South African Reserve Bank

Prudential Authority

Ref.: 15/8/1/3

To: All banks, controlling companies, branches of foreign institutions, eligible institutions and auditors of banks or controlling companies

Proposed directive issued in terms of section 6(6) of the Banks Act 94 of 1990

Matters related to temporary capital relief to alleviate risks posed by the Covid-19 pandemic

Executive summary

Regulation 38(8)(e)(ii) of the Regulations relating to Banks (the Regulations) states that a bank shall have in place robust policies, processes and procedures to ensure that the bank continuously maintains the relevant specified additional required percentage of qualifying common equity tier 1 capital and reserve funds and additional tier 1 capital and reserve funds and tier 2 capital and reserve funds for systemic risk (that is Pillar 2A).

Regulation 38(8)(e)(iv)(D) of the Regulations provides that the capital conservation buffer "is intended to ensure that banks build up capital buffers outside periods of stress identified in writing by the [Prudential Authority], which capital buffers may be drawn down as losses are incurred during the subsequent periods of stress, that is, a bank that writes off losses against its capital conservation buffer during a period of stress will be able to continue to conduct business with constraints being imposed in respect of specified potential distributions of available capital and reserve funds".

The spread of Covid-19 has reached a critical phase and is having an increasingly significant impact on global economic activity, which has placed the local economy under immense strain. As part of the measures employed to address the impact of Covid-19, government as well as business have called upon the banking sector to continue to extend credit to households and sectors in need, particularly small businesses, as well as provide relief measures to reduce the strain on these sectors in an effort to sustain the local economy and maintain financial stability. This, together with a slowdown in economic activity, is expected to reduce bank profitability, which is consequently expected to negatively impact capital supply and the ability of banks, branches of foreign institutions and controlling companies (hereinafter collectively referred to as 'banks') to meet their currently specified minimum required amount of capital and reserve funds, including the abovementioned buffers. As such, the Prudential Authority (PA) has decided to implement various measures to provide

temporary capital relief to banks during this time of financial stress, in a manner that ensures South Africa's continued compliance with the relevant internationally agreed capital framework.

1 Introduction

1.1 In response to pressures on banks' capital supply brought about by the Covid-19 pandemic, the PA has decided to implement measures to reduce the currently specified minimum requirement of capital and reserve funds to be maintained by banks, in order to provide temporary capital relief to enable banks to counter economic risks to the financial system as a whole and to individual banks.

1.2 The Regulations provide that banks shall have in place robust policies, processes and procedures to ensure that the bank continuously maintains, in addition to the base minimum capital requirement of eight percent of risk weighted assets, a systemic risk buffer (Pillar 2A), an idiosyncratic risk buffer (Pillar 2b), a capital conservation buffer, a countercyclical buffer (when imposed, which is an extension of the capital conservation buffer) and a domestic systemically important bank buffer (where applicable).

1.3 The Pillar 2A capital requirement is maintained for systemic risk and is to be held over and above the relevant minimum internationally agreed requirement specified in the Basel III capital framework. The PA considers the Covid-19 pandemic to be a stress event posing risk to the entire financial system and believes that the temporary relaxation of the Pillar 2A capital requirement would assist the banking sector by reducing the minimum required amount of capital and reserve funds to be maintained by banks to facilitate banks' continued lending to the real economy.

1.4 To date, it has not been necessary for South Africa to implement a countercyclical capital buffer (CCyB) as there has not been any period of excess aggregate credit growth that has been associated with the build-up of systemic risk. Consequently, banks are not required to maintain capital to meet any CCyB requirement.

1.5 South African banks did, however, build up a capital conservation buffer of 2.5 per cent as prescribed in regulation 38(8)(e)(iv)(D) of the Regulations. The PA considers the current period to be a period of financial stress and therefore, banks will be allowed to draw down against the capital conservation buffer in the upcoming period. In the event that the capital conservation buffer is reduced, banks are required to consult the PA regarding the capital constraints that will be imposed in terms of Regulation 38(8)(f)(iii) of the Regulations.

1.6 The aforementioned measures are intended to provide relief to banks in response to the Covid-19 pandemic by enabling banks to continue to provide credit to the real economy during this period of financial stress. However, the aforementioned measures aimed at reducing the minimum required amount of capital and reserve funds are not intended to allow banks to distribute earnings in the form of dividends or bonuses. Instead, the intention is to assist banks to continue to serve their clients under very difficult circumstances and to ensure that their capital positions remain healthy and compliant with the relevant internationally agreed capital requirements, and can recover in a short period of time in the event of significant losses. Furthermore, the onus remains on banks to appropriately conserve their capital and reserve funds during the Covid-19 stress period. Therefore, large distributions or ordinary share buy backs will not be approved by the PA.

1.7 It is the PA's intention to reinstate the minimum Pillar 2A capital requirement following the Covid-19 stress period. However, the relevant details of such reinstatement would be communicated at an appropriate time.

2. Directive relating to minimum required capital and reserve funds

Based upon the aforesaid and in accordance with the provisions of section 6(6) of the Banks Act 94 of 1990, banks are hereby directed as follows:

2.1. The Pillar 2A minimum capital requirement as set out in regulation 38(8)(e)(ii) of the Regulations is with immediate effect temporarily reduced to zero; that is, banks will be allowed to conduct business with a zero percent Pillar 2A capital requirement without any regulatory action being taken.

2.1. Banks will be allowed to utilise their capital conservation buffer, as prescribed in Regulation 38(8)(e)(iv)(D) of the Regulations. The temporary relaxation of the Pillar 2A capital requirement will make capital and reserve funds available to banks before any need to draw down against the capital conservation buffer.

2.2 In the event that the capital conservation buffer must be utilised, banks must individually consult the PA, as envisaged in terms of the proviso to regulation 38(8)(e) read with regulation 38(8)(f)(iii) of the Regulations.

3. Invitation for comment

3.1 Banks are hereby invited to submit their comments with respect to the proposed directive to SARB-PA@Resbank.co.za and Zine.Mshengu@resbank.co.za for the attention of Ms Zine Mshengu by no later than 3 April 2020.

Kuben Naidoo
Deputy Governor and CEO: Prudential Authority

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