and public works. Workers who could work from home remotely as well as essential workers were less affected by the job losses that occurred during and as a result of the pandemic. Beland *The short-term economic consequences of COVID-19: Exposure to disease, remote work and government response* PLoS ONE 18(3) 2023 available at https://doi.org/10.1371/journal.pone.0270341 (accessed 29 July 2024).

[169] Mohamed, S *The South African Financial System* 2017 157 available at https://www.researchgate.net/publication/332670332 (accessed on 11 March 2023).

[170] Barrett et al *After-Effects of the COVID-19 Pandemic - Prospects for Medium-term Economic Damage* IMF Working Paper No. WP/21/203, July 2021 3 available at https://www.imf.org/en/Publications/WP/Issues/2021/07/30/After-Effects-of-the-COVID-19-Pandemic-Prospects-for-Medium-Term-Economic-Damage-462898 (accessed 24 February 2024).

[171] Li "A comparative analysis of COVID-19 and global financial crises: evidence from US economy" 2022 *Economic Research-Ekonomska Istraživanja* 2427-2441.

[172] Bernanke "The real effects of disrupted credit: Evidence from the Global Financial Crisis" 2018 *Brookings Papers on Economic Activity* 252.

[173] Barrett et al *After-Effects of the COVID-19 Pandemic - Prospects for Medium-term Economic Damage* IMF Working Paper No. WP/21/203, July 2021 16 available at https://www.imf.org/en/Publications/WP/Issues/2021/07/30/After-Effects-of-the-COVID-19-Pandemic-Prospects-for-Medium-Term-Economic-Damage-462898 (accessed 24 February 2024).

significance lies in being the first major test of the new regulatory frameworks for financial stability implemented in various economies within the global financial system since the GFC.[174]

In South Africa, the Covid-19 pandemic had the effect of a 7.0% contraction of the economy.[175] Public debt was increased, with a foreign selling of government bonds that resulted in a reliance on domestic banks to fund the government.[176] The government, which had already before the Covid-19 pandemic been running a persistent deficit due to its significant financial support for non-performing state-owned entities and tax revenue underperformance, saw that deficit increase sharply from 2.7% of GDP in 2019/20 to 9.7% in 2020/21.[177] Fitch and Moody's also downgraded five of South Africa's banks to sub-investment grade with a negative outlook.[178] Unemployment, which was already problematic at 28.7% at the end of 2019, increased to 35.3%. The irony is that in South Africa, due to the stigma of the GFC and the view of the crisis that it fostered, the Covid-19 pandemic was not labelled as a systemic event by South African regulators, despite clearly meeting the criteria laid out above of being a crisis.[179]

The GFC also had a significant impact on institutions tasked with maintaining financial stability. Before the GFC, the role of central banks was mostly limited to the maintenance of price stability, primarily through the exercise of monetary policy within the tight constraints of models like inflation targeting.[180] Thus, their involvement in issues to do with the overall stability of the financial system was limited to how their

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[174] Li "A comparative analysis of COVID-19 and global financial crises: evidence from US economy" 2022 *Economic Research-Ekonomska Istraživanja* 2427-2441.

[175] The South African Reserve Bank *Financial Stability Department: Financial Stability Focus* 2020 3 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Financial%20Stability%20Focus%20-%20Topical%20Briefings.pdf (accessed 25 March 2024).

[176] Ibid 2.

[177] Ibid 13.

[178] Ibid 15.

[179] The International Monetary Fund *Financial Sector Assessment Program: Technical note on Systemic Risk Oversight and Macroprudential Policy* 2022 10 available at https://www.imf.org/en/Publications/CR/Issues/2022/06/16/South-Africa-Financial-Sector-Assessment-Program-Technical-Note-on-Systemic-Risk-Oversight-519731 (accessed on 23 June 2023).

[180] Meyer "Inflation targets and inflation targeting" 2002 *The North American Journal of Economics and Finance* 10.

other regulatory mandates, such as inflation targeting affected financial stability.[181] The independence of central banks and the financial system as a whole suffered when the practice of direct injections of liquidity by governments during a crisis led to a de jure/de facto nationalisation of large parts of an affected country's financial system.[182] This resulted in central banks questioning the efficacy of their traditional financial stability toolkit, as they moved from their usual role during crises of being lenders of last resort, to having to remake and restructure certain sectors of their respective financial markets.[183] This, of course, becomes more complicated when the decisions and policies of one nation's central bank have implications on international financial markets.[184] On the other hand, if central banks were in times of crisis to continue to exercise their usual independence, this would then raise the question as to whether an unelected body such as a central bank would be undertaking its financial stability mandate without the necessary accountability.[185]

2.7 The dynamic nature of financial stability

A financial system can consist of a combination of different constituent elements that change over time with innovations in technology that affect how consumers engage with financial products, as well as how financial institutions provide these financial products.[186] This usually comes with ancillary political and social developments, which couch a regulator's requirements for and understanding of financial stability.[187] The

[181] Vredin, An *Inflation targeting and financial stability: Providing policymakers with relevant information* BIS Working Papers No. 503 2015 1 available at https://www.bis.org/publ/work503.pdf (accessed 16 November 2023).

[182] Tucker *The lender of last resort and modern central banking: principles and reconstruction* BIS Papers No. 76 2014 20 available at https://www.bis.org/publ/bppdf/bispap79b_rh.pdf (accessed 23 November 2023).

[183] Ibid 27.

[184] Vredin, An *Inflation targeting and financial stability: Providing policymakers with relevant information* BIS Working Papers No. 503 2015 16 available at https://www.bis.org/publ/work503.pdf (accessed 16 November 2023).

[185] In the United States, this is addressed by the US Fed being given the latitude to have extraordinary powers to act in "unusual and exigent" circumstances, however, with the prior approval of the Treasury Secretary. Section 13(3) of the Federal Reserve Act of December 23, 1913, ch. 6, 38 Stat. 251.

[186] Schinasi *Defining Financial Stability* IMF Working Paper No. 2004/187 October 2004 6 available at https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Defining-Financial-Stability-17740 (accessed 14 May 2023).

[187] Gadanecz and Jayaram *Measures of financial stability - a review* IFC Bulletin Chapters, in: Bank for International Settlements (ed) In: Proceedings of the IFC Conference on "Measuring financial

concept of financial stability thus itself will have to be dynamic and evolve in line with contemporary understandings of what makes an economy or financial market functional.

Finance involves the provision of funds in the form of credit, loans, or invested capital to activities that a financial system finds most expedient.[188] Thus, the concept of finance itself is dynamic and can change over time. A financial system is comprised of interconnected markets as well as financial institutions.[189] These infrastructures and entities are constantly changing, and thus our understanding of financial stability in this context is also dynamic. Thus, what defines financial stability in one era, might not do so in another, for example, pre- and post-GFC.[190]

The development of the global financial system has resulted in a level of economic and financial integration that has increased the interconnectedness between financial systems and has thus also increased the risk of contagion of a crisis from one system to another.[191] The risk of contagion requires collaboration between the regulators of different financial systems, which will further result in the definition of what amounts to financial stability being itself in constant flux.

2.8 Synthesis and guiding definition

Defining the concept of financial stability is difficult. Financial Stability can mean different things in the context of different financial markets, with differing monetary and macroprudential policies. The easiest way of expressing financial stability is that you

innovation and its impact" Basel, 26-27 August 2008, 2009 366, available at https://ideas.repec.org/h/bis/bisifc/31-26.html (accessed on 13 November 2023).

188 Houben, Kakes and Schinasi *Toward a framework for safeguarding financial stability* IMF Working Paper No. WP/04/101 June 2004 5 available at https://www.imf.org/external/pubs/ft/wp/2004/wp04101.pdf (accessed 13 November 2023).

189 Goodhart *The changing role of central banks* BIS Working Papers No 326 November 2010 22, available at https://www.bis.org/publ/work326.pdf (accessed 25 September 2023).

190 Allen "A New Philosophy for Financial Stability Regulation" 2013 *Loyola University Chicago Law Journal* 187.

191 Pasini "Financial stability in international law" 2017 *Melbourne Journal of International Law Journal* 19.

will know when it is not there.[192] A lack of financial stability, which can be a precursor to a crisis, will be evident in distortions to the financial system.[193]

The importance of financial stability, especially in a developing country like South Africa, is that it is one of the main indices used by foreign investors in their capital inflow decisions.[194] A financially stable system allows for the allocation of resources to areas of the economy most conducive to growth and development.[195]

Given the above and various definitions of financial stability that have been presented in this Chapter, I propose a guiding definition of financial stability that will serve as a basis for this study as the following:

> "Financial stability occurs in a financial system that is able to effectively provide credit to preferred parts of that system and is able to foresee, pre-empt, prevent or resolve financial risks without irreparable harm to the markets that make up that system. A stable financial system is able to maintain as close to maximum employment levels in the relevant economy, is able to control inflation to a level that does not negatively affect monetary stability, and is one wherein financial intermediation of funds occurs optimally through the medium of healthy financial institutions."

2.9 Conclusion

The practical importance of financial stability is that it allows for financial intermediation to occur, meaning that resources available in a financial system can be efficiently allocated for necessary financial activity. The importance of financial stability to the

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192 Schinasi *Defining Financial Stability* IMF Working Paper No. 2004/187 October 2004 3 available at https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Defining-Financial-Stability-17740 (accessed 14 May 2023).

193 Vredin, An *Inflation targeting and financial stability: Providing policymakers with relevant information* BIS Working Papers No. 503 2015 17 available at https://www.bis.org/publ/work503.pdf (accessed 16 November 2023).

194 Gadanecz and Jayaram *Measures of financial stability - a review* IFC Bulletin Chapters, in: Bank for International Settlements (ed) In: Proceedings of the IFC Conference on "Measuring financial innovation and its impact" Basel, 26-27 August 2008, 2009 368 available at https://ideas.repec.org/h/bis/bisifc/31-26.html (accessed on 13 November 2023).

195 Schinasi *Defining Financial Stability* IMF Working Paper No. 2004/187 October 2004 8 available at https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Defining-Financial-Stability-17740 (accessed 14 May 2023).

real economy is that instability causes erosion of the financial system and its ability to allocate risk.

This narrow understanding of financial stability has however evolved to include a stress test-based definition that is founded on empirical data about the prudential safety and soundness of financial institutions, as well as their ability to prevent or weather financial crises. The SARB's definition of financial stability includes the above metrics, specifically the confidence of the market that the financial system is resilient to systemic risks, and can even in the face of shocks continue to have the ability to efficiently intermediate funds.

The post-GFC landscape represented the moment that financial stability came to the fore of regulators' supervisory role in the global financial system. The assessment of a central bank's or primary financial stability regulator's ability to execute its financial stability mandate was now guided by contemporary definitions of financial stability. The Covid-19 pandemic represented the first true test of the new financial stability regulatory frameworks that were meant to better prepare financial systems and institutions for subsequent crises. The fact that the after-effects of the pandemic did not lead to the collapse of financial institutions and/or the global financial system is indicative that these frameworks have been strengthened post-GFC.

Even though what constitutes financial stability in different financial systems changes, given the crises experienced, the interconnectedness of global financial markets means that it is important to both define as well as codify the concept of financial stability in regulatory frameworks. However, the basic understanding of financial stability remains; that is, it must be congruous with the stability of the financial institutions and market infrastructures that make up that financial system.

Now that we have defined financial stability and determined its parameters, we will delve into the financial stability mandate of the SARB, and how the framework for the maintenance of financial stability operates.

CHAPTER 3: THE FINANCIAL STABILITY MANDATE OF THE SARB

3.1 Introduction

The SARB was established in Pretoria in 1921[196] as the country's central bank, making it the fourth oldest central bank outside of Europe.[197] The Currency and Banking Act 31 of 1920, which established the SARB, was similar to the United States Federal Reserve Act and adopted the term "Reserve Bank" which had previously been used only by the US Fed.[198]

In 1989, the SARB Act was passed. The primary objective of the SARB is stated to be the protection of the value of the currency of the Republic in the interest of balanced and sustainable economic growth in the Republic.[199] This represented the first time that the primary objective of the SARB was codified in legislation.[200]

In 1996, the status of the SARB as central bank of South Africa was confirmed in the Constitution of the Republic of South Africa, 1996 (the Constitution). The Constitutional mandate and primary object of the SARB is indicated to be the protection of the value of the currency in the interest of balanced and sustainable economic growth in the Republic.[201] The SARB, in pursuit of its primary object, must perform its functions independently and without fear, favour or prejudice, but there must be regular consultation between the SARB and the Cabinet member responsible for national financial matters, that is, the Minister of Finance.[202]

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[196] Currency and Banking Act 31 of 1920. This Act was subsequently replaced by the South African Reserve Bank Act 29 of 1944, which itself was also superseded by the South African Reserve Bank Act 90 of 1989 (the SARB Act).

[197] Van Niekerk and Van Heerden "Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability" 2018 *Journal of Contemporary Roman-Dutch Law* 636.

[198] Van Niekerk, MG: "A Comparative Analysis of The Role of The Central Bank in Promoting And Maintaining Financial Stability In South Africa", 2018, *LLD Thesis University of Pretoria* 72 available at https://repository.up.ac.za/handle/2263/67934 (accessed 02 February 2023).

[199] Section 3 of the SARB Act.

[200] Van Niekerk and Van Heerden "Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability" 2018 *Journal of Contemporary Roman-Dutch Law* 637.

[201] Section 224(1) of the Constitution.

[202] Section 224(1) of the Constitution.

The South African financial sector is dominated by its banking sector, and this is further concentrated in four main banks.[203] The entire banking sector is made up of 39 banks, 13 of which are locally controlled banks, 4 foreign-controlled banks, 11 local branches of foreign banks, 4 mutual banks, and 7 cooperative banks.[204] The main instrument of regulation of the banking sector, as well as the enabling legislation for the current legal construction of banks, is the Banks Act (previously known as Deposit-taking Institutions Act).[205] The Banks Act intends to provide for the regulation and supervision of the business of public companies taking deposits from the public as well as to provide for matters connected therewith such as the issuing of licenses.[206] Prior to the 2017 enactment of the FSRA there was silo/sectoral regulation in South Africa.[207] The SARB was a central component of this regulatory framework and was responsible for the regulation of banks, whilst the Financial Services Board (the FSB, which is now the FSCA) was responsible for insurance companies, fund managers, and security exchanges.[208] The National Credit Regulator supervised the lending and credit industry.[209] In this pre-Twin Peaks era, the maintenance and/or the promotion of financial stability was not an explicit mandate or objective of the SARB.

In the lead-up to the GFC in 2008, the SARB was primarily responsible for monetary policy[210] with no even secondary explicitly stated financial stability objective; however, since 2010, the SARB has adhered to a policy of using its macro-prudential toolkit to

[203] The four banks are ABSA, FirstRand, Nedbank and Standard Bank. The International Monetary Fund *South Africa Financial System Stability Assessment* 2014 10 available at https://www.imf.org/external/pubs/ft/scr/2014/cr14340.pdf (accessed on 19 March 2023).

[204] The South African Reserve Bank *South African Registered Banks and Representative Offices* 2024 available at https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/sa-registered-banks-and-representative-offices (accessed 20 July 2024).

[205] Banks Act 94 of 1990 (the Banks Act).

[206] The Preamble of the Banks Act.

[207] Van Niekerk, MG: "A Comparative Analysis of The Role of The Central Bank in Promoting And Maintaining Financial Stability In South Africa", 2018, *LLD Thesis, University of Pretoria* 94 available at https://repository.up.ac.za/handle/2263/67934 (accessed 02 February 2023).

[208] De Jager "The South African Reserve Bank: Blowing Winds of Change (Part 2)" 2013 *South African Mercantile Law Journal* 499.

[209] The National Credit Act 34 of 2005.

[210] The SARB's refinancing system is how it implements monetary policy. The SARB provides liquidity to banks allowing them to meet their daily liquidity requirements, liquidity in this case being the bank's balance at the central bank. This would be available to the bank to settle its transactions, over and above the minimum statutory level of reserves that it is required to hold. The main instrument for managing liquidity in the money market is repo transactions. The repo rate is the price at which the SARB lends cash to the banking system and is the key operational variable in the monetary policy implementation process. It represents the most important indicator for short-term interest rates. The Government Communication and Information System *South Africa Yearbook Finance* 191 available at https://www.gcis.gov.za/sites/default/files/docs/resourcecentre/yearbook/2013-4Finance.pdf (accessed 25 August 2023).

promote financial stability.[211] The transition to the Twin Peaks model of financial regulation[212] explicitly stated a financial stability mandate for the SARB and that it was to be central to the post-GFC regulatory framework.[213]

As part of its traditional functions, the SARB used to have an assumed or implied financial stability role; however, before the enactment of the FSRA, the SARB Act did not have an explicit financial stability objective.[214]

The traditional roles of the SARB that affected the stability of the South African financial system will be discussed below.

3.2 The traditional roles of the SARB in respect of financial stability

3.2.1 The primary objective pre-GFC: Price stability

Before the GFC and the enactment of the FSRA, the primary mandate of the SARB was monetary policy. The SARB Act indicated that the SARB's primary mandate was to achieve monetary stability and balanced economic growth in the Republic by influencing total monetary demand in the economy through the control of the monetary supply and the availability of credit.[215] This primary mandate was reiterated in the Constitution, which states that the SARB must achieve and maintain price stability in the interest of balanced and sustainable economic growth in South Africa.[216]

Price stability in practice involves the adherence to low and stable inflation as the objective of monetary policy.[217] In pursuit of the goal of maintaining price stability, the price stability objective can be met through the implementation of an implicit or explicit

[211] The International Monetary Fund *South Africa Financial System Stability Assessment* 2014 8 available at https://www.imf.org/external/pubs/ft/scr/2014/cr14340.pdf (accessed on 19 March 2023).
[212] The FSRA.
[213] The South African Reserve Bank *Financial Stability Review* 1st edition 2019 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2019/9276/FSR-First-Edition-2019.pdf (accessed 25 August 2023).
[214] Van Niekerk and Van Heerden "Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability" 2018 *Journal of Contemporary Roman-Dutch Law* 637.
[215] Section 3 of the SARB Act.
[216] Section 224(1) of the Constitution.
[217] Bernanke "*A perspective on inflation targeting*" BIS Review 15/2003 2, available at https://www.bis.org/review/r030325d.pdf (accessed 29 July 2023).

inflation objective or an explicit numerical target for inflation.[218] In February of 2000, the Minister of Finance announced that the South African Government would adopt an inflation target framework of between 3 and 6 percent.[219] Under this inflation-targeting framework, the SARB aims to achieve price stability by adjusting the repo rate,[220] which directly influences the interest rate.[221] The effect on liquidity within the country occurs through changes in the lending between banks and other financial institutions, which in turn affects inflation rates as measured using the consumer price index (CPI).[222]

Central banks also function under one of two types of mandate, a hierarchical mandate that makes price stability the primary objective for monetary policy, and subordinates other potential objectives like full employment, alternatively, a dual mandate that recognizes the two objectives of price stability and full employment.[223] Therefore, the SARB's mandate was previously described as a hierarchical price stability mandate with an explicit inflation objective.[224]

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[218] Goodhart *The changing role of central banks* BIS Working Papers No 326 November 2010 21, available at https://www.bis.org/publ/work326.pdf (accessed 25 September 2023).

[219] Lehohla *Statistical Implications of Inflation Targeting in South Africa* Papers presented at an IMF Seminar 2002 55 available at https://www.elibrary.imf.org/downloadpdf/book/9781589061323/ch003.xml (accessed on 16 November 2023).

[220] The repo rate is the price at which the SARB lends cash to the banking system and is the key operational variable in the monetary-policy implementation process. It represents the most important indicator for short-term interest rates. The Government Communication and Information System *South Africa Yearbook Finance* 191 available at https://www.gcis.gov.za/sites/default/files/docs/resourcecentre/yearbook/2013-4Finance.pdf (accessed 25 August 2023).

[221] Interest rates are the foundational element of monetary policy and direct the economy by setting of the rate at which money borrowed. Interest rates determine the availability and price of credit in the economy. This affects household investment (and thus a knock-on effect on industries such as construction), consumer credit (and thus a knock-on effect on industries such as motor vehicle, furniture and appliances), and companies' decisions to invest since any investment must make more than the cost of capital to be viable and so the costlier capital becomes the less investment there will be. Jordan "Debating the Mandate of the Reserve Bank" New Agenda 2017 7-10 available at https://www.ajol.info/index.php/na/article/view/160366/149942 (accessed 16 March 2024).

[222] Bom "Monetary Policy Credibility and Inflation Expectations: Exploring an unconventional channel in South Africa " 2021 *African Journal of Business and Economic Research* 307.

[223] Meyer "Inflation targets and inflation targeting" 2002 *The North American Journal of Economics and Finance* 147.

[224] Ibid 1.

3.2.2 The prudential supervision of banks

Prudential supervision involves the attempt by regulators to reduce insolvency risk of a systemic nature in the banking sector.[225] Banks in their financial intermediation role are fundamental to facilitating the financing of economic activity.[226] The SARB's traditional role in the banking system included ensuring the effective prudential regulation of banks.[227] In South Africa, Acts of Parliament served as the legislative framework for the prudential regulation of banks. The Banks Act emphasised the principle of risk management as a basis for the prudential regulation of banks.[228] The Banks Act created the Office of the Registrar of Banks, known as the Banking Supervision Department, which was housed within the SARB.[229] The four main prudential requirements of the Banks Act were licensing requirements,[230] permissible business activities,[231] disclosure requirements,[232] as well as minimum capital and reserve requirements.[233]

The international convergence on bank capital requirements for prudential regulation occurred with the signature of the G10 countries in 1988 of the Basel I: International convergence of capital measurement and capital standards.[234] The Basel I Accord focused on the definition of standards for credit risk and how to categorise capital, with the ultimate goal of determining appropriate risk measurement and capital adequacy.[235] Under its Charter, Committee members (of which South Africa is) agree

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225 Gilbert "Prudential regulation, its international background and the performance of the banks a critical review of the South African environment since 1970" 2009 *South African Journal of Economic History* 49.

226 Chandavarkar *Promotional Role of Central Banks in Developing Countries* IMF Working Paper No. 87/20, 27 March 1987 5 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=884635 (accessed 04 August 2023).

227 Van Niekerk, MG: "*A Comparative Analysis of The Role of The Central Bank in Promoting And Maintaining Financial Stability In South Africa*", 2018, *LLD Thesis University of Pretoria* 82 available at https://repository.up.ac.za/handle/2263/67934 (accessed 02 February 2023).

228 Gilbert "Prudential regulation, its international background and the performance of the banks a critical review of the South African environment since 1970" 2009 *South African Journal of Economic History* 58.

229 Section 4 of the Banks Act.

230 Section 35 of the Banks Act.

231 Chapter 7 of the Banks Act.

232 Chapter 5 of the Banks Act.

233 Chapter 6 of the Banks Act.

234 The Basel I Accord.

235 See also Jones *The Limits of Globalizing Basel Banking Standards* Journal of Financial Regulation, Volume 3, Issue 1, March 2017 5 available at https://doi.org/10.1093/jfr/fjx001 (accessed on 22 March 2023).

to implement fully Basel standards for their internationally active banks, which standards serve as minimum requirements that BCBS members can choose to exceed.[236]

In June 2004, the Basel II: International Convergence of Capital Measurement and Capital Standards: a Revised Framework was published.[237] The purpose of the Basel II Accord was to create an international standard that banking regulators could use when creating regulations about how much capital banks needed to put aside to guard against the types of financial and operational risks they faced.[238] The Basel II Accord consisted of three pillars; that is, minimum capital standards, a supervisory review process, and an effective use of market discipline.[239] The SARB implemented the Basel II revised capital framework beginning on the 01st of January 2008 in a major exercise that was undertaken over several years.[240]

The GFC was the impetus for the adoption of the Basel III: A global regulatory framework for more resilient banks and banking systems.[241] In 2013, South Africa implemented amended Regulations in line with the Basel III framework, which addressed[242] bank-related and wider financial systemic risks by raising the quality and quantity of capital that banks had to better absorb losses, enhancing the risk coverage of the regulatory framework, introducing capital buffers that could be drawn on in periods of stress, introducing a leverage ratio to prevent the build-up of excessive leverage in the financial system, raising the standards for supervision, introducing the monitoring of proposed minimum liquidity standards to improve banks' resilience, and

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236 Basel Committee on Banking Supervision History of the Basel Committee available at https://www.bis.org/bcbs/history.htm (accessed 26 September 2023).

237 The Basel II Accord.

238 Ferreira et al *From Basel I to Basel III: Sequencing Implementation in Developing Economies* IMF Working paper WP/19/127 2019 2 available at https://www.imf.org/en/Publications/WP/Issues/2019/06/14/From-Basel-I-to-Basel-III-Sequencing-Implementation-in-Developing-Economies-46895 (accessed 26 September 2023).

239 See also The South African Reserve Bank *South Africa's Implementation of Basel II And Basel III* 2020 available at https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/Sector_data/south-africa-s-implementation-of-basel-ii-and-basel-iii (accessed 22 March 2024).

240 The South African Reserve Bank *Annual Report* 2007 available at https://www.resbank.co.za/content/dam/sarb/publications/reports/annual-reports/2007/3966/Annual+Report-2007.pdf (accessed 30 June 2023).

241 The Basel III Accord.

242 The South African Reserve Bank *South Africa's Implementation of Basel II And Basel III* 2020 available at https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/Sector_data/south-africa-s-implementation-of-basel-ii-and-basel-iii (accessed 22 March 2024).

introducing additional capital buffers for the most systemically important institutions to prevent “TBTF”.

