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THE PRUDENTIAL REGULATOR UNDER THE PROPOSED TWIN PEAKS MODEL OF FINANCIAL REGULATION

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Abstract/Summary

The effects and impact of the recent global financial crisis, are yet to fade away as being something of the past. Financial markets worldwide, in particular the major first world countries, are still trying to uncover the real causes that led to the crisis and how best to innovate with new risk mitigants to prevent such a catastrophic fallout from repeating itself. Reformed financial laws were being proposed and passed swiftly to protect the governments as well as its citizens from the so-called bailout packages. It is against this backdrop that there has been a concerted effort by the G20 countries to urgently propagate the reform of the Financial Regulatory environment.

Whilst to a large extent it can be argued that South Africa may not have been directly impacted by the crisis at the time, its regulatory landscape as an emerging economy was and is by no means fool-proof. As a member of the G-20 countries South Africa is also obliged to align and review its financial regulatory laws as its financial markets also operate on a global scale. The South African financial markets framework and structure is largely similar in nature to its global counterparts, although on a smaller scale and less innovative.

My dissertation sets out the global regulatory reaction following the global financial crisis and its challenges. In particular I deal with the review and intended reforms of the South African financial sector and its prudential regulation. The reforms proposed for South Africa are contained in the Financial Sector Regulation Bill. This bill proposes the "Twin Peaks" model of financial regulation. The Twin Peaks model refers to the creation of two dominant regulators for the financial sector, the Prudential Authority and the Financial Sector Conduct Authority. This regulatory reform is intended to bolster the ability of these two super regulators to have stronger monitoring, supervisory and enforcement powers in proactively preventing, mitigating and anticipating any potential threats to the financial system as well as protecting financial customers.

The underlying objectives of these regulatory reforms are aimed at avoiding another global financial crisis as propagated by the G20 countries. Australia is one of the first countries that has embraced and started to adopt the Twin Peaks model of financial reform. I have chosen to compare the Australian Prudential Authority with the envisaged Prudential Authority for South Africa. In undertaking such a comparative exercise I highlight some of the major differences in terms of how the regulatory authorities are structured in both countries and give an assessment on its impact in enhancing its financial regulatory dispensation. I also point out some of the similarities in each country's reform process. I note the benefits (little impact on the global financial crisis) that the Australian Prudential Authority has brought to its financial system and conclude that such benefits could also materialise for South Africa's dispensation if implemented effectively.

Finally I conclude with reasons why I think South Africa would benefit from adopting the Twin Peaks model of regulation in the form of the new Prudential Authority. In particular I am of the view that it would be in a much better position to proactively monitor, supervise, enforce and anticipate any systemic risks to its financial system thereby making it more resilient to any crisis. This reform is also intended to concentrate its efforts in protecting financial customers from unfair market conduct and treating them fairly.

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1. Introduction

The purpose of this dissertation is to explore the reforms propagated under the "Twin Peaks" model of financial regulation. The department of national treasury in its recent update on the Twin Peaks reform for South Africa[1] describes this model as consisting of a comprehensive regulatory system with two main aims, firstly the creation of a dedicated Prudential Authority with its principal objective to strengthen the financial safety and soundness of financial institutions and secondly the creation of a dedicated Market Conduct Authority known as the Financial Sector Conduct Authority with its objective to enhance the protection for financial customers to ensure that they are treated fairly by financial institutions.

The Prudential Authority is responsible for prudential regulation which in essence is charged with ensuring financial stability including the maintenance of the safety, integrity, soundness, capital, solvency and liquidity standards of a financial institution. The Twin Peaks reform has one of its core objectives as the need to enhance the prudential regulation and its authority for more effective and proactive monitoring, supervision, enforcement as well as implementing mechanisms to anticipate and curb systemic risks at an early stage within financial institutions. Banking prudential regulation it is suggested is aimed at sustaining the financial health of banks in order to minimise the risk of failures that may lead to financial crisis.[2] The prudential rules typically relate to rules on capital adequacy, loan loss reserve requirements, minimum cash reserves and liquidity requirements.

It is important to set out upfront what led to the advent of the Twin Peaks reforms. The recent global financial crisis, largely described as unprecedented in its intensity and duration has in fact paved the way for extensive regulatory reforms aimed at restoring public confidence in the financial sector.[3] In essence therefore the recent global financial crisis is regarded as the root cause of financial reviews and reforms worldwide. This is the reason for the advent of the Twin Peaks model amongst many other financial regulatory reforms.

Whilst I will give an overview of the intended reforms I have chosen to restrict my research to the Prudential Regulator under this model and its impact on the South African banking system. The reason for limiting my research to the banking sector is that, if any, the global financial crisis (GFC) largely stemmed from this industry which it can be argued already existed as a highly regulated sector. Schulze noted that there are approximately 150 acts of parliament which have a direct impact on the daily activities and compliance requirements of banks, let alone large legislative amendments, rules, directives, circulars and guidelines in the form of soft law.[4] The purpose of Prudential Regulation under the banking sector is its financial stability oversight. In this regard what needs to be assessed is whether the envisaged improvements would enhance the South African Prudential regulatory environment.

The current South African financial markets regulatory environment is experiencing substantive reforms and is in a state of flux. In this instance the industry is experiencing significant regulatory changes in an attempt to align with global best practice, stricter corporate governance principles and more systemic risk aversion practices. The introduction of the new Financial Markets Act[5] has provided for enhanced formal regulation of the financial markets, especially those previously unregulated areas for licensing, monitoring, closer supervision and enforcement by the regulator.

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[1] Twin Peaks in South Africa: Response and Explanatory Document accompanying the second Draft of the Financial Sector Regulation Bill. December 2014 Department of National Treasury South Africa 6.
[2] Kokkinis "Rethinking Banking Prudential Regulation: Why Corporate Governance Rules Matter" 2012 *The Journal of Business Law* 627.
[3] Kokkinis (n 2) 611.
[4] Schulze 2011 *Annual Survey of SA Law* 484.
[5] Act 19 of 2012, which came into operation on 3 June 2013.

The importance of banks, deserves and justifies special regulation as they are the custodians of monetary policy, financing of the economy, the conducting of payments, credit and power allocation, custodians of depositors and managers of systemic stability.[6]

The main custodians and role players in any financial market worldwide are the central banks. It is argued that central banks were established worldwide because of the realisation that under typical conditions of banking and financial businesses, it was advantageous to have a centralised monetary reserve.[7] Such a central bank would have control of the currency and credit market having state support and be subject to some form of governmental supervision and participation.[8] In this regard it is argued that a central bank cannot be created merely by legislative enactment but that it should grow and evolve like a living organism within the environment provided by the financial and economic system in which it exits.[9]

South Africa's central bank is known as the South African Reserve Bank (SARB) created by the South African Reserve Bank Act.[10] The SARB statutes were at the outset, in several respects based on the laws similar to those contained in the Federal Reserve System of the United States of America as well as the constitution of the Bank of Java.[11] One of the early focus areas and main functions of central banks worldwide was to make and monitor monetary policy. The ultimate objectives of monetary policy consists of a combination of relative stability of the price level, balance of payments equilibrium, optimal and relatively stable economic growth, and a high as well as relatively stable level of employment and the usage of resources in general.[12] One of the primary objectives of the SARB is the protection of the value of the South African currency in the interest of balanced and sustainable economic growth in the country.[13] This objective of the SARB was further entrenched in the Constitution of the Republic of South Africa[14] and is similar to many central banks worldwide.

In the commission's final report[15] it is submitted that monetary policy can be broadly defined as all deliberate actions by the monetary authorities to influence the monetary aggregates, the availability of credit and interest, and exchange rates with the view of affecting the demand, income, output, prices and the balance of payments. Another important function of a central bank is its bank supervisory role. Currently the Bank Supervision Department of the Reserve Bank manages the prudential oversight of banks in South Africa. The strength of any financial system ultimately depends on a combination of the soundness of financial institutions, efficient market infrastructure and good governance on the part of all stakeholders.

De Jager argues that the general philosophy of the financial regulatory structure in a country is to a large extent shaped by the accepted rules and conventions of its financial community as well as the general philosophies and ideologies supported by the authorities.[16]

6 Panourgius 2006 *Banking Regulation and World Trade Law* 4.
7 De Jager "The South African Reserve Bank: An evaluation of the origin, evolution and status of a Central Bank (Part One)", 2006 *SAMLJ* 159.
8 De Jager (n 7) 159.
9 De Jager (n 7) 159.
10 Initially established under the Currency and Banking Act 31 of 1920 and subsequently repealed in its entirety by the current South African Reserve Bank Act 90 of 1989 (the "SARB Act").
11 De Jager (n 7) 161.
12 De Jager (n 7) 164.
13 S 3 of the SARB Act (n 9).
14 S 224 of the Constitution of the Republic of South Africa 1996.
15 Final Report of the Commission of Enquiry into Monetary System and Monetary Policy in South Africa (1985)('Monetary System Report') in par 13.7 139.
16 De Jager (n 7) 279.

Agencies that regulate and supervise the financial systems in various countries differ and may consist not only of central banks but regulatory agencies, government departments or any other agencies that have statutorily been assigned to perform supervisory roles in respect of their respective financial sectors.[17] In South Africa, apart from the SARB, the Financial Services Board (FSB) is another statutory regulatory agency that governs financial markets.[18]

The reforms of the South African financial regulation follows the government's intention back in 2011, when the then minister of finance[19] commissioned the governor of the Reserve Bank to prepare proposals on the implementation of the "Twin-Peaks" model of financial regulation. This was the commencement of the South African reform process which culminated in two policy papers drafted in response to the lessons learnt from the 2008 global financial crisis. These papers were "A Safer Financial Sector to Serve South Africa Better" released with the 2011 budget and a "Roadmap for Implementing Twin Peaks Reforms", released 1 February 2013.[20] Following such policy papers the draft Financial Sector Regulation Bill was released for public consultation.[21] The bill essentially broadly provides that the SARB will be responsible for prudential regulation whilst the FSB will be charged with the market conduct regulation.

It is against this backdrop that I will seek to elaborate on the proposed reforms and benefits to South Africa in making its financial industry, especially the banking sector more resilient in times of difficult and stressful economic conditions. We have recently seen with the African Bank curatorship that despite South Africa's fairly unscathed reputation from the global financial crisis, it is by no means immune from such a calamity.[22] Besides as the South African economy operates on a global scale it is obliged to play catch up with many of its first world counterparts in strenghtening its legal and legislative frameworks.

Jonathan Dixon[23] confirms that reforms of the South African financial regulatory structure commenced as far back as 2000, and whilst at the time discussions centered around the creation of a 'super' regulator, which is one regulator, things turned out differently. He acknowledges that it has been very challenging to achieve a best structure for financial regulation as there are many options, and he notes that South Africa has chosen the Twin Peaks approach as adopted by the Netherlands and Australia, as well as more recently the UK.[24]

As Australia was one of the first countries to adopt the Twin Peaks model of financial regulation, I have chosen to compare their structure and experience with the South African model. I will attempt to compare by way of analysis the similarities and differences in the prudential regulation regime under the Australian and proposed South African models therein. I will conclude with a view on the value proposition inherent in these regulations and its underlying benefit to our banking sector and, in particular, systemic risk mitigation from a prudential perspective.

[17] Llewellyn "The Institutional Structure of Regulatory Agencies", How Countries Supervise their Banks, Insurers and Securities Markets 1999 11 17.
[18] Financial Services Board Act 97 of 1990.
[19] Honourable Minister Pravin Gordhan in his 2011 Budget speech, as per the National Treasury media statement, website: http//www.treasury.gov.za.
[20] (n 19).
[21] Financial Sector Regulation Bill, 2013, "Draft for Publication v12", (proposed section 75) 11 December 2013. Regulation Gazette No. 10082.
[22] Cameron News24.com. 31 August 2014.
[23] Financial Services Board (FSB) Deputy Executive Officer-Insurance Division, quoted by Judy Gilmour, Financial Services, moneyweb article, 2014's Twin peaks, http://www.moneyweb.co.za/moneyweb-financial/2014s-twin-peaks, message delivered at CFA/IASSA event hosted by Merill Lynch 2014/11/25.
[24] (n 23).

2. The Global Regulatory reaction to the Financial Crisis and the Status of its Prudential Regulation

The recent global financial crisis has been the most catastrophic, as its impact had been felt in all developed economies around the world. It has also proven that any regulatory reform or design to create effective and flexible corporate governance rules, principles and norms both in the financial as well as real economies has become a global policy imperative so as to prevent its recurrence.[25] US President Barack Obama emphatically called for a 'new era of responsibility', whilst British prime minister Gordon Brown called for moral restraint within financial centres and the Australian prime minister Kevin Rudd called the crisis 'extreme capitalism'.[26] In his remarks on the conflicts at play during the crisis, president Obama stated as follows:

"There's always been a tension between those who place their faith in the invisible hand of the marketplace and those who place more trust in the guiding hand of the government – and that tension isn't a bad thing. It gives rise to healthy debates and creates a dynamism that makes it possible for us to adapt and grow. In many ways, our financial system reflects us. We see the capacity for innovations that make our economy stronger – and innovations that exploit our economy's weaknesses. We are called upon to put in place those reforms that allow our best qualities to flourish – while keeping those worst traits in check. We're called upon to recognize that the free market is the most powerful generative force for our prosperity – but it is not a free license to ignore the consequences of our actions."[27]

These remarks are directed at the conflict between a public law regulatory concept of corporate law and a private law internal perspective on the other hand. Whereas the one seeks to enhance and promote social and political values, the other is concerned solely with techniques to improve shareholder wealth maximization.[28] It is this need to balance such interests which in many respects led to the regulatory authorities relaxing their supervisory powers by allowing financial institutions to innovate for shareholder wealth, the circumstances of which largely contributed to the financial crisis. I am of the view that it is this so-called 'light-handed' approach by the regulators in the interest of market growth which overshadowed the role of effective regulation. Hence the President's call for governments to step in and put in place regulatory reforms.

