Consumer protection in the financial sector in South Africa: a review of recent developments

Jesse de Beer , Department of Economics, University of the Free State
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The South African financial system, as well as the financial regulatory framework, is recognised as highly sophisticated and developed. Consumer protection in South Africa has historically played a less prominent role in certain financial sub-sectors such as banking. In line with the recent international financial regulatory community increased focus on financial consumer protection, the South African consumer protection framework is re-evaluated and new legislation and regulatory structures are being proposed. The introduction of a Twin Peaks regulatory structure will transform the FSB-SA into a dedicated market conduct regulator with a new mandate, objectives and regulatory and supervisory frameworks. The new framework centres on an intensive and intrusive approach. This implies that the regulator should proactively identify areas of concern and act to prevent negative consumer outcomes, rather than reacting to complaints or existing prejudice. The approach will be pre-emptive and proactive, in contrast to the current largely reactive approach. Furthermore, institutions will have to comply with both principles and rules based regulations, in contrast to the current largely rules based regulations. These changes pose significant challenges to the industry and the regulatory community alike.

The purpose of this paper is to provide an overview of the proposed consumer protection regulatory framework and how it differs from the existing framework. Challenges posed by the implementation of the new framework will be discussed. The new framework will also be benchmarked against international best practices for consumer protection in the financial industry and the international literature on the effectiveness of different policy remedies in helping consumers make well-fare enhancing decisions. The method of research is mainly a literature review and cover both theoretical and empirical papers, as well as policy papers.

Consumer protection aims to address the imbalance of power between an individual consumer and a financial service provider. The imbalance derives largely from information asymmetries that are particularly pronounced in the financial services sector, where products tend to be complex, information can be difficult and costly to obtain, and often the performance of underlying assets can only be judged over time. This further complicated by the fact that the majority of South Africans are financially unsophisticated and illiterate (Finscope 2011; Atkinson and Messy 2012; Japelli 2010), these consideration provide a rationale for consumer financial protection that goes beyond the standard market failures

South Africa is recognised as having one of the most sophisticated and developed financial systems. Consumer protection in South Africa has been substantially enhanced over the past ten years. New laws have been developed and existing laws have been amended to improve consumer protection. These laws include the Financial Advisory and Intermediaries Services Act, 2002 (FAIS), the Financial Services Ombuds Schemes Act, 2004, the National Credit Act, 2005 and, the Consumer Protection Act, No.28 of 2008 (CPA).

General legislation impacting consumer protection in South Africa
Financial Services Ombuds Schemes Act: Provides for the role and obligations of statutory and voluntary ombud schemes, in particular accommodating the statutory FAIS ombud that adjudicates market conduct complaints cases, and the voluntary, self-funded insurance ombuds that adjudicate complaints of alleged contraventions of the Long-term and Short-term Insurance Acts.
The National Credit Act: Applies to all retail credit and related transactions, governing the sales and post-sales processes to prevent irresponsible lending and promote understanding by the borrower of contract terms and costs.
The Consumer Protection Act: Establishes a single and comprehensive framework for consumer protection in South Africa. The scope of the framework is far reaching, and includes banking and financial services.

The financial crisis highlighted the importance of financial consumer protection for the long-term stability of the global financial system. The international financial regulatory community has recently increased its focus on financial consumer protection and numerous other initiatives are underway to strengthen financial consumer protection by international government organizations. In South Africa, the market conduct regulation framework is also being reevaluated and new legislation and regulatory structures are being proposed and implemented. The proposed introduction of a Twin Peaks regulatory structure; will transform the FSB-SA into a dedicated market conduct regulator and
with a new mandate, objectives and regulatory and supervisory frameworks..

It includes an intensive and intrusive approach. This implies that the regulator should proactively identify areas of concern and act to prevent negative consumer outcomes, rather than reacting to complaints or existing prejudice. The policy documents also states that the approach will be pre-emptive and proactive. The stated outcomes based nature of the approach require institutions to comply with both principles and rules based regulations.

By understanding the likely impact of the regulatory reforms the academic research community can assist the regulator to understand the best way to ensure desirable outcomes for users (consumers) of financial services.

Goals of and rationale for consumer protection

Goal of financial regulation should be to improve societal welfare through facilitation of healthy financial markets. Understanding of consumer needs needed. Conduct of business regulation and supervision focuses upon how financial firms conduct business with their customers. Regulatory and supervisory tools include mandatory information disclosure, the honesty and integrity of firms and their employees, the level of competence of firms supplying financial services and products, fair business practices and the way financial products are marketed. It can also include establishing guidelines for the objectivity of advice, with the aim of minimizing those principal-agent problems that can arise when principals and agents either do not have equal access to information, or do not have equal expertise to assess it. Overall, conduct of business regulation is designed to establish rules and guidelines about appropriate behaviour and business practices in dealing with customers. A useful starting perspective in consumer protection in financial services is to ask why a

contract might go wrong for a consumer and to focus regulation on these reasons. Alternative dimensions to a failed contract:
(i) the consumer receives bad advice - perhaps because an agency conflict is exploited;
(ii) the supplying institution becomes insolvent before the contract matures;
(iii) the contract turns out to be different from what the consumer was anticipating;
(iv) fraud and misrepresentation; and
(v) the financial institution has been incompetent.
The key issue is the extent to which regulation can effectively and efficiently address these and reduce the probability of them occurring (Lwellyn 1999)

The international context: consumer protection international best practice

In October 2011, the G20 called for financial consumer protection to be strengthened by new laws and supervisory agencies to address the issues of fair treatment of consumers, proper disclosure and improved financial education. Addressing consumer risk and ensuring consumer protection is seen to be critical in rebuilding trust in the world's financial services sector.

