The Prudential Authority was established on 1 April 2018, in terms of the FSRA which introduces the Twin Peaks approach to financial regulation. Twin Peaks has two main aims: firstly, to strengthen the safety, soundness and integrity of financial institutions and secondly, to better protect financial customers and ensure that they are treated fairly by financial institutions (market conduct). Other objectives of the model include prevention of financial crime, financial inclusion, transformation of the financial sector and enhancing confidence in the financial system by ensuring its stability, efficiency and integrity.
**PRUDENTIAL AUTHORITY – continued**

## SARB STRATEGIC PLAN: SFA 3

### PERFORMANCE SCORECARD

<table>
<thead>
<tr>
<th>STRATEGIC MEASURES</th>
<th>Target (annual)</th>
<th>2017/18 (annual)</th>
<th>2016/17 (annual)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of financial institutions that meet or exceed the quantitative prudential standards for SIFIs</td>
<td>100% or specific regulatory action</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Percentage of financial institutions that meet or exceed quantitative prudential standards for non-SIFIs</td>
<td>100% or under specific regulatory action</td>
<td>Progress made but target not met</td>
<td>90%</td>
</tr>
<tr>
<td>Financial institutions with sound governance compliance and risk management practices</td>
<td>All institutions fully compliant or under specific regulatory action</td>
<td>Progress made but target not met</td>
<td>90%</td>
</tr>
</tbody>
</table>

1. All non-compliant institutions are under specific regulatory action.

Assessments on compliance with the Principles for Financial Market Infrastructures were not conducted due to the delay in promulgating the FSRA, and the Financial Services Board remained responsible for this role during the reporting year. Going forward, the SARB will conduct these assessments.

---

### PROGRESS MADE

- **Develop, improve and integrate the supervision of regulated financial institutions, the SARB:**

  Developed and distributed for consultation the supervisory approach for banking, insurance, cooperative financial institutions and conglomerates. The approach for FMIs is in the early stages of development.

  Completed 50% of the overall integrated supervisory approach and framework.

  Prudential standards are still to be developed. The Prudential Authority is preparing for the Financial Action Task Force (FATF) mutual evaluation in 2019, which will assess the compliance of South Africa’s framework and laws for anti-money laundering and the combating of terrorist financing against international standards. The Solvency Asset Management (SAM) reforms are part of the overhaul of financial sector regulation in South Africa. The Insurance Bill, which is still being considered by Parliament, builds on the regulatory framework created through the FSRA and is expected to be implemented in July 2018.
REPORT OF THE PRUDENTIAL AUTHORITY

THE NEED FOR REGULATORY REFORM

During the most recent global financial crisis in 2008, the South African financial system proved its resilience with no major financial institutions having failed. However, the crisis highlighted the extent to which financial groups are embedded within economic and financial systems, as well as the high degree of interconnectedness. Regulators subsequently agreed that more could be done to improve the strength and adaptability of the system through the implementation of a more proactive model of financial sector regulation.

Historically, the regulatory architecture for the South African financial sector was fragmented. Different sectoral laws applied to different regulatory authorities overseeing individual institutions. For example, there were, and still are, separate pieces of legislation with differing standards and requirements for banks, insurance companies, pension funds, collective investment schemes and credit providers, among others.

The Twin Peaks reform represents a shift away from this siloed approach to reduce the possibility of regulatory arbitrage or ‘forum shopping’ in the financial system. The Prudential Authority’s overarching objective is to harmonise and integrate the approach to prudential supervision across sectors, to the greatest extent possible.

REGULATORS

The Twin Peaks model of financial regulation places equal focus on prudential and market conduct regulation and supervision by creating dedicated authorities responsible for prudential and market conduct objectives.

The Prudential Authority, a juristic person within the SARB’s administration, is the prudential regulator and supervisor of financial institutions¹ and FMIs² in South Africa. The Prudential Authority was established from the Financial Services Board Insurance Prudential team, the Bank Supervision Department of the SARB and the Supervisory Team of the Cooperative Banks Development Agency.

The FSRA also makes provision for a standalone Financial Sector Conduct Authority (FSCA), responsible for enhancing and supporting the integrity and efficiency of South Africa’s financial markets and protecting financial customers.

Together with the FSCA, the Prudential Authority is responsible for licensing banks, mutual banks, cooperative banks, cooperative financial institutions, insurers and FMIs.

IMPLEMENTATION OF THE TWIN PEAKS MODEL

The transition to the Twin Peaks model of regulation will occur in a phased manner. The FSRA gives the new regulatory authorities additional powers, over and above those provided in existing industry-specific laws, to ensure that they have the required tools to perform effectively in the first phase of implementation, without being limited by gaps in existing legislation.

The respective legal frameworks for prudential and market conduct regulation will be developed, harmonised and strengthened in the second phase of implementation. Where required, industry-specific legislation will be repealed and new legislation or regulatory instruments introduced. Legislative developments relating to levies and the conduct of financial institutions and financial markets will be introduced in due course, solidly launching the Twin Peaks model of regulation into the second phase of implementation.

GOVERNANCE STRUCTURES

The governance structure, resources, financial management and reporting obligations of the Prudential Authority are prescribed by the FSRA. Furthermore, the Prudential Authority is required to submit a report on its activities to Parliament and to prepare financial accounts for each financial year which will be included in the SARB’s annual report.

