

Annual Report 2007

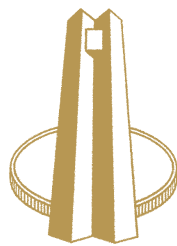
**Bank Supervision
Department**



South African Reserve Bank

Annual Report 2007

**Bank Supervision
Department**



South African Reserve Bank

Mission

To promote the soundness of the banking system through the effective and efficient application of international regulatory and supervisory standards.

Business philosophy

Market principles underlie all our activities and decisions, and we strive to act with professionalism, integrity, credibility and impartiality at all times. We liaise with each individual bank through a single point of entry – a relationship manager, assisted by a team with diverse competencies. We follow a risk-based supervisory approach, not one of inspection, and our objective is to add value. Consequently, our role is that of a ‘watchdog’, not that of a ‘bloodhound’. We place emphasis on empowering our staff to ensure that all interaction and service delivery is characterised by professionalism, and a high premium is placed on ethical behaviour at all levels of activity. A relationship of mutual trust between the Bank Supervision Department and all other key players is regarded as essential and is built up through regular open communication.

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Incentive schemes of banking institutions

As in earlier years, several financial sector regulators and market commentators have, once again, begun to question the appropriateness of incentive schemes that banking institutions employ.

There are usually two key concerns raised about banks' incentive schemes. First, the schemes are misaligned, that is, they are linked to short-term performance, rather than the long-run interests and objectives of the institution. Second, these schemes have significant upside with no or limited downside and therefore may influence behaviour that could encourage excessive risk-taking.

Misalignment between incentive schemes and the long-run objectives of banking institutions include mismatches between the timing of employees' bonus payments and the actual realisation of profits from their activities; inadequate recognition and remuneration of risk management professionals, that is, their 'exclusion' from incentive schemes; and the provision of funding to business units based on income potential, without considering the level of risk these units undertake.

It has been documented that the schemes are structured such that during years when employees meet their targets, 'high-flying' employees can earn bonuses running into millions of rands. In less-successful periods bonuses are lower. However, as a result of the abundance and competitiveness of these schemes, banking institutions appear to fear cutting bonuses by too much, since their employees may seek a 'better-rewarding' employer and resign. In the final instance, during periods where banks perform poorly, all employees face the threat of losing their jobs and there is no distinction between high risk takers and risk-averse employees.

The following remarks are deemed relevant to highlight the importance of an effective governance framework in respect of banks' incentive schemes:

Since the fortunes of even the most technically sophisticated financial institutions ultimately depend on the decisions and judgments of individual managers and traders, senior management must ensure that the right incentives are in place so that risk-taking is appropriately captured in business-line performance evaluation and employee compensation. Senior management must understand the risks assumed by each individual business line and communicate the firm's strategy and risk appetite back down to those business lines. At the same time, senior management must send each business-line manager clear signals about which risk levels are tolerable and which practices are not acceptable. In this way, information and incentives are threads of sound risk management that must be woven into the fabric of each firm's management culture.

...

Any successful organization needs to develop appropriate mechanisms to ensure adherence to and sustainability of its risk management structures, and incentives structures are a key mechanism for this purpose. Appropriate incentives reward good behavior and penalize inappropriate behavior. Of course, incentives work best when they are known well in advance, that is, when they serve as *ex ante* signals of what should and should not be done. Naturally, in very large organizations it is difficult for senior management to monitor each individual, so incentives need to be consistent, permeate even the lowest levels of the organization, and remind each individual that his or her risk-taking affects the whole enterprise.

...

In trading and certain other activities, there is a tendency for business-line heads or individual employees to focus on their short-term compensation and not think about the long-term risks that their activities create for the firm. But it is the responsibility of senior management to provide the proper incentives and controls to counter the potential for individuals within financial firms to discount risks to the broader institution, and of course to ensure that nefarious activity is promptly uncovered and stopped.

Clearly, it is up to financial institutions themselves – not bank supervisors – to decide how compensation should be structured, but managers and boards of directors should understand the consequences of providing too many short-term and one-sided incentives. They would benefit from thinking about compensation on more of a risk-adjusted basis. Accordingly, I encourage institutions to think about ways to alter existing compensation schemes to include some types of deferred compensation, since the risks of certain investments or trades may not manifest themselves in the near term. Thus, it makes sense to try to match the tenor of compensation with the tenor of the risk profile and thus explicitly to take into account the longer-run performance of the portfolio or division in which the employee operates. This type of compensation arrangement is already in use at many nonfinancial firms.

(Mr Randall S Kroszner, Governor: Board of Governors of the Federal Reserve System, United States of America, at the Global Association of Risk Management Professionals Annual Risk Convention, New York, 25 February 2008)

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Annual Report for the calendar year ended 31 December 2007 in terms of section 10 of the Banks Act, 1990, (Act No. 94 of 1990) and section 8 of the Mutual Banks Act, 1993 (Act No. 124 of 1993).

This report presents an overview of the objectives and activities of the Bank Supervision Department of the South African Reserve Bank, with particular reference to the period 1 January 2007 to 31 December 2007.

Chapter 1

Registrar of Banks' review

Throughout 2007 the South African banking system remained stable and banks were adequately capitalised. However, adverse economic developments both in South Africa and internationally have had a negative impact on the banking sector's operating environment. During the year under review the impact on consumers could be clearly observed by the sharp increase in non-performing loans and overdue ratios.

banking system remained stable

This overview therefore discusses, *inter alia*, asset growth, capital adequacy, profitability and asset quality in the South African banking system. It, furthermore, reviews the South African banking sector's exposure to the sub-prime mortgage market, compliance with anti-money laundering (AML) legislation, securitisation, the high-level meeting arranged for African banking supervisors, and the Companies Bill. Finally, the Bank Supervision Department's (the Department) human resources-related developments are discussed.

Overview of the South African banking system

The South African banking system remained stable and banks were sound during 2007. Banks maintained capital-adequacy ratios above the minimum requirement of 10 per cent. The capital-adequacy ratio for the banking sector amounted to 12,78 per cent at the end of December 2007 (December 2006: 12,29 per cent).

adequate capital maintained

Banking-sector assets increased from R2 075,3 billion at the end of December 2006 to R2 547,0 billion at the end of December 2007, representing an annual growth rate of 22,7 per cent (December 2006: 23,7 per cent). The growth rate slowed down during the first two quarters of 2007, reaching 17,8 per cent at the end of June 2007 before recovering in the remaining two quarters of 2007. Loans and advances, and investment and trading positions were the main contributors to the increase in banking-sector assets during 2007.

banking-sector assets increased

Non-bank deposits remained the primary source of funding for the banking sector throughout 2007, and represented 65,1 per cent of total liabilities and capital at the end of December 2007 (December 2006: 65,2 per cent). Total non-bank deposits increased from R1 353,2 billion at the end of December 2006 to R1 657,8 billion at the end of December 2007.

non-bank deposits remained primary source of funding

Profitability ratios remained strong throughout 2007. The return on regulatory capital amounted to 18,1 per cent at the end of December 2007, compared with 18,3 per cent at the end of December 2006, while the return on assets equalled 1,4 per cent at the end of both December 2006 and December 2007. The efficiency ratio (also referred to as the 'cost-to-income ratio') improved from 58,8 per cent at the end of December 2006 to 56,9 per cent at the end of December 2007.

profitability ratios remained strong

The liquid assets held exceeded the statutory liquid-asset requirement throughout 2007. The average daily amount of liquid assets held in December 2007 represented 112,5 per cent of the statutory liquid-asset requirement (December 2006: 111,2 per cent).

Credit risk ratios deteriorated during 2007. Non-performing loans increased from R18,8 billion at the end of December 2006 to R29,4 billion at the end of December 2007, representing an annual growth rate of 56,4 per cent. Expressed as a percentage of total

credit risk ratios deteriorated

loans and advances, non-performing loans deteriorated from 1,1 per cent at the end of December 2006 to 1,4 per cent at the end of December 2007. The increase in interest rates, together with other adverse developments in the South African and international economic environments, contributed to the deterioration of the credit risk ratios.

