

Free Market Foundation

Media Background Briefing Paper

Financial Services Regulation Bill (FSRB)

July 2017

Purpose of Document

This document aims to provide a background for the media to understand what is at stake, to be able to properly inform the public and other interested parties and to ask the right questions of government with regard to nature, impact, costs, effectiveness and consequences of the Twin Peaks regulatory model.

Contents:

1. The FMF's interest in FSRB & Twin Peaks
2. Headlines
3. The FSRB - What the public & media need to know
 - a. What is FSRB
 - b. What is new
 - c. Why is this an issue
 - d. What happens now
 - e. What should happen
4. Architecture of Twin Peaks
 - a. What's wrong with this?
 - b. The role of the FSB
 - c. FSB & the separation of powers & rule of law
 - d. FAIS
 - e. Anything good about the FSRB
5. Social Economic Impact Assessment - SEIA
6. Summary: FSB, FSRB & Twin Peaks
7. The way forward
8. Key questions for the media

1. Free Market Foundation (FMF) interest in FSRB & Twin Peaks

- The FMF is a policy analysis foundation primarily dedicated to (a) preventing counter-productive government intervention, taxation and spending, and (b) constitutionalism, due process and the rule of law. As such we are concerned with all new policy. We are responding to the threat to SA's financial markets including the insurance industry as a result of the Twin Peaks regulatory system being introduced by the FSRB and to be augmented by a number of other new pieces of legislation.
- The FMF is particularly concerned with the grossly inadequate Cabinet mandated Social Economic Impact Assessment (SEIA) required to precede all new policy. The analysis, which was done in the case of Twin Peaks, was wholly inadequate and misleading.

- The FMF is also concerned about whether the legislation complies with fundamental Constitution principles and adheres to the principles of the rule of law.

2. Headlines

- **FSRB (Financial Services Regulation Bill) is bad policy**
- **Urgent reconsideration is required before the President signs into law**
- On 22 June 2017, the FSRB was passed through Parliament, opposed by the DA and others.
- FSRB introduces the regulatory system called “Twin Peaks” – a system that already exists in practice but under a single peak, rather than the proposed expensive and grossly inefficient split into two.
- The Treasury and FSB have failed to give clarity on why this legislation is necessary when its stated objectives can and are being achieved under current, simpler legislation.
- Insurance has been unnecessarily lumped in with banking and other financial services
- No proper SEIA has been done – no analysis of costs v benefits
- The Twin Peaks model is predicted to be extremely harmful to SA’s financial markets
- Twin Peaks will further deter transformation, already greatly hampered by over-regulation.
- Far from increasing competition – monopoly conditions are being created
- Twin Peaks, so far, has failed to deliver in the UK
- Twin Peaks will further compound the inefficiencies and massive costs introduced by FAIS

3. What the Media & Public need to know

What is the FSR Bill?

- The FSR Bill gives effect to the decision to implement a Twin Peaks model of financial regulation. Under the Twin Peaks model, two regulators will be established – a Prudential Authority (PA) within the South African Reserve Bank and a new “market conduct” authority to be known as the “Financial Sector Conduct Authority” (FSCA). Currently both of these functions reside within the FSB (now re-styled as the “FSCA”).

What is new?

- On 22 June 2017, Parliament passed the Financial Sector Regulation Bill (FSRB). The FSRB is one of several Bills that have been circulating, including the Insurance Bill, and are part of a bureaucratic desire for more intrusive regulatory powers, which began in SA with FAIS in 2002.

Why is this an issue?

- This Bill has profound and damaging consequences for the financial services sector, in particular the insurance industry, the “handmaiden of commerce”, one of SA’s oldest, most established and most economically necessary private sector functions.

- Equally importantly, it has severe consequences for transformation, for employment and for consumers of insurance.
- This is a severe setback for SA's economy, with the impact apparently slipping under the radar – where the regulators seem to prefer it. The media and public need to take note of the contents, ask government the right questions and encourage comprehensive debate. Government needs to rethink this policy before yet another important private sector is damaged and another disastrous economic policy is adopted.

What happens now?

- The Bill will go through the National Council of Provinces – a rubber stamping exercise – before heading for the President's pen and into law.

What should happen?

- **The Bill should be sent back for redrafting for four substantial reasons:**
 - The **absence of an adequately conducted SEIA** – mandated by Cabinet as being prerequisite for all new legislation. The SEIA fails to demonstrate any financial benefits.
 - **Lack of adequate and effective public consultation** taking into account all of the cost and benefits contained in the SEIA analysis. Without a properly conducted SEIA there cannot have been a full discussion of all of the facts.
 - It is **bad policy – and will be bad law** - that does not address the need for which it is being designed, for which very adequate, simpler and less expensive regulation already exists.
 - It will further hamper transformation

4. Architecture of Twin Peaks

The issues discussed below are already regulated. What is changing is the overlay of the expensive administrative system, not the substance.

Peak 1: The Prudential Authority (PA) – The Reserve Bank

The Reserve Bank will supervise the solvency of financial institutions.