O'Brien suggests that having taken into account specific national factors, it becomes apparent that three global phenomena were at play during the crisis: "flawed governance mechanisms, including remuneration incentives skewed in favour of short-term profit-taking and leverage; flawed models of financing, including in particular the dominant, originate-and-distribute model of securitisation, which promoted a moral hazard-culture; and regulatory structures predicated on micro-institutional risk reduction which created incentives for capital arbitrage and paid insufficient attention to systemic macro-credit risk." He argues that it is these financial innovative structures that were aimed purely at economic profit and which in the process trumped security.[29]

[25] O' Brien, "The Future of Financial Regulation: Enhancing Integrity through Design", 2010 *Sydney Law Review* 63.
[26] President Barack Obama 'Inaugural Address' (Speech delivered at West Front, Us Capitol, Washington DC, 20 January 2009); Gordon Brown 'The Global Economy' (Speech delivered at the Reuters Building London).
[27] President Barack Obama 'Remarks by the President on 21st Century Financial Regulatory Reform' (Speech delivered at Press Conference White House, Washington DC, 17 June 2009).
[28] Millon 'Theories of the Corporation' 1990 *Duke Law Journal* 201 202.
[29] O' Brien (n 25) 67.

Hence it is clear that one of the major causes of the global financial crisis was the expansive and often reckless risk taking in pursuance of excess profit making by such market participants. Roger Bootle, a London based economist,[30] noted that financial markets became "too big, too greedy, too easily drawn to the fabrication of illusory wealth, and too focused on the distribution of the proceeds, rather than on the financing of wealth creation". There was a serious lack of confidence in accountability processes created by and required of key participants in the financial markets during this period. This shows a lack of proper responsibility and accountability around corporate governance in such financial institutions which was purely aimed at profit-making.

The world's banks were at the centre stage of the global financial crisis with its root cause being in a global and US housing bubble driven by low interest rates in developed economies and a low culture of saving in emerging countries.[31] It is argued that financial markets acted as conduits or transmission channels for the crisis, spreading like a 'virus globally infecting' financial and credit markets the world over.[32] The over-the- counter (OTC) derivatives as specially packaged financial instruments served to highlight the importance of having in place both a robust and responsive regulatory frameworks. These OTC instruments had been largely unregulated and inadequately supervised which contributed immensely to the crisis.[33]

The so-called 'shadow banking' sector with its innovative and structured products such as the OTC instruments also played a central role in the events leading up to the crisis as it operated in parallel with the traditional financial markets. The shadow banking sector which was largely unregulated and less supervised potentially caused systemic risk throughout the domestic and international financial markets.[34] The former treasury secretary Henry M. Paulson[35] suggested that the regulatory framework in the US had become outdated and was unable to keep pace with the changes in the financial markets (shadow banking) indicating that the markets had been driven by global excesses and regulatory shortcomings and concluded "inside and outside the traditional banking system, financial institutions overreached, financial services misused and financial products were isunderstood. In addition, our regulatory system was balkanized, outdated and lacked the infrastructure to oversee these markets."[36]

[30] Bootle, The Trouble with Markets: Saving capitalism from itself (2009) 239, Australian Financial Review (Sydney), 14 January 2009, at 38 Bootle quoted Australian Future Fund chairperson David Murray who commented: "Everybody got carried away by the concept of a 'millionaire's factory' which was not culturally good. Where you don't want your brightest, or at least too many of them, is in jobs which spend time interpreting or arbitraging rules. This is really not effective work and a lot of investment banking is that type of deal structuring, which is not very constructive. It produces over-engineered stuff that is the first to break when anything goes wrong.".

[31] Ciro, The Global Financial Crisis, 2012, "Financial Markets and the GFC", Chapter 4, 75.

[32] Ciro (n 31) 75.

[33] Ciro (n 31) 75.

[34] Ciro (n 31) 85 The Financial Crisis Inquiry Commission (2011) also concluded "that the shadow banking system contributed to the systemic risk now confronting the entire global financial market. According to the Commission, the shadow banking system was "very fragile due to high leverage, short-term funding, risk assets, and inadequate liquidity". It confirmed the interconnectedness of the shadow banking system with the traditional financial markets. According to the Commission when the sub-prime mortgage market collapsed, other financial markets reacted adversely by cutting off the availability of short-term funds, including commercial paper and repo lending markets. They also concluded that banking supervisors failed to adequately and proactively identify and police the weaknesses of the banks and thrifts. In this regard The Federal Reserve realised far too late the systemic danger inherent in the interconnections of unregulated over-the-counter (OTC) derivatives market and did not have the information to act."

[35] Paulson Jr (Testimony before the Financial Crisis inquiry Commission, 6 May 2010) 3.

[36] (n 38).

2.1 The International Monetary Fund Reaction

Following the global financial crisis the International Monetary Fund (IMF) in 2008 undertook an investigation on the relationship between the financial markets, the global financial crisis and the subsequent global recession and made the following conclusions:[37]

"(a) Recessions which are accompanied by severe financial turmoil often are more protracted and deeper compared with other economic downturns;

(b) There is a stronger likelihood that a downturn or recession will accompany an episode of financial turmoil if house prices and aggregate credit rise in the period immediately preceding the downturn;

(c) Countries which have more open financial systems are generally more vulnerable to sharper contractions in global growth because their financial systems are more procyclical, with their innovations in financial instruments and financial markets. Conversely, countries with less open financial systems are less vulnerable to global economic downturns because their banking sector is less procyclical in respect of financial innovation;

(d) Countries with strong financial stability frameworks can help alleviate economic downturns through clear policy direction designed to strengthen and restore the capital bases of financial intermediaries, including banks, broker-dealers, hedge funds, investment banks and mortgage originators;

(e) The relationship of asset prices and aggregate credit in the United States during the current crisis appears to replicate previous episodes that were later followed by recessions."

The above conclusions reached by the IMF suggests that the current crisis had its root cause in the US sub-prime mortgage and global housing boom which escalated unprecendentedly to a credit and liquidity crisis in the world's financial markets, leading further to a dislocation of the wholesale interbank lending markets.[38]

One of the main drivers of the financial turmoil was the function of illiquidity, in which commercial bank liquidity had been used up far down during the unfolding crisis.[39] Goodhart argues that what is needed is for banks to be incentivised to hold more liquid assets in good times so that they can be used in bad times. He suggests that what is required are 'contra cyclical control' mechanisms, which are instruments that allow the monetary regulatory authorities to effectively do something about fluctuations in liquidity conditions.[40]

Delimatsis[41] concludes "With the benefit of hindsight, financial markets and institutions proved to be much more fragile to shocks than regulators and supervisors expected. Financial innovation was accused of having played a decisive role in the recent financial turmoil. In the wake of the crisis and after the adoption of generous rescue packages and liquidity facilities by several governments, a coordinated effort is being made to revise prudential standards, both at the micro- and macro-prudential level.

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[37] International Monetary Fund 2008 (World Economic Outlook. Financial Stress, Downturns, and Recoveries. IMF World Economic and Financial Surveys), 130-131.

[38] Ciro (n 31) 76.

[39] Goodhart (n 40) 52.

[40] Goodhart (n 40) 144, concludes "…the onus for the root-and-branch reform will fall on the form of capital adequacy requirements and they will have to be changed so that they become strictly countercyclical rather than procyclical at present.".

[41] Delimatsis, "Financial Innovation and Prudential Regulation: The New Basel III Rules" Journal of World Trade vol. 46 No.6 (2012) 1309-1342.

In these efforts, governments appear to follow the rules promulgated within the Basel Committee on Banking Supervision (BCBS)." The crisis exposed several shortcomings and failures in prudential regulation as well as the supervision of the financial markets. This exposure in my view could be put down to the so-called 'light handedness' in monitoring and supervision in the interest of encouraging business rather than stifling its growth. Unfortunately business innovation and growth seldom operates within confined parameters, the consequence of which if left unregulated and unsupervised could prove detrimental to the clients, the economy, and the country as a whole. It is these types of business strategies and inactions by the regulators which contributed to the financial crisis.

2.2 The G-20 Countries reaction

The composition of the G-20 countries was: the G7 countries (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States), plus Argentina, Australia, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey and the European Union. In addition representatives of the IMF and World Bank also participate in the G-20 meetings on an ex-offico basis.[42]

The G-20 mandate was stated as "an informal forum that promotes open and constructive discussion between industrial and emerging-market countries on key issues related to global economic stability."[43] In 2008 the representation at the G-20 changed from the finance ministers to the leaders of the countries thereby also enhancing its mandate and international cooperation.

At its first meeting, the leaders of the G-20 countries gathered at Washington D.C. under the invitation of the then president of the US, president Bush. It was themed the 'Summit on Financial Markets and the World Economy'[44] and the G-20 leaders declared that they were determined to enhance their cooperation and work together to restore global growth and achieve needed reforms in the world's financial systems. I have set out below selected parts of this declaration[45] which sums up the G-20 nations understanding of the global financial crisis as well as the need for urgent reform for the overall global economy and financial markets. They concluded amongst others as follows:

"(a) Root Causes of the Current Crisis – they identified amongst others that market participants in seeking higher profits did so without exercising proper due diligence of the risks, weak underwriting standards, unsound risk management practices, increasingly complex and opaque financial products, and excessive leverage combined to create huge vulnerabilities in the system. Policy-makers, regulators and supervisors, did not adequately appreciate and address the risks building up in financial markets nor keep pace with financial innovation. Underlying factors were inconsistent and insufficiently coordinated macroeconomic policies, inadequate structural reforms, which led to unsustainable global macroeconomic outcomes which ultimately resulted in severe market disruption;

[42] G-20, The Group of Twenty: A History (2008) available at http://www.g20.utoronto.ca/g20history.pdf.
[43] G-20, About G-20, http://www.g20.org/about_what_is_g20.aspx.
[44] The G-20 meeting on 15 November 2008, Washington Declaration, www.whitehouse.gov/news/releases/2008/11/20081115-1.html.
[45] (n 44).

(b) Common Principles for Reform of Financial Markets – implement reforms that will strengthen financial markets and regulatory regimes by committing to implementing policies consistent with the following common principles for reform;[46](1) Strengthening Transparency and Accountability- requiring disclosure on complex financial products; (2) Enhancing Sound Regulation – pledge to strengthen our regulatory regimes, prudential oversight, and risk management, and ensure that all financial markets, products and participants are regulated or subject to oversight. Stronger credit rating agencies oversight and commit to transparent assessments of our national regulatory system; (3) Promoting Integrity in Financial Markets – commit to protect the integrity of the world's financial markets by bolstering investor and consumer protection, avoiding conflicts of interest, preventing illegal market manipulation, fraudulent activities and abuse, and protecting against illicit finance risks arising from non-cooperative jurisdictions; (4) Reinforcing International Cooperation – Regulators should as soon as possible strengthen cooperation on crisis prevention, management and resolution; (5) Reforming International Financial Institutions – committed to advancing the reform of the Bretton Woods Institutions so that they can more adequately reflect changing economic weights in the world economy in order to increase their legitimacy and effectiveness.

(d) Tasking of Minister and Experts – we instruct and request our Finance Ministers to formulate recommendations in the following specific areas;[47] (1) Mitigating against pro-cyclicality in regulatory policy; (2) Reviewing and aligning global accounting standards, particularly for complex securities in times of stress; (3) Strengthening the resilience and transparency of credit derivatives markets and reducing their systemic risks, including by improving the infrastructure of over-the-counter markets; (4) Reviewing the mandates, governance, and resource requirements of the IFIs; (5) Defining the scope of systemically important institutions and determining their appropriate regulation or oversight.

(e) Commitment to an Open Global Economy – commitment to free market principles, including the rule of law, respect for private property, open trade and investment, competitive markets and efficient, effectively regulated financial systems."

It is clear from the above Washington Declaration that the G-20 leaders broadly agreed and advocated for common principles to be adopted towards reforming the regulation of the financial markets. The declarations set forth above is what has led to the advent of enhanced financial regulatory reforms globally.

South Africa being a member of the G-20 countries is expected to align its financial regulatory reforms to address and deal with the agreed declarations mentioned above. Hence part of the South African response being its advocating for a Twin Peaks model of financial regulation. As noble as the above declarations appear to be, it remains a challenge in putting adequate measures in place to ensure effective implementation given the innovative speed of business. In my view such regulation needs to keep pace with financial innovation and strategies to remain effective.

