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Consumer financial well-being in South Africa's Twin Peaks regulatory regime: from measurement to confidence in outcomes

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A B S T R A C T

This paper examines aspects of consumer protection in the financial services industry in South Africa. First, the paper briefly outlines the reforms to the financial regulatory architecture in South Africa: the adoption of Twin Peaks. Next, the paper provides an account of the Treating Customers Fairly (TCF) regime, and the manner in which that has served as the groundwork for the Twin Peaks reforms. In the third part a description and analysis is provided of the sources of data available to the consumer protection regulator in South Africa. In the final part a description and explanation is provided of a comprehensive indicator framework being developed in South Africa to measure customer outcomes. This will be the first such framework of its kind in the world. The writer provided the thought-leadership for the development of this framework, in conjunction with a joint South African-Australian management consultancy (DBA), and in partnership with the Consultative Group to Assist the Poor (CGAP), a division of the World Bank.

Keywords: Twin Peaks, financial system regulation, Treating Customers Fairly, TCF, consumer protection, consumer financial well-being, Financial Sector Regulation Act, Conduct of Financial Institutions Bill, CoFI

Ⅰ. Introduction

While there is agreement that financial services firms must demonstrate the efficacy of their policies for, and their commitment to, consumer financial well-being, unless financial well-being is measured, how can we know that these commitments are effective? Moreover, how can we know that consumer financial well-being is improving, unless well-being is consistently tracked and measured?

The reasons why these goals are important should be viewed within a broader, higher-level context: it is consumer financial well-being that should be the ultimate goal, not the protection of the financial industry, or the promotion of the industry's interests, *per se*. As the Chair of Australia's version of the SEC - ASIC, the Australian Securities and Investments Commission - stated at the time of his appointment: "The financial industry must serve the community, not the other way round [paraphrased]."[1]

Work in which the writer has been involved, and recently undertaken[2] in this space, has been focused on

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[1] Patrick Durkin, "James Shipton appointed ASIC chairman", 'News', *Australian Financial Review*, 17 October, 2017.

[2] The writer partnered with a joint Australian-South African consulting firm (DBA) and the Consultative Group to Assist the Poor (CGAP), a division of the World Bank, from November 2019 to June 2020.

consumer financial well-being in South Africa. South Africa is currently rolling out the Twin Peaks model of financial regulation, based to a large extent upon the financial system regulatory architecture that was pioneered in Australia.[3] Whilst this model was first implemented in Australia, it was not devised by an Australian. Rather, it was devised by an Englishman by the name of Michael Taylor,[4] and proposed originally for adoption in the United Kingdom. Despite this intention, Twin Peaks was adopted first in Australia, and only much later in the United Kingdom,[5] and thereafter, and most recently, in South Africa.

Twin Peaks is in fact a misnomer. It is more accurately described as a Triple Peak model, comprising: one peak with responsibility for the prudential soundness of banks and insurers; a second peak with responsibility for consumer protection and good market conduct (hereinafter simply 'conduct'); and the central bank as the third peak, with responsibility as lender of last resort. The first and third peaks have complementary responsibility for financial system stability from a micro- and macro- perspective respectively. The two (plus one) peak model is now clearly discernible in South Africa, with the creation of the Prudential Authority (PA), the Financial Sector Conduct Authority (FSCA), and the South African Reserve Bank (SARB), as the third peak.

As a precursor to our work with CGAP and the World Bank, the author was consulted on the drafting of the aptly named *Conduct of Financial Institutions Bill*[6] (CoFI) in South Africa, as a member of the panel of independent experts convened by South Africa's National Treasury. CoFI is currently in Bill form, and the aim of that legislation, as the title implies, is to compel good conduct amongst financial institutions in South Africa. The Bill itself is based, and draws heavily on, the *Treating Customers Fairly* (TCF) regime, which was first implemented in the United Kingdom in 2005, and then copied in South Africa in 2011.[7]

Ⅱ. Laying the groundwork: TCF

The Treating Customers Fairly regimes, both in the United Kingdom and in South Africa, rest on six core principles. The wording of those six principles is almost identical by comparison between the two countries. They focus, on the whole, on the product life cycle, which

Project # 1264848: *Application of Customer Outcomes Based Regulatory and Supervisory Approach in South Africa*.