The Basel principles were important elements in the SARB’s approach to prudential regulation as the SARB’s Bank Supervision Department was assessed by the IMF[243] in terms of its compliance with these Principles.[244]

3.2.3 The supervisor of the payments, clearing, and settlement system

The SARB has played a crucial role in overseeing the safety, efficiency, integrity, and stability of the payments, clearing, and settlement system within the country's financial system and economy since its establishment.[245] This oversight is carried out by the National Payment System Department[246] within the SARB, and its responsibilities are outlined in the National Payment System Act.[247]

The payments system is a vital market infrastructure that contributes to the overall stability of the financial system. This is due to the interconnected nature of banks, as they are financially linked through lending, borrowing, holding deposit balances, and participating in the payments clearing system. Therefore, the failure of one bank poses a higher risk of contagion to other banks.[248]

3.2.4 The lender of last resort

The SARB had the potential to engage in the lender of last resort (LOLR) function prior to the introduction of the Twin Peaks model of financial regulation, although little public

[243] The International Monetary Fund *South Africa Financial System Stability Assessment* 2022 available at https://www.imf.org/en/Publications/CR/Issues/2022/02/11/South-Africa-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-513014 (accessed on 19 March 2023).

[244] Jacobs “The regulatory treatment of liquidity risk in South Africa” 2012 *South African Journal of Economic and Management Sciences* 294.

[245] Van Niekerk and Van Heerden “Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability” 2018 *Journal of Contemporary Roman-Dutch Law* 655.

[246] The National Treasury *Explanatory Policy Paper accompanying the Conduct of Financial Institutions Bill* 2019 23 available at https://www.treasury.gov.za/twinpeaks/cofi%20bill%20policy%20paper.pdf (accessed 30 May 2023).

[247] Act 78 of 1998.

[248] Kaufman “Bank Failures, Systemic Risk, And Bank Regulation” 1996 *Cato Journal* 20.

information exists due to the SARB's possible fear that this may lead to moral hazard.[249]

The SARB could, when exceptional circumstances arose, provide stabilising financial assistance to institutions, as stated in the SARB Act, wherein it is indicated that loans could be advanced by the SARB to the Government or to a financial institution that the SARB had acquired shares in, and whose acquisition is conducive with any objects of the SARB Act.[250] The SARB as the central bank initially provides liquidity to banks experiencing liquidity shortages through its standing facilities.[251] The accommodation facility is available to all registered banks through repurchase transactions, and liquidity is provided only on condition that the bank provides the SARB with qualifying assets as security.[252] When the qualifying assets of a particular bank have been depleted and the liquidity shortage of the bank continues, the SARB may at its discretion provide liquidity assistance to the bank as part of its LOLR functions.[253] LOLR operations involve either the creation of additional liquidity through special operations (systemic liquidity) or the provision of additional liquidity to a specific institution that is experiencing a temporary liquidity shortage (emergency liquidity assistance).[254]

The lender of last resort role would in the above circumstances have to be executed with the use of taxpayers' money to fund the bail-out of failing institutions, as in the

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[249] De Jager "The South African Reserve Bank: Blowing Winds of Change (Part 2)" 2013 *South African Mercantile Law Journal* 502.

[250] Section 10(f)(i) of the SARB Act.

[251] Standing facilities allow credit institutions to borrow liquidities overnight from their national central banks using the marginal lending facility. Van Niekerk, MG: "*A Comparative Analysis of The Role of The Central Bank in Promoting And Maintaining Financial Stability In South Africa*", 2018, *LLD Thesis University of Pretoria 85 available at https://repository.up.ac.za/handle/2263/67934 (accessed 02 February 2023).*

[252] The South African Reserve Bank *Overview of the South African Reserve Bank's policy framework for the provision of emergency liquidity assistance to banks* 2022 5 available at https://www.resbank.co.za/content/dam/sarb/publications/media-releases/2022/position-paper-on-ela-for-banks/Position%20paper%20on%20ELA%20for%20Banks%20(Final).pdf (accessed 16 March 2024).

[253] The South African Reserve Bank *Press Release on Lender-of-Last-Resort Assistance to FBC Fidelity Bank Limited* 2000 available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/media-releases/2000/4155 (accessed 16 March 2024).

[254] The South African Reserve Bank *Overview of the South African Reserve Bank's policy framework for the provision of emergency liquidity assistance to banks* 2022 5 available at https://www.resbank.co.za/content/dam/sarb/publications/media-releases/2022/position-paper-on-ela-for-banks/Position%20paper%20on%20ELA%20for%20Banks%20(Final).pdf (accessed 16 March 2024).

Pre-Twin Peaks era in South Africa no provision had been made for an explicit deposit insurance system.[255]

3.3 The contemporary roles of the SARB in respect of financial stability as framed by the FSRA

As discussed above, the historical primary mandate of the SARB is to achieve and maintain price stability in the interest of balanced and sustainable economic growth in South Africa, which mandate has been confirmed in the Constitution.[256]

The financial sector is central to the South African economy.[257] The risk-taking of financial institutions in the chasing of profits led to the GFC. This necessitated the need for reformation of the regulatory framework that supervised the financial sector, and financial stability of the financial sector became the focus to attempt to prevent similar crises in the future.[258] National Treasury expanded an already initiated review of the financial regulatory system as a result of the GFC.[259] The aim of the review was to identify gaps and weaknesses in the financial regulatory system in South Africa and to enhance the stability of the financial system.[260] A move to a Twin-Peaks approach to regulation, with a separation of prudential and market conduct regulators,[261] was recommended. In addition, the adoption of a system-wide approach to financial stability and regulation was recommended, together with the supervision of individual

255 Van Niekerk, MG: "*A Comparative Analysis of The Role of The Central Bank in Promoting And Maintaining Financial Stability In South Africa*", 2018, *LLD Thesis University of Pretoria 85 available at https://repository.up.ac.za/handle/2263/67934 (accessed 02 February 2023).*

256 Section 224(1) of the Constitution.

257 The National Treasury *A Safer Financial Sector to Serve South Africa better* 2011 7 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf (accessed 30 May 2021).

258 Van Niekerk and Van Heerden "Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability" 2018 *Journal of Contemporary Roman-Dutch Law* 638.

259 Botha and Makina "Financial regulation and supervision: Theory and practice in South Africa" 2011 *International Business & Economics Research Journal* 27.

260 The National Treasury *A Safer Financial Sector to Serve South Africa better* 2011 5 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf (accessed 30 May 2021).

261 The National Treasury *Response and Explanatory Document: Accompanying the 2nd draft of the Financial Sector Regulation Bill* 2014 45 available at *https://juta.co.za/media/filestore/2015/03/2014_12_12_Response_document.pdf* (accessed 03 August 2023).

financial institutions, better coordination and information sharing, as well as the regulation of financial activities that have the potential to create systemic risks to financial stability.[262] In the Twin Peaks regulatory model, the SARB was chosen to oversee financial stability. The reason for this was that the SARB as South Africa's central bank was best placed to deal with the reforms that the G20 required, given its macroprudential supervisory toolkit.[263] These reforms that regulators were expected to adopt related to the regulation of SIFIs as 'Too-Big-To-Fail' financial institutions being a critical stability objective, as well as the reduction of the likelihood of tax-payer funded bail-outs of failing financial institutions.

The FSRA has now specifically assigned a statutory mandate to the SARB to protect and enhance financial stability in South Africa.[264] The intersection of the SARB's primary and statutory mandates of maintaining price and financial stability meets the SARB's ultimate goal of contributing to the growth of the South African economy.[265]

The FSRA thus aims to achieve a regulatory and supervisory framework based on financial stability, and the SARB's financial stability mandate must importantly be seen in the context of the financial stability role that it plays in the Twin Peaks model of financial regulation that has been introduced in the FSRA. The SARB is given this mandate because, as South Africa's central bank, it is uniquely placed to create synergy between other financial sector laws, monetary policy, and financial market developments.[266]

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[262] The National Treasury *A Safer Financial Sector to Serve South Africa better* 2011 9 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf (accessed 30 May 2021).

[263] The National Treasury *Response and Explanatory Document: Accompanying the 2nd draft of the Financial Sector Regulation Bill* 2014 23 available at *https://juta.co.za/media/filestore/2015/03/2014_12_12_Response_document.pdf* (accessed 03 August 2023).

[264] Section 11(1) of the FSRA.

[265] The South African Reserve Bank *Financial Stability Review* 2nd edition 2023 5 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2023/financial-stability-review/second-edition-2023-financial-stability-review/Second%20Edition%202023%20Financial%20Stability%20Review1.pdf (accessed 16 March 2024).

[266] Godwin, Howse and Ramsay "A jurisdictional comparison of the twin peaks model of financial regulation" 2017 *Journal of Banking Regulation* 4.

3.3.1 The statutory tools of the SARB to execute its financial stability mandate in terms of the FSRA

The SARB has two main functions in relation to financial stability: its preservation and enhancement. Additionally, it assesses whether a systemic event has occurred or is imminent, and if so, takes steps to restore and maintain financial stability.[267] The codification of the SARB's financial stability mandate has been reinforced by an amendment to the SARB Act. In addition to its former standalone primary objective of price stability, the amendment has established that another primary objective of the SARB is to protect and maintain financial stability as envisaged in the FSRA.[268] This amendment not only statutorily confirms the financial stability mandate, but also extends it beyond mere maintenance to include enhancement and restoration in appropriate circumstances.[269] The responsibility of enhancing, maintaining, and restoring financial stability is meant to be discharged within a policy framework that is established between the Minister of Finance and the Governor of the SARB.[270] The FSRA further indicates that the SARB, when fulfilling its responsibilities, may do so with the utilisation of any power vested in it as the country's central bank, or as conferred on it "*in terms of this Act or any other legislation*".[271] This provision could be read to refer to the traditional ancillary powers vested in the SARB as the country's central bank that are important to its ability to change the circumstances of the economy, for example, its price stability monetary policy powers, its ability to control the National Payment System, or its lender of last resort function (the SARB's supervisor of banks function now rests with the Prudential Authority).[272] The SARB must also in dispensing its financial stability responsibility have regard to the roles and functions of other organs of state exercising powers that affect aspects of the economy.[273] Thus, the financial stability mandate of the SARB requires a constant

[267] Section 11(1) of the FSRA.
[268] Section 3(2) of the SARB Act.
[269] The South African Reserve Bank *Financial Stability Review* 1st edition 2019 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2019/9276/FSR-First-Edition-2019.pdf (accessed 25 August 2023).
[270] Section 11(2)(a) of the FSRA.
[271] Section 11(2)(b) of the FSRA.
[272] Van Niekerk, MG: "*A Comparative Analysis of The Role of The Central Bank in Promoting And Maintaining Financial Stability In South Africa*", 2018, *LLD Thesis University of Pretoria 105 available at https://repository.up.ac.za/handle/2263/67934 (accessed 02 February 2023).*
[273] Section 11(2)(c) of the FSRA.

collaborative interplay between the SARB, organs of state responsible for other areas of the South African economy as well as regulators in these spheres.[274]

The SARB is also expected to keep a broad macroeconomic view of the entire perimeter that makes up the South African financial system.[275] This involves the monitoring and reviewing of any potential risk-causing events in the different financial sectors that could affect financial stability.[276] The risk could be of both a systemic nature or a non-systemic nature, as a build-up of non-systemic risk can lead to eventual financial instability.[277] The SARB takes a proactive monitoring role of the financial system, and it actively seeks a high level of compliance with its financial stability standards as well as actively enforces its regulatory tools.[278] Once a risk is identified, steps must be taken to mitigate it.

This macroprudential monitoring framework includes the stress-testing of financial institutions.[279] The SARB conducts regular stress tests of individual financial institutions by simulating the effect of a significant and plausible economic downturn designed to stress the underlying vulnerabilities of the financial institution.[280] These tests help the SARB to understand the financial system's resilience as a whole to large-scale risks, whilst at the same time assisting the individual financial institution to understand its risks and to assess its internal risk management framework. The SARB

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[274] Van Niekerk and Van Heerden "Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability" 2018 *Journal of Contemporary Roman-Dutch Law* 645.

[275] The International Monetary Fund *Financial Sector Assessment Program: Technical note on Systemic Risk Oversight and Macroprudential Policy 2022* 7 available at https://www.imf.org/en/Publications/CR/Issues/2022/06/16/South-Africa-Financial-Sector-Assessment-Program-Technical-Note-on-Systemic-Risk-Oversight-519731 (accessed on 23 June 2023).

[276] Section 12 of the FSRA.

[277] Van Niekerk and Van Heerden "Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability" 2018 *Journal of Contemporary Roman-Dutch Law* 646.

[278] Hollander *A Review of the South African Reserve Bank's Financial Stability Policies* Stellenbosch Economic Working Papers: WP11 2019 13 available at https://www.ekon.sun.ac.za/wpapers/2019/wp112019/wp112019.pdf (accessed 19 March 2023).

[279] The South African Reserve Bank Financial Stability Review 2nd Edition 2023 31 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2023/financial-stability-review/second-edition-2023-financial-stability-review/Second%20Edition%202023%20Financial%20Stability%20Review1.pdf (accessed 16 March 2024).

[280] The South African Reserve Bank *Financial Stability Review* 1st edition 2024 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2024/financial-stability-review/First%20Edition%202024%20Financial%20Stability%20Review.pdf (accessed 20 July 2024).

conducts common scenario stress tests across the banking and insurance sectors every two years,[281] the test results of which are published in the SARB's Financial Stability Review.

The Financial Stability Committee (FSC) is responsible for the type of macroprudential policy in the SARB that this type of monitoring would fall under,[282] as well as being the SARB's financial stability policymaking committee. It is made up of the Governor as Chair of the committee, the Deputy Governors, the members of the Monetary Policy Committee (MPC), and up to seven other SARB officials. When increased risk is identified, the macroprudential policy decision-making process that is applied involves the conducting of a systemic risk assessment, the building of a case for macroprudential intervention, and then the selecting and implementing of the required macroprudential tools to mitigate the identified risks.[283]

The SARB publishes a Financial Stability Review every 6 months that assesses the financial stability of the financial system.[284] This assessment has a set list of items that must be reviewed, including the SARB's assessment of financial stability in the period under review: identification of risks to financial stability in the next 1 year; a review of the steps taken by the SARB and other financial sector regulators to manage the risks under the period being reviewed, as well as a review of the recommendations made by the SARB and the Financial Stability Oversight Committee (FSOC) in that regard to determine the effectiveness of their implementation.[285] The requirement that the recommendations made by the SARB be done in conjunction with the FSOC during

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[281] Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 38 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

[282] The South African Reserve Bank *Financial Stability Review* 1st edition 2019 32 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2019/9276/FSR-First-Edition-2019.pdf (accessed 25 August 2023).

[283] The International Monetary Fund *South Africa Financial System Stability Assessment* 2022 available at https://www.imf.org/en/Publications/CR/Issues/2022/02/11/South-Africa-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-513014 (accessed on 19 March 2023).

[284] Section 13 of the FSRA.

[285] The South African Reserve Bank *Financial Stability Review* 2nd edition 2023 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2023/financial-stability-review/second-edition-2023-financial-stability-review/Second%20Edition%202023%20Financial%20Stability%20Review1.pdf (accessed 16 March 2024).

the period under review,[286] or that the review be put to the FSOC for comment before publishing,[287] again reflects that the requirement of collaboration is important in the execution of the SARB's mandate. The information that could be published in a review could of course be of a sensitive nature and the FSRA allows the SARB to only publish information that may materially increase the possibility of a systemic event, only after the risk of a systemic event subsides or has been addressed.[288] The SARB, together with the Minister of Finance, must determine that the circumstances of a specific event rise up to being a systemic event, or that the circumstances thereof are imminent.[289] The expectation on the SARB in this case is to take all reasonable steps to prevent the systemic event from occurring; alternatively, if the event has already occurred or is imminent, to mitigate the adverse effects on financial stability and/or manage the event and its effects.[290] A copy of the review must also be tabled before parliament.[291] The Financial Stability Review is aimed at the Members of Parliament, participants in the financial sector, international central bank peers, rating agencies, international financial institutions, standard-setting bodies as well as academia.[292] The FSOC reviews the financial stability outlook on an ongoing basis at four meetings per year. The Financial Stability Review, in this context, serves to provide the SARB's assessment of financial stability.

The SARB also manages systemic events as part of its financial stability mandate. After consulting with the Minister of Finance, the Governor of the SARB may determine that a specific event is a systemic event or an imminent systemic event. In this case, the SARB may use its powers or direct financial sector regulators to exercise their powers to manage the event. As part of its crisis management framework for systemic risks and events, the FSLAA introduced a new bank resolution framework into the

[286] Section 13(2)(d) of the FSRA.
[287] Section 13(4)(a) of the FSRA.
[288] Section 13(3) of the FSRA.
[289] Section 14(1) of the FSRA.
[290] The South African Reserve Bank Financial Stability Review 2nd Edition 2023 28 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2023/financial-stability-review/second-edition-2023-financial-stability-review/Second%20Edition%202023%20Financial%20Stability%20Review1.pdf (accessed 16 March 2024).
[291] Section 13(4)(c) of the FSRA.
[292] The South African Reserve Bank *Financial Stability Review* 1st edition 2024 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2024/financial-stability-review/First%20Edition%202024%20Financial%20Stability%20Review.pdf (accessed 20 July 2024).

FSRA that came into effect on 1 June 2023, and a new deposit insurance scheme, which became operational on 1 April 2024.

The SARB Act has also been amended[293] to make the Reserve Bank the Resolution Authority.[294] The Bank's Act is amended to exclude certain provisions pertaining to resolution[295] as well as to make provision for the set-off against any amounts paid by the Deposit Insurer.[296] The FSRA is amended to make provision for the establishment, functions and governance structure of South Africa's Deposit Insurer,[297] the Corporation for Deposit Insurance (CODI),[298] to make provision for the establishment of the scheme, that is, the Deposit Insurance Fund (DIF), and to make provision for the determination of how contributions to the fund will be made, the determination of covered deposits, how the coordination between the Deposit Insurer and other regulatory entities will function, as well as to provide for legal immunities for employees of the Deposit Insurer.[299] The designation of the SARB as the official resolution authority for banks as well as non-bank SIFIs is an important part of South Africa's financial stability regulatory framework as it gives the SARB the ability to deal with the failure of designated institutions. The move from an implicit to an explicit deposit insurance scheme allows for the orderly resolution of SIFIs, which is required in the maintenance of financial stability.[300] This also enables the SARB in the process of

[293] Section 10(1)(d)(i) of Act 90 of 1989.

[294] The SARB as the resolution authority is responsible for managing the resolution of a failing designated financial institution in the public interest, ensuring an orderly resolution process, protecting depositors' money and minimising the burden on taxpayers. The South African Reserve Bank *Financial Stability Review* 1st edition 2024 23 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2024/financial-stability-review/First%20Edition%202024%20Financial%20Stability%20Review.pdf (accessed 20 July 2024).

[295] Section 54(1D) of Act 94 of 1990.

[296] Section 60(1B)(b)(ii) of Act 94 of 1990.

[297] This amendment to the FSRA was brought about by the FSLAA. Deposit Insurance is the process by which a scheme is created and mandated to protect qualifying bank depositors in the event of a bank failure. Qualifying depositors are now protected for an amount up to R100 000 of their deposits in accounts in for qualifying financial products with their bank fail. CODI as a subsidiary of the SARB and the DIF came into operation on 1 April 2024. The South African Reserve Bank *Financial Stability Review* 1st edition 2024 23 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2024/financial-stability-review/First%20Edition%202024%20Financial%20Stability%20Review.pdf (accessed 20 July 2024).

[298] Section 166AE of the FSRA.

[299] Section 166BD of the FSRA.

[300] The National Treasury *Strengthening South Africa's Resolution Framework for Financial Institutions* 2015 41 available at https://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa%E2%80%99s%20Resolution%20Framework%20for%20Financial%20Institutions.pdf (accessed 23 March 2024).

resolution to manage the failure of a designated institution with as little effect on financial stability, while protecting depositors and taxpayers from government-funded bailouts.[301] The designation of the SARB as the resolution authority assists in its mandate of ensuring financial stability in that this strengthens the SARB's ability to deal with the failure of designated institutions.[302]

3.3.2 The financial stability infrastructure established by the FSRA

The Twin Peaks model of financial regulation introduced by the FSRA has expanded the financial stability mandate of the SARB to the point that additional infrastructure is required for the mandate's implementation. One of the pillars of the financial stability infrastructure is the expectation that the different regulatory bodies are supposed to work together when it comes to matters that affect financial stability, even though they operate in their own individual silos.[303] These matters that affect financial stability and that require collaboration could be the determination of risks to the economy, the morphing of risks into systemic events, and the exchange of financial stability reports.[304] The regulatory framework calls for coordination, cooperation, collaboration, and consultation between the SARB and the financial sector regulators[305] when executing their own mandates in respect of financial stability.[306] The SARB, as the main arbiter of financial stability, must, in taking steps to mitigate risks to the financial system, advise the various financial sector regulators and other organs of state in

301 The South African Reserve Bank *The South African Reserve Bank has been designated in terms of the FSRA as the Resolution Authority for banks and non-bank systemically important financial institutions (designated institutions)* 2020 available at https://www.resbank.co.za/en/home/what-we-do/resolution-authority#:~:text=The%20South%20African%20Reserve%20Bank%20has%2C%20in%20terms%%20the,designated%20institutions%2C%20signaling%20a%20significant (accessed on 31 March 2024) and see also Prudential Authority and Another v Habib Overseas Bank and Others (2023/071935) [2024] ZAGPPHC 189 (26 February 2024).

302 The South African Reserve Bank *Financial Stability Department: Financial Stability Focus* 2020 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Financial%20Stability%20Focus%20-%20Topical%20Briefings.pdf (accessed 25 March 2024).

303 Section 26 of the FSRA.

304 Hollander *A Review of the South African Reserve Bank's Financial Stability Policies* Stellenbosch Economic Working Papers: WP11 2019 2 available at https://www.ekon.sun.ac.za/wpapers/2019/wp112019/wp112019.pdf (accessed 19 March 2023).

305 See 3.3.2.3 below

306 Van Niekerk and Van Heerden "The importance of a legislative framework for co-operation and collaboration in the Twin Peaks model of financial regulation" 2020 *South African Law Journal* 143.

regard to the steps it intends to take.[307] The collaboration calls for the provision of assistance and information by financial sector regulators to the SARB and the FSOC.[308] This must especially be in cases where the information relates to matters that pose a risk to financial stability. The SARB is, once it is in possession of this information, then expected to consider the reports of the financial sector regulators as well as any recommendations by the FSOC.

The FSRA specifically creates bodies (the committees and forums discussed below) whose role is to facilitate cooperation among the various financial sector regulators. We will discuss how these bodies function and their impact on creating an operational and stable financial system, as well as how they act as conduits for the collaboration required in the execution of the SARB's financial stability mandate.

3.3.2.1 The Prudential Authority

The PA[309] is a body that is housed in the SARB but has its own juristic personality.[310] It was established to assist in the maintenance of financial stability by ensuring the soundness of financial institutions as well as market infrastructures.[311] In regulating financial institutions, the PA is called on to cooperate with the SARB, FSOC, the FSCA, the NCR and the FIC.[312] It is also expected to monitor the entire regulatory environment and ensure that supervision is meeting the required objectives, as well as meeting the necessary international standards.[313] The PA's functionary model is

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[307] The South African Reserve Bank *Financial Stability Department: Financial Stability Focus* 2020 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Financial%20Stability%20Focus%20-%20Topical%20Briefings.pdf (accessed 25 March 2024).

[308] The National Treasury *Strengthening South Africa's Resolution Framework for Financial Institutions* 2015 6 available at https://www.treasury.gov.za/twinpeaks/Strengthening%20South%20Africa%E2%80%99s%20Resolution%20Framework%20for%20Financial%20Institutions.pdf (accessed 23 March 2024).

[309] Established by Section 32 of the FSRA.

[310] Van Niekerk and Van Heerden "Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability" 2018 *Journal of Contemporary Roman-Dutch Law* 642.

[311] Section 33 of the FSRA.

[312] Section 34 of the FSRA.

[313] These international standards include the capital reserve and liquid asset requirements set by the Basel Committee in the Basel Accords as discussed supra. The FSRA enjoins the SARB and other financial stability infrastructure to stay up to date with the latest international developments set by international bodies such as the Basel Committee and other standard setting bodies.

based on risk assessment that fosters the ability to take pre-emptive steps, including on financial stability matters.[314]

The Prudential Committee of the PA,[315] which is its governance structure, is responsible for the adoption of collaborative memoranda, prudential standards, as well as other policies that may affect its financial stability mandate.[316]

The PA is an important role player in the stress-test simulations that are conducted in respect of financial institutions to determine their ability to deal with crises.[317] The PA sets the requirements, in conjunction with the BCBS's liquidity principles, for the liquidity stress simulations conducted on financial institutions.[318]

3.3.2.2 The Financial Sector Conduct Authority

The FSCA[319] is a body that is tasked with a financial stability mandate, which it fulfils by ensuring the integrity of the financial markets.[320] It achieves this by providing financial literacy programs to financial customers so that they can make sound financial decisions.[321]

As with the PA, the FSCA is called, in regulating the market conduct of financial institutions, to cooperate with the various financial sector regulators, ensure supervision meets established international standards, and apply a pre-emptive risk-based approach in the execution of its functions, including in the maintenance of financial stability.[322]

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314 The South African Reserve Bank *The Prudential* Authority Annual Report 2022/23 27 June 2023 12 available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/2023/Prudential-Authority-Annual-Report-2022-2023 (accessed 29 March 2024).
315 Established in terms of Section 41 of the FSRA.
316 Section 42 of the FSRA.
317 Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 70 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).
318 Principles 10 and 11 of the BCBS principles for Sound Liquidity Risk Management.
319 Established by Section 56 of the FSRA.
320 Section 57 of the FSRA.
321 The Financial Sector Conduct Authority *Regulatory Strategy of The Financial Sector Conduct Authority* 2018 2 available at https://www.fsca.co.za/Documents/FSCA_Strategy_2018.pdf (accessed 30 May 2021).
322 Section 57 of the FSRA.

