

**UNIVERSITY OF THE WESTERN CAPE**

**FACULTY OF LAW**

**REGIONAL INTEGRATION OF FINANCIAL SERVICES  
REGULATION AND SUPERVISION IN THE SOUTHERN  
AFRICAN DEVELOPMENT COMMUNITY**

**Mini-thesis submitted in partial fulfilment of the requirements for  
the LLM in International Trade, Investment and Business Law**

**By**

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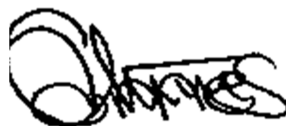
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**DATE: MAY 2015**

## DECLARATION

I, **AME REBECCA CHIMBOMBI** declare that this research is my own work, that it has not been submitted before for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged as complete references.

Signed at **CAPE TOWN** this 12<sup>th</sup> day of May 2015.



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**MISS AME REBECCA CHIMBOMBI**

I, **RIEKIE MARIA WANDRAG**, being the supervisor, have read this research paper and approved it for partial fulfilment of the requirements of the Masters of Law Degree in International Trade, Business and Investment Law, of the University of the Western Cape.

Signed at **CAPE TOWN** this 12<sup>th</sup> day of May 2015.



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**PROF. RIEKIE WANDRAG**

## DEDICATIONS

To my loving parents Dr & Mrs Micus Chimbombi and my brother Mr Matshelo Zuvee Chimbombi



## ACKNOWLEDGMENTS

Goemeone Mogomotsi is the first name that deserves mention since without his insistence I would not have applied for this LLM program. I was merely an LLB student with an incomplete transcript when he practically forced me to apply. Reluctantly I applied, and God's wonderful favour was upon me when out of these strange circumstances I was selected.

My loving parents Dr and Mrs Chimbombi, my dream would have not become a reality without your continued and unwavering support financially, emotionally and as my everyday pillars of strength. Through all your sacrifices I continue to channel a spirit of gratitude. Your true reward is in Heaven

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## ACRONYMS

APRA	Australian Prudential Regulatory Authority
ASIC	Australian Securities and Investment Commission
AU	African Union
BoB	Bank of Botswana
BoT	Bank of Tanzania
CCGB	Committee of Central Bank Governors
CISNA	Committee of Insurance, Securities, and Non-Banking Financial Authorities
EACB	East African Currency Board
EU	European Union
FIP	Finance and Investment Protocol
NBFIRA	Non-Bank Financial Institutions Regulatory Authority
RBM	Reserve Bank of Malawi
SADCC	Southern African Development Coordination Conference
SADC	Southern African Development Community
SARB	South African Reserve Bank
SSBS	Subcommittee on Banking Supervision
TCMA	Tanzanian Capital Markets Securities Authority
TIRA	Tanzanian Insurance Authority



## **KEYWORDS**

Financial sector integration

Financial services regulation and supervision

Integrated Model

SADC Macro-economic convergence

SADC Monetary Union

SADC Triple Peaks

Silos Model

Twin Peaks Model

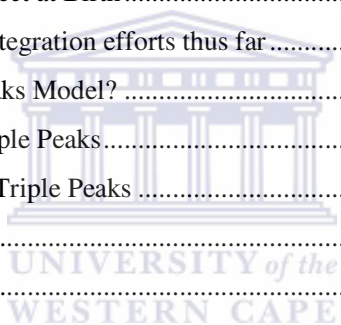
Unification Model



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# CHAPTER 1

## INTRODUCTION AND BACKGROUND

### 1.1 INTRODUCTION

'Regulation' denotes the establishment of rules relating to a particular industry.<sup>1</sup> It has also been defined as a set of binding rules issued by a private or public body.<sup>2</sup> Therefore, financial regulation is a network of rules that governs the conduct of participants in the financial system.<sup>3</sup> The economic theory giving birth to the concept of regulation was first published in 1971 through Stigler's theory.<sup>4</sup>

In his *Theory of Economic Regulation* two schools of thought are advanced, namely, positive theories and normative theories of regulation.<sup>5</sup> Economic theory further suggests that the three main reasons for regulation are to constrain the use of monopoly in a bid to prevent serious distortions to competition and maintain market integrity; to safeguard the needs of ordinary people; and lastly that the social and overall costs of market failure exceed private costs of failure and the extra cost of regulation.<sup>6</sup>

The issue of market failure is cardinal to any discussion on financial regulation and supervision. In fact, it has been authoritatively stated that '*regulation is only necessary to the extent that markets may fail, and then only where it can be demonstrated that the benefits of intervention outweigh its costs.*'<sup>7</sup>

Consequently, it can be argued that the two pillars of the concept of financial regulation which are to mitigate the problem of systemic risk and regulate the conduct of business

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<sup>1</sup> Botha E & Makina D 'Financial Regulation and Supervision: Theory and Practice in South Africa' (2011) *International Business and Economics Research Journal* 10 (11) 27 (hereinafter Botha & Makina (2011)).

<sup>2</sup> Mwenda K *Legal Aspects of Financial Services Regulation and the concept of a Unified Regulator* (2006) (hereinafter Mwenda (2006)).

<sup>3</sup> Carmichael J & Pomerleau M *The Development and Regulation of Non-Bank Financial Institutions* (2002) 21.

<sup>4</sup> Peltzman S 'Towards a more General Theory of Regulation' (1976) *Journal of Law and Economics* 19(2) 211 [accessed 4 November 2014 at <http://raptor1.bizlab.mtsu.edu/SDrive/CKLEIN/ECON%207121/Micro%20III%20Papers/References/Peltzman%281976%29.pdf> ] (hereinafter Peltzman (1976)).

<sup>5</sup> Botha E & Makina D (2011) 28.

<sup>6</sup> International Centre for Monetary and Banking Studies *Geneva Reports on the World Economy 11 Fundamental Principles of Financial Regulation* (2009) 20.

<sup>7</sup> O'Brien J, Gilligan G & Miller S 'Culture and future of financial regulation: how to embed restraint in the interests of systemic stability' (2014) *Law & Financial Markets Review* 8 (2) 115 117.

emerge at the point where the market fails.<sup>8</sup> Furthermore, financial regulation exists on two levels, namely, the micro-prudential level which focuses on the various financial institutions and is thus ‘institutional’, and the macro-prudential level which focuses on the stability of the whole financial system and is thus ‘systemic’.<sup>9</sup>

Countries either adopt a Unified Regulatory Model, with partial or full unification, an Integrated Model, a Twin Peaks Model or a Silos Model with separate financial services authorities for each segment of the financial sector.<sup>10</sup> These are what this study refers to as the primary models of financial services regulation.

Loosely put, the Unification Model has one ‘umbrella’ regulator and supervisor dealing with prudential and conduct of business aspects of the financial sector. It can be fully or partially unified, partial unification is a breakaway from the single regulator with one or two sectors separated from the central hub. The Integrated model is a close cousin to the Unification Model with the main distinction being that it only focuses on prudential regulation.<sup>11</sup>

The Twin Peaks Model has only two agencies- one for prudential (systemic) regulation and the other for conduct of business regulation.<sup>12</sup> Prudential regulation deals with the safety and soundness of financial institutions and the sector as a whole, whilst conduct of business looks into consumer protection. The self-explanatory name of the Silos Model is that each segment of the financial sector has its own ‘separate’ regulatory and supervisory agency.

## 1.2 FOUNDATIONS OF THE STUDY

The concept of a harmonised method of financial services regulation and supervision in the Southern African Development Community (SADC) stems from SADC’s objective to integrate to a monetary union by 2018.<sup>13</sup> The underlying legal undertaking for this

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<sup>8</sup> Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) Polity Press 15-22

<sup>9</sup> International Centre for Monetary and Banking Studies *Geneva Reports on the World Economy 11 Fundamental Principles of Financial Regulation* (2009) 20; O’Brien J, Gilligan G & Miller S ‘Culture and future of financial regulation: how to embed restraint in the interests of systemic stability’ (2014 ) *Law & Financial Markets Review* 8 (2) 115.

<sup>10</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues*, Paper presented at a World Bank seminar on *Aligning Supervisory Structures with Country Needs*, Washington DC, 6th and 7th June, 2006 accessed at <http://siteresources.worldbank.org/INTTOPCONF6/Resources/2057292-1162909660809/F2FlemmingLlewellyn.pdf> on 23rd August 2014 (hereinafter Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006)).

<sup>11</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 3.

<sup>12</sup> De Jager J ‘South African Reserve Bank: Blowing Winds of Change (Part 2)’ (2013) 25 *South African Mercantile Law Journal* 492 507.

<sup>13</sup> Belle M ‘Regional Economic Integration in SADC: progress, prospects and statistical issues for monetary union’ Proceedings of the Irving Fisher Committee Seminar on “Economic and Financial Convergence en Route

'philosophy' is found in Article 5 of the SADC Treaty as read and substantiated with Article 23 of SADC's Trade Protocol and the SADC Finance and Investment Protocol which sets out a timeline.<sup>14</sup>

Saurombe<sup>15</sup> analyses SADC's development oriented and globally relevant regional integration timeline. He outlines that SADC's transformation entails a Free Trade Area (FTA) in 2008, a Customs Union in 2010, a Common Market in 2015 and ultimately a Monetary Union in 2018. In his assessment, the set goals are unattainable and are 'a farfetched dream'. He posits that the biggest hurdle is the SADC institutional framework which he submits was not correctly reformed during the evolution of SADC from SADCC (Southern African Development Coordination Conference).

Although Saurombe appears to be a prophet of doom, he does not discredit the idea of a monetary union entirely but merely highlights the problems SADC may face in such pursuit. One is therefore inclined to agree with his submissions in as far as they map out the challenges that need to be addressed in the regional integration pursuit and the attainment of such in the set timeframe. However, the author doesn't support his assertion and classification of SADC's endeavours as 'a far fetched dream'. The challenges facing SADC are not insurmountable and can be conquered by well structured policies coupled with an overarching political will by the SADC member states. Over and above his reservations, a prerequisite to a monetary union is that there should be uniform standards of financial sector regulation and supervision which ultimately culminate in a robust financial system protected by common prudential rules.<sup>16</sup>

Moreover, the African Union (AU) together with the African Economic Community have adopted a six-stage approach which aims to financially integrate Africa to the point of having a single currency by 2028.<sup>17</sup> It has been correctly submitted that in order to achieve this,

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to Regional Economic Integration: Experience, Prospects and Statistical Issues amidst Global Financial Turmoil". Durban, South Africa (2010) accessed at <http://www.bis.org/ifc/publ/ifcb32e.pdf> 8th October 2014.; Saurombe A 'Regional Integration Agenda for SADC "Caught in the winds of change" Problems and Prospects' (2009) 4(2) *Journal of International Commercial Law and Technology* 100 103.

<sup>14</sup> Nkwanzi Z 'The SADC Finance and Investment Protocol and the Reform of the Malawian Financial Services Regulatory Framework: Reflections in Retrospect' (2009) (3)(1) *Malawian Law Journal* 7.

<sup>15</sup> Saurombe A 'Regional Integration Agenda for SADC "Caught in the winds of change" Problems and Prospects' (2009) 4(2) *Journal of International Commercial Law and Technology* 100.

<sup>16</sup> Jefferis KR 'The Process of Monetary Integration in the SADC region' (2007) 33(1) *Journal of Southern African Studies* 83 89 (hereinafter Jeffries 2007).

<sup>17</sup> Article 6(2) Treaty Establishing the African Economic Community, (1999) 30 ILM 1241; Rossouw J 'An Analysis of Macro-economic Convergence in SADC' (2006) 74(3) *South African Journal of Economics* 382 383.

African financial integration must adopt a bottom-up approach: wherein financial harmonisation will commence at the regional economic communities level and ripple into the rest of Africa.<sup>18</sup>

One such regional economic community is SADC. It has been described as a region with diverse economies ranging from one of Africa biggest economies (South Africa) to some of the smallest and arguably poorest economies in Africa (Lesotho and Swaziland).<sup>19</sup> It is inevitable, as a result, that the idea of adopting one model of financial services regulation and supervision within such a spectrum will pose a challenge.

This has already been observed with the on-going attempts at cross-border banking supervision which is an important factor in the current regulatory and supervisory reform agenda of the Southern African financial sector.<sup>20</sup> Cabello, Hands, Grossman and Hayes reveal that the unfortunate set-back resulting from these attempts is the critical disparity in the financial systems of the SADC Member States, with South Africa and Mauritius having highly developed banking systems when compared to Democratic Republic of Congo and Zimbabwe.<sup>21</sup>

Additionally, and perhaps more importantly, since banks involved in cross-border banking operations in the SADC region originate from different regulatory systems, this makes it difficult to effectively and expediently perform transactions. It is evident that the introduction of a legally enforceable regulatory and supervisory system is incontrovertible not only in the banking industry as highlighted above but in the financial services sector as a whole. Although Cabello, Hands, Grossman and Hayes underscore all the complexities and challenges faced in cross border banking, they fall short of recommending a regional regulatory and supervisory system should be in place.

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<sup>18</sup> Salami I 'Financial Regulation in African frontier markets: can the EU approach work?' 2011 *Law and Financial Markets Review* 380 381.

<sup>19</sup> Governance of Financial Institutions in Southern Africa: Issues for an Institutional Convergence Framework for Regional Financial Integration in SADC (published in ECA-SA/TBUP/GOV/2009/3) accessed 1 September 2014 at [www.uneca.org/sites/default/files/PublicationFiles/govoffininstinsouthernafrika\\_issuesforriframework\\_final.pdf](http://www.uneca.org/sites/default/files/PublicationFiles/govoffininstinsouthernafrika_issuesforriframework_final.pdf)

<sup>20</sup> Cabello M, Hands R, Grossman J, & Hayes J 'Cross Border Banking Supervision in SADC Region' (2013) 4(2) *Applied Capital Markets-Insight* 36.

<sup>21</sup> Cabello M, Hands R, Grossman J, & Hayes J 'Cross Border Banking Supervision in SADC Region' (2013) 4(2) *Applied Capital Markets-Insight* 36.

It would be incorrect to suggest that no work has been done in SADC towards the idea of a regional regulator and supervisor. In fact, certain strides have been made by the SADC Committee of Central Bank Governors (CCBG) and the SADC Subcommittee of Banking Supervisors (SSBS) by signing the Finance and Investment Protocol (FIP) of 2010. This Protocol has led to the formulation of the SADC Model Central Bank Law which addresses financial regulation and supervision in its Chapter VI.

In more relative terms, SADC's FIP is geared to encourage financial integration at different levels. Crucial to this are Article 10 and 12 which deal with banking regulation, and regulation of insurance, securities and non-banking financial institutions respectively.<sup>22</sup> Although no express mention is made in the FIP of the formation of one financial services regulator and/or supervisor for the whole SADC, it does highlight the 'need to go towards the harmonisation of their respective laws and regulations and regulatory and supervisory practices with the aim of preventing or reducing regulatory arbitrage.'<sup>23</sup>

Monetary Unions by their very nature demand 'high and preferably uniform standards of financial services supervision.'<sup>24</sup> Therefore, despite no specific mention of one model of financial services regulation and supervision in the SADC FIP, the existence of such is an inevitable step for the region in its path to becoming a Monetary Union by 2018 and a party to the evolution of an African Monetary Union.

Therefore, undertaking to have a Monetary Union too quickly without considering all the pre-requisites could prove to be detrimental to both SADC and Africa as a whole. One of the pre-requisites identified is the need for common prudential rules and supervision which could be a regional financial services regulator and supervisor.<sup>25</sup>

Financial services regulation must be understood as existing in four phases. At the one end of the spectrum there is no regulation, on the other end there is statutory regulation, where regulations are specified, administered and enforced by the state.<sup>26</sup> Between the two

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<sup>22</sup> Article 10 of the SADC Financial and Investment Protocol as read with Annex 8 sub Art 2(1) (b) and (d) whilst Article 12 is read with Annex 10 sub Art 9.

<sup>23</sup> Annex 10 sub Art 9 FIP.

<sup>24</sup> Jefferis KR (2007) 91.

<sup>25</sup> Jefferis KR (2007) 89.

<sup>26</sup> Sanders D 'Reinventing regulation' (June 2014) *Law and Financial Markets Review* 98 99.

extremes lies the idea of self regulation and co-regulation where financial services regulation and supervision can be categorised by institution, function or by objectives.<sup>27</sup>

It is within the realm of these three categories that the abovementioned ‘models’ of financial services regulation are conceived. Therein, regulations are often issued by the state and/or the regulated organisations and enforced in a similar fashion.<sup>28</sup>

However, it must be noted that different computations tailored for various countries have emerged from these primary models. For example within the Unification Model it may be unification in the central bank or outside the central bank.<sup>29</sup>

Botswana embraced a partial Unification Model in 2008 stemming from the government’s adoption of the Carmichael Report<sup>30</sup>, with one agency regulating and supervising all non-bank financial institutions (NBFIs) on the one hand, and the Bank of Botswana being the central bank regulating and supervising all banks, on the other. Generally, it has been stated that no particular model is better than the other and often countries adopt models tailored to suit their needs at a particular time. Factors, such as, the size of the country, structure of its financial sector and the political climate at the time, all contribute towards the matrix adopted.<sup>31</sup>

This study explores the development of a financial services regulator and supervisor for SADC by examining the various legal issues that are related to the different models and potentially recommending one model to suit SADC’s circumstances.

### 1.3 STATEMENT OF RESEARCH PROBLEM

The main issue examined is whether the SADC’s aim to integrate financial services regulation is attainable, and which model would then be ideal for this proposed integration. This is done in the light of the various models of financial regulation that exist within the SADC Member States.

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<sup>27</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues*, Paper presented at a World Bank seminar on *Aligning Supervisory Structures with Country Needs*, Washington DC, 6th and 7th June, 2006 accessed at <http://siteresources.worldbank.org/INTTOPCONF6/Resources/2057292-1162909660809/F2FlemmingLlewellyn.pdf> on 23rd August 2014.

<sup>28</sup> Sanders D ‘Reinventing regulation’ (June 2014).

<sup>29</sup> Mwenda K *Legal Aspects of Financial Services Regulation and the concept of a Unified Regulator* (2006) The International Bank for Reconstruction and Development / The World Bank: Washington DC.

<sup>30</sup> Carmichael J & Pomerleano M *The Development and Regulation of Non-Bank Financial Institutions* (The World Bank, Washington, DC 2002); Bojosi K ‘An appraisal of the new legal framework for the regulation of non-banking financial institutions in Botswana’ (2012) 15 *University of Botswana Law Journal* 29.

<sup>31</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 4.

For instance, whereas the Botswana government has recently adopted the Unification Model as outlined above, South Africa has moved away from this model to adopt the Twin Peaks Model which comprises of prudential regulation and conduct of business regulation.<sup>32</sup>

Against this backdrop, a need arises first to examine the four primary models as outlined above. It is worth clarifying that although there are theoretically four primary models, the study only extensively discusses three as the fourth, being the Integrated Model is very similar to the Unification Model and requires no independent analysis. Thereafter, this study examines the various permutations and combinations to the said models adopted by several SADC Member States in order to make an informed recommendation, on which model of financial services regulation would be ideal and practical for a regional economic community, such as the SADC.

Further, the study examines the impact that regional integration of financial services regulation in the SADC will have on the existing legal structures of the Member States. Since compatible or harmonised regulations are pivotal for the monetary union to become a reality<sup>33</sup>, will such harmonisation favour certain Member States at the expense of others?

Undoubtedly, South Africa, being the largest economy in the SADC, often dictates the terms to be followed in any integration. This can be seen by how the South African Trade Development Cooperation Agreement with the European Union (EU) has set the tune for SADC's Economic and Partnership agreement with the EU.<sup>34</sup> The mini-thesis examines, as a consequence, whether the adoption of the South African Twin Peaks Model is inevitable for all other Member States to enable them to reap the benefits of regional integration.

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<sup>32</sup> KPMG Twin Peaks reports, South Africa accessed at: <http://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/KPMG%20Twin%20peaks.pdf> and United Kingdom accessed at: <http://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/Twin%20Peaks%20Regulation%20Key%20Changes%20and%20Challenges%20-%2019%20Oct%2012.pdf> both accessed on the 23 August 2014.

<sup>33</sup> International Monetary Fund Working Paper (African and International Capital Markets Division), *Regional Integration of Stock Exchanges in Eastern and Southern Africa: Progress and Prospects* (June 2005) 12: where reference is made to the harmonisation of listing requirements for all SADC Member States.

<sup>34</sup> 'Southern African region and the EU complete negotiations for an Economic Partnership Agreement' European Commission Press Release IP/14/872 22/07/2014, Brussels, 22 July 2014 available at [http://europa.eu/rapid/press-release\\_IP-14-872\\_en.htm](http://europa.eu/rapid/press-release_IP-14-872_en.htm) [accessed 21 October 2014]; 'The EU's EPA negotiations with the Southern African Development Community (SADC): July 2014 update' available at <http://www.tralac.org/news/article/5907-the-eu-s-epa-negotiations-with-the-southern-african-development-community-sadc-july-2014-update.html> [accessed 22 October 2014].

## 1.4 SIGNIFICANCE OF STUDY

In order for smaller countries to stay abreast of the process of global financial integration, resort has been taken to the formation of regional economic communities with the hope that a more solid contribution and participation in the global community will be achieved.<sup>35</sup> The study therefore examines how SADC can deepen its integration levels in order for it to effectively benefit from the combined forces of being a regional cooperation arrangement.

Moreover, the success of this study will enable SADC Member States to take a further step to achieve their Monetary Union goals under the auspices of the African Union and the African Economic Community.<sup>36</sup> It is trite within the African context that improved participation of regional economic communities in the global arena will ultimately lead to increased and improved African participation as a whole.

## 1.5 RESEARCH QUESTION AND OBJECTIVES

The purpose of this research is to examine the legal and institutional framework of financial services supervision and regulation in SADC. In doing so the study will probe the various models of financial services regulation with the purpose of discerning what each model sets out to do and how, in doing so, it effectively exercises its function.

This study answers the question: is there a model of financial services regulation and supervision that is legally sound and best embraces SADC's circumstances? The legal soundness will be extracted by examining which model achieves the main objectives of independence and accountability to the greatest extent.

The first objective of the study is to discuss the structure and operations of each of the identified primary models of financial services regulation with the aim of determining whether certain cardinal administrative law principles are upheld.

Secondly, it then takes a practical look at how the primary models are applied and effectively work within some of the SADC Member States. Similarly, the study's main focus will be to discern whether the financial services regulation models are 'tangible' when country dynamics are introduced.