Concentration in the South African banking system

The Herfindahl–Hirschman index (H-index) is a commonly accepted measure of market concentration in a banking system. The index is calculated by squaring the market share of each bank in the system and subsequently summing the squares. The higher the index, the less competition exists in the market and vice versa.

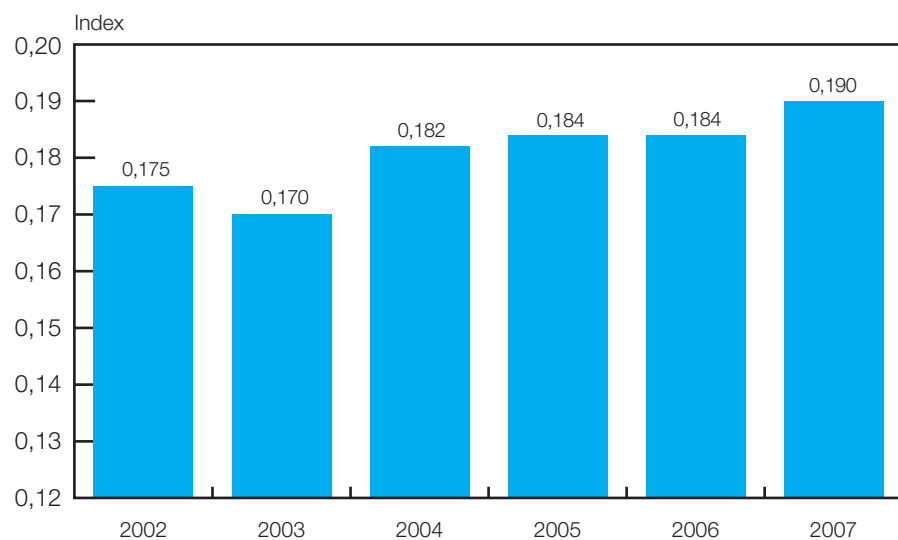
An H-index below 0,1 indicates that there is no concentration in an industry, while an H-index between 0,1 and 0,18 is an indication of moderate concentration. However, an H-index above 0,18 represents a highly concentrated industry.

H-index deteriorated

As portrayed in Figure 1, the level of concentration in the South African banking system increased from 0,184 in December 2006 to 0,190 in December 2007. The increase in concentration can be attributed to a rise in market share of the four largest banks. The total balance sheet of these banks amounted to R2 167,8 billion and represented 85,1 per cent of banking-sector assets in December 2007, compared with 84,1 per cent in December 2006. Three of the four largest banks reported a balance-sheet annual growth percentage exceeding 24 per cent in December 2007.

At the end of December 2007 there were 33 banking institutions reporting data to the Department (excluding two mutual banks; however, including one institution conducting banking business in terms of an exemption from the provisions of the Banks Act, 1990 (Act No. 94 of 1990), namely Ithala Limited).

Figure 1 H-index for the South African banking system (2002–2007)



The South African banking-sector exposure to the sub-prime mortgage market and the impact of the turmoil in the international markets on the South African banking groups

The turmoil caused by the sub-prime mortgage market was undoubtedly the major development in financial markets during 2007. What began as credit concerns in the United States (US) sub-prime mortgage market developed into concerns in global credit markets as the extent of exposures and potential losses from the sub-prime market were not known. The resultant uncertainty made financial market participants exceedingly risk-averse, that is, they were unwilling to invest in any markets or financial instruments that were not regarded as a 'safe haven', which led to severely reduced levels of liquidity in the global financial system.

turmoil in financial markets

Background

In the years preceding the financial market turmoil, the global economy was characterised by favourable annual growth, lower interest rates, buoyant financial markets and increasing asset prices. The US was no exception to this phenomenon.

favourable conditions
globally preceded turmoil

Since the early 1990s, housing prices in the US have been growing at an unprecedented pace. The favourable housing market developments resulted in an increased demand for housing from both an investment and occupational perspective. The continuous boom in this market attracted clients who would not normally have qualified for loans. These were clients with a poor or non-documented credit history, no or negligible assets and in most instances no steady income. Loans granted to these clients are what are commonly known as 'sub-prime mortgage loans'. The assumption was that the growth in equity of these clients would allow them to refinance their loans as housing prices continued to increase.

growing US housing prices

Institutions granting these sub-prime mortgage loans became creative by offering these loans at initial low 'teaser' rates, which reset to higher rates after a few years. As these loans began to reset and the housing market began to cool off during 2006, that is, growth in house prices decreased, these clients found themselves unable to meet the higher payment obligations and were not able to refinance their loans. It was during this period that non-performing sub-prime mortgage loans increased rapidly. In 2007 concerns regarding the level of non-performing sub-prime mortgage loans became more pronounced. Institutions that granted these loans and maintained them on their books faced major losses.

Concurrent with the granting of sub-prime mortgage loans, certain institutions securitised their loans in special-purpose institutions (SPIs) that issued mortgage-backed securities. These securities offered high yields and the high levels of liquidity in the global financial system attracted large numbers of investors to these products. To complicate matters, various tranches of lower-grade mortgage-backed securities were repackaged, assigned ratings and sold off to conduits (structured investment vehicles (SIVs)) as collateralised debt obligations (CDOs). The SIVs were mainly attracted to investing in the CDOs due to the higher yields offered by these products. Severe liquidity mismatches developed in the SIVs as a result of the CDOs acquired by SIVs being long-dated financial instruments (e.g. five years), while the SIVs were dependent on short-term funding that needed to be rolled over continuously. This structure posed significant liquidity risk to the SIVs, that is, the risk of short-term funding not being rolled over.

loans securitised

Mortgage-backed securities were sold in tranches, namely equity (high-risk), mezzanine (medium-risk) and low-risk tranches. However, many investors were of the view that the housing prices would continue to increase and therefore did not expect high levels of default, that is, investors were attracted to the higher-risk tranches.

credit crunch experienced

With the increased levels of default on sub-prime mortgage loans in 2007, financial institutions and regulators became concerned about these institutions' exposure, either directly or indirectly, to the sub-prime mortgage market, resulting in the so-called market turmoil or credit crunch experienced in the global markets during the second half of 2007.

Methodology used by the Bank Supervision Department

Department requested information from banks

Given the developments in the international markets, broadly insofar as off-balance-sheet activities were concerned, a selection of South African banks was requested to provide the Department with a detailed document setting out the results of the work undertaken to assess the banks' own position vis-à-vis any potential contagion (or other) risks, together with an indication of the action taken by both the board risk subcommittee and the chief risk officer of the banks to mitigate such risks. Furthermore, the following information was requested:

- Full details of any direct and/or indirect exposure that the bank or banking group may have had to the so-called sub-prime market.
- A full list and value of securitisation schemes undertaken (and capacity), with funding details and recent reviews of these schemes that had been conducted.
- A review of off-balance-sheet activities, including any conduits or so-called SIVs. Such review had to include the size and nature of the underlying assets, and the degree to which any funding mismatch existed.
- A detailed quantification of any liquidity support that the bank or banking group provided to either its own or third-party conduits and, if so, whether such facilities were effectively integrated into the bank's/group's asset and liability committee (ALCO) process, including stress testing.
- Whether the bank or banking group managed or participated in any portfolios on a geared/leveraged basis, where small movements in the value of the underlying assets could cause a (significant) loss to the holders of the equity/units. If so, relevant details of such portfolios had to be provided.
- In respect of any foreign funding that the bank or banking group may have had:
 - the extent of its reliance thereon
 - any indication of change in behaviour in roll-overs having been granted
 - any change in pricing
 - any roll-overs due in the next six months and the contingency plans in place should such roll-overs not occur.

The Department held meetings with the chairpersons of the board risk subcommittees and the chief risk officers to discuss the information presented.

