DIS.[402] These objectives pertains to the enhancement of both the financial and banking sectors so as to address the system-wide macro-prudential risks while protecting the vulnerable bank customers against any form of loss. [403] To achieve the objectives, the sector is overseen by two distinct regulators established by the Twin-Peaks – the Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA),[404] and their key responsibilities shall be discussed later in the study.

a. Twin-Peaks replacing the Silos Model

Before the advent of the Twin-Peaks, South Africa followed the Silos approach of financial regulation which is different from the Twin-Peaks. The distinction is drawn by Botha who provides that the Silos Model entails the appropriation of financial regulation in accordance to its financial lines which includes inter alia insurance, securities and banking.[405] On the other hand, the Twin Peaks entails a separation of regulatory duties between two regulators (PA and FSCA) on the basis that one regulator assumes the duty of safety and soundness supervision, whereas the other regulator only focuses on the conduct of business regulation.[406] Mwenda raise a significant point insofar as regulatory framework is concerned. He illustrate that prior to drafting a regulatory framework, drafters need to understand the nature of the industry, and the role of the regulator in that country.[407] In light of the Silos Model, the impression therefore is that each segment of the financial sector had its own authority to regulate, thus presupposing a clear demarcation of each of the financial services.[408] Thus the researcher is of the view that the replacing of the Silos Model with the Twin

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[402] See Taylor M 'Twin Peaks Revisited: a second chance for regulatory reforms' Available at *http://static1.squarespace.com/static/54d620fce4b049bf4cd5be9b/t/55241044e4b03769e017208a/1428426820095/Twin+Peaks+Revisited.pdf* (accessed on 23 February 2020).

[403] National Treasury *'Twin Peaks in South Africa: Response and Explanatory Document'* (2014) 7 (Hereinafter referred to as 'National Treasury (2014)').

[404] National Treasury 'New Twin Peaks Regulators Established' available at *http://www.treasury.gov.za/twinpeaks/Press%20release%20Twin%20Peaks%20implementation%20March2018_FINAL.pdf* (Accessed on 28 March 2019).

[405] Botha E & Makina D 'Financial Regulation and Supervision: Theory and Practice in South Africa' (2011) *IBERJ* 30 (Hereinafter referred to as 'Botha & Makina (2011)').

[406] Botha & Makina (2011) 30.

[407] Mwenda K *Legal Aspects Of Financial Services Regulation And The Concept Of A Unified Regulator* (2006) 6.

[408] Chimbombi R *Regional integration of financial services regulation and supervision in the Southern African development community* (Published LLM, University of the Western Cape, 2015) 12 (Hereinafter referred as 'Chimbombi (2015)').

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Peaks closely aligns with Mwendas' analysis insofar as adopting a suitable model for the banking industry is concerned.

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b. The inadequacy of the Silos Model

The Silos Model has been fraught with regulatory shortcomings. The dominant shortcoming being that the model gives rise to the fragmentation and complexity of the financial market which posed a risk of regulatory arbitrage.[409] Regulatory arbitrage entails the financial transactions designed to decrease costs or capture profit opportunities created by different regulations.[410] The financial institutions therefore act beyond the reach of regulators thus threatening sovereignty of nation-states and the stability of national economies.[411] This specifically pertained to the regulation of conglomerates regulated by the three lines of financial regulations, thus created levels of inconsistency, and made regulatory arbitrage an inevitable reality.[412] Concentration in the banking sector is another factor whereby, by virtue of the big banks owning large assets, they further instilled concentration and hegemony in the banking sector.[413] Therefore, the Twin-Peaks, by way of establishing the PA and FSCA as regulators, was aimed at redressing these shortcomings and ensuring an enhanced financial sector while safeguarding vulnerable bank customers.[414]

4.4 The two fundamental regulators of the Twin-Peaks

4.4.1 The Prudential Authority (PA)

The PA is the first regulator thus exist independently despite its location at the SARB. The key functions of the PA concerns a microprudential supervision whereby the PA has to, amongst other things, instil safety and soundness in banks and other financial institutions, and also safeguard the protection of depositors by ensuring the institutions operate within the confines of the law.[415] However, the United Kingdom (UK) model gives an understanding that having the PA within the SARB is nothing new. This is

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[409] Van Niekerk G & Van Heerden G 'Twin peaks in South Africa: A new role for the central bank' (2017) 11 *LFMR* 154.

[410] Riles A 'Managing regulatory arbitrage: A conflict of laws approach' Available at *https://www.lawschool.cornell.edu/research/ILJ/upload/Riles-final.pdf* (Accessed on 24 February 2020).

[411] Riles A 'Managing regulatory arbitrage: A conflict of laws approach' Available at *https://www.lawschool.cornell.edu/research/ILJ/upload/Riles-final.pdf* (Accessed on 24 February 2020).

[412] Botha & Makina (2011) 30.

[413] Godwin A 'Australia's Trek towards Twin Peaks_ Comparisons with South Africa' (2017) 11 *LFMR* 183.

[414] See Banking Association of South Africa '*Twin Peaks: Regulations for a safer financial sector'* 18.

[415] National Treasury (2014) 7.

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because the UK also adopted the system whereby its Prudential Regulatory Authority (PRA) is considered to form part of the Reserve Bank, thus assumes duties similar to those of the PA.[416]

The safety and soundness has its centrepiece on the institution's financial strength and prudential management.[417] Knowing that financial crises are caused by financial or banking institutions, the integrated role of microprudential supervision is appropriately guided because of targeting institutions such as banks, insurers to mention a few.[418] In essence, moral hazards may result in a bank being unable to further the obligations owed to the depositors, therefore the PA safeguard the banking system by way of strengthening banking stability to preserve trust and confidence in the system.[419] Since the DIS attracts moral hazards, the viewpoint is that the PA can be fully leveraged as a mitigant regulatory instrument. That aspect is similarly endorsed by Ketcha[420] who argues that the scope of the prudential supervision and the DIS has a correlative goal because, to a large extent, the presence of a DIS begs for a strengthened supervision and regulation of banks by the government. Barth et al[421] similarly propound that the regulatory and supervisory mandates of the PA potentially attenuates moral hazards. Under the stewardship of the PA, the banks are further required to have a framework that effectively manage their liquidity risk which captures the full range of liquidity risks to which a bank is exposed and to stress test these risks.[422]

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416 Journal Regulation Compliance 'Prudential Regulation Authority (PRA)' Available at https://thejournalofregulation.com/en/article/prudential-regulation-authority-pra/ (Accessed on 20 February 2020).

417 National Treasury (2014) 28.

418 South African Reserve Bank 'Prudential Authority' available at https://www.resbank.co.za/AboutUs/Departments/Pages/Prudential-Authority.aspx (accessed 27 October 2018).

419 Minister of Finance *'Implementing the Twin-Peaks Model of financial regulation'* (2013) 43.

420 Ketcha (09 February 2019).

421 Barth J, Lee C & Phimiwasana T 'Deposit insurance schemes' Available at Https://www.springer.com/cda/content/download/cda_downloaddocumnet/99781461453598-c1.pdf?SGWID=0-0-45-1372839-P174735940 (accessed 27 October 2018).

422 Prudential Authority 'Bank Licensing in the Republic of South Africa' available at https://www.resbank.co.za/PrudentialAuthority/Deposit-takers/Documents/Banking%20licencing%20in%20the%20Republic%20of%20South%20Africa.pdf (accessed on 29 October 2018).