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<sup>35</sup> Regional trade and financial integration in the Southern African Development Community, *Address by the then Governor of the South African Reserve Bank, Dr Chris Stals, at a meeting for business people arranged by the Reserve Bank of Zimbabwe in Harare, Zimbabwe.* (18 June 1999) accessed 1 September 2014 at <http://www.bis.org/review/r990630a.pdf>.

<sup>36</sup> Articles 3(h), 4(1)(a), 4(1)(d) and 4(2) of the Treaty Establishing the African Economic Community, (1999) 30 ILM 1241.



Thereafter, the study reconnoitres the possibility of SADC adopting a ‘harmonised’ financial services regulator and supervisor. It is worth noting that ideal as it may be; the author has no intention of prescribing one of the primary models but merely uses them as a springboard to ascertaining the viability of a single financial services regulator and supervisor in SADC. The objective is to assess how best SADC can deepen its integration levels in this area of concern. The ultimate result may very well be that such deeper relations are not feasible or that different components from the primary models be adopted to make SADC’s ‘unique’ model of financial services regulation and supervision.

## **1.6 RESEARCH METHODOLOGY**

The research aims to employ both primary and secondary sources. With the former this will mostly be legislation enacted in the SADC Member States for the purpose of regulation and supervision of financial services, the SADC Treaty and its various protocols and memorandums of agreement; the latter entails a plethora of academic material such as, journal articles, books, newspaper commentary together with presentations and/or reports made by various international organisations such as SADC and the World Bank.

## **1.7 CHAPTER OUTLINE**

Chapter 2 examines the Unification Model of financial services regulation and supervision. It looks at both full unification and partial unification. Thereafter, it discusses some of the SADC Member States that have adopted the Unification Model. Malawi is the point of reference for full unification whereas Botswana will provide practical insight into partial unification. This is then followed by a scrutiny of the degree to which such model upholds independence and accountability.

Chapter 3 focuses on the Twin Peaks Model. Herein, in the same way, the central components of the model are studied. This is followed by the South African example: a SADC member state that has adopted the Twin Peaks Model. Similarly, the question of optimum accountability and independence will be examined with reference to this model.

Chapter 4 looks at Silos Model of financial services regulation. While discussing the central characteristics, this chapter will draw comparisons and distinctions between this model and the previously discussed models. After the requisite critique, Tanzania is then brought to the fore as the SADC Member State that has adopted the Silos Model approach of financial services regulation and supervision. Ultimately, in tune with the golden thread, the accountability and independence of these models are assessed.

Lastly, Chapter 5 contains what the author has termed the SADC Triple Peaks Model. This is a recommendation of a hybrid model, in light of the discussion, that best suits SADC's circumstances and strives to effectively maintain accountability and independence.

## CHAPTER 2

### THE UNIFICATION MODEL

#### 2.1 INTRODUCTION

In examining whether one model can be recommended as a regional financial regulator in SADC one must first examine the four primary models as noted in Chapter 1. It must be emphasised that the four primary models that this research explores in the context of a SADC 'regional regulator' are just different computations of the institutional and legal frameworks of a financial regulator.

These primary models are: the Unification Model, with partial or full unification, its close cousin the Integrated Model, the Twin Peaks Model; and the Silos Model of financial services authorities.<sup>37</sup> One of the distinguishing features that can directly be associated with the variations in regulatory models is whether they fall under the functional or institutional categorisation. With the former the focus is on the functions to regulate and supervise whereas that of the latter is on the institution responsible for such regulation and supervision.<sup>38</sup> Although this distinction is illuminating as a means of understanding the primary models, Llewellyn insightfully notes that in reality it is institutions and not functions that fail and become insolvent. Despite these internal variations the root concept of a financial services regulation remains unchanged.<sup>39</sup>

This chapter examines the Unification Model of financial services regulation and supervision. It commences by looking at the general terminology and definitional components of the model, elaborating on how the model should theoretically work, and assessing its advantages

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<sup>37</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 2.

<sup>38</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 11.

<sup>39</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 17

and disadvantages. There are two types of unification discussed herein: *full* and *partial* unification. Full unification denotes a scenario where an agency regulates and supervises all the business activity of the entire financial sector<sup>40</sup> whereas in partial unification a few segments of the financial sector are supervised by a single regulator such as, in the case of Zambia where pension funds and insurance companies have been grouped together.<sup>41</sup>

Following the introductory segment and a brief recap of the types of unification, the chapter delves into the country case studies that represent the two forms of the Unification Model: Malawi for the one end and Botswana for the other. The chapter is wrapped up by objectively assessing the independence and accountability of the said model. This independence and accountability analysis forms an integral part of the ultimate determination of which model best suits the SADC.

## 2.2 What is the Unification Model?

The Unification Model embodies the concept of a ‘single’ or ‘unified’ regulator which in its purest form there is one regulatory and supervisory agency for the entire financial sector. It is vital to note from the outset that, generally, the Unification Model is born from the functional categorisation of regulation and supervision: different functions are regulated and supervised irrespective of the institutions actively performing them.<sup>42</sup> As a consequence, this would suggest that the Unification Model is the antithesis of the Silos Model (which falls under the institutional categorisation) and that the two are mutually exclusive.

However, Mwenda makes a very interesting argument: he submits that the two apparently dissimilar models can complement each other and in some instances co-exist.<sup>43</sup> In his opinion the ‘co-existence’ of the models can occur when within the Unification Model various departments are formed along institutional lines, for example, licensing would be separate from the pensions division, securities division, and insurance division, giving a semblance of a Silos Model within the Unification Model.<sup>44</sup> This would be different from unification where licensing for all of the above (pensions, securities and insurance) is done by one department, for example, the Licensing Department.

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<sup>40</sup> Mwenda ‘*Legal Aspects*’ 38.

<sup>41</sup> Mwenda ‘*Legal Aspects*’ 38.

<sup>42</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 11

<sup>43</sup> Mwenda K *Legal Aspects* 10.

<sup>44</sup> Mwenda K *Legal Aspects* 37.

Although the author treads carefully when inclined to differ with Professor Mwenda, his analysis is unfortunately not sustainable in this discussion. It is submitted that the departmental divisions are in pursuit of a cleaner, more refined, structured and organised manner of operation and in no way an attempt to merge the two models of financial services regulation and supervision as alleged. In the Silos Model fully discussed below in Chapter 4, the agencies are independent from each other, and the adoption of this model presupposes a clear demarcation between each of the financial services.<sup>45</sup>

These clear cut boundaries are not envisioned in the Unification Model and in fact this model acknowledges that such differences are often blurred. Llewellyn favours the Unification Model by stating that ‘a regulatory system which presupposes a clear separation between banking, securities and insurance is no longer the best way to regulate a financial system in which these distinctions are increasingly irrelevant’.<sup>46</sup>

Their differences momentarily aside, the Silos Model, often referred to as the traditional or vertical model, has in many instances been a precursor to the Unification Model. Canada, Denmark, South Africa and the United Kingdom are all examples of countries where the Unification Model was adopted in a bid to address the shortcomings of the Silos Model.<sup>47</sup> It is believed that Norway was the first country to establish a single supervisor in 1986 before being followed by its other European counterparts, such as, the United Kingdom and Germany in 1997 and 2002, respectively.<sup>48</sup> Despite its colourful and isolated history of apartheid the South African evolution also dates back to the 1980’s when the idea of a consolidated regulatory and supervisory structure was discussed also springing from separately regulated and supervised entities.<sup>49</sup>

Another key distinction vital to an understanding of the Unification Model is its difference from the Integrated Model. Whereas the Integrated Model focuses only on prudential regulation of all financial firms, the Unification Model covers a wider range of prudential regulation and conduct of business regulation and supervision.<sup>50</sup> Simply, the former deals

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<sup>45</sup> Marsciandaro D & Quintyn M *The Evolution of Financial Supervision: the Continuing Search for the Holy Grail* SUERF’s 50<sup>th</sup> Anniversary Volume Chapters (2013) 263 accessed 7 December 2014 at [http://suerf.org/download/50ymf/50y\\_ch8.pdf](http://suerf.org/download/50ymf/50y_ch8.pdf) (hereinafter Marsciandaro D & Quintyn M 2013).

<sup>46</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 19.

<sup>47</sup> Mwenda *Legal Aspects* 10.

<sup>48</sup> Marsciandaro D & Quintyn M 2013 277.

<sup>49</sup> Botha E & Makina D ‘Financial Regulation and Supervision: Theory and Practice in South Africa’ (2011) 10(11) *International Business and Economic Research Journal* 27 32 (hereinafter Botha E & Makina D 2011).

<sup>50</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 3

only with the aspect of ensuring stability of financial firms through protecting their safety and soundness<sup>51</sup>; whereas the latter encompasses this dimension together with the conduct facet which ensures the proper running of the market by monitoring issues, such as, market abuse and consumer protection.<sup>52</sup>

### 2.3 Preconditions for establishing a unified regulator

The overarching goal of the establishment of any regulator or supervisor, including one within the Unification Model is the development of regulatory capacity.<sup>53</sup> Against this backdrop, the prerequisites or preconditions for the establishment of a unified regulator must be aligned with this paramount mandate or objective.

Mwenda<sup>54</sup> submits that some of the decisive factors for establishing a unified regulator are the following: sound and sustainable macroeconomic policies, the necessary political will of stakeholders, cooperation and sharing of information, skilled human capital, sufficient financial resources, and the existence of conglomerates and cross ownership *inter alia*.

#### 2.3.1 Sound and Sustainable Macroeconomic Policies

Simply put, the establishment of a unified regulator must be the appropriate step correctly in line with the objectives of a country or, for our purposes region, as embodied in its macroeconomic policies.<sup>55</sup> Although the leap to a unified regulator without first establishing solid macroeconomic policies may be seen as an effort to adopt international best practices or even gain market access to certain parts of the developed world, a solid macroeconomic policy is incontrovertible.<sup>56</sup> If the Unification Model is to be considered for SADC then it is of vital importance that macroeconomic policies for the regional body be in place to accommodate the introduction of this phenomenon. An argument can be made that the SADC FIP together with the work done by the CCGB is strategically aligned with the ultimate goal

<sup>51</sup> The United Kingdom's Prudential Regulatory Authority as part of the Bank of England established through the Financial Services Act of 2012 accessed at <http://www.bankofengland.co.uk/pru/Pages/default.aspx> on 7 December 2014.

<sup>52</sup> The United Kingdom Financial Conduct Authority also established through the Financial Services Act of 2012 accessed 7 December 2014 at <http://www.legislation.gov.uk/ukpga/2012/21/part/2/crossheading/financial-conduct-authority-and-prudential-regulation-authority/enacted> is responsible **ONLY** for conduct of business regulation and supervision and serves as the second branch to UK's Twin Peaks Model.

<sup>53</sup> International Monetary Fund Working Paper, *Issues in the Unification of Financial Sector Supervision* (December 2000) 5.

<sup>54</sup> Mwenda K *Legal Aspects* 41-42 where twelve decisive factors are outlined

<sup>55</sup> Chul P K A *Macprudential Approach to Financial Supervision and Regulation: Conceptual and Operational Issues* (October 2006) accessed 7 December 2014 at <http://www.imf.org/external/np/seminars/eng/2006/macpr/pdf/yungchul.pdf>.

<sup>56</sup> Read generally the International Monetary Fund Country Report No. 06/196 on the Republic of Armenia (2006) accessed 8th December 2014 at [www.imf.org](http://www.imf.org).

of a SADC Monetary Union taking into account the prospects of a harmonised, uniform or standardised system of financial services regulation and/or supervision.

### 2.3.2 The Necessary Political Will among Stakeholders

The formation and implementation of regulation and supervision rests on the political will of the relevant stakeholders. This proposition is valid in the case of both country specific pre-requisites and for purposes of this research, SADC's specific criteria. Therefore, the political will of the SADC Member States (through its various organs) would be a necessary step to ensuring the success of the Unification Model, and in fact any model if so recommended.

Unfortunately, the lack of political will has remained a challenge for SADC from conception.<sup>57</sup>The reality however is that in every regional integration drive, financial regulation and supervision being no exception, political will coupled with the surrender of sovereignty to a certain degree is vital. This lack of political will in the SADC region continues to impede the growth of regional integration.<sup>58</sup>

An indication of political will would, for example, entail SADC adopting rule-based mechanisms as opposed to cooperative endeavours because these are a fundamental necessity in the fulfilment of any regional integration pursuit. To date; SADC's secretariat, which is responsible for the co-ordination of trade and regional integration initiatives, lacks the legal basis to ensure accountability, compliance and enforcement of decisions. Further, 'SADC lacks a supranational authority to enforce decisions'.<sup>59</sup>

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<sup>57</sup> SADC Major Achievements and Challenges: 25 years of Regional Cooperation and Integration October 2005 accessed 14 March 2015 at <http://www.sadc.int/documents-publications/show/SADC%20Major%20Achievements%20and%20Challenges%20Handbook>; Fisher L M & Ngoma N 'The SADC Organ: Challenges in the New Millenium' (2005) (114) *Institute For Security Studies* 5.

<sup>58</sup> Ganetsang G 'Whither SADC?' *Sunday Standard* 22 August 2014 accessed 14 March 2015 at <http://www.sundaystandard.info/article.php?NewsID=20842&GroupID=4> where it is reported that when the SADC Heads of State convened in Victoria Falls, Zimbabwe it was opined that 'regional integration remains a mirage because of the lack of political will by SADC leaders.'; see also [http://www.sadcppnetwork.org/index.php?option=com\\_content&view=article&id=373:lack-of-political-will-is-slowing-public-private-projects&catid=25&Itemid=257](http://www.sadcppnetwork.org/index.php?option=com_content&view=article&id=373:lack-of-political-will-is-slowing-public-private-projects&catid=25&Itemid=257) on how SADC's lack of political will is slowing down its Private-Pubic-Partnership Projects.

<sup>59</sup> Sauroombe A 'Regional Integration Agenda for SADC "Caught in the winds of change" Problems and Prospects' 100 104.

The proposal to have rule-based mechanisms must not be seen or understood as allowing political interference in the running of the said regulator.<sup>60</sup> The independence aspect of a regulator and supervisor and the underlying requirement of non-interference must never be misunderstood as non-accountability on the part of the regulator or supervisor.<sup>61</sup>

### 2.3.3 Co-operation and Sharing of Information

The Unification Model by its very nature denotes unity or co-operation within the financial services being regulated or supervised. The need for cooperation and information sharing is even more critical for a regional regulatory and supervisory agency or body, such as one considered in this research. The Unification Model, if adopted, would require that the financial sectors of the SADC Member States have an intricate communication and information sharing network to enable effective regulation, and not lead to the ‘Christmas tree’ effect.<sup>62</sup> The current SADC set-up, based mainly on memorandums of understanding, lacks the legal requirement to set in motion a concrete information sharing network and thus does not meet this precondition.<sup>63</sup>

### 2.3.4 Skilled Human Capital

The skilled human capital precondition is two-dimensional. On the one hand, there is a need for skilled labour to effectively establish, develop and run the operations of a unified financial services regulator or supervisor. This would be especially vital in instances where there is a shift from the Silos Model to the Unification Model. The second dimension relates to the scarcity of skilled human capital. It has been submitted that the Unification Model best utilises this limited resource.<sup>64</sup>

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<sup>60</sup> International Monetary Fund Working Paper, *Issues in the Unification of Financial Sector Supervision* (December 2000); International Monetary Fund Working Paper, *Regulatory and Supervisory Independence and Financial Stability* (March 2002).

<sup>61</sup> International Monetary Fund Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration of Principles accessed 10 December 2014 at <http://www.imf.org/external/np/mae/mft/code/index.htm>.

<sup>62</sup> Mwenda in his *Legal Aspects 43* describes this as a situation where economies of scale are watered down by regulators being overwhelmed with too much work rendering them inefficient and creating possible avenues for corruption.

<sup>63</sup> Cabello M, Hands R, Grossman J, & Hayes J ‘Cross Border Banking Supervision in SADC Region’ (2013) 4(2) *Applied Capital Markets-Insight* 36 37.

<sup>64</sup> Mwenda K & Flemming A ‘International Development in the Organisational Structure of Financial Services Supervision’ (April 2001) accessed 10 December 2014 at [http://lnweb90.worldbank.org/eca/eca.nsf/abdf2b83e74f58ef852567d10011a8ba/29e7611f0e618a528525689e006b1e1b/\\$FILE/International%20developments%20in%20the%20organizational%20structure%20of%20financial%20services%20supervision.pdf](http://lnweb90.worldbank.org/eca/eca.nsf/abdf2b83e74f58ef852567d10011a8ba/29e7611f0e618a528525689e006b1e1b/$FILE/International%20developments%20in%20the%20organizational%20structure%20of%20financial%20services%20supervision.pdf).

For SADC, if the Unification Model is recommended, the available skilled human capital will be tasked with merging the divergent systems to create this new regional Unification Model. Secondly, the skilled staff would have to implement this on a much larger regional scale. If hypothetically the only feasible implementation is by means of a supranational entity adopting the Unification Model, then the limited human resources not only has to merge the regulatory regimes, but must also be able to coordinate their implementation and supervision from one central place.

### 2.3.5 Sufficient Financial Resources

Regulatory and supervisory agencies within the Unification Model require adequate financial resources to carry out their activities, such as, on-site and off-site visits or even staff remuneration. Resources are also tied to the issues of independence and accountability. As the saying goes, ‘talk is cheap but money buys the whiskey’: whoever provides the funding will inevitably have a say in the manner in which the regulation and supervision is undertaken. This reality is the reason why regulatory and supervisory authorities are often funded by an industry levy giving the regulator the flexibility to adequately address its needs.<sup>65</sup>

### 2.3.6 Conglomerates and Cross-ownership

This prerequisite sprouts from the reality that the Unification Model thrives in circumstances where there is an influx or growth of financial conglomerates.<sup>66</sup> In the traditional Silos Model, the introduction of conglomeration or cross-ownership opened up the risk of regulatory arbitrage.<sup>67</sup> This regulatory or supervisory arbitrage can be seen in firms channelling or redirecting risky activities to areas where there are softer rules of regulation and supervision.<sup>68</sup>

On the SADC front the existence of such cross-ownership or conglomeration is without doubt. Several commercial banks, such as, First National Bank and Barclays Bank/ABSA are

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<sup>65</sup> International Monetary Fund Working Paper, *Issues in the Unification of Financial Sector Supervision* (December 2000); International Monetary Fund Working Paper, *Regulatory and Supervisory Independence and Financial Stability* (March 2002) 7.

<sup>66</sup> Mwenda K ‘Legal Aspects of Unified Financial sector Supervision in Germany’ (2003) 4 (10) *German Law Journal* 1009 1016.

<sup>67</sup> Martínez J & Rose T ‘International Survey of Integrated Financial Sector Supervision’ *World Bank Policy Research Working Paper: Financial Sector Operations and Policy Department*. (July 2003) accessed 10 December 2014 at <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-3096>.

<sup>68</sup> International Monetary Fund Background Paper, *Financial Sector Regulation: Issues and Gaps* (17 August 2004) 6 accessed 10 December 2014 at <http://www.imf.org/external/np/mfd/2004/eng/081704.pdf>.



based in one SADC state and carry out financial services in other SADC states. A grand example of a financial conglomerate in the SADC region is the Old Mutual Group which carries out insurance, banking and asset management activities in the SADC region.<sup>69</sup> As a result, difficulty often arises with adhering to the varied regulatory and supervisory demands in place in the SADC states.

### 2.3.7 Universal Banking Practice

Closely linked to financial conglomerates and cross-ownership is the practice of universal banking.<sup>70</sup> Therefore a similar argument is made that this precondition is sufficiently met within the SADC context. The SADC Banking Association provides an example of a regional attempt at taking strides in embracing the practice of universal banking.<sup>71</sup>

### 2.3.8 Interconnected Segments of the Financial Sector

The Unification Model cannot work if the financial sector or financial services that it aims to regulate and supervise lack interconnectedness.<sup>72</sup> As already highlighted, the 'unified' element of this model was often embraced as addressing the misconception created by the Silos Model that the financial industries are separate, independent constituents of the financial sector. This precondition also allows the regulation or supervision under the Unification Model to be comprehensive as no 'intermediate' form of financial activity can go unnoticed and escape regulation.

Although it is conceded that financial conglomerates exist within the SADC region and that the practice of universal banking forms part of the fabric of the SADC financial sector to allege interconnectedness of the segments therein would not be a true account. However, credit must be given to the SADC committees in place such as the CCGB, the Committee of SADC Stock Exchanges and the Committee on Insurance, Securities and Non-Banking

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<sup>69</sup> Southern African Development Community, 'Creating a Foundation for the Future' Part III of Series accessed 10 December 2014 at <http://www.forbescustom.com/SectionPDFs/121012SADCSection.pdf>.

<sup>70</sup> Defined at <http://lexicon.ft.com/Term?term=universal-bank> as a financial service conglomerate combining retail, wholesale and investment banking services under one roof and reaping synergies between them.

<sup>71</sup> SADC Banking Association website accessed 1 February 2015 at <http://www.sadcbanking.org/about.aspx>

<sup>72</sup> Mvula J & Mwenda K 'Unified Financial Services Supervision in Latvia, the United Kingdom and the Scandinavian Countries' 2003 10 (1) *Murdoch University Electronic Journal of Law* paragraph 8 accessed 9 December 2014 at <http://www.austlii.edu.au/au/journals/MurUEJL/2003/8.html>.

Financial Authorities (CISNA), which have made strides in trying to create this link within the financial segments of the SADC Member States.<sup>73</sup>

### 2.3.9 A Well Developed Public Infrastructure

This includes buildings to house the regulatory agencies, good communication networks to create a solid link amongst the regulators and financial institutions. A good transport system is also an added advantage as this enables effective on-site supervision at a pace enabling the regulator to cover a large base in a limited amount of time.

The disparity within the SADC Member States need not be emphasised. The regional community has financial service giants with intricate systems, such as, Mauritius and South Africa, in the same pot as those still developing such as Malawi and Botswana stewing in the direction of regional integration. It is important therefore that a good infrastructure is established in the SADC region.

Once the preconditions have been discussed and possibly met, the next sensible step is to examine the advantages and disadvantages of the Unification Model. This is a natural step especially when one seeks to weigh up various models with regard to their effectiveness and efficiencies with the aim of either suggesting a viable one or a combination of various components of existing models. This is the object of this research.