[46] (n 44) "G-20 Washington Declaration continued".
[47] (n 44) "G-20 Washington Declaration continued".

Since the inaugural meeting of the G-20 leadership subsequent summits have all had its own action plans, recommendations and resolutions for adoption by the member countries either in the form of general commitments and partly in the form of specific actions.[48]

Such action plans, recommendations and resolutions in particular reflect the common challenges facing the global financial markets and the impact to the economies as a whole. Key topics documented at such subsequent Summits declarations included, amongst others:[49]

1. " London Summit of April 2009 – Financial Stability Board (FSB); Extended scope of regulation and oversight; Credit-rating agencies; Additional resources for the IMF;
2. Pittsburgh Summit of September 2009 – Framework for strong, sustainable and balanced growth; Strengthening the international financial regulatory system; Modernising global institutions (IMF and Multilateral Development Banks); The G-20 as the premier forum for international economic cooperation;
3. Toronto Summit of November 2010 – Securing global economic recovery; Strengthening the international financial regulatory system; Global financial safety nets; Risk of currency war;
4. Cannes Summit of November 2011 – Reform of the international monetary system to be more representative, stable and resilient; action plan for growth and jobs; Guiding the management of capital flows; Global governance; Poverty mitigation; Eurozone crisis."

No doubt, given the broad spectrum of key topics on which recommendations and resolutions were made by the G-20 leadership, this clearly points towards a global imperative in resolving the problems following the crisis. In particular, greater emphasis was given to the strengthening of the financial regulatory landscape, as this sector was the centre of the crisis. The G-20 nations leadership conceded and acknowledged that the lack of strong financial regulatory controls, insufficient checks and poor supervisory monitoring all contributed to the birth of the global financial crisis. These G-20 declarations in essence signify the international response to the global financial crisis. This response is certainly serious given the depth and values of the bail-out packages as well as losses suffered by governments and the public at large. The bold identification and acknowledgement of some of the agencies (such as the Credit Rating) that caused this crisis is a step in the right direction and putting measures to mitigate such risks is in my view a necessary imperative.

2.3 The Basel Committee mandate

The Basel Committee on Banking Supervision's (BCBS) mandate is to set primary global standards for the prudential regulation of banks and it provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability.[50]

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[48] Weber, "The Legitimacy of the G20 as a Global Financial Regulator", Banking and Finance Law Review, 2012-2013, vol.28, 389-407.

[49] Declaration G20 Leaders Summit, London-2009, online:<http://www.g20.utoronto.ca/2009/2009, Declaration G20 Leaders Summit, Pittsburgh-2009, online supra; Declaration G20 Summit Toronto-2010, online supra; Declaration G20 Summit Seoul-2010, online supra; Declaration G20 Summit Cannes-2011, online supra; Declaration G20 Summit Los Cabos, Mexico-2012, online above.

[50] Basel Committee on Banking Supervision (BCBS) Charter, January 2013, online http://www.bis.org/bcbs/charter.htm.

The BCBS was charged with the responsibility of developing and reaching agreement on new capital and liquidity standards and the Financial Stability Board (FSB) was expanded to include all G-20 members.[51] The FSB was made a permanent institution with its primary responsibility to coordinate the actions agreed by the G-20 as well as given powers to report directly to the G20 finance ministers on issues relating to regulatory reform and implementation.[52]

The new Basel III framework focuses primarily on the regulation of banks following the global financial crisis. Its primary emphasis is to establish high capital and liquidity requirements in terms of both quantity and quality to ensure that banks are better equipped to absorb losses in times similar to the global financial crisis.[53] Basel III aims to increase the loss-absorbing capacity of banks and therefore the resilience to crisis by introducing capital requirements which oblige banks to build up capital in good times, which can be used in periods of distress.[54] Basel III requires that banks maintain higher and better-quality liquid assets as well as manage their liquidity risk more effectively.

It makes proposals for more solid risk management, covering corporate governance, off-balance sheet exposures and securitisation activities or compensation practices, better supervision at times when the bank's liquidity risk management and its level of liquidity is at stake, as well as calls for stronger and effective cooperation from supervisors and central banks.[55]

S. D. Sharma[56] records that after the Summit in London in 2009 the G-20 nations agreed to "empower" the international bodies, the IMF, the Bank for International Settlements (BIS), and other "standard setting" bodies such as the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSC), The International Association of Insurance Supervisors (IAIS) and the International Accounting Standards Board (IASB). It specifically pledged $5 trillion in fiscal stimulus spending to increase funding for the IMF and other multilateral development banks by $1.1 trillion, including tripling the IMF's lending capacity to $850 billion, also increasing to transfer about 6% of the voting power in the IMF to "dynamic emerging-market and developing countries" by the end of 2012.

The financial services market is one of the most 'densely regulated' areas of any advanced economy, due largely because of the central economic role the financial system enjoys and of the development of prudential policies which pre-empt or reduce systemic risk and provide safety nets vital for a safe and sound financial system to protect consumers, investors and the markets.[57] It is argued that risk in banking is inherent and that prudential regulation, whilst not a 'panaceas', attempts at limiting and managing such risks.[58] Prudential regulation traditionally controls the entry into the banking industry and determines the regulatory and supervisory scope of banking.

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[51] (n 50) 305-306.
[52] (n 50) 305-306.
[53] BCBS, Basel III: A Global Regulatory Framework for more Resilient Banks and Banking Systems, Dec.2012 (revised June 2011).
[54] (n 53).
[55] (n 53).
[56] Sharma, Global Financial Contagion, "Building a resilient World Economy after the Subprime Crisis", 2014, 305-306.
[57] (n 50) 306.
[58] Lindgren, Garcia, and Saal, Bank Soundness and Macroeconomic Policy, (IMF) 1996 ch 9 "External Governance: Regulation and Supervision" 123-135.

‘Prudential rules refer to the financial soundness of financial service suppliers and aims to prevent the risk of suppliers not being able to meet their liabilities as they fall due.’[59] These rules aim to remedy information inadequacies and includes rules to protect consumers of financial services against financial institutions that are rapacious or incompetent.[60] One of the failures leading to the crisis was the lack of countercyclical prudential regulation and that the existing capital adequacy rules of Basel I and II were not sufficient to capture risks stemming from bank exposures to transactions and instruments such as securitisation or OTC derivatives, nor did they take into account the systemic risk.[61]

In the “de Larosiere Report” significant new changes have been made to the European financial supervision legislative environment, amongst others, the establishment of several supranational bodies, both at the micro and macro-prudential level, being the creation of the European Systemic Risk Board (ESRB), European System of Financial Supervisors (ESFS), European Supervisory Authorities (ESAs), European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).[62]

In the US the Financial Stability Oversight Council (FSOC) was established with the objective of being in charge of risk identification and management as well as effective interagency cooperation. Supervision is divided into two supervisors, the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC). The introduction of the Dodd-Frank Act requires the Fed in terms of Section 165 to impose stricter prudential standards, including capital requirements on bank holding companies with consolidated assets over USD 50 billion that pose risks on financial stability in the US. This act[63] also regulates reforms for OTC derivatives. The authorities in charge are the Securities Exchanges Commission (SEC) and the Commodity Futures Trading Commission (CFTC).

In the United Kingdom the regulators response to the financial crisis led the UK government to adopt the Twin Peaks structure of regulation. In this structure, the Financial Services Authority (FSA) was divided into the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) in 2013. It is submitted that the FSA’s ‘light-touch’ approach preceding the crisis has been replaced by much tougher, forward looking, judgement-led method of supervision of the financial sector.[64]

[59] Sharma, in Blair QC & G, Walker (eds.), Financial Services Law, at 369 (Oxford University Press 2006).
[60] (n 53).
[61] (n 59).
[62] The European Commission’s Staff Working Document, SEC(2009), 1233, Sept.23, 2009 “ This structure follows the proposal of the de Larosiere Report of transforming the Lamfalussy level 3 Committees into European authorities with increased powers.”.
[63] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.
[64] Michael The “Twin Peaks” Regulatory Model: “The future of Financial Regulation”, Banking Today Mar-Apr,2014 4.

This Twin Peaks model[65] was first debated whilst the UK was investigating its regulatory landscape for financial regulation, but only chose to adopt the model after the financial crisis. The other countries to adopt the Twin Peaks model of financial regulation were the Netherlands and Australia, who did so prior to the UK.

3. The Current Status of Prudential Regulation in the South African Banking industry

In the introductory section, I alluded to the status of the South African regulatory landscape, briefly setting out the establishment of the central bank (SARB) and its creation by statute.[66] The SARB's role was also reinforced and its independence confirmed by the Constitution of the Republic of South Africa.[67] The operations, being the powers and functions of the SARB are those 'customarily exercised and performed by central banks, which powers and function must be determined by an Act of Parliament and must be exercised or performed subject to the conditions prescribed in terms of that Act.'[68] Accordingly the SARB is a creature of statute with its powers and duties prescribed by the Act.[69]

The other important legislation impacting the banking industry is the Banks Act[70] which is focussed on the regulation and supervision of deposits from the general public, as well as its prudential regulation or soundness of the banks. Hence it can broadly be concluded that the SARB and Banks Acts currently dictate the prudential regulation of banks in South Africa. The keys acts[71] that directly impact the Banks in South Africa are: (1) South African Reserve Bank Act; (2) Mutual Banks Act; (3) Co-operative Banks Act; (4) The National Payments System of South Africa Act; (5) National Credit Act; (6) Financial Intelligence Centre Act; (7) Financial Advisory and Intermediary Services Act; (8) Financial Services Board Act; (9) Financial Markets Act; (10) Financial Services Laws General Amendment Act.

Given that the business of banking involves inherent risks it becomes important that such risks are controlled, managed and supervised in a prudent manner so as to ensure public confidence in the industry. Legislation is an enabler for enforcing such prudential controls, management and supervision. It is submitted that the regulatory role of the state is paramount as it has to maintain the public confidence in the functioning of the banking industry.

[65] Taylor, published a paper in 1995 titled "Twin Peaks", "a Regulatory Structure for the New Century", where he "emphasised that there are two separate aims of regulating financial institutions, the first aim is to ensure the soundness of the financial system, while the second is to protect consumers." He called these two aims "Twin Peaks" and he proposed the adoption of such model for the UK, who initially did not adopt such a model only until after the global financial crisis. In his speech in 2011 Taylor warned against adopting the twin peaks because it was fashionable and suggested that individual countries need to be careful in selecting a regulatory structure for their peculiar circumstances. He advocated such a model for the UK as "firstly the banks in the UK do not dominate the financial sector, but occupy it with other non- financial institutions and secondly the UK has a highly developed consumer protection regime."
[66] (n 10) the SARB Act.
[67] (n 14).
[68] S 225 of the Constitution.
[69] (n 10) the SARB Act.
[70] Banks Act 94 of 1990, including its regulations, and amendments.
[71] (1) 90 of 1989; (2) 124 of 1993; (3) 40 of 2007; (4) 78 of 1998; (5) 43 of 2005; (6) 38 of 2001; (7) 37 of 2002; (8) 97 of 1990; (9) 19 of 2013; (10) 45 of 2013.

Confidence in the system which amongst others, also protects against externalities and systemic risk are just as crucial. Systemic risk, is the risk of a sudden unexpected collapse of a significant portion of the financial sector so that the economic activity in the wider economy suffers, leading to contagion risk.[72]

The Registrar of Banks, appointed by the Minister of Finance is currently responsible for the regulation and supervision of Banks under the SARB's Bank Supervision Department. The mission of the supervision department is to ensure the soundness of the domestic banking system and reduce systemic risk by implementing effective and efficient international regulatory and supervisory standards as well as adopting best practice.[73] The Banks Act[74] regulates prudential regulation in South Africa, prescribing minimum capital requirements of banks, with its monitoring, supervision and control currently enforced by the SARB.

In Chapter VI of the Banks Act the prudential requirements are set out as follows;

"Section 70 deals with minimum share capital and unimpaired reserve funds (1) for the purposes of this Act "allocated capital and reserve funds" means such amount of qualifying capital and reserve funds as may be approved and assigned by the board of directors of a bank as capital and reserve funds designated to provide for the risks pertaining to the particular nature of such bank's business as contemplated in subsection (2), (2A) or (2B), as the case may be ; and "qualifying capital and reserve funds" means the net sum of capital and reserve funds required to be held by a bank, calculated and determined in accordance with the provisions of subsection (2), (2A) or (S2B), as the case may be, having regard to the nature of such bank's business."[75] This section sets out upfront the definitions of a bank's minimum share capital and unimpaired reserve funds in relation to its business activities and more importantly the prudential requirements therein.

"Section 70 (2)(a) A bank of which the business does not include trading in financial instruments shall manage its affairs in such a way that, subject to the provisions of paragraph (b), the sum of its primary and secondary capital and its primary and secondary umimpaired reserve funds in the Republic does not at any time amount to less than the greater of (i) R250 000 000 or (ii) an amount which represents a presecribed percentage of the sum of amounts calculated by multiplying the average of the amounts of such different categories of (aa) assets and (bb) other risk exposures in the conduct of its business, as may be prescribed in the regulations relating to Banks, by the risk weights, expressed as percentages, so prescribed in respect of such different categories of assets and other risk exposures."