'Consumer protection' issues arise for two main reasons: because an institution where clients hold funds might fail, or because of unsatisfactory conduct of business of a firm with its customers. The failure of a financial firm may have adverse effects on systemic stability, and also cause loss to individual depositors who are regarded as being unable to look after their own interests. The impact of the failure of financial institutions on systemic stability and the interests of consumers means that regulators are almost inevitably bound to have a prudential concern for the liquidity, solvency and riskiness of financial institutions. Such regulation must necessarily focus on institutions *per se.* Conduct of business regulation, on the other hand, focuses upon the functions of financial firms irrespective of the type of firm conducting the business.

Market conduct regulation is essential because financial service providers often have far more expertise than consumers in assessing the quality of financial products and possess far more knowledge on the array of services available. Unfortunately this can create the incentive for financial service providers to exploit their superior information. Abuses range from milder complaints of providing deficient financial advice to egregious and blatant cases of fraud and misrepresentation
Moreover, big financial service providers with substantial market power may charge higher fees, sell products that are not appropriate for their clients and exploit their market power in other ways that may be deemed unfair to consumers.
Market conduct regulation restricts such abuses and also complements prudential objectives. As was demonstrated in the subprime crisis, inappropriate selling of financial products can have systemic effects and, a lack of confidence in the financial system due to poor market conduct practices causes losses to consumers and inhibits economic growth

Arguably, the financial services industry should be held to a higher standard of consumer protection than other industries for a number of reasons:

Loss of deposits or savings imposes immediate costs on consumers
The underperformance or even failure of financial products such as retirement annuities may impose considerable hardship on consumers
Quality or appropriateness of financial products such as life, property and income-protection insurance is only established some time after purchase or when a disaster occurs
Many long-term financial contracts impose heavy penalties for cancellation and switching.
However, the financial services sector also has a number of peculiarities which require slightly different treatment. For example, although the purchaser of a retirement annuity should be allowed a ―cooling-off‖ period to reconsider her decision, someone who trades shares should not because this might introduce systemic risk. Moreover, the cost of this systemic risk will be borne by the economy as a whole, and many might lose their savings, even though the original share trader remains protected.
For this reason, consumer protection legislation for the financial services sector needs to be designed appropriately.

South Africa: framework for market conduct regulation

Over the past few years, South Africa‘s regulatory framework for market conduct and consumer protection in financial services has been bolstered by the introduction of a number of laws to protect consumers, including the Financial Advisory and Intermediaries Services Act (2002), the Financial Services Ombuds Schemes Act (2004), the National Credit Act (2005), and most recently the Consumer Protection Act.
The new Consumer Protection Act (CPA) sets a high standard for the protection of consumers. It establishes a single and comprehensive framework for consumer protection. It is far-reaching, applying not only to contracting parties but users, recipients and beneficiaries of goods and services.
There is a focus on vulnerable consumers‖ that includes many poor and uneducated persons. Goods and services have a much broader scope in terms of the Act than traditional definitions and will include, among others: retailers of goods, casinos, print media industry, airlines, estate agencies, and banking and financial services.

A distinction is usually made between search, experience and credence goods and services. In the case of search goods, quality and price can be ascertained at low cost prior to purchase, such as the selection of a shirt, for example. By contrast, experience-goods are those whose quality can be ascertained at low cost through use, though not prior to purchase. So for example, evaluation of a vacuum cleaner is typically made after purchase. Moreover, a faulty vacuum cleaner can be returned and a replacement obtained at relatively low cost to the consumer, implying that the degree of uncertainty is bounded. Credence goods and services, on the other hand, are those where quality can be ascertained only at some cost after purchase. A frequent characteristic of these goods and services is that the value of the purchase is either spread over a long period of time, or emerges only after a considerable lapse of time. Reversal of such a purchase usually involves considerable loss, both in terms of actual costs and benefits foregone of selecting some alternative. Financial services tend to fall in the category of credence services. The value of many such services can often only be determined once the disaster befalls. Many financial transactions that they involve incomplete contracts, in that their value is determined in large part by the behaviour of the seller/supplier after the point of purchase, or even by the behaviour of other firms in the industry. For example, an investment manager may turn out to be incompetent or even corrupt, and a financial institution may become insolvent while having fiduciary commitments to its customers, perhaps because of a systemic crisis, such as the sub-prime disaster.

National Treasury's policy documents states that "market conduct oversight must be sufficiently strong to complement prudential regulation, particularly in the banking sector.