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The duties of the PA pertain to the promotion of the safety of depositors' deposits, and the interest of the beneficiaries of the financial institutions.[423] By implication, the PA ensures that the financial institutions do not operate beyond the demarcation point of what is sensibly accepted by the law.[424] An argument thus accords that the structures implemented to advance these objectives significantly ensure that banks do not take excessive risk that may tamper with the stability of the banking system and the broader economy. This aspect is imperative because, by further implication, the DIS would not be compelled to make exorbitant reimbursements and revive multiple of banks which is a task that could potentially strain the operation of the DIS. The impression created therefore is that the PA promotes the fundamental objectives of the DIS. This is the reason why the study construes both the DIS and PA as essential financial safety-nets aimed at stabilizing the banking sector in the best interests of customers. The operation of these safety-nets can be stimulated by a high probity of coordination.[425]

4.4.2 The Financial Sector Conduct Authority (FSCA)

The FSCA is another regulator that has been introduced by the Twin-Peaks. The FSCA is commonly known as a stand-alone market conduct regulator conferred with the role of supervising the conduct of the financial institutions in pursuance of business while ensuring an equitable treatment of customers in the sector.[426] In essence, the FSCA execute its responsibilities taking into account how the financial products are, inter alia purchased and traded by way of enforcing equitability and allegiance pertinent to the provisions of the financial products.[427] The further designs are aimed at stimulating financial inclusion and protecting customers of financial institutions. This is achieved through the enhancement of awareness whereby financial education programs are considered pivotal to promote financial capacity and literacy.[428]

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[423] South Africa Reserve Bank 'Prudential Authority' available at *https://www.prudentialauthority.co.za/Deposit-takers/Banks/Resolution/Pages/default.aspx* (accessed 28 October 2018).
[424] Chimbombi (2015) 32.
[425] Minister of Finance *'Implementing the Twin-Peaks Model of financial regulation'* (2013) 15.
[426] Van Niekerk G & Van Heerden G *'Twin peaks in South Africa: A new role for the central bank'* (2017) 11 *LFMR* 155.
[427] Van Niekerk G & Van Heerden G *'Twin peaks in South Africa: A new role for the central bank'* (2017) 11 *LFMR* 155.
[428] Financial Sector Conduct Authority *'Regulatory strategy of the FSCA'* (2018) 4.

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The pillars of the FSCA further stimulates integrity and efficiency in the financial market, with the ultimate goal of curbing market abuse.[429] Regulation on market integrity and efficiency guarantees the promotion of equitability in the capital market whereby, amongst other things, financial institutions should act fair and ensure there is adequate access to information concerning their products.[430] This aspect comes in a form of attempting to ostracize the poor services offered by the financial institutions, together with the opaque and complex products sold to customers at higher prices. The financial education is thus construed by the study as a vehicle to raise awareness concerning the sophisticated products of the banking sector offered to vulnerable depositors. Ultimately, the researcher submits that, with the knowledge accruing from the financial education, the bank customers can be put in a position which would encourage them to incentivise the banks not to engage in excessive risk taking. This aspect is vital because the issue of lack of incentives in the presence of a DIS has been identified by the previous study as a genuine fear that is held by academics and regulators.

4.5 An assessment of the role of the PA and FSCA

It has clearly been established that the PA and FSCA forms part of the safety-net setting. Therefore the distinct roles of these regulators are not an obstruction of coordination as propounded by the previously discussed Key Attributes (KAs) read with the Core Principles. In fact, but for the slight title difference, the PA and FSCA seem to be modelled on the PRA or Financial Conduct Authority (FCA).[431] In the same vein, the aspect of regulatory coordination does not mean the regulators would be susceptible to external directives other than those encapsulated in the Financial Sector Regulation 2017.[432] But the FSCA, PA and other safety-net participants have an equal standing with the DIS for the purposes of information sharing and the coordination of activities.[433] The coordination between the regulators is further aimed at establishing

[429] Address made by the Ministry of Finance to the staff at the launch of the Financial Sector Conduct Authority. 'Financial Sector Conduct Authority' available at *http://www.treasury.gov.za/twinpeaks/Minister's%20speech%20-%20Launch%20of%20FSCA.pdf* (Accessed on 29 March 2019).
[430] Financial Sector Conduct Authority *'Regulatory Strategy of the FSCA'* (2018) 11.
[431] See Godwin A 'Introduction to special issue – the twin peaks model of financial regulation and reform in South Africa' (2017) 4 *Law and Financial Markets Review* 151-153.
[432] See Act 9 of 2017.
[433] SARB (2017) 42.

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an integrated view of risks in the sector and implement coordinated initiatives.[434] In light of the coordination pillar, the understanding is that the mandate of all financial safety-nets would be carried out in the broader context of strengthening the DIS to mitigate moral hazards and enhance depositor's confidence in the banking system. This scope embraces the reforms of the G-20 pertaining to dealing with the systemically important financial institutions (SIFIs) and TBTF institutions. The reforms are a centrepiece of the stability objective which aims to discard the reliance on government support to revive failing institutions and embolden the banking sector.[435]

The awareness, financial literacy and knowledge promoted by the PA and FCSA is therefore construed by the study as a yardstick of raising awareness concerning the sophisticated products of the banking sector offered to the depositors. By solely looking at public awareness, the researcher is of the view that it remains a fundamental pillar for an effective DIS, hence the DIS requires to be regularly publicized to constantly strengthen public confidence.[436] This point resonates with the essence of Core Principle 12 which considers public awareness as an imperative pillar of a well-functioning DIS as discussed in the previous chapter. In essence, a positive awareness disseminates the appropriate message, instils a positive perception and behaviour while constructing a credible foundation simply to maintain a healthy financial sector.[437] Generally put, education about the system is important insofar as incentivising the banks is concerned.

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The coordination between the regulators is in a sense that the market conduct regulator dispels market misconduct, whereas the PA ensures that the selling of the products is within the prescripts of the required principles.[438] On the other hand, the National Credit Act of 2005 is also included in the picture by virtue of ensuring that banks and other service providers do not encourage consumers to take on loans they

[434] Minister of Finance *'Implementing the Twin-Peaks Model of financial regulation'* (2013) 19
[435] National Treasury (2014) 7.
[436] International Association of Deposit Insurers *'Public awareness of Deposit Insurance Systems'* (2009) 2.
[437] International Association of Deposit Insurers *'Public Awareness of Deposit Insurance Systems*' (2009) 5.
[438] Hargarter A & Van Vuuren G 'Assembly of a conduct risk regulatory model for developing market bank' available at *http://www.scielo.org.za/scielo.php?script=sci_arttext&pid=S2222-34362017000100011* (accessed on 01 November 2018).

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cannot afford as it leads to the consumers being over-indebted.[439] As part of holding the banking institutions accountable for any banking malpractice, the regulators are empowered rescind or revoke banking licenses or fine the directors for their lack of compliance with the law.[440] On the other hand, revoking or rescinding a banking license often become challenging because of the Too-Big-To-Fail doctrine, and also the importance of banking institutions in the broader economy. This lead to the regulators to only issue fines, which most banking institutions would rather pay than have their banking licenses revoked.[441]

4.6 Overview of the South African Reserve Bank

4.6.1 The role of the Central Bank

The fact that many of the financial safety-nets are housed within the South African Reserve Bank (SARB) is a justified ground to give an overview of the role of the SARB. This is aimed ensuring that there is no meddling of responsibilities concerning the regulation and supervision of banks.

In his address, the former governor, Tito Mboweni[442] highlighted that, by virtue of the SARB functioning as the central bank of the Republic of South Africa, its mission is to maintain financial stability, oversee, regulate and supervise South Africa's banking sector for the sustainability of efficiency and soundness in the banking system while issuing notes and coins. It can be gathered from the address that the SARB scope of mandate is broad. This justifies why the SARB operates differently from any other ordinary bank. Other writers have considered the SARB to operate on a 'non-profitable' and 'non-competitive' basis, but operating in the best interest of the general public.[443]

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[439] See Hargarter A & Van Vuuren G 'Assembly of a conduct risk regulatory model for developing market bank' available at http://www.scielo.org.za/scielo.php?script=sci_arttext&pid=S2222-34362017000100011 (Accessed on 01 November 2018).

[440] Ernst & Young *'Financial Sector Regulation Act: Implementing Twin Peaks and the impact on the industry'* (2018) 5.

[441] Issing O 'Central bank independence – economic and political dimensions' (2006) 196 *National Institute Economic Review* 67.