The Executive Committee of the FSCA is responsible for the adoption of collaborative memoranda and market conduct standards, licensing of financial institutions, as well as the adoption of joint standards with other regulatory bodies that may affect its financial stability mandate.[323]

A financial system that is burdened by participants that engage in misconduct will become unstable, while compliance with a regulatory environment maintains and enhances financial stability.[324]

3.3.2.3 The Financial Stability Oversight Committee

The FSOC[325] is a committee that was established by the FSRA and its main goal is to support the SARB in its financial stability mandate.[326] It is also the main vehicle of collaboration between the various financial sector regulators and the SARB in respect of matters relating to financial stability. This FSOC forum has as components of its membership the Governor of the SARB, the Deputy Governor of the SARB that is responsible for financial stability, the CEO of the PA, the Commissioner of the FSCA, the CEO of the NCR, the Director of the FIC, as well as 3 additional role players that are chosen by the Governor.[327]

The FSOC has the power to advise the Governor of the SARB on the designation of SIFIs.[328] It must also advise the Minister of Finance of risks to financial stability, as well as on crisis management or preventative measures in relation thereto.[329] The FSOC is expected to meet at least once every 6 months.[330]

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323 Established in terms of Section 60 of the FSRA.

324 Schinasi *Defining Financial Stability* IMF Working Paper No. 2004/187 October 2004 10 available at https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Defining-Financial-Stability-17740 (accessed 14 May 2023).

325 Established by Section 20 of the FSRA.

326 Van Niekerk and Van Heerden "Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability" 2018 *Journal of Contemporary Roman-Dutch Law* 645.

327 Section 22 of the FSRA.

328 Section 29 of the FSRA.

329 Section 21 of the FSRA.

330 Section 24 of the FSRA.

Systemic risks to the financial system are identified using quantitative indicators[331] as well as a qualitative assessment by the FSOC.[332] In late 2019, this assessment revealed that the main risk to financial stability facing South Africa over a medium-term horizon was the development of what would become the Covid-19 pandemic.[333]

3.3.2.4 The Financial Sector Contingency Forum

The FSCF[334] is a committee that was established by the FSRA and its main goal is to provide support to the FSOC in identifying potential risks to the financial system, as well as the plans to address those risks.[335]

This FSCF forum is comprised of the Deputy Governor of the SARB as designated, the representatives of the various financial sector regulators, the representatives of the various other state organs as determined, as well as the representatives of the

[331] The relevant quantitative indicators are the following (1) Financial soundness indicators that monitor the soundness of the broader financial sector specifically from a macroprudential perspective. (2) The SARB financial stability heatmap that is a graphical representation of changes in a wide range of financial stability indicators. (3) Systemic risk analyses that identifies the build-up of a systemic risk or vulnerabilities. (4) The SARB's common scenario stress test (CSST) that is conducted every two to three years and covers banks that are designated as SIFIs. (5) Network and interconnectedness measures that assess how developments in one part of the financial system affect other parts. (6) The SARB's financial conditions index (FCI) that is a composite index of asset prices and funding costs across the domestic and global economy. (7) Analyses conducted by SARB line departments of developments and topics of Policy Paper relevant to financial stability. (8) Industry and regulator engagements by the SARB regularly to obtain information about, and a better understanding of, systemic risks and vulnerabilities. (9) Financial stability research outputs that the SARB conducts on a broad range of topics related to financial stability to inform macroprudential policy. The South African Reserve Bank *Financial Stability Monitoring and Assessment Framework* 2024 5 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/macroprudential-policy/SARB%20financial%20stability%20monitoring%20and%20assessment%20framework.pdf (accessed 20 July 2024).

[332] The South African Reserve Bank *Financial Stability Review* 1st edition 2024 4 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2024/financial-stability-review/First%20Edition%202024%20Financial%20Stability%20Review.pdf (accessed 20 July 2024).

[333] Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 14 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

[334] Established by Section 25 of the FSRA.

[335] The South African Reserve Bank *Financial Stability Review* 1st edition 2023 28 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2023/financial-stability-review/First%20Edition%202023%20Financial%20Stability%20Review.pdf (accessed 25 March 2024). The SARB, through the FSCF, has continued to plan for the possible scenario of a national electricity grid shutdown. These plans are centred on developing, coordinating and testing contingency plans to mitigate the impact of a shutdown on the financial system and the economy.

various other relevant financial sector industry bodies as determined.[336] The FSCF must meet at least once every 6 months.

The FSCF's 17 industry participants[337] conduct cooperative research as well as stress-testing exercises every three years that are designed to provide opportunities for regulatory authorities and participants in the financial system to practice information-sharing and coordination in simulated crisis scenarios.[338] The large scale of the Covid-19 pandemic with its extensive ramifications resulted in the FSCF postponing the 2020 simulation exercise to 2022 and converting the crisis simulation exercise to a discussion and documentation of the Covid-19 regulatory interventions taken, as the pandemic was viewed as a real-life stress-test, the experience of which was more tangible than a simulation.[339]

3.3.2.5 The Financial System Council of Regulators

The FSCR[340] is a forum that was created to allow the senior representatives of the institutions represented thereon to discuss matters of common interest, including financial stability issues. These include issues to do with enforcement and financial crime, financial stability and resolution, policy and legislation, standard-setting, financial sector outcomes, financial inclusion, transformation of the financial sector,

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336 The International Monetary Fund *Financial Sector Assessment Program: Technical note on Systemic Risk Oversight and Macroprudential Policy 2022* 6 available at https://www.imf.org/en/Publications/CR/Issues/2022/06/16/South-Africa-Financial-Sector-Assessment-Program-Technical-Note-on-Systemic-Risk-Oversight-519731 (accessed on 23 June 2023).

337 These participants include ASISA (The Association for Savings and Investment South Africa), BankservAfrica (The South African Bankers Services Company (Pty) Ltd), BASA (The Banking Association South Africa), FIC (The Financial Intelligence Centre), FSCA (The Financial Sector Conduct Authority), JSE (The Johannesburg Stock Exchange), MASTERCARD (Mastercard South Africa), NCR (The National Credit Regulator), NDMC (The National Disaster Management Centre), NT (National Treasury), PA (Prudential Authority), PASA (The Payments Association of South Africa), SABRIC (The South African Bank Risk Information Centre), SAIA (The South African Insurance Association), SARB (South African Reserve Bank), Strate (Strate Ltd) and VISA (Visa Incorporated).

338 The International Monetary Fund *South Africa Financial System Stability Assessment* 2022 46 available at https://www.imf.org/en/Publications/CR/Issues/2022/02/11/South-Africa-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-513014 (accessed on 19 March 2023).

339 Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 10 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

340 Established by Section 79 of the FSRA.

and any other matter the Director-General of the National Treasury may determine after consulting the other members of the FSCR.[341]

The FSCR is made up of the Director Generals of several government departments, the CEOs of various financial sector regulators, as well as the SARB Deputy Governor that is responsible for financial stability matters.[342] The FSCR must meet at least twice a year,[343] and must establish a working group or sub-committee that is responsible for financial stability.[344]

3.3.2.6 The Financial Sector Inter-Ministerial Council

The FSIMC[345] is a council that was established by the FSRA to facilitate collaboration between cabinet ministers that are responsible for the administration of the financial sector laws and the various industries that they are responsible for.[346] The committee is meant to be a forum for discussions of matters of common interest, including financial stability issues. It is comprised of the Minister of Finance, the Minister of Trade and Industry, the Minister of Health, as well as the Minister of Economic Development.[347]

The FSIMC must every 2 years commission an independent analysis of the effectiveness of the collaborative mechanisms between the various financial sector regulators, including an evaluation of the various memoranda of understanding.[348]

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[341] Van Niekerk and Van Heerden "The importance of a legislative framework for co-operation and collaboration in the Twin Peaks model of financial regulation" 2020 *South African Law Journal* 124.

[342] Ibid 123. The council is chaired by the Director-General of the National Treasury, and also comprises of the Chief Executive Officers of the PA and the NCR together with senior representatives of the Department of Trade and Industry, the Department of Health, the Council for Medical Schemes (CMS), the Financial Intelligence Centre, the National Consumer Commission, the Competition Commission, the SARB, the Deputy Governor responsible for financial stability matters, and any organ of state or other organisation that the Minister of Finance may determine. The FSCA is responsible for performing secretariat and administrative functions in relation to the Council.

[343] Section 80 of the FSRA.

[344] Section 81 of the FSRA.

[345] Established by Section 83 of the FSRA

[346] See also Van Niekerk and Van Heerden "The importance of a legislative framework for co-operation and collaboration in the Twin Peaks model of financial regulation" 2020 *South African Law Journal* 124.

[347] Ibid 125.

[348] Section 86 of the FSRA.

3.3.2.7 Internal SARB Financial Stability Infrastructure

In addition to the above statutorily created framework to maintain financial stability, the SARB has its own internal apparatus to assist in executing its financial stability mandate. The SARB's mandate to protect and enhance financial stability is housed under its Financial Stability Department (the "FSD"), which is tasked with identifying and mitigating systemic risks that may disrupt the financial system.[349] The FSD executes its mandate by identifying the inherent weaknesses and the build-up of risks that may result in financial system disturbances, and the FSD is also tasked with keeping abreast of international best practices in financial stability regulation. The FSD monitors systemic risk for both bank and non-bank financial institutions by considering available information and data that is plotted and monitored on a Risk Assessment Matrix (RAM).[350] The RAM captures the main risks to financial stability over a medium-term horizon, and in December 2019 and January 2020, the RAM revealed that the Covid-19 pandemic was one of the main risks facing the financial system.[351] Another internal organ of the SARB is the Financial Stability Committee (the "FSC").[352] The FSC is responsible for developing policy on a macroprudential level with respect to issues to do with financial stability. The Governor, Deputy Governors, members of the MPC and other relevant SARB officials make up this committee. If risks are identified, then the committee must respond by conducting a systemic risk assessment, developing a plan for macroprudential intervention, and implementing the necessary macroprudential tools to prevent or mitigate the risks.[353]

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[349] The South African Reserve Bank *Financial Stability Review* 1st edition 2024 4 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2024/financial-stability-review/First%20Edition%202024%20Financial%20Stability%20Review.pdf (accessed 20 July 2024).

[350] Ibid 4.

[351] Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 30 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

[352] The South African Reserve Bank *Financial Stability Review* 2004 1 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2004/3940/FSRsept2004.pdf (accessed 25 August 2023).

[353] The South African Reserve Bank *Financial Stability Review* 1st edition 2024 23 available at https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2024/financial-stability-review/First%20Edition%202024%20Financial%20Stability%20Review.pdf (accessed 20 July 2024).

3.4 The main connective tissue in the FSRA financial stability toolkit

The most important tools available to the SARB and that serve as the golden thread running through the financial stability framework created by the FSRA are the following:

3.4.1 The Designation of SIFIs

The SARB Governor has the authority to designate a financial institution as a SIFI.[354] This is an important and powerful financial stability power that the SARB possesses. It allows the SARB to monitor the SIFI for the build-up of systemic risk thus not allowing for SIFIs to become "TBTF", impose heightened prudential standards on the SIFI, and require the concurrence of the SARB in the resolution of the SIFI should it fail.[355] Financial customers and other relevant role players in the financial system must be made aware of this designation by its publication.[356]

The designation is done by notice to both the relevant financial institution, as well as to FSOC, which notice calls for submissions to be made by these parties.[357] Certain factors are taken into consideration in this determination of the significance of the financial institution, including its size; the complexity of the financial services it provides; its interconnectedness with other financial institutions in the market – which has the risk of leading to contagion, whether or not financial customers can easily receive its products and services at other financial institutions, the recommendations of the FSOC, as well as the submissions of the financial institution itself.[358] In 2019, the Governor of the SARB, after giving notice to FSOC, designated the six largest South African banks as SIFIs. Absa Bank Limited, Standard Bank of South Africa

[354] Section 29 of the FSRA.

[355] The South African Reserve Bank *Financial Stability Department: Financial Stability Focus* 2020 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Financial%20Stability%20Focus%20-%20Topical%20Briefings.pdf (accessed 25 March 2024).

[356] Section 29(7) of the FSRA.

[357] Section 29(1)(a) of the FSRA.

[358] Section 29(3) of the FSRA. See also The South African Reserve Bank *Financial Stability Department: A methodology to determine which banks are systemically important within the South African context* 2019 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/resolution-planning/A-methodology-to-determine-which-banks-are-systemically-important-within-the-South-African-context%20(2).pdf (accessed 28 June 2023).

Limited, FirstRand Bank Limited, Nedbank Bank Limited, Investec Bank Limited, as well as Capitec Bank Limited all accepted their designations.[359]

The occurrence or the imminence of a systemic event can also lead to the designation of a financial institution as a SIFI.[360] In such circumstances, because of the urgency, the notification, collaboration, and other requirements discussed above do not have to be complied with.[361] The "TBTF" culture that led to the 2008 GFC was based on the assumption that regulators and organs of state would bail out failing institutions for their risk-taking and poor decision-making, as letting the institutions fail would have greater consequences for the economy of the relevant country.[362] The FSRA attempts to avoid this moral hazard problem by making it clear that such designation does not lead to an implication that the financial institution is entitled to a guarantee or credit from any state organ.[363]

The SARB can, in collaboration with and through the mechanism of the PA, pre-empt the risks to financial stability that can be caused by a systemic event by imposing prudential standards and regulatory directives on a SIFI.[364] These measures can have to do with the solvency, capital, and liquidity buffers that it can expect financial institutions to have, leverage ratios, the financial institution's required statistical returns, the financial institution's organisational structure, the risk management requirements placed on the SIFI, the structural and geographical areas to which the SIFI can be exposed, as well as its recovery and resolution planning.[365]

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359 The South African Reserve Bank *Financial Stability Review* 2nd edition 2019 4 available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/reviews/finstab-review/2019/9606 (accessed 28 June 2023).

360 Section 29(4) of the FSRA.

361 See also The International Monetary Fund *Financial Sector Assessment Program: Technical note on Systemic Risk Oversight and Macroprudential Policy 2022* 8 available at https://www.imf.org/en/Publications/CR/Issues/2022/06/16/South-Africa-Financial-Sector-Assessment-Program-Technical-Note-on-Systemic-Risk-Oversight-519731 (accessed on 23 June 2023).

362 Van Niekerk and Van Heerden "Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability" 2018 *Journal of Contemporary Roman-Dutch Law* 649.

363 Section 29(5) of the FSRA. See also The Financial Stability Board *Reducing the moral hazard posed by systemically important financial institutions* 2010 1 available at https://www.fsb.org/wp-content/uploads/r_101111a.pdf?page_moved=1 (accessed 25 August 2023).

364 Section 30 of the FSRA.

365 Section 30(1) of the FSRA.

3.4.2 The Determination of Systemic Events

A systemic event is defined in the FSRA 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 economic activity in the Republic, including an event or circumstance that leads to a loss of confidence that operators of, or participants in, payment systems, settlement systems or financial markets, or financial institutions, are able to continue to provide financial products or financial services, or services provided by a market infrastructure."[366]

The SARB Governor, in consultation with the Minister of Finance, has the power to determine that a specific event or certain set of circumstances rises to the level of being determined to be a systemic event.[367] The opinion of the FSOC may be solicited should the SARB believe it to be necessary. The event may be imminent; alternatively, it may have already occurred at the time of determination.[368] The buy-in of the Minister of Finance is required with respect to any further action regarding the determination of the systemic event, including placing the determination under review, as well as amending and/or revoking it.[369] The other financial sector regulators must be merely notified of any further steps taken with respect to a determination. The openness and transparency measures required by our constitutional democracy are met by the tabling of the determination in parliament, as well as its publication.[370] This ensures that the SARB remains accountable for the actions that it takes.

The SARB must, in the event of determining that a systemic event has occurred or is imminent, inform the Minister of Finance of all steps taken or to be taken in mitigation.[371] In the circumstances of a systemic event, the SARB is expected to take proactive measures to prevent or mitigate the effect on financial stability, or alternatively must take the necessary measures after the event to restore financial

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[366] Section 1(1) of the FSRA.
[367] Section 14 of the FSRA.
[368] Section 14(4) of the FSRA.
[369] Section 14(5) of the FSRA.
[370] Section 14(7) of the FSRA.
[371] Section 15 of the FSRA.

stability.[372] The SARB is obliged to take measures that minimise the cost of the systemic event to the Republic, especially when exercising its LOLR role. This obligation is embodied in the provisions that indicate that the SARB cannot without the Minister of Finance's approval take steps that will bind or likely bind the National Revenue Fund, have a material impact on the cost of borrowing for the Fund, or create a future financial commitment or a contingent liability for the Fund.[373]

If the SARB makes a systemic event determination, then it may issue directives to the various financial sector regulators that they must provide the SARB with all information in their possession that may be relevant to the systemic event.[374] These directives can, for example, deal with issues to do with the resolution of a particular financial institution, whose significance could result in the contagion of risk to the rest of the financial system.[375] The financial sector regulators, or any other organ of state,[376] must further consult with the SARB before exercising any power during a systemic event that may have adverse effects on the event's management.[377] The SARB is enjoined to consider the advice of the various financial sector regulators, as well as the opinions of the FSOC when exercising its powers.

The determination of a systemic event is, however, not easily made. Despite its devastating consequences on the South African economy, the Covid-19 pandemic was surprisingly not determined to be a systemic event. The potential reasons given were that the knock effect of such a determination would in itself risk further contagion to an already fraught environment regarding financial stability. This leads to a tension arising between macroprudential policymaking and actual crisis management, which tests the potential implementation of financial stability policies.[378]

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372 Van Niekerk, MG: "*A Comparative Analysis of The Role of The Central Bank in Promoting and Maintaining Financial Stability in South Africa*", 2018*, LLD Thesis University of Pretoria available at https://repository.up.ac.za/handle/2263/67934 (accessed 02 February 2023).*

373 Section 16 of the FSRA.

374 Section 17 of the FSRA.

375 Section 18 of the FSRA.

376 An example of such a financial sector regulator is the NCR, which falls under the jurisdiction of the Department of Trade and Industry as the relevant organ of state.

377 Section 19 of the FSRA.

378 The International Monetary Fund *Financial Sector Assessment Program: Technical note on Systemic Risk Oversight and Macroprudential Policy 2022* 10 available at https://www.imf.org/en/Publications/CR/Issues/2022/06/16/South-Africa-Financial-Sector-Assessment-Program-Technical-Note-on-Systemic-Risk-Oversight-519731 (accessed on 23 June 2023).

3.4.3 The Collaboration of the Financial Sector Regulatory Infrastructure

The FSRA requires collaboration between financial sector regulators themselves, as well as between the financial sector regulators and the SARB when performing their functions in terms of the relevant financial sector laws.[379] Collaboration is also required between an organ of state, financial regulators, and the SARB, as far as it is possible when an organ of state exercises its supervisory function on a relevant financial institution.[380]

The duty to collaborate is reinforced by Memoranda of Understanding (MOUs) that deal specifically with the issue of financial stability. The SARB and the financial sector regulators must enter into these MOUs and undertake to assist in the execution of their duties that affect financial stability.[381] For example, the MOU entered into in 2018 between the SARB, the PA, and the NCR dealt with mapping out exactly how cooperation would function on issues ranging from financial stability, licensing, how to handle SIFIs, resolution procedures, and the integration of platforms to ensure seamless information sharing.[382] These MOUs must be reviewed every 3 years.[383] These MOUs must also be distributed to the Minister of Finance as well as the other cabinet members responsible for the specific financial sector. The MOUs serve as soft law and do not supersede the provisions in the financial sector law that regulates any specific relevant part of the economy.[384]

3.5 The performance of the South African regulatory framework in respect of financial stability in a post-GFC crisis

3.5.1 Introduction

[379] Section 76 of the FSRA.
[380] Section 78 of the FSRA.
[381] Section 77 of the FSRA.
[382] The South African Reserve Bank, the Prudential Authority and the National Credit Regulator *Memorandum of Understanding* 2018 available at https://www.resbank.co.za/content/dam/sarb/publications/prudential-authority/pa-financial/sector-regulation-act/2018/8803/PA-SARB-NCR-Memorandum-of-Understanding.pdf (accessed on 28 June 2023).
[383] Section 26 of the FSRA.
[384] Godwin, Howse and Ramsay "A jurisdictional comparison of the twin peaks model of financial regulation" 2017 *Journal of Banking Regulation* 30.

South Africa adopted the "Twin Peaks" model of financial regulation as a response to the GFC and in search of a more robust prudential and market conduct regulatory environment. Application of the Twin Peaks in South Africa had to develop to deal with the specific systemic financial risk associated with the highly interconnected and concentrated banking and insurance sectors that exist in the country.[385] The Twin Peaks model was tested in the subsequent crisis that the South African financial system had to deal with, namely, the Covid-19 pandemic.[386]

South Africa has certain macroeconomic factors that impacted the ability of the Twin Peaks regulatory framework to respond to the pandemic.[387] Some of these socioeconomic and macroeconomic factors include the high unemployment rate as well as a large portion of the population living in poverty, both of which resulted in a significant segment of the population requiring social and economic assistance.[388] This resulted in several rapid financial stimulus measures being put in place.[389]

3.5.2 The Covid-19 Pandemic

The South African economy recovered strongly in 2021 after a severe contraction in 2020.[390] The ability of the financial system to weather the crisis was revealed through stress testing of its financial institutions, and these stress tests revealed that the

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385 The National Treasury *Response and Explanatory Document: Accompanying the 2nd draft of the Financial Sector Regulation Bill* 2014 23 available at https://juta.co.za/media/filestore/2015/03/2014_12_12_Response_document.pdf (accessed 03 August 2023).

386 Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 34 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

387 The South African Reserve Bank *The Prudential Authority Annual Report 2019/20* 36 available at https://www.resbank.co.za/content/dam/sarb/publications/shares-correspondence/2020/10045/South-African-Reserve-Bank-Annual-Report-2019-20.pdf (Accessed 09 June 2021).

388 Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

389 The South African Reserve Bank *Financial Stability Department: Financial Stability Focus* 2020 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Financial%20Stability%20Focus%20-%20Topical%20Briefings.pdf (accessed 25 March 2024).

390 The South African Reserve Bank *The Prudential* Authority Annual Report 2022/23 4 June 2023 12 available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/2023/Prudential-Authority-Annual-Report-2022-2023 (accessed 29 March 2024).

Domestic Systemically Important Banks (D-SIBs) were the primary source of potential domestic contagion.[391] Sufficient capital and liquidity buffers allowed the financial system to handle the Covid-19 shock relatively well, and solvency stress testing of the six largest banks in 2020 revealed that they were resilient to the shock of the pandemic.[392] The loan-to-deposit ratio (LDR)[393] remained above the SARB's requirements, even though liquidity stress tests revealed that some banks were vulnerable to liquidity shocks.[394] All banks met the Basel liquidity coverage ratio (LCR)[395] requirements at the beginning of the pandemic,[396] although some saw these ratios fall below the Basel requirements due to the loosening of regulatory requirements by the PA.[397]

Certain regulatory measures, using monetary policy and the regulatory tools within the mandate of the various regulators within the Twin Peaks framework, were taken to

[391] The International Monetary Fund *South Africa Financial System Stability Assessment* 2022 18 available at https://www.imf.org/en/Publications/CR/Issues/2022/02/11/South-Africa-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-513014 (accessed on 19 March 2023).

[392] Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 39 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

[393] The loan-to-deposit ratio helps assess a bank's liquidity by comparing its total loans to its total deposits. This provides insight into how much risk a bank has taken on and if it would be able to meet its liquidity requirements (pay depositors) in a market crunch. The South African Reserve Bank *Financial Stability Department A new macroprudential policy framework for South Africa* 2016 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/A%20new%20macroprudential%20policy%20framework%20for%20South%20Africa.pdf (accessed 02 June 2023).

[394] The International Monetary Fund *South Africa Financial System Stability Assessment* 2022 17 available at https://www.imf.org/en/Publications/CR/Issues/2022/02/11/South-Africa-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-513014 (accessed on 19 March 2023).

[395] The liquidity coverage ratio is the Basel Accords' mandated proportion of highly liquid assets that financial institutions must hold to ensure that they can meet their short-term obligations as well as weather any disruptions as a result of shocks to the financial market. The South African Reserve Bank *Financial Stability Department A new macroprudential policy framework for South Africa* 2016 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/A%20new%20macroprudential%20policy%20framework%20for%20South%20Africa.pdf (accessed 02 June 2023).

[396] The International Monetary Fund *South Africa Financial System Stability Assessment* 2022 16 available at https://www.imf.org/en/Publications/CR/Issues/2022/02/11/South-Africa-Financial-Sector-Assessment-Program-Financial-System-Stability-Assessment-513014 (accessed on 19 March 2023).

[397] Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 71 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

meet the financial instability in the South African economy that had been posed by the Covid-19 pandemic.[398]

In order for the financial system to remain stable, banks were required to continue to extend credit, especially to households and small businesses, particularly in the early stages of the pandemic.[39978] In light of these requirements, the SARB, through the PA, took measures to temporarily amend the minimum requirements relating to the LCR to provide some liquidity relief, and this was done by issuing of three directives to support the banking sector.[400]

The first of these directives was published on 31 March 2020 and allowed the banks to comply with a revised minimum LCR requirement of 80% until a period when the PA was of the view that the financial system had stabilised.[401] The second directive was published on 6 April 2020, with the PA introducing further temporary capital relief measures that allowed for the relaxation of Pillar 2A capital requirements to zero, consequential adjustments to qualifying capital and reserve funds, and the allowance of banks to utilise the capital conservation buffer.[402] The third directive was also published on 6 April 2020 and enabled banks to continue to extend credit to the economy without creating the need for higher capital requirements while at the same time maintaining overall credit risk standards.[403]

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398 The South African Reserve Bank *The Prudential* Authority Annual Report 2022/23 18 June 2023 12 available at https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/2023/Prudential-Authority-Annual-Report-2022-2023 (accessed 29 March 2024).