Overview of the findings

local banks had no direct exposure

Local banks had no direct exposure to the sub-prime mortgage market, while the banks' international franchises had very limited exposure. The securitisation schemes of local banks in South Africa are traditionally cash-backed securitisation schemes, and are used mainly as part of banks' liquidity and capital management strategies. In a traditional securitisation scheme, the legal and economic transfer of assets to a special-purpose vehicle (SPV) takes place. All rights and obligations of the referenced assets are transferred to the SPV.

offshore-listed operations exposed minimally

One of the banks selected for assessment, to a limited extent through its separately offshore-listed operations, was exposed minimally to the sub-prime mortgage market.

This resulted in a negative mark-to-market adjustment to its portfolio. The offshore operations of another local bank had structured transactions using off-balance-sheet entities for bankruptcy-remote purposes, but these exposures were on-balance sheet.

The banks had also participated in various capacities in the securitisation schemes of external parties. In those instances where banks had acted as liquidity providers for external parties, such contingent liabilities were included in the banks' ALCO processes. Banks implemented plans to lengthen the duration of the liabilities. The programmes involved rolling maturing commercial paper into longer-term floating rate notes. In some instances, banks had capped the undrawn portion of the facilities and steps were under way to restructure some of the facilities. In one case, a bank had included its cash reserves and statutory liquid assets in its contingency planning. The Department is therefore of the opinion that in most cases stress testing in respect of liquidity contingency planning is still rudimentary and further enhancements are required.

participated in securitisation schemes

The use of foreign funding by the banks selected for assessment differed widely. It ranged from the use of longer-term foreign funding to lengthening their funding structure, and thereby managing liquidity mismatches, to overnight facilities and to the management of their offshore operations.

use of foreign funding

The banks had not been exposed to any change in the behaviour of providers of foreign funding towards roll-overs, since at that stage most of them did not have facilities maturing within the following six months. In those limited cases where funding had to be rolled over, the credit spreads widened; reflecting the reassessment of risk by fund providers.

South African banks have mostly been isolated from the turmoil in the international markets. As the South African banking sector has had no direct exposure to the sub-prime mortgage market, the impact has been minimal. The wider impact of the global crisis on the local banking sector is still uncertain, but it is expected that as credit spreads widen and pricing for risky assets increases, the borrowing costs of banks will increase. Although there is no immediate concern for the South African banking sector, the second-round effects of the markets will invariably impact on the earnings of banks.

Internationally, further deterioration of asset quality is expected as more borrowers fail to meet their repayments as the lending rates continue to reset. This uncertainty will continue as long as banks continue to write off exposures. Furthermore, counterparty risk is expected to increase during 2008.

further deterioration of asset quality expected

Compliance with anti-money laundering legislation

The Department's endorsement of the revised Core Principles for Effective Banking Supervision (Core Principles), released by the Basel Committee on Banking Supervision (the Basel Committee) in October 2006, signalled an increase in the bank supervisor's duties and the strengthening of supervisory systems in a wide range of aspects, including the areas of anti-money laundering and the combating of the financing of terrorism (AML/CFT). In endorsing the Core Principles, the Department committed itself to co-operating with the Financial Intelligence Centre (FIC), the primary authority responsible for assessing compliance with laws and regulations against the abuse of financial services by criminal elements, to achieve compliance with the criteria mentioned in revised Core Principle 18. A key criterion for assessing compliance with Core Principle 18, which was not present in the previous Core Principle 15, is to have laws or regulations that clarify the duties, responsibilities and powers of the banking supervisor regarding the supervision of banks' internal controls.

Department committed to co-operating with FIC

Financial Intelligence Centre Amendment Bill, 2007

Bill aims to adhere to international standards

The Financial Intelligence Centre Amendment Bill, 2007 was released for comment in November 2006. The Bill primarily aims to adhere to international standards for regulation and supervision with regard to compliance with AML measures and measures to combat the financing of terrorism as contained in the recommendations of the Financial Action Task Force on Money Laundering (FATF). While the Financial Intelligence Centre Act, 2001 (Act No. 38 of 2001) (FICA) provides for the enforcement of its provisions only through criminal sanctions, the proposed amendments seek to introduce an administrative enforcement framework to FICA. Some of the changes to be introduced include the following:

- Co-ordinating and integrating the FIC's powers with supervisory bodies in the supervision of accountable institutions
- Detailing the mandate of supervisory bodies when supervising and enforcing compliance with FICA
- Empowering the FIC and supervisory bodies, *inter alia*, to undertake inspections, issue directives, request information and impose administrative sanctions
- Enhancing co-operation between the FIC, the supervisory bodies and law enforcement agencies.

Ongoing supervision

pre-emptive steps in supervising compliance with FICA

In 2007, in keeping with current global expectations to optimise banks' compliance with AML/CFT, the Department took pre-emptive steps in supervising compliance with FICA. The flavour-of-the-year topic for trilateral discussions between the Department, banks' audit committees and banks' external auditors during the 2007 calendar year focused on the activities of the internal audit function vis-à-vis AML/CFT. To satisfy itself of the effectiveness of the internal audit functions in banks and that AML/CFT was being implemented, the Department requested banks to report on the following:

- A high-level overview of internal audit functions in respect of the implementation of AML/CFT measures
- Key internal audit findings in respect of the previous financial year (2006) as well as the current financial year (2007) to date
- An overview of internal audit AML/CFT reports issued, actions taken and their timing, in order to address the key findings
- Interaction between internal audit, the audit committee and the AML control officer
- An overview of the internal audit AML/CFT plan for the forthcoming 12 months (2007/08), including adequacy of resources
- An overview of the current compliance status with AML/CFT requirements.

As part of the ongoing co-operation between the Department and the FIC, Mr Murray Michell, Director of the FIC, attended a number of the above-mentioned trilateral discussions.

The steps set out above are in addition to the following supervisory steps taken by the Department to ensure that banks had implemented measures to comply with FICA, the Core Principles and FATF processes since 2002:

- Banks were required to provide the Department with the following:
 - the name of the person responsible for ensuring compliance with the provisions of FICA

- a completed questionnaire, signed by the chief executive officer and compliance officer, to enable the Department to assess the status of AML measures already taken by banks
- detailed plans on how the bank intended to achieve full implementation of, and compliance with, FICA and FIC regulations.
- As part of its ongoing supervisory process, the Department met with banks to monitor progress made with the implementation of FICA.
- The Department visited banks on-site to inspect the AML measures taken by them.
- In co-operation with the FIC, the Department enforced deadlines for banks' identification and verification of their clients. The Department monitored compliance on a quarterly basis.

Mutual evaluation

As a member of FATF, South Africa will undergo a mutual evaluation in 2008 to assess whether the necessary laws, regulations or other measures required under the new standards are in force and effective; that there has been full and proper implementation of all necessary measures; and that the systems in place are effective. These evaluations are based on the 40 Recommendations of 2003 and the 9 Special Recommendations of 2001 (40 + 9 FATF Recommendations), and use the AML/CFT Methodology of 2004.

FATF mutual evaluation in 2008

This is the third round of mutual evaluations for members of FATF, which began in January 2005. A key feature of the process is an on-site visit to the jurisdiction by a team of FATF experts in legal, law enforcement and financial regulatory issues (drawn from institutions in FATF member countries) and the FATF Secretariat, during which they will conduct comprehensive meetings with government officials, supervisory authorities and the private sector over a two-week period.

key feature of process is on-site visit

The team is expected to visit South Africa during August 2008. All participants are expected to be equipped with the *Handbook for Countries and Assessors*, published in June 2006, which provides procedural information and detailed instructions for performing a proper and fair evaluation. Among financial-sector bodies that will be visited in South Africa are

- the Department
- the FIC
- The Banking Association South Africa
- senior executives, compliance officers and internal auditors from a representative sample of financial institutions, including banks
- a representative sample of external auditors.

The findings of the FATF assessment team will be compiled in a *Mutual Evaluation Report*, which will describe in detail the system in place, and assess and rate its effectiveness. A summary of each report will be published on the FATF website.