"Section 70 (2)(b) Notwithstanding the provisions of paragraph (a), (i) the sum of the bank's primary share capital and primary unimpaired reserve funds shall, in the calculation of the aggregate amount which the bank is in terms of paragraph (a) required to maintain, be calaculated by deducting from the amount thereof such amounts as may be prescribed; and (ii) the sum of the bank's secondary capital and secondary umimpaired reserve funds shall, in the calculation of the aggregate amount which the bank is in terms of paragraph (a) required to maintain, be (aa) calculated by deducting from the amount thereof such amounts as may be prescribed;

[72] Cecilia van Zyl, Ziets Botha, Peter Skerritt, Ingrid Goodspeed, Understanding South African Financial Markets, third edition 2009, ch 2, 3, 5 and 14, 81.
[73] Schulze (n 4) 487.
[74] Ch vi s 70 to 75 (n 70).
[75] S 70(1) (n 70).

and (bb) taken into account to an amount not exceeding the sum of the bank's allocated and qualifying primary share capital and allocated and qualifying primary umimpaired reserve funds."[76] Section (2A) deals with the business of a bank which consists solely in the trading of financial instruments and to manage its affairs in a way that maintains the minimum primary and secondary capital and its primary and secondary unimpaired reserve funds and its tertiary capital in the Republic the calulations of which are linked to the prescribed regulations relating to Banks' Financial Instrument Trading and Section (2B) deals with the business of a bank which includes financial instruments and to manage its affairs in a way that maintains the minimum requirements of its primary and secondary capital and its primary and secondary unimpaired reserve funds and its tertiary capital in the Republic.[77]

"Section 70A deals with minimum capital and reserve funds in respect of a banking group and provides that "notswithstanding the provisions of section 70(2), (2A) and (2B), a controlling company shall manage its affairs in such a way that, subject to the provisions of subsection (2), the sum of the capital and reserve funds of the banking group structured under such controlling company does not at any time amount to less than the sum of the amounts of the required capital and reserve funds determined, in respect of the respective entities constituting such banking group, in accordance with the rules and regulations of the respective regulators responsible for the supervision of those entities, plus such amount as may be prescribed by the Registrar in respect of entities that are included in such banking group but are not subject to the supervision of a regulator."[78]

Section 72 deals with minimum liquid assets of a bank and provides that " a bank shall hold in the Republic liquid assets to a value which does not amount to less than the sum of amounts, calculated as prescribed percentages, but which in no instance may exceed 20 per cent, of such different categories of its liabilities as may be specified by regulation with reference to the time when such liabilities fall due or with reference to any other aspect pertaining to such liabilities. The amounts of the liquid assets and of the liabilities referred to in subsection (1) shall be calculated in such a manner and be determined at such times as may be prescribed. A bank shall not pledge or otherwise encumber any portion of the liquid assets held by it in compliance with the provisions of subsection (1): Provided that the Registrar may exempt a bank from the prohibition contained in this subsection on such conditions and to such extent and for such a period as the Registrar may determine."[79]

Section 73 deals with large exposures of a bank, controlling company, branch or branch of a bank and provides that "(a) shall not make investments with or grant loans or advances or other credit to any person, to an aggregate amount exceeding 10 per cent of such amount of its capital and reserves as may be prescribed, without first having obtained the permission of its board of directors, or of a committee appointed for such purpose (for the composition of which committee the prior written approval of the Registrar has to be obtained), to make such investments or to grant such loans, advances or other credit; and

[76] S 70(2)(a)(b) (n 70).
[77] S 70(2A)(a)(b) and (2B)(a)(b) (n 70).
[78] S 70A(1) (n 70).
[79] S 72(1)(2)(3) (n 70).

(b) shall in the event of the aggregate amount of investments, loans, advances and other credit contemplated in paragraph (a), relating to any private sector non-bank person, exceeding 800 per cent of such an amount of its capital and reserves as may be prescribed, be subject to such additional requirements as may be prescribed."[80] This section further provides that "notwithstanding anything to the contrary contained in this Act, a bank, controlling company, branch or branch of a bank (a) shall not without the prior written approval of the Registrar make an investment with or grant a loan, advance or other credit to any private sector non-bank person, which transaction, either alone or together with any previous transaction or transactions entered into by it with that private sector non-bank person, results in the bank, controlling company, branch or branch of a bank being exposed to that private sector non-bank person to an amount exceeding 25 per cent of a prescribed amount; (b) shall in such manner and on such a form as may be prescribed report to the Registrar whenever it makes an investment with or grants a loan or advance or other credit to any person other than a private sector non-bank person, which transaction, either alone or together with any previous transactions entered into by it with that other person, results in the bank, controlling company, branch or branch of a bank being exposed to that other person up to an amount exceeding 25 per cent of a prescribed amount; and (c) shall, in the event of the Registrar granting such written approval as contemplated in paragraph (a) be subject to such additional capital requirements as may be prescribed."[81]

Section 74 deals with the consequences arising from a failure or inability of a bank to comply with the prudential requirements and provides "(1) If a bank fails to comply with a provision of section 70 or 72, or is unable to comply with any such provision, it shall forthwith in writing report its failure or inability to the Registrar, stating the reasons for such failure or inability; (2) The Registrar may summarily take action under this Act against a bank referred to in subsection (1) or, if in the circumstances the Registrar deems it fit to do so, condone the failure or inability and afford the bank concerned an opportunity, subject to such conditions as the Registrar may determine, to comply with the relevant provision within a specified period; (3) irrespective of whether criminal proceedings in terms of this Act have been or may be instituted against a bank in respect of any failure or inability referred to in subsection (1), the Registrar may, subject to any condonation granted under subsection (2), by way of a written notice impose upon that bank, in respect of such failure or inability, a fine (a) in the case of any failure or inability to comply with th provisions of section 70, not exceeding one-tenth of one per cent of the amount of the shortfall for each day on which such failure or inability continues; or (b) in the case of any failure or inability to comply with the provisions of section 72, not exceeding three per cent of the amount of the shortfall; (4) A fine imposed under subsection (3) shall be paid to the Registrar within such period as may be specified in the relevant notice, and if the bank concerned fails to pay the fine within the specified period the Registrar may by way of civil action in a competent court recover from that bank the amount of the fine or any portion thereof which the Registrar may in the circumstances consider justified."[82]

Finally section 75 sets out the statutory and prescribed returns that the bank is required to file with the Registrar in order to confirm its compliance with the provisions of sections 70 and 72 and the nature and amounts of the bank's assets, liabilities and contingent liabilities.[83]

[80] S 73(1)(a)(b) (n 70).
[81] S 73(2)(a)(b)(c) (n 70).
[82] S 74(1)(2)(3)(a)(b) and (4) (n 70).
[83] S 75(1)(a)(i)(b) (n 70).

This is the current law governing the South African bank's prudential requirements which are operationalised by substantial regulations under the Banks Act which gives effect to the implementation thereof by the banks. The Reseve Bank is charged with ensuring strict and constant compliance with these regulations. Notably some of the key regulations relating to compliance with the prudential requirements are as follows;

1. The monthly return (Form BA 200) relating to a bank's credit risk the purpose of which amongst others sets out "(a) an executive summary and overview of the reporting bank's exposure to and capital requirement in respect of credit risk; (b) provide a detailed analysis of the reporting bank's exposure to credit risk, including information in respect of key credit risk parameters, counterparty credit risk and credit impairments; (c) in the case of bank that adopted the IRB '(internal risk based)' approach for the measurement of its exposure to credit risk, is to provide an analysis in respect of expected loss and credit impairments, including information in respect of any related impact on qualifying capital and reserves; (d) provide an analysis of any relevant exposure in respect of specialised lending, which exposure is subject to specified risk weights and specified risk grades; (e) provide an analysis of any other assets and their capital requirements."[84]
2. The quarterly return (Form BA210) relating to a bank's credit risk the purpose of which is to provide selected information regarding "(a) credit risk mitigation; (b) restructured credit exposure; (c) credit risk classification and related credit imparment or allowance for credit impairment raised by a bank that adopted the standardised approach for the measurement of the bank's exposure to credit risk; (d) credit concentration risk; (e) large exposure to a person; (f) exposures included on a watch list of the reporting bank in order to duly manage the said exposures due to particular circumstances that warrant more than normal attention from the reporting bank's senior management."[85]
3. The monthly return (Form BA 300) relating to a bank's liquidity risk the purpose of which is to determine "(a) at the reporting date, in respect of specified time buckets (i) the contractual mismatch between assets and liabilities; (ii) the "business-as-usual" mismatch between assets and liabilities; (iii) the bank specific stress mismatch; (b) in respect of a crisis scenario, the quantity and sources of funding available to the reporting bank; (c) in respect of funding sources, the reporting bank's potential concentration risk; (d) in respect of significant currencies, the reporting bank's exposure to foreign exchange; (e) the expected change in the bank's balance sheet."[86]
4. The monthly return (Form BA 310) relating to a bank's minimum reserve balance and liquid assets which provides "(2) A bank shall comply with the provisions of any Notice issued by the Governor of the Reserve bank under section 10A of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989), regarding the determination of the minimum reserve balance to be held with the Reserve Bank, and the provisions of regulations 8(1) and 8(2) regarding the calculation of the average daily amount of Reserve Bank notes and subsidiary coin and liquid assets held during the reporting month. In respect of the minimum liquid assets the regulations provides "(a) for the purposes of complying with the provisions of Section 72(1) of the Act, a bank shall during the period prescribed in subregulation (5) hold an average daily amount of liquid assets that shall not be less than an amount equal to 5 per cent of its liabilities as reduced as reported in item 4 column 2 of the latest monthly BA 310 furnished to the Registrar in terms of the provisions of S75(1)(a) of the Act provided that (i) the minimum amount of liquid

[84] Reg 23(2)(a)-(e).
[85] Reg 24(2)(a)-(f).
[86] Reg 26(2)(a)-(e).

assets held by a bank at the close of business on any day during the period prescribed in subregulation (5) shall not be less than an amount equal to 75 per cent of the average daily amount of liquid assets required to be held by the bank in terms of the provisions this subregulation (3); (ii) the minimum amount of liquid assets held by the bank at any time during the day shall not be less than an amount equal to 50 per cent of the average daily amount of liquid assets required to be held by the bank in terms of the provisions of this subregulation (3); (iii) at least 95 per cent of liquid assets required to be held by the bank in terms of the provisions of this subregulation (3) at the close of business on any day during the period prescribed in subregulation (5) shall be liquid assets not subject to further commitment; and (b) no foreign- currency assets, except gold coin and billion, and no instruments acquired in terms of securities lending transaction shall qualify as liquid assets."[87]

5. The daily return (Form BA 325) relating to a bank's selected risk exposure, the purpose of which is to "(a) determine on a daily basis the nature and extent of the reporting bank's exposure to and the related capital requirements in respect of (i) market risk or position risk and (ii) counterparty risk arising from positions held in the bank's trading book; (b) obtain selected liquidity related information from the banks that submit daily information in respect of their exposure to market risk; (c) obtain selected information in respect of the bank's exposure to currency risk arising from positions held in the bank's banking book and trading book."[88]
6. The six-monthly return (Form BA 400) relating to a bank's operational risk, the purpose of which is to "(a) provide a reconciliation between gross operating income reported in the form BA 120 and gross income used by a bank that adopted the basic indicator approach or standardised approach in order to calculate the bank's required amount of capital and reserve funds in respect of operational risk; (b) to calculate a bank's capital requirement in respect of operational risk."[89]
7. The monthly return (Form BA 500) relating to a bank's securitisation schemes, the purpose of which is to "(a) determine the amount of assets securitised by the reporting bank; (b) determine the required amount of capital and reserve funds of the reporting bank in respect of securitisation exposures; (c) to obtain selected information in relation to securitisation schemes, including selected information relating to the role(s) played by the reporting bank in respect of securitisation schemes. Securitisation exposures include asset-backed securities, mortgage-backed securities, credit-enhancement facilities or instruments, liquidity facilities or instruments, interest-rate swaps or currency swaps, credit-derivative instruments, refundable price discounts tranched cover, specified reserve accounts, such as a cash collateral account, which account subsequently is recorded by the relevant originating bank as an asset."[90]
8. The quarterly consolidated return (Form BA 600) relating to a bank's consolidated supervision, the purpose of which is to "(a) establish minimum standards in respect of consolidated supervision; (b) in the case of a bank, is to determine on a consolidated basis the financial condition and performance of the relevant bank, including (i) the nature and extent of (A) the bank's on-balance sheet assets and liabilities; (B) the bank's off-balance sheet items; (C) the bank's exposure to credit risk, including (i) any relevant large exposures; (ii) allowance for any relevant credit or other impairments; (iii) any relevant intragroup exposures; (iv) any relevant exposure to a connected or related person; (D) the bank's exposure to market risk; (E) the bank's exposure to operational risk; (F) the bank's exposure to currency risk;

[87] Reg 27(2)(3)(a)(i)(ii)(iii)(b).
[88] Reg 29(2)(a)(i)(ii)(b)(c).
[89] Reg 33(2)(a)(b).
[90] Reg 35(2)(a)-(c)(4)(e)(i)-(ix).

