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Submission

to the
Standing Committee on Finance

on the
Financial Sector Regulation Bill [B34-2015]

About the Free Market Foundation
The Free Market Foundation is an independent public benefit organisation founded in 1975 to promote and foster an open society, the rule of law, personal liberty, and economic and press freedom as fundamental components of its advocacy of human rights and democracy based on classical liberal principles.

The Foundation's specialised work falls under dedicated units with committees of recognised experts. The applicable unit in this case is the Financial Policy Unit.

The FMF has a consumer-centred approach regarding financial policy. It is primarily concerned about the rights and interests of consumers. As such, it pays special attention to the cost-benefit implications for consumers of market conduct regulation of the kind envisaged in the Financial Sector Regulation Bill (FSRB). The FMF fills the gap left by advocates in favour of controls and taxes who tend to overlook or understate (a) costs imposed on and passed onto consumers, and (b) the impact on consumers of the market distortion effects of controls and taxes.

We consider consumer-centred analysis to be particularly important in view of the fact that, as far as we can tell, little or no input has been received from consumers and the rights and interests of consumers are scarcely mentioned in thousands of pages of submissions and hundreds of pages of official documents regarding the FSRB. We are aware only of references to hypothetical "problems", "concerns", "risks" and the like, but not of actual documented problems or how best to deal with them.

Submission
According to the 2011 National Treasury Policy Document (under the heading "A Safer Financial Sector to Serve South Africa Better"):

> The financial services sector is at the heart of the South African economy and touches the life of each and every citizen. Financial services allow people to make daily economic transactions, save and preserve wealth to meet future aspirations and retirement needs, and insure against personal disaster. At the level of the macroeconomy, the financial sector enables economic growth, job creation, the building of vital infrastructure and sustainable development for South Africa and her people.

Given the paramount importance attached to the financial sector and the FSRB by the Treasury, we respectfully submit that Parliament should not proceed without a **Socio Economic Impact Assessment** (SEIA) as required by the Cabinet, the Presidency and the Treasury's own Minister, Minister Hlanhla Nene.

It seems to us to be unacceptable for the Honourable Minister's staff to disregard him and proceed as if he had not mentioned the matter in his recent Medium-Term Budget Speech.

Not only did the Honourable Minister say that all new measures must be preceded by a **Socio Economic Impact Assessment** (SEIA), but his announcement followed a Cabinet resolution and elaborate Guidelines issued by the Presidency in 2012[1].

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1 The term used was Regulatory Impact Assessment (RIA).

Given the prominence of the matter, the cost and effort that went into it, and the Honourable Minister's commitment, a properly, independently and expertly conducted SEIA should be regarded as an absolute precondition for further consideration of the Bill.

The need of a SEIA takes on particular significance in view of the fact that not only was the Financial Advisory and Intermediary Services Act (FAIS) preceded by a SEIA[2], but that none of the substantive predictions and promises materialised. On the contrary, the opposite of what was promised occurred. What should have improved deteriorated, and actual costs far exceeded promised costs.

In the absence of a professionally, properly and independently conducted SEIA, the government has no way of knowing whether benefits are likely to exceed costs, what benefits and costs are likely to be, who will enjoy benefits and who will endure costs, what the nature and extent of costs and benefits might be, and how society and the country's economy will be impacted.

The Bill proposes "twin peaks". The "peak" in particular need of a SEIA is the "market conduct" peak. The prudential regulation (the other "peak") has been the norm in most countries for many years. It is to be restored to the Reserve Bank (SARB) and entails, or should entail, a conceptually simple formula for insurers and another for banks.

Market conduct regulation, on the other hand, is a new idea imported from the United Kingdom, where many regard it as a failed attempt to remedy problems arising from their equivalent of FAIS.

Since neither the Bill nor any of the voluminous documentation surrounding it provides any detailed or objective criteria for what market conduct regulation might be, or what actual (as opposed to hypothetical) problems it is supposed to address, parliament is being asked to empower the Financial Services Board (FSB) to do something unknown and unknowable.