Mutual Evaluation Report

The latest work of the Basel Committee on AML/CFT

In June 2007 the Basel Committee established a dedicated AML/CFT Expert Group. Previously, AML/CFT matters were overseen by the Basel Committee's Working Group on Cross-border Banking, consisting of members of the Basel Committee and the Offshore Group of Banking Supervisors (OGBS). In addition to representatives of the Basel Committee and the OGBS, the AML/CFT Expert Group is open to representatives of the Basel Committee's International Liaison Group (ILG). The Department is a member of the AML/CFT Group and the ILG.

AML/CFT Expert Group

tasks of Expert Group

The tasks of the AML/CFT Expert Group are to

- monitor AML/CFT issues that have a bearing on banking supervision;
- serve as a forum for AML/CFT experts from banking supervisory agencies;
- act as interlocutor for FATF and industry groups active in AML/CFT matters; and
- provide guidance, where appropriate.

Basel Committee supports implementation of FATF recommendations

The Basel Committee recognises the FATF as the cross-sectoral standard setter for AML/CFT matters. To this end, the Basel Committee contributes to FATF efforts and supports the implementation of FATF recommendations. However, its perspective differs. From a sectoral perspective, the Basel Committee focuses on banks and banking supervisory issues. From a prudential perspective, it recognises the importance of know your customer (KYC) as not exclusive to AML, but for the management of other risks.

FATF work on risk-based supervision

FATF has undertaken work on the issue of the risk-based approach to combating money laundering and terrorist financing under the auspices of the Electronic Advisory Group (EAG), established by FATF in December 2005. The Department and The Banking Association South Africa were among the participants who volunteered to be part of this initiative. Other participants included FATF members and observers, and members from the banking and securities industries. The work of the EAG followed a number of steps that culminated in the adoption, in June 2007, of high-level principles and procedures in a paper titled "Guidance on the Risk-based Approach to Combating Money Laundering and Terrorist" (the Guidance paper). This is the first time that FATF has developed guidance using a public-private sector partnership approach.

Guidance paper

The purpose of the Guidance paper is to

- support the development of a common understanding of what the risk-based approach involves;
- outline the high-level principles involved in applying the risk-based approach; and
- indicate good public- and private-sector practice in the design and implementation of an effective risk-based approach.

It is hoped that by adopting the risk-based approach, competent authorities and financial institutions will be able to ensure that the measures to prevent or mitigate money-laundering and terrorist financing are commensurate with the risks identified.

The Department has adopted the risk-based approach as outlined in the Guidance paper as the benchmark for assessing the ongoing effectiveness of its supervisory processes, and intends to address the recommendations in this regard by means of scheduled action plans in 2008 and beyond.

Securitisation

Background

review of securitisation regulatory framework

During 2007 extensive work was undertaken to review the existing securitisation regulatory framework. This culminated in the finalisation of the proposed amended Exemption Notice relating to Securitisation Schemes (the proposed amended Exemption Notice), which was due to be published on 1 January 2008. This would replace Government Notice No. R. 681 published in *Government Gazette* No. 26415 on 4 June 2004. Further regulatory amendments are discussed elsewhere in this report. The proposed amended Exemption Notice provides for both traditional and synthetic securitisation schemes. It also provides for various roles that may be performed in respect of such securitisation schemes. Where banks are a party to securitisation

schemes, it is important to distinguish between the type of securitisation scheme (traditional versus synthetic) and the role(s) that the banks are required to play in respect of the scheme (originator versus liquidity provider or credit enhancement provider).

A typical securitisation scheme involves the creation of a bankruptcy remote SPV. Traditionally, an originator transfers assets to the SPV that funds the purchase price by issuing multiple classes of equity and debt securities to be taken up by investors. These securities are usually listed on the Bond Exchange of South Africa (BESA).

Securitisation can achieve four objectives for the asset originator:

objectives of securitisation

1. Removal of the applicable financial assets and related indebtedness (financing costs) from the originator's balance sheet.
2. Attainment of funding at a lower cost than available through other means of financing as a result of isolating the assets from the potential bankruptcy risk of the originator.
3. Improvement of the originator's liquidity.
4. Matching maturing assets and liabilities.

Securitisation curtails balance-sheet growth and eases the regulatory capital charge by moving assets off the books of the originating bank or by reducing the cost of capital as a proportion of asset exposure. The benefits derived from such activities are, however, not without risk.

Risks associated with securitisation

Interest rate risk

As with all fixed-income securities, the pricing of asset-backed securities (ABSs) fluctuates in response to changing interest rates. When interest rates decline, prices rise and vice versa. The prices of ABSs with floating rates are, however, much less affected. Some ABSs, especially mortgage loans, are also subject to the risk that a change in interest rates may influence the pace of repayments of the underlying loans which, in turn, affects yields.

price fluctuations

Default risk

The risk of default is generally when a borrower fails to make timely payments. It may, however, also occur when a borrower fails to meet other obligations, such as the obligation to maintain a required amount or quality of financial assets as specified in the agreement.

borrower fails to meet obligations

Liquidity risk

Liquidity risk relates to the relative ease with which a particular ABS can be traded and sold at any point at a price that reasonably approximates its intrinsic value. The level of liquidity depends on a variety of factors, including the supply and demand characteristics of the broader market and the interest rate environment. For investors who plan to hold a particular ABS until maturity, liquidity risk is less important. Liquidity risk is also relevant when banks become too reliant on funding from SPVs in a securitisation scheme.

liquidity depends on variety of factors

Funding risk

Funding risk occurs when an SPV issues securities with maturities that are shorter than the maturities of the underlying assets. In such a case, there is a risk that the bank will be required to fund some or all the underlying assets when the securities mature.

difference in maturities

Servicer risk

The risks for a bank acting as servicer are principally operational. The number of loans in the portfolio and the number of parties involved in a securitisation scheme increase the risk of a malfunction for which the servicer could be liable.

Retention of credit risk

credit enhancement is expensive

Third-party credit enhancement is expensive. Banks will therefore often provide credit enhancement to a securitisation scheme themselves. In some cases, this results in the bank being exposed to as much credit risk as it would have had had it retained the loans on-balance sheet.

Reduction in asset quality

best assets for securitisation purposes

The risk is always that a bank originates its best assets for purposes of securitisation, thereby reducing the overall quality of assets on-balance sheet. The issue for supervisors is whether the level of capital requirements is still appropriate on the riskier assets remaining on the books.

Reputational risk

banks have multiple roles

Although the assets of a bank are transferred to a so-called bankruptcy remote SPV in terms of a securitisation scheme, the risk remains that, in cases where the securitisation scheme encounters problems, the bank will be approached to make good any losses. This is not only because of the fact that the assets were originally those of the bank, but also because of a variety of other roles that the bank might have in terms of the securitisation scheme, such as the promoter, arranger, servicer, liquidity provider or credit-enhancement provider.

Market size

The total value of assets securitised by securitisation schemes, involving banks directly (as originator) and indirectly (in performing a secondary role), that have been approved by the Department since 2001, is approximately R223 billion. This amount is the amount to which the seven participating banks are potentially exposed. This should be seen against the backdrop, at 31 December 2007, of the total balance-sheet size of the banking sector of R2 547 billion and total loans and advances of some R2 124 billion.

High-level meeting for African banking supervisors

FSI held high-level meeting in Cape Town

On 5 and 6 February 2007 the Financial Stability Institute (FSI) of the Bank for International Settlements (BIS) held a high-level meeting in Cape Town, South Africa, on the Implementation of Basel II in Africa and other regional supervisory priorities. The focus of the meeting was on Basel II preparation and implementation, the revised Core Principles and AML/CFT. Among the attendees were four members of the Basel Committee, including its Chairperson, Dr Nout Wellink. The proceedings were chaired by Mr Josef Tošovský, Chairperson of the FSI. Supervisors from central and southern Africa attended the meeting.

introductory remarks

The first day's proceedings commenced with introductory remarks by the chairperson of the meeting, Mr Josef Tošovský. Thereafter, Mr Errol Kruger, Registrar of Banks and Executive General Manager of the South African Reserve Bank (the Bank), described the South African Basel II implementation process and its progress. He also described how

South Africa had benchmarked its supervisory processes against the revised Core Principles and, in areas where gaps had been identified, was in the process of rectifying such gaps. On AML/CFT, he gave some history relating to South Africa's admittance as a member of the FATF and the importance of such continued membership to the country. He also explained the work undertaken by the Department to ensure that banks complied with the 40 + 9 FATF Recommendations.