(G) the bank's deposit sources; (ii) information relating to the bank's income statement, that is, the bank's profit or loss position; (iii) the bank's capital adequacy position; (iv) the bank's liquidity position and liquidity structure; (c) in the case of a controlling company, is to determine on a consolidated basis the financial condition and performance of the relevant controlling company."[91] The information required to be reported in respect of the controlling company is similar in content to the reporting bank information under subregulation (2)(b) above.

9. The monthly return (Form BA 700) which relates to a bank's capital adequacy, which deals with the measurement of a bank's aggregate risk-weighted exposure in terms of section 70(2), 70(2A) or 70(2B) of the Act and the bank "(a) shall at the discretion of the bank, use one of the alternative methodologies specified beloe to determine, the bank's exposure to credit risk; (i) The standardised approach, using one of the alternative frameworks prescribed in regulation 23(5) read with the relevant provisions of regulations 23(6) to 23(9); (ii) Subject to the prior written approval of the Registrar and such conditions as may be specified in writing by the Registrar, the IRB approach, using one of the alternative frameworks prescribed in regulation 23(10) read with the provisions of regulations 23(11) to 23(14); (iii) Subject to the prior approval of the Registrar and such conditions as may be specified in writing by the Registrar, a combination of approaches envisaged in subparagraphs (i) and (ii) above; (b) use one of the alternative methodologies to determine the bank's exposure to counter-party risk; (c) exposure to market risk; (d) exposure to operational risk."[92]

10. The regulation dealing with the process of corporate governance of a bank which provides that "(1) The board of directors of a bank is ultimately responsible for ensuring that an adequate and effective process of corporate governance, which is consistent with the nature, complexity and risk inherent in the bank's on-balance sheet and off-balance sheet activities and that responds to changes in the bank's environment and conditions, is established and maintained, provided that the board of directors may appoint supporting committees to assist it with its responsibilities; (2) the process of corporate governance includes the maintenance of effective risk management and capital management by a bank; (3) The conduct of the business of a bank entails management of risks which may include, amongst others, the following types of risk; (a) capital risk; (b) compliance risk; (c) concentration risk; (d) counterparty risk: (e) credit risk; (f) currency risk; (g) equity risk arising from positions held in a bank's banking book; (h) interest-rate risk; (i) liquidity risk; (j) market risk (position risk) in respect of positions held in the bank's trading book; (k) operational risk; (l) reputational risk; (m) risk relating to procyclicality; (n) solvency risk; (o) technological risk; (p) translation risk; (q) any other risk regarded material by the bank; (4) In order to achieve the objective relating to the maintenance of effective risk management, every bank shall have in place comprehensive risk-management processes and board-approved policies, and procedures (a) to identify; (b) to measure; (c) to monitor; (d) to control; and (e) to report, amongst other things, the risks referred to in subregulation (3); (5) As a minimum, the risk-management processes, policies and procedures (a) shall be adequate for the size and nature of the activities of the bank, including the bank's activities relating to risk mitigation and exposure to counterparty credit risk, and shall periodically be adjusted in the light of the changing risk profile of the bank, and external market development; (b) aligned with the business strategy of the reporting bank; (c) shall duly specify relevant limits and allocated capital relating to the bank's various risk exposures;

[91] Reg 36(2)(a)(b)(i)-(iv)(c).
[92] Reg 38(2)(a)(i)(ii)(iii)(b)-(d).

(c) shall be sufficiently robust (i) to ensure that the bank raises appropriate and timely credit impairments and maintains adequate allowances or reserves for potential losses in respect of its loans or advances; (ii) to identify and manage material interrelationships between the bank's relevant risk exposures; (iii) to ensure the bank's continued compliance with the relevant documented set of internal policies, controls and procedures; (e) shall in the case of the bank's exposure to counterparty credit risk (i) duly take into account the market risk, liquidity risk, legal risk, and operational risk normally associated with counterparty credit risk; (ii) ensure that the bank (A) duly takes intop account the creditworthiness of all relevant counterparties; (B) duly takes into account any relevant settlement and pre-settlement risk; (C) continuously monitors the utilisation of credit lines; (D) measures its current exposure gross and net of collateral in all relevant cases including in the case of margin lending; (E) manages all relevant risk exposures at a counterparty and bank-wide level;"[93]

It is clear, given the detail in the regulations set out above, that banks are indeed required to comply with stringent prudential requirements. The make-up of such prudential requirements given the business of a bank, are substantial and has to be very comprehensive so as to adequately ensure compliance with the law herein. Its is clear that the business of the bank involves various risk types which require stringent laws, regulations, rules etc to amongst others protect the public at large, the economy of any country and the industry as a whole. The laws governing prudential regulation essentially details the financial stability, soundness and financial economical strength of a bank.

In the case of *Registrar of Banks v New Republic Bank Limited*, Hurt J[94] in a matter involving the curatorship and subsequent application for the winding up of the bank, noted as follows "The prudential requirements are, as the Registrar himself indicates in his founding affidavit, aimed at facilitating the supervision and ensuring the financial health of a bank in the day to day operation of its business. The institution of curatorship presupposes that a bank is not in good financial health and that it requires much more intense and direct supervision than would ordinarily be necessary." The judge noted that prudential regulation dealt specifically with the soundness of the ban's finances and in this respect allured to the fact that part of a curatorship role of the Reserve Bank is to cure the instable financial health of an ailing bank rather than liquidate same, especially if there are chances of restoring the bank to its former financial standing. These remarks were made as an affirmation of the bank's prudential role and its need for stronger supervisory intervention during the curatorship of a bank.

The principles of Basel II were adopted in South Africa since 2008, through amendments to the Banks Act.[95] The Bank for International Settlement (BIS), also included in the Basel framework under the Basel Capital Accord, is responsible for issuing guidelines for minimum bank capital adequacy and liquidity ratios.

Kokkinis[96] argues that as capital adequacy is an important component of prudential regulation "there is, in my view an intrinsic link between sound bank governance and capital adequacy that results in the former being a necessary prerequisite for any capital adequacy regulation regime to be effective and efficient."

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[93] Reg 39(1)-(5).
[94] 1999 2 All SA 459 (D) 22; Also *Apha Bank BPK en Andere v Registrateur van Banke en Andere* 1996 1 SA 330.
[95] Banks Amendment Act 20 of 2007.
[96] Kokkinis (n 2) 619.

One of the BIS guidelines under Basel II requires banks to maintain a certain level of capital against risk-weighted assets ie banks are required to maintain capital equivalent to 8 per cent of their risk-weighted assets, half of whichneed sto be tier 1 capital.[97] The South African banks tend to exceed the prescribed minimum ratios, thereby making the industry fairly well capitalised.

Prudential regulation is intended to embrace and enforce such BIS guidelines for the industry as part of its responsibilities to protect depositor's funds, minimise the possibility of systemic risk and encourage prudential behaviour in banks given their mismatch of assets and liabilities.

The Banks Supervision Department is currently charged with dispensing prudential regulation in the banking industry. In doing so it is obliged in terms of its prudential requirements to monitor various risk factors, including market risk, credit risk, liquidity risk and operational risk through the use of various risk assessment models.

Such risk assessment must include compliance and legal risk, which is now a requirement globally. Compliance with laws and other rules must be monitored by the regulator and in this regard banks are required to appoint a compliance officer who reports to senior management and submits compliance reports directly to the regulator.[98]

These measures aim to prevent breaches of the law, as well as assist in the detection of breaches that will be subject to enforcement action by the regulators. Ethical conduct is another important phenomenon that has become prominent during the global financial crisis and its lack of enforcement is a serious concern. Hence the regulatory reforms aim amongst others, to enhance ethical standards globally.

The government has realised that the fragmentation of the regulatory structure in South Africa may be affecting its proper functioning and effectiveness. A joint task team, comprising members from the SARB and the National Treasury, had been formed to review the existing financial regulatory environment, and to recommend the most appropriate institutional framework for effective financial regulatory functioning in South Africa.

The brief of this task team was to research regulatory best practice and prepare a position paper to guide policy formulation by the government. This task team was referred to as the Financial Regulatory Reform Steering Committee (FRRSC).[99]

The regulatory structure in the South African financial markets is largely fragmented because different sections of the financial markets are regulated by different institutions, often creating duplication and mismatches in effective regulation. Banks are regulated by SARB, whilst non-banks are regulated by the FSB independently, but both report and are accountable to the Ministry of Finance. The regulatory duties and powers of some industries are also split horizontally since functions are delegated to associations or self-regulatory organizations.

[97] Basel II para 40, Basel Committee on Banking Regulation, International Convergence of Capital Measurement and Capital Standards (2006) Part IV B Guiding Principles (Basel II). http://www.bis.org/publ/bcbs 128.htm.

[98] S 60A Compliance function (n 70).

[99] The task team is co-chaired by the Deputy Governor of the SARB, Deputy Director-General: Tax and Financial Sector Policy of the National Treasury and the Chief Executive Officer of the FSB.

3.1 The Background, Development and Reason for the proposed Twin Peaks model of Financial Regulation in South Africa

Since the advent of democracy the South Africa in many ways became a conformist member of the global economy, including mainly its membership in the G-20 nations, as well as its membership in BRICS (Brazil, Russia, India, and China).[100]

Its involvement with such global bodies meant that it has had to also deal with regulatory gaps following the global financial crisis and the G-20 declarations and recommendations in response thereto.[101] The then minister of finance, honourable Pravin Gordhan following the publication of the original policy document "A safer financial sector to serve South Africa better", stated as follows:

"Through our participation in multilateral institutions and forums such as the IMF, the G-20, the Financial Stability Board, the Basel Committee on Bank Supervision, the International Organisation of Securities Commissions, and the international Association of Insurance Supervisors, South Africa has committed itself to implement higher global financial standards to make the financial sector safer and better."[102] It is these words uttered by the minister of finance which prompted South Africa's financial regulatory reform measures to align with its global counterparts and commit to best practice. The Financial Regulatory Reform Steering Committee[103] published a comprehensive road map for implementing a twin peaks model of financial regulation in South Africa.[104]

The Twin Peaks approach entails creating a prudential regulator housed in the SARB, and transforming the FSB into a dedicated Market Conduct Regulator. The objective of the prudential regulator will be to maintain and enhance the safety and soundness of regulated financial institutions. Prudential safety and soundness imply the continued financial health of regulated institutions. The Market Conduct Regulator's objective will be to protect consumers of financial services and promote confidence in the South African financial system. Underlying the twin peaks regulatory system will be the strengthening of the macro-prudential supervision system, by enhancing the SARB's powers to promote financial stability and empowering it to become the systemic regulator, supervising and monitoring the system-wide risks caused by the financial system. It is envisaged that the SARB's bank supervision department will be dissolved and replaced by the Prudential Authority.

The SARB will be allocated new powers with respect to financial markets infrastructure such as exchanges, clearing houses, insurance companies and the central securities depository (Strate Ltd). "A strong, sustainable and inclusive financial sector is one of South Africa's key strengths. The above reforms will be complemented by on-going modifications to make the financial sector more accessible to poor households. These reforms will ensure that our system continues to be amongst the best regulated in the world."[105]

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[100] Boulle "Rebuilding state systems post-GFC: the South African case" ch 3, Globalisation, the Global Financial Crisis and the State, Farrar JH and Mayes DG (2013) 42-67.
[101] Boulle (n 100) 58-59.
[102] (n 19).
[103] (n 82).
[104] FRRSC Published proposals for implementing the Twin Peaks model of financial regulation for public comment, 1 February 2013, website:http//www.treasury.gov.za.
[105] Media statement issued by National Treasury, 1 February 2013, website:http//www.treasury.gov.za.

The above media statement in essence underlines the government's resolve to work towards the implementation of the twin peaks model of financial regulation.

Jonathan Dixon[106] states that Twin Peaks is designed to streamline interaction between the regulators and the financial services industry, with a more functional approach to regulation and supervision replacing the current industry silo-based approach. He points out that the reason the reform is necessary for South Africa is its two main objectives being, firstly to strengthen South Africa's approach to consumer protection and market conduct in financial services and secondly to create a more resilient and stable financial system. The other main reason for the Twin Peaks model is that South Africa has businesses which are regarded as large conglomerates having both banking and insurance products intertwined in its systems thereby making its regulatory supervision and monitoring tasks challenging. He confirms that the Financial Sector Regulation Bill being the underlying statute to introduce twin peaks has been published and public comments have already been received.[107]

Another reason put forward by the FRRSC for proposing the twin peaks model is that in their investigation they ascertained that since 2008 a number of influential think tanks, practitioners and academics have argued for a wider adoption of the twin peaks model.[108] In this regard Australia has adopted this model, whilst the Netherlands, UK and USA also have similar models.