## **2.4 Advantages of the Unification Model**

### 2.4.1 Supervision of Financial Conglomerates

This advantage is a direct consequence of the precondition requiring the existence of financial conglomerates and to a certain extent the practice of universal banking. Fragmented regulation and supervision, unlike the Unification Model, has given rise to the concern that such entities can't be seamlessly regulated and supervised because of their presence in different jurisdictions.<sup>74</sup>

If SADC is to adopt the Unification Model, this advantage will accrue because of the fragmentation concern expressed under the precondition of interconnectedness. This will not only benefit the regulatory and supervisory agency but will extend to the financial

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<sup>73</sup> See SADC Website accessed 10 December 2014 at <http://www.sadc.int/themes/economic-development/finance/capital-markets/>.

<sup>74</sup> International Monetary Fund Working Paper, *Issues in the Unification of Financial Sector Supervision* (December 2000); International Monetary Fund Working Paper, *Regulatory and Supervisory Independence and Financial Stability* (March 2002) 10.

conglomerates themselves as once one system is in place they will spend less time and resources adhering to different regulatory laws in different SADC countries.

#### 2.4.2 Competitive Neutrality

It is trite that as financial services evolve and mature the demarcations between products and financial institutions have blurred. The Unification Model ensures that financial institutions that may be categorised differently but offering similar products are not regulated or supervised differently.<sup>75</sup> This curbs instances where one institution offering similar services as another would have a competitive advantage because its regulation may be less stringent or cost less.

The competition in non-Unification Models is not only among the service providers but may extend to the regulatory and supervisory agencies where one agency weakens its mechanisms in order to attract more financial institutions. Certain financial services may subsequently be re-designed or modified to fit the criteria of the regulator offering more favourable terms.

This advantage can be beneficial to SADC in its pursuit to make the whole region the ultimate investor destination. Instead of SADC states lowering or weakening their regulatory and supervisory standards in a competition to have financial institutions set up in their jurisdictions, one uniform system curbs this regulatory arbitrage.

#### 2.4.3 Regulatory Flexibility

This advantage caters for the emergence of financial products, institutions or services that may not have been originally catered for in the initial framework of a particular financial sector. The Unification Model therefore captures all other by-products that are not easily classifiable.<sup>76</sup>

The flexibility is beneficial in both developed and developing or transition economies. With the former, financial innovation is rapid and changes in financial services being provided are often too fast for the law and regulations in place. The latter is often made up of 'infant or test' institutions where the likelihood of success in that particular financial sector is unknown. Regulatory flexibility therefore provides the emerging and transition economies with a

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<sup>75</sup> Jadhav N 'Single Regulator vs. Multiple Regulator' accessed 10 December 2014 at [http://www.drnarendrajadhav.info/newversion/drjadhav-data\\_files/Published%20papers/Single%20versus%20Multiple%20Regulator.pdf](http://www.drnarendrajadhav.info/newversion/drjadhav-data_files/Published%20papers/Single%20versus%20Multiple%20Regulator.pdf).

<sup>76</sup> Supervision of financial services in the OECD area accessed 11 December 2014 at <http://www.oecd.org/finance/financial-markets/1939320.pdf>

platform to refine, restructure and polish the financial services to suit their economy without rendering laws obsolete.<sup>77</sup>

As previously highlighted the SADC package is a peculiar one with developed, developing and least developed economies. This Unification Model advantage of flexibility is one that falls smoothly into the SADC dynamic. Whereas South Africa will be battling rapidly-changing financial services, Lesotho, Democratic Republic of Congo and Swaziland may still be trying to determine whether certain financial services should be woven into the fabrics of their economies.

#### 2.4.4 Regulatory Efficiency

The rationale has always been that a larger organisation permits finer specialisation of labour and more intensive utilisation of input. This may be extended to a regulatory framework that will enable sharing of infrastructure, administration and support systems and will avoid the duplication that is seen in the Silos Model.<sup>78</sup> A central data collection point is also beneficial to effective and timely reporting. Once the reports are submitted on time the agencies are then able to make good comparisons and address concerns appropriately.

#### 2.4.5 Developing a Professional Body of Staff

Tied to the prerequisite of skilled human capital is the advantage that a professional body of staff will be developed where there is no competition for the limited skills available. It has been submitted, correctly so, that a larger employer of financial regulators is better placed to create a coherent human resource policy and take into account career planning and maximum utilisation of the resource.<sup>79</sup>

Secondly, in the era where the demarcations in the financial sectors are admittedly blurred, the Unification Model allows regulators and supervisors with specialised knowledge in a particular industry that encroaches on another to extend their expertise to the sector in need. An example would be where insurance-based financial services sprout in the banking sector: the insurance experts of the Unification Model can advise the assigned banking regulators and supervisors accordingly.

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<sup>77</sup> Ganapoulou VAN 'The FSA as an institutional Model for the Emergence of (Single) Unified European Financial Service Regulator' (2003) 14 (3) *European Business Law Review* 277.

<sup>78</sup> International Monetary Fund Working Paper, *Issues in the Unification of Financial Sector Supervision* (December 2000) 13.

<sup>79</sup> International Monetary Fund Working Paper, *Issues in the Unification of Financial Sector Supervision* (December 2000) 14.

## 2.5 Disadvantages of the Unification Model<sup>80</sup>

### 2.5.1 Unclear Objectives

Large direction lacking entities by their very nature can create some confusion. Under the Unification Model the regulators and supervisors are tasked with a range of activities from avoiding systemic risk to protecting consumer fraud. This may create a scenario where the entity appears to have no determined sense of direction.<sup>81</sup> The problem with unclear objectives is that it can create a lacuna as to who bears responsibility for certain actions or a finger-pointing blame game within the agency.

By the same token, unwanted political influence in an entity with unclear objectives can cause strife.<sup>82</sup> If the regulators and supervisors do not explicitly know what they aim to do, then political leaders can issue directives to the detriment of the overall mandate of the regulatory authority.

If such concerns are raised in countries, it goes without question that the complexity of unclear convoluted objectives in a regional Unification Model agency would cause chaos. If one entity is tasked with regulating and supervising the entire SADC financial sector one can be sure that the reality of unclear objectives will be first to surface. This is so because the different states forming the regional economic community are at different levels of financial development and have different aims. An attempt to unify all their objectives under one umbrella entity might simply be impractical.

### 2.5.2 Diseconomies of Scale

Diseconomies of scale are also incidental to the existence of a large unified ‘monopoly’ regulator. One of the highlighted challenges is the bureaucratic nature of unified regulators and supervisors.<sup>83</sup> A small change to a rigid bureaucratic agency may be difficult to implement. Large unified regulators or supervisors may also create an opportunity to be turned into some kind of ‘dumping site’. This occurs when even sectors not directly within their purview are squeezed in to try and make use of the available resources. This

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<sup>80</sup> The framework of these disadvantages is provided by the International Monetary Fund Working Paper, *Issues in the Unification of Financial Sector Supervision* (December 2000) 17-19.

<sup>81</sup> Hussain B *Integrated Financial Supervision and its Implications for Banking Sector Stability* (unpublished honours thesis, New York University, 2009) 11.

<sup>82</sup> International Monetary Fund Working Paper, *Is One Watchdog Better than Three? International Experience with Integrated Financial Sector Supervision* (March 2006) 11.

<sup>83</sup> Schüler M *Integrated Financial Supervision in Germany*, ZEW Discussion Paper No.04-35 3

disadvantage, like the unclear objectives concern needs solid structures and focused management teams.<sup>84</sup>

### 2.5.3 Limited Synergies

Although one would like to think that the operations of all regulators and supervisors are materially similar, this is not often the case.<sup>85</sup> One of the biggest tasks the management of a Unification Model has is to try and align the tasks of these agencies. It has been said that whereas banking supervisors operate like doctors examining the health and wellbeing of their patients, securities supervisors are like policemen trying to catch unruly dealers.<sup>86</sup> The reality may therefore be that whereas the aim and hope of unification is that it should be a joint and collective effort of financial sector regulation and supervision, the disparities may hinder this.

### 2.5.4 Moral Hazard

Moral hazard relates to a situation where the public may be misguided into believing that the Unification Model necessarily means that all financial institutions are regulated the same manner and therefore confidence in one sector means confidence in all.<sup>87</sup>

In the SADC context this may be risky for investors who may strongly believe for example that having set up in Tanzania or Namibia which is being regulated under the Unification Model, the same results should be anticipated or will yield when setting up in the Democratic Republic of Congo or in Zimbabwe. Ideal as this might be, the unfortunate reality is that such may not be a true reflection of the real situation. Harmonised regulation does not mean that the services provided will be received equally in all states.

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<sup>84</sup> International Monetary Fund Working Paper, *Issues in the Unification of Financial Sector Supervision* (December 2000) 17

<sup>85</sup> Working Paper in Responsible Banking and Finance, *The Impact of the Organisation of Bank Supervision on Bank's Risk Taking Behaviour* (4<sup>th</sup> Quarter 2013) 7.

<sup>86</sup> International Monetary Fund Working Paper, *Issues in the Unification of Financial Sector Supervision* (December 2000).

<sup>87</sup> Financial Services Authority Occasional Paper 2 *The Rationale for Single National Financial Services Regulator* (May 1999) 26; Mwenda K 'Are African Countries Ready for Unified Financial services Regulator?' *African Growth Agenda* June-August 2006.

## 2.6 Types of Unification

As noted above, a key distinction is made between full and partial unification. Botswana is a country embracing partial unification with the Bank of Botswana overseeing the banking NBFIRA regulating and supervising the remaining portion of the financial sector. On the other hand, a Malawi is an example of full unification where the entire financial sector is regulated under the auspices of the Reserve Bank of Malawi.

## 2.7 CASE STUDIES

### 2.7.1 BOTSWANA

#### 2.7.1.1 Introduction

Historically Botswana's financial sector has been very small and its development very slow. The Bank of Botswana (BoB) was first established in 1975 and soon thereafter the Pula, Botswana's national currency, was introduced in 1976.<sup>88</sup> At the material time only two commercial banks (Barclays Bank and Standard Chartered Bank) operated in the jurisdiction and the conditions for granting the banking licences were very strict and to some extent unattainable as the existing banks could object to the grant of a banking licence.<sup>89</sup> The dominant duopoly was finally broken in 1982 when the Bank of Credit and Commerce Botswana was established in Botswana, but it remained relatively small and did nothing to actively challenge the two major banks.<sup>90</sup>

Other existing financial institutions at the time were the Botswana Savings Bank (originally established in Botswana in 1911 as the Post Office Savings Bank, a subsidiary of the South African Post Office Savings Bank), the National Development Bank established in 1964, the Botswana Development Corporation of 1970 and the Botswana Building Society which was locally incorporated in 1977.<sup>91</sup>

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<sup>88</sup> Chapter 6 of Botswana's National Development Plan 9 (NDP 9) accessed 11 December 2014 at <http://www.sarpn.org/documents/d0001172/> ; Currently NDP 10 is in place and will be completed in 2016 marking 50years of independence for Botswana. NDP 10 is available at [http://www.nationalplanningcycles.org/sites/default/files/country\\_docs/Botswana/ndp\\_botswana.pdf](http://www.nationalplanningcycles.org/sites/default/files/country_docs/Botswana/ndp_botswana.pdf) .

<sup>89</sup> Botswana Financial Sector Overview 2009/2010 accessed 11 December 2014 at <http://www.econsult.co.bw/tempex/BOTSWANA%20FINANCIAL%20SECTOR%20OVERVIEW.pdf> (hereinafter Botswana FSO 2009/2010).

<sup>90</sup> See Bank of Botswana website accessed 19 April 2015 at <http://www.bankofbotswana.bw/content/2009112321034-major-developments-since-the-establishment-of-bank-botswana>

<sup>91</sup> Botswana FSO 2009/2010 4.

The current complexion of the financial sector can be separated into two broad categories, viz. the banking sector and the non-bank financial institutions sector.<sup>92</sup> The banking sector comprises nine commercial banks, one merchant bank, one off-shore bank, and one statutory deposit taking institution. The non-bank financial institutions are the Botswana Stock Exchange, insurers (short-term and long-term), pension funds, asset managers, credit institutions, micro-finance institutions, collective investments undertakings, statutory development financial institutions, statutory funds, and the Public Debt Service Fund.<sup>93</sup>

#### 2.7.1.2 Regulation of Botswana's Financial Sector

Botswana's financial sector has embraced the partial Unification Model (outside the central bank) with the banking sector and the bureaux de change regulated and supervised by the Bank of Botswana (BoB) in terms of the Banking Act (CAP 46:04 of the Laws of the Republic of Botswana)<sup>94</sup> and the non-bank financial institutions regulated and supervised by the Non-Bank Financial Institutions Regulatory Authority (NBFIRA) in terms of the Non-Bank financial Institutions Regulatory Authority Act (CAP 46:08 of the Laws of the Republic of Botswana).<sup>95</sup>

The central aim of the regulation of Botswana's financial sector is to ensure that its operations and performances are sound and limit systemic risk.<sup>96</sup> Ultimately, once this is ensured, depositors and the integrity of the financial system as a whole are protected.

According to the Bank of Botswana Annual Report 2013<sup>97</sup> the banking system was healthy during 2013, with such assessment being made with the aid of bilateral and trilateral meetings together with on-site and off-site supervision. Banks are reported as prudently managed, profitable, liquid, safe, and sound.<sup>98</sup>

Fifteen enquiries were received in 2013 with regard to establishing a banking business in Botswana but no subsequent applications were made. Four applications were made in 2012,

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<sup>92</sup> Botswana NDP 10 .

<sup>93</sup> Botswana FSO 2009/2010 8.

<sup>94</sup> Accessed 11 December 2014 at <http://www.bankofbotswana.bw/assets/uploaded/Banking%20Act.pdf> .

<sup>95</sup> Accessed 11 December 2014 at <http://www.nbfira.org.bw/sites/default/files/CHAPTER%204608%20NON-BANK%20FINANCIAL%20INSTITUTIONS%20REGULATORY%20AUTHORITY.pdf>.

<sup>96</sup> Botswana NDP 10 Finance and Banking 134.

<sup>97</sup> The 2013 BoB annual report was themed around the topic *Household Participation in the Financial Sector, Debt Sustainability and Impact on Financial Stability* was accessed 11 December 2014 at [http://www.bankofbotswana.bw/assets/uploaded/BoB%20AR%202012%20Main%20only\\_1.pdf](http://www.bankofbotswana.bw/assets/uploaded/BoB%20AR%202012%20Main%20only_1.pdf). (hereinafter BoB annual report 2013)

<sup>98</sup> BoB annual report 2013 22.



two were approved with the banks commencing business in 2013; and two were unsuccessful.<sup>99</sup>

In practice, the Banking Act as the primary legislation provides the basis for some of the requirements in the banking sector. For example, Section 6(1) (a) of the Banking Act provides:

*'Every application for a licence to transact banking business in Botswana shall-*

*(a) be made in writing to the Central Bank in such form as shall be determined by the Bank, and accompanied by such processing fee as may be prescribed; and the Central bank shall cause such application to be published in the Gazette;...'*

The governing statute provides for the regulatory agency (herein the Central Bank) to set such further requirement as it may deem fit to effectively carry out its mandate.<sup>100</sup> Further specific and detailed requirements, where the BoB exercises discretion include a minimum capital requirement which has been set at P5million, technical knowledge, experience of the applicant, character of the business and the needs of the community or market to be served.<sup>101</sup>

The Non-Bank Financial Institutions (NBFIs) can be classified into six categories. These are the capital markets comprising of the Botswana Stock Exchange, Pensions and Provident Funds, Insurance, Collective Investment Undertakings, Non-bank lenders (for example Micro finance Institutions), and, lastly, Asset Managers.<sup>102</sup> The bulk of the aforementioned categories remained unregulated and unsupervised before the establishment of NBFIRA in 2006. The few that were regulated such as the Botswana Stock Exchange and the Pensions and Provident Funds were under the purview of the Minister of Finance and Development Planning.

NBFIRA, like BoB aims to ensure ultimate stability, safety, soundness, and high standards within the NBFIs. It performs its objectives in terms of the various rights and regulatory functions conferred by the Acts.<sup>103</sup> Similarly, these principal Acts merely set the base for

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<sup>99</sup> BoB annual report 2013 23.

<sup>100</sup> This is also noted in Section 8 (3) of the Banking Act.

<sup>101</sup> Botswana FSO 2009/2010 9.

<sup>102</sup> Bojosi K 'An appraisal of the new legal framework for the regulation of non-bank financial institutions in Botswana.' (2012) 15 *University of Botswana Law Journal* 29 31.

<sup>103</sup> Sections 7 and 8 of the NBFIRA Act.

NBFIRA's work and it continues to be tasked with creating prudential rules and regulations to supplement and complement the rules under the main statutes.<sup>104</sup>

The relationship between NBFIRA, the Ministry of Finance and Development Planning and the BoB is also observed in the composition of the NBFIRA Board of Directors.<sup>105</sup> Both the Central Bank Governor and the Permanent Secretary to the Ministry sit on the Board *ex officio*. Moreover, NBFIRA shall consult and/or enter into agreements with the BoB and other government departments as regards its regulation and supervision activities, taxation, social security or the general financial system.<sup>106</sup>

In light of the above relationship, questions have been raised about the independence of NBFIRA which is a crucial factor for any regulatory authority. A discussion of the independence and accountability of the Unification Model follows below.

## 2.7.2 MALAWI

### 2.7.2.1 Introduction

The Reserve Bank of Malawi (RBM) was established in July 1964 under an Act of Parliament (Reserve Bank of Malawi Act Chapter 44:02 of the Laws of Malawi) and started its operations in June 1965 replacing the Federal Bank of Rhodesia and Nyasaland which was serving as the central bank of the Federation of Rhodesia and Nyasaland.<sup>107</sup>

The evolution of today's Malawian financial sector can be traced to the late 1980's when the RBM and the Banking Acts were put under review.<sup>108</sup> This review led to the establishment of the presently operational Banking Act of 1989. Other Acts such as the Capital Market Development Act were also introduced to enhance the Malawian financial sector.

As at 31 December 2012, the Malawian banking sector comprised twelve commercial banks with over seventy branches across the country. These are the National Bank of Malawi, Standard Bank, First Merchant Bank, NBS Bank, Malawi Savings Bank, Indebank Limited,

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<sup>104</sup> Mosinyi W 'Bank CEO quits to play 'second fiddle' at NBFIRA' *Mmegionline* accessed 12 December 2014 at <http://www.mmegi.bw/index.php?sid=4&aid=40&dir=2009/October/Friday2>.

<sup>105</sup> Section 11 of the NBFIRA Act.

<sup>106</sup> Section 40(1) and (2) of the NBFIRA act.

<sup>107</sup> Reserve Bank of Malawi accessed 14 December 2014 at <https://www.rbm.mw/>.

<sup>108</sup> Kalanda A, 'Development of Malawi's Microfinance Regulation and Supervision' (2006) *Essays on Regulation and Supervision* 4.

NEDBANK Malawi Limited, Opportunity Bank of Malawi, ECOBANK Malawi Limited, FDH Bank, International Commercial Bank, and CDH Investment Bank.<sup>109</sup>

Other members of the finance sector include two leasing companies, one discount house, a building society, a finance company, four development institutions, and several insurance companies and pension funds.<sup>110</sup> As can be observed, banks, dominate the financial sector accounting for 80% of total financial sector assets. Further, two main banks hold more than 50 per cent of the banking industry's total assets and deposits.<sup>111</sup> Meanwhile, less than 20 per cent of the Malawian population have access to banking services while only 3 per cent utilise insurance products.<sup>112</sup>

Despite these apparent challenges Malawi's financial sector has remained broadly sound as it strives to comply with Basel II requirements.<sup>113</sup>

#### 2.7.2.2 Regulation of Malawi's Financial Sector

The RBM is the central player in the Malawian financial system. It is committed to safeguarding financial stability and tightening financial sector surveillance and monitoring.<sup>114</sup> Formal regulatory reforms in Malawi commenced in 2002 under the auspices of the World Bank and the Malawian Government. The Malawian Financial Sector Regulatory Reform Program revealed *inter alia* the underdeveloped and bank-centric nature of the Malawian financial sector.<sup>115</sup>

It is upon such realisation that Malawi has adopted the *full* Unification Model where the Registrar of Financial Institutions who is the Governor is the Reserve Bank of Malawi is the regulator and supervisor of the entire financial sector.<sup>116</sup> The Malawian Financial Services

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<sup>109</sup> Reserve Bank of Malawi Bank Supervision Annual Report 2012 accessed 14 December 2014 at <http://www.rbm.mw/documents/basu/RBM%20BASU%20ANNUAL%20REPORT%202012.pdf>.

<sup>110</sup> Burritt K, 'Expanding Access to Financial Services in Malawi' UNCDF

<sup>111</sup> Mwanakatwe P 'Malawi 2014' AIDB, OECD, UNDP 2014 accessed 14 December 2014 at [www.africaneconomicoutlook.org](http://www.africaneconomicoutlook.org) (hereinafter Mwanakatwe P 'Malawi 2014').

<sup>112</sup> Mwanakatwe P 'Malawi 2014' 9.

<sup>113</sup> Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) 32-42 which candidly explains the history of the Basel requirements from Basel I of 1997 and ultimately that Basel I was agreed on in 2004 based on the three pillars of minimum capital requirements, supervisory review and market discipline.

<sup>114</sup> Mwanakatwe P 'Malawi 2014' 10.

<sup>115</sup> Speech by the Deputy Bank Governor of the Reserve Bank of Malawi (Supervision of Financial Institutions) one Grant Kabango at a seminar on Financial Service Laws for Lawyers on the 22<sup>nd</sup> June 2012 in Zomba, Malawi accessed 14 December 2014 at <http://www.bis.org/review/r120904c.pdf>

<sup>116</sup> Presentation on Regulation of Financial Cooperatives: The Case of Malawi by Mtchaisi Chintengo being the Chief Examiner (Microfinance Institutions and SACCOS) at the Reserve Bank of Malawi accessed 12 December 2014 at

Act of 2010<sup>117</sup> provides in its *preamble* that it is ‘An Act to make provision for the supervision and regulation of financial institutions and for matters connected therewith and incidental thereto’.