Context: other financial regulatory objectives

Enhancing financial stability
Policy documents emphasize that a crisis in one economy can easily spread to another, introducing an increased financial stability risks and the need for enhanced supervision of the financial sector. The crisis has also highlighted the need for financial regulation to be better coordinated with monetary, fiscal and other economic policies and to take into account systemic risks. Thus, the macroprudential approach is emphasized as the basis of financial system regulation and broader financial sector policy reforms in the years ahead in South Africa.

Improving consumer protection and market conduct
The consumer detriment trends in the South African financial sector emphasized in the policy documents include high and opaque fees, and, in some cases, the unfair treatment of customers, limited, expensive and inappropriate savings products limited and difficult access to credit. Regular complaints to the relevant ombuds and numerous independent studies demonstrate that fees and charges are a problem.

Promoting financial inclusion
Sustainable and inclusive economic growth and development will be aided by improving access to financial services for the poor, vulnerable and those in rural communities. Government will act to ensure the implementation of the transformation objectives of the Financial Sector Charter, focusing on greater access for the poor and the promotion of broad-based black economic empowerment. These objectives can be achieved without undermining financial stability or promoting reckless credit practices. To promote financial inclusion, the Financial Sector Charter has worked towards developing product standards for products that should be seen to qualify towards charter compliance.28South Africa's Financial Sector Charter sets targets for the financial industry in order to stimulate black participation at ownership, employment and consumption levels. Only products that meet the agreed product standards satisfy charter obligations.

Combating financial crime and protect, enhance efficiency and integrity of financial markets
This includes initiatives to combat financial crime and abuses, including the stealing of trust and beneficiary funds, money laundering and addressing the financing of terror. This would include attempts to improve the efficiency and transparency of the price discovery system, promoting market liquidity and ensuring the safety and soundness of the clearing and settlement processes.
(Source: Implementing Twin peaks, National Treasury 2013)

Context: the global financial crisis and international regulatory reform

The global financial crisis, which commenced in 2007, revealed and accentuated fundamental weaknesses in international financial markets. In response to these weaknesses, international standard-setting bodies such as the G-20, the FSB and the BCBS announced various initiatives, strategies, and new or amended requirements and standards. The BSD continuously monitor these developments, and incorporates them into its supervisory approach as and when deemed appropriate.

The financial regulatory reform in South Africa, including the increased emphasis on consumer protection, is largely a response to G20 international recommendations. These reforms were first introduced in the policy document "*A safer financial sector to serve South Africa better"* in 2011. This was followed by the document *Implementing Twin peaks 2013*. Rationalise, improve framework for financial regulatory co-ordination and accountability. This is a response to the global financial crisis and will be implemented over couple of years. The shift to a twin peaks approach to financial regulation was part of a broader financial regulatory reform agenda. The "Twin Peaks" approach entails creating a prudential regulator housed in the South African Reserve Bank (SARB), and transforming the Financial Services Board into a dedicated market conduct regulator. The objective of the prudential regulator will be to maintain and enhance the safety and soundness of regulated financial institutions. The market conduct regulator's objective will be to protect consumers of financial services and promote confidence in the South African financial system. The Financial Stability Oversight Committee is to co-ordinate efforts to maintain financial stability. It's roles would include: overseeing financial stability, identifying risks to the financial system and responding to them appropriately, advising on crisis management and resolution, while taking into consideration the role of other stakeholders. Additional responsibilities for the Reserve Bank include to regulate, supervise and oversee key financial market infrastructures (FMIs) and supervision of conglomerates.

There is however, an urgent need to address gaps within financial sector legislation to mitigate exiting risks in the financial system. This is addressed in *The Financial Services Laws General Amendment Bill*, 2012 that provide urgent interim emergency powers to supervisors. Reserve Bank the systemic regulator responsible for the prudential regulation and supervision of banks and insurers. FSB responsible for market conduct regulation Financial Stability Oversight Committee to co-ordinate efforts to maintain financial stability *The Financial Services Laws General Amendment Bill.* This enhances the supervisory powers of regulators and the Minister of Finance in dealing with potential risks to the financial system. The FSB is assigned greater powers to impose regulations without reference to the Minister of Finance, Parliament to take action against companies, individuals placing consumers or the broader financial services industry at risk. The aim of the bill is further to close gaps identified by the FSAP. Makes FSB lead regulator where there is concurrent jurisdiction; Minister of Finance and SARB greater powers to intervene in case of bank failure, systemic risk

Regulators need to act "at the speed of light" when there are threats to the financial services industry. Allow FSB inspection teams to summon people and take possession of documentation, and to publish inspection reports when it is in the public interest to do so. The FSB will be allowed to make on-site visits to unregulated entities that could be operating unlawfully. When false allegations are made against the FSB, the regulator should have the power to publish the information from inspection reports to allow it to dispel false claims and mis-information.

In the FSB peer review, the move towards the twin peaks system is described as "a good opportunity for South Africa to streamline responsibilities and elevate the importance of market conduct regulation, which has historically played a less prominent role in certain financial sub-sectors. It was also noted that there was much discussion, but little progress on the establishment of a Council of Financial Regulators as a mechanism for enhancing co-operation and information-sharing. Do not seem to reduce the number of agencies involved in regulating and supervising the financial sector, but provide more clarity on the assignment of responsibilities and the concentration of related expertise. Concern was also raised about the fact that NCR falls outside the proposed structure.