Deliberations on the first day continued with brief comments made by Dr Nout Wellink, Chairperson of the Basel Committee and President of the Netherlands Bank, setting out the way forward with regard to the implementation of Basel II. This was followed by Thomas Hoenig, President of the Federal Reserve Bank of Kansas City, who addressed the topic "Ensuring Adequate and Competitive Capital Levels in a Rapidly Changing Banking Environment". He described the vast array of new activities that banks had become involved in and the rapid pace of innovation by banks, all of which presented challenges to regulators worldwide. He also described the Basel II implementation process in the US.

implementation of Basel II

Mr Karl Cordewener, Deputy Secretary General of the Basel Committee, touched on select Basel II implementation issues. His overview included an exploration of the context underpinning the development and release of the Basel II Framework: what was sought to be achieved; some implementation issues, including consideration of timing by countries to implement Basel II; and the relationship of Basel II implementation with the Core Principles. Furthermore, he highlighted the need for more co-operation between supervisors to enable an effective and efficient implementation.

Mr Rudi Bonte, a member of the Basel Committee and Management Committee member of Banking Supervision at the Banking, Finance and Insurance Commission in Belgium, dealt with cross-border issues and information sharing in Basel II. He discussed cross-border challenges with respect to Basel II implementation and how to address the home-host supervisory co-operation, and proposed a practical approach to supervisory co-ordination in Basel II implementation. He further addressed the need to co-ordinate requirements, implementation and approval processes between supervisors, and the need to understand a group's internal strategy, plans and processes for Basel II. He also stressed the importance, as highlighted in the Core Principles, of sharing information between supervisors and that the need to ensure the protection of confidentiality of information should not impede effective co-operation and information sharing between supervisors.

information sharing in Basel II

Mr Barthelemy Kouezo (on behalf of Mr Mahamat Mustapha, Chairperson of the Committee of Bank Supervisors in West and Central Africa), covered developments and remaining challenges related to Basel II implementation in West and Central Africa. Messrs Gert Kruger, Head of Group Credit and Economic Capital, FirstRand Banking Group, and Paul Smith, Chief Risk Officer, Standard Bank Group Limited (the SBG), described Basel II implementation from their banking groups' perspectives, covering the various aspects that had to be considered and addressed the challenges that needed to be overcome. They also explained the co-operative approach adopted in South Africa between the Department, the banking sector, and the accounting and audit profession, which underpinned the Basel II implementation process.

Basel II implementation in West and Central Africa

As regards the revised Core Principles, Ms Zahra El-Mekawy, Vice President of the Federal Reserve Bank of New York, described the process followed and considerations taken into account during the revision of the Core Principles. She also described the rationale for the review and the deadlines from September 1997 when the original Core

revision of the Core Principles

Principles were published to October 2006 when the revised Core Principles were approved and endorsed by bank supervisors from 120 countries at the International Conference of Banking Supervisors. She touched on policy considerations relating to risk treatment of Basel I and Basel II, risk management enhancements, home-host relationships, risk-based supervision, corporate governance and internal controls that had to be taken into consideration during the review process. The Department provided a detailed explanation of the manner in which it had benchmarked its supervisory process against the revised Core Principles, also setting out examples of action plans implemented towards achieving full compliance.

current issues and developments in AML/CFT

The second day was devoted to AML/CFT. Mr Phillip Marr, Director of Banking at the Guernsey Financial Services Commission – who also served as a member of the Basel Committee Working Group on Cross-border Banking – dealt with the evolution of current issues and developments in AML/CFT. He traced the history of AML/CFT, starting with the development of FATF's 40 Recommendations in 1990, which were initially targeted at 'non-co-operative' jurisdictions, the development of the KYC best practice paper drafted by the Working Group on Cross-border Banking, the addition of CFT standards, and the impetus given to the finalisation of these standards as a result of the events of 11 September 2001 leading to the publication, in October 2001, of the Basel Committee's "Customer Due Diligence" paper. He also dealt with the FATF's further revision of its 40 Recommendations, and the fact that CFT standards had to be applied on a risk-sensitive basis, and explained the provisions of Recommendation 5, which set out the key CFT measures to be taken by financial institutions, and Recommendation 6, requiring enhanced due diligence in respect of politically exposed persons. He highlighted the fact that Core Principles 7, 18 and 24 included provisions dealing with AML/CFT.

AML/CFT in South Africa

Mr Murray Michell, Director of South Africa's FIC, dealt with the implementation of AML/CFT in South Africa. He gave the history of events aimed at AML/CFT in South Africa, starting from 1996 when legislation was passed, up to the creation of the FIC in 2003. He highlighted the need, identified, *inter alia*, by the FATF mutual evaluation report, for amendments to South African-enabling legislation. He advised that proposed legislation aimed at clarifying the functions of supervisors in relation to overseeing compliance with AML/CFT measures was under discussion. (See also the section on Financial Intelligence Centre Amendment Bill, 2007 on page 6 of this report.)

AML/CFT in Belgium

Mr Rudi Bonte described the implementation activities relating to AML/CFT and enforcement actions in Belgium, which was followed by a report on implementation activities relating to AML/CFT and enforcement actions in the western African region by Mr Kouezo. Mr Mike Triggs, Group Head Financial Crime Risk at Standard Chartered Bank in the United Kingdom (UK), and Ms Isabelle Monestes from Citigroup in Russia each outlined challenges in implementing AML/CFT regulatory requirements from their individual banking group's perspectives.

Companies Bill, 2008

aims to modernise company law

The second and final draft of the Companies Bill, 2008 was released by the Department of Trade and Industry in November 2007. The proposed Bill, an extensive document of 480 pages, will replace the Companies Act, 1973 (Act No. 61 of 1973). The Bill represents a significant departure from the Companies Act, as it aims to modernise company law, aligning it with other South African statutes, notably the Auditing Profession Act and the Securities Services Act, and international best practice.

The Department welcomes the promulgation of the Companies Bill as a law of general application, and will set out to prepare action plans to adapt and amend the Banks Act, 1990 accordingly to enable the Department to discharge its roles and responsibilities properly in respect of banks, controlling companies and banking groups.

Section 11 of the Banks Act, 1990 provides that no person shall conduct the business of a bank unless such person is a public company and is registered as a bank. Thus the litmus test before an entity can qualify to be a bank is, first and foremost, to meet the requirements of the Companies Act, 1973, namely to operate as a public company and adhere to the provisions of this Act. A public company can graduate to bank status only by fulfilling additional requirements, such as start-up capital and tighter systems, including higher thresholds of governance, risk awareness and prudential requirements than in non-banks, which are all underscored by a higher standard of fitness and propriety.

meet requirements of
Companies Act and
Banks Act

In view of the essential function fulfilled by banks in an economy and their special nature, the Department believes that the Banks Act, 1990 should prevail in the case of an inconsistency between the Banks Act and the proposed Companies Bill, thus ensuring the Department's continued ability to regulate and supervise the banking system effectively and efficiently, thereby maintaining confidence in the overall banking system. Confidence is one of the most critical cornerstones of a banking system, and any loss of confidence can lead to the immediate withdrawal of deposits and capital, in turn, inducing a banking-system crisis.