399 Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 71 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

400 Ibid 71.

401 The South African Reserve Bank *Directive D1/2020: Temporary measures to aid compliance with the liquidity coverage ratio during the Coronavirus (Covid-19) pandemic stress period* 2020 available at https://www.resbank.co.za/content/dam/sarb/publications/prudential-authority/pa-deposit-takers/banks-directives/2020/9821/Temporary-Measures.pdf (accessed 07 September 2024).

402 The South African Reserve Bank *Directive D2/2020: Matters related to temporary capital relief to alleviate risks posed by the Covid-19 pandemic* 2020 available at https://www.resbank.co.za/content/dam/sarb/publications/prudential-authority/pa-deposit-takers/banks-directives/2020/9843/D2-of-2020---Matters-related-to-temporary-capital-relief-in-light-of-COVID-19.pdf (accessed 07 September 2024).

403 The South African Reserve Bank *Directive D3/2020: Matters related to the treatment of restructured credit exposures due to the Coronavirus (Covid-19) pandemic* 2020 available at https://www.resbank.co.za/content/dam/sarb/publications/prudential-authority/pa-deposit-takers/banks-directives/2020/9844/Matters-related-to-the-treatment.pdf (accessed 07 September 2024).

The SARB, the National Treasury, and the commercial banks also made provision for access to loan funding to small and medium-sized enterprises through the Covid-19 Loan Guarantee Scheme.[404] The scheme was implemented to enable businesses with an annual turnover of less than R300 million to continue to meet their ongoing operational expenditure, with the loans being substantially guaranteed by the government as well as the commercial banks.[405]

The FSCA, the PA, and the NCR further issued notifications to those financial institutions that they regulated that there would be some relaxation of the requirements for the submission of identified standard reports and returns.[406] The FSCA also made provision for the temporary suspension of monthly contributions to pension funds by both employers and employees that showed that they were under financial stress.[407]

The cooperation between the various regulatory bodies[408] that manage the regulatory supervision of financial institutions as well as the financial system has been deemed excellent during the pandemic.[409]

3.6 Conclusion

The SARB is the main functionary tasked with the financial stability mandate. However, given the size and complexity of the South African financial system, the

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404 Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 73 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

405 The National Treasury *Answering your questions about the Covid-19 Loan Guarantee Scheme 2020 1* available at https://www.treasury.gov.za/comm_media/press/2020/COVID-19%20loan%20guarantee%20scheme%20FAQs%2026%20July.pdf (accessed 30 May 2023).

406 Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 73 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

407 The Financial Sector Conduct AuthorityCovid-19: Section 13a of the Pension Funds Act, 1956 and financially distressed employers and employees – Submission of urgent rule amendments 2020 available at https://www.masthead.co.za/wp-content/uploads/2020/04/FSCA-COMMUNICATION-11-OF-2020-RF-1.pdf (accessed 30 May 2023).

408 These bodies further included the PA, the FSCA, the MPC, the FSC, the FSCR, the FSOC, and the FSCF.

409 Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 99 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

SARB, even as the country's central bank, could never singularly execute this mandate.[410] The regulatory framework in South Africa calls for the maintenance of financial stability to be at the cornerstone of the execution of the SARB's functions, as well as for financial stability to be the main tenet of regulation. This accords with international standards such as those of the Basel Committee that have crystalized mainly after the GFC.[411]

The toolkit at the disposal of the SARB is extensive, given that it is interwoven with the natural powers that the SARB has as the central bank, its statutory powers in terms of the FSRA, and the additional powers it almost as a result appropriates from other financial sector laws through the requirement of collaboration with those sectors' relevant regulators.[412] Collaboration allows for the entire perimeter of the South African financial system to be monitored, for systemic events to be determined, and for steps to be taken in response to address threats to the system.[413]

The impact of the FSRA and its statutory confirmation of the SARB's financial stability mandate is still a work in progress. Some of the concerns that have arisen include the possible compromise of the ability of the SARB and other regulators to deal with crises that can develop quickly and uniquely to their circumstances, in instances where collaboration and consultation can slow down the process of responding to the crises.[414] The micro-prudential objectives of managing the prudential regulation of financial institutions or a particular sector of the economy may not align with the macro-prudential objectives of managing monetary policy that are usually entrusted to the central bank.[415] The central bank, for example, could not let a financial institution that

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[410] Van Niekerk and Van Heerden "Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability" 2018 *Journal of Contemporary Roman-Dutch Law* 645.

[411] The Basel III Accord.

[412] See also Hollander *A Review of the South African Reserve Bank's Financial Stability Policies* Stellenbosch Economic Working Papers: WP11 2019 2 available at https://www.ekon.sun.ac.za/wpapers/2019/wp112019/wp112019.pdf (accessed 19 March 2023).

[413] The International Monetary Fund *Financial Sector Assessment Program: Technical note on Systemic Risk Oversight and Macroprudential Policy 2022* 2 available at https://www.imf.org/en/Publications/CR/Issues/2022/06/16/South-Africa-Financial-Sector-Assessment-Program-Technical-Note-on-Systemic-Risk-Oversight-519731 (accessed on 23 June 2023).

[414] Godwin, Howse and Ramsay "A jurisdictional comparison of the twin peaks model of financial regulation" 2017 *Journal of Banking Regulation* 3.

[415] Van Niekerk, MG: "*A Comparative Analysis of The Role of The Central Bank in Promoting And Maintaining Financial Stability In South Africa*", 2018, *LLD Thesis University of Pretoria 35 available at https://repository.up.ac.za/handle/2263/67934 (accessed 02 February 2023).*

is under distress fail as it should naturally do, in circumstances where the central bank has to take into consideration its role in managing the wider economy.[416]

There can also be a conflict created when the use of short-term interest rates as a monetary policy tool by the SARB leads to contrary results between its two primary objectives of price stability and financial stability.[417] The LOLR function of the SARB can lead to issues to do with independence of the SARB when the inevitable involvement of the government occurs when taxpayer-funded bailouts have to be used to restore financial stability.[418] Another aspect of the regulatory framework that is key to financial stability is the housing of the PA within the SARB and the possible conflicts that can arise. There are advantages that can come from this, including coordination of expertise and the sharing of information; however, consideration must always be had that the role of the PA is to exercise its supervisory prudential role as independently as possible, as this is a critical element of the financial stability framework.[419]

Even though the FSRA places the maintenance of financial stability at the core of all financial regulation, the preservation and enhancement of financial stability have risen to become its own element of monetary policy within the context of wider regulatory policy.[420] For economic activity to be vibrant, for market infrastructures to be strong, for financial institutions to be able to meet their financial obligations, and for consumers to be protected, this all requires a financial system in which the relevant financial institutions are stable and capable of allowing financial intermediation and activity to occur unimpeded, even when systemic events occur that cause instability. The ultimate construction of what the financial stability mandate of the SARB is in terms of the FSRA is that it is all-encompassing in terms of the monitoring and regulation of the financial system, through a carefully designed regulatory toolkit.

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416 Tucker *The lender of last resort and modern central banking: principles and reconstruction* BIS Papers No. 76 2014 27 available at https://www.bis.org/publ/bppdf/bispap79b_rh.pdf (accessed 23 November 2023).

417 De Jager "The South African Reserve Bank: A central bank in the firing line" 2018 *Annual Banking Law Update* 116.

418 De Jager "The South African Reserve Bank: Blowing Winds of Change (Part 2)" 2013 *South African Mercantile Law Journal* 498.

419 Godwin, Howse and Ramsay "A jurisdictional comparison of the twin peaks model of financial regulation" 2017 *Journal of Banking Regulation* 16.

420 De Jager "The South African Reserve Bank: Blowing Winds of Change (Part 2)" 2013 *South African Mercantile Law Journal* 492.

The committees of the SARB that form the regulatory infrastructure for the SARB's conveyance of its financial stability mandate, as well as the regulatory measures at its disposal, allowed the South African financial system to deal with the major disruptive event to the system that was the Covid-19 pandemic.[421]

[421] See Paragraphs 3.3.2 and 3.4 supra.

CHAPTER 4: THE FINANCIAL STABILITY MANDATE OF THE US FEDERAL RESERVE IN TERMS OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

4.1 Introduction

The US regulatory system for financial institutions is complex, with a mix of supervision at the federal (national) and state (provincial) levels.[422]

The federal regulatory system for commercial banks is supervised by three agencies; namely, the Federal Reserve (the US Fed), the Office of the Comptroller of the Currency (the OCC), and the Federal Deposit Insurance Corporation (the FDIC).[423] The federal regulatory system also includes the regulation of securities by the Securities and Exchange Commission (the SEC), the sale of commodity and financial futures by the Commodities Futures Trading Commission (the CFTC), the regulation of pension funds by the Pension Benefit Guaranty Corporation (the PBGC) as well as by the Employee Benefits Security Administration (the EBSA) that is housed in the Department of Labor, consumer protection by the Consumer Financial Protection Bureau (the CFPB), and a limited role by the US Department of the Treasury (the US Treasury) in supervising national banks and enforcing federal finance laws.

Regulation of the insurance industry is done exclusively by the states.[424] Individual states are also responsible for the regulation of financial services providers that are chartered or licensed in their jurisdictions.[425]

The US Fed, as part of this regulatory framework, was created by the Federal Reserve Act,[426] which was passed in 1913 to address recurrent financial crises.[427] The Federal Reserve Act did not state any macroeconomic goals regarding financial stability. The

[422] Kushmeider "The U.S. Federal Financial Regulatory System: Restructuring Federal Bank Regulation" 2005 *Banking Review* 1.
[423] The US Federal Reserve *The Fed Explained: What the Central Bank Does 2021* available at https://www.federalreserve.gov/aboutthefed/files/the-fed-explained.pdf (accessed on 16 April 2024).
[424] Martin *The Future of Insurance Regulation in the United States* (2009) 33.
[425] The US Federal Reserve *The Fed Explained: What the Central Bank Does 2021* available at https://www.federalreserve.gov/aboutthefed/files/the-fed-explained.pdf (accessed on 16 April 2024).
[426] Section 112(a)(2)(M) of the Dodd-Frank Act.
[427] Kushmeider "The U.S. Federal Financial Regulatory System: Restructuring Federal Bank Regulation" 2005 *Banking Review* 3.

original mandate of the US Fed was to maintain the stability of the currency, as well as to, in certain circumstances, provide liquidity to the financial system to avoid financial instability (for example, in the event of runs on banks).[428] The traditional roles of the US Fed that affected the stability of the US financial system are discussed below.

4.2 The Traditional Roles of the US Fed in respect of financial stability

4.2.1 Monetary Stability

The US Fed, on its creation, conducted monetary policy through direct lending to banks.[429] The US Fed's primary role was thus to ensure monetary stability and not financial stability in the modern meaning of what financial stability is known as today.[430]

The US Fed has in modern times now managed the supply of money through what are termed open market operations, which it uses in the secondary market for government securities to keep the funds rate at the target level.[431] This involves purchases and sales that are designed to keep a short-term interest rate within a target framework that is set by the Federal Open Market Committee.[432] The aim is to keep inflation low and stable. The Federal Funds rate,[433] is the rate at which commercial banks borrow and lend their excess reserves to each other.[434]

The interest rate has become an indicator of US Fed policy, the intent of which is to affect overall money market conditions rather than individual financial institutions.[435]

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[428] Haltom "Should the Fed Have a Financial Stability Mandate? Lessons from the Fed's First 100 Years" 2015 *Economic Quarterly Issue 1Q* 50.

[429] Ibid 55.

[430] Toniolo *The evolution of the financial stability mandate: from its origins to the present day* NBER Working Paper Series No. 20844 2015 available at https://www.nber.org/system/files/working_papers/w20844/w20844.pdf (accessed 11 April 2024).

[431] Campbell "The impact of the Federal Reserve Bank's open market operations" 2002 *Journal of Financial Markets 5* 223.

[432] Haltom "Should the Fed Have a Financial Stability Mandate? Lessons from the Fed's First 100 Years" 2015 *Economic Quarterly Issue 1Q* 55.

[433] Chappell *Committee Decisions on Monetary Policy: Evidence from Historical Records of the Federal Open Market Committee* (2005) 4, Cambridge, Mass: The MIT Press

[434] Sriya, A "New Daily Federal Funds Rate Series and History of the Federal Funds Market, 1928-1954" 2020 *Finance and Economics Discussion Series 2020-059* 13.

[435] Madigan, BF *The Design of U.S. Monetary Policy: Targets, Indicators, and Information Variables* 1994 114 available at https://www.elibrary.imf.org/view/book/9781557754196/ch004.xml (accessed on 10 April 2023).

Conventional wisdom was that the tools that the US Fed already had at its disposal to provide monetary stability were its best contribution to financial stability.[436]

4.2.2 The prudential supervision of banks

Before the advent of central banking in the US, bank supervision was done independently through state banking systems, which had their own separate state regulatory agencies.[437] The only national regulator of the banking system was the OCC, which was initially a bureau in the US Treasury.[438] The head of the agency was known as the Comptroller of the Currency.

Even with the establishment of the US Fed, it is still not the dominant regulator of the US banking system, unlike certain central banks in other countries.[439] The regulation of banks and financial institutions in the US is now dependent on state charters as well as the activities that they undertake, these being the determinant factors as to which one of several regulatory agencies becomes the principal regulator for a financial institution.[440] State chartered banks are regulated at the state level.[441] The US Fed can intervene to take regulatory measures if the financial institution is a member of the Federal Reserve System, alternatively the FDIC, if it has insured deposits.[442]

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436 Haltom "Should the Fed Have a Financial Stability Mandate? Lessons from the Fed's First 100 Years" 2015 *Economic Quarterly Issue 1Q* 51.

437 Tabor A Brief History of the U.S. Regulatory Perimeter UCD Finance and Economics Discussion Series 2021 available at https://www.federalreserve.gov/econres/feds/files/2021051pap.pdf (accessed 11 April 2023).

438 Kushmeider "The U.S. Federal Financial Regulatory System: Restructuring Federal Bank Regulation" 2005 *Banking Review* 2.

439 Grosse "Bank regulation, governance and the crisis: a behavioral finance view" 2012 *Journal of Financial Regulation and Compliance* 18.

440 Wachtel P "The Evolving Role of the Federal Reserve" 2011 4 available at *NYU Working Paper No. 2451/31339* (accessed 08 April 2024).

441 Tabor A Brief History of the U.S. Regulatory Perimeter UCD Finance and Economics Discussion Series 2021 available at https://www.federalreserve.gov/econres/feds/files/2021051pap.pdf (accessed 11 April 2023).

442 Kushmeider "The U.S. Federal Financial Regulatory System: Restructuring Federal Bank Regulation" 2005 *Banking Review* 28.

4.2.3 Maximum Employment

A dual mandate of maximum employment was created for the US Fed by the US Employment Act of 1946.[443] However, this goal was only fully described in the Full Employment and Balanced Growth Act,[44429] wherein it is explicitly indicated that the dual mandate is to promote "full employment" in the US economy as well as "reasonable" price stability.

The US Fed executes monetary policy within the adaptable and flexible framework of its dual mandate.[445] The Federal Open Market Committee, in implementing the inflation target framework, considers the price stability and employment objectives as being generally complementary to one another. However, the Committee is required to take a balanced approach in promoting them.[446] The US Fed's dual mandate amounts to a flexible inflation-targeting framework.[447]

4.2.4 The lender of last resort

The lender of last resort function has been carried out by central banks through the provision of funds to solvent institutions that are struggling with liquidity.[448] The US Fed LOLR role was done through the so-called "discount window", which is made up of three lending programs, namely, the primary credit program, the secondary credit program, and the seasonal credit program.[449]

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443 The Employment Act, Public Law 79-304, (1945).

444 The Full Employment and Balanced Growth Act, Public Law 95-523, U.S. Statutes at Large 92 (1978): 1887-1908.

445 The International Monetary Fund *Advancing the Frontiers of Monetary Policy* 2018 4 available at https://www.elibrary.imf.org/view/book/9781484325940/9781484325940.xml (accessed on 13 April 2024).

446 Campbell "The impact of the Federal Reserve Bank's open market operations" 2002 *Journal of Financial Markets 5* 227.

447 Bernanke "*A perspective on inflation targeting*" BIS Review 15/2003 5 available at https://www.bis.org/review/r030325d.pdf (accessed 29 July 2023).

448 De Jager "The South African Reserve Bank: A central bank in the firing line" 2018 *Annual Banking Law Update* 117.

449 Madigan, BF *The Design of U.S. Monetary Policy: Targets, Indicators, and Information Variables* 1994 113 available at https://www.elibrary.imf.org/view/book/9781557754196/ch004.xml (accessed on 10 April 2023).

The primary credit program is an extension of credit to depository institutions in good financial condition so that they can access mainly overnight funding with no questions asked and at an interest rate higher than the target policy short-term rate.[450] The secondary credit program is given to financial institutions that do not qualify for primary credit and are subject to a greater degree of interrogation, and is given at a rate that is more than the primary credit rate.[451] The seasonal credit program is extended to financial institutions that have a seasonal need for funding as well as an approved seasonal line of credit with its corresponding State Reserve Bank.[452]

The GFC, rather than diminishing the importance of the LOLR function of the US Fed, actually showed its continuing importance and the US Fed's lending capabilities averted the crisis from being of a worse nature.[453] The US Fed's ability to gather timely information about a borrowing financial institution, is perhaps the most relevant argument that the US Fed as the central bank should have a role in the regulation of financial institutions.[454] The use of the LOLR resort function becomes of most importance in the case of financial institutions whose instability and/or failure could pose a threat to the entire financial system.[455]

4.3 The raison d'être for the Dodd-Frank Wall Street Reform and Consumer Protection Act

Financial stability, as a critical requirement of regulatory frameworks worldwide, was emphasised by the GFC, which caused significant instability in global financial markets.[456] The lack of adequate regulation in the US financial system, especially in

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450 The US Federal Reserve *Discount Window Lending* 2024 available at https://www.federalreserve.gov/regreform/discount-window.htm#:~:text=Primary%20credit%20is%20a%20lending,funds%20borrowed%20under%20primary%20credit (accessed on 16 April 2024).

451 Ibid.

452 Ibid.

453 Grosse "*Bank regulation, governance and the crisis: a behavioral finance view*" 2012 *Journal of Financial Regulation and Compliance* 23.

454 The US Federal Reserve *The Fed Explained: What the Central Bank Does* 2021 11 available at https://www.federalreserve.gov/aboutthefed/files/the-fed-explained.pdf (accessed on 16 April 2024).

455 Ibid 54.

456 Van Niekerk and Van Heerden "Twin Peaks: The Role of the South African Central Bank in Promoting and Maintaining Financial Stability" 2018 *Journal of Contemporary Roman-Dutch Law* 638.

its banking sector, was the spark of the Great Recession as it was known and led to the greatest crisis since the Great Depression.[457]

The GFC was caused by the risky lending practices by banks to mortgage borrowers who did not qualify for the loans and whose non-performing loans could ultimately not be repaid.[458] This caused the development of a subprime mortgage bubble in the US housing market, and when this credit bubble burst, it led to runs on several SIFIs that were the main underwriters of the subprime mortgage securitised loans.[459] Some of these SIFIs were conglomerates that offered a blend of complex financial products mixed with the traditional credit extension role of banks,[460] and operated in markets that remained vulnerable to the traditional risks associated with liquidity shortages.[461]

The GFC spread from the US credit markets to other parts of the US economy, and eventually to the rest of the world markets due to the contagion caused by the interconnectedness of the global financial system.[462]

The GFC was triggered by the collapse of several major US financial institutions, which resonated throughout the US financial system and had profound effects on both domestic institutions and consumers. The TBTF fail principle,[463] coupled with the taxpayer-funded bailouts of these failing institutions, elicited widespread anger among US taxpayers.[464] This discontentment spurred legislative action aimed at safeguarding financial stability and enhancing consumer protection.[465]

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457 Bernanke "The real effects of disrupted credit: Evidence from the Global Financial Crisis" 2018 *Brookings Papers on Economic Activity* 265.

458 Aymanns "Models of Financial Stability and Their Application in Stress Tests" 2018 *Handbook of Computational Economics* 330.

459 The National Treasury *A Safer Financial Sector to Serve South Africa better* 2011 10 available at https://www.treasury.gov.za/twinpeaks/20131211%20-%20item%202%20a%20safer%20financial%20sector%20to%20serve%20south%20africa%20better.pdf (accessed 30 May 2021).

460 The Congressional Research Service *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework* 2023 15 available at https://crsreports.congress.gov/product/pdf/R/R44918/8 (accessed on 23 February 2023).

461 The US Federal Reserve *The Fed Explained: What the Central Bank Does* 2021 52 available at https://www.federalreserve.gov/aboutthefed/files/the-fed-explained.pdf (accessed on 16 April 2024).

462 Mishkin FS "Over the Cliff: From the Subprime to the Global Financial Crisis" 2011 *Journal of Economic Perspectives* 50.

463 See footnote 48 supra

464 Mishkin FS "Over the Cliff: From the Subprime to the Global Financial Crisis" 2011 *Journal of Economic Perspectives* 56.

465 Congressman Barney Frank and Senator Chris Dodd are the responsible lawmakers, both of whom were members of the Democratic Party. See North and Buckley "The Dodd–Frank Wall Street

As a result, lawmakers developed and enacted comprehensive reforms, most notably the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act),[466] which became the cornerstone of regulatory efforts to prevent future crises and mitigate their impact. The preamble of the Dodd-Frank Act outlines its core objectives, emphasising the promotion of financial stability through enhanced accountability within the financial system. Specifically, the Dodd-Frank Act seeks to address the TBTF principle by implementing measures to mitigate systemic risk and prevent the need for taxpayer-funded bailouts. Additionally, it aims to protect consumers from abusive practices perpetrated by financial institutions.[467]

The Dodd-Frank Act represents a significant piece of regulatory legislation addressing various critical aspects of the US financial system through its different titles (sections). These include measures for the orderly liquidation of financial institutions, insurance provided by the Federal Deposit Insurance Corporation, prudential regulation of banks and other financial institutions, transparency and accountability in Wall Street practices, protections for investors, enhancements to the US payment, clearing and settlement system, provisions for the repayment of funds made available to financial institutions during the GFC, prevention of predatory lending practices, and the establishment of a dedicated consumer protection body. Title 1 of the Dodd-Frank Act specifically focuses on financial stability, and its provisions will be the main focus of this chapter.[468]

4.4 The contemporary roles of the US Federal Reserve in respect of financial stability as framed by the Dodd-Frank Act

The Dodd-Frank Act does not explicitly define financial stability, which may be seen as a flaw in the Act. However, a thorough exploration of the Act reveals the intention of the US Congress (legislature) regarding regulatory objectives aimed at achieving

Reform and Consumer Protection Act: Unresolved Issues of Regulatory Culture and Mindset" 2012 *Melbourne University law review*.

466 The "Dodd-Frank Wall Street Reform and Consumer Protection Act", Public Law 203, U.S. Statutes at Large 124 (2010): 1376-2223.

467 North and Buckley "The Dodd–Frank Wall Street Reform and Consumer Protection Act: Unresolved Issues of Regulatory Culture and Mindset" 2012 *Melbourne University law review* 57.

468 The different Titles in the Act are in themselves cited as in effect being their own pieces of legislation. Title 1 is referred to as the Financial Stability Act of 2010.

financial stability. By deconstructing these goals, one can analyse the regulatory toolkit available to US regulators to maintain and restore financial stability. The definition of financial stability can also be gleaned from some of the various US financial regulators.

4.4.1 The concept of financial stability in the Dodd-Frank Act

The US Fed defines financial stability as a financial system wherein its markets and institutions—including banks, savings and loans, and other financial products and service providers—are resilient and able to function even following a bad shock. This means that households, communities, and businesses can count on having the resources, services, and products they need to invest, grow, and participate in a well-functioning economy.[469]

The US treasury defines financial stability as a financial system being resilient to events or conditions that could impair its ability to support economic activity such as the intermediation of financial transactions, facilitating payments, allocating resources, and managing risks.[470]

4.4.2 The regulatory infrastructure established by the Dodd-Frank Act to foster financial stability

In contrast to the FSRA delegating the responsibility of maintaining financial stability to the SARB in South Africa,[471] the Dodd-Frank Act does not designate a single dominant authority responsible for protecting financial stability. Instead, it establishes a forum that serves as a collaborative body for various regulatory agencies in the quest to maintain financial stability.[472] The central bank of the United States, the US Fed, works together with the US Treasury as the primary entities overseeing financial

469 The US Federal Reserve *Financial Stability* 2017 available at https://www.federalreserve.gov/financial-stability.htm (accessed on 16 April 2024).

470 The Financial Stability Oversight Council *Annual Report* 2023 7 available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf (accessed 25 August 2023).

471 The FSRA as amended, has assigned a statutory mandate to the SARB to protect and enhance financial stability in South Africa. The aim is to achieve a regulatory framework based on financial stability within the Twin Peaks model of regulation that has also been introduced in the FSRA.

472 Baily "The Impact of the Dodd-Frank Act on Financial Stability and Economic Growth" 2017 *The Russell Sage Foundation Journal of the Social Sciences, vol. 3, no. 1* 37.

stability.[473] The Dodd-Frank Act also grants the US Fed additional authority to supervise and enforce the prudential regulation of certain financial institutions to protect financial stability and mitigate the risk of contagion during a systemic crisis. The following paragraphs will focus on this collaborative body as well as the enhanced regulatory powers of the US Fed in greater detail.