Mandate of the market conduct regulator in South Africa

The Market conduct regulator will be mandated to:

Promote the fair treatment of customers
Promote financial awareness and literacy
Protect, enhance the efficiency and integrity of South Africa's financial markets
Contribute to other financial sector policy objectives
Mandate: promote customer's financial awareness and literacy

National Treasury maintains that consumer protection is necessary to reduce the information asymmetry between financial institutions and consumers but the only way to address the asymmetry itself – and so increase consumer's bargaining power- is to increase financial literacy levels. The market regulator, together with role players such as schools, government and financial institutions, is mandated to develop, promote and implement a national financial literacy strategy. This is a long term strategy.

Mandate: promote financial inclusion

Ensuring responsible financial inclusion by implementing consumer protection regulations
Promoting financial capability training to help consumers understand financial products and services, and truly comprehend the financial system. Implementing, supervising and enforcing specific inclusion frameworks, such as the micro insurance framework
Improved financial inclusion comes with the risk of the most vulnerable consumers being exploited. Consequently, policies supporting access to financial services must be supported by an active consumer protection strategy. The overarching features of the strategy are to combine prudential and market conduct requirements to cohesively support better protection of consumers, taking into account South Africa's specific market strengths and weaknesses.

Mandate: Protect, enhance efficiency and integrity of financial markets

A financial market regulator need to stay abreast of financial market developments in order to protect consumers and ensure efficiency, integrity and reputation of financial markets.
Need to address disregard for product regulation, improper trading practices, unfair treatment of orders, market manipulation, unfair trading practices, misuse of clients assets and fraudulent practices. The market conduct regulator will assume responsibility for regulating financial markets infrastructure conduct. Current FSB Directorate of Market abuse

incorporated into new market conduct regulator and is mandated to ensure financial market integrity by investigating cases of insider trading, market manipulation and false reporting to the affairs of a public company.

Government's policy documents state that these actions are related and cannot be delivered in isolation. One of the key reasons to promote the efficiency and integrity of the financial system is to ensure that customers are treated fairly. Customers more confident of fair treatment will be more willing to sue financial services and thus enhance the effectiveness of the system. National Treasury also mentions that improvements in financial literacy is the most appropriate way to ensure that customers are treated fairly.

Regulatory and supervisory priorities that guide the market conduct regulator

Eight overarching regulatory and supervisory principles:
Transparent:
Comprehensive and transparent: The regulatory and supervisory framework will seek to balance rules based and principles based components. The treat customers fairly initiative will universally apply to all the conduct of all regulated institutions. Rules will be applied and implemented as needed.
Appropriate, intensive and intrusive: the regulator will proactively identify areas of concern and act to prevent negative consumer outcomes, rather that to reacting to complaints or existing prejudice.
Outcomes-based:
Risk-based and proportional: Banks that consistently comply with market conduct obligations and deliver TCF outcomes will attract less market conduct regulatory scrutiny than those who show less regard for fair treatment of customers.
Pre-emptive and pro-active: Need to pre-emptively intervene to prevent or limit material damage that might result in negative consumer outcomes. The FSB will need to build additional capability to monitor (and communicate) emerging conduct risks and undesirable trends.
A credible deterrent to market misconduct: Both consumers and banks must be confident that the regulator will detect and take meaningful action against misconduct and unfair customer treatment. The regulatory consequences of material misconduct must be visible
Aligned with applicable international standards
Intensive and intrusive: Oversight will need to be more intensive and intrusive than has been the case historically – albeit in a risk-based manner.

TCF as an integral part of consumer protection in South Africa

TCF seek to ensure the fair treatment of all bank customers by adopting and enforcing and outcomes based TCF approach to regulation and supervision, which will require registered firms to deliver specific fairness outcomes to their customers.

The rationale for a TCF approach

<u>Information asymmetry </u>: financial services consumers are particularly vulnerable to unfair treatment .SA financial sector regulation includes various measures aimed at protecting consumers, but a holistic and co-ordinated consumer protection regulatory framework that

applies consistently across the financial services sector – and is tailored to address the specific conduct risks peculiar to the sector – has been lacking.
TCF is a regulatory approach that seeks to ensure that specific, clearly articulated **fairness outcomes** for financial services customers are **demonstrably** delivered by regulated financial institutions.
Ultimate desired outcomes of TCF

Market conduct framework that will ensure that customers' financial services needs are appropriately met through a sustainable industry. TCF intended to contribute to this final, desired outcome, by delivering the following intermediate outcomes:
Improved customer confidence
The supply of appropriate products and services a
Enhanced transparency and discipline in the industry

An effective TCF supervisory framework

TCF implementation is guided by 6 fairness outcomes, BUT clear, enforceable rules and regulations must also be in place to ensure that these outcomes are achieved.
Relying on firms to "do the right thing" is not on its own sufficient to drive the behavioural, culture change required to deliver fair outcomes. Regulatory framework should effectively balance principles-based and rules-based regulation
Appropriate mix of legislation, subordinate legislation and specific guidance for firms, to ensure that firms clearly understand the FSB's regulatory expectations.
Need to develop processes and controls to manage their compliance with the rules-based components of TCF. TCF delivery strategy should not be seen as a "compliance project", Compliance and risk management functions within firms will need to form part of the firms' overall TCF strategy. Ultimately, achievement of the TCF outcomes will be the responsibility of the firm's management and board