[442] This was an address made by the former governor of the SARB, Tito Mboweni at the Pretoria Counsil for Businesswomen held on 14 March 200. Available at https://www.bis.org/review/r000321a.pdf (Accessed on 20 March 2019)

[443] Van Niekerk G & Van Heerden 'Twin Peaks: The Role of the South African Bank in promoting and maintaining financial stability' available at

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The SARB was established in terms of section 9 of the Currency and Banking Act 1920,[444] and it is currently governed by the South African Reserve Bank Act 1989 as amended.[445] At the moment, both Bank Act 1990[446] and the South African Bank Act 1989 and the regulations established in terms of the legislations – provide a legislative framework for the operation of the SARB. This legislative framework gives context to the Constitutional mandate of the SARB as envisage by section 224 of the Constitution of the Republic of South Africa.[447] Accordingly, section 224(a) of the Constitution provides that the duties of the SARB concern the protection of the value of currency, done in the best of a balanced and sustainable economic expansion.[448] These obligations are aimed at sustaining a consistent financial and price stability while stabilizing the banking system. In light of the oversight role, stability is guaranteed by effectively enforcing global and domestic regulatory and supervisory standards.[449] This aspect makes it necessary for the PA to be effective in the global financial landscape to ensure a domestic implementation of the international frameworks.[450] Despite the safety-nets being housed at the SARB, the independence and autonomy of the Reserve Bank is still guaranteed as envisaged by section 224(2) of the Constitution.[451]

The SARB has a sub-structure known as the Bank Supervision Department (BSD), which is entrusted with the responsibility to execute regulatory responsibilities on behalf of the general public.[452] Furthermore, the BSD promotes the stability and soundness of the banking system while assuming duties similar to those of the PA.[453]

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https://repository.up.ac.za/bitstream/handle/2263/64057/VanNiekerk_Twin_2017.pdf?sequence=1&isAllowed=y (accessed 02 November 2018)

[444] Currency and Banking Act 31 of 1920

[445] See the South African Reserve Bank Act 90 of 1989.

[446] Act 94 of 1990.

[447] The Constitution of the Republic of South Africa, 1996.

[448] The Constitution of the Republic of South Africa, s224(1).

[449] Shawe L & Colegrave A 'Banking regulation in South Africa' Available on *https://uk.practicallaw.thomsonreuters.com/w-007-6934?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1* (accessed on 02 November 2018).

[450] Shawe L & Colegrave A 'Banking regulation in South Africa' Available on *https://uk.practicallaw.thomsonreuters.com/w-007-6934?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1* (accessed on 02 November 2018).

[451] See The Constitution of the Republic of South Africa, s224(2).

[452] South African Reserve Bank *'Bank Supervision Department Annual Report 2016'* (2016) 1.

[453] South African Reserve Bank *'Bank Supervision Department Annual Report 2016'* (2016) 1.

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This aspect significantly takes into account that robust regulatory oversight empirical to banking activities justifies the necessity to maintain the economic soundness and stability of the banking system.[454]

Guaranteeing a clear demarcation of duties between the safety-nets and the Reserve Bank is essential for the purposes of the study because that dispels the fear of interference of duties. At the same time, a convergence of the duties should be guided by the goal of effectively managing the banks. The goal does not negate the importance of independence and autonomy, especially for the Reserve Bank. This study is also not oblivious to the general concerns levelled against the independence of the Reserve Banks.

4.6.2 Concerns about the independence of the SARB

The concerns pertains to the excessive powers vested in the central bank which makes the Bank least susceptible to accountability while also paving a path for political influence.[455] In that sense, Goodhart and Lastra argue that central bank independence entails the freedom from political authority and from financial markets.[456] The authors further consider these two aspects to go hand in hand with their dual mandate of government's bank and banker's bank.[457] However, there are conflicting views insofar as the issue of independence is concerned. The first view is advanced by authors like Issing[458] submitting that the central bank independence embraces the notion of institutional independence whereby the presence of the set of legal frameworks ensures the Bank execute its mandate without external interference. The other view is held by Okeahalam[459] who departs from Issing's view, thereby perceiving the

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[454] See South African Reserve Bank *'Bank Supervision Department Annual Report 2016'* (2016) 1.
[455] Balls E, Howat J & Stansbury A 'Central bank independence revisited: After the financial crisis, what should a model central bank look like?' available at https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/working.papers/x87_final.pdf (Accessed on 20 March 2019).
[456] Goodhart C & Lastra R 'Populism and Central Bank Independence' Available at https://link.springer.com/content/pdf/10.1007/s11079-017-9447-y.pdf (accessed on 24 February 2020).
[457] Goodhart C & Lastra R 'Populism and Central Bank Independence' Available at https://link.springer.com/content/pdf/10.1007/s11079-017-9447-y.pdf (accessed on 24 February 2020).
[458] Issing O 'Central bank independence – Economic and political dimensions' (2006) 196 (1) *National institute Economic Review* 67.
[459] Okeahalam (1998) 40.

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independence of the SARB as a misnomer since central banks are not entirely immune to external directives in the event certain banks fail. The author's view is more concerned with an instance where there is no DIS to effectively manage bank failures. Accordingly, the SARB approach of bank failure management has been driven by political factors as opposed to pure central bank ethics.[460] This has been proven by the previous methods of bank rescues implemented when a number of small banks failed in South Africa. The arguments further resonate with the narratives expounded in the previous chapter which pointed out that the selective nature of rescuing banks begs for the adoption of a DIS with a clearly stated mandated.

4.7 Overview of the legislative framework

The legislative overview is essential insofar as the issue of corporate governance is concerned in the banking sector. For instance, the occurrence of the 2008 GFC has been attributable to the aspect of poor governance standards which is implicated as the dominant of contributor.[461] In the South African context, the breakdown in good governance has led to the failure of a number of small banks as depicted under figure one in chapter two.

The assumption therefore is that, the greater a bank is managed by way of upholding the principles of good governance, the lesser the banking risks may occur and threaten the existence of banks. This denotes that reasonable risk taking would always be guided by the principles of good governance which will be discussed in the following study. Ultimately, banking stability would be preserved whereby banking risks and the loss of depositors' deposits would be circumvented. A benefit would therefore accrue to the DIS because the system favours a banking system that is effectively managed. This does not take away the freedom of directors to run their corporation only to the extent that the freedom is within the boundary of good governance and effective accountability as guided by the regulatory and legislative frameworks.[462]

Understanding that good governance is instilled by directors or those in senior managerial positions, it is imperative for the study to explore the Companies Act 2008,

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[460] See Okeahalam (1998) 38.

[461] Kumar N & Singh J 'Global Financial Crisis: Corporate Governance Failures and Lessons' (2013) 4 *JFAM* 21-22.

[462] Kiadó A 'The ethical principles determining the contents of corporate governance rules and systems' (2005) 27 (2) *Society & Economy* 197.

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the Banks Act 1990 and King IV[463] which are a comprehensive framework aimed at ensuring that directors and executives of banks adhere to good governance principles. The essence of the frameworks takes into account that good governance stimulates efficiency in the functioning of the banking system such that, any breakdown or weaknesses thereof, may result in the transmission of problems in both the banking system and the economy.[464]

The study acknowledges that the concept 'corporate governance' does not have a universal definition. For the purposes of this research, corporate governance simply refers to the manner in which a corporation is directed and controlled,[465] done to safely secure the interest of those on whose behalf the corporation is managed and those who may be affected by how the corporation is managed.[466] The rationale of the control and management is further aimed at promoting and instilling proper behavioural standards while acquiring a maximum efficiency.[467]

The good governance propounded by the study pertains to the reasonable risk taking standards as pointed out earlier on. This is necessary because excessive risk taking gives rise to moral hazards that can inevitably tamper with banking stability and affect the operation of the DIS.[468] To this point, it is clear in the research that international bodies are committed to improve the standards of good governance while ensuring there is accountability in the banking sector. The commitment has been demonstrated by the previously expounded best practices such as Key Attribute (KA) 3.2 read with Core Principle 14 - all advancing the notion of good governance while directing for appropriate measures to be taken against culprits of poor governance.[469] Against this background, the following study explores the domestic legislative frameworks resonating with the best practices.