4.4.2.1 The Financial Stability Oversight Council (FSOC)

4.4.2.1.1 Introduction

The Financial Stability Oversight Council[474] (the US FSOC) is a Council that bears the same acronym as the committee established by the FSRA in South Africa.[475] The US FSOC was established in 2010 under the Dodd-Frank Act and was created to provide comprehensive monitoring of the stability of the US financial system. Its main goal is to identify risks to US financial stability stemming from significant distress or failure in the activities of large, interconnected financial institutions.[476] Additionally, it aims to promote market discipline by eliminating the expectation among market participants that the US government will bail them out in the case of failure.[477] This moral hazard feature is crucial for the US financial system, which, although large and complex, is surprisingly less regulated than other developed nations, emphasising the importance of free market principles.[478] The US FSOC also performs the now traditional post-GFC regulatory function of pre-empting the development of systemic events and addressing emerging threats before they fully manifest into a crisis.[479] Similarly to the South

473 The Financial Stability Oversight Council Annual Report 2023 7 available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf (accessed 25 August 2023).
474 Established by Section 111(a) of the Dodd-Frank Act.
475 See Paragraph 3.2.2.3 in Chapter 3 of this dissertation.
476 Section 112(a)(1) of the Dodd-Frank Act.
477 The Congressional Research Service *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework* 2023 22 available at https://crsreports.congress.gov/product/pdf/R/R44918/8 (accessed on 23 February 2023).
478 Tabor A Brief History of the U.S. Regulatory Perimeter UCD Finance and Economics Discussion Series 2021 3 available at https://www.federalreserve.gov/econres/feds/files/2021051pap.pdf (accessed 11 April 2023).
479 Thornton and Giustiniani "*Post-Crisis Financial Reform: Where Do We Stand?*" 2011 *Journal of Financial Regulation and Compliance, 19(4)*.

African FSOC, the US FSOC serves as a hub of collaboration among various US financial sector regulators.

The Secretary of the US Treasury serves as the Chairperson of the Council.[480] The US FSOC's voting membership is made up of the Secretary of the US Treasury, the Chairman of the US Fed, the Comptroller of the Currency, the Director of the CFPB, the Chairman of the SEC, the Chairperson of the FDIC, the Chairman of the CFTC, the Director of the Federal Housing Finance Agency (the FHFA), the Chairman of the National Credit Union Administration Board (the NCUAB), as well as an independent member with insurance expertise appointed by the US President.[481] The non-voting membership is made up of the Director of the Office of Financial Research (the OFR) and the Director of the Federal Insurance Office (the FIO).[482]

Each voting member of the US FSOC must annually submit a statement to Congress affirming that the US FSOC, the government, and the private sector are collectively taking all reasonable steps to maintain financial stability and mitigate systemic risks that could negatively impact the economy. Alternatively, they are required to outline the actions necessary to achieve these objectives.[483] Additionally, the Chairperson of the US FSOC is tasked with presenting an annual report to the Financial Services Committee of the House of Representatives, as well as to the Banking, Housing, and Urban Affairs Committee of the Senate. This report details the US FSOC's activities related to its financial stability mandate over the past year and outlines its plans for the upcoming year.[484] The US FSOC has the authority to request assistance from any US government department or agency for advice needed to fulfil its financial stability mandate, as well as access to the resources (including funds, services, and staff), of those agencies as deemed necessary.[485]

[480] Section 111(b)(1)(A) of the Dodd-Frank Act.
[481] Section 111(b)(1) of the Dodd-Frank Act.
[482] Section 111(b)(2) of the Dodd-Frank Act.
[483] Section 112(b) of the Dodd-Frank Act.
[484] Section 112(c) of the Dodd-Frank Act.
[485] Section 112(h) of the Dodd-Frank Act.

4.4.2.1.2 The Financial Stability Regulatory toolkit of the US FSOC

The US FSOC has the authority[486] to collect information, data, and analysis from its agency members, federal and state financial regulators, and relevant financial institutions if such information is necessary to assess risks to the US financial system.[487] If the US FSOC cannot make the determination of risk on its own, it can request the US Fed to examine the financial institution to determine if that institution should be supervised by the US Fed.[488] The US FSOC then facilitates the sharing of this information among member agencies to develop appropriate policies, rules, regulatory reports, as well as enforcement actions.[489] Furthermore, the US FSOC is empowered to monitor the financial services market, both domestically and internationally, to identify any threats that may destabilise market effectiveness. It can take preventative measures to mitigate harm to the system, including consulting with the government.[490]

It is the role of the US FSOC to take the recommendations made during their meetings and, based on these recommendations, develop supervisory priorities that align with agreed-upon principles.[491] An important aspect of this role is to identify lacunas in the regulatory system that could pose a threat to US financial stability.[492] The US FSOC has the authority to require the US Fed to supervise financial institutions that would pose a material risk to the US financial system in the event of their distress or failure.[493] This power includes the ability to recommend increased prudential standards for large, interconnected financial institutions, covering areas such as capital, leverage, liquidity requirements, risk and credit exposure, and enhanced resolution planning in the event of failure.[494] Additionally, the US FSOC is empowered to identify SIFIS, markets, and market infrastructures, such as payment, clearing and settlement systems.[495]

[486] Section 112 of the Dodd-Frank Act.
[487] Section 112(a)(2) of the Dodd-Frank Act.
[488] Section 112(d)(4) of the Dodd-Frank Act.
[489] Section 112(E) of the Dodd-Frank Act.
[490] Section 112(a)(2)(D) of the Dodd-Frank Act.
[491] Section 112(a)(2)(F) of the Dodd-Frank Act.
[492] Section 112(a)(2)(G) of the Dodd-Frank Act.
[493] Section 112(a)(2)(H) of the Dodd-Frank Act.
[494] Section 112(a)(2)(I) of the Dodd-Frank Act.
[495] Section 112(a)(2)(J) of the Dodd-Frank Act.

The US FSOC can also recommend that a primary financial regulatory agency apply additional regulatory standards to specific financial activities identified as posing increased risks of significant credit or liquidity problems spreading amongst US financial institutions and markets.[496] Additionally, the Council may review existing or proposed accounting principles and make recommendations to any financial sector regulator.[497] The US FSOC is also responsible for reporting to the US government on its activities in executing its mandate, significant developments in the regulatory landscape, important developments related to US financial stability, potential threats to the US financial system, and recommendations for enhancing the integrity of US financial markets, while considering market discipline and investor confidence.[498]

The US FSOC also possesses the authority to request that certain financial institutions be subjected to the supervision, regulation, and imposition of prudential standards by the US Fed.[499] This authority requires the US FSOC to determine that the institution's material financial distress, nature, size, interconnectedness, and portfolio of financial activities pose a threat to US financial stability. Factors considered in this determination include the institution's leverage, off-balance-sheet exposures, transactions and relationships with other financial institutions, the importance of the financial institution as a source of credit and liquidity for the US financial system, the degree to which it is already regulated by its primary financial regulatory agency, the scale of its financial assets and liabilities, including its reliance on short-term funding, and any other pertinent risk-related factors identified by the Council.[500]

The US FSOC not only determines whether or not new financial institutions should be supervised but also has the authority to call for the enhancement of supervisory and prudential standards for institutions already regulated by the US Fed.[501] These heightened standards may include more stringent reporting and disclosure requirements commensurate with the risk posed to US financial stability by the financial institution.[502] The determination is based on an individual assessment of the institution's assets, capital structure, risk profile, complexity, financial activities, size,

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[496] Section 112(a)(2)(K) of the Dodd-Frank Act.
[497] Section 112(a)(2)(L) of the Dodd-Frank Act.
[498] Section 112(a)(2)(N) of the Dodd-Frank Act.
[499] Section 113(a)(1) of the Dodd-Frank Act.
[500] Section 113(a)(2) of the Dodd-Frank Act.
[501] Section 115 of the Dodd-Frank Act.
[502] Section 115(a)(1) of the Dodd-Frank Act.

or any other relevant risk factors identified by the US FSOC, including the application of these factors to the institution's subsidiaries.[503] The development of these standards considers the risk-based capital requirements, leverage limits, liquidity requirements, resolution planning, credit exposure reporting, enhanced public disclosures, short-term debt limits, and overall risk management requirements.[504] The objective of enhancing standards is to improve the safety and soundness of financial institutions, reduce risks to US taxpayers, and promote stability in the US financial system.

Resolution planning is an important element of maintaining financial stability, serving as a measure to mitigate the moral hazard associated with TBTF institutions. The US FSOC has the authority to make recommendations to the US Fed that financial institutions periodically report to the Council, the US Fed, and the FDIC on their plans for rapid and orderly resolution in the event of material distress or failure.[505] Moreover, supervised financial institutions may be subject to enhanced public disclosures to enable consumers and market participants to assess their risk profile, capital adequacy, and risk-management capabilities.[506] Additionally, the Council can recommend short-term debt limits[507] to the US Fed to mitigate risks associated with excessive accumulation of such debt by supervised financial institutions, thereby safeguarding the US financial system.

The Council can further impose additional reporting requirements on financial institutions with assets of more than US$250 billion or those subject to enhanced supervisory requirements by the US Fed or any subsidiaries of such institutions.[508] These reports must discuss and assess the financial condition of the institution, its operational and risk management systems, its transactions with any subsidiary that is a depository institution, and the potential negative impacts of these activities on financial markets or US financial stability.[509]

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[503] Section 115(a)(2) of the Dodd-Frank Act.
[504] Section 115(b)(1) of the Dodd-Frank Act.
[505] Section 115(d) of the Dodd-Frank Act.
[506] Section 115(f) of the Dodd-Frank Act.
[507] Section 115(g) of the Dodd-Frank Act.
[508] Section 116 of the Dodd-Frank Act.
[509] Section 116(a) of the Dodd-Frank Act.

The US FSOC has the authority to designate specific financial activities or practices as posing a risk to financial stability.[510] This designation results in a recommendation by the US FSOC to the primary regulatory agency overseeing the financial institution involved, suggesting that it may apply more stringent prudential and safety standards if the institution's size, nature, and interconnectedness with other financial institutions warrant it. Such recommendations must consider the potential impact on long-term economic growth and must outline the exact parameters that the activity will be able to be conducted by the financial institution, including limiting its scope, imposing capital or risk-management requirements, or prohibiting it entirely.[511] The primary regulatory agency is responsible for implementing these heightened standards and enforcing them in cases of non-compliance. The US FSOC may also report to the US Congress regarding its recommendations, the outcomes of their implementation, instances of primary regulatory agencies failing to implement them, or recommendations for legislation to regulate activities posing a threat to US financial stability.[512]

The US Fed, in executing its financial stability role as part of the US FSOC, may take mitigatory actions if it determines that a financial institution with assets of more than US$250 billion, or one supervised by it, poses a threat to US financial stability.[513] These actions could include restricting the financial institution's ability to merge with another financial institution, offer certain financial products, provide financial services, impose business conduct conditions, or mandate asset sales if necessary.

In executing its financial stability mandate, the US FSOC is tasked with conducting ongoing studies over five-year cycles to assess the impact of regulatory limitations.[514] This aim is to ensure effectiveness while minimising any adverse effects on economic growth. Identified activities posing a risk include the large size, complexity, and diversification of certain financial institutions, the lack of separation of business units making resolution planning difficult, and the blending of commercial and financial activities of large financial institutions, as well as of traditional financial activities, with

[510] Section 120 of the Dodd-Frank Act.
[511] Section 120(b)(2)(B) of the Dodd-Frank Act.
[512] Section 120(d) of the Dodd-Frank Act.
[513] Section 121 of the Dodd-Frank Act.
[514] Section 123 of the Dodd-Frank Act.

high-risk operations.[515] These studies aim to pinpoint systemic risks and devise appropriate mitigation strategies.[516]

An important tool within the US FSOC's arsenal is its provision of a forum for discussing and analysing emerging developments in the US financial system.[517] Additionally, it serves as a platform for resolving jurisdictional disputes among member agencies, which are likely to occur in such a large and complex system.[518]

4.4.2.2 The Office of Financial Research

4.4.2.2.1 Introduction

The OFR[519] operates as a Department within the US Treasury and serves as a key supporting body for the US FSOC.[520] Its statutory duties include collecting data on behalf of the US FSOC and its member agencies,[521] standardising financial data collection and reporting methods, conducting long-term research on the US financial system, developing tools for risk monitoring and management, and providing reports on its findings to the primary financial regulatory agencies that supervise financial institutions.[522]

Staffing within the OFR is determined by the OFR Director in collaboration with the Chairperson of the US Fed. Similarly to the US FSOC, the OFR has the authority to request assistance from any US government department or agency for special advisory or technical services, facilities, staff, finances, or other necessary support.[523]

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515 Section 123(a)(1) of the Dodd-Frank Act.

516 For example, one of the latest Section 123 studies prepared under the direction of the Chairperson of the US FSOC, outlines the financial stability risks and regulatory gaps posed by various types of digital assets and provides recommendations to address such risks. See The Financial Stability Oversight Council *Report on Digital Asset Financial Stability Risks and Regulation* 2022 7 available at https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf (accessed on 23 June 2023).

517 Section 112(a)(2)(M) of the Dodd-Frank Act.

518 Section 119 of the Dodd-Frank Act.

519 Subtitle B under Title I of the Dodd-Frank Act.

520 Established by Section 152(a) of the Dodd-Frank Act.

521 See Paragraph 4.3.2.1 supra.

522 Section 153 of the Dodd-Frank Act.

523 Section 152(e) of the Dodd-Frank Act.

4.4.2.2.2 The Financial Stability Regulatory Toolkit of the OFR

The OFR is empowered to be a rule-making authority and can, in consultation with the US Fed, issue regulations necessary to carry out its duties. Member agencies are tasked with implementing any regulations issued by the OFR concerning the standardisation of data collection and reporting.[524]

The primary function of the OFR is to facilitate research into the US financial system while ensuring the protection of intellectual property laws, confidentiality of business information, and the overall stability of the US financial system.[525] As a result of its research, the OFR is mandated to develop analytical capabilities on behalf of the US FSOC, including the ability to assess financial stability metrics, monitor system-wide risk levels and patterns, coordinate financial institution and market regulation, evaluate stress tests developed by member agencies, provide expertise to financial regulators, offer recommendations on addressing disruptive failures in financial markets, advise on systemic risk policies, and promote best practices for financial risk management.[526] Additionally, the OFR is required to annually report to the US Congress on its research analysis and assessment of significant developments and potential emerging threats to US financial stability.[527]

The OFR is granted subpoena powers,[528] enabling it to compel financial institutions to produce necessary data. It may also request financial institutions to submit periodic reports for assessment on the impact of their financial activities on financial stability, on the markets they participate in, as well as on their financial condition.[529] However, in requesting reports from financial institutions, the OFR must coordinate with their primary regulatory agency and prioritise data collected from such agencies.[530] Furthermore, the OFR has the authority to publish[531] collected data through the creation of databases documenting information on financial institutions and

[524] Section 153(c) of the Dodd-Frank Act.
[525] Section 154(b)(6) of the Dodd-Frank Act.
[526] Section 154(c) of the Dodd-Frank Act.
[527] Section 153(e) of the Dodd-Frank Act.
[528] Section 153(f) of the Dodd-Frank Act.
[529] Section 154(b)(1)(B)(i) of the Dodd-Frank Act.
[530] Section 154(b)(1)(B)(ii) of the Dodd-Frank Act.
[531] Section 154(b)(2)(A) of the Dodd-Frank Act.

instruments, promoting market transparency, and ensuring financial stability through improved market conduct.[532]

4.4.2.3 The Consumer Financial Protection Bureau

The CFPB is a government agency dedicated to ensuring that consumers are treated fairly by banks, lenders, and other financial institutions.[533] While the CFPB is not explicitly designated a financial stability mandate within the Dodd-Frank Act, it remains an important component in upholding it. Much like its South African counterpart, the FSCA, the CFPB's primary goal is safeguarding consumers within the financial system from exploitative practices of certain institutions.[534] It achieves this by providing consumer education on financial products and their regulation, by publicly disclosing vital financial information about institutions, and by enhancing consumer access and awareness.[535] Thus, the CFPB plays a crucial role in fostering financial stability through empowering and informing consumers.[536]

4.4.3 The powers of the US Federal Reserve with respect to financial stability

The US Fed, in its capacity as the nation's central bank, holds a key position within the US FSOC, alongside the US Treasury Secretary who chairs the Council. It thus is given a myriad of powers in terms of the Dodd-Frank Act to strengthen its regulatory powers.[537] Any significant decision made by the US FSOC, beyond standard quorum regulations, typically involves consultation with the US Fed. This underscores the critical role of the US Fed as an important entity in fulfilling the financial stability mandate established under the Dodd-Frank Act.

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[532] Section 154(b)(6) of the Dodd-Frank Act.
[533] The Consumer Protection Financial Protection Bureau *BCFP Collaborates With Regulators Around The World To Create Global Financial Innovation Network* 2018 available at https://www.consumerfinance.gov/about-us/newsroom/bcfp-collaborates-regulators-around-world-create-global-financial-innovation-network/ (accessed on 20 April 2024).
[534] Section 1031 of the Dodd-Frank Act.
[535] Section 1032 of the Dodd-Frank Act.
[536] Section 1033 of the Dodd-Frank Act.
[537] Subtitle C under Title I of the Dodd-Frank Act.

The US Fed is authorised to issue regulations pertaining to the implementation of its financial stability mandate under the Dodd-Frank Act.[538] Furthermore, the Dodd-Frank Act empowers the US Fed to request reports from certain financial institutions already under its regulation, focusing on their financial status, the risks they pose to financial stability, and their compliance with the Dodd-Frank Act.[539] The US Fed is also authorised to conduct examinations of these institutions to assess their financial condition, operational risks, risk monitoring systems, and adherence to regulatory requirements.[540] Collaboration with the primary regulatory agency overseeing each institution is mandated to ensure effective coordination in fulfilling these responsibilities.[541]

The US Fed has the authority to refer a financial institution to its primary regulatory agency if it deems the institution's condition or activities to be non-compliant with regulations. In such cases, the primary regulatory agency must initiate supervisory actions and/or enforcement proceedings.[542] Should the primary agency fail to act on the referral within 60 days, the US Fed retains the option to take enforcement actions independently.

The US Fed, either independently or based on recommendations from the US FSOC, can establish or make more stringent prudential standards for large interconnected financial institutions with assets exceeding US$250 billion, if the financial distress of the institution would pose a threat to US financial stability.[543] This threshold can be changed if the circumstances call for it. The factors considered in determining additional standards include the riskiness of the financial institution's activities, its capital structure, size, and complexity of operations.[544] These regulations aim to promote the safety and soundness of such financial institutions, thereby strengthening the overall stability of the financial system. Prudential standards may include risk-based capital requirements, liquidity requirements, risk management practices, concentration limits, public disclosure mandates, restrictions on short-term debt limits

[538] Section 168 of the Dodd-Frank Act.
[539] Section 161(a) of the Dodd-Frank Act.
[540] Section 161(b) of the Dodd-Frank Act.
[541] Section 161(c) of the Dodd-Frank Act.
[542] Section 162 of the Dodd-Frank Act.
[543] Section 165 of the Dodd-Frank Act.
[544] Section 165(a)(2) of the Dodd-Frank Act.

as well as resolution planning.[545] Before imposing standards, the US Fed is mandated to consult with the primary regulatory agency overseeing the financial institution.[546]

The US Fed also has the authority to mandate financial institutions subject to these enhanced prudential standards, particularly those publicly traded, to establish a risk committee responsible for overseeing the institution's enterprise-wide management practices.[547] Additionally, the US Fed is required to conduct annual stress tests, in collaboration with primary regulatory agencies, to assess whether supervised financial institutions have sufficient capital on a total consolidated basis to withstand potential losses during adverse economic conditions.[548] Furthermore, the US Fed can request financial institutions to conduct their own stress tests and submit reports on the findings.[549]

To maintain financial stability, regulatory authorities must be empowered to take pre-emptive action to prevent crisis, if possible. The US Fed has the power to take early remedial action.[550] The purpose of such action is to implement a set of measures that a distressed financial institution can undertake to reduce the likelihood of insolvency, thereby mitigating potential harm to the US financial system.

A yearly report[551] must be submitted to Congress concerning the implementation of prudential standards designed to mitigate risks to the US financial system.[552] Additionally, the US President, the US Treasury Secretary, the US FSOC, and the US Fed are granted powers to engage in international policy coordination. This collaboration aims to limit the influence of large interconnected financial institutions, engage with international regulatory bodies, and negotiate multilateral agreements aimed at protecting US financial stability. Such efforts take into account the global

[545] Section 165(b)(1) of the Dodd-Frank Act.
[546] Section 165(b)(4) of the Dodd-Frank Act.
[547] Section 165(h) of the Dodd-Frank Act.
[548] Section 165(h)(4)(i)(1) of the Dodd-Frank Act.
[549] Section 165(h)(4)(i)(2) of the Dodd-Frank Act.
[550] Section 166 of the Dodd-Frank Act.
[551] In his 2011 Report, a year after the implementation of Dodd-Frank, the then Chairperson of the US Fed, Ben Bernanke, indicated that in its financial stability mandate, the US Fed had adapted well in its new macroprudential approach to supervision, that the aim of prudential oversight and resolvability regulations was to end the "TBTF" principle by letting financial institutions fail in an orderly manner that did not lead to crisis in the US financial system, and that stress testing had shown that there was an improvement in the ability of financial markets and their infrastructures to absorb material shocks.
[552] Section 165(b)(5) of the Dodd-Frank Act.

economic landscape, the stability of the international financial system, and the interconnected nature of global financial markets.[553]

4.4.4 The main connective tissue in the Dodd-Frank financial stability tool-kit

The most important tools available to the US Fed and that serve as the golden thread running through the financial stability framework created by the Dodd-Frank Act are the following:

4.4.4.1 The designation of SIFIs

The US FSOC and the US Fed have the authority to designate a financial institution as a systemically important financial institution and thereafter subject the institution to enhanced supervision.[554] Similarly to South Africa's FSRA, various factors are considered in determining the significance of the financial institution, such as its size, complexity of financial services offered, and interconnectedness with other market entities.[555] This designation allows regulators to impose heightened prudential standards and regulatory directives on the designated SIFI should they feel that it could pose a risk to other SIFIs or to the financial system as a whole.[556] In this process, the US Fed becomes the regulator for SIFI purposes, alongside the existing primary regulator.

The designation of SIFIs can be divided into domestic systemically important financial institutions (D-SIFIs) and global systemically important financial institutions (G-SIFIs).[557] The designation of D-SIFIs in the US can further be divided into bank holding

553 Section 175 of the Dodd-Frank Act.
554 Sections 113, 115 and 165 of the Dodd-Frank Act as discussed in Paragraphs 4.3.2.2.1 and 4.3.3 supra.
555 Gao, Liao and Wang "Capital markets' assessment of the economic impact of the Dodd-Frank Act on systemically important financial firms" 2018 *Journal of Banking and Finance* 204.
556 The Congressional Research Service *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework* 2023 15 available at https://crsreports.congress.gov/product/pdf/R/R44918/8 (accessed on 23 February 2023).
557 The South African Reserve Bank *Financial Stability Department: A methodology to determine which banks are systemically important within the South African context* 2019 5 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/resolution-planning/A-

companies and non-bank financial companies.[558] The designation of bank holding companies and non-bank financial companies as SIFIs is done through the Dodd-Frank Act in conjunction with guidelines issued periodically by the US FSOC.

All bank holding companies with US$50 billion or more in assets are automatically designated as SIFIs and subjected to the heightened prudential requirements.[559] Under the US Fed's capital framework for bank holding companies, an even more stringent regulatory regime is imposed on bank holding companies with US$100 billion or more in total consolidated assets.[560] In addition to the US FSOC process, a similar designation process for G-SIFIs has been implemented by the Financial Stability Board (the FSB), which is an intergovernmental international body that the US participates in. The FSB designation is used in the US regulatory framework to determine which banks will be assessed a capital surcharge under Basel III.[561] This is used in conjunction with the US regulatory framework, such as the US Fed's capital framework for bank holding companies, which determines that once designated as a G-SIB, an additional capital surcharge of at least 1.0 percent must be applied to that financial institution.[562]

The designation of non-bank financial companies is a two-stage process in terms of the US FSOC's Final Interpretive Guidelines.[563] The first stage involves the monitoring and analysing of financial markets, financial companies, and the financial system to determine the potential risks to US financial stability. The second stage involves an in-depth review of the non-bank financial company using information collected directly from the company through the OFR, including public and regulatory information. This engagement occurs with the company under review and its primary financial regulator.

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methodology-to-determine-which-banks-are-systemically-important-within-the-South-African-context%20(2).pdf (accessed 28 June 2023).

558 Sections 113 and 115 of the Dodd-Frank Act.

559 Section 165 of the Dodd-Frank Act.

560 The US Federal Reserve *Large Bank Capital Requirements* 2023 3 available at https://www.federalreserve.gov/publications/files/large-bank-capital-requirements-20230727.pdf (accessed on 16 April 2024).

561 The Bank of International Settlements *The G-SIB framework – Executive Summary* 2 available at https://www.bis.org/fsi/fsisummaries/g-sib_framework.pdf (accessed on 08 October 2023).

562 The US Federal Reserve *Large Bank Capital Requirements* 2023 3 available at https://www.federalreserve.gov/publications/files/large-bank-capital-requirements-20230727.pdf (accessed on 16 April 2024).

563 The Financial Stability Oversight Council *Guidance on Nonbank Financial Company Determinations* 2023 80112 available at https://home.treasury.gov/system/files/261/Interpretive-Guidance-Regarding-Authority-to-Require-Supervision-and-Regulation-of-Certain-Nonbank-Financial-Companies.pdf (accessed on 23 June 2024).

The designation of SIFIs contributes to financial stability as it constrains the behaviour of financial institutions and the TBTF manner in which they previously rendered their financial services.[564]

4.4.4.2 The determination of systemic risk

The determination and management of systemic risk are core to the abilities of regulatory agencies to maintain financial stability.[565] In the US, this determination enables the primary financial stability agencies to take additional measures to attempt to restore financial stability.