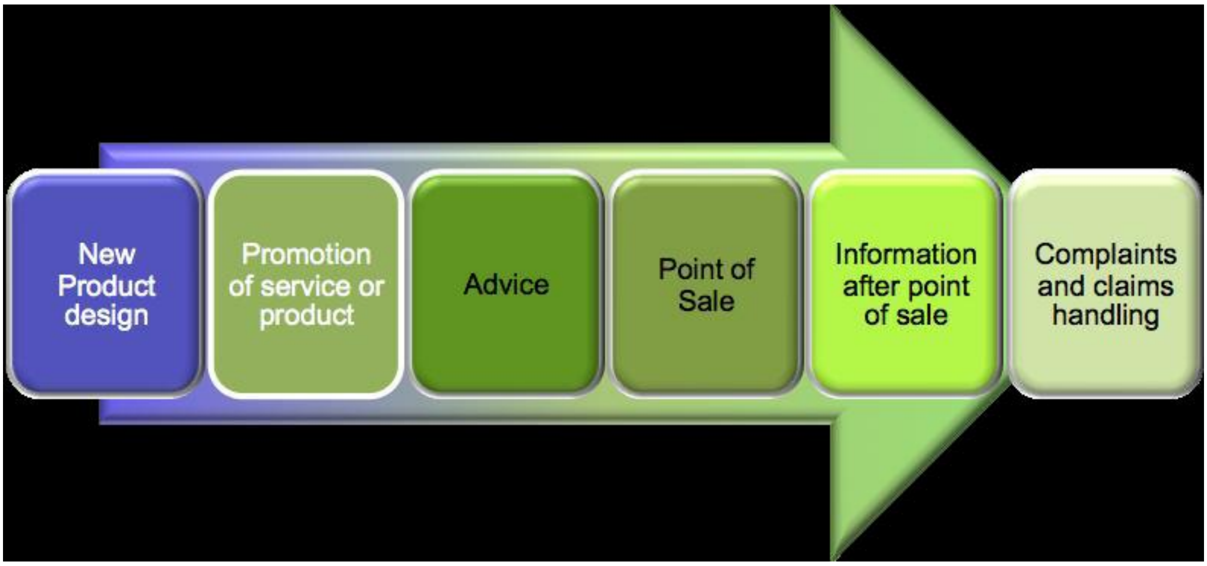
The six fairness outcomes

The six TCF outcomes are:
Outcome 1: Customers are confident that they are dealing with firms where the fair treatment of customers is central to the firm culture.
Outcome 2: Appropriately targeted design and marketing of products and services: Products and services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly.
Outcome 3: Clear information Customers are given clear information and are kept appropriately informed before, during and after the time of contracting

Outcome 4: Suitable advice:. Where customers receive advice, the advice is suitable and takes account of their circumstances.
Outcome 5: Products perform as expected and acceptable service Customers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and what they have been led to expect.
Outcome 6: No unreasonable post sale barriers:
Customers do not face unreasonable post-sale barriers to change product, switch provider, submit a claim or make a complaint.

Fairness outcomes to be delivered throughout the product life cycle

TCF will require regulated firms to consider their treatment of customers at all stages of their relationship with the customer, from product design and marketing, through to the advice, point-of-sale and after-sale stages. Firms will ultimately be required to demonstrate – through management behaviours and monitoring – that they are consistently treating customers fairly throughout the stages of the product life cycle to which they contribute.