3.2 The New Financial Sector Regulation Bill, its Purpose and Objectives of Prudential Regulation

The preamble to the Financial Sector Regulation Bill provides as follows:

"To establish regulatory authorities for the purposes of strengthening financial stability and the fair treatment of financial customers in the interest of a safer financial sector; to establish and provide for the Financial Stability Oversight Committee, the Prudential Authority, and the Market Conduct Authority; to provide for co-operation between the regulatory authorities, including co-operation in rule making; to provide for co-operation between regulatory authorities and other financial regulators; to promote the maintenance of financial stability; to provide for the management and mitigation of financial crisis; provide for administrative penalties; to provide for the establishment of the Financial Services Tribunal to hear appeals; to provide for regulations and codes of good practice; to provide for transitional provisions; and to provide for matters connected therewith."[109]

The purpose of the Act[110] is to "(1) promote a financial system that works in the interests of financial customers, and supports balanced and sustainable economic growth in the Republic, by establishing, in conjunction with regulatory laws, a supervisory and regulatory framework that promotes (a) financial stability; (b) the safety and soundness of financial institutions; (c) the fair treatment and protection of financial customers; (d) confidence in the financial system;

[106] Chairman, Twin Peaks Implementation Committee at the FSB, "Twin Peaks legislation nears its final stages".
[107] (n 106).
[108] G30 Report on the Structure of Supervision (2009) available at http://www.group30.org/rpt.
[109] (n 21).
[110] S 3(1)(a)-(f) and 3(2)(a)-(c).

(e) financial inclusion; and (f) the integrity of the financial system and the prevention of financial crime; (2) the supervisory and regulatory framework established in terms of this Act and the regulatory laws must ensure that (a) an institution can only operate as a financial institution with an appropriate valid license, permission or authorisation; (b) persons in positions of significant responsibility in a financial institution, or interacting with financial customers, must be fit and proper persons; and (c) all financial institutions are subject to regulation and supervision."

In the bill's objectives and scope of responsibilities in respect of the Prudential Authority[111] provides that "(1) The objective of the Prudential Authority is to promote and enhance the safety and soundness of financial institutions carrying out dual-regulated activities; (2) The Prudential Authority is responsible for the regulation and supervision, in conjunction with the Market Conduct Authority, of all financial institutions carrying out dual-regulated activities, solely with respect to their safety and soundness; (3) The Prudential Authority is the lead regulatory authority as described in section 55 in relation to financial institutions carrying out dual-regulated activities."

The prudential regulator's role will be wholly developed, managed, controlled, supervised and regulated by the Reserve Bank. In dispensing with some of its regulatory functions the prudential regulator may be obliged to enter into a memorandum of understanding with other regulators to ensure co-operation therein.

The bill also provides for the establishment of the Council of Financial Regulators, with both the Prudential Authority and Financial Sector Conduct Authority having representation thereon.[112] The bill further provides for the minister to make regulations to facilitate the effective and practical implementation of the provisions of the bill when it becomes an Act.[113] In particular such regulations will deal with what "must or may be prescribed in terms of a provision of this Act, relating to the implementation of targeted financial sanctions arising from resolutions of the United Nations Security Council, and to provide for other procedural or administrative matters that are necessary to give effect to the provisions of this Act."[114]

The bill in addition makes provision for the Minister to prescribe codes of good practice, including codes " (a) for market conduct practices to protect households from over-indebtedness; (b) to protect deposits held in trust or fidelity funds for any reason; or (c) to require financial institutions to comply with internationally-accepted standards on anti-money laundering and corruption."[115]

3.3 The Reserve Bank's Role as the New Prudential Regulator under the Twin Peaks model

The prudential regulator's internal governance model will be based on the current Reserve Bank's governance system. Its board, which includes independent non-executive external members, will have administrative oversight over matters such as budgets, remuneration, risk management, audit and performance management. The prudential regulator will operate within the control of the Reserve Bank, with departments that will report to a deputy governor of the Reserve Bank.

[111] S 13(1)-(3). Also see s 1 interpretation on "dual-regulated activity" means business of the nature contemplated in part 2 of Schedule 2", as may be prescribed.
[112] S 56.
[113] S 92 (1).
[114] S 92 (1)(a)-(c).
[115] S 92 (2)(a)-(c).

The sections in the bill dealing with the management and administration of the Prudential Authority[116] provides "(1) The Reserve Bank is responsible for the oversight, effective functioning and administration of the Prudential Authority as contemplated in section 33(2). (2) The Prudential Authority is managed by a Chief Executive officer under the oversight and direction of a Management Oversight Committee. (3) The Chief Executive Officer must be a Deputy Governor of the Reserve Bank, designated by the Governor in consultation with the Minister. (4) The Management Oversight Committee consists of the (a) Governor, who is the Chairperson of the Management Oversight Committee; (b) Chief Executive Officer; and (c) other Deputy Governors of the Reserve Bank."

It is submitted that placing the prudential regulator function within the Bank will support the efficient, effective and continual information-sharing that is key to the financial stability mandate. This will help to facilitate coordination with other relevant authorities in the event of a crisis. The prudential regulator will be accountable to the SARB and will also provide information as well as interact regularly with the minister of finance on regulatory and supervisory matters, and provide a report annually to parliament. In this regard part 5 of the bill relating to administrative matters and in particular general administrative powers provides "(2)(a) The Reserve Bank is responsible for administratively managing the affairs and funds of the Prudential Authority and must for that purpose provide sufficient staff, accommodation and other administrative support as may be necessary to enable the Prudential Authority to exercise its powers and perform its duties; (b) the Prudentail Authority may, for the purpose of exercising its powers and performing its duties, insure itself against any loss, damage, risk or liability which it may suffer or incur.[117]

Funding for the prudential regulator will be in line with international best practice to ensure transparency regarding the cost of supervision as well as for the protection of the regulator's independence.[118]

In this new structure the Reserve Bank will no doubt have its hands full given that it will require additional resources to capacitate its new role. It will also need to contend with the vast legislative softlaw changes and structures to fulfil its mandate. Although the intention is to phase in the twin peaks model over a two year period, this may seem unlikely given the large number of tasks anticipated for its fulfilment under the Financial Sector Regulation Bill.[119]

The Reserve Bank will be responsible for financial stability and for establishing the Financial Stability Oversight Committee[120] under Twin Peaks. The objective of this committee is to assist the Reserve Bank to maintain, protect and enhance financial stability. This section provides "(2) in pursuing its objectives, the Financial Stability Oversight Committee must, consistent with the provisions of Chapter 5 of this Act (a) continuously monitor the financial system for risks, weaknesses, disruptions, or any developments that threaten to harm or are harming financial stability, whether those risks, weaknesses or disruptions arise from structural imbalances, cyclical occurrences, failing financial institutions, contagion or any other factor; (b) determine (i) the extent and seriousness of any risk, weakness or disruption detected;

[116] Part 3 s 24(1)-(4)(a)(b)(c).
[117] S 33(2)(a)(b).
[118] (n 86).
[119] Financial Sector Regulation Bill draft publication v2, 11 December 2013, (As introduced in the National Assembly by the Minister of Finance), (proposed Section 75).
[120] Ch 2 part 1 and part 2 s 4 to 10 of the Bill.

(ii) whether that risk, weakness or disruption is of a localised or systemic nature; and (iii) whether it is casuing a potential, impending or actual financial crisis in the financial system; (c) initiate, in accordance with this Act, any action necessary to mitigate or remedy a risk, weakness or disruption detected, having due regard to the need to pursue its objective in a manner that does not unduly adversely impact the ability of the financial system to provide favourable conditions for balanced and sustainable economic growth in the Republic; (d) promptly advise the Minister of any developments or trends that may contribute to the instability of the financial system; and (e) promptly submit a recommendation to the Minster when the Financial Stability Oversight Committee identifies that a financial institution should be designated as a systemically important financial institution."[121]

The bill[122] provides that the Reserve Bank will be primarily responsible for promoting financial stability in terms of section 3 of the Reserve Bank Act. As mentioned above the Reserve Bank will be responsible for oversight, effective functioning, management and administration of the Prudential Authority. This will also entail that the Reserve Bank forms part of the Management Oversight Committee and the chief executive officer whose roles are "(1) The Management Oversight Committee is responsible for (a) approving the regulatory strategy of the Prudential Authority in terms of S15; (b) determining the decision-making policy of the Prudential Authority in terms of S31; (c) overseeing the management and administration of the Prudential Authority; (d) exercising the Prudential Authority's powers and performing the Prudential Authority's duties in relation to (i) the submission of reports and information in terms of section 39; (ii) the making of rules in terms of section 104 or joint rules in terms of section 48(1); and (iii) any other matter which the Management Oversight Committee considers it is necessary to perform; and (e) taking decisions on behalf of the Prudential Authority in relation to matters referred to in paragraphs (a) to (d); (2) The Chief Executive Officer is responsible for (a) the management and administration of the Prudential Authority; and (b) subject to subsection (1) and section 33, (i) exercising all of the Prudential Authority's powers or performing all of the Prudential Authority's duties; (ii) taking decisions in relation to matters referred to in paragraphs (a) and (b)(i); (3) in fulfilling the responsibilities in terms of subsection (2), the Chief Executive Officer must act with due regard to the strategies and policies determined by the Management Oversight Committee in terms of subsection (1).[123]

Another new invention in the bill is to provide for the management and mitigation of any financial crisis.[124] These provisions place responsibility on the Reserve Bank in its capacity as resolution authority to manage and mitigate any crisis as speedily and effectively as possible. In this regard the Reserve Bank's functions are as follows "(a) maintaining and protecting financial stability; (b) managing and mitigating the crisis with the lowest public cost, the minimum disruption to the financial system and the least negative impact on the economy; (c) ensuring continuity in the provisions of financial services by systemically important financial institutions and (d) protecting, as appropriate, the various interests of depositors, policyholders, investors and other financial customers affected by the crisis."[125]

121 S 5(2)(a)(b)(i)(ii)(iii)-(e).
122 S 4(1).
123 S 25(1)(a)-(d)(i)(ii)(iii)(e)(2)(a)(b)(i)(ii)(3).
124 Ch 5 part 2 s 62 to 68.
125 S 65(1)(2)(a)(b)(c)(d).

This section also sets out the 'powers'[126] of the Reserve Bank in crisis management with its key function to exercise its resolution powers as well as take specific actions in consultation with the Minister.

Another important provision of the Bill is the 'general co-operation between regulatory authorities' and which provides for a Memorandum of Understanding to be concluded between the regulatory authorities defining and setting out the basis for such co-operation.[127]

Accordingly the Reserve Bank is expected to play a very significant, meaningful and dominant role as prudential regulator as well as supporting the market conduct regulator within the twin peaks model. Aside from its new Prudential Authority role the Reserve Bank will still be responsible for a considerable amount of monitoring and supervision with more responsibilities, but with distinct accountabilities.

4. The Background and Adoption by Australia of the Twin Peaks model of Financial Regulation

The Reserve Bank of Australia (RBA) was the central bank charged with the prudential regulation and supervision of its financial institutions.[128] Prior to its financial reforms the RBA was responsible for prudential supervision of its banks. In this regard the RBA was required to promote sound prudential practices by requesting banks to conduct their operations in a way so as to keep themselves in a sound financial position, not to cause or promote instability in the Australian financial system, and to act with integrity, prudence and professional skill.[129]

The twin peaks model of financial regulation, was pioneered in Australia following recommendations from the Wallis Commission[130] whose recommendations led to a fundamental restructure of Australia's financial regulators in 1998, leading to the establishment of two regulatory "peaks" agencies. Under the new system prudential regulation was placed in the hands of the Australian Prudential Regulation Authority (APRA), while the responsibility for regulating the conduct of business was placed in the hands of the Australian Securities and Investments Commission (ASIC).[131]

The ASIC was given the powers to regulate market integrity and consumer protection with the objectives of promoting market fairness and consumer confidence.[132] The APRA was given the power to regulate asymmetric information problems by setting and enforcing standards of prudential behaviour on all institutions making promises in the areas of deposit taking, insurance and superannuation.

[126] S 66(1)-(5).
[127] Ch 4, part 1 s 43 and 44.
[128] Reserve Bank Act no. 4 of 1959; Banking Legislation Amendment Act no. 129 of 1989 gave wider prudential supervisory powers to the RBA.
[129] Weerasooria, "Current regulation/supervision of banks by Reserve bank of Australia" Banking Law and Financial Systems in Australia 4th edition 1996 58-70.
[130] Wallis chair of the "Wallis Inquiry" into the Deregulation of the Australian financial system in the 1980s to 1990s, held in 1996; It is recorded that this 'inquiry was not prompted by any particular failure or financial crisis in the Australian financial markets, but rather during a period of steady growth'.
[131] Wallis (n 130).
[132] Wallis (n 130).