In the evaluation to determine whether or not a financial institution poses a systemic risk, the regulator must consider whether the financial institution is in default or in danger of default, a description of the effect that the default of the financial institution would have on US financial stability, a description of the effect that the default of the financial institution would have on economic conditions or on financial stability for low income, minority, or under-served communities, a recommendation regarding the nature and the extent of actions to be taken regarding the financial institution, an evaluation of the likelihood of a private sector alternative to prevent the default of the financial institution, an evaluation of why a case under the Bankruptcy Code is not appropriate for the financial institution, an evaluation of the effects on creditors, counterparties, and shareholders of the financial institution and other market participants, and an evaluation of whether the financial institution satisfies the definition of a financial institution in the Dodd-Frank Act.[566]

[564] Some of the US financial institutions that were on the FSB's 2023 SIFI list were JP Morgan Chase in the 2.5% additional capital buffer threshold, Bank of America in the 2.0% additional capital buffer threshold, Goldman Sachs in the 1.5% additional capital buffer threshold, and Morgan Stanley in the 1.0% additional capital buffer threshold. See The Financial Stability Board *2023 List of Global Systemically Important Banks (G-SIBs)* 2023 3 available at https://www.fsb.org/uploads/P271123.pdf (accessed 25 August 2024).

[565] Aymanns "Models of Financial Stability and Their Application in Stress Tests" 2018 *Handbook of Computational Economics* 331.

[566] Section 203 of the Dodd-Frank Act.

4.4.4.3 The collaboration between financial sector regulators

Almost every provision within the financial stability framework of the Dodd-Frank Act necessitates collaboration among various financial supervisory authorities.[567] This collaboration extends to local and international government agencies, lawmakers, and the authorities themselves.[568] Such cooperation prevents duplication of efforts and ensures access to comprehensive information when making critical decisions about events that could jeopardise financial stability.

4.4.4.4 The monitoring of potential risks to the financial system and pre-emption

Observing the entirety of a financial system is paramount, particularly in complex systems like that of the US, which are deeply interconnected across borders and can pose a threat to the global financial system. The Dodd-Frank Act aims to streamline the otherwise fragmented regulatory landscape to achieve comprehensive oversight.[569] Once a risk is identified, the ability to take pre-emptive steps to prevent its escalation or to stop a crisis from worsening is critical for maintaining financial stability.[570]

4.4.4.5 Data collection and analysis

The OFR was established as a vital component of the US financial stability infrastructure, with its primary mandate being the collection of high-quality financial data and analysis concerning US financial institutions and the financial services they

[567] Testimony by Mr Ben S Bernanke, Chairman of the Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, US Senate, Washington DC, 30 September 2010, 35 available at https://www.govinfo.gov/content/pkg/CHRG-111shrg64796/html/CHRG-111shrg64796.htm (accessed 20 April 2024).
[568] Sections 112(2)(E) and 175 of the Dodd-Frank Act.
[569] The Congressional Research Service *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework* 2023 2 available at https://crsreports.congress.gov/product/pdf/R/R44918/8 (accessed on 23 February 2023).
[570] Baily "*The Impact of the Dodd-Frank Act on Financial Stability and Economic Growth*" 2017 *The Russell Sage Foundation Journal of the Social Sciences, vol. 3, no. 1* 34.

provide.[571] This data collection not only enables an empirical assessment of risk but also ensures the provision of accurate and reliable information necessary for effective decision-making.[572] By providing comprehensive and reliable data and analysis, the OFR's efforts directly contribute to promoting financial stability.[573] This information supports regulators and policymakers in making informed decisions to identify and mitigate systemic risks, ultimately promoting the resilience and stability of the financial system.

4.4.4.6 Financial reporting

Reporting by financial institutions to the supervisory bodies established under the Dodd-Frank Act constitutes one of its central principles.[574] Equally significant is the requirement for these agencies to report to the government on the impact of the financial activities undertaken by relevant market participants on the US financial system.[575] This dual reporting mechanism ensures transparency, accountability, and informed decision-making, all essential elements for maintaining the stability and integrity of the financial system.

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[571] The Office of Financial Research *Annual Report* 2023 5 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

[572] Testimony by Mr Ben S Bernanke, Chairman of the Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, US Senate, Washington DC, 30 September 2010, 27 available at https://www.govinfo.gov/content/pkg/CHRG-111shrg64796/html/CHRG-111shrg64796.htm (accessed 20 April 2024).

[573] As an example, the OFR after the 2023 bank failures monitored and collected data of lending in the repo markets as this could potentially pose a risk to financial stability as dealers in these markets pass dollars on to riskier institutions such as hedge funds. The difficulty in determining exactly what kinds of risks are building up in these low-visibility markets is what led to the 2008 GFC, thus it is important for regulators to use market data to see what types of institutions dealers are lending cash to enable regulators to properly assess sources of potential short-term funding disruptions. The Office of Financial Research *Annual Report* 2023 44 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

[574] The Congressional Research Service *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework* 2023 5 available at https://crsreports.congress.gov/product/pdf/R/R44918/8 (accessed on 23 February 2023).

[575] See Sections 154(d)(1), 156(b)(1), 210(a)(16)(A), 719(a)(4), 1022(c)(4)(B)(ii), and 1067(b)(1) of the Dodd-Frank Act

4.4.4.7 Transparency through public disclosures

The GFC inflicted significant harm not only on the US financial system but also on US consumers. Many consumers were unaware of the dire financial condition of institutions, leaving them vulnerable to predatory behaviour from some of these institutions that eventually collapsed. As a result, transparency through public disclosures emerged as a key objective of regulation.[576] Financial institutions are now required to publicly disclose comprehensive financial information to ensure that consumers are informed about their financial condition and market conduct.[577] This transparency not only helps rebuild trust and goodwill among customers but also promotes a healthier and more stable financial system.

4.4.4.8 Stress testing

The capacity of a financial institution to withstand economic crises remains uncertain until such crises actually transpire, in which case it may be too late to implement preventive measures. However, this uncertainty can be pre-empted or minimised through the implementation of stress tests.[578] Stress testing postulates a macroeconomic shock and simulates its effect on the balance sheet of a financial institution to determine whether it has sufficient capital to cope with the hypothesised stress.[579] Stress testing can also be described as a micro-prudential exercise that is conducted at the individual financial institution level, utilising industry-level data to assess the potential repercussions of significant distress on the institution's ability to

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[576] Mulhern "The Dodd–Frank Act: Its implications for change in the banking industry" 2011 *Journal of Payments Strategy & Systems Volume 5 Number 2* 127.

[577] Section 115(f) of the Dodd-Frank Act as discussed in Paragraph 4.3.2.1.1 supra. See also North and Buckley "The Dodd–Frank Wall Street Reform and Consumer Protection Act: Unresolved Issues of Regulatory Culture and Mindset" 2012 *Melbourne University law review* 514.

[578] Section 165(h)(4)(i)(1) of the Dodd-Frank Act as discussed in Paragraph 4.3.3 supra. See also Allen "A New Philosophy for Financial Stability Regulation" 2013 *Loyola University Chicago Law Journal* 187.

[579] Wachtel P "The Evolving Role of the Federal Reserve" 2011 *NYU Working Paper No. 2451/31339* 10 available at https://archive.nyu.edu/bitstream/2451/31339/2/Wachtel-EvolvingRoleFedRes-Dec2011.pdf (accessed 08 April 2024).

navigate market fluctuations.[580] These tests evaluate the prudential safety of financial institutions and their capacity to absorb the impact of potential crises.[581]

The importance of stress tests can be shown by the initial stress tests conducted by the US Fed on the 19 largest financial institutions in the US in 2009 in response to the GFC, the results of which calmed the panic in the markets as the capital shortfalls were less than had been expected.[582]

4.4.4.9 Resolution planning

The risk management requirements placed on financial institutions require thorough resolution planning.[583] This involves creating a detailed plan to address the possibility of a sudden stop of financial services, payment to creditors, and winding up of operations by the institution.[584]

Regulators are provided statutory powers to either resolve a failing financial institution by taking over control of it and initiating what is known as a conservatorship, which entails the regulator running the firm on an ongoing basis; a receivership, which entails the regulator winding the financial institution down; alternatively regulators can proceed with an orderly liquidation to resolve financial institutions.[585]

The significance of resolution planning cannot be overstated, as an unmanaged wind-up could have catastrophic consequences for the financial system, particularly

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580 Ramskyi "Comparison Worldwide and Ukrainian Practice of Bank Stress Testing" 2011 *Management and Entrepreneurship: Trends of Development, 4(10)* 20.

581 Baily "The Impact of the Dodd-Frank Act on Financial Stability and Economic Growth" 2017 *The Russell Sage Foundation Journal of the Social Sciences, vol. 3, no. 1* 41.

582 The Board Of Governors *of The* Federal Reserve *The Supervisory Capital Assessment Program* 2009 available at https://www.federalreserve.gov/newsevents/speech/bernanke20090511a.htm (accessed 26 July 2023).

583 See Sections 112(a)(2)(I), 115(b)(1)(D), 115(d)(1), 165(b)(1)(A)(iv), and 165(d)(1) of the Dodd-Frank Act.

584 These documents are referred to as "Living Wills". The Board Of Governors *of The* Federal Reserve *Guidance for 165(d) Resolution Plan Submissions by Domestic Covered Companies* 2019 available at https://www.federalreserve.gov/supervisionreg/resolution-plans.htm (accessed 26 July 2023).

585 Title II of the Dodd-Frank Act. See also The Congressional Research Service *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework* 2023 14 available at https://crsreports.congress.gov/product/pdf/R/R44918/8 (accessed on 23 February 2023).

depending on the interconnectedness of the financial institution.[586] During the GFC, the major losses faced by many large interconnected financial institutions caused financial panic due to the concerns of consumers of these institutions' potential unorderly resolution.[587] The importance of resolution planning lies in its ability to mitigate the risk of financial instability caused by such panic, thereby preventing damaging bank runs and preserving confidence in the financial system.

4.4.4.10 Fostering of economic growth within the context of regulation

The US legislature made it clear that when imposing regulations on US financial institutions, relevant supervisory bodies must consider the impact on long-term economic growth.[588] This emphasis is not surprising in a country that has embraced free-market capitalism. The aim is to establish economically sensible rules that balance the cost and benefits of regulation, particularly for smaller financial institutions, while also promoting the extension of credit to support economic growth.[589]

However, financial stability is important in mitigating the potential harm that the free market could cause to consumers, emphasising financial stability's fundamental importance to the proper functioning of the financial system. The Dodd-Frank Act's primary objective is to prevent crises from occurring for the same reasons that led to the GFC, as well as to prevent the financial instability that affects long-term economic growth.[590]

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[586] The Board Of Governors *of The* Federal Reserve *Guidance for 165(d) Resolution Plan Submissions by Domestic Covered Companies* 2019 available at https://www.federalreserve.gov/supervisionreg/resolution-plans.htm (accessed 26 July 2023).

[587] Baily "The Impact of the Dodd-Frank Act on Financial Stability and Economic Growth" 2017 *The Russell Sage Foundation Journal of the Social Sciences, vol. 3, no. 1* 24.

[588] Section 165(b)(5) of the Dodd-Frank Act.

[589] Bernanke "The real effects of disrupted credit: Evidence from the Global Financial Crisis" 2018 *Brookings Papers on Economic Activity* 256.

[590] Testimony by Mr Ben S Bernanke, Chairman of the Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, US Senate, Washington DC, 21 July 2011 2 available at https://www.bis.org/review/r110722a.pdf (accessed 10 July 2023).

4.5 The performance of the US Dodd-Frank regulatory framework in respect of financial stability in post-GFC crises

After the shock caused by the GFC, regulators spent the next few years having to reconsider regulatory efforts and to move from their either macro-economic focus on monetary stability or their micro-economic focus on the operations of individual financial institutions or sectors to a complete recalibration toward financial stability being at the heart of regulation.[591] This was achieved by the promulgation of the Dodd-Frank Act that introduced new financial stability regulatory tools that empowered newly created regulatory bodies like the US FSOC and the OFR, in order to take the necessary steps to maintain financial stability.[592]

The requirement for interagency collaboration led to regulators that formed part of the old, fragmented US financial system having to coordinate their efforts, including memoranda of understanding being concluded.[593]

The two recent crises that have tested this new regulatory framework are the coronavirus disease 2019 (the Covid-19 pandemic) and the 2023 banking turmoil that affected some US banks.

4.5.1 The Covid-19 pandemic

The Covid-19 pandemic[594] served as the first major stress test of the new Dodd-Frank Act regulatory framework that was implemented after the GFC.[595] Due to the capital and liquidity standards (internationally standardised in most major economies by the Basel Committee on Banking Supervision Standards) imposed by the Dodd-Frank Act in the lead-up to the Covid-19 pandemic, banks were well-capitalised and held substantial liquid assets. The impact this had on the financial stability of the banking

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591 Allen "A New Philosophy for Financial Stability Regulation" 2013 *Loyola University Chicago Law Journal* 175.
592 See Paragraphs 4.3.2.1 and 4.3.2.2 supra.
593 See Section 1035(d) of the Dodd-Frank Act.
594 See footnote 76 for a full description of the coronavirus disease 2019.
595 Abboud *COVID-19 as a Stress Test: Assessing the Bank Regulatory Framework* Finance and Economics Discussion Series 2021-024: Washington: Board of Governors of the Federal Reserve System 2021 2 available at https://doi.org/10.17016/FEDS.2021.024 (accessed on 21 April 2024).

system was that it remained resilient through the crisis, and that it continued to extend credit in the early stages of the pandemic.[596]

The Covid-19 pandemic impacted financial stability in a manner that was the equivalent, and in certain instances had an even greater impact than previous major economic crises in the US, such as the GFC and the 1929 Great Depression.[597] The hard lockdowns that were imposed ground economic activity to a halt and led to a recession.[598] Unemployment was at a rate that was even higher than during the GFC.[599]

The Covid-19 pandemic showed that the interconnectedness of the global financial markets still meant that shock could spread from one part to another by contagion, despite changes to the US structural regulatory framework post-GFC.[600] Regulators acted pre-emptively to maintain the safety and soundness of the banking system. Regulators, given the lessons of the GFC, right at the start of the crisis, took financial stability measures to maintain financial stability and public confidence in the US financial system.[601585] These measures included the US Fed exercising its LOLR powers to provide liquidity during times of crisis.[602] It did so by utilising its traditional toolkit of open market operations and discount window lending.[603] In exercising its LOLR function through emergency lending programs, these programs were required

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[596] Barrett et al *After-Effects of the COVID-19 Pandemic - Prospects for Medium-term Economic Damage* IMF Working Paper No. WP/21/203, July 2021 19 available at https://www.imf.org/en/Publications/WP/Issues/2021/07/30/After-Effects-of-the-COVID-19-Pandemic-Prospects-for-Medium-Term-Economic-Damage-462898 (accessed 24 February 2024).

[597] Li "*A comparative analysis of COVID-19 and global financial crises: evidence from US economy*" 2022 *Economic Research-Ekonomska Istraživanja* 2427.

[598] Centre of excellence in financial services *Lessons from the Covid-19 pandemic in South Africa* 2020 20 available at https://www.resbank.co.za/content/dam/sarb/what-we-do/financial-stability/Lessons%20from%20the%20Covid-19%20pandemic%20in%20South%20Africa.pdf (accessed 26 July 2024).

[599] See Paragraph 2.6 supra.

[600] Sydow et al *Shock amplification in an interconnected financial system of banks and investment funds* ECB Working Paper Series, No 2581 / August 2021 available at https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2581~63c8ffb7dc.en.pdf (accessed 30 May 2023).

[601] Remarks by Jelena McWilliams, Chairwoman of the Federal Deposit Insurance Corporation, at the Federalist Society Conference: "The Dodd-Frank Act Post Covid-19 and the Future of Financial Regulation", 11 May 2021 available at https://www.fdic.gov/news/speeches/2021/spmay1121.html (accessed 07 May 2024).

[602] The Congressional Research Service *The Federal Reserve's Response to COVID-19: Policy Issues* 2021 2 available at https://crsreports.congress.gov/product/pdf/R/R46411 (accessed on 11 October 2023).

[603] Abboud *COVID-19 as a Stress Test: Assessing the Bank Regulatory Framework* Finance and Economics Discussion Series 2021-024: Washington: Board of Governors of the Federal Reserve System 2021 21 available at https://doi.org/10.17016/FEDS.2021.024 (accessed on 21 April 2024).

to benefit the broader financial system rather than support a single financial institution.[604] Additionally, these provisions required the US Fed, in conjunction with the US Treasury Secretary, to ensure that taxpayers were protected against losses.

The US Fed also established a number of additional emergency lending programs designed to support the credit needs of households and businesses. This ensured that consumers continued to have access to credit so that they could pay their home loans, as well as allowed businesses to continue to function.[605] Households received unprecedented liquidity injections through various government transfer programs,[606] including Economic Impact Payments[607] and Child Tax Credits.[608]

In addition to the US Fed's above-mentioned emergency facilities/emergency lending programs wherein recipients received direct assistance, the US Fed also used its traditional toolkit of interest rate reduction and market liquidity promotion, which collectively served as its monetary policy response to the Covid-19 pandemic.[609] The aim of these monetary policy manoeuvres was not to address the economic disruption caused by the pandemic but rather to ensure that interest rates remained low, and that affordable credit was available to borrowers such as businesses, households, and the government.[610] Monetary policy in the US is guided by the statutory goals of promoting maximum employment, stable prices, and moderate long-term interest rates.[611] Economic disruptions instigated by Covid-19 caused extremely high unemployment;

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[604] Section 13(3) emergency lending programs under the Federal Reserve Act as amended by the Dodd-Frank Act.

[605] The Congressional Research Service *The Federal Reserve's Response to COVID-19: Policy Issues* 2021 2 available at https://crsreports.congress.gov/product/pdf/R/R46411 (accessed on 11 October 2023).

[606] The Office of Financial Research *Annual Report* 2023 31 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

[607] Known colloquially as "stimulus checks", Economic Impact Payments were a series of stimulus payments made through the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) of 2020, the COVID-related Tax Relief Act of 2020, and the American Rescue Plan Act of 2021. These payments were made to Americans to increase household liquidity and helped mitigate the impact of the economic shock of the pandemic on aggregate demand (aggregate demand is the total demand for goods and services within a particular market, and it is assumed that increases in credit stimulate aggregate demand), as well as helped mitigate the impact on financial stability. Ibid 111.

[608] Child Tax Credits were part the American Rescue Plan Act of 2021 and increased an existing Child Tax Credit and expanded its coverage to assist families with children. Ibid 111.

[609] The Congressional Research Service *The Federal Reserve's Response to COVID-19: Policy Issues* 2021 available at https://crsreports.congress.gov/product/pdf/R/R46411 (accessed on 11 October 2023).

[610] Ibid 21.

[611] 12 U.S. Code § 225a - Maintenance of long run growth of monetary and credit aggregates.

however, inflation remained below the US Fed's 2% target.[612] As a result of this, the US Fed interpreted its mandate as calling for a more stimulative monetary policy with the severity of the economic downturn; however, there were also concerns that the US Fed's aggressive monetary policy stance would be challenging to unwind when economic conditions eventually normalised.[613]

The tool usually utilised by the US Fed to implement its monetary policy is the targeting of the federal funds rate; that is, the overnight interbank lending rate.[614] When the federal funds target is lowered, other interest rates also tend to fall.[615] During the GFC, the US Fed developed two further tools to provide stimulus to the financial system when short-term rates reached nearly zero,[616] these being forward guidance and quantitative easing. Both these tools aim to reduce long-term interest rates, which, as opposed to short-term rates, are not directly determined by the US Fed but are nevertheless important for stimulating economic activity.[617] These tools were again revived as methods of responding to the pandemic, as lower interest rates stimulate business and household spending.[618]

Forward guidance occurs when the US Fed issues public communications on its future plans for short-term interest rates.[619] In this regard, early in the pandemic on 15 March

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[612] The Congressional Research Service *The Federal Reserve's Response to COVID-19: Policy Issues* 2021 21 available at https://crsreports.congress.gov/product/pdf/R/R46411 (accessed on 11 October 2023).

[613] This has come to fruition with as the US is facing its highest inflation in 40 years and inflation has emerged as the central economic problem from the COVID era. Ball et al *Understanding U.S. Inflation during the COVID era* IMF Working Paper No. WP/22/208 2022 24 available at https://www.imf.org/en/Publications/WP/Issues/2022/10/28/Understanding-U-S-525200 (accessed 16 November 2023).

[614] See Paragraph 4.1.1 supra.

[615] Harvey "The impact of the Federal Reserve Bank's open market operations" 2002 *Journal of Financial Markets* 223–257.

[616] On the 15th of March 2020 interest rates feel to within the range of 0% - 0.25%, a range that the US Fed terms as the "zero lower bound" (only the second time the interest rate has ever hit this level, the first being during the GFC), and which indicates that this US Fed's traditional monetary policy tool is exhausted to the point that it can no longer be used to provide additional stimulus to the financial system. See The Congressional Research Service *The Federal Reserve's Response to COVID-19: Policy Issues* 2021 22 available at https://crsreports.congress.gov/product/pdf/R/R46411 (accessed on 11 October 2023).

[617] The US Federal Reserve *The Fed Explained: What the Central Bank Does* 2021 23 available at https://www.federalreserve.gov/aboutthefed/files/the-fed-explained.pdf (accessed on 16 April 2024).

[618] The Financial Stability Oversight Council Annual Report 2023 8 available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf (accessed 25 August 2023).

[619] Bernanke *The New Tools of Monetary Policy* American Economic Association Presidential Address, Brookings Institution 2020 2 available at https://www.aeaweb.org/articles?id=10.1257/aer.110.4.943 (accessed 14 May 2023).

2020, as the US Fed reduced short-term rates to zero, it announced that the expectation was that it would maintain this target range until it was confident that the economy had weathered the economic shock on maximum employment and price stability caused by the pandemic.[620]

Quantitative easing, on the other hand, involves large-scale asset purchases; these assets include long-term US Treasury securities, mortgage-backed securities, or debt issued by the government.[621] The US Fed focuses on these types of assets as they pose no credit risk because they are government-guaranteed, as well as because they are more liquid than other types of assets.[622] The US Fed on 15 March 2020 announced it would increase its purchases of Treasury securities and resume its purchases of mortgage-backed securities to amounts needed to support smooth market functioning and effective transmission of monetary policy, as well as to both stimulate the economy and restore liquidity to the Treasury and mortgage-backed securities markets until progress had been made towards restoring the maximum employment and price stability goals.[623] These purchases occurred at an unprecedented rate of US$125 billion per day from 19 March 2020 up to 1 April 2020. As a result of these purchases, the US Fed's balance sheet exceeded its post-GFC peak of US$4.5 trillion, and its securities holdings increased by about US$1.2 trillion. By comparison, during the three rounds of quantitative easing as a result of the GFC, the US Fed increased its holdings of securities by an average of about US$100 billion, US$70 billion, and US$80 billion per month, respectively.[624] The US regulatory response to the Covid-19 pandemic was, on the whole, swift, comprehensive, and effective, and the lessons learned during the GFC, coupled with the additional regulatory powers given to supervisors by the Dodd-Frank Act, allowed for the crisis to be mitigated as much as it could be despite its devastating effects.[625]

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[620] The Congressional Research Service *The Federal Reserve's Response to COVID-19: Policy Issues* 2021 23 available at https://crsreports.congress.gov/product/pdf/R/R46411 (accessed on 11 October 2023).

[621] Ibid 24.

[622] The US Federal Reserve *The Fed Explained: What the Central Bank Does* 2021 23 available at https://www.federalreserve.gov/aboutthefed/files/the-fed-explained.pdf (accessed on 16 April 2024).

[623] The Congressional Research Service *The Federal Reserve's Response to COVID-19: Policy Issues* 2021 7 available at https://crsreports.congress.gov/product/pdf/R/R46411 (accessed on 11 October 2023).

[624] Ibid 25.

[625] Abboud *COVID-19 as a Stress Test: Assessing the Bank Regulatory Framework* Finance and Economics Discussion Series 2021-024: Washington: Board of Governors of the Federal Reserve System 2021 37 available at https://doi.org/10.17016/FEDS.2021.024 (accessed on 21 April 2024).

4.5.2 The 2023 banking turmoil

The 2023 banking turmoil was the most significant system-wide banking stress since the GFC.[626] Four major banks with total assets of about US$900 billion were shut down, placed under receivership, or rescued between 8 and 19 March 2023. The concerns that arose from these bank failures triggered a broader crisis of confidence in the financial stability of banks across financial systems in different jurisdictions across the world. As had happened during the GFC, wide-scale public support measures such as significant central bank liquidity provision to banks, government guarantees, as well as the extension of deposit guarantee schemes, were utilised by these different jurisdictions to mitigate the impact of the turmoil.[627] The contagion from these distressed banks to the banking system in several other jurisdictions resulted in sharp falls in some banks' equity prices, as well as reduced access to capital markets for funding due to the redistribution of liquidity.[628] Regulators in some jurisdictions issued public statements reiterating the approach that losses would be imposed on shareholders and creditors in resolution proceedings.[629]

The key macroeconomic developments that created the ground for the occurrence of the bank turmoil included that many jurisdictions implemented highly stimulative fiscal policies to mitigate the impact of the Covid-19 pandemic, with many central banks undertaking the large-scale asset purchase programs that had also occurred during the GFC.[630] This was followed by some of the most intense monetary policy tightening in recent records in an effort to stop the high inflation that had been caused by various factors, such as the supply-side disruptions that had occurred during the Covid-19 pandemic, as well as the rise of energy and food prices due to the war in Ukraine.[631]

[626] Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 1 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).
[627] Single Resolution Board *The 2023 Banking Turmoil* 2024 28 available at https://www.srb.europa.eu/system/files/media/document/2024-07-02_Staff-Paper-4_The-2023-Banking-Turmoil.pdf (accessed 22 February 2024).
[628] Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 4 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).
[629] The Financial Stability Oversight Council Annual Report 2023 56 available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf (accessed 25 August 2023).
[630] Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 5 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).
[631] The Office of Financial Research *Annual Report* 2023 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

The increase in interest rates and quantitative tightening by central banks resulted in a worsening of financial conditions in high-risk credit markets.[632] Some of the banks in the US that were affected had cross-border operations, and so contagion occurred in other markets like the United Kingdom and Switzerland.[633]

In 2022 prior to the banking turmoil, 39 banks in the US were placed on the so-called FDIC "Problem Bank List."[634] This was the lowest number of banks on the list since the FDIC began publishing it and had led to a false sense of security among financial regulators. Four banks failed, namely, Silicon Valley Bank (SVB), Signature Bank (SB), First Republic Bank (FRB), and Heartland Tri-State Bank (HTSB).[635] These financial institutions had US$549 billion in aggregate assets, which exceeds the US$545 billion in aggregate assets that the 165 banks that failed during the GFC had.[636] In addition to these four banks, a 5th bank with operations in the US and that had previously been designated as a G-SIB, Credit Suisse (CS), had to be rescued.[637]

SVB was closed by the California Department of Financial Protection and Innovation on 10 March 2023.[638] On 8 March 2023, as the risks to its balance sheet grew, SVB announced a plan to restructure its balance sheet by selling US$21 Billion in securities and seeking to raise US$2.25 billion in capital, however, on 9 March, the bank experienced a bank run as unprecedented withdrawals of uninsured deposits occurred, fuelled by social media.[639]

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632 The Financial Stability Oversight Council Annual Report 2023 24 available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf (accessed 25 August 2023).