Banks Act should prevail

Human resources issues in the Bank Supervision Department

During 2007 one of the Department's key initiatives was to fill its vacancies. Good progress was made in that 17 new staff members were appointed, while 8 resigned, which resulted in the workforce increasing from 84 to 93. Furthermore, 20 promotions and 34 salary adjustments were effected during this period.

fill vacancies

With the proposed targets of 50 per cent blacks and females at all levels of the Bank's staff compliment by 2011, the filling of the vacancies resulted in the Department achieving its employment equity objectives as a whole. At the end of 2007, 51 per cent of the Department's workforce was black. In terms of gender, 49 per cent of the staff members were males and 51 per cent were females.

employment equity
objectives

An analysis of the race progress by level, however, indicates that the Department met its target in three out of five broad band levels, namely General Management, Junior Professional and Supervisory, and Trainee Professional and Clerical. In the Professional and Vocational Management broad band 46 per cent of the workforce was black, while in the Senior Professional and Management broad band only 7 per cent was black. An analysis of the gender progress by level indicates that the Department reached its proposed target on the non-management level, that is, Junior Professional and Supervisory, and Trainee Professional and Clerical, where 32 per cent of the staff members were male and 68 per cent were female.

On the management level, that is, General Management, Senior Professional and Management, and Professional and Vocational Management the Department has not achieved its gender targets, where 64 per cent of the staff members were male and 36 per cent were female. The Department is proactively trying to find solutions and interventions to meet the proposed 2011 employment equity targets.

Staff training

skills base constantly improving

To ensure that the skills base of the Department is constantly improved, considerable resources are allocated for training purposes. During the year under review 95 employees of the Department received training at a total cost of R1,4 million. The training enables staff to

- implement sound global supervisory standards and practices;
- share supervisory practices and experiences; and
- promote cross-border supervisory contacts and co-operation.

A foundation-level course was introduced for new graduate staff joining the Department. The aim of the week-long course was to provide a broad and solid foundation for the new staff in the Department. The course covered the following:

- Overview of the banking system
- Regulatory framework
- Risk-based supervisory approach.

This was supplemented with training on specialised software programs used in the Department. Four of these courses were held during the year.

latest developments in the banking industry

To enable staff to stay abreast of the latest developments in the banking industry, the following presentations were held in-house:

- Change management
- Liquidity risk management
- Developments in the economy
- Strategic issues in the banking industry
- Amendments to the Companies Act
- International Financial Reporting Standards (IFRS)
- Global economic crime survey.

International courses attended

During the year under review, staff members attended the following courses:

- International Monetary Fund (IMF) Seminar Integrating Off-site and On-site Supervision, in Tunisia
- Banking Sector Education and Training Authority (BANKSETA) International Executive Development Programme, in Canada
- Swedish International Development Co-operation Agency (SIDA) Seminar on Risk Management, in Sweden
- Meeting on Risk Minds, in Switzerland.

Basel II training

The implementation of Basel II is a significant challenge to supervisory authorities and the Department has recognised these challenges and commenced training on a number of fronts as outlined below:

- The proposed amended Regulations relating to Banks (proposed amended Regulations)
- Quantitative impact study (QIS) 5.5
- Working sessions after the second formal field test
- Basel II industry sessions
- Credit risk modeling and model reviews
- Operational risk – sound practices and different approaches.

Issues to receive particular attention in 2008

In addition to fulfilling its normal supervisory and regulatory tasks, the Department will place particular focus on the following issues during 2008:

focus areas for 2008

- The effective implementation of the amended regulatory framework, which encapsulates Basel II and the revised Core Principles.
- Continued refinement of the Department's supervisory processes to support the implementation of the amended regulatory framework.
- Ongoing assessment and monitoring of the South African banking industry's exposure to the global financial market turmoil. This includes the ongoing monitoring of the banking industry's initiatives to deal with the impact of the financial market turmoil, while also enhancing the Department's contingency arrangements.
- Assessment of the involvement of board remuneration subcommittees in banks' incentive schemes.
- Evaluation of board members' involvement in the implementation of banks or banking groups' internal capital-adequacy assessment processes.
- Review of the involvement of boards of directors in the oversight of banks' operational risk frameworks.
- Continued monitoring of bank's compliance with AML/CFT legislation.
- Ongoing assessment of banks' corporate governance and risk management policies and processes.
- Ongoing participation in the initiatives and activities of international and regional bank supervisory bodies, such as the Basel Committee and the Subcommittee of Bank Supervisors of the Southern African Development Community.
- Continued combating and investigation of illegal deposit-taking by unregistered institutions and persons, and participation in consumer education initiatives.
- Ongoing training of staff, focusing on the latest regulatory and supervisory standards as well as local and international financial market developments.

Expression of gratitude

I wish to extend my appreciation to the Minister and Deputy Minister of Finance for their valued input on requests not only in terms of statutory requirements, but also in terms of general counsel. Sincere thanks also go to the Governor and deputy governors of the Bank for their continuous co-operation, guidance and support.

Several individuals and organisations, locally and abroad, continued their co-operation with the Department. These include, to name but a few, the Chief Executive of the Financial Services Board (FSB) and his staff; the senior executives of banking institutions and their external auditors; The Banking Association South Africa; the Standing Committee for the Revision of the Banks Act, 1990 (the Standing Committee); the individuals in the auditing profession; staff of other departments of the Bank; the Basel Committee; and the central bankers and bank supervisors, both in southern Africa and elsewhere in the world, with whom the Department interacted on an ongoing basis.

My sincere appreciation also goes to the staff members in the Department for their continued professionalism and enthusiasm. The implementation of Basel II, in particular, required extreme dedication and perseverance.

Errol M Kruger

Registrar of Banks and Executive General Manager: Bank Supervision Department

Chapter 2

Current issues in banking supervision

important supervisory and regulatory developments

This chapter reports on the most important supervisory and regulatory developments during 2007. The key focus is the implementation of Basel II in South Africa and a comprehensive review is provided in this regard. The application for the acquisition of shares in a major South African bank is discussed, while other issues covered in this chapter include illegal deposit-taking, maintenance of a board directorship continuity programme, consumer education and bank on-site visits.

Implementing Basel II in South Africa

Introduction

Basel Committee's revised capital framework

The Department's effort to implement Basel II – the Basel Committee's revised capital framework – on 1 January 2008 was a major exercise undertaken over several years. Accordingly, the discussion below takes a holistic view of Basel II implementation from the start of the process, shortly after the millennium change, up to the date of implementation.

The discussion covers the process of incorporating Basel II into the regulatory framework, along with the development, implementation and embedding of the following elements of Basel II:

- Pillar 1, relating to the determination of the minimum required regulatory capital in respect of credit, market and operational risk, including the application and approval processes that were followed in respect of credit and operational risk, where banks targeted approaches other than the base approaches, the quantitative impact studies, field tests and parallel runs, and the recognition of eligible external credit assessment institutions.
- Pillar 2, relating to capital management, including the initial internal capital adequacy assessment process (ICAAP) assessments and the updating of the supervisory review and evaluation process (SREP).
- Pillar 3, relating to market discipline, which included industry training.

Background

culmination of more than five years' work

On 26 June 2004, the Basel Committee issued the publication titled *International Convergence of Capital Measurement and Capital Standards: A Revised Framework*, commonly referred to as 'Basel II'. It represents the culmination of more than five years' work by the Basel Committee.

Basel II seeks to set significantly more risk-sensitive capital requirements (in respect of operational risk as well) and is aimed at greater international convergence through capital requirements and better disclosure, thus enhancing the role of market discipline; and to ensure improved supervisory processes and procedures.

Initial considerations and decisions

Should South Africa adopt Basel II?

The mission of the Department is to promote the soundness of the banking system through the effective and efficient application of international regulatory and supervisory standards.

Nonetheless, before proceeding with the implementation of Basel II, the Department considered a range of preconditions that would facilitate the successful implementation of Basel II and was satisfied that South Africa met these preconditions. These included the following:

range of preconditions

- Macroeconomic policies and environment.
- Fiscal discipline and environment.
- Accounting (compliant with international standards, namely IFRS).
- Auditing (compliant with international standards, namely International Standards on Auditing (ISA)).
- Legal environment
 - Corporate law
 - Insolvency law
 - Banking law (compliant national standards, namely with the Basel Core Principles and Basel I)
 - Financial Advisory and Intermediary Services Act
 - FICA (compliant with international standards, namely FATF recommendations)
 - National Credit Act (NCA).
- Bank supervision (compliant with international standards, namely with the Core Principles and Basel I).
- Corporate governance (compliant with international standards, namely relevant Basel Committee prescriptions contained in the publication titled *Enhancing Corporate Governance for Banking Organisations*, as well as the local best practice standards, that is, with the King I and II reports on corporate governance).
- Risk management (compliant with international standards, namely with Core Principles, Basel I and various other relevant Basel Committee guidelines contained in various publications. Furthermore, the Department strives towards best practice on an ongoing basis.).
- Payment system (compliant with international standards, namely Core Principles for Systemically Important Payment Systems)
- Disclosure (compliant with international standards, namely IFRS).