It therefore provides the foundation for the regulation and supervision of financial institutions in Malawi which aims to fulfil the main object of fostering safe and sound financial institutions with high standards and general stability of the financial system.<sup>118</sup>

Additionally, the Government of Malawi together with the RBM adopted a policy drive to address the deficit in the non-bank financial sector in order for it to add a degree of resilience to the existing financial system. One of its biggest achievements is the Pensions Act of 2011 which cured Malawi’s awkward, fragmented and non-comprehensive original social security system to create a solid framework for the operation and regulation of the system.<sup>119</sup>

Although all being housed in the Central Bank, the RBM like Botswana’s NBFIRA has several ‘subsets’ within the single regulator aimed at the regulation of different aspects of the financial sector. The three main ones are: the bank supervision department, the pensions and insurance department, and the microfinance and capital markets department.

Under the 1989 Banking Act and the Reserve Bank of Malawi Act, the RBM is tasked with supplementing the provisions of the Acts by issuing prudential directives that will assist Malawi in complying with international standards. An example of this is Directive NO. LRR1-07 FMO being the Liquidity Reserve Requirement authorised by Section 38 of the Banking Act of 1989, (CAP 44:01 Laws of Malawi), and Section 30, 36 and 48 of the Reserve Bank of Malawi Act, 1989, (CAP 44:02 Laws of Malawi).<sup>120</sup>

The existence of one regulator in Malawi for the entire financial sector has been seen as advantageous to the extent that it creates leverage on financial resources, utilises fully the available knowledge and skills and creates a solid information network for the regulation and supervision of financial institutions.

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<http://www.treasury.gov.za/coopbank/Conferences/CFI%20Indaba%20and%2014th%20SACCA%20Congress%2028%20Oct%20-%201%20Nov%202013/Regulation%20of%20financial%20cooperatives.pdf> .

<sup>117</sup> Accessed 12 December 2014 at

<https://www.rbm.mw/documents/basu/FINANCIAL%20SERVICES%202010.pdf>

<sup>118</sup> Section 3 Malawian Financial Services Act paraphrased.

<sup>119</sup> Mhango M & Thejane P ‘The Malawi Pensions Act: A General Commentary on some of the core mandatory provisions with specific reference to sections 9, 10, and 15’ (2012) 129 *The South African Law Journal* 758

<sup>120</sup> Directive on the Liquidity Reserve Requirement accessed 14 December 2014 at <https://www.rbm.mw/documents/basu/Liquidity%20Reserve%20Requirement%20No%20LRR1-07-FMO.pdf>.

## 2.8 Conclusion

Finally, there is need for one to look at whether this Unification Model is both independent and accountable and viable for the SADC region. From the above analysis, it can be submitted that accountability of the model would not create the biggest concern as only one or two entities (depending on the type of unification) will be held accountable. The one-stop shop approach to data collection may also be beneficial for the model's accountability.

The greatest concern is the independence of this model. Independence is needed in various forms, such as, regulatory, supervisory and budgetary independence.<sup>121</sup> The Malawian example is a clear depiction of how independence of the agency in all the above respects may be compromised. For example with the funding mostly coming from the government, there is no doubt that this is an indication that there is a deficit in the budgetary independence of the regulator. The regulatory and supervisory functions of the entire state are housed in the Central Bank, a precarious place which might be subject to indirect political influence. A more significant and direct influence is seen with the Governor of the RBM which is a political office.<sup>122</sup>

Botswana is no exception. NBFIRA has a legislative obligation to report and consult the Minister of Finance and Development Planning who also sits on the authority's Board. The Minister is a political figure with natural political endeavours, ties and ideas that may not positively benefit the regulatory authority. Political pressures are very detrimental to financial services regulators and supervisors and often render them incapacitated and unable to perform their duties turning them into 'toothless bulldogs'.<sup>123</sup>

One very noteworthy argument is made in the case of Malawi. Nkowitz<sup>124</sup> insightfully submits that Malawi's recent financial sector reform did not use the SADC's FIP as a guideline and therefore its tenets are in some respects not in tune with SADC's ultimate mission of regional integration. Some of the reasons he advances are that Malawi's transformation began long before the adoption of the 2006 SADC FIP and that even after its

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<sup>121</sup> Madise S *Developing an Independent Regulatory Framework for the Financial Sector in Malawi* (unpublished LLM thesis, University of the Western Cape 2010-2011) 19.

<sup>122</sup> Nkowitz Z 'The SADC Finance and Investment Protocol and the Reform of the Malawian Financial Services Regulatory Framework: Reflections in Retrospect' (2009) (3)(1) *Malawian Law Journal* 7 20.

<sup>123</sup> International Monetary Fund Working paper, *The Accountability of Financial Sector Supervisors: Principles and Practice* (March 2005).

<sup>124</sup> Nkowitz Z 'The SADC Finance and Investment Protocol and the Reform of the Malawian Financial Services Regulatory Framework: Reflections in Retrospect' (2009) (3)(1) *Malawian Law Journal* 7 17.

adoption it remained relatively unknown to some stakeholders involved in the Malawian reform process.

The next chapter analyses the Twin Peaks Model with South Africa as the case in point for its adoption in SADC. Thereafter, the mini-thesis continues to discuss the other primary model being the Silos Model before attempting to make a noteworthy recommendation regarding SADC's regional regulator.



## CHAPTER 3

### THE TWIN PEAKS MODEL

#### 3.1 INTRODUCTION

The previous chapter discussed the Unification Model which denotes, as the term suggests, a model that is united and falls under one umbrella regulator and supervisor. Although this is truly an oversimplification of the nature and character of the Unification Model, it is perhaps a good starting point when one introduces the Twin Peaks Model which, as the name also suggests has two ‘twin’ authorities regulating and supervising the financial sector.

The Twin Peaks Model as it is understood today is the brain child of an officer of the Bank of England one Michael Taylor who first advocated for it in his famous 1995 compilation ‘*Twin Peaks*’: *A Regulatory Structure for the New Century*.<sup>125</sup> The gist of his proposal was to make a clear distinction between the prudential regulators which would focus on systemic protection vis-à-vis the conduct of business regulator having consumer protection objectives.<sup>126</sup> Often an analogy is made of a ‘doctor’ role for the prudential arm and a ‘cop’ for the conduct of business arm.<sup>127</sup> Whereas the doctor will focus on curing the illness in the financial system, cop will police and address regulatory breach.

Thereafter, the next pivotal recollection in the evolution of the Twin Peaks Model is in Australia under the Financial Systems Inquiry of 1997 (Wallis Inquiry 1997).<sup>128</sup> Therein, a radical change to the financial services regulation and supervision in Australia was recommended and Australia became the first country to adopt the Twin Peaks Model in 1998.<sup>129</sup> The result was that Australia abandoned its Silos Model with ten regulators (the Silos Model is discussed further in chapter 4) and created two new regulators as envisioned by the Twin Peaks Model. These are the Australian Prudential Regulatory Authority (APRA)

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<sup>125</sup> Bakir C ‘The Governance of Financial Regulatory Reform: The Australian Experience’ (2009) 87(4) *Public Administration* 910-917.

<sup>126</sup> Taylor M ‘The Road from “Twin Peaks” and the Way Back’ (2009) 16(1) *Connecticut Insurance Law Journal* 61.

<sup>127</sup> Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) 191

<sup>128</sup> Financial Systems Inquiry Final Report (18 March 1997) accessed 18 February 2015 at <http://www.google.co.bw/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&cad=rja&uact=8&sqi=2&ved=0CCcQFjAC&url=http%3A%2F%2Fsi.treasury.gov.au%2Fcontent%2Fdownloads%2FFinalReport%2FPrelim.doc&ei=kWrkVNLKCYaT7AaLIYGYBg&usq=AFQjCNFTRGwN3yf9mgPDRm9fo4ofKStRaQ&sig2=ws4gW3w4qLjx2Bi8RF4LFO&bvm=bv.85970519,d.ZWU>.

<sup>129</sup> Bakir C ‘The Governance of Financial Regulatory Reform: The Australian Experience’ (2009) 87(4) *Public Administration* 910-911.

which became fully operational 1 July 1998 and the Australian Securities and Investment (ASIC) with the former as the prudential regulator and the latter being for conduct of business.<sup>130</sup>

### 3.2 What is the Twin Peaks Model?

Like the Unification Model, the Twin Peaks Model is not set along institutional lines and is regulation and supervision by objectives. For its part it envisages the creation of two agencies responsible for prudential and conduct of business regulation and supervision.<sup>131</sup> Simply, the former's main objective is to ensure the safety and soundness of the institutions (protect customers' assets) whereas the latter focuses on consumer protection (protect customers' rights).<sup>132</sup> Since these two pillars of prudential regulation and conduct of business form the bedrock of the Twin Peaks Model it is vital for one to have a deeper understanding of what these entail.

#### 3.2.1 Prudential Regulation

Prudential regulation aims to 'safeguard the stability of the financial system and to protect deposits'.<sup>133</sup> Therefore it examines the 'deposit takers' in the financial sector being both the banks and the non-bank financial institutions to ensure that they are being operated in a sensible way within the confines of the law. An interesting position is advanced by a professor of economics one Joshua Aizenman that for as long the economy is healthy the 'financial doctor' being the prudential regulator is considered redundant.<sup>134</sup> He calls this the paradox of prudential regulation in the capitalist economy.

This paradox, he further submits, is what ultimately leads to a financial calamity because for as long as the prudential regulator is perceived as redundant and as an inhibitor of growth and development, the players in the financial market become complacent. In some instances the calamity isn't created by the complacency of the financial service providers but by loopholes in the prudential regulations and weak enforcement of the same.<sup>135</sup> Brownbridge cites Zambia

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<sup>130</sup> Hussain B *Integrated Financial Supervision and its Implications for Banking Sector Stability* (unpublished honours thesis, New York University, 2009) 7.

<sup>131</sup> Llewelyn 2006 27.

<sup>132</sup> Strickett C 'What do the changes in regulation mean for the SA insurance industry?' *CapeTimes Business Report* 30 April 2015

<sup>133</sup> Brownbridge M 'Policy Lessons for Prudential Regulation in Developing Countries' (2002) 20(3) *Development Policy Review* 305 306.

<sup>134</sup> Aizenman J 'On Prudential Regulation: To Regulate Foreign or Domestic Intermediation?' *Havard International Review* (Winter 2009) 56.

<sup>135</sup> Brownbridge M 'Policy Lessons for Prudential Regulation in Developing Countries' (2002) 20(3) *Development Policy Review* 305 307-308.



as a country where the bank licensing regulations were lax leading to banks with inadequate capital being licensed.<sup>136</sup> If this led to calamity the issue then isn't that the prudential regulator didn't properly discharge its functions but that the regulations in themselves are insufficient.

### 3.2.2 Conduct of Business

Conduct of business regulations create an obligation on the financial companies or financial service providers to act fairly and impartially towards their consumers.<sup>137</sup> In its purest form it 'recognises that ordinary consumer protection laws do not go far enough when dealing with the financial sector, which needs much higher and tailored standards than generic legislation'<sup>138</sup>. Therefore, consumer protection issues are at the heart of conduct of business regulation.<sup>139</sup> Simply, conduct of business regulation dictates how financial service providers should carry on their business with their customers.

Some of the objectives embodied in conduct of business regulation are to protect consumers from incomplete information, bad practices and generally unfair rules that financial firms may impose on their consumers making their positions weak in the financial contracts.<sup>140</sup>

One cannot speak of the Twin Peaks Model and not mention the opposing views advanced by many scholars on this notion that Taylor had conceived. The biggest criticism to the Twin Peaks Model was that Taylor's distinction between the prudential regulator and the conduct of business regulator was not as clean and neat as he had outlined it. In fact the idea was seen as duplicitous in some regards and impractical and unrealistic in others.<sup>141</sup> This is when the Unification Model (as discussed above in Chapter 2) was seen as a better alternative for the United Kingdom as opposed to the Twin Peaks Model since it had an all-encompassing approach that would ideally be more efficient.

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<sup>136</sup> Brownbridge M 'Policy Lessons for Prudential Regulation in Developing Countries' (2002) 20(3) *Development Policy Review* 305 307-308.

<sup>137</sup> Irish Financial Services Regulatory Authority *Consultation Paper on the Review of Conduct of Business Rules for Financial Service Providers* (March 2004)

<sup>138</sup> National Treasury of South Africa Discussion Document *Treating Customers Fairly in the Financial Sector: A Draft Market Conduct Policy Framework for South Africa* (December 2014) as subsequently amended accessed 20 March 2015 at <http://www.treasury.gov.za/public%20comments/FSR2014/Treating%20Customers%20Fairly%20in%20the%20Financial%20Sector%20Draft%20MCP%20Framework%20Amended%20Jan2015%20WithAp6.pdf> (hereinafter *NT Treating Customers Fairly*).

<sup>139</sup> Financial Services Authority Occasional Paper 2 *The Rationale for Single National Financial Services Regulator* (May 1999) 24.

<sup>140</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 15

<sup>141</sup> Financial Services Authority Occasional Paper 2 *The Rationale for Single National Financial Services Regulator* (May 1999) 24.

Needless to say Taylor's critics were disappointed when the global financial crisis revealed that the Unification Model had, at least in the UK scenario, compromised prudential regulation and focused mainly on conduct of business which meant that critical issues of systemic stability has simply slipped through the cracks.<sup>142</sup>

### 3.2.3 The role of the Central Bank

Salient to the discussion on the Twin Peaks Model is the role of the central bank. In some jurisdictions the prudential authority is housed in the Central Bank (South Africa and the Netherlands) whereas other jurisdictions an independent entity is formed (Australia).<sup>143</sup> An informed submission has been made by Carmichael that in emerging markets (SADC being no exception) prudential regulation should be kept with system stability within the central bank.<sup>144</sup> This in simple terms means that if SADC was to propose the Twin Peaks Model the prudential peak should ideally remain in the Central Bank.

From conception the Twin Peaks Model aims not only to reap the benefits and efficacies of the Unification Model but to take a step further in addressing a common conflict that may arise within the unified context. This is in the case where prudential regulation is in conflict with conduct of business regulation and consumer protection issues, there is no bulldozing in the Twin Peaks Model therefore no regulation will be deemed 'superior'.<sup>145</sup>

## 3.3 Advantages of the Twin Peaks Model

### 3.3.1 Clearly defined objectives

Unlike with the Unification Model where objectives can be blurred, under the Twin Peaks Model the two agencies have clearly defined objectives enabling them to carry out their work expediently and creating an obligation of accountability on the part of each agency.<sup>146</sup> The author's understanding goes as far as suggesting that each of the 'peaks' keeps checks and balance on the other and ensures that each is performing their designated roles.

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<sup>142</sup> Taylor M 'The Road from "Twin Peaks" and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 61; Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 25.

<sup>143</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 28.

<sup>144</sup> Carmichael J *Regulatory Structure* Presentation at Regional Seminar of NBFIs in East Asia, Bangkok September 2002 accessed 25 February 2015 at <http://info.worldbank.org/etools/docs/library/157129/nbfilac/pdf/03carmichael2.pdf>.

<sup>145</sup> Group of Thirty *The Structure of Financial Supervision: Approaches and Challenges in a Global Marketplace* (2008) accessed 20 February 2015 at <http://www.group30.org/images/PDF/The%20Structure%20of%20Financial%20Supervision.pdf>.

<sup>146</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 28.

This advantage is undoubtedly vital to the development of a regional regulator for SADC since it will be operating and working in over ten jurisdictions. The problem of unclear objectives can lead to unwanted political influence and interference and therefore the idea that a regulator can have clearly set objectives is an attractive feature for the proposed SADC model.

### 3.3.2 Balanced Regulation and Supervision

When only one unified regulator is in place there is a danger that only one aspect of regulation will be 'guarded' often at the expense of the other. For instance, it has been alleged that with the Unification Model focus is on the prudential aspect and the conduct of business wing lags behind.<sup>147</sup> In the UK scenario, the inverse was discovered where focus appeared to have been on the conduct of business at the expense of the prudential wing.<sup>148</sup> Since the Twin Peaks Model embodies two distinct agencies, no one should dominate over the other.

Similarly, a model that strives to have a balanced approach to regulation and supervision will be ideal for the proposed SADC regional regulator because when a regulator covers a large spectrum, if one 'arguably insignificant' aspect is overlooked it could culminate into a problem in the regulatory process and make it susceptible to manipulation. Hypothetically if during times of financial tranquillity prudential regulation was overlooked by a regional regulator in the entire SADC region, it is truism that financial service providers would try and manipulate the situation (such as take bigger unwarranted risks) which could lead to financial calamity.

### 3.3.3 Less concentration of power

As compared to the Unification Model, the Twin Peaks has less concentration of power with one entity. This allows the Twin Peaks Model to accommodate changes taking place in the financial services market.<sup>149</sup> The Australian proactive and anticipatory approach to the adoption of this model is the best example to cite when the twin peaks' accommodative nature is discussed. Despite the fact that nothing was inherently wrong with the old

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<sup>147</sup> Group of Thirty *The Structure of Financial Supervision: Approaches and Challenges in a Global Marketplace* (2008) 40 accessed 20 February 2015 at <http://www.group30.org/images/PDF/The%20Structure%20of%20Financial%20Supervision.pdf>.

<sup>148</sup> HM Treasury White Paper on Reforming Financial Markets (CM 7667 of July 2009) accessed 18 March 2015. at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/238578/7667.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/238578/7667.pdf).

<sup>149</sup> Bakir C 'The Governance of Financial Regulatory Reform: The Australian Experience' (2009) 87(4) *Public Administration* 910 918.

Australian model, it was the astuteness of the Wallis Inquiry that put Australia in an 'accommodative' position when the global financial crisis hit in 2008.<sup>150</sup>

As already noted SADC is comprised of emerging economies and therefore changes in the financial services is an undeniable consequence of any developing economy. A regulatory framework that is accommodative in nature would be beneficial to any financial services sector going through changes. More significantly and has been highlighted throughout the entire research the SADC Member States are at different levels of economic advancement and therefore a regulator that has the elasticity to accommodate all these diverging economies would be welcome.

#### 3.3.4 Better regulation of Financial Conglomerates

The best way to elucidate this advantage is to draw from the lessons of the United Kingdom. After Taylor's Twin Peaks proposal was rejected and the Unification Model adopted in the UK, the global financial crisis hit in 2007 leading to the failure of the Northern Rock mortgage bank in the UK which could be characterised as a financial conglomerate.<sup>151</sup>

One of the realisations in the wake of the crisis was that the single regulator had focused mainly on conduct of business at the expense of the prudential wing of regulation.<sup>152</sup> This is not a sentiment expressed by Taylor alone, the British Government's White Paper on regulatory reform after the crisis also stated that 'too much weight had been placed on conduct of business regulation of the banking sector rather than prudential regulation of banking institutions',<sup>153</sup>

In the previous chapter mention is made of the growing number of financial conglomerates in SADC, it goes without question that a model that proposes to address the regulation and supervision of financial conglomerates in a more effective manner is an attractive option and indeed a worthwhile consideration for the SADC regional regulator.

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<sup>150</sup> Australian Prudential Authority Working Paper 3 *APRA and the Financial System Inquiry* (January 2000) accessed 19 April 2015 at <http://www.apra.gov.au/AboutAPRA/Research/Documents/APRA-and-the-Financial-System-Inquiry-Jan-2000.pdf> .

<sup>151</sup> 'Northern Rock Lessons of the Fall: How a financial darling fell from grace and why regulators did not catch it' *The Economist* 18 October 2007 accessed 18 March 2015 at <http://www.economist.com/node/9988865> .

<sup>152</sup> Taylor M 'The Road from "Twin Peaks" and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 61 80.

<sup>153</sup> HM Treasury White Paper on Reforming financial Markets (CM 7667 of July 2009) accessed 18 March 2015 at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/238578/7667.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/238578/7667.pdf) ; MacNeil I 'The Trajectory of Regulatory Reform in the UK in the Wake of the Financial crisis' (2010) 11 (4) *European Business Organisational Law Review* 483 517.

### 3.4 Disadvantages of the Twin Peaks Model

#### 3.4.1 New wave of Overregulation

From those from the Unification Model, the Twin Peaks Model with two regulators may appear to be an over regulation and as such can be classified as a disadvantage. As has been aptly described by one author ... 'having to jump to the tune of two units rather than one is not something that fills the industry with glee.'<sup>154</sup> This overregulation fear may be founded in some respects especially as far as the actual number of regulators is concerned but this doesn't necessarily always amount to an 'overregulation' in the true because the result in any regulatory mechanism is to address prudential and conduct of business regulation. Whether such is undertaken in one Unification Model or in the Twin Peaks Model doesn't in any way create a further obligation 'over and above' the primary regulatory mandate. Therefore, this disadvantage should be understood only as far as it differs from the one-stop shop created by the Unification Model.

Assuming the Twin Peaks Model is recommended for the SADC regional regulator and further that the position by Carmichael on the position of the central bank in emerging markets is also supported<sup>155</sup>, then in the SADC context, this disadvantage would not be strongly felt because the central banks (which would then be the prudential peaks) have always had an integral part in the regulatory structures of the Member States. There would in essence be no 'overregulation' per day.

#### 3.4.2 Elimination of Checks and Balances

Unlike in the case of multiple regulators, only one regulator for market conduct may lead to a reduction in the necessary checks and balances. This could result in excessive use of powers.<sup>156</sup> This is best understood when one starts from the premise of the Silos Model

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<sup>154</sup> Quinn J 'Rainmaker: Twin Peaks regulation gets a poor review' *The Telegraph* 31 March 2012 accessed 20 February 2015 at <http://www.telegraph.co.uk/finance/comment/james-quinn/9178018/Rainmaker-Twin-peaks-regulation-gets-a-poor-review.html>

<sup>155</sup> Carmichael J *Regulatory Structure* Presentation at Regional Seminar of NBFIs in East Asia, Bangkok September 2002 accessed 25 February 2015 at <http://info.worldbank.org/etools/docs/library/157129/nbfi-lac/pdf/03carmichael2.pdf> where he submits that central banks in emerging markets should be the prudential peak

<sup>156</sup> Bailey S 'Super regulator' *Chartered Accountants Journal* December 2010 accessed 20 February 2015 at <http://www.google.co.bw/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0CBwQFjAA&url=http%3A%2F%2Fnzica.com%2FTechnical%2FGovernment-policy%2F~%2Fmedia%2FNZICA%2FDocs%2FTech%2520and%2520Bus%2FGovernment%2520policy%2FSuper%2520regulator%2520article%2520December%25202010.ashx&ei=RSTuVKjDHcuxUZvegPAI&usg=AFQjCNGEItY1YW589n0gTRWoy4s-IgWBUw&sig2=G6qVxFefAQItzn9tKH89OA&bvm=bv.86956481,d.ZWU> .