[3] For more on South Africa's adoption of the Twin Peaks model see: Financial Regulatory Reform Steering Committee, "Implementing a twin peaks model of financial regulation in South Africa", series edited by the Financial Services Board, 1 February 2013; National Treasury, Republic of South Africa "Twin Peaks in South Africa: Response and Explanatory Document - Accompanying the Second Draft of the Financial Sector Regulation Bill", in *National Treasury Policy Document*, December 2014; Andrew Schmulow, "Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks", *African Journal of International and Comparative Law*, Vol. 25, no. 3 (1 August, 2017); Andrew J. Godwin & Andrew D. Schmulow, "The Financial Sector Regulation Bill In South Africa, Second Draft: Lessons From Australia", *South African Law Journal*, Vol. 132, no. 4 (9 October, 2015); Andrew Schmulow, "Retail Market Conduct Reforms in South Africa Under Twin Peaks", *Law and Financial Markets Review*, Vol. 11, no. 4 (3 January, 2018); A. J. Godwin, T. Howse & I. Ramsay, "Twin Peaks: South Africa's Financial Sector Regulatory Framework", *South African Law Journal*, Vol. 134, no. 3 (August, 2017); Gail Pearson, "Making prudence: Consumer credit and twin peaks, a comparison of Australia and South Africa", *Journal of Banking and Finance Law and Practice*, Vol. 27, no. 3 (November, 2016); A. D. Schmulow, "Twin Peaks plus other means will strengthen SA", 'Opinion & Analysis', *The Star*, Late Edition, 19 March, 2015; A. D. Schmulow, "New Twin Peaks model: The Big Bang of SA's financial industry", *South African Business Integrator*, 31 August, 2018. For more on Twin Peaks see: Michael Taylor, "Welcome to Twin Peaks", *Central Banking Journal*, Electronic Article, Vol. 21, no. 1 (17 August, 2010); Michael W. Taylor, ""Twin Peaks": A regulatory structure for the new century", series edited by the Centre for the Study of Financial Innovation, no. 20, December 1995; Michael W. Taylor, "The Road from "Twin Peaks" - and the Way Back", *Connecticut Insurance Law Journal*, Vol. 16, no. 1 (2009-2010); A.D. Schmulow, "Twin Peaks: A Theoretical Analysis", *CIFR Research Working Paper Series*, no. 064/2015 / Project No. E018, Centre for International Finance and Regulation (CIFR), (July, 2015); Andrew D. Schmulow, "The Four Methods of Financial System Regulation: An International Comparative Survey", *Journal of Banking and Finance Law and Practice*, Vol. 26, no. 3 (8 December, 2015); Andrew Godwin, Timothy Howse & Ian Ramsay, "A jurisdictional comparison of the twin peaks model of financial regulation", *Journal of Banking Regulation*, Vol. 18, no. 2 (1 April, 2017); Andrew Schmulow, Virginia Dore, Jacob Reardon & William Hanna, "AFCA: The first foothill between Australia's Twin Peaks", *Law and Financial Markets Review*, Vol. 14, no. 3 (15 September, 2020); Andrew D. Schmulow & James O'Hara, "Protection of Financial Consumers in Australia", in *An International Comparison of Financial Consumer Protection,* edited by Tsai-Jyh Chen, 2018.

[4] See fn 3, above.

[5] Michael W. Taylor, "Regulatory Reform in the UK", *North Carolina Banking Institute*, Vol. 18, no. 1 (November, 2013).

[6] *Conduct of Financial Institutions Bill*, 2020, (Republic of South Africa).

[7] Andrew Schmulow, "Treating Customers Fairly (TCF) in the South African Banking Industry: Laying the Groundwork for Twin Peaks", *African Journal of International and Comparative Law*, Vol 21, 2021 (forthcoming).

Table 1. Treating Customers Fairly principles: United Kingdom v South Africa

TCF in the United Kingdom[8]	TCF in South Africa[9]
Outcome 1 Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.	**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 Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.	**Outcome 2** 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 Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.	**Outcome 3** Customers are given clear information and are kept appropriately informed before, during and after the time of contracting.
Outcome 4 Where consumers receive advice, the advice is suitable and takes account of their circumstances.	**Outcome 4** Where customers receive advice, the advice is suitable and takes account of their circumstances.
Outcome 5 Consumers are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect.	**Outcome 5** 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 Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.	**Outcome 6** Customers do not face unreasonable post-sale barriers to change product, switch provider, submit a claim or make a complaint.

is a more extensive cycle than the customer journey: the product life cycle begins before a customer is involved, when the product is first devised or conceived. But there are also TCF strictures that apply, or that seek to drive conduct, at the level of firm culture and firm governance. So, for example, outcome number one (Table 1) requires that customers be confident that they are dealing with firms in which the fair treatment of customers is central to the firm's culture.