4.7.1 Position of South Africa's legislative frameworks

[463] King IV Report is a voluntary policy framework. See Institute of Directors in Southern Africa 'King *IV Report on Corporate Governance for South Africa* (2016) (Hereinafter referred to as 'Institute of Directors in Southern Africa (2016)').
[464] Basel Committee on Banking Supervision *'Guidelines: Corporate governance principles for banks'* (2015) 3.
[465] Rossouw G, Van der Wat A & Malan D 'Corporate governance in South Africa' (2002) 37 *JBE* 289.
[466] Wiese T *Corporate governance in South Africa, with international companies* 2 ed (2017) 2
[467] Wiese T *Corporate governance in South Africa, with international companies* 2 ed (2017) 2.
[468] Ketcha (09 February 2019).
[469] See KA 3.2 read with Core Principle 14.

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The Companies Act 2008 is significant insofar as it stresses the need for directors to be responsible and accountable, thus instilling a standard of behaviour to the directors.[470] The Banks Act 1990 operates alongside Companies Act 2008 for a better enhancement of good governance in the banking sector. As a matter of interpretation, the Banks Act does not supersede the application of the Companies Act 2008 and the provisions of other legislations. However, if the provisions of the Companies Act 2008 conflicts with the provisions of other legislations, both provisions of the legislations will prevail with an exception in the context of the Banks Act 1990 whereby if the conflict is irreconcilable, the provisions of the Banks Act 1990 takes precedence.[471]

The relevance of the legislations on the issue of corporate governance have their centrepiece on the regulation of the conduct of directors in the banking sector. In light of the codified duties under the Companies Act 2008, the banking directors are required to adhere to the standards of care, knowledge and skill generally applicable to all corporate directors as envisaged by section 76(3)(c) of the Act.[472] Since the banking business is given special attention because of carry a significant public profile in contrast with ordinary corporations,[473] the banking directors are therefore subjected under additional and specific requirements as codified by the Banks Act 1990, particularly under section 60(1A)[474] read with Regulation 40.[475] In essence the directors need to, amongst other things, act bona fide for the benefit of the bank, uphold a particular kind of care, skill and possess the knowledge expected of directors of banks in the performance of their duties.[476] The duties would essentially denote the banking director's care and skill to take reasonable risks without putting the sector at risk, and also being informed of the accompanying consequences and benefits. The 'standard of care' is particularly determined on the basis of a diligent person in a similar position as the director.[477] In essence, a director's conduct that is contrary to the spirit

[470] Deloitte *'Duties of Directors''* (2013) 4.
[471] Act 71 of 2008 s5.
[472] Act 71 of 2008 s76*(3)(c).*
[473] Deloitte *'Duties of Directors''* (2013) 76.
[474] Act 94 of 1990 s60(1A).
[475] This regulation is part of the Banks Act 94 of 1990 regulations. The regulation specifically requires directors to have basic knowledge concerning the banking business, and the directors are further obliged to carry their duties with care and diligence. Banks Act regulations in GN 1029 OF *GG* 35950 of 12/12/2012.
[476] See Act 94 of 1990 s60(1A) read with GN 1029 OF *GG* 35950 of 12/12/2012, reg 40.
[477] See Act 94 of 1990 s60(1A).

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of these provisions constitutes a breach of duties in accordance to the provisions of the Companies Act that will be detailed later in the study.

The process of corporate governance has to be effectively consistent with the nature, complexity and risks embedded in the bank's balance sheet activities, while also flexible to the changing environment of the banking sector.[478] The risk management strategy comes as an attempt to promote good governance expected of the directors in the running of the banking business. This aspect resonates with regulation 38[479] which confers a responsibility on the directors to implement a potent corporate governance structure for the banks. The structure is aimed at ensuring that the bank's risk, complexity and nature of operation does not go beyond the point of good governance because, the banking business is significantly based on a proper and adequate handling of distinct risks having a negative impact on the banking system.[480]

To ensure there is compliance with the variety of legislative and regulatory frameworks, the banking directors have to implement and internal compliance function so as to attenuate the risk of non-compliance and regulatory arbitrage.[481] Put broadly, compliance with the prescripts of the law remains a vital pillar, albeit appearing as a burden to the banks. In that vein, Marx and Mynhardt affirmed the complexity of cost implications associated with regulatory compliance, and proposes that the banks be assisted with the calculations, and in the reduction of such costs.[482]

4.7.2 Overview of King IV Report

The above legislative framework is supplemented by the King IV Report on Corporate Governance in South Africa (King IV) as established by the Institute of Directors in Southern Africa (IoDSA).[483] The concept corporate governance believed to have been improved and broadened under King IV because of promoting the notion of ethical leadership and effective leadership simply to achieve, inter alia, ethical culture, good

[478] Global Legal Insight 'Bank governance and internal controls' available at https://www.globallegalinsights.com/practice-areas/banking-and-finance-laws-and-regulations/south-africa (Accessed on 18 November 2018)
[479] GN 1029 OF *GG* 35950 of 12/12/2012, reg 38.

[481] See GN 1029 OF *GG* 35950 of 12/12/2012, reg 47.
[482] Marx J & Mynhardt R 'The cost of compliance: The case of South African banks' (2011) 8 *COCJ* 8.
[483] See Institute of Directors in Southern Africa (2016) 1.

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performance and effective control.[484] The concept further gives a novel impetus that corporate governance is not only concerned with merely running a company. While management concerns itself with the running of the corporation, governance ensures that the corporation is ran properly.[485] The ultimate understanding, however, is that corporate governance is all about the sustainability of companies.[486] To achieve the goal of sustainability as expected by King IV, pillars such as leadership, oversight management, ethical conduct, transparency and accountability remains the driving factors so as to advance the interests of the stakeholders.[487]

King IV has [a] universal application. This means corporations of all kind, banks included, can adopt the framework to enhance good governance. The universal application is enforced taking into account that the framework is voluntarily assumed with an exception on the companies listed in the Johannesburg Stock Exchange (JSE) which are obligated to comply with King IV.[488] Accordingly, the obligation has been established by section 3 of the 2017 amended JSE listing requirements whereby the JSE listed companies are mandated to comply with King IV.[489] This mandatory application entails that King IV is applied with the legislative frameworks, thus creating a shift towards a hybrid approach of instilling good governance.

A bank's compliance with the requirements, despite their voluntary nature, can essentially contain the risk moral hazard because both King IV and the legislations are the bedrock principles of good governance. However, King IV and its application further dispenses a distinct impetus concerning the enforcement of adequate leadership that is underpinned by the observance of good governance of all kind,[490] hence banks need to observe the principles simply to maintain the status of responsible 'corporate citizenship'. To qualify this claim, the study relies on the argument advanced by IoDSA that – it has become acceptable that corporations

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[484] Padayachee V 'King IV is here: Corporate governance in South Africa revisited' (2017) 2017 *SAJSEP* 17.
[485] Tricker R Corporate Governance (2000).
[486] Amned M *Corporate governance in the Southern African development community* (Published LLM, University of the Western Cape, 2016) 21
[487] Amned M *Corporate governance in the Southern African development community* (Published LLM, University of the Western Cape, 2016) 21
[488] LexisNexus '*The JSE Listings Limited Listings Requirements'* Bulletin 1 of 2017
[489] LexisNexus '*The JSE Listings Limited Listings Requirements'* Bulletin 1 of 2017
[490] Institute of Directors in Southern Africa (2016) 6.