(which is discussed fully in Chapter 4). The idea is that each ‘industry’ within the financial sector will have its own conduct of business regulator. The introduction of a conduct of business regulator for the entire financial sector through the Twin Peaks Model can therefore appear to be eliminating check and balances that the individual regulators would have vis-à-vis each other.

In a discussion of a SADC regulator one needs to be weary of this not only because some SADC states have the Silos Model in place and could legitimately raise these concerns; but also because the regulator will be tasked with setting conduct of business standards cutting across a spectrum of countries with such strong and firmly rooted disparities that any careless attempt at a compromise may genuinely eliminate checks and balances.

### 3.4.3 Regulatory Overlap

Conceptually the regulatory overlap is best captured by Briault in the following way:

*“There is a considerable overlap – both conceptually and in practice – between prudential and conduct of business regulation. Both have a close and legitimate interest in the senior management of any financial institution subject to both of these types of regulation, in particular because of the crucial roles of senior management in setting the “compliance culture” of a firm...”<sup>157</sup>*

These sentiments were expressed in Briault’s 1999 paper as a response to Taylor’s Twin Peaks proposal in 1997. Briault was in support of the UK adopting the Unification Model, which it in fact did at the material time. Although it has already been stated that the UK has subsequently abandoned this model for the Twin Peaks Model<sup>158</sup>; this doesn’t make the Twin Peaks Model infallible.

The best cited example indicating this disadvantage is the Australian situation. The argument is correctly so, that the ASIC and the APRA in reality regulate the same entities and often require different regulatory requirements which can be cumbersome on the entity.<sup>159</sup> An example is subsequently cited in relation to the superannuation industry where entities are

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<sup>157</sup> Financial Services Authority Occasional Paper 2 *The Rationale for Single National Financial Services Regulator* (May 1999) 25.

<sup>158</sup> MacNeil I ‘The Trajectory of Regulatory Reform in the UK in the Wake of the Financial crisis’ (2010) 11 (4) *European Business Organisational Law Review* 483 492.

<sup>159</sup> Chaaya M *The regulation of Trustee Governance in Australia: Time for a Rethink?* 13<sup>th</sup> IPELBA 13<sup>th</sup> Conference Berlin, Germany 23 May 2011.

required to comply with financial service requirements (ASIC) and responsible superannuation entity requirements (APRA).

This disadvantage is crucial in the determination of the best model for the SADC framework because one of the main reasons advanced as a need for a regional regulator and supervisor is regulatory overlap among the SADC Member States. However, the current SADC overlap doesn't relate to two arms of regulation administering different requirements over the same financial matter; but rather different states with different regulatory matrix seeking adherence from the same financial institution over the same matter in a different way. It would be (to some extent) going against reason to recommend a regulatory model that will create the same problem it was put in place to address.

### 3.5 CASE STUDY

#### 3.5.1 SOUTH AFRICA

##### 3.5.1.1 Introduction

Before the introduction and implementation of the Twin Peaks Model in South Africa, the South African regulatory framework comprised of multiple government agencies, self advisory and oversight committees and self regulatory organisations.<sup>160</sup> Although one can submit that the model had naturally evolved and aligned itself with the needs of the booming post-apartheid South African economy, its roots can be correctly traced to the De Kock Commission's report of 1985.<sup>161</sup> It is however not clear from the structure whether one can classify it as the partial Unification Model similar to Botswana or whether it takes a more complicated stance. It has been suggested that the old South African model loosely took after the United Kingdom and Canadian models.<sup>162</sup>

The main agencies responsible for the regulation and supervision of the South African financial sector (pre-twin peaks) were the Bank Supervision Department (BSD) of the South African Reserve Bank (SARB), tasked to regulate and supervise banks<sup>163</sup>; the Financial Services Board of South Africa (FSB-SA) with the role to regulate and supervise most non-

<sup>160</sup> Financial Stability Board *Peer Review of South of South Africa* (5 February 2013).

<sup>161</sup> Kantor B S 'The De Kock Commission Report: A Monetarist Perspective' (1986) 54(1) *The South African Journal of Economics* 94 ; See also Address by Governor of the South African Reserve Bank one Dr. C Stals in Pretoria on the 15 May 1997 accessed 19 February 2015 at <http://www.bis.org/review/r970602b.pdf> .

<sup>162</sup> De Jager J 'South African Reserve Bank: Blowing Winds of Change (Part 2)' (2013) 25 *South African Mercantile Law Journal* 492 506.

<sup>163</sup> The Banks Act No. 94 of 1990 accessed 19<sup>th</sup> February 2015 at <https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/2591/Banks+Amendment+Act+2007%5B1%5D.pdf> provides for the regulation and supervision of banks.

bank financial institutions and securities markets. Thus far, the model appears to resemble the partial Unification Model, however, a further National Credit Regulator (NCR) under the Department of Trade and Industry (DTI), is responsible for regulating the market conduct aspects of granting of consumer credit by all credit providers.<sup>164</sup>

From as early as September 1992 discussions focusing on the possible restructuring of the financial services regulators and supervisors in South Africa commenced.<sup>165</sup> In 2007, government launched a formal review of the regulatory system. It was however only in 2009 after the Global Financial crisis hit in 2008 that the deliberations gained momentum.

Ultimately in February 2011 the Ministry of Finance published a document titled *A Safer Financial Sector to Serve South Africa Better*<sup>166</sup> (known also as the Red Book) taking into account the lessons learnt from the crisis and setting out the new 'South African' Twin Peaks Model. Although the rest of this research refers to this model as simply the Twin Peaks Model, it is perhaps vital to note that the model to be adopted by South Africa is not the twin peaks in its purest form. Naturally, it is a permutation and modification altered to best suit the circumstances of the state but undoubtedly, the core and marrow of the new South African regulatory framework is Twin Peaks.

It came as no surprise when on the 22 February 2012 in his budget speech the Minister of Finance Pravin Gordhan said;

*“As announced last year, we intend to shift towards a twin peaks system for financial regulation, where we separate prudential from market conduct supervision of the financial sector. Consultations will continue this year, with a view to tabling legislation in early 2013.”*<sup>167</sup>

The first draft legislation guided by the fifteen cabinet approved principles<sup>168</sup> was tabled in December 2013 as the Financial Sector Regulation Bill (hereinafter FSR Bill) and the second

<sup>164</sup> Financial Stability Board *Peer Review of South of South Africa* (5 February 2013) 5.

<sup>165</sup> De Jager J 'South African Reserve Bank: Blowing Winds of Change (Part 2)' (2013) 25 *South African Mercantile Law Journal* 492 507.

<sup>166</sup> Accessed 20 March 2015 at <http://www.treasury.gov.za/documents/national%20budget/2011/A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf> ; see also Financial Regulatory Reform Steering Committee 'Implementing a Twin Peaks Model of Financial Regulation in South Africa' 1 February 2013

<sup>167</sup> 2012 South African Budget Speech accessed 19 February 2015 at <http://www.treasury.gov.za/documents/national%20budget/2012/speech/speech.pdf> .

<sup>168</sup> The fifteen principles are succinctly outlined in the Response and Explanatory Document Accompanying the Second Draft of the Financial Sector Regulation Bill issued by the National Treasury in December 2014 accessed



draft was tabled in December 2014. Consultations with relevant stakeholders are still ongoing with the deadline for comments being the 2 March 2015.<sup>169</sup>

It must be categorically stated and clearly understood that the Twin Peaks Model in South Africa has not been fully implemented to form a part of the fabric of South African law. The author merely uses South Africa as indication of how a SADC country which has embraced this model intends to implement it. In his 2015 budget speech, the current Minister of Finance, Nhlanhla Nene after highlighting the need for the reform, informed that nation that the bill on the Twin Peaks Model will be tabled during the year.<sup>170</sup>

The driving force behind South Africa's new regulatory mechanisms is the desire to shift away from a fragmented regulatory approach and adopt a more robust and comprehensive regulatory system that will reduce the possibility of regulatory arbitrage. Secondly and arguably more importantly, the twin peaks was deemed suitable because South Africa's financial sector didn't have consumer interests at heart where 'wealthier, urban customers tend to get a wider range of more suitable products, while poorer and rural customers may get inappropriate or expensive financial services or none at all.'<sup>171</sup>

### 3.5.1.2 Regulation under the Twin Peaks Model

As highlighted above one of the main reasons for the adoption of the Twin Peaks Model in South Africa was the global financial crisis of 2008. Although South Africa's financial system 'weathered the storm', the ripple effects of the financial crisis led to one million job cuts in the Republic.<sup>172</sup>

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20 March 2015 at <http://www.treasury.gov.za/public%20comments/FSR2014/2014%2012%2012%20Response%20document.pdf> (herein after *NT Response and Explanatory Document* December 2014).

<sup>169</sup> National Treasury Media Statement on TWIN PEAKS: Second draft of Financial Sector Regulation Bill and draft Market Conduct Policy Framework discussion document published for comment accessed 20 February 2015 at [http://www.treasury.gov.za/comm\\_media/press/2014/2014121201%20-%20Media%20release%20FSR%20Bill%20and%20MCP.pdf](http://www.treasury.gov.za/comm_media/press/2014/2014121201%20-%20Media%20release%20FSR%20Bill%20and%20MCP.pdf).

<sup>170</sup> 2015 South African Budget Speech accessed 25<sup>th</sup> February 2015 at <http://www.treasury.gov.za/documents/national%20budget/2015/>.

<sup>171</sup> *NT Response and Explanatory Document* December 2014 6

<sup>172</sup> Financial Regulatory Reform Steering Committee *Implementing a Twin Peaks Model of Financial Regulation in South Africa* 1 February 2013

The Republic of South Africa through the guidance of President Jacob Zuma has subsequently undertaken commitments aimed at strengthening financial stability and overall growth of the economy post- the global financial crisis.<sup>173</sup> The main commitment areas are:

#### A stronger regulatory framework

This is undeniably the commitment that has given rise to the birth of the Twin Peaks Model. This important commitment can also be noted in South Africa G20 Comprehensive Growth Plan where it springs from the thirst of financial stability as an overall mandate.<sup>174</sup> Emphasis is also made on the need for this new phenomenon to embrace macro-prudential tools of regulation.

#### Effective Supervision

Like love and marriage a strong regulatory framework cannot be divorced from effective supervision. This commitment therefore complements and supplements the need for a stronger regulatory framework. More importantly, South Africa has taken the position that this commitment should encompass domestic and international coordination of regulators.<sup>175</sup>

This immediately suggests that a SADC regional regulatory and supervisory authority **could** genuinely be in the contemplation of the SADC Member States. Although it would be a distortion of this commitment to stretch it as far as suggesting a regional regulator, the need for international coordination is appreciated.

#### Addressing systemic issues and crisis resolution

The strong regulatory framework and effective supervision would inevitably address issues of systemic stability and crisis resolution. One can perhaps argue that this commitment is given its own place as a need to emphasise the macro-prudential approach to regulation.<sup>176</sup> The South African National Treasury states that this commitment seeks to ensure that; ‘...the

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<sup>173</sup> National Treasury *A Safer Financial Sector to serve South Africa Better* (23 February 2011) accessed 20 March 2015 at

<http://www.treasury.gov.za/documents/national%20budget/2011/A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf> (hereinafter NT ‘*A Safer Financial Sector to serve South Africa Better*’)

<sup>174</sup> Australia G20 2014 *Comprehensive Growth Strategy: South Africa* accessed 20 March 2015 at [https://g20.org/wp-content/uploads/2014/12/g20\\_comprehensive\\_growth\\_strategy\\_south\\_africa.pdf](https://g20.org/wp-content/uploads/2014/12/g20_comprehensive_growth_strategy_south_africa.pdf).

<sup>175</sup> NT *A Safer Financial Sector to serve South Africa Better* 4

<sup>176</sup> See footnote 20 in Financial Stability Board *Peer Review of South Africa* accessed 20 March 2015 at [http://www.financialstabilityboard.org/wp-content/uploads/r\\_130205.pdf](http://www.financialstabilityboard.org/wp-content/uploads/r_130205.pdf).

costs of a financial institution's failure are as small as possible, and that such a failure does not affect the broader financial system- **macro-prudential stance**.<sup>177</sup> (Emphasis mine)

#### International Assessment and Peer Review

This speaks to the need to regularly ensure that the regulatory and supervisory structures are in tune with international standards. In January 2013 South Africa amended its regulations to align then with Basel III requirements.<sup>178</sup> South Africa also undertakes peer reviews such as the one issued by the financial stability board in February 2013.<sup>179</sup>

Coupled with these four main commitments are policy objectives which are deliberately structured to enable a smooth transition into the Twin Peaks Model. The four main policy objectives are financial stability, consumer protection and market conduct, expanding access through financial inclusion and, combating financial crime.<sup>180</sup>

Under the Twin Peaks Model South Africa will have two main regulators; on the one hand is the prudential authority responsible for the safety and soundness of banks, insurance companies and other financial institutions, and on the other is the financial sector conduct authority mandated to oversee the manner in which financial services firms conduct their businesses and treat consumers.<sup>181</sup>

From a cursory glance one can easily discern that the above mentioned policy objectives are aligned with the new regulatory reform (i.e. Twin Peaks). The first policy objective on financial stability gels in with the prudential regulator making emphasis on the need for a macro-prudential approach to regulation. The need for macro-prudential regulation also appreciates that a crisis in one part of the financial sector may affect the entire economy and many other economies (such as the global financial crisis of 2008).

The second policy objective of consumer protection and market conduct is also in tune with the Twin Peaks Model's second peak of market conduct regulation. This objective springs

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<sup>177</sup> NT A Safer Financial Sector to serve South Africa Better 4

<sup>178</sup> See South African Reserve Bank website in the Implementation of Basel I and III requirements accessed 20 March 2015 at <https://www.resbank.co.za/RegulationAndSupervision/BankSupervision/TheBaselCapitalAccord%28Basel%20I%29/Pages/AccordImplementationForum%28AIF%29.aspx>.

<sup>179</sup> Financial Stability Board Peer Review of South Africa accessed 20 March 2015 at [http://www.financialstabilityboard.org/wp-content/uploads/r\\_130205.pdf](http://www.financialstabilityboard.org/wp-content/uploads/r_130205.pdf).

<sup>180</sup> NT A Safer Financial Sector to serve South Africa Better 4.

<sup>181</sup> Centre for International Finance and Regulation Research Working Paper Series *The Financial Sector Regulation Bill in South Africa: Lessons from Australia* (January 2015).

from South Africa's realisation that historically there has been an inherent neglect on market conduct regulation.<sup>182</sup>

The Financial Sector Regulation Bill (FSR Bill)<sup>183</sup> starts by setting out the mandate which naturally seeks to cover all issues from financial stability to consumer protection. The phrase that crisply captures the regulatory proposal states that the bill seeks '...to establish authorities to supervise and regulate, on a consistent and comprehensive basis, the provision of financial products and financial services in South Africa...'<sup>184</sup>

The prudential authority (Chapter 3 FSR Bill) will be housed within the South African Reserve Bank and will work within the administration of the Reserve Bank. It will focus on both micro and macro prudential aspects of regulation.<sup>185</sup> The objective of the said prudential authority is outlined in Section 28 of the FSR Bill as being to 'enhance the safety and soundness of financial institutions that provide financial products, market infrastructures or payment systems.'

Section 29 then outlines the functions of the prudential authority which include assisting the Reserve Bank in financial stability issues and cooperating with the Financial Service Conduct Authority and the National Credit Regulator. The Governor of the Reserve Bank is to appoint a Deputy Governor and the Chief Executive Officer of the Prudential Authority for a term not exceeding ten years (i.e. two five year terms).<sup>186</sup>

The Financial Service Board will be transformed into the Financial Sector Conduct Authority (Chapter 4 FSR Bill). Section 52 sets out the objective of the Financial Sector Conduct Authority generally as to protect financial customers. Its subsections give a further account on what this sought for protection entails. It is said to include treating customers fairly and giving educational programs in a bid to improve financial literacy.<sup>187</sup> In essence Section 52

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<sup>182</sup> NT A Safer Financial Sector to serve South Africa Better 29

<sup>183</sup> This refers to the latest bill which was issued in December 2014 with comments being closed on it on the 2 March 2015.

<sup>184</sup> Preamble to FSR Bill accessed 20 March 2015 at <http://www.treasury.gov.za/public%20comments/FSR2014/2014%2012%2011%20FSRB%20including%20Consequential%20Amendments%20and%20Memo%20of%20Objects.pdf>.

<sup>185</sup> Dixon J 'Twin Peaks Legislation near its Final Stages' *FSB Focus* (First Quarter 2014).

<sup>186</sup> Section 31 and 32 of the FSR Bill.

<sup>187</sup> Section 52(a) and (c) of the FSR Bill.

encapsulates the idea that market conduct regulation should minimise financial institutions' possibility to exploit customers or treat them in an unfair manner.<sup>188</sup>

Similar to Section 29 with the prudential authority Section 53 outlines the functions that the conduct authority should perform. Like the prudential authority it is tasked with coordinating and cooperating with the Prudential Authority and the National Credit Regulator.<sup>189</sup>

For its governance structure the Minister of Finance shall appoint in terms of Section 57(1) an appropriate person to be the Commissioner to the Financial Sector Conduct Authority. Thereafter the Minister must appoint at least two but no more than four Deputy Commissioners.<sup>190</sup>

Back to the proposed SADC model it must be noted that since the mechanisms set to churn and channel the twin peaks smoothly into the South African financial sector have not been started it is difficult for one to make an assessment of the twin peaks' practical advantages in a Southern African context. The assessment may however be made from the current theoretical stance and from the reasons advanced by South Africa in adopting the twin peaks.

### 3.6 Conclusion

The Twin Peaks is certainly an attractive regulatory framework for SADC for many reasons. In the first instance it makes a clear distinction between the prudential wing and conduct of business aspects which the last global financial crisis has shown require separate and equally dedicated agencies. This is of course the selling point of this model especially vis-à-vis the Unification Model which seeks to have the two important regulatory aspects under one roof.

#### Independence

As the author has tried to highlight throughout this research, independence is not isolation. The idea of a regulatory authority being independent should not be seen as equivalent to a suggestion that the regulatory authority should be isolated from the entire financial sector it wishes to regulate and/or supervise or from other arms of government.

In fact the regulator should work hand in hand with the arms of government in the fulfilment of its regulatory functions. The Twin Peaks Model, at least as far as the South African example goes, is relatively independent. Although the FSR Bill sets out the main objectives

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<sup>188</sup> NT *Treating Customers Fairly* 24.

<sup>189</sup> Section 53 (1) (b) FSR Bill.

<sup>190</sup> Section 53 (4) FSR Bill.

and the functions (as seen in sections 28 and 29 with prudential authority and 52 and 53 with conduct authority), it doesn't go to the extent of dictating the actual regulations (i.e. legislative instrument) that should be imposed. So although the legislative arm has provided a platform and guidance, it has not gone as far as dictating and effectively micro managing the entity.<sup>191</sup>

Although the need for legislative oversight cannot be overemphasised, the words of Woodrow Wilson must always underscore a discussion on independence. He is quoted as saying that ...

*“There is some scandal and discomfort, but infinite advantage, in having every affair of administration subjected to the test of constant examination on the part of the assembly which represents the nation.”*<sup>192</sup>

The South African Twin Peaks Model best embraces this. There is enough scandal and discomfort as there is advantage in the manner in which the drafters have sought to erode and protect its regulatory independence.

A questionable relationship exists between the Governor of the Reserve Bank and the Chief Executive Officer of the Prudential Authority. The CEO is actually appointed a Deputy Governor first before being effectively 'seconded' to the prudential authority. It is humbly submitted that questionable as this may appear *prima facie*, the central bank and the prudential authority should not be viewed as separate entities but one as a subset of the other. In the earlier discussion in this chapter, a note is made on the role of the central bank in the Twin Peaks Model. Further, the discussion authoritatively suggests that if the Twin Peaks Model was to be adopted in an emerging economy, the prudential peak should be kept in the central bank.

Although one cannot convincingly argue that this was the idea behind having the prudential peak housed in the South African Reserve Bank, this would certainly hold as any argument advanced for the SADC financial sector whose composition is mainly emerging markets. The direct link between the Governor and the CEO therefore causing no erosion, at least as far as

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<sup>191</sup> Quintyn M & Taylor MW 'Should Financial Sector Regulators be Independent?' (2004) *IMF Economic Issues* No 32 (hereafter Quintyn & Taylor (2004) accessed 20 March 2015 at <http://www.imf.org/external/pubs/ft/issues/issues32/#1> (note that article has no pages).

<sup>192</sup> International Monetary Fund Working Paper, *The Accountability of Financial Sector Supervisors: Principle and Practice* (December 2005) 22.

the SADC model is concerned, on the independence of the prudential regulatory authority. This is because the central bank is and should be the prudential peak.

If any argument is made at all it should be that this relationship enhances accountability on the part of the prudential authority as the Governor will ensure that the CEO carries out his functions.

The political argument can of course never be overlooked. In some SADC states (such as Malawi) the Governor is a political office and could therefore be unduly influenced. Similarly, the Commissioner of the conduct authority is also appointed by a political office being the Minister. The Minister also appoints the Deputy Commissioners.

Madise submits that during times of crises undue political interference has worsened the situation by weakening financial regulatory structures.<sup>193</sup> The immediate concern in this particular instance is that the regulatory structures that could be weakened are built on political bedrock with two political figures appointing the management of the regulatory agencies.

### Accountability



The first accountability argument on behalf of the Twin Peaks Model has been made above when addressing the relationship between the Governor and the CEO of the prudential peak.

The second argument relates to the legally imposed coordination between the two peaks. The drafters of the FSR Bill took a deliberate step to include the coordination and cooperation of the two peaks as an indication of the importance this has in the accountability of the two peaks.<sup>194</sup> The prudential authority is therefore able to keep checks and balances on the conduct authority peaks and inhibits in going astray under the misconception that they are not accountable to anyone. Further if any conflict persists, it is to be formally resolved by the Council of Financial Regulators.<sup>195</sup>

This position is not only manifested as between the authorities, in fact Section 31 (2) and Section 57 (8) serve as 'internal accountability provisions' for both the Prudential Authority

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<sup>193</sup> Madise S *Developing an Independent Regulatory Framework for the Financial Sector in Malawi* (unpublished LLM thesis, University of the Western Cape 2010-2011) 19.

<sup>194</sup> Parliamentary Accountability is discussed in depth by Quintyn and Taylor in the International Monetary Fund Working Paper, *The Accountability of Financial Sector Supervisors: Principle and Practice* (December 2005) 20.