The Australian government retained the RBA and the Australian Competition and Consumer Commission (ACCC). The RBA oversees systemic stability, largely through its influence over monetary policy, and the ACCC regulates anti-competitive behaviour. The advantage of the twin peaks model was that it created two specialised regulatory agencies with clearly defined and understandable regulatory roles as well as a division along functional lines.[133]

The 'Wallis Inquiry' recommended and concluded that the APRA should operate separately from the central bank RBA mainly because: "(1) The combination of deposit taking, insurance and superannuation regulation is unlikely to be carried out efficiently and flexibly by a central bank whose primary operational relationships are with the banks alone and whose operational skills and culture have long been focused on banking; (2) Separation will clarify that, while the central bank may still provide support to maintain financial stability, there is no implied or automatic guarantee of any financial institution or its promises in the event of insolvency; and (3) Separation enables both the RBA and APRA to focus clearly on their primary objectives and will clarify the lines of accountability and the regulatory task."[134]

Accordingly the RBA no longer has any responsibility for prudential regulation, but instead has specific responsibility for systemic stability, monetary policy, as well as the efficiency and stability of the payments system. The APRA was formed by combining the prudential regulation activities previously undertaken by the RBA, the Australian Financial Institutions Commission (AFIC) and the Insurance and Superannuation Commission (ISC).[135] It is responsible for the supervision of financial institutions which issue liabilities with a high 'intensity of promise' (a concept devised and referred to by the Wallis Inquiry) capable of causing significant market failure arising from the provision of imperfect information.[136]

The institutional structure of the regulatory sector aims to provide a clear description of each regulator's role and responsibilities as well as achieve minimal overlaps or duplication, and provide comprehensive coverage of areas requiring regulation. In this regard if there are overlaps then those are facilitated by way of an agreed and signed memorandum of understanding between such regulators. Collectively the RBA, APRA and ASIC form the Council of Financial Regulators with some cross-representation on government boards.[137]

4.1 The Australian Prudential Regulation Authority, its Mission, Supervision and Objectives

In terms of its structure under the twin peaks model, the Australian Prudential Rugulation Authority Act[138] is the governing legislation that regulates the APRA prudential sector and institutions, responsible for supervising deposit takers, insurance companies and superannuation funds.

[133] Cooper deputy chairperson ASIC, "The Integration of financial regulatory authorities – the Australian experience, paper presented to the Securities and Exchange Commission of Brazil, 30th Anniversary Conference, "Assessing the Present, Conceiving the Future" 4-5 September 2006 1-6.
[134] Wallis (n 130).
[135] Wallis (n 130).
[136] Wallis (n 130).
[137] Wallis (n 130).
[138] Australian Prudential Regulation Authority Act no. 50 of 1998 as amended.

APRA is structured as a body corporate with perpetual succession as a non-corporate Commonwealth entity, being part of the Commonwealth (not for profit entity) and with a recognisable seal of office.[139] In terms of the Act the purpose of establishing APRA provides as follows "(1) APRA exists for the following purposes (a) regulating bodies in the financial sector in accordance with other laws of the Commonwealth that provide for prudential regulation or for retirement income standards; (b) administrating the financial claims schemes provided for in the banking Act 1959 and the Insurance Act 1973; (c) developing the administrative practices and procedures to be applied in performing that regulatory role and administration; and (2) In performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and , in balancing these objectives, is to promote financial system stability in Australia."[140]

Its mission statement is 'to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by the institutions we supervise are met within a stable, efficient and competitive system'.[141]

APRA is primarily a supervisory agency and with its principal aim being to ensure that financial promises made by regulated entities are met within stable, efficient and competitive financial markets. It does so by trying to ensure that the quality of the financial institution's systems for identifying, measuring and managing the various risks in its business, including adequacy of capital risk are sound and act to reduce the risk of any failure. In this regard if failure does occur the APRA will step in to maintain public confidence in the financial system by helping the entity exit the market in an orderly and diplomatic manner.[142]

APRA has three main types of powers in regulating financial institutions: "(1) authorisation or licensing powers; (2) supervision and monitoring powers; and (3) powers to act in circumstances of financial difficulties to protect depositors, policy holders and superannuation fund members, including powers relating to taking control of entities and /or winding up insolvent entities."[143] In terms of the Act APRA's functions are the following "(a) the functions conferred on it by or under this Act or any other law of the Commonwealth; (b) the functions conferred on it by or under any law of a State or Territory in accordance with subsection 9A(1); (c) the function of providing prudential regulation or advice services under agreements entered into in accordance with S9A(2).[144]

In its policy document dealing with supervision APRA's approach is forward-looking, primarily risk-based, consultative, consistent and in line with international best practice. This approach recognises that the board and management of the regulated entities are responsible for financial soundness and prudent risk management. This approach involves identifying key risks taken by supervised institutions, ensuring that they are adequately measured, managed, monitored and assessing the adequacy of these institutions to have in place financial resources to withstand any potential losses. APRA undertakes this mission through appropriate risk analysis and supervisory actions/responses.[145]

139 S 13(1)(2).
140 S 8(1)(a)-(c)(2).
141 APRA's Objectives and Funding, http://www.apra.gov.au/CorporateInfo/APRAobjectivesfunding.pdf;
142 (n 141).
143 (n 141).
144 S 9(a)-(c) and 9A.
145 APRA, Supervision Blueprint, Public release January 2010, Section 1: "Principles and approach", http:www.apra.gov.au;

APRA's framework of prudential supervision is aimed at balancing the need to take a structured and methodical approach to implementation of APRA's requirements as against the need to maintain sufficient flexibility to respond to new and emerging risks.

This framework provides a 'baseline' level of supervisory activity which seeks to give APRA sufficient information to adequately identify and assess the key risks affecting each of the regulated institutions, as well as an objective basis to determine its risk-based priorities.[146] This framework for its supervision encompasses all activities, supporting procedures, processes, systems and guidelines that are used in forming risk assessments and supervision strategies to ensure that entities are best able to meet their financial 'promises' to beneficiaries.

The framework supports a vision which is risk-based, outcomes-focussed, principles-based and consistent with APRA's values.[147] In this regard APRA's values includes foresight (forward-looking assessments to anticipate future events for preparedness), accountability (justification for its assessments and decisions), collaboration (cooperation and consultation with other supervised institutions, experts and resources), integrity (balanced, consistent outcomes and fair supervisory actions), professionalism (activities and assessments of high quality with appropriate levels of professional judgements).[148] Its prudential framework is also meant to evolve with changes to the regulatory landscape and innovations in the industries APRA supervises, so as to continue enhancing it supervisory tools, consistent with its vision.

Consequently APRA claims to be committed to ongoing review of its supervisory activities and tools against its international regulatory counterparts to ensure that it remains in line with international best practice.[149] The main objectives of its entity risk assessment are to (1) determine the probability that a supervised institution will not meet its financial promises; (2) measure the impact of the potential consequences of not meeting those promises; (3) determine an appropriate supervisory action plan incorporating actions to address key issues identified and uses its Probability and Impact rating System (PAIRS) assessment tool to achieve same.

It also uses its Supervisory Oversight and Response System (SOARS) tool for allocating resources to key risk areas. APRA's other supervisory activities include undertaking prudential reviews (challenges and tests the effectiveness of the institutions processes and procedures which involves both on and off-site components), prudential consultations (updates on key strategic and risk issues as well as the institutions operations), entity financial analysis (financial strength, performance and emerging trends or potential issues for monitoring on an ongoing basis), other off-site analysis, ongoing interaction (meetings and providing advice to supervised institutions) and industry analysis (research and assessments of the state of supervised industry, peer group reviews), requests for approvals and interpretations (structural approvals, prudential approvals and interpretations of prudential requirements), licensing (approving qualifications for licensed institution to operate in Australia), and enforcement (maintains a separate enforcement team to undertake enforcement activities governed by an Enforcement Committee).[150]

[146] (n 145).
[147] (n 145).
[148] (n 145).
[149] (n 145).
[150] (n 145).

The regulatory standards and approach of APRA are aligned to the Basel standards of risk-weighted capital requirements, adopting "a two-tier approach to risk measurement and management (relying on agreed use of acceptable internal models for risk management and specification of a required method otherwise) and emphasis on disclosure, accountability and governance."[151] In this regard APRA in a recent self-assessment exercise against the core principles for banking supervision as prescribed by the Basel Committee, it was only non-compliant in 2 out of 25 principles. The overall impression being that internationally APRA has a relatively high degree of authority and freedom to exercise power of 'forbearance and discretion'.[152]

In the case of *X v Australian Prudential Regulation Authority*[153] were Kirby J in a majority judgement decided in favour of the APRA having criminal enforcement authority and in compliance with its legislative mandate the authority to intervene in other proceedings to investigate persons falling within its regulatory jurisdiction. In this case APRA sought to use the testimony given by two senior insurance employees of a German company based in Australia to discredit and disqualify such employees as being not fit and proper to be employed in the insurance industry. This case involved huge losses suffered by Australian investors in such insurance company, the governance and controls of which was under the management of the two German senior employees. The Court found that as APRA is an authority responsible for the administration of a law of the Commonwealth being the Insurance Act the law allows APRA to take steps in its administration thereof to investigate and place reliance certain information or in this case evidence given at the Royal Commission. The court accordingly found that APRA had jurisdiction to launch a criminal investigation to determine the fitness and qualifications of the German employees in continuing to hold office under the Insurance Act. APRA argued that it was entitled by virtue of its powers to access the German employees testimony and use same to disqualify them from practising under the Insurance Act.

4.2 Comparison of the Prudential Regulatory regime of Australia and the Proposed Prudential regime for South Africa

As mentioned above the APRA, under the Australian twins peaks model, was established in 1998 and as such its experiences and ongoing reforms have to a large extent been embedded. In this regard APRA as a regulatory entity has been developed through efforts propagated internationally for financial reform, as well as substantial internal assessment such as the Wallis inquiry.[154] The APRA system also constitutes the Australian reform efforts as part of its membership of the G-20. South Africa, to a large extent has a similar financial landscape to Australia and as such will, amongst others, look at the Australian experiences when assessing reviews of its reform.

Upon assessing the current Financial Sector Regulation Bill in comparison with the APRA system, one clearly finds many similarities, especially on the strategy and need for regulation, objectives and purposes of prudential regulation.

[151] Davis "Financial Reform in Australia" The International Handbook on Financial Reform ch1 (2003) 21.
[152] (n 145).
[153] 2007 HCA 4 611. Also *Robert Morrison v National Australia Bank Ltd 2008* American International Law Cases (2d. Cir. 2008) 1631.
[154] (n 130).

Both systems have as their priority of prudential regulation a sound and stable financial market for the protection of depositors, policyholders and pension funds. Both have a principles based and functional approach to supervision with the primary monitoring ability geared towards forward-looking analysis. Both systems are legislatively designed to describe and set up the prudential roles as specialist regulatory authorities with distinct functions, but with the ability to foster strong co-operation amongst other regulatory authorities within the financial industry.

The Financial Sector Regulation Bill makes provision for regulators co-operating with each other and more importantly entering into Memorandum of Understanding[155] contracts to entrench such working relationships. The South African peak of proposed prudential regulation appears largely in line with the Australian model. In this regard the APRA Act also makes provision for cooperation with other agencies and provides that "(1) The Parliament intends that APRA should, in performing and exercising its functions and powers, have regard to the desirability of APRA cooperating with other financial sector supervisory agencies, and with other agencies specified in regulations for the purposes of this subsection."[156] Both regulations therefore value the importance of prescribing cooperation amongst the various regulatory agencies.

The major difference in the model is the structure of the prudential regulatory authority, in that whereas Australia has created a separate functionary altogether separated from its central bank, the South African system plans to retain the prudential authority under its central bank, the Reserve bank of South Africa. This is a fundamental difference between these two countries systems.

Australia has chosen to carve out its prudential regulation under APRA, from RBA largely due to the fact that it not only regulates banks (depositors) but also regulates the insurance and pension funds industry. The Australian rationale according to the 'Wallis inquiry' was to retain the separation so as to create stronger efficiencies and flexibility given the combination of industries to be regulated. Hence the RBA only concentrates on banks.[157] APRA has been set up as a non-corporate Commonwealth body corporate with separate identity by way of a recognisable seal of office given judicial notice whereby the courts may presume that an APRA seal imprinted on a document is indeed legitimate.[158]

Under the South African proposed Financial Sector Regulation Bill, the prudential regulator will be managed and administered within the existing SARB structure.[159] In this regard unlike the RBA, the SARB will have full authority over prudential regulation in South Africa. Whilst this may not be a bad idea given that the SARB has been managing the existing prudential regulation for years, the challenge will arise when it has to take on the regulation of other financial sectors apart from banks, such as the insurance and pension sectors therein.

One of the major reasons for Australia keeping its prudential regulation separate from the central bank is that it is able to also mange, supervise and monitor other financial sectors for prudential compliance. In this regard the APRA Act defines 'prudential regulation framework law' as meaning the following Acts: "(a) this Act; (b) the Banking Act 1959; (c) the Financial Institutions Supervisory Levies Collection Act 1998; (d) the Financial Sector (Collection of Data) Act 2001; (e) the Financial Sector (Shareholdings) Act 1998; (f) the Financial Sector (Business Transfer and Group Restructure)

[155] Ch 4 Part 1 s 43 and 44 (n 21).
[156] S10A(1).
[157] (n 125).
[158] (n 139) and s 13(3).
[159] S 24 read with s33(2)(a)(b) (n 21).