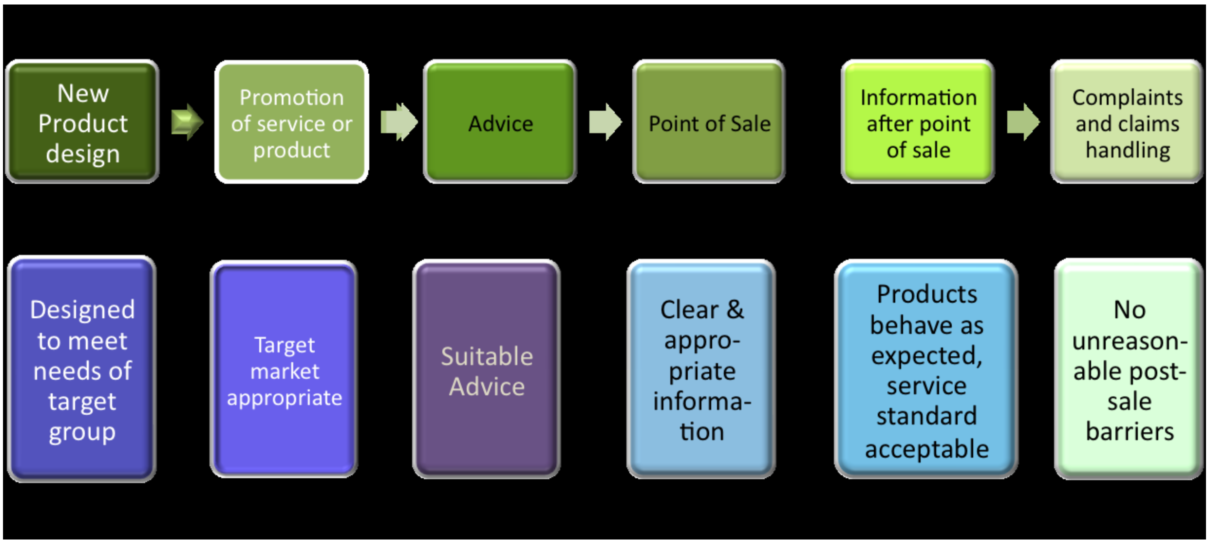


Product and service design: Products and services – and the distribution strategies chosen to bring them to market – are designed and developed for specific target markets, based on a clear understanding of the likely needs and financial capability of each customer group.
 Promotion and marketing: Products are marketed to specific target groups, through clear and fair communications that are not misleading and are appropriate to the target group.
 Advice: Firms need to ensure that, where advice is provided, advisers are fully equipped to provide advice that is suitable to the needs of the customer concerned, balancing the commercial objective of increasing sales with the objectives of TCF and avoiding conflicts of interest.
Point-of-sale: Firms need to provide clear and fair information to enable customers to make informed decisions about transacting with the firm, its products and services. This means that product risks, commitments, limitations and charges must be transparent. Disclosure around bundled products must enable customers to understand the different components of the bundle.

Information after point-of-sale: Firms need to provide customers with ongoing relevant information to enable them to monitor whether the product or service continues to meet their needs and expectations, and provide acceptable levels of service for post-sale transactions or enquiries. Firms must also monitor and respond to changes in the wider environment that may affect products and impact on particular groups of customers.

Complaints and claims handling: Firms need to honour representations, assurances and promises that lead to legitimate customer expectations. Legitimate expectations must not be frustrated by unreasonable post-sale barriers. There is a requirement for fair and consistent handling of claims and a mechanism to deal with complaints timeously and fairly. Firms should undertake to identify common underlying causes of complaints and take action to eliminate the root cause.

The TCF approach will require banks to consider how they treat customers at all times, from product design and market to the advice, point of sale and after sale stages. Banks will need to adopt a TCF culture and governance framework, embedding TCF principles and controls on their leadership, strategy, decision making, performance management and reward processes. The market conduct regulator will monitor the efficacy of a bank's TCF governance and controls.



Other possible consumer protection regulatory initiatives

Enhanced effectiveness of the ombud system. Simple, effective, independent dispute resolution mechanisms that can secure fair outcome when broader protection frameworks have failed. Fragmented nature of current ombud system, with its combination of statutory and voluntary schemes, poses several actual and potential risks: Consumer confusion, Gas and overlap in jurisdiction, Administrative inefficiencies, Inconsistencies in approach, Concerns regarding the independence of the industry-sponsored voluntary schemes

Supervisory tools

The market conduct regulator will rely on a combination of traditional supervisory tools and more innovative tools to achieve its mandate. Traditional supervisory tools include scheduled and ad hoc site visits, regular compliance and other reporting, ad hoc information request and reviews and analyses of independent information. New supervisory tools include mystery shopper techniques, sourcing information from third parties such as the media and ombud schemes, new or existing industry surveys and revised and enhanced regulatory reporting.

<u>Enhanced reporting requirements</u>
To proactively identify conduct risks
Market discipline role
<u>Pre-emptive intervention to mitigate industry wide market conduct risks</u>

Occasionally the market conduct regulator will need to intervene pre-emptively to mitigate emerging conduct risk. Possible industry-wide interventions include:
Engage industry associations to drive sector-wide communication and were appropriate, self regulation through industry standards and codes of conducts.
Alerting industry to regulatory concerns regarding an identified risk through specific regulatory guidance
Thematic on-site monitoring of banks to gather information on the extent of risk or suspected breach of conduct. Warning and informing consumers of the financial products or services concerned. Tighten regulatory requirements to close identified gaps.
With regard to Institutions specific conduct risk, the likely intimal response will be discussions with senior managements about: a course of action to ensure that the identified inappropriate action stops, redress for customer prejudice already caused, disciplinary or other appropriate action to be taken by the bank against individuals responsible for the unfair treatment and training interventions.

<u>Product suitability</u>

Range from regulatory preapproval before product is launched (most intrusive) to disclosure requirements (least intrusive)

Reporting requirements
These will need to be sufficiently comprehensive and rigorous to put the FSB in a position to pro-actively identify industry level (macro) and firm-specific (micro) conduct risks and early warning signs of unfair customer treatment. An appropriate range of reporting mechanisms will be developed, in consultation with industry and other stakeholders, as part of the supervisory framework. These reporting mechanisms will include both non-public components, to be incorporated as appropriate into existing regulatory returns and / or compliance reports, as well as public disclosure of identified TCF related measures.