Peak 2: Market Conduct: A newly formed FSCA – Financial Services Conduct Authority – in reality, the rebranded FSB – will attempt to direct how financial services companies (largely banks and insurers) design their products and conduct their business. **It is here that the damage will be done.**

1. The Twin Peaks model will compound and exacerbate the problems and enormous waste of resources introduced in 2002 (currently R600 m pa) by the Financial Advisory and Intermediary and Services Act 37 of 2002 (FAIS), which in SA marked the beginning of a new and insidious regulatory wave in financial services. It has had profound consequences for the economy, jobs, the industry and transformation.

2. The Reserve Bank has no experience and no constitutional mandate to manage the prudential matters of insurance companies – only of banks. The FSB has little in-house experience of product design or market competition. Indeed, state agencies should not interfere in the field of competitive activity (e.g. SAA etc.). Current law is more than adequate for the protection of consumers and there is no empirical evidence to show otherwise.

The FSB talks up FAIS - why is it a failure?

- Although it was one of the few pieces of legislation to be subject to a cost benefit analysis, not one of the promised benefits have materialised and the original purpose of the legislation has been forgotten, while it has acquired an expensive life of its own.
- 15,900 independent intermediaries, mainly emerging black entrepreneurs, have been put out of business (“Debarred” or “De-registered”).
- Low-income consumers are increasingly losing contact and advice. They now have to deal with large insurance company call centres, which cannot give individual or specialist advice.
- Yet – we still don’t know why FAIS exists today since the original reason has been abandoned.

To sum up - what’s wrong with the FSRB regulatory system?

A lot!

The FSRB:

1. Will cost R4.8 bn.pa (Conservative estimate by National Treasury)
2. No evidence has been provided that any additional benefit will derive from the billions spent
3. Will create an expanding enormous regulatory bureaucracy
4. Does not provide a “new and different approach” (as FSB says) or tell us why we need one. No justification given
5. The FSB spouts vague notions of “treating the customer fairly” and “protecting the people” – none stands up to scrutiny.
6. Does not “apply a remedy” to an acknowledged “mischief” - the founding principle for all new laws
7. Contains little in the way of substantive preventative laws against a known “mischief”
8. Violates the principles of the Rule of Law and Separation of Powers (need more)
9. Introduces more expensive compliance costs
10. Means consumers will pay more
11. Stifles innovation, reduces consumer choice and access to low cost advice
12. Reduces competition – the opposite of the intention
13. Will keep small entrepreneurs out of the industry

Anything else?

Yes. The FSB (FSCA) violates the Rule of Law and Separation of Powers. It is a unitary State within the State

***This is important! These principles are being flouted in many spears of government.
This is another example.***

- The FSB violates the separation of powers because in addition to being part of government, it also has the power to legislate, with its 'regulations' amounting to substantive law.
- The FSB also has an adjudicatory function and prosecutes violations of its regulations and financial services legislation.
- The FSB then keeps the money collected through penalties, which is constitutionally unsound. Indeed, it budgets for this money every year!
- Therefore, the FSB combines the powers of the executive, Parliament, and the courts into one to become a: '**unitary state within the state**' - Prof Robert Vivian.
- The result of this is that both Parliament and the courts are increasingly being rendered redundant.

Anything good about FSRB?

No. Except perhaps for 'consultants'

- "Consultants" hired by financial services companies to manage the new compliance demands cost the industry an estimated R2 for every rand paid to the regulator* This has created a whole new industry of consultants including "compliance officers and managers" – jobs for the higher end at the expense of mainly black entrepreneurs hoping to enter the industry. Nice work – if you can get it!

5. What's a properly conducted SEIA & why is it important?

- A Social Economic Impact Assessment - SEIA - deals with the costs versus the benefits of proposed legislation.
- Since October 2015, a Cabinet resolution has been in place to the effect that all new laws and policies have to be preceded by a SEIA.
- A special unit has been created in the planning department to supervise and advise organs of state.
- SEIAs have to comply with guidelines produced by the Presidency.

FMF executive director Leon Louw, one of SA's leading experts on impact assessments and global best practice:

- *"SEIAs are not clearly a Constitutional requirement. However according to Section 33* all administrative action must be fair and reasonable. If this is applied to policy formation, it can be argued that there must be something amounting to a SEIA. It*

has been suggested in an informal counsel opinion that it would be unfair and unreasonable to adopt policies without proper consideration of costs and benefits, constitutionality, evidence and more.”

The FSB cannot rationally argue that proper industry and public consultation has taken place unless a properly conducted SEIA is carried out and full details of the analysis are publically available.