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operate within the dimension of the environment, society and economy, and their methods of generating a profit impacts these three dimensions.[491] On the basis of a similar analysis, Benston[492] believes that the ultimate result of a bank's failure negatively impact the banks' stockholders, employees, customers and the communities wherein they are located. The significance of the social responsibility of directors and their corporations has been considered in the *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Company Limited and others* 2006 (5) SA 333 (W).[493] The court emphasized on the broader responsibilities of directors and the corporation, and had directly referenced King Code which is contemporarily interpreted as being *de facto* part of the director's duties.[494]

In light of the above arguments, the researcher maintains that the bank's engagement in risk taking unguided by the principles of good governance can cause a disruption in a number of aspects. In fact, excessive risk taking creates a banking business that is unsafe whereby the trust of depositors and the public is undermined.[495] Taking it a step further, the idea of responsible 'corporate citizenship' is the pillar of the SARB which is aimed at ensuring that banking business is conducted with transparency necessitated by ethical values, and the respect for the law and the environment.[496] The SARB's approach resonates with the Code of Banking Practice of South Africa which strengthens both the services and conducts of the banking business when dealing with customers – all guided by amongst other things transparency, accountability and fairness.[497]

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4.8 Evaluating the legislative frameworks

To this point, it can be understood that regulation and supervision is key to a healthy functioning banking sector. On the other hand, the legislative frameworks, and the

[491] Institute of Directors in Southern Africa (2016) 4.
[492] Benston G 'Is government regulation of banks necessary' (2000) 18 *JFSR* 190.
[493] *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Company Limited and others* 2006 (5) SA 333 (W)
[494] See *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Company Limited and others* 2006 (5) SA 333 (W)
[495] Brown M 'Report by the chairman' available on *https://www.banking.org.za/news-media/publications/reports/2019-report-by-the-chairman* (accessed on 22 March 2019).
[496] South African Reserve Bank 'Corporate Citizen' Available at *https://www.resbank.co.za/AboutUs/CorporateCitizenship/Pages/CorporateCitizenship-Home.aspx* (accessed on 1 November 2018).
[497] Banking Association of South Africa *'Code of Banking Practice'* (2012) 3.

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Twin-Peaks, create an impression that banks would be strictly regulated or 'overregulated' to a point that generating a profit would be a cumbersome task. Strict regulation is considered to be a cause of unintended consequences by virtue of diminishing creativity among the banking directors, resulting in exorbitant compliance costs and vast capital requirements.[498] On the other hand, the stringent regulation is aimed at preserving the trust that has been attained through sound governance, transparency and good conduct.[499] This is the reason why Marx and Mynhardt affirmed the complexity of cost implications associated with compliance, and proposes that the banks be assisted with the calculations, and in the reduction of such costs.[500]

To closely examine the aspect of overregulation, a strong argument persist that the compliance with a variety of legislation or regulations cannot be equated to overregulation insofar as the ultimate goal of regulatory measures is aimed addressing prudential and conduct of business regulation.[501] In a similar vein, the growth and finance literature also propounds that regulation, compliance and enforcement are essential tools to instil a sound operation of the financial system, ultimately the banking sector.[502] Despite other academics supporting a deregulated system, the study assumes that banks cannot be trusted to prudently act on their own, and this has been proven by the 2008 GFC.[503] Regulatory weaknesses such as inadequate capital, insufficient liquidity and poor governance were viewed as contributory factors that led to the 2008 GFC, therefore regulatory supervision has been preferred by the BCBS to address these systemic inadequacies.[504] The preference gives credence to the strict

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498 Financial Times 'Too much regulation creates bank brain drain' Available at *https://www.ft.com/content/4dfc4190-719f-11e5-9b9e-690fdae72044* (Accessed on 28 November 2018).

499 Brown M 'Report by the chairman' available on *https://www.banking.org.za/news-media/publications/reports/2019-report-by-the-chairman* (Accessed on 22 March 2019)

500 Marx J & Mynhardt R 'The cost of compliance: The case of South African banks' (2011) 8 *COCJ* 8

501 Chimbombi (2015) 37.

502 Centre for Economic Policy Research *'The causes and consequences of banking regulation: The case of Sweden'* (2011) 2.

503 Reichwald H 'Does Overregulation Lead to Underperformance' Available at *http://ww2.cfo.com/regulation/2016/10/does-overregulation-lead-to-underperformance/* (Accessed on 28 November 2018).

504 Zairis A & Zairis G 'The effects of banking regulation and supervision on the banking system overall stability: the case of Greece' available at *https://www.europeanbusinessreview.eu/page.asp?pid=2397* (Accessed on 30 November 2018.

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regulation of banks as a way of preserving their reputation in the domestic and global banking system simply to avoid another financial meltdown.

However, the duties outlined by section 76 of the Companies Act 2008 read with section 60 (1A) of the Banks Act 1990 raise the bar for the directors, and they are a foundation for good governance. In fact, when directors accept their appointment, they commit to perform their duties to a certain standard, and it is a reasonable assumption that they shall apply their skills, experience and intelligence for the benefit of the corporation.[505] On the other hand, it cannot be overlooked that directors are not perfect, therefore not all judgment would be accurate. The salient question is what happens to the decisions that were made with a high degree of honesty, but turned out wrong. This question is vital because if a decision turns out wrong, adverse financial impact may result in a corporation. Statutorily, that constitutes a breach of directors' duties which further attracts liability insofar as the Companies Act is concerned. Put differently, should the director's conduct not satisfy the standard of care, skill and knowledge as expected by both the Banks Act and Companies Act, or carries banking business in a reckless manner, liability will be attracted in a manner shown herein;

(i) Firstly, the director may be civilly liable in terms of section 77(2)(b) for the losses sustained by the bank caused by the breach of the duties.[506]

(ii) Secondly, the banking director may also be civilly liable in terms of 77(3)(b)[507] and 218[508] for the loss, damage and costs sustained by the bank if the director deliberately carry the business in a reckless manner that is prohibited by section 21 (1) of Companies Act.

(iii) Lastly, section 26(6), known as the catchall section, ensures that shareholders have a claim for damages against any person's intentionally causes a bank to do anything contrary to Act.[509]

[505] Deloitte *'The Companies Act: Implications for directors and prescribed officers'* (2013) 3.
[506] Act 71 of 2008 s77(2)(b).
[507] Act 71 of 2008 s77(3)(b).
[508] Act 71 of 2008 s218.
[509] Act 71 of 2008 s26(6).

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Furthermore, section 60(1B)[510] of the Banks Act present a fundamental inconsistency because of drawing a distinction between the banks that are in liquidation and the banks that are not in liquidation. In that vein, the provision empowers the Registrar of the SARB to invoke section 77 of the Companies Act 2008 to hold accountable the directors of banks that in liquidation. On the hand, the Registrar can enforce section 424 of the Companies Act 1973[511] against the directors of banks that are either in liquidation or not in liquidation. The implication of the inconsistency gives rise to the process of decriminalizing the directors' misconduct which is adopted by of the Companies Act 2008.[512] The next chapter shall briefly discuss the inconsistency with further recommendations.

[510] Act 94 of 1990 s60(1B).
[511] Companies Act 61 of 1973.
[512] Hogan Lovells 'Criminal liability for bank directors? A look at the United Kingdom and South Africa' Available at *https://www.hoganlovells.com/publications/criminal-liability-for-bank-directors-a-look-at-the-united-kingdom-and-south-africa* (Accessed on 29 November 2018).

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4.9 Shielding banking directors against liability

This section of study is sought to dispel the fear of liability among banking directors. It must nonetheless be noted that, the success of a company is deeply based on the director's ability to take reasonable, yet risky business decisions.[513] Banks are not an exception to this aspect. The Business Judgement Rule (BJR) is a judicially established legal principle aimed at protecting directors of companies against the exposure of liability for their error in judgement or lapse of ordinary care wherein the error in judgement or business making decision turns out bad.[514]

The aim is to ensure that directors are not prevented or threatened to take bold decisions to maximize profit because, the business is about risk, and sometimes the best laid plans do fail.[515] Only when the decision is within the confines of section 76(4)(a) of Companies Act 2008 would the allegation of breach fall short. According to this provision, the director satisfies his/her obligations under section 76(3)(b) and (c) if he/she;[516]

i. takes reasonable and diligent steps to become sufficiently informed of the specific matter under consideration by the board,

ii. had no material personal financial interest regarding the matter of the decision taken, or discloses his/her interest to the board, and

iii. Rationally believes that the taken decision was in the best interest of the company.