Public disclosure of identified TCF performance measures
Possible items which firms will be required to disclose publicly could include measures relating to claims statistics (e.g. repudiations, disputes, timelines), complaints volumes and responses, adherence to service levels, investment performance against benchmarks, and regulatory sanctions or interventions. Public disclosure is likely to apply both in respect of specific firms' measures and also on an aggregated basis, where appropriate, at industry or sector level. Effective aggregation processes will be required.
Care will have to be taken to ensure that public disclosure leads to fair and meaningful comparisons between firms and sectors – that "apples are compared with apples". The reputational impact of meaningful public disclosure can then act as a powerful deterrent of unfair customer treatment, and an incentive for firms to compete over the quality of the customer experiences they deliver. TCF reporting information per sector can also encourage firms to apply peer pressure to competitors that are not delivering adequate TCF outcomes. It may be that publication of such information may lead competitors to report negative behaviour to the relevant authorities, to avoid the sector's reputation being tainted by the conduct of "bad apples".
Conversely, those firms who perform well on publicly disclosed TCF measures should gain competitive advantage from improved public and stakeholder perceptions. Although arguably this should in itself constitute a sufficient positive incentive ("carrot" as opposed to "stick") for adhering to TCF principles, the FSB may consider additional methods of reinforcing positive TCF outcomes. In a risk-based supervisory framework, firms who consistently

anddemonstrably deliver on their TCF commitments will also attract proportionally less regulatory scrutiny than their riskier competitors

Enforcement mechanisms for credible deterrence
For TCF to achieve its desired outcomes, firms must know that the regulator is in a position to – and will - enforce firms' TCF accountabilities. Consumers and other stakeholders must also have confidence in the regulator's enforcement powers. The FSB must not only develop the TCF framework and monitor its delivery, it must also enforce adherence to the framework.
Pre-emptive intervention for industry conduct risks
The FSB's supervisory approach will be broadened to proactively identify emerging conduct risks, with a view to pre-empting negative consumer outcomes. This proactive approach will need to cover both risks within specific firms (micro conduct risks), as well as concerns at an industry, sector or business model level (macro conduct risks). Where such risks are identified, the FSB will need to take action to mitigate these risks to prevent or minimise harm to consumers. Where macro industry- or sector-wide risks are concerned, the regulatory response will need to be appropriate to ensure consistent, sector-wide behaviour change.

Possible types of intervention include:

Engagement with appropriate industry associations to drive sector-wide communication and, where it is likely to be effective24, self-regulation through industry standards or codes of conduct.
Issuing specific guidance to alert affected sectors of the FSB's concerns and expectations in regard to the risk identified.
Thematic on-site monitoring of relevant firms to gain more comprehensive information of the extent of the risk (or breach, where applicable) concerned.
Publishing warnings or other guidance to consumers of the financial products or services concerned.
Introducing new regulations or tightening existing regulations (subordinate legislation).

A particular question that will require debate is the matter of **whether or to what extent the regulator should intervene in the actual structure of financial products**, where products or product features are identified as being unfair to consumers – or at least to certain categories of consumer. A range of possible interventions exists, with different international examples. These range from regulatory pre-approval of financial products before launch, the most interventionist extreme, to mere compulsory disclosure of key product features, the least interventionist extreme. A number of other options exist between, including prescription of certain product features for certain target markets and powers to "ban" or order withdrawal of certain products or product features

Incentives & deterrence

Application of positive and negative incentives to encourage commitment by firms to achieve TCF outcomes
Viable TCF approach requires credible deterrence measures- market participants must know that unfair treatment of customers will be detected and that those responsible for unfair

treatment will face consequences. They must also appreciate that fair treatment of customers will be to their advantage.
The approach to incentives and deterrence will require firms to be able to provide clear information on their TCF performance, and require the FSB to analyse and respond effectively and decisively to this information

Action by regulated firms

Comprehensive and rigorous disclosure and reporting requirements. Public and non-public reporting .Possible items which firms will be required to disclose publicly could include measures relating to claims statistics (e.g. repudiations, disputes, timelines), complaints volumes and responses, adherence to service levels, investment performance against benchmarks, and regulatory sanctions or intervention
Reputational impact of meaningful public disclosure can then act as a powerful deterrent of unfair customer treatment, and an incentive for firms to compete over the quality of the customer experiences they deliver
Enforcement mechanisms for credible deterrence
"Firms must know the FSB will take serious action." The FSB must not only develop the TCF framework and monitor its delivery, it must also enforce adherence to the framework. An analogy from road behaviour is applicable: It is not enough that traffic authorities prescribe speed limits and supervise road behaviour (via speed traps, for example) – they also need to ensure that those caught exceeding the speed limits are punished in a way that discourages similar behaviour in the future

Pre-emptive intervention for frim specific conduct risks

FSB's likely initial response will be to engage with the senior management concerned to reach agreement on one or more of the following, as applicable:a course of action to ensure that the identified unfair treatment stops. This could include changes in business processes, or changes in product design or withdrawal of products or promotional material. Redress for customer prejudice already caused. This could include tracing and communicating with affected or potentially affected customers. Disciplinary or other appropriate action to be taken by the firm against those responsible for unfair treatment.