The only solution for parliament would be for it to have a properly conducted SEIA. It will clarify, specify and quantify:

1. What real documented problems exist (the "mischief principle")?
2. Who precisely endures those problems?
3. How serious they are?
4. How common they are?
5. To what extent does existing law, including common law, not already provide protection and redress?
6. What concrete measures will be taken to redress problems?
7. Why and by what mechanism (causal nexus) those measure are expected to succeed?
8. To what extent they are expected to succeed?
9. What direct and indirect costs and benefits will be per problem successfully redressed?
10. Who will endure costs and enjoy benefits?
11. How will different socioeconomic groups be impacted?
12. By what methods will cost and benefits be monitored?
13. How and when will monitoring be reported?
14. What remedial action will be taken if predicted costs and benefits do not materialise?
15. Whether all provisions in the Bill are Constitutional?

[2] The term used was Cost-Benefit Analysis (CBA).

There is legal opinion[3] to the effect that section 33 of the Constitution (the administrative justice clause) could mean that all legislation must be preceded by something amounting to a SEIA[4].

Conclusions

Few bills have been preceded by as much cause and effect confusion as the FSR Bill, which highlights the need for a SEIA.

A common mantra, for instance, is that it is necessary because of "lessons learned from the financial crisis". There is nothing in the Bill of relevance to the crisis. The crisis was a narrowly defined phenomenon that impacted banks, governments and a few other institutions that were heavily invested in US government-backed subprime mortgage derivatives.

Secondary effects were so diluted that most companies and economies carried on growing. Most African countries grew at accelerated rates, and the sub-continent became the world's highest growth region. Our Treasury observed that "South Africa's financial institutions were resilient in the face of the crisis".

In the absence of a SEIA, there is no reason to expect the Bill to reduce the likelihood of failures that occurred by virtue of common law offences notwithstanding FAIS and the FSB (Masterbond, Fidentia, Tannebaum, African bank etc).

The "crisis" had nothing to do with insurance, and is therefore of no relevance to insurance regulation proposed in the Bill.

There is much talk of the need to reduce "mis-selling" and improve insurance policy "persistency". That is what FAIS was meant to achieve. The opposite happened. In the absence of a SEIA, there is no reason to believe that this Bill will improve persistency.

It is not even clear whether there is a problem in need of a solution. So long as consumers have any freedom of choice at all, they will make mistakes. Freedom is the right to be wrong. All regulatory (as opposed to educational) attempts at improving consumer behaviour, raise costs and reduce choices. It is also not clear why insurance is regarded as a special case. There are no regulations aimed at reducing "mis-selling" of houses, cars or wedding rings, even though the implications for consumers of making sub-optimal decisions are usually more severe.

Only a properly conducted SEIA will establish whether the Bill will reduce mis-selling (if there should indeed be less of it).

The Bill might well have benefits that exceed costs in these and other contexts, but Parliament has no evidence to that effect. It does know that FAIS failed, and that the absence (as in this Bill) of any substantive departure from the FAIS concept is also likely to fail.

Parliament has not been given quantified estimates (as required by a SEIA) of what the Bill is expected to change – what problems precede it and what solutions will follow – or what each change will cost in cash and kind, directly and indirectly.

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[3] Advocate Ashina Singh.

[4] The matter has not yet been addressed by the Constitutional Court.

Above all, we respectfully submit that it is disrespectful for the Minister's staff to proceed with this Bill without a SEIA in defiance of his instruction, backed by the Cabinet.

The simple, correct and obvious thing for Parliament to do is, we suggest, to return the Bill to the Treasury with an instruction to resubmit it only with properly conducted, independent and professional SEIA. Parliament should make it clear that, in the absence of such a SEIA, it is in no position to perform its legislative function properly, thereby doing justice to the country and all who live in it.

Leon Louw
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