Outcome two requires that products and services are sold, marketed and designed to meet the needs of identified customer demographics, and that they are targeted appropriately.

Outcome three requires that customers be given clear and appropriate disclosure (which includes use of plain English, and where important disclaimers and limitation of liability clauses are used, that those be made prominent and are not buried in fine print); and that consumers be appropriately informed before, during and after the time that they contract with the company.

Where customers receive advice, outcome four requires that the advice must not only be suitable, but must take account of the customer's circumstances, for example: their level of financial sophistication; level of education; financial literacy; or their needs.

Outcome five requires that customers be provided with products and services that perform as they have been led to believe they will, and that the service associated with those products and services is acceptable. Typically, this would include the difficulty and time spent in contacting the provider, and length of time taken to respond to enquiries.

Finally, outcome six requires that consumers do not face unreasonable post-sale barriers to change to a different product; switch providers; submit a claim; or, crucially, lodge a complaint.

Because South Africa is a developing country, with a large number of highly vulnerable financial consumers who have traditionally been excluded from the financial system, these requirements are also interpreted to include

[8] Financial Services Authority, United Kingdom, "Treating customers fairly - towards fair outcomes for consumers", in *Treating Customers Fairly*, no. 2624, Financial Services Authority, July 2006, p. 3.

[9] Financial Services Board, Republic of South Africa, "Treating Customers Fairly. The Roadmap", in *Financial Services Board Policy Document*, Financial Services Board, 31 March 2011, p. 7.

the goal of increasing financial inclusion. That requires facilitating access to financial products and services for those members of the community traditionally excluded from equitable participation in the financial system.

Significantly, in the United Kingdom TCF has had the force of legislation,[10] whereas in South Africa the TCF regime was aspirational, and evaluated by self-assessment.[11] That is set to change, however, as these requirements will henceforth be codified in the forthcoming *Conduct of Financial Institutions Act*. But in order to determine whether financial service providers (FSPs) are in compliance with these principles, the conduct regulator, the Financial Sector Conduct Authority (FSCA), will need to be able to measure progress; conduct thematic reviews of the industry; and to conduct risk assessments - the risk that certain products and services may pose to the public. Moreover, the regulator will need to be able to do so in respect of risks identified *ex ante*, and not only in respect of breaches *ex-post*. Put simply, the regulator needs to be able to see risks that have not yet eventuated, but that are likely to eventuate.

Ⅲ. An 'as is' situational review of data sources for the South African Financial Sector Conduct Authority

In late 2019 the writer was approached by CGAP to lead, and partner on, a project to devise a framework of indicators to measure customer outcomes in the South African financial industry.

First, we examined the sources from where the South African market conduct and consumer protection regulator, the FSCA, obtains information. That evidenced an extensive set of inputs, including: from other regulators; information collected from on-site and off-site supervision; their own data-analytics; questionnaires; and an already existing conduct of business review (COB) for the South African insurance industry. That conduct of business review tracks, *inter alia*, TCF implementation and compliance.

There existed already highly detailed and fulsome cooperation from six different South African Ombud schemes: the Ombud for long-term insurance;[12] the Ombud for short-term insurance;[13] the banking ombud;[14] the financial advisors and intermediaries Ombud;[15] an Ombud for credi t[16] (as distinct from the Ombud for banking); and a pensions industry Ombud[17] (designated as an 'Adjudicator'). It is noteworthy in this regard that while South Africa is a developing country with many of the typical challenges that developing countries face (such as corruption and maladministration), its constellation of Ombuds is highly sophisticated, staffed by highly-qualified individuals, with, in our view, exceptional leadership. Each of the Ombud schemes that we assessed was found to be in possession of rich and extensive data that afforded deep and longitudinal insights into TCF compliance across the industry over which they have jurisdiction. Those insights were capable of being *mined* in a myriad of different ways: by TCF category; by sub-categories; by root cause; by service; by product; and by provider. Of particular interest - and from a consumer benefit / deterrence of misconduct perspective - was the practice by each Ombud of regularly identifying FSPs in their determinations and their annual reports. This *naming and shaming* culture adhered to by South Africa's Ombuds is, we believe, a powerful adjunct in driving improved conduct in each sector of the financial industry. Of further note in our assessments of South Africa's Ombuds was their overall, whole-of-entity culture, which we assessed to be fearless in approach to holding the industry over which they have jurisdiction accountable. We also found, across the gamut of Ombud schemes, a high degree of motivation to assist - at times at their own initiative - the FSCA, in order to drive good consumer outcomes in the financial industry. Finally, the FSCA receives input from civil society groups, and from other government departments, such as the National Credit Regulator.

