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FINANCE & BANKING ALERT

IN THIS ISSUE

THE PA REVEALS ITS THREE-YEAR STRATEGY FOR BANKS AND FINANCIAL INSTITUTIONS

On 28 September 2018, the Prudential Authority (PA) released its Regulatory Strategy for the period 2018–2021.

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The enactment of the Financial Sector Regulation Act, 2017 (FSR Act), also known as "Twin Peaks" aims to address the previously fragmented approach to the regulation of financial institutions which, according to the PA, led to the inconsistent application of legislation and a degree of regulatory arbitrage.

The transition to the Twin Peaks model will be implemented in a phased approach. The first phase involves the establishment of the two regulatory authorities, namely, the PA which will play a supervisory role by setting policy and prudential requirements to ensure compliance with international standards, and the Financial Sector Conduct Authority (FSCA) which will be responsible for enhancing market conduct rules applicable to financial institutions. The second phase involves developing and solidifying legal frameworks by amending legislation to provide for prudential and market conduct regulation.

Three Year Regulatory Strategy

According to the Regulatory Strategy released by the PA, the PA will endeavour to integrate and harmonise prudential supervision over the next three years across various sectors through several key focus areas summarised as follows:

i. Banks: Strengthening the regulation and supervision of banks

   The PA, now as the prudential regulator and supervisor of banks, mutual banks, co-operative banks and co-operative financial institutions (CFIs) says it will seek to enhance the safety of the banking system by gaining an in-depth understanding of individual and collective institutions and the environment in which they operate to mitigate against potential risks. The PA will actively participate in the Basel Committee on Banking Supervision (BCBS) and ensure that banks operate in accordance with Basel III requirements. One of the PA's key objectives will be to issue new regulatory instruments in line with global principles and standards. In the medium term, prudential frameworks will then be updated (through the issue of Prudential Standards) to cater for new business models for the operation of mutual banks and further developed to cater for the regulation and supervision of CFIs.

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The PA will be subjecting designated "financial conglomerates" to higher levels of scrutiny through a new regulatory framework to be released "in the coming months".

ii. Credit providers: Long term objectives

As part of its longer-term strategy, the PA has mentioned that it may consider the currently limited prudential regulation of non-bank retail credit providers.

iii. Conglomerates: Implementing the financial conglomerate regulation and supervision framework

Many institutions in South Africa operate across multiple industries, offering a myriad financial products and services across the continent and offshore. A few major South African entities operate bank holding companies that also have insurance subsidiaries, stockbroking arms, financial services providers and corporate and investment banking divisions, and in some instances, unregulated non-financial institutions (which are not subject to any capital or solvency requirements). In their strategy, the PA recognises that those entities are susceptible to greater contagion risk and against this backdrop, the PA will be subjecting designated "financial conglomerates" to higher levels of scrutiny through a new regulatory framework to be released "in the coming months". The PA's strategy also indicates that they will be publishing criteria for the designation of "financial conglomerates". The PA intends applying a multi-tiered supervisory framework which includes the supervision of individual stand-alone institutions, specialist group institutions and conglomerate groups which will focus on depositor, policy holder and member protection. Risks will be managed carefully due to the broad scope of the environment in which the financial conglomerates operate.

iv. Market Infrastructures: Implementing a prudential regulatory and supervisory framework

The PA and FSCA are seeking to expand the scope of regulatory oversight in the OTC derivatives market, define licensing requirements for Market Infrastructures (MIs) and ensure risk management and governance procedures are in place for central counterparties (CCPs).

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The FSB (as it was then known) together with the South African insurance industry have, through the SAM project, established a risk-based approach which will ensure that solvency and liquidity requirements are consistently met by life and non-life insurers.

The regulations published under the Financial Markets Act to regulate the trade of OTC derivatives transactions have been drafted in accordance with international standards to provide for safer financial markets. The Twin Peaks model further provides the PA with regulatory authority over providers of securities services, which include, authorised users of exchanges, participants of central securities depositories, clearing members of clearing houses and CCPs so that potential systemic risks in the financial markets can be appropriately and proactively managed.

v. Applying the Insurance SAM Regulatory and Supervisory Framework

The FSB (as it was then known) together with the South African insurance industry have, through the SAM project, established a risk-based approach which will ensure that solvency and liquidity requirements are consistently met by life and non-life insurers. The old FSB Insurance Prudential team has now been seconded to the PA.

vi. Establishing the regulatory and supervisory framework for "significant owners"

The FSR Act defines significant owners across financial institutions and grants financial regulators additional powers over significant owners of financial institutions (for example with regards to approval and/or notification of changes in significant ownership, fit and proper requirements for significant owners etc). According to the PA's strategy, the PA and the FSCA may issue directives to ensure that the objectives of the FSR Act are achieved.

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On 2 October 2018, the signed MoUs between the PA and the National Credit Regulator, as well as the MoU between the PA and the FSCA were released. The PA's MoU with the Financial Intelligence Centre was published on 3 October 2018.

Implementation

The PA says it will adopt a collaborative and consultative approach to the implementation of regulations by engaging with and building professional relationships with other regulators and key stakeholders in the financial sector to ensure that the application of new regulatory requirements is in accordance with international standards insofar as these are also in compliance with South African legislation. The collaboration mechanisms between the PA and existing regulators will be governed by Memorandums of Understanding (MoUs) which are being published as and when they become available.

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Next steps

The Regulatory Strategy sets important and ambitious objectives for the PA to achieve over the next three years and the market will be better placed to assess the impact of the Regulatory Strategy once the Prudential Standards giving effect to the intended strategy are released.

Bridget King and Zakithi Mthembu

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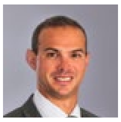

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Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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