<sup>195</sup> NT A *Safer Financial Sector to serve South Africa Better* 29.

and the Financial Sector Conduct Authority. With the former, the Governor and the CEO must agree on performance measures that assess the CEO's performance. Similarly, the Minister and the Commissioners must reach a similar performance indicator agreement that will inevitably ensure that they are accountable whilst performing their duties.

In the end, the twin peaks has many benefits and could certainly be a worthwhile consideration in the development of a regional regulatory structure for SADC. Chapter 5 discusses in more detail how it could be moulded to provide guidance for the regional regulator. In the next chapter the discussion is on the Silos Model. The discussion will follow the same tangent as the Unification Model and Twin Peaks Model.





## CHAPTER 4

### THE SILOS MODEL

#### 4.1 INTRODUCTION

The two previous chapters discussed the Unification Model and the Twin Peaks Model respectively. Although in reality the two forms of regulation and supervision are not similar they at least share the underlying notion that regulation is of the entire financial sector and don't often go further to disintegrate the different industries within the financial sector. In fact one of the supporters of the Unification Model expressly states that 'a regulatory system that presupposes a clear separation between banking, securities and insurance is no longer the best way to regulate the financial system in which such distinctions are becoming increasingly irrelevant.'<sup>196</sup>

It is against the backdrop of this bold statement that the silo model is introduced. In contrast to the above position, the Silos Model or vertical model by its very nature denotes a clear separation between the different industries forming the financial sector.<sup>197</sup> This type of model is often referred to as the traditional model and as the name suggests, all subsequent models have sprung from it and have sought to address its weaknesses. This has already been noted throughout this paper with the case studies that indicate that the different countries initially followed this regime.

Its roots can perhaps be traced to the American system which to date still has the idea of multiple regulators at both the federal and state level. One Huang Hui who writes with the aim to recommend one of the regulatory models to China notes that the United States has the Silos Model because of its chequered history.<sup>198</sup> Huang submits that in the aftermath of the Great Depression of 1923 new restrictive measures such as the Glass Steagall Act (Banking Act of 1933) were introduced segmenting financial markets and confining financial institutions to specific business lines.

The result, which undoubtedly forms the bedrock of the Silos Model of financial regulation, is that the business of banks, securities and insurances were separated from each other and

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<sup>196</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 19.

<sup>197</sup> Zimbabwe Economic Policy Analysis and Research Unit *Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options* (2014) accessed 10 April 2015 at <http://elibrary.acbfpact.org/acbf/collect/acbf/index/assoc/HASH3ed8.dir/Financial%20Regulation.pdf> .

<sup>198</sup> Huang H 'Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (April 2010) *Journal of Corporate Legal Studies* 219 239.

each allocated a corresponding statute. Subsequently, the regulation of these ‘apparently’ clear and distinct business lines was also kept separate.

Although the idea of each sector having a regulator sounds neat and clean, the reality and practicality of it can be very tasking and is the main reason why countries either shy away from this model or have changed to a different model. Indeed it has been suggested that the regulatory structures of countries that have the Silos Model in place are fragmented and convoluted and often develop through a non-systematic, ad-hoc, trial and error process throughout the years.<sup>199</sup>

#### 4.2 What is the Silos Model?

The model has also been referred to as the vertical model, institutional model and as noted the traditional model. As the names suggest, the model envisions a financial sector made up of ‘silos’ forming the different industries or defined along the ‘institutional’ lines which are represented by the various financial institutions within the sector.<sup>200</sup> For its part, the term ‘vertical’ arises as contrast to the unified or ‘horizontal’ model which encompasses all the sectors within on unified umbrella. For purposes of this discussion the terms used to refer to the Silos Model, represent the same ideology and are therefore used interchangeably. The above merely gives one the meaning of the names attached to this model, but the ultimate question is; what is it?

This is a form of financial regulation and supervision over each single category or each single segment of the financial sector through the use of different authorities or agencies responsible for each unit.<sup>201</sup> Consequently, each and every participant in the financial sector in need of regulation and supervision must fall within one of the ‘categories’ or ‘segments’ streamlined for regulation. In essence a firm’s legal status determines which regulator oversees its activities in terms of both safety and soundness and conduct of business.<sup>202</sup>

The main ‘traditional and vertical silos’ are the banking sector, the insurance sector and the securities. By extension or at least as far as the definition goes one would imagine a country

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<sup>199</sup> The PEW Economic Policy Department Financial Reform Project *The International Experience with Regulatory Consolidation Briefing Paper #6* (2009).

<sup>200</sup> Botha E ‘Financial Regulation and Supervision: Theory and Practice in South Africa’ 10(11) *International Business and Economic Research Journal* 27.

<sup>201</sup> Di Giorgio G & Di Noia C ‘Financial Market Regulation and Supervision: How Many Peaks for the Euro Area?’ (2003) *Brooklyn Journal of International Law* 4.

<sup>202</sup> Group of Thirty (G30) *The Structure of Financial Supervision: Approaches and Challenges in the Global Marketplace* (2008) accessed 13 April 2015 at <http://www.group30.org/images/PDF/The%20Structure%20of%20Financial%20Supervision.pdf>.

would have three regulators responsible for each of the main sectors that have been outlined. However, often times this is not the case. Zimbabwe is a SADC country which can correctly be classified as embracing the Silos Model with five regulators being the Reserve Bank, the Ministry of Finance, the Deposit Protection Corporation, the Securities Exchange Commission and the Insurance and Pensions Commission.<sup>203</sup> Similarly, China has four regulators and supervisors being those responsible for the three main industries together with the central bank.<sup>204</sup> The case study below of Tanzania is an example of a Silos Model with the three main sectors.

### 4.3 Advantages of the Silos Model

#### 4.3.1 Independent Agencies

Whereas other models have, in some extreme cases such as Malawi, the entire regulatory mechanism for the financial sector housed in the central bank creating an avenue for political interference; one of the advantages advanced for the Silos Model has been that the regulatory agencies are often independent and divorced from political influence.<sup>205</sup> The argument has been aired, especially in the United States of America where the Silos Model is deeply rooted, that the independent bureaucrats are free from electoral battles and can therefore dedicate their valuable time to developing skills and building expertise that can effectively regulate the intricate details of the regulatory areas.<sup>206</sup>

The applicability of this advantage in the SADC context creates some difficulty *prima facie*. In the first instance SADC is an inter-governmental entity and therefore has an inherent characteristic of political influence. By birth, SADC is a political being.<sup>207</sup> Consequently, it is difficult to imagine a politically founded and a politically driven unit such as SADC taking deliberate steps to allow external independent entities to regulate its financial sector at a regional level. This doesn't however erode the value of independence in the Silos Model.

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<sup>203</sup> Zimbabwe Economic Policy Analysis and Research Unit *Financial Regulation and Supervision in Zimbabwe: An Evaluation of Adequacy and Options* (2014) accessed 10 April 2015 at <http://elibrary.acbfact.org/acbf/collect/acbf/index/assoc/HASH3ed8.dir/Financial%20Regulation.pdf>.

<sup>204</sup> Huang H 'Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis (April 2010) *Journal of Corporate Legal Studies* 219-221.

<sup>205</sup> Madise S *Developing an Independent Regulatory Framework for the Financial Sector in Malawi* (unpublished LLM thesis, University of the Western Cape 2010-2011) 19 as he outlines the fear of political influence in Malawi's Financial Regulation

<sup>206</sup> Gadinis S 'From Independence to Politics in Financial Regulation' (2013) (101) *California Law Review* 327-330.

<sup>207</sup> See the brief history of SADC on the SADC website accessed 18 April 2015 at <http://www.sadc.int/about-sadc/overview/history-and-treaty/>

Upon a more comprehensive examination it is submitted that SADC may genuinely reap from this advantage if correctly proposed. The SADC political influence should not be allowed to extend to the internal structure of the regulatory mechanisms. Simply, in order to reap from the benefits of independent authorities in the SADC context, the SADC Member States should be the political driving force behind the formation of independent entities to regulate their financial sector. The political influence should be allowed to permeate only to the extent that it gives life to the idea of independent entities. In any event, which political agenda would a regional regulator pursue? It would be a devastating set back for the entire region if a regional regulator was introduced and in each state it pursued a national political agenda.

In the end it is important to appreciate the different dynamics the idea of independent agencies may bring to SADC. It is also vital to note this when one makes an assessment of the independence of a regional regulator.

#### 4.3.2 Highly Specialised Regulation

Since each and every sector has its own regulator, as the sector develops and adopts more intricate methods of operation so does the regulator.<sup>208</sup> This is unlike the unified and Twin Peaks Models where one needs to be jack-of-all-trades and in so doing a regulator needs to keep up with all the developing trends in the various sectors. This can end up in a situation where only one aspect of regulation is addressed effectively at the expense of the other as highlighted in the disadvantages of the Unification Model in Chapter 2.

In the SADC context the importance of this advantage can not be overstated. The very need for a regional regulator stems from the idea that the financial services sector is not only delicate but so deeply intertwined that regional oversight is required. It would be a dream come true for SADC to not only have a regional regulator but one with highly specialised personnel to be able to address the ever-emerging issues associated with the various segments of the financial sector.

Nevertheless, it is submitted that the practicality of this advantage also needs to be considered. An aim to have highly specialised regulation is fair and indeed desirable. One should be cautious however not to vouch for highly specialised within the Silos Model to the

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<sup>208</sup> Di Giorgio G & Di Noia C 'Financial Market Regulation and Supervision: How Many Peaks for the Euro Area?' (2003) *Brooklyn Journal of International Law* 4 which argues that highly specialised regulation and supervision can lead to reduced costs of regulation.

extent that such regulation will deepen barriers between the different industries within the financial sector. Therefore although the Silos Model appreciates that each sector is a stand-alone, it might cause a practical difficulty if the idea of highly separated authorities is directly applied to the SADC context where regional integration is pursued.

#### 4.3.3 Constructive Competition

This is a very delicate advantage and one should tread carefully when advancing it. Its evil twin sister is noted below in the disadvantages to the model. On a positive note though, having multiple regulators increases healthy competition between the regulators and naturally the services provided are improved to best suit the needs and circumstances of each sector.<sup>209</sup> This is closely connected to the above advantage of highly specialised regulation which is in reality a direct consequence of constructive and healthy competition. Undoubtedly once a regulator has a competitor, they will strive to improve and specialise its services in order to fully satisfy its customers. Hence, constructive competition begets highly specialised regulation.

By a similar token if SADC was to adopt a Silos Model for its regional regulatory structure then the healthy competition would exist between the different industries giving birth to clean efficient and cost effective ways of regulation. This of course may be cumbersome if one company has to adhere to highly specialised regulation in two or three industry-specific regulators within the Silos Model.

### **4.4 Disadvantages of the Silos Model**

#### 4.4.1 Race to the Bottom

This disadvantage is what the author describes as the evil twin sister to constructive competition. For its part, the position is that such competition between the regulators can have adverse effects since it will breed a need for there to be a scramble between the regulators in order to try and get as many financial institutions as possible under its purview. Naturally, the regulator with the less stringent rules will attract the biggest clientele pool since strict regulations are sometimes viewed as suppressing bigger risks and ultimately

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<sup>209</sup> The PEW Economic Policy Department Financial Reform Project *The International Experience with Regulatory Consolidation Briefing Paper #6* (2009).

bigger returns. In such pursuit, a regulator, which is usually funded by levies from 'costumers' may relax its regulations to try and become very profitable.<sup>210</sup>

For SADC the idea of the race to the bottom and its possible ramifications is truly a matter of concern. A banking regulator for example that seeks to loosen or lower its regulations in a bid to attract as many banks can lead to a calamity that won't only affect its sector but may very well ripple to other segments of the financial services matrix.

#### 4.4.2 Financial Conglomerates

The emergence of financial conglomerates presents by far the biggest shortcoming for the Silos Model.<sup>211</sup> This is one of the reasons why the supporters of the Unification Model have succeeded to such a great extent in the era where such entities are booming.<sup>212</sup> The challenge results where one company or group operates across various sectors of the financial sector. If for instance a group of companies operate across the banking, insurance and securities sector the result is that the group is required to comply and be supervised by three different regulators within the Silos Model.

One of the benefits that had been advanced on behalf of the Unification Model is that it would be able to embrace the growing rate of financial conglomerates in Southern Africa. Several examples such as the Old Mutual Group, First National Bank and the Barclays/ABSA Group are given in Chapter 2 to strengthen arguments in favour of the Unification Model. The converse can be said for the Silos Model and the existence of financial conglomerates in SADC. Although being a stretch of the imagination, one might say that if SADC was to adopt the Silos Model then the financial conglomerates would only have to adhere to the demands of the industry specific regulator once and not each time in each country. Simply, the current situation is such that a financial conglomerate involved in banking, insurance and securities wishing to penetrate the Zimbabwean and Tanzanian markets would have to comply with the regulations and supervisory standards for at least six regulators in the two jurisdictions. The adoption of the Silos Model in the entire SADC could narrow this to three.

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<sup>210</sup> The PEW Economic Policy Department Financial Reform Project *The International Experience with Regulatory Consolidation Briefing Paper #6* (2009).

<sup>211</sup> International Monetary Fund Working Paper, *Issues in the Unification of Financial Sector Supervision* (December 2000); International Monetary Fund Working Paper, *Regulatory and Supervisory Independence and Financial Stability* (March 2002) 10.

<sup>212</sup> Financial Services Authority Occasional Paper 2 *The Rationale for Single National Financial Services Regulator* (May 1999) 11.

#### 4.4.3 Regulatory Arbitrage

The existence of various regulators can also lead to financial institutions ‘racing to the bottom’ in that they would then choose a regulator that best suits them and enables them to make the largest profit. Consequently, a financial conglomerate will deliberately move its operations to a sector that has the most lax regulations.<sup>213</sup> The idea of regulatory arbitrage can be fully embraced when dealing with decentralised financial conglomerates as opposed to integrated financial conglomerates.<sup>214</sup> One Amir Licht writing on the regulatory arbitrage affecting the international securities market notes that one securities transaction may be subject to different legal regimes in which case should one country fail to curb insider trading, insiders could channel their trade to that market and frustrate the efforts of the other countries.<sup>215</sup>

By the same token if one of the regulatory agencies within a silos-style model presents a more unperturbed approach to regulation and supervision, it will be in correct estimation of any financial conglomerate to divert its trading activities significantly in the direction of a more favourable regulator. The consequences of this diversion can be grave and therefore this disadvantage should not be ignored when dealing with SADC and the idea of a regional regulator.

The key distinction between regulatory arbitrage and ‘the race to the bottom’ discussed above is the beneficiaries of each of the disadvantages. Whereas the race to the bottom is a pursuit by the regulators to make the regulations lax and make a profit, regulatory arbitrage is the financial institutions shifting their trading activities to a more relaxed regulator to enable them to take bigger unsubstantiated risks and make a profit. The regulators subject to regulatory arbitrage may not have necessarily gone out of their way to lure clients in their direction by making lax regulations.

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<sup>213</sup> Botha E ‘Financial Regulation and Supervision: Theory and Practice in South Africa’ 10(11) *International Business and Economic Research Journal* 30; see also Masciandaro D ‘The Great Reversal? Reshaping the Financial Supervision Architectures and the Effects on Insurance’ *Geneva Association Progress e-Newsletter* January 2013.

<sup>214</sup> Freixas X, Loranth G & Morrison AD ‘Regulating Financial Conglomerates’ (2007) *Journal of Financial Intermediation* 479 481.

<sup>215</sup> Licht A ‘Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets’ (1997) *Harvard Law School John M. Olin Centre for Law, Economics and Business Discussion Paper Series* Paper 219 3.

## 4.5 CASE STUDY

### 4.5.1 TANZANIA

#### 4.5.1.1 Introduction

The turn of the 20<sup>th</sup> century saw the introduction of the formal supply of money in Tanganyika (now Mainland Tanzania) when it became a German East African Colony together with Rwanda and Burundi.<sup>216</sup> At this time the German East African Company was managing the money supply in the colony and by extension one can suggest that this amounted to regulation and supervision although in its coarsest state.<sup>217</sup> The German government subsequently took over this role of administering the then German East African currency being the Rupees.<sup>218</sup>

The end of the First World War and the fall of the German Empire through the Treaty of Versailles saw the German Territory of Tanganyika being given to the British Empire which introduced the East African Rupee of other British colonies (Kenya and Uganda) into Tanganyika.<sup>219</sup> Soon thereafter in 1919 the East African Currency Board (EACB) was established with its aim being to supply and control the circulation of money and the currency which in 1921 changed to the Pound-Shilling.<sup>220</sup> At this time three commercial banks (National and Grindlays Bank, Standard Bank and Barclays Bank) had replaced the old German banks and were operating in Tanganyika.<sup>221</sup> In the years leading to independence the Indian Bank of Baroda and Bank of India also began operations in Tanganyika. Although mention is made of the EACB, it has been suggested that no true regulation took place in this era and the 'big three' commercial banks merely used the Tanzanian banking system as a

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<sup>216</sup> Lwiza DRB & Nwankwo S 'Market-driven transformation of the banking sector in Tanzania' (2002) (20) (1) *International Journal of Bank Marketing* 38 39.

<sup>217</sup> Sandrock JE 'A Monetary History of German East Africa' accessed 15 April 2015 at [http://www.thecurrencycollector.com/pdfs/A\\_MONETARY\\_HISTORY\\_OF\\_GERMAN\\_EAST\\_AFRICA.pdf](http://www.thecurrencycollector.com/pdfs/A_MONETARY_HISTORY_OF_GERMAN_EAST_AFRICA.pdf) ;

<sup>218</sup> Tanzania Mainland 50 Years of Independence : A Review of the Role and Functions of the Bank of Tanzania (June 2011) accessed 14 April 2015 at <https://www.bot-tz.org/Adverts/PressRelease/2011-Nov-04-PressRelease.pdf>

<sup>219</sup> Lindemann S & Putzel J 'State Resilience in Tanzania-Draft Analytical Narrative' accessed 14 April 2015 at <http://www.lse.ac.uk/internationalDevelopment/research/crisisStates/download/seminars/PutzelLindemannTanzaniaApr30.pdf> .

<sup>220</sup> Tanzania Mainland 50 Years of Independence : A Review of the Role and Functions of the Bank of Tanzania (June 2011) accessed 14 April 2015 at <https://www.bot-tz.org/Adverts/PressRelease/2011-Nov-04-PressRelease.pdf>

<sup>221</sup> Mutaitina OR 'Liberalisation of the Banking Industry in Tanzania: Issues and Prospects' (1999) (7) (2) *The African Journal of Finance and Management* 98 99.



conduit for transferring local mobilised funds to investments abroad.<sup>222</sup> The sad reality was therefore that the financial needs of the people of Tanzania were not on their agenda and were therefore inadequately addressed.

9<sup>th</sup> December 1961 marks the independence of Mainland Tanzania and a time of great uncertainty for the business community that was unsure of the consequences of the new regime. Naturally, the banking system suffered a blow. In the interim, the EACB continued its 'central bank functions' to the former colonies.<sup>223</sup> In an attempt to give guidance to the newly formed states a commission was set up from the Central Bank of the Federal Republic of Germany headed by one Dr Blumenthal who recommended that the EACB be a regional central bank with each state having its own smaller central bank.<sup>224</sup>

The political climate at the time dismissed the idea of a regional central bank however pursuant to this report in 1965 the Bank of Tanzania (BoT) was officially established through the Bank of Tanzania Act.<sup>225</sup> Unfortunately before any true assessment could be done on how the bank had carried out its regulatory and supervisory duties the Arusha declaration was proclaimed in 1967.<sup>226</sup> The Arusha Declaration set in motion a socialist egalitarian agenda nationalising all commercial banks and forcing the BoT to realign its duties to the new dynamics.<sup>227</sup> The nationalisation of the commercial banks led to the establishment of one wholly government owned bank, the National Bank of Commerce.<sup>228</sup> The harsh realities of the Arusha declaration on the financial sector eventually dawned on the government of the day

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<sup>222</sup> Lwiza DRB & Nwankwo S 'Market-driven transformation of the banking sector in Tanzania' (2002) (20) (1) *International Journal of Bank Marketing* 38 40.

<sup>223</sup> Marten L and Kula NC 'Meanings of Money and the Semantics of Currency in Zambia and Tanzania' (2008) (20) (2) *Journal of African and Cultural Studies* 183 191.

<sup>224</sup> Masson PR & Pattillo C 'The Monetary Geography of Africa' (2005) 28.

<sup>225</sup> Cooper S & Asay C 'East African Monetary Union: The Domestic Politics of Institutional Survival and Dissolution' in *Perspectives on Global Development & Technology* (June 2003) 133; see also Tanzania Mainland 50 Years of Independence : A Review of the Role and Functions of the Bank of Tanzania (June 2011) and Bank of Tanzania Act of 1965 accessed 16 April 2015 at [http://www.saflii.org/tz/legis/num\\_act/bota1996142.pdf](http://www.saflii.org/tz/legis/num_act/bota1996142.pdf)

<sup>226</sup> Havnevik K 'A Historical Framework For Analysing Current Tanzanian Transitions: The Post Independence Model, Nyerere's Ideas and Some Interpretation' in Havnevik K(ed) & Isinika AC (ed) *Tanzania in Transition: From Nyerere to Mkapa* (2010) 20.

<sup>227</sup> Scaling Up Poverty Reduction: A Global Learning Process and Conference *Tanzania's Economic Reforms and Lessons Learned* (2004) A case study from Reducing Poverty, Sustaining Growth—What Works, What Doesn't, and Why A Global Exchange for Scaling Up Success International Bank for Reconstruction and Development/ World Bank: Shanghai accessed 14 April 2015 at <http://info.worldbank.org/etools/docs/reducingpoverty/case/31/fullcase/Tanzania%20Country%20Study%20Full%20Case.pdf>.