The King Report also recommends the protection of directors against liability for the breach of care and skill to the extent that the directors' exercise of business judgement was within the confines of 76(4).[517] This approach came as a need to expand business

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[513] Cassim et al *Contemporary Company Law* 2ed (2012) 572.
[514] Branson D *'Business judgment rule for incorporation jurisdictions in Asia'* (2011) 23 *SAcLJ* 688.
[515] Institute of Directors in South Africa 'Director's duties and liability' Available at https://www.iodsa.co.za/news/378187/Directors-duties-and-liability.htm (accessed on 29 November 2018).
[516] Act 71 of 2008, s76(4)
[517] Joubert D *Duty of care: A legal analysis of the Business Judgment Rule and the liability of directors of directors for environmental damage in the South African mining industry* (Published LLM, University of Pretoria, 2017) 45

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development whereby individuals who possess the necessary expertise are not discouraged to accept appointments, and be innovative in the business industry.[518]

However, the BJR is not a fortress for any fraudulent and shady business dealings.[519] Put simply, the banking directors cannot rely on the BJR in instances where the directors took risky decisions falling outside the prescripts of section 76(4). The rule furthers the objectives of the Companies Act 2008 because directors are responsible for the day to day activities of corporations, not regulators or judges who may not be at best position to balance the interests of parties in the operation of the business.[520] This is not to say reckless misconduct should be condoned because it is equated to gross negligence strictly prohibited under section 22(1) of the Companies Act 2008.[521] For instance, excessive risk taking by the banking directors can inevitably give rise to moral hazards as was shown earlier in the study. Moral hazards are not desirable for both the banking and financial systems. In light of that, the researcher submits that moral hazard goes beyond the demarcation point of the BJR, therefore banking directors may not be protected for putting the banking system at risk.

4.10 Conclusion

It has been established in the study that the DIS favours a healthy banking sector that is governed by robust regulatory frameworks. To a large extent, South Africa's banking system is the safest insofar as the regulatory frameworks are constantly reformed. This argument strongly persist since the reformation saw the introduction of the Twin-Peaks that introduced the PA, which guarantees the prudential safety and soundness of the banking system and the FSCA, which promotes the consumer protection.[522] The consumer protection and stability of the banking system is similarly advanced by the DIS. Therefore, a coordination between these safety-nets has been propounded for the realisation of those goals, especially the goals of the DIS so as ensure a profound implementation of the system while mitigating moral hazards.

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[518] See Joubert D *Duty of care: A legal analysis of the Business Judgment Rule and the liability of directors of directors for environmental damage in the South African mining industry* (Published LLM, University of Pretoria, 2017) 46

[519] Cassim F *The practitioner's guide to the Companies Act 71 of 2008* (2011) 92

[520] Muswaka L 'Directors' duties and business judgment rule in South African law: An analysis' (2013) 3 *IJHSS* 92.

[521] Act 71 of 2008 s 22(1).

[522] Minister of Finance *'Implementing the Twin-Peaks Model of financial regulation'* (2013) 6

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The legislative frameworks has been expounded for the purposes of enhancing good governance, accountability, and ensuring there is liability for engaging in moral hazards. Directors are also guaranteed protection upon meeting the prescripts of section 76(4) of the Companies Act of 2008. However, the regulatory and legislative frameworks are not an ultimate arbiter of moral hazards. They are simply aimed at containing the feared risk of moral hazards by way of instilling the pillar of good governance in the banking. However, the expounded legislative and regulatory frameworks shall be used as a yardstick in the next chapter to determine whether South Africa is ready to have a safety net in a form of the DIS.

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Chapter 5

Conclusion and recommendations

5.1 Introduction

This research aimed to evaluate and discuss the significance of a Deposit Insurance System (DIS) as a form of financial safety-net for the protection of bank customers, and reforming the regulatory stability in the South African banking sector. The advantages and disadvantages of the DIS have been weighed against those of the implicit method of bank rescue. In that sense, it has been shown that the current implicit system is a government policy framework whereby banks are rescued using taxpayer's money. To that end, the qualitative measures for a bank to qualify for a rescue under the implicit system have been considered to be inequitable. Thereby, working against small banks and stifling competition by way of promoting the concentration and dominance of the big banks in the banking sector. However, the DIS has sought to discard the aforesaid factors, and to ensure that the small banks could compete on an equal footing with the big banks.

In light of the discussion and evaluation done in the research, this chapter gives a conclusion by answering the research question of 'whether South Africa should adopt the DIS'. The chapter further makes recommendations on how to achieve an effective and feasible implementation of the system. However, the answer and recommendations herein are imperatively influenced by the sub-inquiries expounded under chapter one which, in turn, influenced the findings made in the research.[523]

5.2 Conclusion

5.2.1 Brief findings about the DIS

The findings in the research has essentially shown that the DIS plays a huge role in the economic and banking stability by way of safeguarding against financial shocks and protecting depositors. The extended protection significantly preserves the pillar of trust and confidence in the banking system. In the research, it has been shown that

[523] See paragraph 2.2.1 of chapter one which dispensed the sub-inquiries.

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the system has long been the cornerstone of the American banking sector since the Great Depression (GD), adopted to mitigate banking panics, and had, seemingly, restored confidence in the banking system.[524]

It can be inferred from the study that interest in the DIS had dissipated over time until the 2008 Global Financial Crisis (GFC) occurred. In essence, the aftermaths of the 2008 GFC exposed the weaknesses of the existing regulatory frameworks and methods of circumventing banking crisis.[525] To remedy this deficiency, the adopted best practices such as the Key Attributes (KA), Core Principles and Basil Accord III, became pivotal instruments that gave guidance towards the implementation of a robust DIS to protect banking systems and relinquish the government from bearing the burden of rescuing banks. The international financial institutions that issued the best practices had further imposed a duty on their member states to adopt the DIS. Many jurisdictions attempted to align their deposit insurances with the best practices, with others simply replacing the implicit system with the DIS. Since then, the role of the DIS as a measure of preserving financial stability has evolved, and the role of the system in the financial safety-net has been enhanced and clarified.[526]

5.2.2 Expressed intentions to have the DIS in South Africa

South Africa has since acknowledged the significance of the DIS albeit the implementation of the system still being in the pipeline. This has been highlighted in the proposed policy frameworks as a comprehensive regulatory foundation of the DIS aimed at achieving the fundamental objectives of an ordinary DIS which conforms to the needs of the South African banking sector. These needs ordinarily pertains to, amongst other things; the assurance of vulnerable depositors that their deposits are safe; minimizing systemic risks during bank failures and assuring bankers not to wind-up their assets to meet deposits on demand since the deposits are guaranteed by the DIS. The assurance given to the bankers and depositors is aimed at preserving trust and confidence in the operations of the South African banking business.[527] Most

[524] See paragraph 2.1 of chapter one insofar as the historic background of the DIS is dispensed.
[525] See paragraph 3.2 of chapter three giving an indication that interest in the DIS resurfaced in 2008 since the 1930s Great Depression (GD).
[526] See paragraph 3.3 of chapter three giving an overview of the best practices many under compliance.
[527] See paragraph 2.1 of chapter one read with paragraph 2.5 of chapter 2 giving a brief overview of the proposed framework of the DIS, the rationale and the banking pillars sought to be enhanced.

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importantly, the DIS is aimed at addressing the existing gap in South Africa's financial safety-net by bringing South Africa on par with international best practices and innovations, and other G-20 members that have already implemented the system.[528]

5.2.3 Inadequacy of the current system

The inadequacy of the current implicit method of bank rescue has been of serious concern in the research. Under this system, small banks have continuously failed leading to the inconveniencing of vulnerable depositors. This is because the implicit system does not have a clear policy framework, thereby rescuing banks selectively as per the demonstrated case of BEO bank and Saambou bank as well as the case of African Bank and VBS mutual bank.[529] The small banks continuously suffered a competitive disadvantage because of the concentration and hegemony implanted by the big banks leading to the latter banks being considered safer than the former banks because of their 'Too-Big-To-Fail' status. The research then relied on empirical evidence which projected the big banks as putting the banking sector at greater risk because of having a high systemic risk percentage, coupled with a large market share percentage.[530] The absence of the DIS therefore entails that the risk is made the responsibility of the government as per the uncertainty of the implicit policy of bank rescue. In light of this analysis, the researcher ultimately contend that the implicit system is disadvantageous, therefore undesirable. Thereby, making it significant to consider the DIS simply to disburden the government from bearing the costs of the risks imposed by the banking sector.[531]

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[528] See paragraph 2.2.2.1 of chapter one insofar as sub-inquiry 2.2.1.2 is concerned, considered in conjunction with paragraph 3.3 of chapter three wherein South Africa attempts to comply with its international obligation of adopting the DIS as imposed by the Financial Stability Board.