633 Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 9 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

634 The Office of Financial Research *Annual Report* 2023 67 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

635 Ibid 67.

636 Ibid 67.

637 Credit Suisse was removed as a G-SIB in 2022. The Financial Stability Board *2023 List of Global Systemically Important Banks (G-SIBs)* 2023 3 available at https://www.fsb.org/uploads/P271123.pdf (accessed 25 August 2024).

638 Single Resolution Board *The 2023 Banking Turmoil* 2024 11 available at https://www.srb.europa.eu/system/files/media/document/2024-07-02_Staff-Paper-4_The-2023-Banking-Turmoil.pdf (accessed 22 February 2024).

639 Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 6 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

SB was closed down by the New York State Department of Financial Services on 12 March 2023, with the Department appointing the FDIC as receiver of the bank.[640] The major cause of SB's failure was the illiquidity caused by deposit runs due to the contagion effects as a result of the failure of SVB.[641]

FRB was a bank that focused on offering single-family residential (SFR) loans as their primary loan product.[642] On 1 May 2023, FRB was closed by the California Department of Financial Protection and Innovation, which simultaneously appointed the FDIC as its receiver.[643] The FDIC then entered into a purchase and assumption agreement with JPMorgan Chase Bank for all the deposits and assets of FRB, with 84 of FRB's offices in eight US states re-opening that same morning as branches of JPMorgan Chase Bank and depositors of FRB becoming depositors of JPMorgan Chase Bank.[644] The initial FDIC estimate of the cost to the Deposit Insurance Fund was US$13 billion, with the final cost to be determined on termination of the FDIC's receivership.[645]

CS, in the second half of 2022, suffered a sudden liquidity problem due to material liquidity outflows, and as a result, its clients withdrew significant deposits following negative market rumours about the financial health of the bank.[646] After the failure of SVB and SB, markets turned to the next weakest bank, CS, whose stock price had lost more than 70% since 1 January 2023.[647] On 16 March 2023, the Swiss Federal

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640 Single Resolution Board *The 2023 Banking Turmoil* 2024 10 available at https://www.srb.europa.eu/system/files/media/document/2024-07-02_Staff-Paper-4_The-2023-Banking-Turmoil.pdf (accessed 22 February 2024).
641 Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 9 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).
642 The Federal Deposit Insurance Company *Material Loss Review of First Republic Bank* 2023 44 available at https://www.fdicoig.gov/news/summary-announcements/material-loss-review-first-republic-bank (accessed 20 April 2024).
643 Single Resolution Board *The 2023 Banking Turmoil* 2024 17 available at https://www.srb.europa.eu/system/files/media/document/2024-07-02_Staff-Paper-4_The-2023-Banking-Turmoil.pdf (accessed 22 February 2024).
644 Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 9 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).
645 Ibid 17.
646 Single Resolution Board *The 2023 Banking Turmoil* 2024 13 available at https://www.srb.europa.eu/system/files/media/document/2024-07-02_Staff-Paper-4_The-2023-Banking-Turmoil.pdf (accessed 22 February 2024).
647 Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 13 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

Council adopted emergency measures aimed at ensuring the viability of CS and allowing for its takeover by the Union Bank of Switzerland (UBS).[648]

Following the collapse of the SVB and SB, one of the ways the US Fed, FDIC, and the US Treasury maintained financial stability was to utilise the “systemic-risk exception”[649] under the Federal Deposit Insurance Act.[650] This allowed the depositors of these two banks to be protected by the FDIC Deposit Insurance Fund, no matter even if their deposits exceeded the deposit insurance limit of US$ 250,000.

The FDIC is responsible for the resolution of all Insured Depository Institutions under the Federal Deposit Insurance Act,[651] as well as the resolution of financial holding companies under the Dodd-Frank Act.[652] The resolution procedures under the two frameworks are similar and based on transfer strategies that entail the sale of the assets of the failing bank to the private sector as soon as possible, either during resolution or shortly afterward.[653] This is executed through Purchase and Assumption transactions wherein the liabilities and assets of the failed financial institution are transferred to a third party or a bridge bank, which can then be sold at a later stage via a deferred Purchase and Assumption transaction.[654] The Purchase and Assumption transaction is facilitated by a loss-sharing[655] arrangement financed by the

648 The Financial Stability Oversight Council Annual Report 2023 57 available at https://home.treasury.gov/system/files/261/FSOC2023AnnualReport.pdf (accessed 25 August 2023).
649 The Office of Financial Research *Annual Report* 2023 66 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).
650 Section 13(4)(G) the Federal Deposit Insurance Act.
651 Section 38 of the Federal Deposit Insurance Act.
652 Title II of the Dodd-Frank Act.
653 Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 10 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).
654 Single Resolution Board *The 2023 Banking Turmoil* 2024 12 available at https://www.srb.europa.eu/system/files/media/document/2024-07-02_Staff-Paper-4_The-2023-Banking-Turmoil.pdf (accessed 22 February 2024).
655 A Loss-sharing agreement (LSA) is one wherein the FDIC’s goal is to sell the majority of a failed institution’s assets to an acquiring institution and have a private buyer manage the assets in a manner that benefits itself and the FDIC. LSAs reduce the FDIC’s immediate cash needs and are operationally convenient to the customers of the failed institution. Buyers of failed institutions view the LSA structure as attractive because the FDIC’s loss coverage provides substantial protection against losses on covered assets. The terms of an LSA transaction are embodied in the LSA, which supplements the FDIC’s Purchase and Assumption Agreement with the acquiring institution. The Federal Deposit Insurance Corporation *FDIC Loss-Sharing Agreements: A Primer* 2010 3, available at https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum10/sisummer10-article1.pdf (accessed 20 April 2024).

Deposit Insurance Fund (the DIF). FDIC is usually constrained by a least-cost-test,[656] which may lead to unsecured depositors having to receive less in compensation; however, the systemic risk exception can be used to avoid losses to uncovered depositors in circumstances where there is a serious risk to US financial stability, as occurred in the resolution of SVB and SB.[657] The aim of this arrangement is that the cost of the Purchase and Assumption for the DIF is reduced by the bail-in of uninsured, subordinated liabilities as well as shareholders' equity.[658] These uninsured, subordinated liabilities and shareholders' equity are not transferred, but left behind in the old entity; that is, the receivership, resulting in them turning into claimants against the receivership estate.[659]

The issues that were identified as having led to the financial instability of the 2023 banking turmoil were predominantly a lack of adequate risk management and governance from ineffective senior management and board oversight.[660] The banks failed to appreciate the build-up of traditional banking risks such as interest rate risk and liquidity risk.[661] The banks also failed to adequately respond to supervisory feedback and recommendations.[662] This lack of oversight led to unrealised losses in securities portfolios as well as uninsured deposits that exceeded the threshold limit insured by the FDIC, thus making them vulnerable to losses in the event of a bank failure or a bank run during the withdrawal of deposits by clients who no longer had confidence in these financial institutions.[663] The banks were placed under receivership, and the FDIC's DIF suffered a $31.5 billion loss covering the vulnerable deposits. The bank runs further revealed that regulation of the level of liquidity banks were expected to have could not alone prevent liquidity runs on these banks, as the

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[656] Single Resolution Board *The 2023 Banking Turmoil* 2024 19 available at https://www.srb.europa.eu/system/files/media/document/2024-07-02_Staff-Paper-4_The-2023-Banking-Turmoil.pdf (accessed 22 February 2024).

[657] See footnote 184 above.

[658] Section 11(11) of the Federal Deposit Insurance Act.

[659] Section 210(7)(D) of the Dodd-Frank Act and Section 11(10)(C) of the Federal Deposit Insurance Act.

[660] The Federal Deposit Insurance Corporation *Material Loss Review of First Republic Bank* 2023 44 available at https://www.fdicoig.gov/news/summary-announcements/material-loss-review-first-republic-bank (accessed 20 April 2024).

[661] The Office of Financial Research *Annual Report* 2023 11 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

[662] Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 1 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

[663] The Office of Financial Research *Annual Report* 2023 67 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

ongoing digitalisation of finance, such as the on-demand access to banking services through mobile apps, and the technological advancements that have allowed for faster payment and settlement services, have given depositors an easier ability to withdraw their funds.[664]

In addition to the above-identified failures, it is indicated in the most comprehensive regulator report to come out on the failures (that of the US Fed – which is the regulator with the most supervisory authority over these banks) that one of the contributing factors was de-regulation of some of the provisions of the Dodd-Frank Act that prevented the previously more stringent capital and liquidity standards from being enforced.[665] The Economic Growth, Regulatory Relief, and Consumer Protection Act,[666] was the piece of legislation that made changes to some of the regulations embodied in the Dodd-Frank Act. It did this by increasing the asset threshold for SIFIs from US$50 billion to US$250 billion; exempting bank holding companies with less than US$100 billion in assets from enhanced prudential standards imposed on SIFIs,[667] exempting bank holding companies with between US$100 billion and US$250 billion in assets from the enhanced prudential standards; and limiting stress testing conducted by the US Fed to banks and bank holding companies with US$100 billion or more in assets.[668] These provisions drastically amended the Dodd-Frank Act regulations that indicated that any bank in the US with an asset size of US$50 billion or more could be designated as a D-SIB.[669] This would then allow national bank regulators like the US Fed to impose enhanced prudential standards on capital meant to sustain unexpected losses in a crisis, on liquidity, including calculating the liquidity coverage ratio (LCR), liquidity stress tests, and bank resolution plans or living wills.[670]

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[664] Basel Committee on Banking Supervision *Report on the 2023 banking turmoil* 2023 6 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

[665] The Board Of Governors of The Federal Reserve *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* 2023 82 available at https://www.federalreserve.gov/publications/review-of-the-federal-reserves-supervision-and-regulation-of-silicon-valley-bank.htm (accessed 26 July 2023).

[666] The Economic Growth, Regulatory Relief, and Consumer Protection Act, Public Law 115 – 174, (2018). In the preamble of the Act the aims are stated to promote economic growth, provide tailored regulatory relief, and enhance consumer protections.

[667] Section 165 of the Dodd-Frank Act. These standards included but were not limited to resolution planning and enhanced liquidity and risk management requirements.

[668] Section 401 of the Economic Growth, Regulatory Relief and Consumer Protection Act.

[669] Title I of the Dodd-Frank Act.

[670] See Paragraph 4.3.2.1.1 supra.

Even when compared with the bank failures of the past, the 2023 bank failures represented some of the biggest in US history, especially given that they all occurred in 1 year, and individually are the second, third, and fourth biggest bank failures the US has ever experienced.[671] The resultant instability has to some extent shaken the confidence of the markets in the US banking system and brought up memories of the GFC.[672] The crisis revealed that these heightened standards could alone not prevent banks from failing in circumstances of bad governance, poor risk management practices, unsustainable business models, and weak application of the required regulatory standards.[673] The US regulatory response to the 2023 banking turmoil however further revealed that the higher capital and liquidity requirements that had been implemented post-GFC had successfully averted the crisis from affecting the financial stability of the whole system, thereby also averting the causing of a similar recession.

4.6 Conclusion

The GFC was most acutely felt in the US. The ability of large conglomerates to engage in risky financial activities, coupled with a comparatively unregulated environment, led to the very recession that has reframed how regulation is viewed. The proliferation of these large conglomerates resulted from increased consolidation and concentration in the banking industry. Unbeknownst to regulators, due to their lack of insight, US finance was morphing into a realm that required even more proactive regulation than had been implemented before 2008.

The US Fed should however still be commended for the regulatory role they played during the GFC as innovative measures they took, such as the skilled balance sheet evaluations of the failing financial institutions, quantitate easing, and their rapid lending responses, were critical to mitigating the adverse effects of the crisis. The resultant post-GFC regulatory toolkit, inclusive of the Dodd-Frank Act, at the disposal of the US

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671 The Office of Financial Research *Annual Report* 2023 67 available at https://www.bis.org/bcbs/publ/d555.htm (accessed 22 February 2024).

672 Ali "Reputational contagion from the Silicon Valley Bank debacle" 2024 *Research in International Business and Finance, Volume 69* 1.

673 Single Resolution Board *The 2023 Banking Turmoil* 2024 6 available at https://www.srb.europa.eu/system/files/media/document/2024-07-02_Staff-Paper-4_The-2023-Banking-Turmoil.pdf (accessed 22 February 2024).

Fed and the US FSOC is extensive. It is also indicative of global efforts to give regulators the ability to monitor both their domestic financial systems while at the same time factoring in cooperation with international regulators. This allows for faster determination of systemic events, and the more resolute addressing of any threats to both domestic and global financial stability that may arise.

The Dodd-Frank Act dramatically changed the regulatory environment in the US by amending important legislation like the Federal Reserve Act,[674] and enhancing the ability of federal authorities to set tighter supervisory standards to protect financial stability.[675] Financial stability as an aim is achieved through the effective control of risk and volatility.[676] The US FSOC is the body in the US regulatory body that is tasked with bringing together different regulators in the execution of the financial stability mandate. The two member agencies that are given primacy within the Council are the US Treasury, whose affirmative vote is needed on every decision taken no matter the quorum voting requirements, as well as the US Fed which is tasked with imposing standards and enforcing them. The US Fed, as with other central banks around the world, has been legislated to factor in financial stability in its overall monetary policy strategy.[677]

The fragmented nature of the regulatory environment in the US means that collaboration with primary regulatory agencies that have the main supervisory mandate over financial institutions is an even more important element of ensuring financial stability. This is a collaboration in both monitoring of the financial system as well as rule-making. This has dramatically shifted the singular institutional silo approach of regulation to a consolidated macroprudential approach similar to the twin peaks model of financial regulation applied in South Africa.[678] The greatest impact of the Dodd-Frank Act is that it expanded the regulatory net to non-bank financial

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674 The Federal Reserve Act of December 23, 1913, ch. 6, 38 Stat. 251.

675 Mulhern "The Dodd–Frank Act: Its implications for change in the banking industry" 2011 *Journal of Payments Strategy & Systems Volume 5 Number 2* 125.

676 Haddon *The effect of the Dodd-Frank act on risk in the financial sector* Senior Honors Projects 2015 6 available at https://commons.lib.jmu.edu/honors201019/5?utm_source=commons.lib.jmu.edu%2Fhonors201019%2F5&utm_medium=PDF&utm_campaign=PDFCoverPages (accessed 13 November 2023).

677 Oet "Does Financial Stability Matter to the Fed in Setting US Monetary Policy?" 2017 *Review of Finance, Volume 21, Issue 1* 389.

678 Botha and Makina "Financial regulation and supervision: Theory and practice in South Africa" 2011 *International Business & Economics Research Journal* 27.

institutions, such as hedge funds, that posed a threat to financial stability, which institutions in the past had not been adequately supervised.

However, when some legislators and market participants conduct a cost-benefit analysis of the Dodd-Frank Act vis-à-vis the US free market system, they are of the view that this results in tension between the short-term interests of economic growth versus the long-term interests of financial stability.[679] This has caused attempts to dull the regulatory effect of important provisions of the Dodd-Frank Act, especially in its financial stability aims.

The Dodd-Frank Act was passed during the Obama Administration,[680] but the Trump Administration[681] reeled in some of its regulations as it purportedly was seen as being limiting to the provision of liquidity to the market and hence economic activity.[682] This was done by exempting some financial institutions from disclosure requirements; the federal oversight of fewer banks that no longer had to deal with some of the enhanced supervisory standards; subjecting fewer banks that had to undergo stress testing; as well as side-lining some of the regulators created by the Dodd-Frank Act, such as the Bureau for Consumer Protection.[683] The effect of this deregulation was partially the cause of the 2023 banking turmoil; however, due to financial stability measures from the Dodd-Frank Act that did remain, the regulators – despite deregulation – managed to maintain financial stability during the pandemic as well as during the 2023 banking crisis.

679 Allen "A New Philosophy for Financial Stability Regulation" 2013 *Loyola University Chicago Law Journal* 173.

680 Barack Obama was the 44th President of the United States from 20 January 2009 to 20 January 2017.

681 Donald Trump was the 45th President of the United States from 20 January 2017 to 20 January 2021.

682 Annelise "*Conclusion: Between the Last Financial Crisis and the Next One: Financial Citizenship: Experts, Publics, and the Politics of Central Banking*" 2018 *Cornell University Press* 85.

683 Seila Law LLC v. Consumer Financial Protection Bureau, 591 U.S. __ (2020).

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

A "light touch" approach to regulation prior to the GFC, particularly in countries such as the US and Europe, was considered a significant cause of the supervisory and financial system failures that occurred.[684] Regulators in these impacted jurisdictions did not adequately monitor their financial systems and institutions and thus did not observe the build-up of the systemic risks that led to the crisis.[685] This resulted in an inability to take adequate corrective measures to restore financial stability. The opposite of this approach is a principle-based approach to regulation, which requires regulators to set out basic principles, such as the solvency, governance, and consumer protection rules that financial institutions must comply with in conducting their activities.[686] The aim is that regulation is based on a prudential framework that is aimed at preventing risk from occurring and, if a crisis does occur, to prevent the possibility of collapse and contagion.[687]

The US does not follow a system of regulation that can easily be placed in the traditional categories. It involves a chartered system of dual federal and state regulation, with multiple regulators with several supervisory responsibilities, depending on the nature of the financial institutions and the services they render.[688] The regulatory response to the GFC in the US was the passing of the Dodd-Frank Act in 2010. The Act restructured the US financial system and made attempts to introduce more supervisory oversight. The aim was to end the "TBTF" principle by no longer having a system of the implicit guaranteeing of taxpayer-funded bailouts in future

[684] See Paragraph 1.1 supra.
[685] See Paragraph 4.2 supra.
[686] Clarke and Hardiman *Crisis in the Irish Banking System* UCD Geary Institute Discussion Paper Series Geary WP2012/03 February 2012 25 available at https://www.ucd.ie/geary/static/publications/workingpapers/gearywp201203.pdf (accessed 28 July 2024).
[687] Hollander *A Review of the South African Reserve Bank's Financial Stability Policies* Stellenbosch Economic Working Papers: WP11 2019 9 available at https://www.ekon.sun.ac.za/wpapers/2019/wp112019/wp112019.pdf (accessed 19 March 2023).
[688] See Paragraphs 4.1 and 4.2.2 supra.

crises, as well as separating the traditional banking system from the new and riskier financial products in the market that had caused the crisis.[689]

The South African financial system did not suffer the same damage during the GFC as the financial systems of other G20 members.[690] This is because regulators did not engage in light-touch regulation, and South Africa's financial regulatory framework prevented financial institutions from engaging in the risky lending practices that had caused the GFC in other countries.[691] However, the extraordinary job losses in the South African economy revealed that South Africa and its financial sector were still closely connected to global financial markets, and financial stability measures had to be taken to prevent future risks that could lead to potential crises.[692]

Following the GFC, the G-20 members, including South Africa, decided in 2011 to implement the Basel III standards, commonly known as the international regulatory framework for banks. These measures included stricter requirements for the quality and quantity of regulatory capital and aimed to implement minimum requirements for internationally active banks in the G-20 members' jurisdictions to strengthen the regulation, supervision, and risk management of these banks.[693]

South Africa subsequently implemented a Twin Peaks approach to financial regulation that involves two different agencies, each with its specific mandate: a prudential regulator that seeks to maintain and enhance the safety and soundness of financial institutions, as well as a market conduct regulator that seeks to protect the consumers of financial services.[694] The PA and the FSCA each have clear, dedicated objectives. This decentralization of powers into two different bodies, with a concomitant separation of operations, allows for a regulatory framework that is more accountable to the public.[695] The mandate of the SARB was expanded to include the maintenance and enhancement of financial stability with the enactment of the FSRA.[696] The FSRA

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689 Section 619 of the Dodd-Frank Act.
690 See Paragraph 1.1 supra.
691 See Paragraph 1.1 supra.
692 See Paragraph 1.1 supra.
693 See Paragraph 1.1 supra.
694 See Paragraph 1.1 supra.
695 Van Niekerk, MG: "*A Comparative Analysis of The Role of The Central Bank in Promoting And Maintaining Financial Stability In South Africa*", 2018 *LLD Thesis University of Pretoria 57 available at https://repository.up.ac.za/handle/2263/67934 (accessed 02 February 2023).*
696 See Paragraph 1.1 supra.

reformed the financial sector in line with the Basel III post-GFC standards and brought a primary focus on financial stability in supervisory and regulatory efforts. The FSRA framework gives the SARB the lead role in ensuring overall financial stability.

5.2 The purpose of the study

The purpose of this study was to examine the relevance of financial stability as a regulatory principle in the post-GFC regulatory landscape and its impact on interconnected global financial markets that have experienced several crises in the decade and a half following the GFC. Financial stability can only be maintained in resilient regulatory frameworks that are equipped with the necessary tools to achieve and sustain financial stability. This is especially important for an emerging market economy like South Africa.

This research examines the financial stability mandate of the SARB within the FSRA Twin Peaks framework of financial regulation. It seeks to explore the impact of the GFC on South Africa's approach to financial stability. Furthermore, the study evaluates the effectiveness of the powers granted to US regulatory authorities under the Dodd-Frank Act in safeguarding financial stability. The objective is to assess the adequacy of the SARB’s regulatory toolkit and consider whether insights from the post-GFC US framework can be adapted to strengthen South Africa's financial stability strategy.

5.3 Defining financial stability

Chapter 2 aims to synthesise a guiding definition of financial stability for use in this research. Financial stability can be defined broadly or narrowly. In its broad sense, it reflects the sentiment of both financial institutions and consumers that the financial system’s institutions and market infrastructure will be resilient to potential risks. A narrower definition links financial stability specifically to the financial system’s ability, through institutions and markets, to price and allocate financial risks effectively.

Historical definitions of financial stability focused primarily on the financial system’s capacity for financial intermediation. In contrast, contemporary definitions emphasise stress-test-based modelling aimed at ensuring that financial institutions are prudentially safe and sound enough to withstand potential financial crises.

A major challenge that regulators face post-GFC in defining financial stability is the multitude of metrics that can describe it. Regulators may focus on the prudential safety and soundness of SIFIs, the stability of market infrastructure, or the presence or absence of instability in other parts of the financial system. While reaching a universally accepted definition of financial stability may be difficult, it is essential. Understanding the general parameters of financial stability enables regulators to assess the resilience of the financial systems they supervise. Moreover, how financial stability is defined directly impacts the supervisory responses regulators will take during future crises.

The importance of financial stability lies in its ability to protect the real economy. Instability can damage economic performance and erode the financial system's capacity to allocate risk and funds to productive economic activities. Regulatory measures aimed at promoting financial stability positively affect economic growth and efficiency. A definition of financial stability must consider economic growth, as financial stability without reference to economic benefits is meaningless.

Technological advancements, shifts in consumer engagement with financial products, changes in how financial institutions deliver these financial products, and political and social developments necessitate a dynamic definition of financial stability. Static thinking contributed to the regulatory environment that led to the GFC. However, the constant golden thread in contemporary definitions of financial stability is the necessity of ongoing monitoring, supervision, and regulation of financial institutions and market infrastructures to identify potential risks that could lead to a crisis.

The chapter concludes by defining financial stability as: "a financial system that is able to effectively provide credit to preferred parts of that system, and can foresee, pre-empt, prevent or resolve financial risks without irreparable harm to the markets that make up that system. A stable financial system maintains maximum employment levels in the relevant economy, controls inflation to a level that does not negatively affect monetary stability and is one wherein financial intermediation of funds occurs optimally through the medium of healthy financial institutions."[697]

5.4 The financial stability mandate of the SARB in terms of the Financial Sector Regulation Act

Chapter 3 delves into the financial stability mandate of the SARB as the primary authority responsible for maintaining financial stability under the regulatory framework established by the FSRA. There is not only statutory confirmation of the SARB (as the country's central bank) being responsible for the maintenance of financial stability, but also of financial stability being the main cornerstone of regulation in accordance with the post-GFC Basel Committee international standards.

The regulatory toolkit at the SARB's disposal is comprised of its powers as the central bank, its statutory powers in terms of the FSRA, and the additional powers at the disposal of other financial sector regulators with which it must collaborate to maintain financial stability. While the South African financial system is concentrated in banking, it remains large and complex. The heightened requirement for collaboration enables comprehensive monitoring of the financial system for risks or threats that could lead to systemic events and facilitates timely regulatory interventions to prevent crises. However, it is essential to recognise that the FSRA regulatory framework is still in its infancy and that collaboration should not compromise the ability of the SARB and other regulators to respond decisively to emerging crises.

The regulatory tools at the disposal of the SARB include the ability of its Governor to determine whether a specific financial instability event is a systemic event or an imminent systemic event, and in that case use its powers or direct other financial sector regulators to exercise their powers in order to manage the event. The SARB Governor also has the authority to designate a financial institution as a SIFI, which allows the SARB to monitor the SIFI for the build-up of systemic risk, impose heightened prudential standards on the SIFI, and require the concurrence of the SARB in the resolution of the SIFI should it fail. The SARB further oversees, through its

[697] Paragraph 2.8 supra.