The Prudential Committee is responsible for the overall governance of the Prudential Authority. It is chaired by the Governor of the SARB and comprises the CEO of the Prudential Authority (who is also a Deputy Governor of the SARB) and the remaining Deputy Governors of the SARB.

---

1. A financial institution refers to licensed, regulated and/or supervised banks and insurers, as well as institutions required to be licensed in terms of applicable financial sector legislation.

2. Section 1(1) of the Financial Markets Act 19 of 2012 (FMA) defines a market infrastructure as a central counterparty, a central securities depository, a clearing house, an exchange and a trade repository.
OBJECTIVES OF THE PRUDENTIAL AUTHORITY

Section 33 of the FSRA

| Promote and enhance the safety and soundness of financial institutions that provide financial products and securities services. | Promote and enhance the safety and soundness of market infrastructures. | Protect financial customers against the risk that financial institutions may fail to meet their obligations. | Assist in maintaining financial stability. |

Specific strategic objectives that cut across the statutory objectives

<table>
<thead>
<tr>
<th>Attract and retain critical skills.</th>
<th>Inculcate organisational values.</th>
<th>Promote the safety, soundness and integrity of regulated institutions.</th>
<th>Develop, improve and integrate the supervision of regulated institutions.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Develop a holistic view on regulatory issues.</td>
<td>Coordinate and collaborate with internal and external stakeholders.</td>
<td>Improve technology, data, information and analytics processes.</td>
<td>Collaborate on the regulatory framework for resolution.</td>
</tr>
</tbody>
</table>

The Prudential Authority assesses its progress in executing its strategic objectives on a six monthly basis as part of the SARB’s strategic plan. This ensures alignment between the Prudential Authority and other departments of the SARB.

FUNCTIONS OF THE PRUDENTIAL AUTHORITY

Prudential regulation and supervision

A healthy, sound, and properly functioning financial institution is able to meet its obligations to financial customers such as depositors and policyholders. Prudential regulation aims to ensure that financial institutions comply with minimum prudential requirements related to capital, liquidity, credit and other requirements, and that they are managed by suitably qualified and skilled individuals.

A number of new areas of regulatory and supervisory responsibilities have been placed on the Prudential Authority. Two of the most significant reforms to prudential oversight relate to financial conglomerates and FMIs.

The South African financial system is dominated by a few large financial institutions. As a result of this concentration and the high level of interconnectedness, the risk of contagion is high. The FSRA allows the Prudential Authority to designate members of a group of companies as a financial conglomerate. The more detailed regulatory and supervisory requirements, for example the designation criteria for financial conglomerates, will be released by the Prudential Authority in the coming months.

The Prudential Authority, together with the FSCA (the responsible authority for the FMA), will develop a supervisory framework for FMIs during 2018/19.
The FSRA requires the Prudential Authority to follow an integrated risk-based, forward-looking and outcomes-focused supervisory approach in its microprudential supervision. In addition, financial institutions need to be aware of the risks to their businesses and have adequate corporate governance frameworks and risk management processes in place to appropriately mitigate these risks. Therefore, the Prudential Authority may issue prudential standards in addition to sector legislation, as well as joint standards with the FSCA.

It is important to note that in its development of a comprehensive and consistent prudential regulatory and supervisory approach, the Prudential Authority is committed to the implementation of internationally agreed regulatory and supervisory standards in a manner that appropriately takes into account the context, realities and the capacity of South Africa’s financial institutions. It participates in the processes of international standard setting bodies and after assessing the appropriateness of various international standards for South Africa, the Prudential Authority will adopt and adapt these standards into the South African regulatory frameworks.

**Financial inclusion**

By achieving its objectives, the Prudential Authority will support financial inclusion and sustainable competition in the provision of financial products and services. It will monitor fintech, particularly developments that have the potential to facilitate financial inclusion through affordable and appropriate financial services and the entrance of smaller players into the market. This work will be undertaken together with the SARB and the FSCA to develop appropriate actions that support innovation and fintech.

**Cooperation and collaboration with other regulators**

The Prudential Authority values transparency, collaboration and coordination in promoting the safety and soundness of financial institutions. It is required to enter into Memoranda of Understanding with, among others, the FSCA, the SARB in its macroprudential role, the National Credit Regulator and the Financial Intelligence Centre on a number of areas of common interest to ensure effective alignment and efficiencies in the supervisory approach.

**Looking ahead**

The Prudential Authority’s Regulatory and Supervisory Strategy document will be published on its website by 1 October 2018, in line with the requirements of the FSRA. The document will provide general guidance and information to the public regarding the Prudential Authority’s approach to regulation and supervision, the principles that will guide its decisions, the key priorities over the next three years and the key outcomes it intends to achieve. The Prudential Authority appreciates that the implementation of the Twin Peaks reform will involve significant changes to existing processes, practices, structures and operations. It is therefore committed to communicating timely and in an open and transparent manner to assist the transition of the financial sector regulatory landscape.

In the coming months, the Prudential Authority intends to publish:

- the approach to licensing;
- the supervisory framework for financial conglomerate supervision;
- the supervisory framework for FMI supervision;
- the integrated supervision framework;
- the enforcement approach;
- Memoranda of Understanding with other regulators; and
- guidance on the regulation of significant owners.