[529] See paragraph 2.2 and 2.3 in conjunction with 2.5 of chapter two insofar as the advanced hypothesis and the demonstration have shown that the implicit system is inadequate, which is the reason why small banks have failed in abundance since 1994.

[530] See paragraph 2.4 and 2.10 which clearly unveiled the risks posed by the big banks and the extent to which small banks are disadvantaged by the dominance of the big banks.

[531] See paragraph 2.2.1 of chapter one on account that this narrative covers the aspects of sub-inquiry 2.2.1.1 and the examples made thereto.

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5.2.4 Risks of the DIS and mitigant strategies

The research has conceded that the risk of moral hazards and the lowering of depositors' incentives are a perverse effect created by the DIS, thus becoming formidable hurdles for the implementation or operation of the system. However, there are measures that can be put in place to mitigate the identified risks for the purposes of achieving a robust and effective DIS. The regulatory frameworks, especially the Core Principles, gives clear guidance on how to avoid the risks. The opinions of academics are also imperative insofar as crafting a robust DIS is concerned. Amongst other things, there has to be sufficient public awareness of the system; the system should be built on a robustly regulated and supervised banking sector; the system should be carefully designed, thus equipped with robust design features and a proper administration; and there has to be an enhanced coordination among the financial safety-net participants – pillars considered to be a bedrock in order for the DIS to achieve its foremost goals.[532] The aspect of moral hazards has been construed to disadvantageously occur when banks partake in excessive risk taking knowing they will be rescued in the event the bank is distressed. On the other hand, the diminishing of depositors' incentives stimulates moral hazards because of the scale-back by depositors to monitor the activities of the banks since the DIS guarantees the reimbursement of their deposits in the event of bank failure.[533] The risks are not taken lightly by the research and it would be imprudent of any regulator to undermine the reality of their existence because they can be disadvantageous if not carefully taken into consideration when designing a DIS.

5.2.5 The explored domestic regulatory and legislative frameworks

The existing South African legislative and regulatory frameworks and best practices have also been identified as key instruments for the mitigation of the indicated risks, thereby ensuring an efficient operation of the DIS.

In essence, the regulatory framework, in the form of the Twin-Peaks, vest the Prudential Authority (PA) and Financial Sector Conduct Authority (FSCA) with the role

532 See paragraph 2.8 and 2.9 of chapter two in conjunction with paragraph 3.3.2 of chapter three insofar as proposed mitigating the risks attracted by the DIS is concerned.
533 See paragraph 3.4 for a better understanding of how the risk of moral hazard and the undermining of depositors' incentives manifest in the presence of the DIS.

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of stabilizing the banking sector while protecting bank customers. By virtue of the PA and FSCA being part of the safety-nets for financial stability, the coordination pillar under Core Principle 6 is applicable, thus transcends to an integrated role of all financial safety-net participants to stimulate the functioning of the DIS to contain moral hazards. In the coordination setting, the PA solely promotes prudential soundness and stability, meanwhile the FSCA ensures that the bank's conduct is within the confines of the law.[534]

On the other hand, the legislative frameworks comprising of the Banks Act 94 of 1990 and the Companies Act 71 of 2008 read with King IV significantly focus on enhancing corporate governance by prescribing a standard of behavior to the banking directors. It has been shown that the Banks Act strictly enhances the standard of behavior prescribed by section 76(3) of the Companies Act. In essence, section 60(1A) of the Banks Act expects the banking directors to uphold a particular kind of behavior, thus prescribing additional requirements for the directors. To attempt a delineation of the provisions, the research propounds that the banking directors need to aim for a high probity of effective and ethical leadership for the attainment of components such as good performance, ethical culture and effective control. The ultimate notion therefore is that the director's will to comply with the prescribed duties would be equivalent to taking banking risks reasonably. This significantly refers to the risk that is consistent with the pillar of good governance which is a driving factor in the banking system. The identified banking directors' duties on good governance further encompasses the idea of effective board oversight, robust internal controls, compliance and effective risk management. In a slightly different vein, the research takes into account that yielding high profitability is premised on the taking of risks, and sometimes the risks are taken without malice, yet they turnout wrong. The presumption therefore is that the banking directors have breached their duties. This is because the failure of the banking directors to live up to their duties of directorship as prescribed by the legislation constitutes a breach of duties, thereby attracting liability as was detailed in the previous chapter.[535]

[534] See paragraph 4.4 of chapter four which details the role of the existing financial safety-nets for the purposes of mitigating the identified risks.
[535] See paragraph 4.7 of chapter four which identified and discussed the legislative frameworks that guides the actions and behaviour of the banks in the context of good governance so as to avoid putting the banking sector at risk.

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However, the approach of the regulatory and legislative frameworks is consistent with the Core Principles and KAs, altogether enforcing accountability, regulation and supervision to achieve better standards of corporate governance. The research thus interpreted the sought-after governance standards as a yardstick to contain the risks attracted by the DIS.[536] This partly dispels much of the detractions advanced by the anti-explicit DIS proponents that the DIS attracts risks, therefore should not be implemented. The research also acceded to the genuine concerns that the DIS detracts from directors' creativity because of the fear of potential liability for breaching section 76(3) of the Companies Act read with section 60(1A) of the Banks Act. However, that concern has simply been addressed by exploring the Business Judgment Rule (BJR) which affords protection to the banking directors for decisions that have been taken honestly, yet turned out wrong. But only to the extent that the decisions are within the confines of section 76(4)(a) of the Companies Act will the banking director find protection.[537]

5.2.6 Should South Africa adopt the DIS?

Whether South Africa should adopt the DIS remains a central question which is at the heart of the research. Prior to answering the question, and despite some people opposing the system's implementation, the researcher has made significant findings that the concern of moral hazard and detraction of depositors' incentives are sometimes levelled without heeding the expounded legislative and regulatory frameworks that have successfully safeguarded the South African banking sector. The strong finding on the robust frameworks led to the research agreeing that South Africa's banking sector is among the safest and healthiest banking sectors across the globe.[538] On the other hand, the trendy failure of the small banks gives an impression that the sector may not be safe enough for the survival of small banks and their vulnerable depositors. This is because the regulator has always been reluctant to rescue the small banks because of the perception that these banks do not pose a systemic risk to the banking stability, therefore are not TBTF as per the advanced hypothesis in chapter two.[539] The perception is peculiar because the collapse of these

[536] See paragraph 4.7 of chapter four dealing in-depth with the enhancement of good government.
[537] See paragraph 4.9 of chapter four insofar as protecting the directors against liability is concerned.
[538] See paragraph 2.1 of chapter two highlighting the adequacy of the banking sector.
[539] See paragraph 2.7 insofar as the hypothesis are concerned.

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banks have always exposed the vulnerable depositors to a severe vulnerability, and this vulnerability appears to be of no concern to the regulators.[540]

Given the fact that the advantages of the DIS outweighs the disadvantages of the system; the DIS is more favorable than the implicit system; and given that the DIS favors a well-regulated and supervised banking sector like that of South Africa, the researcher therefore submits that South Africa is in a better position to adopt a safety-net in the form of a DIS. The perceived robustness of the banking sector gives firm hope that the DIS will have a strong foundation which is a significant aspect that determines the effectiveness of a DIS. By virtue of adopting the DIS, the safety of vulnerable depositors would be guaranteed, the banking sector would be reformed and banking stability would be emboldened.

Most importantly, guidance can be derived from the international best practices and lessons can be learned from the jurisdictions in the Eurozone and the United States (US) which have distinctly designed theirs as shown in chapter three.[541] The ultimate goal should be to implement a DIS that furthers its objectives without burdening the banking sector.

5.3 Recommendations

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The research has discussed and evaluated the importance of a DIS, ultimately contending that it is safe for South Africa to implement the system. The risks posed by the DIS have also been explored together with the legislative and regulatory frameworks sought for mitigation purposes. However, to achieve a feasible implementation of the DIS, its effectiveness and adequacy without tampering with the banking sector while enforcing good governance standards, the following recommendations are proposed:

[540] See paragraph 2.4 of chapter two whereby the small banks and their vulnerable customers have always been given minimal attention amidst their collapse.
[541] See paragraph 3.5 of chapter three giving a comparative analysis of how the jurisdictions adopted the DIS.