National Payment System Department, the stability of the payments, clearing, and settlement system, which is a vital market infrastructure that contributes to the overall stability of the financial system.

The SARB and other financial sector regulators have the duty to collaborate – which is reinforced by MOUs that deal specifically with the issue of financial stability, and wherein undertakings are made to assist in the execution of their respective financial stability mandates. The SARB also has the ability to execute the lender of last resort function in exceptional circumstances, to provide stability to the financial system through loans advanced by the SARB to the Government, or to a financial institution that the SARB has acquired shares in. In order to prevent moral hazard, the SARB is enjoined to take measures that minimise the cost of exercising its LOLR role. The SARB toolkit was expanded by the FSLAA, which amended the SARB Act to make the SARB the Resolution Authority for bank as well as non-bank SIFIs, and introduced a new resolution framework that came into effect on 1 June 2023, as well as a new deposit insurance scheme that became operational on 1 April 2024. The FSRA was also amended to make provision for the establishment of the CODI as the Deposit Insurer and to make provision for the establishment of the DIF, which will also contribute to the SARB's ability to maintain financial stability in a crisis by protecting depositors, preventing bank runs as well as taxpayer bailouts in future.

Conflicts may arise between the SARB's objectives of micro-prudential regulation of financial institutions or a particular sector of the economy and its macro-prudential goal of managing overall monetary policy. Additionally, when the SARB uses short-term interest rates as a monetary policy tool, conflicts can occur between its primary objectives of short-term price stability as opposed to the objective of long-term financial stability. These conflicts must be resolved based on what is in the best interests of the long-term stability of the financial system, as this tends to lead to greater social benefits. Another potential conflict of interest that could arise is the fact that the PA is housed within the SARB. As a critical element of the financial stability framework, the independence of the PA in the exercise of its supervisory prudential role must be maintained, despite the advantages in coordination of expertise and sharing of information that come from the PA being housed in the SARB.

Taxpayer-funded bailouts must be avoided, as this can result in the independence of the SARB being negatively affected when the inevitable involvement of the government occurs due to the injection of taxpayer funds. The LOLR function, which is an important financial stability tool, must be used with a full assessment of how the funds for the bailout of financial institutions will be sourced.

The well-designed regulatory toolkit at the disposal of the SARB in terms of the FSRA enables it to execute its financial stability mandate, with substantial powers to monitor and regulate the entire South African financial system effectively.

5.5 The financial stability mandate of the US Federal Reserve in terms of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Chapter 4 explores the regulatory framework established in the US following the GFC, with the US being the epicentre of the crisis. The US financial system housed large conglomerates that were deeply interconnected with global financial markets and engaged in risky financial activities that contributed to the crisis, reshaping the way regulation is viewed.

Despite the regulatory shortcomings before the GFC, the US Fed responded to the crisis with effective and innovative measures that were critical in mitigating its adverse effects. The subsequent enactment of the Dodd-Frank Act significantly expanded the US Fed's regulatory toolkit, empowering it to monitor and identify risks threatening the US financial system. The Dodd-Frank Act also established the US FSOC (the US Fed and the US Treasury being the lead bodies) to foster domestic collaboration among regulators and promote cooperation with international regulatory bodies, addressing the contagion risks the GFC exposed in global financial markets. This framework enabled quicker assessments of risks with the potential to develop into systemic crises, threatening both domestic and global financial stability.

The regulatory toolkit for the maintenance of financial stability created by the Dodd-Frank Act includes the ability of the US FSOC to collect information from its member agencies, other financial sector regulators, and the relevant financial institutions themselves, in order to assess risks to the US financial system. The US FSOC is also given the authority to monitor the domestic and international financial services market, to identify any threats that may cause financial instability, thereby allowing for the implementation of pre-emptive measures to mitigate potential harm to the financial system. The US FSOC can request that the US Fed supervise financial institutions that pose material risk to the US financial system, and on the basis of this request recommend increased prudential standards and enhanced resolution planning. The US FSOC also has the authority to identify SIFIs, as well as systemically important market infrastructures. The enhanced resolution planning involves the authority to make recommendations to the US Fed that financial institutions provide reports to regulators, including to the FDIC,[698] on their plans for rapid and orderly resolution in the event of material distress or failure. Supervised financial institutions in these circumstances are subjected to enhanced public disclosures to enable consumers and market participants to assess their risk profile, capital adequacy, and risk-management capabilities. The US FSOC can recommend short-term debt limits to the US Fed to mitigate risks associated with excessive accumulation of such debt by supervised financial institutions. The US FSOC can further recommend that a primary financial regulatory agency apply additional regulatory standards to specific financial activities identified as posing a risk to the broader US financial system. The US FSOC can also impose additional reporting requirements on financial institutions with assets of more than US$250 billion or on those subject to enhanced supervisory requirements by the US Fed, which set out the financial condition of the institution and the potential risk it poses to US financial stability. The US Fed can then in conjunction with the US FSOC take mitigatory actions such as restricting the financial institution’s ability to merge with another financial institution rendering certain financial services, or the mandating of asset sales.

The Dodd-Frank Act also allowed for the creation of the OFR, whose primary function is to facilitate research into the US financial system with respect to intellectual property laws, confidentiality of business information, and the overall stability of the US financial system. The OFR, in consultation with the US Fed, is empowered to issue regulations, specifically concerning the standardisation of data collection and reporting. The OFR

[698] The FDIC is an independent agency created by the Congress to maintain financial stability and public confidence in the US financial system. The FDIC insures deposits, examines and supervises financial institutions for safety, soundness, and consumer protection, and is the resolution authority that resolves large and complex financial institutions as well as manages receiverships.

can serve subpoenas on financial institutions, compelling them to produce required data.[699] The OFR can also request financial institutions to submit reports on the assessment of the impact of their financial activities on the financial stability of the markets they participate in, as well as on these institutions' financial condition. The OFR further promotes market transparency, improved market conduct, and financial stability through the publication of collected data and through the creation of databases documenting information on financial institutions and instruments.

The CFPB is the market conduct regulator and as part of the US regulatory framework ensures that consumers are treated fairly by financial institutions, thereby fostering financial stability. It does so by providing consumer education on financial products and their regulation, by publicly disclosing vital financial information about institutions, and by enhancing consumer access and awareness.[700]

The US Fed is in its own right authorised to issue regulations in respect of the implementation of its Dodd-Frank Act financial stability mandate. The US Fed can request reports from financial institutions under its regulation on their financial status, the risks they pose to financial stability, and their compliance with the Dodd-Frank Act and other regulatory requirements. The US Fed can conduct examinations of these institutions to assess their financial condition, operational risks, and risk monitoring systems. The US Fed can also refer a financial institution to its primary regulatory agency if its condition is non-compliant with regulations. The US Fed can impose more stringent prudential standards for large interconnected financial institutions with assets exceeding US$250 billion if the financial distress of the institution would pose a threat to US financial stability. The US Fed conducts annual stress tests, in collaboration with primary regulatory agencies, to assess whether supervised financial institutions have sufficient capital to withstand potential losses during periods of financial instability.

The Dodd-Frank Act reshaped the US regulatory environment by enhancing federal regulators' ability to set stricter supervisory standards aimed at protecting financial stability. The US FSOC was created to bring together different regulators in the execution of the financial stability mandate. The US Fed, as the US central bank, is one of the bodies that sits on the US FSOC and is tasked with the imposition as well

[699] See Paragraph 4.3.2.1 supra.
[700] See Paragraph 4.3.2.3 supra.

as with the enforcement of prudential and supervisory standards. Additionally, the US Fed was legislatively required to consider financial stability in its overall monetary policy considerations.

Before the GFC, the fragmented nature of the US regulatory environment allowed risks to accumulate without the necessary preventative measures being taken. The collaboration with primary state/federal regulatory agencies with other bodies that supervise financial institutions and markets was an important focal element of the financial stability requirements of the Dodd-Frank regulatory framework. This collaboration in both monitoring of the financial system and rule-making has led to a more consolidated macroprudential approach, similar to the Twin Peaks model of financial regulation applied in South Africa.

However, tensions have arisen in the US during the implementation of the Dodd-Frank framework. These tensions are between the short-term priorities of economic growth and the long-term goals of financial stability. As a result, this has caused the repeal of some of the effective and important provisions of the Dodd-Frank Act, especially in respect of its financial stability requirements. This led to less regulatory supervision of certain financial institutions, less enhanced supervisory standards, and the subjection of fewer banks to stress testing, as well as side-lining some of the regulators created by the Dodd-Frank framework, such as the CFPB. This deregulation contributed to the environment that led to the 2023 banking crisis, prompting renewed debates on whether the current regulatory toolkit, despite its ability to in large weather the banking crisis, is still adequate to address modern financial crises.

5.6 Recommendations for the SARB

Recommendation 1:

The adoption of a flexible inflation target framework that, over and above the mandated framework, uses an additional requirement of "maximum employment" as a metric of financial stability.

Many jurisdictions such as South Africa and the US have adopted an inflation targeting framework as their barometers for measuring monetary stability.[701] South Africa's 3-6% inflation targets can allow for an outward appearance of a functioning and stable financial system that is not always indicative of the actual situation when other factors are considered.[702] Countries like the US apply a flexible inflation targeting framework that enables the US Fed to consider other factors – such as the employment rate – when making financial and price-stability decisions.[703]

The SARB should consider the adoption of the use of a flexible inflation targeting framework, with the additional metric of maximum employment as one of its measures of the stability of the financial system. The US Fed has adopted this as its official policy.[704] In a country with high levels of unemployment, such as South Africa, placing a strong labour market at the heart of regulation would be beneficial to financial stability.

Recommendation 2:

The inclusion in the FSOC of additional significant financial sector regulators.

The primary objectives of the FSOC, which was established by the FSRA, are to support the SARB when it performs it's functions in relation to financial stability, as well as to facilitate cooperation and collaboration between the SARB and other financial sector regulators. As with the US FSOC, which itself was established by the Dodd-Frank Act, the aim of FSOC is to provide comprehensive monitoring of the stability of the financial system.

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701 Gilbert "Prudential regulation, its international background and the performance of the banks a critical review of the South African environment since 1970" 2009 *South African Journal of Economic History* 46.

702 Jonsson *The Relative Merits of Inflation Targeting for South Africa* WP/99/116, 1999, African Department: International Monetary Fund 1999 19 available at https://www.imf.org/external/pubs/ft/wp/1999/wp99116.pdf (accessed on 11 May 2024).

703 Oet "Does Financial Stability Matter to the Fed in Setting US Monetary Policy?" 2017 *Review of Finance, Volume 21, Issue 1* 390.

704 The Full Employment and Balanced Growth Act, Public Law 95-523, U.S. Statutes at Large 92 (1978): 1887-1908.

The SARB should consider the inclusion of other significant financial sector regulators in the FSOC, such as the CEO of the Johannesburg Stock Exchange (the JSE) as the regulator of the securities industry – which is important for financial stability – as efficient capital formation markets protect investors; as well as the CEO of the CODI which would contribute to financial stability as the provision of deposit insurance automatically protects insured qualifying depositors in the event of bank failures.

Recommendation 3:

The SARB as the resolution authority must consider implementing a systemic-risk exception for qualifying deposits in terms of the Deposit Insurance Fund, or the application of the exception for uncovered depositors.

The current maximum limit of cover for insured deposits that may be applied from the CODI's Deposit Insurance Fund in respect of a qualifying deposit is R100 000-00.[705] The US Fed, FDIC, and the US Treasury, in the resolution of financial holding companies,[706] supervised insured depository institutions,[707] as well as all uninsured depository institutions,[708] utilise a "systemic-risk exception" as part of their financial stability arsenal. The exception allows for depositors to be protected by the FDIC's Deposit Insurance Fund, no matter even if their deposits exceed the deposit insurance limit of US$250 000-00.

The use of a systemic risk exception by the SARB could be implemented through the determination by the Governor of the SARB, in conjunction with the Minister of Finance and the CEO of the CODI, of a systemic crisis event that warrants deviation from the normal emergency measures that are taken or deposit cover that is given. This assessment would have to incorporate the consideration of the possible serious adverse effects on the economy or on financial stability of providing extended cover. Any action taken or extended cover given should also aim to avoid or mitigate the

[705] A qualifying deposit in terms Section 166AB of the FSRA read with the Deposit Insurance Regulations.
[706] As referred to in the Dodd-Frank Act.
[707] As referred to in the Federal Deposit Insurance Act.
[708] See Paragraph 4.4.2 supra.

adverse effects of the systemic event, and the likely effect of such action on the incentives and conduct of insured depository institutions with respect to moral hazard.

Recommendation 4:

The SARB must be even more transparent in its regulatory efforts to enhance its financial stability mandate.

Even though financial stability has metrics that can assess it, it also substantially comprises consumer and market participant sentiment that the financial system is healthy and that financial services can be rendered unimpeded, even if unforeseen events arise.[709] This can only be done if the public is aware of the supervisory measures that regulators are engaged in and of what benefit to the financial system these measures are.[710]

Transparency through public disclosures has become a key objective of financial regulation in the US, requiring financial institutions to publicly disclose comprehensive financial information to enhance consumers' understanding of their financial condition and market conduct. The SARB has, at times, faced criticism for inconsistencies in its information dissemination; for example, differences between the information released to domestic and international audiences.[711] Adopting a more transparent approach would strengthen market sentiment and support the SARB's financial stability mandate.

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[709] Abboud *COVID-19 as a Stress Test: Assessing the Bank Regulatory Framework* Finance and Economics Discussion Series 2021-024: Washington: Board of Governors of the Federal Reserve System 2021 16 available at https://doi.org/10.17016/FEDS.2021.024 (accessed on 21 April 2024).

[710] Tiberto "Does transparency of central banks communication affect credit market? Empirical evidence for advanced and emerging markets" 2020 *The North American Journal of Economics and Finance* 17.

[711] The International Monetary Fund *Technical Assistance Report: Monetary and Financial Statistics (South Africa)* 2023 7 available at https://www.imf.org/en/Publications/CR/Issues/2023/07/18/South-Africa-Technical-Assistance-Report-Monetary-and-Financial-Statistics-Duty-Station-536713 (accessed on 11 May 2024).

Recommendation 5:

The SARB as the resolution authority should consider the use of Purchase and Assumption agreements in resolving regulated financial institutions.

The SARB may incorporate a company in accordance with the Companies Act[712] in the exercise of its resolution functions.[713] This "bridge company" as it is referred to must on incorporation be wholly owned by the SARB. The SARB, in order to ensure facilitation of the orderly resolution of the designated financial institution, may then transfer some or all of the shares that it holds in the bridge company to any person.

The resolution framework available to US regulators is similar, but the transfer strategies for the sale of the assets of the failing bank in addition involve Purchase and Assumption agreements that are entered into with the private sector specifically. These Purchase and Assumption agreements involve the transfer of the liabilities and assets of the failed financial institution to a third party or to a bridge bank, which can then be sold at a later stage. These Purchase and Assumption agreements involve a loss-sharing arrangement financed by the FDIC's Deposit Insurance Fund, wherein the parties agree to share the losses from loans or other sources. The deposit insurer and the third party thus share in the losses and potential recoveries on the loans covered by the loss–share agreement. The Purchase and Assumption agreements can serve to protect depositors, as private companies assume the deposits and the assets of the failing institutions, and depositors would then still have access to their deposits. Deposits will continue to be insured by the deposit insurer, and customers will not need to change their banking relationship in order to retain their deposit insurance coverage. The bridge bank thus serves as a temporary bridge between the failing bank and its acquisition by a third party and ensures the continuity of banking services.[714] This model of resolution also involves the constraining of the deposit

[712] Act 71 of 2008.
[713] Section 166F of the FSRA.
[714] A resolution toolkit must comprise of a "rescue tool" to deal with the resolution of a failing bank in an optimal manner. A resolution authority will be required to consider whether or not there are parts of the failing bank that can be saved back to viability. Resolution is thus not only aimed at facilitating the orderly exit of the bank from the financial system, but also salvaging the healthy and rescuable parts of the failing bank, therefore ensuring minimal impact to financial stability. See Nyaude, AB: "Regulatory measures to address bank failures in Zimbabwe", 2021 *LLD Thesis, University of Pretoria* available at https://repository.up.ac.za/handle/2263/80388 (accessed 02 February 2023).

insurer by the application of a “least-cost-test” that aims to reduce the cost of the Purchase and Assumption for the Deposit Insurance Fund by requiring the bail-in of uninsured liabilities as well as shareholders’ equity.

The SARB should thus consider the use of resolution through Purchase and Assumption agreements, which would result in a highly competitive bidding process by private sector third parties, as well as resolution transactions with the least losses to taxpayers or the Deposit Insurance Fund.

Recommendation 6:

The production of studies every five-year cycle of the impact financial stability regulations have on financial stability and economic growth.

US regulators are mandated to conduct ongoing studies over five-year cycles to assess the impact of their regulatory limitations on the execution of their financial stability mandate, the adverse effects on economic growth, as well as the effectiveness of the implementation of their regulatory framework.

The SARB should consider studies every five-year cycle of the impact of its regulatory toolkit on economic growth, as well as assess the effectiveness of the execution of its financial stability mandate on identifying systemic risks and developing mitigation strategies.

Recommendation 7:

The SARB could create a data collection office, like the OFR in the US, that has the ability to survey, collect, and process economic data specifically geared to protecting financial stability.

The collection of financial data relevant to the assessment of financial stability goes beyond just expecting reports from the financial institutions that regulators supervise.

It must include surveillance powers for independent information gathering, as well as the ability to analyse the collected data.[715] The aim of the data collection is to create the necessary empirical measurements and standards for the assessment of financial stability.[716]

The SARB currently has two internal departments for the collection of economic data; namely, the Economic Research Department and the Economic Statistics Department. The Economic Research Department assists in economic policy formulation by providing economic information, analysis, and recommendations to the SARB.[717] The Economic Statistics Department compiles economic and financial statistics based on international best practices for use by policymakers, financial market participants, and the general public. These statistics present an overview of the economic situation in South Africa and inform the SARB's monetary policy decisions.[718]

These departments' data collection activities, however, are for both monetary policy decision-making as well as financial stability purposes. The OFR in the US is a statutory body that was created by the Dodd-Frank Act, which specifically collects data to promote financial stability. Its analysis is principally used to support the US FSOC and its member agencies in carrying out their financial stability mandates. It is also a separate juristic entity and has rule-making authority given to it by the Dodd-Frank Act. A similar data collection office that can collect financial stability data could significantly improve the SARB and the FSOC's execution of their financial stability mandates without the impediment of data being collected for other policy considerations.

[715] Implementing The Dodd–Frank Wall Street Reform and Consumer Protection Act, hearing before the Committee on Banking, Housing, and Urban Affairs, US Senate, Washington DC, 30 September 2010, 164 available at https://www.banking.senate.gov/hearings/implementing-the-dodd-frank-wall-street-reform-and-consumer-protection-act (accessed 20 April 2024).
[716] Ibid 157.
[717] The South African Reserve Bank *Economic Research Department: Research Agenda 2021–2023* 2021 3 available at https://www.resbank.co.za/en/home/what-we-do/research/ResearchAgenda (accessed 07 May 2024).
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5.7 Concluding remarks

The aim of this study was to determine how the SARB defines the concept of financial stability and executes its legislative mandate to maintain financial stability. A stable financial system requires the mitigation of financial risks, the management of systemic events that pose a threat to stability, and the continued public confidence in the services that the financial system renders. Financial systems are conduits for economic activity. The stability of the financial institutions that render financial services, as well as of the architecture that makes up a specific financial system, is what must be kept stable. Financial services include banking, investing, and insurance services, while financial infrastructure includes the payment and settlement systems that are the conduits for financial intermediation. Central banks usually play a regulatory role in supervising financial institutions and monitoring macroeconomic risks in a financial system. Supervision is an important part of the implementation of financial stability regulation, as it serves to ensure market discipline.

The GFC served as the impetus for the reconsideration of the concept of financial stability and its importance in financial regulatory frameworks. Synchronisation of the redevelopment of these frameworks through international bodies such as the Basel Committee became inevitable once the GFC exposed the risks brought about by the interconnectedness of the global financial system. The rise of conglomerates that provided complex cross-border financial products and a “TBTF” attitude resulted in some financial institutions taking risks that led to their inability to continue to render financial services and their eventual collapse. The manner in which a financial system can respond to crises is determined by the regulations in place for pre-empting, managing and recovering from any significant systemic shocks that may occur.

The SARB executes its financial stability mandate within a regulatory framework that is predominantly structured by the FSRA, and includes other functionaries such as the FSOC, the FSCA, the PA and other regulators. The SARB has a toolkit at its disposal that is extensive and comprises of its statutory powers in terms of the FSRA, its powers as the central bank, and the additional powers it exercises in terms of other financial sector laws in collaboration with other regulators. Collaboration allows for the entire South African financial system to be monitored and regulated, in order to prevent threats to its stability. This statutory confirmation of the SARB's financial stability mandate is a significant regulatory development. The preservation and enhancement of financial stability now stands alone within overall monetary policy considerations.

The various collaborative requirements have led to some thinking that over-regulation might compromise the ability of the SARB and other regulators to deal with crises in an efficient and effective manner. The conflict of micro-prudential regulation of financial institutions or a particular sector of the economy, sometimes runs contrary to the wider macro-prudential objectives of monetary policy that the SARB as central bank is also entrusted with. The use of short-term interest rates as a monetary policy tool by the SARB can also lead to contrary results between its two primary objectives of price stability and financial stability. The independence of the SARB can sometimes be compromised by the inevitable involvement of the government when it exercises its lender of last resort function in taxpayer funded bailouts to restore financial stability in a crisis. The housing of the PA within the SARB is predominantly advantageous due to the coordination of expertise and the sharing of information that occurs and contributes significantly to financial stability.

Healthy economic activity and financial intermediation require stable market infrastructures and financial institutions, and when systemic events occur that cause instability, the regulatory framework must have the necessary tools to restore financial stability. The well-designed financial stability regulatory toolkit of the SARB in terms of the FSRA has allowed it to monitor and regulate the financial system effectively, and has allowed the South African financial system to weather the major disruptive systemic events that the Covid-19 pandemic and 2023 banking turmoil represented.

The US is the ideal jurisdiction to consider the development of its regulatory environment post-GFC, given that the genesis of the GFC was the build-up of risk in the US financial market, especially in its banking industry, resulting in the collapse of large financial conglomerates. As the contemporary of the SARB, the US Fed, performed an important regulatory role in the GFC crisis and used its existing regulatory toolkit, such as extensive quantitative easing, to attempt to mitigate the adverse effects of the crisis. The resultant recession and job losses led to the promulgation of the Dodd-Frank Act that established the US FSOC and provided it and the US Fed with an extensive regulatory toolkit to better monitor their financial system.

The determination of systemic events and a comprehensive ability to address threats to both domestic and global financial stability lay at the heart of the new framework. Important legislative amendments were made to instruments such as the Federal Reserve Act, which enhanced the ability of regulatory authorities to set higher supervisory standards for the protection of financial stability and the effective control of risk and volatility. One of the pre-GFC challenges in the US financial system was the fragmented nature of the regulatory environment, resulting in some lack of collaboration between primary state regulatory agencies and federal authorities. This led to the financial instability that caused the GFC.

The US FSOC serves as the collaborative body between different regulators in the execution of the financial stability mandate. The collaboration is required to monitor the financial system and to make the necessary regulations. The US Treasury and the US Fed take the lead role on the Council, with the US Fed especially being tasked with the imposition and enforcement of standards. The US Fed was given the legislative mandate by the Dodd-Frank Act to consider financial stability in the implementation of its overall monetary policy. The shift from the singular institutional silo approach of regulation to a consolidated macroprudential approach has led to a Twin Peaks-like model similar to the framework applied in South Africa, thus making a comparison between the two systems even more viable.

A key element introduced by the Dodd-Frank Act was an expanded regulatory net that covered non-bank financial institutions – such as hedge funds – that had posed a threat to financial stability without previously being adequately supervised. Some deregulation has occurred post-GFC due to the normal tensions that arise in financial stability frameworks between the short-term interests of economic growth and the long-term interests of financial stability. The roll back of some of the important regulatory provisions of the Dodd-Frank Act, especially in its financial stability aims and reduced supervisory standards, has resulted in a reduced ability to protect financial stability. The US regulatory framework has however still been able to maintain financial stability during the Covid-19 pandemic as well as during the 2023 banking turmoil.

The SARB's well-designed regulatory toolkit could be improved by the adoption of a flexible inflation targeting framework, with the additional metric of maximum employment as one of its measures of the stability of the financial system, as well as the inclusion of other significant financial sector regulators in the FSOC that can provide more comprehensive monitoring ability of the financial system. The SARB could also be provided, in its capacity as the resolution authority and together with the CODI, with additional powers to implement a systemic-risk exception for qualifying deposits in terms of the Deposit Insurance Fund. It can increase the current maximum limit, or cover currently non-qualifying depositors in exceptional circumstances, as well as make use of Purchase and Assumption agreements in resolving regulated financial institutions with the least losses to taxpayers or to the Deposit Insurance Fund. The SARB could be more transparent in its regulatory efforts to enhance its financial stability mandate through more accurate public disclosures. Five-year cyclical studies of the impact financial stability regulations have on financial stability and economic growth could result in a more effective implementation of the regulatory framework. The SARB could create an independent data collection office with the abilities to survey, collect and process economic data that is specifically geared to protecting financial stability.

Financial stability has risen in significance as a concept on its own, apart from central banks' overall conduct of monetary policy, and over and above their price stability considerations. Post-GFC it has come to be that true financial stability requires macroprudential regulation of the financial system and the use of the macroprudential tools that central banks and other regulators have in their regulatory toolkits.

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