In respect of civil society groups, this is an area in

[10] Through regulatory enactments such as: Financial Conduct Authority, "Principles for Businesses - FCA Handbook", Release 54, September 2020, and pursuant to: *Financial Services and Markets Act*, Chapter 8 of 2000, (United Kingdom of Great Britain and Northern Ireland), s 1C; 5.

[11] See fn 7, above.

[12] https://www.ombud.co.za.

[13] https://www.osti.co.za.

[14] https://www.obssa.co.za.

[15] https://faisombud.co.za.

[16] https://www.creditombud.org.za.

[17] https://www.pfa.org.za.

which South Africa is, unfortunately, largely un-developed. Civil society groups that tackle consumer welfare are virtually non-existent. There exist *law clinics* at various leading universities,[18] but little else. In respect of co-operation and support from other regulators, arguably the most important is that of the National Credit Regulator.[19]

In addition, the FSCA is able to look to media and social media.[20] There are sentiment indices, such as HelloPeter,[21] which the regulator is able to interrogate. There are also reports from time to time from the Competition Commission, and from trade associations.[22] All of these data sets contribute to the regulator's ability to evaluate the industry and individual FSPs against the core goals of the FSCA, as elucidated in the legislation and regulations (such as the Banking Standard), that they are empowered to issue.[23] To that end South Africa, like Australia, whose regulatory model South Africa has copied, has a regulator that is empowered to issue[24] what are termed 'Standards', and those standards have force of law.[25]

In addition to the information that the conduct authority is able to garner, and in a separate work-stream, we conducted detailed consultations over a period of six months with five financial service providers: Capitec Bank and Nedbank, both of which are big five South African banks;[26] Metropolitan Life and Old Mutual, which are both a short- and long-term insurer; and KGA Life, which is a life insurer. Despite the fact that South Africa is a developing country, it has a highly sophisticated, developed-world style financial industry,[27] and this was reflected in the sophistication and depth of the data that these FSPs track, engage, and retain. Much of this data was relatable to TCF outcomes and adherence.

Ⅳ. The Indicator framework

In a partnership between the writer, DBA, CGAP and the World Bank, we were able to devise a set of 157 customer-outcomes indicators. Each one of these is a type of information that can be delivered to the FSCA by FSPs.

For the purposes of this paper, Table 2 provides a brief snapshot of four indicators that relate to product suitability. There are principally three kinds of indicators that were formulated: *quantitative*, *qualitative* and *attestations*. The first line lists an indicator in which is assessed features, benefits and price (second column). It is based on customer insights and needs in varied segments (third column). It incorporates customer analysis and market research to determine whether the products are being accurately segmented (that is to say, marketed

18 The oldest of which is the law clinic at the University of the Witwatersrand. That clinic has gained a substantial profile in representing the poor and indigent, but mainly in respect of human rights abuses and Tortious claims (what in South Africa are termed 'Delicts'). Claims successfully litigated for vulnerable consumers in respect of financial well-being are vanishingly small, but one notable exception is that of the law clinic attached to the University of Stellenbosch, which has litigated on behalf of vulnerable consumers on matters including so-called *garnishee* orders (more correctly called emolument orders), and the statutory *in duplum* rule. See further: Angelique Ardé, "Collection costs judgment brings relief for millions of debtors", 'Money', *Business Day*, 13 December, 2019.

19 National Credit Regulator, "Home", in *NCR National Credit Regulator*, 2016, accessed: 2 August, 2016.

20 The FSCA has partnered with the firm *BrandsEye*, which uses a highly innovative, crowd-sourced (as opposed to AI) approach to analysis of social media sentiment (see for eg https://www.brandseye.com/research/south-african-banking-sentiment-index/). This approach, while more labour-intensive, is more reliable than AI, because *BrandsEye's* approach is able to discern negative sentiment that is expressed - facetiously - as positive. For example comments such as 'thank you [bank name] for making me stand in a queue today for an hour'.

21 https://www.hellopeter.com. See for example sentiments expressed regarding banks (eg https://www.hellopeter.com/absa; https://www.hellopeter.com/capitec-bank; https://www.hellopeter.com/first-national-bank; https://www.hellopeter.com/nedbank; https://www.hellopeter.com/standard-bank) and insurers, both short-term (eg https://www.hellopeter.com/momentum-short-term-insurance; https://www.hellopeter.com/santam), and life (eg https://www.hellopeter.com/old-mutual; https://www.hellopeter.com/momentum; https://www.hellopeter.com/sanlam).