<sup>228</sup> Ibhawoh B & Dibua JI 'Deconstructing Ujamaa: The Legacy of Julius Nyerere in the Quest for Social and Economic Development in Africa' 2003(8)(1) *African Journal of Political Science* 59 65.

and ultimately in 1978 the Bank of Tanzania Act was amended enabling it to start regulatory and supervisory duties.<sup>229</sup>

A new era for the Tanzanian financial sector emerged in 1986 when President Mwinyi assumed office and introduced an economic reform program which essentially sought to dismantle the structures that Arusha had developed.<sup>230</sup> In such pursuit, the Nyirabu Commission was set up in 1988 whose recommendations proposed a market based financial sector and strategies to undo the harm of the socialist regime.<sup>231</sup>

One such achievement was the enactment of the Banking and Financial Institutions Act of 1991 and the subsequent amendment of the Bank of Tanzania Act of 1995 for banking regulation. Both Acts were subsequently amended in 2006 and the current regulatory structure discussed below reflects the subsequent amendments. Tanzania has also taken strides to adhere to the international Basel standards and is currently implementing Basel II.<sup>232</sup> No decision has been taken on the prospects, adoption or implementation of Basel III in Tanzania.<sup>233</sup>

#### 4.4.1.2 Regulation under the Silos Model

One of the main reasons given for Tanzania's adoption of the Silos Model is the disjointed nature of their financial sector. This lack of linkages explains, at least to some degree, why the country's circumstances were best suited for the Silos Model.<sup>234</sup> Although this has not been explicitly noted, it is submitted that another reason for the adoption of the Silos Model is because the different industries within the financial sector emerged at different times. The banking sector as an example has been in operation arguably from the early days of the

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<sup>229</sup> Tanzania Mainland 50 Years of Independence: A Review of the Role and Functions of the Bank of Tanzania (June 2011).

<sup>230</sup> Simpasa AM 'Competitive Conditions in the Tanzanian Commercial Banking Industry' (2011) (23) (1) *African Development Review* 88 89.

<sup>231</sup> Nord R, Sobolev Y, Dunn D, Hajdenberg A, Hobdari N, Maziad S & Roudet S 'Tanzania: The story of an African Transition' International Monetary Fund 2009; see also Yona L & Inanga 'Financial Sector reform in bank ownership and its impact on service quality case of commercial banks in Tanzania' (2013) (2) (12) *Journal of Business Administration and Management Sciences Research* 335.

<sup>232</sup> Tanzania Mainland 50 Years of Independence: A Review of the Role and Functions of the Bank of Tanzania (June 2011).

<sup>233</sup> Financial Stability Institute *Basel II, 2.5 and III Implementation* (July 2014) accessed 25 April 2015 at <http://www.bis.org/fsi/fsiop2014.pdf>

<sup>234</sup> International Monetary Fund Country Report *United Republic of Tanzania: Financial System Stability Assessment Update* (June 2010).

German Empire when the insurance and securities sector were unknown to Tanzania (then Tanganyika).<sup>235</sup>

Tanzania has its silos along the three main traditional lines of banking, insurance and capital markets and securities. For a better appreciation, the three industries are individually addressed below.

### Banking

As at 2013, the Tanzanian banking sector had 45 reporting banks divided into four categories targeting different markets and different clientele.<sup>236</sup> The regulation and supervision of banks and financial institutions<sup>237</sup> in Tanzania can be found within the parameters of the Bank of Tanzania Act of 2006(BoT Act), the Banking and Financial Institutions Act of 2006 (BAFIA Act) together with the Companies Act of 2002.

More supplementary regulations exist within the framework of the BAFIA Act such as the Risk Management Guidelines for Banks and Financial Institutions of 2008, the Outsourcing Guidelines for Banks and Financial Institutions of 2008; the Banking and Financial Institutions (Liquidity Management) Regulations of 2008; the Banking and Financial Institutions (Capital Adequacy) Regulations of 2008; the Banking and Financial Institutions (Microfinance Companies and Micro Credit Activities) Regulations of 2005; and the Banking and Financial Institutions (Licensing) Regulations of 2008.<sup>238</sup>

The BoT Act establishes the Bank of Tanzania under section 4. It then enunciates its regulatory and supervisory functions in Section 6. This same preposition is captured in section 4 of the BAFIA Act which gives the BoT all powers relating to licensing, regulation and supervision. The immediate and perhaps inevitable question that arises is; what exactly is the relationship between the BoT Act and the BAFIA Act as far as the regulation and supervision of the Tanzanian banking sector is concerned?

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<sup>235</sup> Lwiza DRB & Nwankwo S 'Market-driven transformation of the banking sector in Tanzania' (2002) (20) (1) *International Journal of Bank Marketing* 38 39.

<sup>236</sup> Kapinga WB, Khalid RA & Kapinga K W 'Tanzania' in Putnis J (ed) *The Banking Regulation Review* (2013) 773.

<sup>237</sup> Which in terms of the Banking and Financial Institutions Act of 2006 means an entity engaged in the business of banking, but limited as to size, locations served, or permitted activities, as prescribed by the Bank or required by the terms and conditions of its licence, the Banking and Financial Institutions Act was accessed 16 April 2015 at <https://www.bot-tz.org/BankingSupervision/BAFIA2006.pdf>.

<sup>238</sup> Kapinga WB, Khalid RA & Kapinga K W 'Tanzania' in Putnis J (ed) *The Banking Regulation Review* (2013) 773 774.

The Preamble to the BAFIA Act stipulates that the Act provides for the comprehensive regulation of banks and financial institutions and the regulation and supervision of activities of savings and credit cooperatives societies and schemes with the view to maintaining the safety and soundness of the financial system *inter alia*. Meanwhile the BoT Act reinforces the position of the Bank of Tanzania in its position as the regulator and supervisor of all banks and financial institutions. One cannot attempt to make the acts subsets of each other but in fact; the two statutes supplement and complement each other in the regulation and supervision of banks and financial institutions in Tanzania.

This argument is further substantiated by the fact that there seems to be no power dynamic between the two Acts. The Governor, Deputy Governors and Board of Directors are all appointed by the BoT Act under sections 8 and 9 respectively and the BAFIA act doesn't in any way challenge their positions or authority. It is however worthy to note that the Governor and Deputy Governor are both appointed by the President. The Governor becomes the chairman to the board which has the permanent secretaries of the Treasury departments of Tanzania and Zanzibar occupying *ex officio* posts. These appointments naturally bring into question the political influence this might have on the independence of the central bank in carrying out its regulatory and supervisory duties.

The government's influence on the regulation of the banking sector is not peculiar as this is the lifeline of the economy. Such influence shouldn't be allowed to culminate into negative political influence and the advancing of political agendas at the expense of the proper regulation of the banking sector. This is especially important in a country that has a chequered history of excessive political influence in the socialist period.<sup>239</sup>

### Insurance

Section 5 of the Insurance Act<sup>240</sup> establishes the Tanzanian Insurance Authority (TIRA). The authority is tasked with the responsibility of coordinating policy and other matters relating to insurance in the United Republic of Tanzania.<sup>241</sup> Its main objectives include the formulation of standards in the conduct of the business of insurance which shall be observed by insurers,

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<sup>239</sup> The Arusha Declaration of 1967 set in motion the socialist agenda. See Tanzania Mainland 50 Years of Independence: A Review of the Role and Functions of the Bank of Tanzania (June 2011).

<sup>240</sup> Accessed 16 April 2015 at [http://www.tanzania.go.tz/egov\\_uploads/documents/The\\_Insurance\\_Act,\\_2009\\_%28Act\\_No\\_sw.pdf](http://www.tanzania.go.tz/egov_uploads/documents/The_Insurance_Act,_2009_%28Act_No_sw.pdf)

<sup>241</sup> Section 5(2) Insurance Act of 2009.

brokers and agents.<sup>242</sup> Further TIRA aims to effectively supervise and monitor insurers, brokers and agents to comply with the aforementioned standards as required by the Insurance Act. For its organisational structure TIRA is headed by the National Insurance Board<sup>243</sup> with the Commissioner<sup>244</sup> and Deputy Commissioner<sup>245</sup> of Insurance taking their respective role subsequently. Thereafter the entity is divided in several units or divisions ranging from legal services to market development. The main units for purposes of this discussion are the technical services division and the unit on surveillance and research.<sup>246</sup>

The former focuses on the regulatory aspect whereas the latter focuses on supervision. If one was to attempt to draw further distinctions one could safely state that the technical services unit together with the legal services department addresses the prudential aspect of regulation whereas the surveillance and research division in conjunction with the market development unit deals with conduct of business. The above submission is made on the strength of the roles that each of the units plays at TIRA both individually and collectively.

The impact of TIRA in Tanzania since its birth in 2009 is noteworthy. As at July 2014 it is reported that the number of persons insured in Tanzania, a country with a population of 45million people was 13%.<sup>247</sup> Despite this achievement TIRA continues to embark on a nation-wide campaign that seeks to sensitize the public on the need for insurance especially car insurance which is said to be a cause of great concern to the nation. An official from TIRA interviewed by The Guardian above responded by saying that the deficit with car insurance was created in the statute and could thus not be effectively addressed by TIRA without Parliamentary intervention to amend the statute.<sup>248</sup> On the overall however, TIRA reports that the nation has embraced health insurance and its benefits in a promising way.<sup>249</sup>

On the question of independence and accountability, the governing structures of TIRA represent a more balanced stance. Although both the Commissioner and Deputy

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<sup>242</sup> Tanzania Insurance Regulatory Authority website accessed 18 April 2015 at <http://www.tira.go.tz/?q=objectives>.

<sup>243</sup> Established under section 13 of the Insurance Act of 2009.

<sup>244</sup> Appointed by the president under section 7 of the Insurance Act of 2009.

<sup>245</sup> Appointed by the president under section 8 of the Insurance Act of 2009.

<sup>246</sup> See TIRA website on organisational structure accessed 18 April 2015 at <http://www.tira.go.tz/?q=org>.

<sup>247</sup> Andrew F 'TIRA: 13 Per cent of Tanzanians Covered in insurance services' *The Guardian* 14 July 2014 accessed 18 April 2015 at <http://www.ippmedia.com/frontend/index.php?l=69930>.

<sup>248</sup> Andrew F 'TIRA: 13 Per cent of Tanzanians Covered in insurance services' *The Guardian* 14 July 2014 accessed 18 April 2015 at <http://www.ippmedia.com/frontend/index.php?l=69930>.

<sup>249</sup> See the report commissioned by the Tanzanian Ministry of Health and Social Security and Tanzanian Social Security Regulatory Authority *Tanzania Health Insurance Regulatory Framework Review* accessed 25 April 2015 at <http://moh.go.tz>

Commissioner are appointed by the President, the National Insurance Board has representation from all relevant stakeholders. Section 13 provides that of the seven members, one shall be from the Tanzanian Insurance Agents Association, another from the Association of Tanzanian Insurers, one from the Tanzanian Insurance Brokers Association and three additional members that have the required expertise with at least two hailing from the United Republic of Tanzania. Another member of the board also appointed by the Minister is from the Attorney General's Chambers. This representation depicts a spirit of transparency and ultimately an aim to be accountable to the people they wish to serve.

### Capital Markets and Securities

The Tanzanian Capital Markets and Securities Act (CMSA) was enacted in 1994 establishing the Capital Markets and Securities Authority which would promote and facilitate the development of an orderly, fair and efficient capital markets and securities in Tanzania.<sup>250</sup> Section 6 of the CMSA establishes the Capital Market and Securities Authority and Section 10 sets out its general functions.

In 1996 after an assessment of the corporate sector demands the Authority adopted a two tier equity securities market structure but cautiously only operated one.<sup>251</sup> Consequently the Dar es Salaam Stock Exchange (DSE) was established in 1996 and started admitting companies in 1998.

To date the DSE has 14 domestic-listed companies and 7 cross listed companies with their most recent listings being on the 29<sup>th</sup> December 2014 and the 15<sup>th</sup> August 2014 respectively.<sup>252</sup> At the time the Authority was established there had been seven hundred poorly managed parastatals operating in Tanzania with a very small private sector. Currently three hundred such parastatals have been privatised with five of them having done so through the DSE.<sup>253</sup>

Like the other regulatory and supervisory authorities the Capital Markets and Securities has a governing structure established by section 6(3) of the CMSA. Although the poorly drafted

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<sup>250</sup> Preamble to the Tanzanian Capital Market and Securities Act accessed 18 April 2015 at <http://www.cmsa-tz.org/popup/pdf/THE%20CAPITAL%20MARKETS%20AND%20SECURITIES%20ACT.pdf>

<sup>251</sup> Norman ASK 'The Evolution of Capital Markets in Tanzania and the Benefits for Investors' (2013) (1) (2) *International SANANM Journal of Marketing and Management* 103 104.

<sup>252</sup> Dar es Salaam Stock Exchange website accessed 18 April 2015 at <http://www.dse.co.tz/content/listed-companies>

<sup>253</sup> Norman ASK 'The Evolution of Capital Markets in Tanzania and the Benefits for Investors' (2013) (1) (2) *International SANANM Journal of Marketing and Management* 103 104.

statute makes no specific reference to a governing board, it is understood that the ‘authority’ it seeks to establish under section 6(3) is indeed a governing body.<sup>254</sup> To this end it consists of four ex officio members seconded from the treasury, BoT, registrar of companies and the Attorney General’s chambers. Other members include a chairman appointed by the president and the chief executive officer of the regulatory authority.

It is perhaps crucial at this point to highlight the fact that unlike the National Insurance Board herein four of the seven board members are from government agencies. Moreover, the chairman of the board is appointed by the President with recommendation from the Minister responsible for finance.<sup>255</sup> In reality this means that the majority of the board members will be pursuing the interests of the government and will indeed have an influence on the regulatory and supervisory agenda. This is an interesting realisation when one takes into account that the Silos Model has been seen as one that retains a greater level of political independence.<sup>256</sup> Herein, the authority appears to be merely an extension of the government and will undoubtedly be subject to political influence.

Although the Silos Model does work, it appears, through the Tanzanian example and the examination of the previous models that it would probably be in its best interest to adopt a more accommodative model like the Unification Model or the Twin Peaks Model.

#### 4.6 Conclusion

The Silos Model presents a lot of practical challenges when one imagines its tenets being extended to a regional context. Firstly, its legal structure doesn’t effectively change the current dynamic as far as numbers are concerned. It will still require at least three regulators for the regional structure to work. This presents a problem for financial conglomerates wishing to extend their services into SADC. One of the core reasons advanced for the development of the regional regulatory and supervisory authority is in pursuit of regional integration and a deeper and easier way for investors to have access to the entire SADC market. It is hard to imagine a scenario where a silos style regional regulator will attract investors wishing to drink from the wells that the emerging SADC economies have to offer.

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<sup>254</sup> See Capital Markets and Securities Authority website accessed 18 April 2015 at [http://www.cmsa-tz.org/about/governing\\_body.htm](http://www.cmsa-tz.org/about/governing_body.htm)

<sup>255</sup> Section 6(3)(a) CMSA.

<sup>256</sup> Gadinis S ‘From Independence to Politics in Financial Regulation’ (2013) (101) *California Law Review* 327-330.

If anything, the model could lead to excessive regulatory arbitrage where financial conglomerates exploit the idea of a regional regulator and divert their trading activities to a sector with more relaxed rules.

### Independence

The above discussion has shown that being isolated doesn't necessarily mean being independent. The mere fact that different agencies regulate different industries of the financial sector should not be seen to suggest that such sectors are therefore independent. This is clearly shown in the Tanzanian Regulatory Authority when compared to the Capital Markets and Securities Authority. Whereas one appears to be a mere extension of the government arm and therefore susceptible to extensive political influence, the other has a balanced approach represented by the members of the government together with all relevant stakeholders in the industry.

When talking about the Silos Model, the issue of independence is two-dimensional, the independence from political interference as discussed above and the independence of the regulatory and supervisory authorities from each other. The former kind of independence may be good whereas the latter may lead to a fragmented and disjointed and can be detrimental to the functioning of a well oiled financial sector. It would be difficult to advance this form of regulatory structure to a market like SADC that has a growing rate of financial conglomerates.

### Accountability

Since the idea is to have independent agencies addressing the different aspects of the financial sector, no in-built check and balances system effectively operates in this model. The insurance authority may carry on its business to the best of its ability regardless of what endeavours the capital and securities market has in place. This is unlike the twin peaks system where the peaks are legally obliged to cooperate, coordinate and improve accountability.

All in all the Silos Model is not an attractive model for the SADC regional regulator. Its disjointed nature, susceptibility to regulatory arbitrage and inability to effectively regulate and supervise financial conglomerates are its biggest flaws. The next chapter deals with the proposed SADC Triple Peaks Model being the author's idea of the best model for SADC.



## CHAPTER 5

### THE SADC TRIPLE PEAKS MODEL

#### 5.1 INTRODUCTION

From the discussions in the previous chapters it is common cause that all the different models have both positive and negative characteristics. For example, whereas the Unification Model is praised for its regulatory flexibility<sup>257</sup>, it overlooks the importance of conduct of business as a separate and distinct regulator and supervisor away from prudential aspects. The Twin Peaks then makes an attempt to remedy this by having two ‘peaks’ one focusing solely on prudential regulation, and the other on conduct of business<sup>258</sup>; its shortcoming however, is that this often leads to a regulatory overlap.<sup>259</sup> The Silos Model, which is to the author the least attractive, has issues of duplicity, inflexibility and regulatory arbitrage<sup>260</sup> but does embody highly specialised regulation.<sup>261</sup>

Ideally, one would recommend for SADC a hybrid-model that captures all positive features of the previously discussed models and minimises the disadvantages. This is however simply impractical. The question therefore is which permutation or combination of the various models is realistically best for SADC? It would be ignorant for one to propose a model or a manner of financial regulation and supervision in a regional trading community without embracing and building on the models in place in the various countries and the existing structures at the regional level.

Simply, the research doesn’t propose a ‘SADC model’ of financial regulation and supervision in a vacuum. It takes into account the various regulatory regimes in the respective countries and the achievements and failures of regional integration pursuits in SADC at the regional level. Secondly, the author seeks to propose a model that best suits SADC’s current

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<sup>257</sup> Ganapoulou VAN ‘The FSA as an institutional Model for the Emergence of (Single) Unified European Financial Service Regulator’ (2003) 14 (3) *European Business Law Review* 277.

<sup>258</sup> <sup>258</sup> Taylor M ‘The Road from “Twin Peaks” and the Way Back’ (2009) 16(1) *Connecticut Insurance Law Journal* 61.

<sup>259</sup> Financial Services Authority Occasional Paper 2 *The Rationale for Single National Financial Services Regulator* (May 1999) 25.

<sup>260</sup> Licht A ‘Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets’ (1997) *Havard Law School John M. Olin Centre for Law, Economics and Business Discussion Paper Series* Paper 219 3.

<sup>261</sup> Di Giorgio G & Di Noia C ‘Financial Market Regulation and Supervision: How Many Peaks for the Euro Area?’ (2003) *Brooklyn Journal of International Law* 4.

institutional structure and enforceability mechanisms.<sup>262</sup> It would be a research in vain if one proposes a model that is practically unenforceable and theoretically unattainable within the existing structures of SADC.<sup>263</sup> It has already been highlighted that one of the biggest challenges in SADC is its institutional framework which was not properly amended when SADC transformed from Southern African Development Coordination Conference (SADCC) to SADC and this has become a big hurdle in the regional integration drive.<sup>264</sup> In fact, one scholar categorically states that the transformation of SADC from SADCC was merely the dropping of the 'C' and didn't involve the institutional shift that is required in pursuit of SADC's new and refined mandate.<sup>265</sup>

Although one is tempted to propose that SADC Member States adopt a legally enforceable structure that catalyses regional economic integration including the smooth introduction of a regional and supervisory agency, this has been the call by academics for many years and therefore such recommendation on its own will not in any way benefit present day SADC and current institutional framework. The author's wish is to propose a model of financial services regulation and supervision that not only works within the current deficient structures of SADC but one that will seamlessly function even when SADC ultimately adopts more tangible and legally enforceable measures.

Consequently, the key is to build on the existing efforts by stakeholders in the drive to regional economic integration. It must be emphasised that no model is necessarily better than the other but the adoption of the various models by the SADC countries has sprung from the facts and circumstances of each state.<sup>266</sup> In order to fully comprehend the reasons and the nature of the proposed model, it is vital to briefly outline SADC's history and institutional or rule-making structure together with current efforts geared at regional integration of financial services regulation and supervision in SADC.

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<sup>262</sup> Van Nieuwkerk A 'Regionalism into Globalism? War into Peace? SADC and ECOWAS compared' 2001 10(2) *African Security Review* 6 7.

<sup>263</sup> Kellermann A J & Mosch R H J 'Good Supervision and its Limits in the Post-Lehman Era' in Kellermann A J, de Haan J, de Vries F (eds) *Financial Supervision in the 21<sup>st</sup> century* (2013) 2 6 explaining at length that good supervision and regulation is two-pronged having both a theoretical and practical components.

<sup>264</sup> Saurombe A 'Regional Integration Agenda for SADC "Caught in the winds of change" Problems and Prospects' (2009) 4(2) *Journal of International Commercial Law and Technology* 100 103.

<sup>265</sup> Ng'ong'ola C 'Regional Integration and Trade Liberalisation in the Southern African Development Community' 2000 3(3) *Journal of International Economic Law* 485 494.

<sup>266</sup> Llewellyn DT *Institutional Structure of Financial Regulation and Supervision: The Basic Issues* (2006) 4.

## 5.2 From SADCC to SADC: Defect at Birth

SADCC was formed in 1980 through the Lusaka Declaration from the cooperation of what was then known as the Frontline States (Angola, Botswana, Lesotho, Mozambique, Tanzania, Zambia, and Zimbabwe) with the sole purpose of reducing reliance on apartheid South Africa who was their major trading partner.<sup>267</sup> SADCC was therefore conceived as an ‘economic pillar of the anti-colonial and anti-apartheid struggle in the region.’<sup>268</sup>

Since birth, SADCC states deliberately eschewed from the idea of a supra-national entity and therefore the ceding of sovereignty to this newly formed organisation was not on the agenda.<sup>269</sup> It is perhaps the reason why to-date SADC has challenges in making and adopting enforceable rules in many areas including integration of financial services supervision.

SADCC’s second constitutive document, July 1981 Memorandum of Understanding in Harare, Zimbabwe recognised the Summit as the highest body and the one responsible for all the ‘binding decision making’, it was assisted by the Council of Ministers and the Standing Committee of Officials. A secretariat was also set up in Gaborone, Botswana but it has been said that ‘the small secretariat in Gaborone had neither the institutional capacity, nor the legal powers, to compel under-performing states to improve.’<sup>270</sup>

When SADCC was ultimately transformed to SADC through the 1992 SADC Declaration in Windhoek Namibia, the bulk of the institutional structure remained the same.<sup>271</sup> As such SADC still lacks supra-nationality as a characteristic to its operations. All the decisions decided at the summit are to be implemented at the national level through the work of the SADC National Committees.<sup>272</sup> Even so, the National Committees do not impose any obligations on sovereign states and rules of international law on the application of treaties and conventions must still be followed.