Formal regulatory enforcement action

A number of the following enforcement actions are already within the FSB's (or the applicable Registrar's) powers. Proposed regulatory framework include recommendations to enhance the FSB's enforcement powers where gaps are identified.
Enforcement options include:
Administrative fines and penalties.
Declaration of business practices to be undesirable, with associated powers to order cessation or amendment of the practices concerned.
Suspension or withdrawal of regulatory licenses.
Termination or withdrawal of the approval of certain individuals to act in certain capacities.
Damages and compensation awards (including punitive damages).
Referral of certain matters to the High Court.

Referral to the National Prosecuting Authority for criminal prosecution of individual wrongdoers, where a statutory or common law criminal offence is committed

Name and shame

Reputational consequences for firms of public disclosure of their TCF successes and failures, introduces market discipline into the TCF framework.
Risk of public disclosure of TCF enforcement action being taken against a firm should be an effective deterrent of unfair customer treatment.
Publication prescribed for various formal enforcement actions, such as withdrawal and suspension of licenses.
Criminal proceedings, where applicable, are also a matter of public record.
In addition, a "name and shame" approach to less formal regulatory interventions. For example, the fact that an agreement has been entered into between the FSB and a firm to address identified conduct concerns. This decision will be driven in the main by what the FSB considers to be in the best interests of affected or potentially affected consumers

Support structures

The role of ombud schemes in delivering "ultimate fairness" to financial consumers; the underpinning of the broader national consumer protection frameworks through complementary and co-ordinated measures of other regulators; and ensuring that customers are empowered to demand fair treatment through consumer education and awareness initiatives.

Some specific issues related to consumer detriment and consumer protection in the South African financial system

Issues relating to credit agreements

Consumer protection in the area of credit agreements is of special importance. The National Credit Act provides extensive protection to credit consumers. Positive contributions of the NCA often cited in South Africa policy documents include tempering the effect of the global financial crisis, creating awareness of consumer's rights, obligations, addressing over-indebtedness, increased access to credit, creation of a single legislative framework and improving welfare through credit. However, despite this extensive legislative protection, several areas of concern remain. Some of these concerns were highlighted in the recent Policy review document. Reckless lending is partly due to the fact that there is a lack of incentives to comply with regulations, inadequate details on scope, limits, enforcement of agreements entered into in reckless manner. It was recommended that provisions should be made for debt counsellors, ombuds, etc. to report all suspected reckless lending to NCR and provisions for minimum standards related to affordability assessments needed. Consumer education is seen as catalyst for proper outcome of many of objectives of NCA but effective, implementable education remains a problem. In terms of credit information, NCA provision regarding credit bureaux had positive impact but National Credit Register has not come into being and reporting to credit bureaux by credit providers has not been fully enacted Need to challenge notion that sharing of information is voluntarily. NCA was unable to change long-ingrained habit of SA consumer to take credit where it is first found– legislative emphasis on pre-agreement disclosure has not been entirely effective. Some people may qualify for both unsecured loan (longer term, higher amount) and microloan, but interest cost on micro loan much higher. Some credit providers treat microloan as revolving credit

Credit amnesty proposal: erasing some of the adverse information from credit reports– but not debt. Other proposals: Affordability assessment guidelines;
Timeous submission of data to credit bureaus;
Amend legislation to make it easy, inexpensive for paid-up judgments to be removed from credit bureau records. There is also a campaign to educate consumers “The purpose of the amnesty is not to enable consumers who cannot afford further credit to access it; it is rather to help those who can afford credit to access it at a reasonable cost. Industry negative about proposals and of the opinion that it“will only aggravate problem of over indebtedness” and “encourages an inappropriate culture”. Another concern is the use of credit bureau status to determine employment suitability. “Underlying assumption: consumers who get into financial trouble are dishonest. If you have a judgment against you, this stays on your record for five years. Sometimes the information is not removed and this prejudices consumers. Information can be removed sooner if you can get the judgment rescinded by a court, but this is costly for the consumer. There are also several issues that need to be addressed about credit bureau information, including loading information onto a credit profile that is not supposed to be loaded, such as multiple listings of the same debt. Low take-up by consumers of their annual free report from each of the credit bureaus is another problem. Debt review status and other information relating to loans not being loaded on time or at all, allowing credit access to consumers who should not be accessing credit.. Education about credit bureau information

Ponzi schemes and issues related to illegal deposit insurance schemes

Statement by the South African Reserve Bank, on the launch of a national deposit-taking schemes awareness campaign (28/06/2012)**.** The campaign encourages members of the public to report any information on these schemes to a dedicated email address or to report it to the Crime Line number. “ My appeal to all is to speak to an accredited financial service provider before investing and to report any suspected Ponzi and pyramid schemes to the South African Police Service or the SARB.” The campaign also includes a call€ on all banks in South Africa to support the campaign. Campaign elements are primarily radio and print to create awareness in respect of Ponzi and pyramid schemes. The campaign message is Beware of oMashayana. If it sounds too good to be true, it probably is. Speak to your Bank or an authorised financial services provider. In the Bank Supervision Department’s Annual Report, the Reserve Bank states that in 2012 there were 38 schemes under review relating to illegal deposit-taking schemes, compared to 51 in 2010 it was 51. “Certain inspections prompted the department to extend the original mandates given to inspectors to also inspect companies and/or individuals related to these schemes. This was because some of the schemes had established a number of franchisees and/or schemes following a similar modus operandi.