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5.3.1 The discussed regulatory and legislative risk management tools should be constantly reformed

The research has shown that the 2008 GFC unveiled anomalies in the existing regulatory risk management mechanisms of the global banking system. On the other hand, South Africa's regulatory and legislative mechanisms of risk management have been construed to be robust such that they can mitigate the risks attracted by the DIS. Despite the perceived robustness of the existing risk management mechanisms, the research recommends that these mechanisms should be constantly reformed simply to be compatible with the growing need of risk taking in the banking business. This aspect is imperative because, in this era of technological advancements, the risk taking standards of the banks will inevitably evolve like they did during the GD leading to the 2008 GFC. The constant reformation will allow the risk management instruments to be consistent with the evolution of the contemporary kinds of risks which are stimulated by the technological innovations.[542]

The essence of this recommendation dismisses the notion of some scholars endorsing a deregulated banking sector because the dispensed narratives in the study showed that banks cannot be trusted to prudently act on their own. Therefore, the risk management mechanism in a form of the legislation and regulations are pivotal insofar as preserving the standards of good governance is concerned.

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5.3.2 Remedying the deficiency in the current legislation

There is a deficiency in our law which has been identified under chapter four. The deficiency specifically concerns the application of section 60(1B) of the Banks Act 1990. This provision draws a differentiation insofar as it mandates the application of section 424 of the Companies Act 1973 against directors of banks that are in winding-up, and section 77 of the Companies Act 2008 against directors whose banks are not in liquidation. This creates an inconsistency because the latter Act substitutes the criminal sanctions with civil liability insofar as the banking directors' misconduct is concerned.[543]

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[542] See McKenzy&Company *'The future of bank risk management'* (2015) 3
[543] See paragraph 4.8 of chapter four in that regard.

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The recommendation therefore is that the old Companies Act should not at all apply to banks when they are in liquidation. In a nutshell, section 424 of this Act imposes criminal sanctions against banking directors who knowingly carry the banking business in a reckless manner. Previous experience has unveiled the shortcomings of this provision wherein many banking directors have not been prosecuted because of the lack of skills and the reluctance to prosecute technical corporate offense leading to directors going scot-free.[544] The recommendation also takes into account that the approach of section 424 has been differently incorporated in section 76 of the Companies Act 2008 which prescribes for the banking directors' standard of conduct. The breach of section 76 allows for the institution of civil liabilities as empowered by section 77(2)(b), section 76(3)(c) and section, and section 20(6) of the new Companies Act. This would allow depositors to have a recourse for any damages suffered as a result of the directors' reckless conduct. In essence, section 60B of the Banks Act 1990 should be amended to align with section 76 of the Companies Act 2008.

5.3.3 There has to be an early implementation of the DIS as a precautionary measure to safeguard the depositors

An early implementation of the DIS is also recommended as opposed to implementing the system in times of financial crises. This recommended approach is vital insofar as it allows for a robust DIS to be designed. This DIS can be fairly instilled with credible and adequate design features in anticipation of any banking crises. The essence is that an early implementation of the system will inevitably instill assurance in the adequacy of the DIS and the banking system. As it has been emphasized in the research, assurance significantly strengthens confidence and trust which are imperative pillars for an effective running of the banking business. The most recent 2008 GFC has also proven that implementing the DIS in times of financial crisis is not desirable because crises are panic-based events, as a result they can be circumvented by an early and credibly designed DIS.[545] This recommendation is advanced in light of the fact that South Africa's financial economy is strongly integrated to the global economy on the basis that South Africa is a member of a number of

[544] See Hogan Lovell 'Criminal liability for bank directors? A look at the United Kingdom and South Africa' available at *https://www.hoganlovells.com/en/publications/criminal-liability-for-bank-directors-a-look-at-the-united-kingdom-and-south-africa* (Accessed on 27 June 2019)
[545] See paragraph 2.5.1.2 chapter two above.

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international financial forums and these forums expect their member states to implement the DIS.[546]

Following the narratives of chapter two, the research provides that if the integrated global economy could be in a financial calamity, South Africa would be directly affected. As a result, only small banks' customers would be severely affected given the fact that these small banks are least prioritized by the regulator.[547] Therefore, South Africa need not wait for another GFC to occur simply to realise the importance of the system. Lessons should be learned from other jurisdictions while being guided by the explored best practices in chapter three.

5.3.4 The plausible mitigant strategies should be considered

In accords that the robustness of a DIS is dependent on how the system has been designed and its administration. It is worth considering that, amongst other things, making membership compulsory, limiting coverage and privately administering the DIS are key designs features that that emboldens the robustness of the DIS, and these features should be maintained. A DIS with design features contrary to the aforementioned constitutes to a poorly designed system.[548]

On the other hand, the research strongly believes in the pillar of coordination among the safety-net participants as proposed by domestic and international regulatory frameworks. Therefore, the existence of the DIS as a separate juristic person need not trump the pillar of coordination. In essence, coordination strengthens stability, and also guarantees the protection of the depositors' interests. The enhancement of this pillar should be done in two forms; the first being the coordination among the domestic safety-nets in the financial sector whereby the integrated duties of all financial safety-nets should be carried out in a manner that mitigates the risk of moral hazards. Thereby, stimulating the productivity of the DIS. The second aspect of coordination assumes the form of coordination across country borders whereby agreements should be effected between the domestic DIS and foreign DIS insuring its banks in South Africa. This simply transcends to having a cross-border crisis management tool which

546 See paragraph 3.3 of chapter two which identified this international bodies.
547 See paragraph 2.7 of chapter two which advanced fundamental hypothesis in that regard.
548 See paragraph 2.6 of chapter two above.

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shall stimulate the sharing of information between the jurisdictions simply to guard against banking risks.

All these forms of coordination should not be used as an opportunity to interfere with the mandate of the DIS such that its policy objective would be reduced to redundancy. As per the research, the policy objectives of the DIS pertains to amongst other things, the protection of vulnerable depositors while stabilizing the banking sector simply to achieve a less concentrated banking sector whereby small banks could fairly compete with the big banks. This policy objective must be well understood by all financial safety-net participants as well as the public simply to avoid the distortions that may result in the occurrence of moral hazards.

Final comments

The aim of the research was a significant 'evaluation and discussion of a Deposit Insurance System' so as to determine whether South Africa is ready to implement a system of this nature simply to, inter alia, protect vulnerable depositors and strengthen the banking.

The conclusion of the research essentially acknowledges the significance of the DIS, thus South Africa should adopt the system given the fact that she is in an advantageous position. Arriving at this conclusion has been as a result of the discussion undertaken throughout the research. To that end, the researcher believes that the DIS is the most plausible system that can safeguard the interest of small depositors, strengthen the banking sector and achieve a less concentrated banking sector wherein all banks will compete equitably. Given the presence of robust regulatory and legislative frameworks, the proposed design features and recommended approach, the DIS is most likely to operate without much hurdles. Thereby achieving the identified policy objectives while also disburdening the government from bailing out the collapsing banks.

However, the recommended approach has to be implemented to the extent that achieving the objectives of the DIS is concerned. Thus should not unnecessarily stifle profitability in the banking sector. Most importantly, the implementation of the DIS should not be construed as a panacea of all systemic risks since effectiveness is premised on its coordination with other financial safety-net participants.

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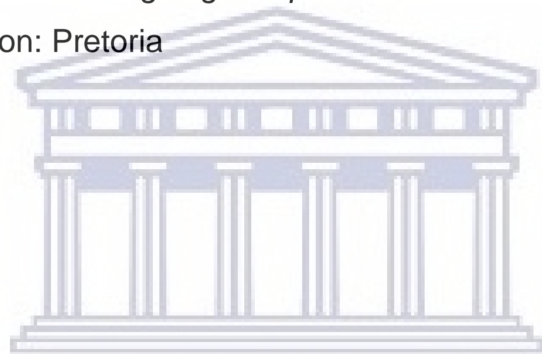

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