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<sup>267</sup> Masemola H *An Analysis and Appraisal of Restructuring in SADCC/SADC since 1990* (unpublished Masters of Arts in Political Science Thesis, University of South Africa, 2005) 44.

<sup>268</sup> Schoeman M ‘From SADCC to SADC and beyond: The politics of economic integration’ (2002) 22 *Paper delivered at XIII Economic History Congress* .

<sup>269</sup> Ng’ong’ola C ‘Regional Integration and Trade Liberalisation in the Southern African Development Community’ 2000 *Journal of International Economic Law* 485 489.

<sup>270</sup> Ng’ong’ola C ‘Regional Integration and Trade Liberalisation in the Southern African Development Community’ 2000 *Journal of International Economic Law* 485 490.

<sup>271</sup> See the SADC institutional framework on the SADC website accessed 27 April 2015 at <http://www.sadc.int/about-sadc/sadc-institutions/org/>

<sup>272</sup> SADC National Committees mandate outlined at <http://www.sadc.int/about-sadc/sadc-institutions/national-committees/> accessed 27 April 2015.

In the end it is gathered that the SADC institutional framework was not properly revisited when the 1992 transformation took place from SADCC to SADC. As such SADC's lack of supra-nationality continues to present a hiccup in the effective implementation of regional integration endeavours.

### 5.3 Building Blocks: Regional Integration efforts thus far

As already highlighted above, the SADC model is not proposed in a vacuum. As such, one is tasked with examining the current efforts towards regional integration of financial services regulation before attempting to flesh them out substantively in the form of a well-structured financial services regulatory model suitable for SADC.

#### 5.3.1 SADC Committee of Central Bank Governors

The SADC Committee of Central Bank Governors (CCBG) was created in July 1995 with the support from SADC Ministers responsible for national financial matters. It was subsequently approved by the SADC Council at their meeting in August 1995.<sup>273</sup> The main reason for the establishment of this committee was the need for a specialised body in SADC to be responsible for the promotion, coordination and monitoring of the macroeconomic convergence criteria set by SADC.<sup>274</sup> Macroeconomic convergence refers to the idea forming the bedrock of this research being the deepening integration levels sought by SADC to ultimately form a monetary union.<sup>275</sup>

The SADC CCBG coordinates and cooperates in various aspects of general central bank functions such as monitoring inflation, interest rates, general intra-SADC trade and economic growth in the region basing such on the set targets of macroeconomic convergence by 2018.<sup>276</sup> The inflation rate as an example has been set at 3 per cent.

Within the structures of the SADC CCBG emerges the subcommittee on banking supervisors tasked specifically with ensuring sound and well-managed banking institutions in the region

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<sup>273</sup> SADC Central Bank Governors Website accessed 27 April 2015 at <https://www.sadcbankers.org/Pages/default.aspx>

<sup>274</sup> Rossouw J 'An Analysis of Macro-economic Convergence in SADC' (2006) 74(3) *South African Journal of Economics* 382-384.

<sup>275</sup> Maruping M 'Challenges for regional integration in Sub-Saharan Africa: Macroeconomic convergence and monetary coordination.' (2005) *Africa in the World Economy* 129-141.

<sup>276</sup> See most recent *Integrated Paper on Recent Developments in SADC* prepared for the Committee of Central Bank Governors by the Central Bank of Lesotho (August 2014) accessed 27 April 2015 at <https://www.sadcbankers.org/Lists/News%20and%20Publications/Attachments/195/Integrated%20Paper%20-%20Aug%202014%20Final.pdf>.

including the facilitation of harmonised regulation and supervision.<sup>277</sup> The subcommittee on banking supervision is therefore a subset of the general CCBG. However, unlike the CCBG which is chaired and housed in South Africa through their reserve bank, it is chaired in Mauritius. The subcommittee has set into motion the idea of harmonised banking regulation and supervision in the region and has continued to publish country reports on the status and implementation of both International Accounting Standards (IAS) and Basel I, II and III requirements to ensure that principles of regulation and supervision in the banks gradually become harmonised.<sup>278</sup>

This is a noteworthy achievement and one can concede that the very existence of the subcommittee coupled with the work it has undertaken is a valuable indication of SADC's dedication towards the harmonisation of financial services regulation and supervision in the banking sector.

### 5.3.2 SADC Committee of Insurance, Securities and Non-Banking Financial Authorities

Whereas the SADC CCBG deals with the banking sector, SADC Committee of Insurance, Securities, and Non-Banking Financial Authorities (CISNA) with its self-explanatory name deals with Capital Markets, Collective Investment Schemes, Insurance companies, Retirement funds and providers of intermediary services in the SADC.<sup>279</sup> It was established in 1998 pursuant to Article 2 of Annex 10 of SADC's Finance and Investment Protocol.

CISNA aims to facilitate the harmonisation of risk based regulatory framework for the SADC member states in the identified areas. CISNA also strives to address matters like market infrastructure and liquidity of capital markets which act as a catalysts for greater participation of local and foreign investors in the SADC region.<sup>280</sup>

In October 2001, 23 national authorities within SADC signed a CISNA multilateral memorandum of understanding (MMoU) setting into motion its regional integration

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<sup>277</sup> See SADC CCBG website accessed 27 April 2015 at <https://www.sadcbankers.org/subcommittees/BankSupervisors/Pages/default.aspx>

<sup>278</sup> Belle M 'Regional Economic Integration in SADC: progress, prospects and statistical issues for monetary union' (2010) *IFC Bulletin* 32 85 91.

<sup>279</sup> CISNA website accessed 27 April 2015 at <https://www.cisna.net/Pages/default.aspx>

<sup>280</sup> Jeffries K *SADC –COMESA Bond Market Mapping Study Technical Report* (2009) AECOM International Development 16; see also address by Dr Perks Ligoya, Governor of the Reserve Bank of Malawi, at the Conference for the Committee of Insurance, Securities and Non-Bank Financial Authorities, Lilongwe, 17 September 2009 accessed 29 April 2015 at <http://www.bis.org/review/r090925b.pdf>

cooperative endeavours.<sup>281</sup> In October 2003 during a meeting of relevant stakeholders in Angola prospects of another MMoU were discussed, analysed and a general consensus existed leading to another MMoU being ultimately signed in Mauritius in April 2004.<sup>282</sup> The restructuring and renewal of CISNA's MMoU is an indication of its growth and proper alignment of its role within the SADC structures. Under the said MMoU the signatories agree to cooperate, share and assist each other to the fullest extent as permissible under their respective laws.<sup>283</sup>

One of CISNA's noteworthy achievements is its input and contribution given while assisting the Financial Sector Coordinating Unit in the preparation of the SADC FIP.<sup>284</sup> For its shortcomings, it has been seen as lacking adequate resources at both the national and regional level leading to a slow reform mechanism.<sup>285</sup>

#### 5.4 What is the SADC Triple Peaks Model?

As can be discerned from the above discussion the current regional integration efforts in financial services regulation in SADC are along the partial Unification Model. This can be seen by how the regulatory agencies have aligned themselves along the banking (with the CCBG) and insurance, securities and non-banking financial authorities (with CISNA). Therefore the building blocks or foundations in place are along the lines of the partial Unification Model evidenced by the Botswana case study.

In light of this and in an attempt to enhance the existing efforts the author proposes a **Triple Peaks Model** as the suitable model for SADC's regional financial services regulator and supervisor. This is a hybrid of the Unification Model and the Twin Peaks Model. The idea is to retain and strengthen the existing committees and ultimately transform them into regional regulatory and supervisory authorities for banking and non-banking financial activities.

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<sup>281</sup> CISNA website accessed 11 May 2015 at <https://www.cisna.net/mmou/Pages/default.aspx>.

<sup>282</sup> Financial Service Board *Sixth Annual Report of the Registrar of Short-term Insurance* (2003) 20

<sup>283</sup> Chisadza M *The Role of Cross-Listings in Establishing a SADC Regional Stock Exchange* (unpublished LLM thesis, University of the Western Cape 2013) 88 where he discusses the notion of multilateral memorandum of agreements for securities regulators; see also address by the Tanzanian Minister of Finance Honourable Basil Mramba at the opening of the meeting of the SADC Committee of Insurance, Securities, and Non-Banking Financial Authorities (CISNA) 10-11 October 2001 in Dar es Salam Tanzania accessed 11 May 2015 at <http://www.google.co.bw/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&uact=8&ved=0CCEQFiAB&url=http%3A%2F%2Fwww.mof.go.tz%2Fmofdocs%2Fnews%2Fspeeches%2Fcsna.doc&ei=PfJQVbnclMzIsQSjm4DIDA&usq=AfQjCNFhj7Tyg4NIDQYwG8MxzFhtFRmh5g&sig2=11DUGrUPoMGpvDy02REfiw>.

<sup>284</sup> Mowatt R *Prospects of Financial Service Reform in the context of Regional Integration in SADC* (unpublished article, University of Witwatersrand 2001) 33.

<sup>285</sup> Jeffries K *SADC –COMESA Bond Market Mapping Study Technical Report* (2009) AECOM International Development 52.

Thereafter, the author proposes a third peak for conduct of business. This peak should be formed in the same way that the CCBG and CISNA were formed, with the same considerations and regard and the ultimate approval by the SADC Council.

The CCBG will be not only a fully fleshed banking regulator and supervisor but also the prudential peak ensuring systemic stability and the overall welfare of the financial system in the region. As has already been highlighted in Chapter 3 with the Twin Peaks discussion, it has been advised that the prudential peak be kept with the central bank in emerging economies.<sup>286</sup> This recommendation is ideal for SADC because except South Africa, all other member states are transforming economies which fall squarely within the ambit of the recommendation. The classification is also apparent in international trade law terms where, with the exclusion of South Africa, all the other SADC Member States fall under the classification of developing or least-developed countries.<sup>287</sup> The subcommittee on banking supervision will naturally continue to direct its activities in the pursuit of banking supervision.

The proposed SADC Triple Peaks also introduces the vital third conduct of business peak. The importance of conduct of business as a stand-alone pillar was thoroughly discussed in the Twin Peaks Model captured in Chapter 3 and will only be briefly outlined herein for emphasis. Conduct of business focuses on consumer protection issues within the financial services sector that are admittedly not adequately addressed by ordinary consumer protection laws.<sup>288</sup> It is vital that both prudential regulation and conduct of business issues a properly protected in every regulatory structure as the neglect of one can be calamitous.<sup>289</sup>

The three regulatory authorities will be required to religiously use the SADC Finance and Investment Protocol as their blueprint in the formulation and implementation of any regulatory and supervisory standards. One author examining Malawian regulatory and supervisory regime brilliantly pointed out the financial sector regulatory and supervisory

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<sup>286</sup> Carmichael J *Regulatory Structure* Presentation at Regional Seminar of NBFIs in East Asia, Bangkok September 2002 accessed 25 February 2015 at <http://info.worldbank.org/etools/docs/library/157129/nbfi-lac/pdf/03carmichael2.pdf>.

<sup>287</sup> Ng'ong'ola C 'Regional Integration and Trade Liberalisation in the Southern African Development Community' 2000 3(3) *Journal of International Economic Law* 485 498.

<sup>288</sup> NT *Treating Customers Fairly*; See also Inderst R 'Retail Finance: Thoughts on Reshaping Regulation and Consumer Protection after the crisis' 2009 10(3) *European Business Organisation Law Review* 455.

<sup>289</sup> Taylor M 'The Road from "Twin Peaks" and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 61 where he discusses how the United Kingdom Unification Model had compromised prudential regulation to its detriment as can be seen through the effects of the 2008 global financial crisis. UK ultimately adopted Twin Peaks.

reforms in Malawi had failed to take into account the vision and spirit of the SADC Finance and Investment Protocol and as such had not enhanced SADC's regional integration pursuit.<sup>290</sup>

The adoption of the SADC Finance and Investment Protocol as the regional blueprint is not only important because it holds the best account of SADC's plans to regionally integrate, it is also accepted as a legal basis that all SADC Member States have agreed to and therefore its application will also have the benefit of overcoming to some extent the institutional framework challenge for the SADC Triple Peaks.<sup>291</sup>

It is crucial for one to pause here and explain exactly what the idea of a legally enforceable document in community law such as SADC is. Using regional economic integration as the bedrock, the SADC Finance and Investment protocol of 2006 encapsulates the ideas, notions and goals that SADC's finance and investment sectors aims to achieve collectively as a regional economic unit.<sup>292</sup> At a cursory glance it embodies five crucial phases of regional integration starting with member states preparing for integration by modernising and upgrading their financial and investment regimes and ends with ultimate unification and the idea of a single monetary union.<sup>293</sup>

In relation to financial services regulation and supervision the reading of the Protocol should be done together with a close examination of Annex 5, Annex 8, and Annex 10 which are all an integral part of the Protocol.<sup>294</sup> Annex 5 deals specifically with the harmonisation of legal and operational frameworks whereas Annex 8 and 10 outline cooperation and coordination in the area of banking regulation and supervisory matters and cooperation on non-banking financial institutions and services respectively.

The next crucial questions are; what is the value of this eloquently drafted Protocol in real terms? What is the intention of the author in suggesting that the SADC Finance and

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<sup>290</sup> Nkowani Z 'The SADC Finance and Investment Protocol and the Reform of the Malawian Financial Services Regulatory Framework: Reflections in Retrospect' (2009) (3)(1) *Malawian Law Journal* 7 20.

<sup>291</sup> Sooklal S 'Financial Services and Regional Integration and Regional Integration' *Presentation at the Multi-Year Expert Meeting on Trade, Services and Development*: (15-17 April 2014) Geneva

<sup>292</sup> SADC Finance and Investment Protocol introduction accessed 29 April 2015 on the SADC website at <http://www.sadc.int/documents-publications/show/Protocol%20on%20Finance%20and%20Investment%20%282006%29>; See also the Preamble to the SADC Protocol .

<sup>293</sup> Striving for Regional Integration Baseline Study on the Implementation of the SADC Protocol on Finance and Investment accessed 29 April 2015 at <http://www.giz.de/en/downloads/giz2012-en-implementation-sadc-finance-investment.pdf> .

<sup>294</sup> See Article 23 of the SADC Finance and Investment Protocol.



Investment Protocol be the blue print of the SADC Member States in the application of the proposed SADC Triple Peaks? These questions all go back to open Pandora's box in the world of international law and its application in national legal systems.<sup>295</sup>

Article 25 of the SADC Finance and Investment Protocol provides that parties shall take such appropriate measures to ensure that their obligations arising from the protocol are fulfilled. The applicability of this will vary depending on the legal regime present in a particular SADC state. Namibia for example has the monist position<sup>296</sup> and therefore once an international instrument has been ratified it will have legal force in the country meanwhile Botswana with a dualist regime<sup>297</sup> would have a two-staged approach of ratification and domestication through an act of Parliament before international law becomes enforceable in the country. Community law is part of the fabric of international law.<sup>298</sup>

This doesn't however diminish the value of the SADC Finance and Investment Protocol as a backbone and blueprint to the effective implementation of the SADC Triple Peaks. The SADC committees outlined above have already taken positive steps in the direction of turning the Protocol into a living document away from the challenges of the applicability of international law in national jurisdictions. Therefore, despite SADC's lacking enforceability mechanisms through cooperation the committees continue to uphold the integrity of the institution.

The SADC Triple Peaks merely adds on this by suggesting that the existing committees gradually culminate into regional authorities and that a conduct of business authority driven by the same dedication must be conceived. As seen with the other peaks, conduct of business will first have to become a committee before it can mature into an authority. It is further proposed that the conduct of business committee be temporarily housed and chaired in the South African conduct of business authority (Financial Sector Conduct Authority) being the only SADC Member state with the Twin Peaks (once established) in order to learn the rules of the game.

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<sup>295</sup> Oppong RF 'Making regional economic community laws enforceable in national legal systems – constitutional and judicial challenges; in Bosl A (ed), Breytenbach W (ed), Hartzenberg T (ed), McCarthy C (ed) & Schade K(ed) *Monitoring Regional Integration in Southern Africa Yearbook* (2008) 149-178.

<sup>296</sup> See Section 144 of the Namibian Constitution accessed 30 April 2015 at <http://www.orusovo.com/namcon/>

<sup>297</sup> See *Kenneth Good v the Attorney General* 2005 (2) BLR 337 (CA).

<sup>298</sup> Oppong RF 'Making regional economic community laws enforceable in national legal systems – constitutional and judicial challenges; in Bosl A (ed), Breytenbach W (ed), Hartzenberg T (ed), McCarthy C (ed) & Schade K(ed) *Monitoring Regional Integration in Southern Africa Yearbook* (2008) 149-178.

## 5.5 Advantages of the SADC Triple Peaks

Since the SADC Triple Peak Model embodies essentially both the Unification Model (although partial unification) and the Twin Peaks Model ideally all advantages under both regulatory and supervisory regimes should be in the Triple Peaks Model. Fortunately, unlike with the Silos Model and the Unification Model no major clashes exist between the two regulatory regimes. Since a full discussion is given on both the Unification Model and Twin Peaks Model in Chapter 2 and 3 respectively, a few crucial advantages are discussed below.

### 5.5.1 Financial conglomerates and Competitive Neutrality

The growth of financial conglomerates in SADC is not in dispute, in fact, it is a welcomed development since these multinationals not only invest in the region but open up the region to other parts of the world. The SADC Triple Peaks' hybrid nature embraces this new development. The unification aspect enables it to cater for financial conglomerates that cut across the financial sectors, the twin peaks angle on the other hand ensures that the companies setting up meet the required standards for the overall health of the financial sector (prudential peak in CCGB) and that the citizens of SADC are not exploited by the new often deceiving product offered in big financial conglomerates (conduct of business peak).

The advantage of competitive neutrality emanates from the Unification Model however at a regional level this benefit is heightened. It tries to address the idea that financial institutions offering the same or similar products can sometimes be regulated differently.<sup>299</sup> Through the SADC Triple Peaks, the investor is assured that in the SADC region no such unfair advantage can exist. A financial institution in Botswana will not have a 'regulatory' advantage over one setting up in Madagascar. The SADC Triple Peaks will ensure this neutrality.

### 5.5.2 Regulatory Flexibility

The SADC Triple Peaks has great flexibility which is beneficial to its emerging economies. It goes without saying that the financial services being provided will continue to evolve into others that cannot be conceived today. It is pertinent that a regional regulator and supervisor should be able to respond to these changing conditions with ease.

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<sup>299</sup> Jadhav N 'Single Regulator vs. Multiple Regulator' accessed 10 December 2014 at [http://www.dnarendrajadhav.info/newversion/drjadhav-data\\_files/Published%20papers/Single%20versus%20Multiple%20Regulator.pdf](http://www.dnarendrajadhav.info/newversion/drjadhav-data_files/Published%20papers/Single%20versus%20Multiple%20Regulator.pdf).

The SADC region also has ‘unique’ financial services (such as the mobile money) that do not fall into the conventional traditional sectors and therefore it is good that a certain level of flexibility is maintained in its regulatory structures.<sup>300</sup>

## **5.6 Disadvantages of the SADC Triple Peaks**

Similarly, the main disadvantages to the two models forming the hybrid SADC Triple Peaks have been discussed extensively in their respective chapters, the aim herein is to bring to the fore any disadvantages unique to the SADC Triple Peaks or any that need emphasis.

### 5.6.1 Slow and Gradual Application

Supporters of regional economic integration agree that a mere leap into regional integration without ensuring that all the necessary mechanisms are in place can lead to a calamity.<sup>301</sup> In light of SADC’s institutional structure and implementation deficit as discussed above, the formation of a regulator and supervisor of this magnitude is going to be a very slow process. Unfortunately, the global village moves at a much swifter pace and the benefits of the harmonised regulatory regime may not be felt in SADC for many years to come. The efforts by the CCGB and CISNA are however still very commendable.

### 5.6.2 Lack of Supra-Nationality

A regional financial services regulator and supervisor born from an organisation without supra-nationality cannot be bestowed with such power. The SADC Triple Peaks will therefore continue to be the work of cooperative measures by the SADC states through the committees and the SADC National Committees.

If however, the work of these committees continues on the right tangent, their strong recommendations will ultimately weave their way into the fabrics of the laws belonging to the SADC Member States. Through the work of the SADC Triple Peaks any subsequently promulgated banking laws or insurance laws or amendments to the same will strive to follow the Finance and Investment Protocol as the blue print and ultimately become harmonised in the entire region.

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<sup>300</sup> Mochiko T ‘Mobile Money in Africa: Move Towards Partnerships’ *Financial Mail* 26 February 2015

<sup>301</sup> Jeffries 2007; Saurombe A ‘Regional Integration Agenda for SADC “Caught in the winds of change” Problems and Prospects’ (2009) 4(2) *Journal of International Commercial Law and Technology* 100.

### 5.6.3 Burden on South Africa

The Frontline States formed SADCC to try and exclude South Africa; it is with the greatest irony that South Africa has become the big brother to all SADC states. South Africa is the only country in SADC with the Twin Peaks and it is on such basis that it is suggested that the conduct authority should also be housed in its jurisdiction. This can however be burdensome on a state that is itself undergoing transformation to its financial sector regulatory and supervisory regime. South Africa may therefore be hesitant to take another responsibility over and above the CCGB. This may delay the establishment of the conduct authority and hinder the SADC Triple Peaks. Although not completely advisable, in the interests of progress another SADC member may undertake this responsibility.

### **5.7 Conclusion**

Despite the challenges that the SADC Triple Peaks has, the author strongly believes that this model will benefit SADC's regional integration efforts in financial services regulation and supervision.

The model embraces SADC's existing efforts and builds on the cooperation and coordination that the Member States have. Like any proposal, the SADC Triple Peaks has its weaknesses but the author strongly believes that its benefits far outweigh its weaknesses and it will be in the best interests of the regional community to consider the application of this regulatory mechanism.

The SADC Triple Peaks is a reflection of the two favourable models discussed in this study. It has a true appreciation of all the essential requirements that any regulatory and supervisory authority in a region that is a part of a civilised comity of states should have. Moreover, the Triple Peaks embodies the Twin Peaks which has been adopted by SADC's big brother South Africa; it will hopefully have the support of this nation and assist the other SADC states to be inclined to embrace it.

Lastly, the SADC Triple Peaks strives to advance the underlying reasons for economic theory: to constrain the use of monopoly and prevent serious distortions to competition in the region; through its prudential peak it maintains market integrity; and through its conduct of business peak it safeguards the needs of ordinary people.

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