The implementation date that was decided upon was 1 January 2008, to all banks.

South Africa's approach to the scope of its implementation of Basel II

A fundamental decision that underpinned the Department's preparation for the implementation of Basel II was that Basel II would be adopted in its letter and spirit as an absolute minimum standard, and no sub-Basel II deviations would be permitted, although enhancements to Basel II that set a higher standard were, and in future may be, incorporated into the regulatory and supervisory framework.

no sub-Basel II deviations

The Department has a responsibility to ensure the promotion and adoption of sound, robust and universally applicable standards relating to such aspects as are material to all dimensions of banking and the banking system. This approach enables the Department to promote a sound and robust banking system that is best positioned to deliver optimal value to South Africa. The Department remains committed to ensuring that its approach remains relevant in the face of market and international regulatory developments. As such, the Department sees Basel II not as a single destination, but rather as an important milestone on the journey towards best practice.

robust and universally applicable standards

Basel II contains a menu of approaches

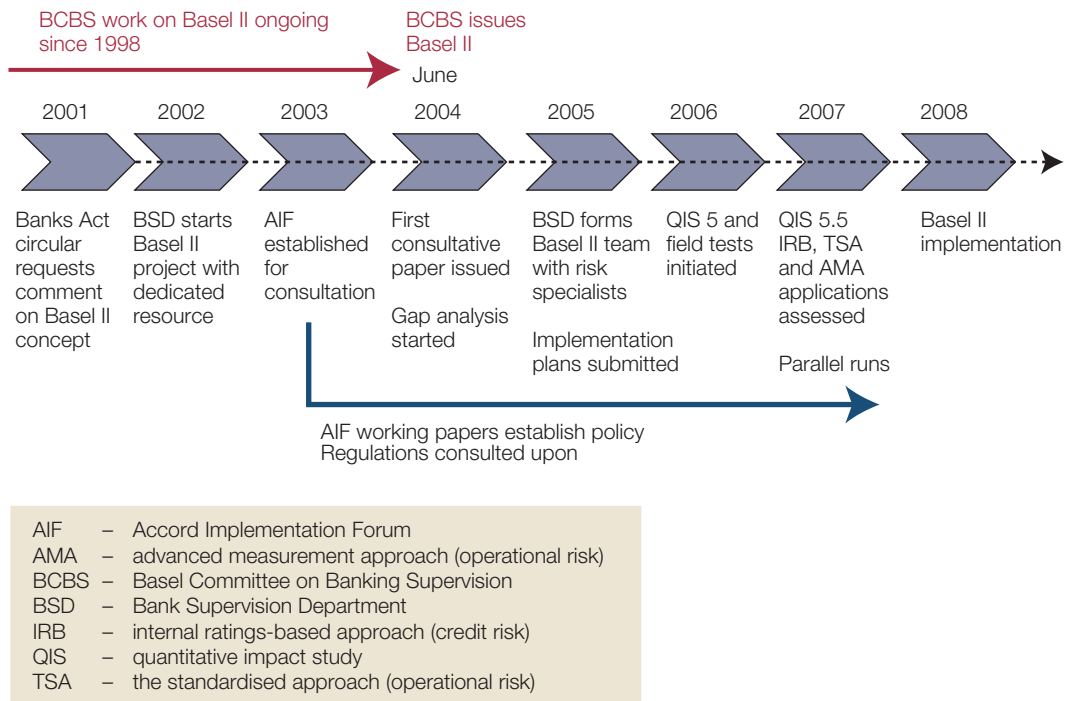
It is in this regard that the Department welcomes the fact that Basel II contains a menu of approaches that cater for a spectrum of banks, banking groups, or bank regulators and bank supervisors, from the basic to the highly sophisticated. All approaches contained in Basel II are available to banks in South Africa, subject to relevant conditions being met.

does not discriminate

As Basel II caters for the full spectrum of banks, banking groups and banking systems, it does not discriminate against any particular bank, banking group, bank regulator or supervisor. Furthermore, whether or not the bank, banking group, banking system or bank regulator and supervisor are sophisticated; or located within a developing country or within a developed country, the same standard and minimum requirements apply to all parties in relation to a particular approach. Accordingly, Basel II has the flexibility to enable a bank or banking group to make choices relating to the scope of the adoption of Basel II that are relevant and appropriate to its individual circumstances. At the same time, should a bank regulator or supervisor in a developing country make available an advanced approach to banks within its jurisdiction, it would be expected to attain and maintain the minimum Basel II standards in relation to its regulatory and supervisory frameworks and policies, practices and procedures.

The time line for Basel II implementation is outlined in Figure 2.

Figure 2 Time line for Basel II implementation



Familiarisation

understanding of Basel II

The first step in the implementation process was to gain an understanding of Basel II. This entailed, *inter alia*, presentations and workshops with the industry. In view of the nature, extent and complexity of Basel II, a process of updating and informing will be sustained into the future.

Project management

The Department applied a project management approach to the implementation of Basel II. To this end, a master plan titled “Key Milestones” was compiled, consisting of key deliverables, deadlines and the allocation of responsibilities. A separate document titled “Road to Parliament” captured the planning around the required proposed amendments to the regulatory framework.

project management approach applied

The plans were updated as and when required by changed circumstances and/or as unanticipated bottlenecks developed.

The Department was cognisant throughout the implementation phase of factors such as a shared sense of the importance of the project; commitment from the top in respect of all stakeholders; a participative approach; effective planning; sound communication; clear fixing of duties and responsibilities; holding responsible parties accountable; regular monitoring; and sound meeting procedures, all of which contributed to the success of the project.

Human resources allocated by the Bank Supervision Department to Basel II implementation

During 2002 the Department appointed a person to head the Department’s Basel II implementation initiative and in 2005 a dedicated team was established to drive the implementation. The team included risk specialists and quantitative analysts. The Basel II team mostly consisted of staff transferred from within the Department.

appointed person to head Basel II implementation

Each risk specialist had a dedicated responsibility for a specific risk area or aspect of a particular risk area. These responsibilities included, *inter alia*, the development of minimum criteria for applications to use more advanced approaches; development of agendas for on-site visits; the conducting of on-site visits; and the provision of technical guidance for model evaluation.

responsibility for specific risk areas

In addition, the Department allocated a lead analyst to each of the larger banks – those intending to apply to use an advanced approach for regulatory minimum capital adequacy purposes. The lead analyst, assisted by other analysts, had the overall responsibility for the supervision of a bank or banking group, but was also assigned the dedicated responsibility for Basel II implementation, including monitoring the implementation and state of readiness of the allocated bank or banking group. Lead analysts liaised with risk specialists concerned to assist in gaining an understanding of, and assessing, the quality of risk management in the relevant risk area within an allocated bank or banking group. In the case of banks or banking groups intending to adopt an advanced approach, the risk specialist and quantitative specialist concerned were engaged to assist with the assessment of relevant models, methodologies, data requirements, input, output and related controls.

allocated a lead analyst to each of the larger banks

The Department’s Analysis Division and the risk specialists will henceforth continue to work together in a similar way on a matrix basis.

Consultative and participative approach

The implementation process constituted a participative consultative process which involved the immediate stakeholders, namely the banks, the National Treasury, the Bank, external auditors of banks, The Banking Association South Africa and the Department.

involved the immediate stakeholders

extensive consultation

From the outset there was extensive consultation with all stakeholders to gain insight into their views on Basel II and to develop a consensus on the objectives of, and processes for, the implementation of Basel II.