No adequate SEIA = no meaningful public consultation

6. SUMMARY: Twin Peaks Legislation - Twin Fiasco Consequences.

1. Insurance has been unnecessarily combined with other financial services sectors under the dangerous and futile legislation known as “Twin Peaks”.
2. Twin Peaks is put forward as a solution for a problem that has yet to be identified, researched, analysed or quantified. No identification in terms of the “mischief principle” has revealed the problem that this legislation is supposedly designed to fix.
3. It will cause further damage to the insurance industry, the “handmaiden of commerce”, which is fundamental to the economy and has successfully provided reliable insurance, jobs and investment for more than 200 years in SA.
4. No data exists which demonstrates the size and scope of the supposed problem in insurance.
5. Yet a radical and intrusively draconian “solution” has been proposed, which will dramatically and negatively change the nature of the insurance business for both consumers and providers.
6. Under Twin Peaks, there will be two regulatory authorities to oversee two different aspects of the financial services business: Solvency and “market conduct”.
7. The FSB will supervise market conduct and the SA Reserve Bank, solvency. These two regulators will interact with a complex array of committees in an attempt to reconcile the inevitable conflicts that will naturally arise because each has diametrically opposed objectives. This is also a duplication of costs.
8. International financial history and hard experience clearly shows that this model has not worked globally and will not work in SA. Not least because the authorities tasked with regulation do not understand the nature of the business they oversee. Therefore, all they can do is regulate harder and harder in an attempt to bring all insurance and financial business under their direct control.
9. The justification is that the global financial crisis has made this move imperative. However, an *examination of the facts show this argument to be false. There are other motivations at play. (*Details available from the FMF media office)

10. The FMF holds the view that not only are the arguments for Twin Peaks disingenuous, false and based on a different agenda, but that the proposed law is unconstitutional on several counts. This view is now also supported by a legal opinion from one of SA's leading constitutional advocates Gilbert Marcus.

The Way Forward

1. The correct approach is to apply plain common sense, to identify the problem and then pass the remedial legislation to fix it. This has not happened. There is no problem to fix.
2. Instead, the answer is always to create yet another bureaucracy via legislation.
3. A RIA (Regulatory Impact Assessment) was carried out for FAIS – feedback is needed to compare the costs and benefits of what was promised against what has happened. Available evidence shows that, after 15 years, FAIS has completely failed to achieve any of its stated objectives.
4. The additional Twin Peaks legislation should be halted until a full and proper SEIA is carried out. The costs of the legislation should be listed as should the costed benefits
5. An annual review should be submitted to Parliament showing if the costs and benefits are on target
6. The analysis should take the impact on small business of all new legislation into consideration.
7. The golden rule for financial markets regulation, which existed from 1900 to 1986, should be reinstated: one market one regulatory system. FSB should regulate both peaks.
8. Apply the rule of law: "Regulation by law, not by man"
9. The regulatory system must be brought back within the constitutional requirements
10. The Reserve Bank should focus on understanding the causes of banking failures – so far 20 banks have collapsed or nearly collapsed in recent times in SA whereas only two significant insurers have gone under, without any loss to the public. The Reserve Bank should concentrate on banks.
11. Do not try to regulate every aspect of financial services. Already insurance is highly regulated. It works - don't fix it.
12. Move away from the mind set "Appoint a regulator and all will be well". This merely creates larger and more complex bureaucracies in the attempt to deal with an unidentified problem.

13. Judiciary and laws can deal with market conduct issues. Regulators destroy companies.

7. Suggested questions for the media

1. Why is this being introduced?
2. What – and whose – purpose does it serve?
3. Who will really benefit?
4. Why do we need Twin Peaks when under FAIS the system already exists?
5. Where is the properly conducted SEIA? The existing one is clearly inadequate.
6. How can the President sign the FSRB into law without his own Cabinet’s mandated SEIA report?
7. How can there be public consultation in the absence of a properly conducted SEIA?
8. How can a Bill pass through Parliament in the absence of a properly conducted SEIA and the accompanying detailed reports and analysis? Obviously MPs do not have all the facts.
9. What is the true cost to:
 - consumers?
 - the insurance industry?
 - the economy?
10. How many people does FSB employ?
11. Why will FSB not provide sound justifications instead of sound bites and anecdotes?
12. What does “treating the customers fairly” actually mean?
13. Where is the evidence that the industry is failing the consumer? Not with the Ombudsmen!
14. Why is the FSB forcing an experimental and failing UK system on SA?
15. Who oversees the activities – and inexorable expansion – of the FSB?
16. How can the FSB justify closing the insurance sector to black entrepreneurs?
17. Instead of more competition – monopoly conditions are being created – why?
18. Why does the FSB use the global financial crisis as justification when this had nothing to do with insurance?

Ends

For more information contact the FMF media office as below

Note to the editor

The FMF is an independent, non-profit, public benefit organisation, created in 1975 by pro-free market business and civil society national bodies to work for a non-racial, free and prosperous South Africa. As a policy organisation it promotes sound economic policies and the principles of good law. As a think tank it seeks and puts forward solutions to some of the country’s most pressing problems: unemployment, poverty, growth, education, health care, electricity supply, and more. The FMF was instrumental in the post-apartheid negotiations and directly influenced the Constitutional Commission to include the property rights clause: a critical cornerstone of economic freedom.

The FMF has a wealth of information in papers, articles and opinion pieces available on the website which can influence the public debate and present alternative policies to the people of South Africa. Please look at our website www.freemarketfoundation.com. www.facebook.com/fmfsa | Twitter - @fmfsouthafrica

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