Act 1999; (fa) the First Home Saver Accounts Act 2008; (g) the Insurance Act 1973; (h) the Insurance Acquisitions and Takeovers Act 1991; (i) the Life Insurance Act 1995; (j) the Medical Indemnity (Prudential Supervision and Prodcut Standards) Act 2003; (k) the Retirement Savings Account Act 1997; (l) the Superannuation Industry (Supervision) Act 1993; (m) the Superannuation (Self Managed Superannuation Funds) Taxation Act 1987; (n) any Act imposing a levy to which the Financial Institutions Supervisory Levies Collection Act 1998 applies; (o) another Act that is prescribed for the purposes of the section."[160] In the current Financial Sector Regulation Bill no definition is provided regarding the nature and extent of the envisaged regulatory framework for prudential supervision. Although the bill refers to "financial institution" means an institution or person carrying out a mono- or dual-regulated activity and 'financial service' means any service or product provided by a financial institution in performing a regulated activity, and includes any service or product corresponding to a service or product normally provided by a financial institution."[161]

The one benefit of the separation for Australia is that the public may not want to look at the APRA for automatic bail-outs, as with any central bank.[162] Whilst the SARB will have to capacitate itself operationally to create efficiencies in regulating non-bank entities, the other difference between APRA and SARB would be dual-regulated activities. The South African prudential authority will have to play dual-regulated activities from time to time, unlike the APRA.

The framework for the South Africa Financial Sector Regulation Bill appears to have many supervisory and governance rules similar to the APRA. In terms of its powers APRA's powers are "(1) APRA has power to do anything that is necessary or convenient to be done for or in connection with the performance of its functions; (2) APRA's powers include, but are not limited to the following powers: (a) the power to acquire, hold and dispose of real and personal property; (b) the power to enter into contracts; (c) the power to lease the whole or any part of land or a building for the purposes of APRA; (d) the power to occupy, use and control any land or building owned or held under lease by the Commonwealth and made available for the purposes of APRA; (e) the power to do anything incidental to any of its functions; (3) APRA may enter into contracts in its own right."[163]

Whereas in the bill the powers of the Prudential Authority are specific but rather generic applicable to the 'regulatory authorities' and provide as follows "(1) In order to achieve their objectives, the regulatory authorities must without fear, favour or prejudice, take all reasonable steps within its means at their disposal to (a) implement a regulatory system for financial institutions in accordance with this Act and the applicable regulatory laws; (b) co-operate with and support each other in pursuit of their respective objectives; (c) support the Reserve Bank in promoting, and in the event of a financial crisis implementing steps towards restoring, financial stability; (d) assist in the prevention oand combating of financial crime; (f) co-operate and interact with international counterparts in other jurisdictions; (g) actively participate in the various international regulatory, supervisory, stability and standard setting bodies; and (h) conduct, and publish, as appropriate, research concerning trends in financial services and financial markets that are relevant to the pursuit of their respective objectives; (3) A regulatory authority may do anything necessary or expedient to perform its functions, and has for this purpose (a) the powere and duties assigned to it in terms of this Act or regulatory law; and

[160] S3 "definition of prudential regulation framework law".
[161] S 1 interpretation.
[162] (n 134).
[163] S 11(1)(2)(a)-(e)(3) (n 138).

(b) such auxiliary powers as are necessary to exercise the powers and duties referred to in paragraph (a) effectively."[164] Both authorities appear to have fairly wide powers with the ability to do anything and act in the interest of their regulatory mandates. In the bill provision is also mad for the South African regulatory authorities to take part in 'international regulatory, supervisory, stability and standard setting bodies", whereas APRA does not specify such a provision. In principle, however APRA's powers are wide enough for it to participate in international engagements.

Both the Prudential Authority and APRA have dispensations allowing it to engage with the applicable minister for advice and decisions relating to any distressed entities under its supervision. In this regard the APRA Act provides "(1) APRA must advise the Minister as soon as practicable if it considers that a body regulated by APRA is in financial difficulty; (2) APRA must advise the Minister, if requested by the Minister, and may advise the Minister on its own initiative, respecting: (a) matters that would improve the financial safety and efficiency, competition, contestability or competitive neutrality of the sectors in which the bodies regulated by APRA operate; or (b) changes to, or in relation to, any prudential regulation framework law that APRA consider would overcome or assist in overcoming problems APRA has identified in the course of performing or exercising any of its functions and powers."[165]

The bill refers to recommendations by the Financial Stability Overisght Committee to the regulatory authorities and in this regard provides "(1) In performing its functions in terms of section 5(2), the Financial Oversight Committee may, when it has identified a material risk to financial stability, recommend to either or both regulatory authorities that they use their powers to give effect to specific actions, strategies or guidelines aimed at maintaining financial stability in the financial sector, including measures to ensure that a specific financial institution (a) follow a practice or carry out a specific activity; (c) refrain from following a specific practice or carrying out a specific activity; and (3)(a) If the Financial Stability Oversight Committee and a regulatory authority fail to agree on the implementation of a recommendation, the matter may be referred to the Minister for a decision; (b) The Minister must determine the procedure to be followed and the documents to be submitted for the purposes of taking a decision on the matter; 'In addition the Minister is responsible for crisis management in terms of which' (1) The Minister is at all times solely responsible for taking decisions relating to crisis management which may have an actual or potential impact on public finances, including: (a) an increase, or risk of an increase, in pu blic expenditure; (b) an increase, or risk of an increase, in actual or contingent liabilities assumed by the Government; or (c) anything that may affect the price at which Government is able to raise money in the debt markets; (2) the Minister may designate a financial institution as a systemically important financial institution."[166]

In addition both regulatory authoriyies may be guided by the applicable minister in respect of its policies and strategies as well as its priorties. In essence the administrative structure, policy framework and crisis mitigation strategy remains largely similar in content and remains to be seen whether South Africa will implement same as effectively as has been shown in Australia.

[164] S 14(1)(a)-(d)(f)-(h)(3)(a)(b).
[165] S 10(1)(2)(a)(b).
[166] S 60(1)(a)(c)(3)(a)(b) and s 64(1)(a)-(c)(2).

5. Conclusion

The recent media statement by the newly appointed Minister of Finance Honourable Nene[167], at the media briefing following the recent G-20 summit held at Brisbane Australia noted that amongst the agenda items included a session on “delivering global economic resilience (modernizing the international tax system, strengthening the financial system and IMF reform)”. The Minister stated that “they agreed that while there might be scope in some countries to still use macroeconomic policies to stimulate and support the economy, a bigger boost to growth will have to come from country specific structural reforms.”[168] This is the case with the proposed Twin peaks model for South Africa which is structured around the existing local regulatory framework in the form of the Reserve Bank unlike Australia’s separate structure regarding APRA in respect of its prudential functionary.

He further stated that with the “substantial internationalization of African banks regulatory developments and reforms it will become a driving factor for attracting foreign banks to establish subsidiaries in Africa. We must improve our regulatory environments and markets infrastructures and we should develop crisis prevention and resolutions mechanisms to continue in the ongoing improvements to our system of financial regulation.”[169]

In addition, he noted that “supervisors may need to enhance their efforts to monitor and address balance sheet mismatches, such as those arising from foreign currency funding, while balancing the costs and benefits of any associated regulatory measures. Steps should be taken to better address crisis prevention and resolution mechanisms, to strengthen existing safety nets.”[170] A major development in the Financial Sector Regulation Bill[171] is the provisions around crisis management which will no doubt require substantial regulations to ensure effective implementation and operational enforcement.

Dixon[172] explains “that Twin Peaks is well suited to South Africa because of the prominence of large financial conglomerates, with some groups housing both banking and insurance options. Also by giving the mandate of financial stability to the SARB, regulators can look holistically across the entire financial system, rather than at institutions in isolation.

Twin Peaks has a more pre-emptive anticipatory approach, and will be able to detect build-up of risks with greater foresight. The model will look all the way down the value chain to wholesale market, which includes product developers, and that its financial stability mandate will ensure that regulators look across the entire economy.”

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[167] Media Statement issued by the ministry of finance, honourable minister Nhlanhla Nene, 18 November 2014 www.treasury.gov.za.
[168] (n 167).
[169] (n 167).
[170] (n 167).
[171] S 62 to 68 (n 21).
[172] (n 23).

Ingrid Goodspeed[173] notes that the coordination of the G20 has been necessary to restore global financial stability ensure that reckless behaviour, irresponsible practices and misaligned incentives do not happen again and that the establishment of a global financial system serves the real economy. She further submits that globally increased regulation has been an inevitable result of the financial crisis. She also notes that the Twin Peaks model will improve the South African financial regulatory framework to improve the protection of consumers through market conduct that ensures a fair treatment of consumers, and improved supervisory oversight to improve disclosure of the over-the-counter derivatives market and other shadow banking products as well as reinforce stability with the revised prudential regulatory framework for insurers.
She nevertheless cautions that there will indeed be challengers for the regulators due to reluctance by financial entities to support revised policy goals, costs of compliance, complexity, the technical nature and volume of new regulations.[174]

The planned implementation of twin peaks in South Africa is not without criticism as Mtende Mhango[175] comments and states that the "choice a country makes in adopting any regulatory model will depend primarily on a careful study of the existing industry structure, consumer protection and the nature of the relevant financial markets. It will also be necessary to consider the social, economic and historical context and the capacity of the institutions responsible for implementing such measures. Measures that exclude a significant segment of society cannot be said to be reasonable."

According to Dr Michael Taylor[176] who initially emphasised the case for Twin Peaks in the UK, he suggested that before a country can adopt this model they need to be careful in selecting the right model for its peculiar circumstances. He argues that as the UK has a well-developed consumer protection regime and its banking system is not dominant but rather occupies the sector with other non-bank financial institution, twin peaks was a favourable model. It is for this reason it is argued by Mhango, that South Africa should not adopt twin peaks as its banks dominate the financial market and nor does it have a well-developed and mature consumer protection regime in place, as is the case in the UK.[177] He further asks the question "should we not be finding an African solution to an African problem when it comes to choosing an appropriate financial regulatory model?"[178]

Other critics argue that the costs of restructuring the financial regulators might outweigh the benefits, particularly since it would affect financial institutions that are already experiencing regulatory fatigue since the global crisis. It will increase the compliance costs and the need for additional staff to monitor compliance, will reduce the available resources for innovation, and for customers mean a reduction in credit offerings, trade finance and risk management services.

[173] Goodspeed chief director of the Financial Sector Development, national treasury, presentation at SAIFM, "What could the changes to the regulatory environment mean for risk and compliance" 10 September 2014.
[174] (n 173).
[175] Associate Professor University of Witwatersrand "Twin Peaks is not for SA" News24.com 06 February 2014.
[176] (n 69).
[177] (n 175).
[178] (n 175).

On the other hand there has been praises for Australia regarding their positive outcomes from having adopted the twin peaks early through the financial crisis. Professor Elizabeth Brown argues that Australia's twin peaks regulatory model helped it during the global financial crisis and records "the evidence from this examination suggests that Australia was able to avoid many of the problems that arose in the United States and the United Kingdom and this was at least partly due to its twin peaks regulatory structure"[179]

Hans Hoogevorst[180] commented that the financial crisis showed that the twin peaks model of separating prudential and securities supervision worked effectively in his country and outperformed many other European nations that has single financial regulatory authorities. He further adds "to be effective, a regulator should have a clear, focused sense of purpose. It should never be in a position where it is tempted to sacrifice the goal of transparency to prudential concerns or vice versa."

Accordingly, it is clear that financial reform is indeed an imperative given the vast amounts of regulatory fines recently imposed on major banks worldwide. These fines in essence depict the state of poor integrity and lack of moral governance within what should typically have been regarded as a highly regulated and sophisticated financial system. The lead investigator in such major financial lapses has been the US Fed and its State attorney, who have been instrumental in unpacking the complex financial innovative instruments pre-and post the financial crisis developed by financial institutions in the name of excess profits.

I note that whilst there are indeed valid concerns for the adoption of twin peaks within the South African financial landscape financial reform is a necessity, given the recent African Bank rescue which led to it being placed in curatorship by the Reserve Bank. The SARB's speedy efforts to stave off African Bank's demise must be commended. I am of the view that the transition to twin peaks will only benefit the South African public and enhance the reputation of our financial markets and its maturity.

No doubt as the minister has indicated, with South African banks becoming more global in their reach, enhanced regulation is a priority for such growth. As the gateway to Africa, South Africa must be the lead in overhauling its regulatory infrastructure as a lead example for other African banks to follow. In this instance, as is currently the state of investor confidence in South Africa, same will receive a significant boost in the adoption by our regulatory authorities of such best and international practices. It, however, remains to be seen what challengers will arise from the pratical implementation of the twin peaks model.

These challenges are indeed realistic, but given the resolve of government to push through the legislation, it remains crucial for the local financial institutions to offer their full co-operation and support to ensure its successful implementation. The Reserve bank will no doubt have to equip itself to deal with the dual-regulated financial entities and not just the banks.
It is hoped that the government's planned phased in approach to implementing the Prudential Authority regulations under twin peaks which will significantly better the chances of financial soundness and stability as well as financial market co-operation. Therefore, I am of the view that there is merit in the value proposition offered through the development, strategy and business case for the adoption of the twin peaks model of financial regulation, for all the reasons stated above.

[179] Taylor (n 68).
[180] Taylor (n 68).

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