22 Such as The Banking Association, South Africa (BASA).

23 See: Financial Sector Conduct Authority, "Notice Regarding the Publication of Draft Conduct Standard 1 of 2019 (Banks). Financial Sector Regulation Act, 2017", 30 April 2019, read with: Financial Sector Conduct Authority, "Statement Supporting the Draft Conduct Standard - Conduct Standard for Banks", 29 April 2019.

24 *Financial Sector Regulation Act*, No 9 of 2017, (Republic of South Africa), (enacted: GG 41060 of 22 August 2017), s 106(1)(a).

25 See for example: ibid, s 120(1)(c)(ii); 127(1); 144(1)(c); 158; 159; 164; 174; 291.

26 Staff Writer, "Battle of the banks: South Africa's big 5 banks compared", *BusinessTech*, (8 September, 2019), published electronically.

27 Using Tier 1 Capital as a measure, South African banks rank on a global scale in terms of their size as follows: Standard Bank: 152; FirstRand Bank: 169; ABSA Bank: 190; Nedbank: 232; Investec: 463; Capitec: 571. Source: Financial Times Ltd., "50th Anniversary Top 1000 World Banks 2020", *The Banker*, (10 July, 2020), published electronically.

Table 2. A Small Snapshot of Eight of the Indicators

Outcome	Element	Business area	Indicator	Rationale	Variable
Suitability	Features, benefits, price based on customer insights & needs in varied segments	Segmentation; customer analysis & market research	*We segment our customer base into clearly defined target markets with useful insights and reporting that provide a shared understanding of the customers we serve.*	Reporting, measurement & tracking at a customer segment level entrenches customer-centric activity throughout an organization while also providing an entity-wide definition & description of customer profiles	
Suitability	Features, benefits, price based on customer insights & needs in varied segments	Segmentation; customer analysis & market research	Number of segments & segment rules	Evidence to support Attestation 1. *We segment our customer base into clearly defined target markets with useful insights and reporting that provide a shared understanding of the customers we serve*	List of grouping with the rules / thresholds / brackets that defined them
Suitability	Features, benefits, price based on customer insights & needs in varied segments	Segmentation; customer analysis & market research	*We use customer insights into needs, preferences, life-styles & behaviours to ensure that the design & positioning of product / propositions are suited to specific segments & target markets*	The insights gathered from research and analysis are applied to the design phase. Conversely, all assumptions made about design are supported by verifiable evidence	
Suitability	Features, benefits, price based on customer insights & needs in varied segments	Segmentation; customer analysis & market research	Number and annual average balances / values of products at a high-level product class, mapped to corresponding customer needs		

and sold appropriately, taking account of demographics, income and asset levels, levels of sophistication, education, financial literacy and the like). In the fourth column is an indication of an attestation (an attestation is a question to the FSP, like for example: “do you segment your customer base into clearly defined target markets with useful insights and reporting that provides a shared understanding of the customers you serve? Yes or No?”). While it might be tempting for an FSP to respond to that attestation by declaring “yes, we do that,” when in fact they do not, such erroneous responses will be picked-up by cross-reference to the suite of other indicators. Put differently, while there will be a place for an FSP to make an attestation: “yes, we do do these things,” there are a range of other indicators designed to check whether the respondent FSP really does do the things that they have claimed they do. For example, the second row indicates in column five an opportunity to collect evidence to support the attestation contained in row one, column four. In row two, column six, information to support that same attestation is called for, at a more granular level: provide a list of groupings (customer segment groupings and market segment groupings), with the parameters that define those groupings.

In the third row, fourth column is an opportunity to provide an attestation: “do you use customer insights into needs, preferences, lifestyles and behaviours to ensure that products are designed and positioned appropriately for their intended target markets and market segments?” Below that (row four, column four) is an opportunity to collect evidence to support that attestation.

Not every one of the 157 indicators developed will be applicable to every kind of FSP: some will be applicable to all FSPs, some only to insurers, some only to banks, and so forth. After the indicator framework is finalised, the indicators will then be compiled into a questionnaire, or a request for information, in the form of what is called a *Conduct of Business Review.* Those will then be sent to all FSPs in South Africa, with an obligation to complete the review and return to the FSCA for analysis.

No doubt the framework will be refined over time, especially prior to, and immediately after, its debut. But, representing as it does the first of its kind anywhere in the world, the potential benefits are substantial, and the potential importance of this development internationally, even if only somewhat successful, cannot be over-stated. Evaluating the success of the framework will now become the next juncture for scholars in this important field.

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