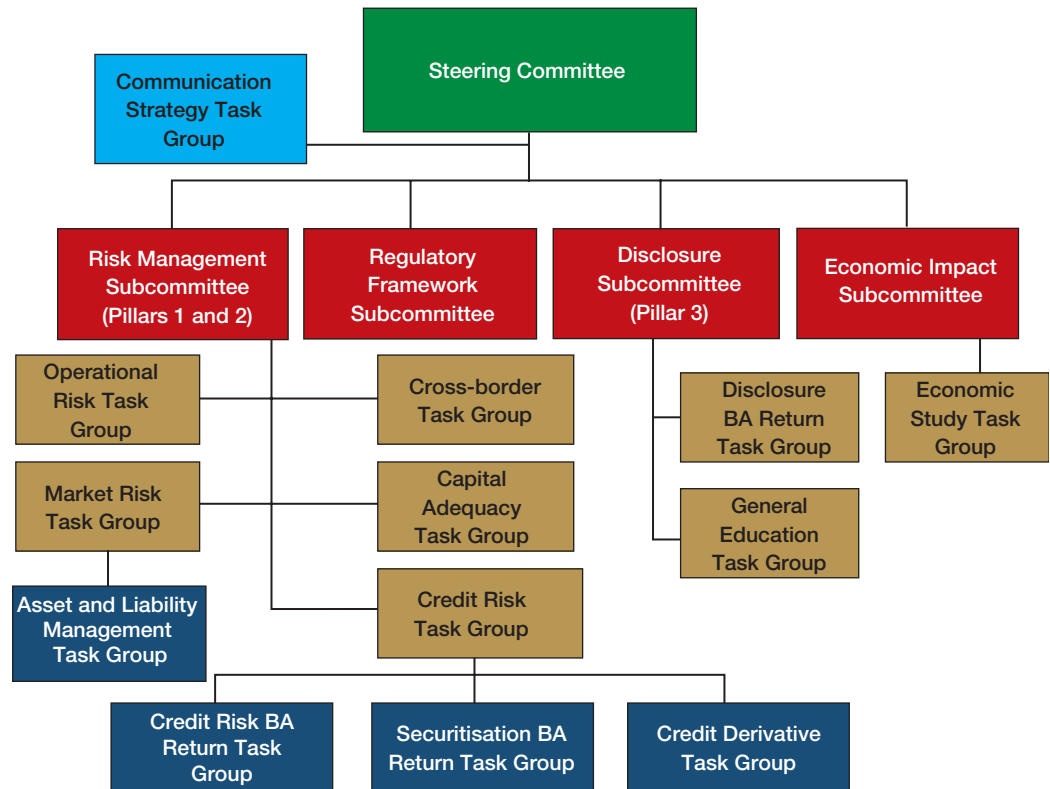
The Department's official communiqués relating to Basel II were by way of Banks Act circulars and included the following:

- Banks Act Circular 4/2001 in which banks were requested to comment on the initial pronouncements of the Basel Committee relating to the Basel II Framework.
- Banks Act Circular 14/2003 communicated the Department's initial thoughts on the implementation of Basel II to banks. Feedback was also requested on banks' and banking groups' intended approaches in order for the Department to formulate its strategy around Basel II.
- The first consultative paper was communicated to banks in Banks Act Circular 1/2004.
- The implementation date in South Africa for all approaches under Basel II was confirmed as 1 January 2008, in Banks Act Circular 20/2004, dated 14 December 2004.

established the Accord Implementation Forum

During 2003 the Department established the Accord Implementation Forum (AIF) – a joint public- and private-sector forum – to assist in driving the Basel II implementation process. The AIF's mandate was to promote, co-ordinate and drive initiatives for the implementation of Basel II in South Africa. The AIF, through its Steering Committee, was chaired by the Registrar of Banks and the Secretariat was provided by The Banking Association South Africa.

Figure 3 Accord Implementation Forum Steering Committee



As outlined in Figure 3, the AIF consisted of the following subcommittees:

AIF subcommittees

- Steering Committee – responsible for the overall implementation of Basel II
- Risk Management Subcommittee – responsible for the Pillar 1 and Pillar 2 dimensions of Basel II
- Regulatory Framework Subcommittee – responsible for converting Basel II into the appropriate South African compatible regulatory framework
- Disclosure Subcommittee – responsible for the Pillar 3 dimension of Basel II, including the education requirements around Basel II
- Economic Impact Subcommittee – responsible for addressing the economic implications for South Africa of implementing Basel II.

The Registrar of Banks was the Chairperson of the AIF Steering Committee, which met quarterly. As Chairperson, he had veto rights over any final decision. The deputy heads of the Department, as well as the Basel II project leader also attended Steering Committee meetings. South Africa's largest banks were represented by their chief financial officers or chief risk officers and heads of the Basel II project. The Chairperson of the Banking Project Group of the South African Institute of Chartered Accountants also attended these meetings, as did the National Treasury. As and when required, task groups were established to address relevant aspects of Basel II.

AIF Steering Committee

The AIF forums held more than 250 meetings of the different subcommittees and task groups, and generated over 250 working documents, which constituted important input into the drafting of the amendments to the regulatory framework.

The Department also worked with, or followed closely the work done by, international regulatory bodies and standard setters, such as the Basel Committee and the Committee of European Banking Supervisors (CEBS). Furthermore, the Department was represented on various subcommittees of the Accord Implementation Group (AIG), a subcommittee of the Basel Committee, which focuses on Basel II implementation.

international regulatory bodies and standard setters

Gap analysis and readiness assessment, and implementation plans

As regards the goal of each bank implementing Basel II, banks were requested to perform a high-level gap analysis and readiness assessment to facilitate planning, identification of key deliverables, deadlines and the responsible person(s). The gap analysis and readiness assessment were based on a high-level top-down perspective and were initiated through Banks Act Circular 15/2004.

gap analysis and readiness assessment

To ensure comparability between, and to draw conclusions from, the outcomes of the self-assessments by banks and banking groups, a standardised set of templates was issued for use in performing the gap analysis and readiness assessment. The Department reviewed the gap analysis and readiness assessments submitted by banks, following which the Department compiled a report on the process that was shared with the banking sector.

Subsequently, during the latter half of 2005, all banks were requested to submit their implementation plans to the Department for scrutiny.

Economic impact study

To assess the potential economic impact of the implementation of Basel II, South Africa's National Treasury commissioned an independent economic impact study focusing on the expected changes in capital levels in the South African banking system and any resulting change in bank behaviour that could have a knock-on effect on the macroeconomy.

National Treasury commissioned independent economic impact study

Basel II would have a largely neutral impact

The study suggested that, in aggregate, the introduction of Basel II would have a largely neutral impact on the minimum regulatory capital that South African banks would be required to hold once active capital management is taken into account, although results may vary between banks. Consequently, while pricing was not driven only by capital requirements, the study found that pricing was unlikely to be affected by the change in the capital regime and thus the National Treasury expected the direct short-term macroeconomic impact of Basel II to be limited, while the indirect longer-term impact in terms of improved capital allocation, risk management and international competitiveness should be positive for the economy.

no adverse impact on access to finance and black economic empowerment

In addition, the National Treasury did not expect Basel II to impact adversely on access to finance and black economic empowerment (BEE) objectives, as banks are subject to clear commitments in terms of the Financial Sector Charter (the Charter). As part of the qualitative assessment, banks indicated that they entered into commitments in terms of the Charter and BEE financing with full knowledge of the imminent introduction of Basel II. Furthermore, it is expected that the introduction of Basel II would have a positive impact on access to finance by small and medium enterprises (SMEs), as regulatory capital requirements for lending to SMEs are expected to decrease under Basel II.

Lastly, the National Treasury anticipated that the risk of any short-term disruptive impact on bank behaviour or macroeconomic impact is mitigated by specific transition arrangements that allow for the smooth adjustment of regulatory capital over time.

Quantitative impact studies, field tests and parallel runs

purposes of quantitative impact studies

The Basel Committee designed, developed and distributed quantitative impact studies, *inter alia*, for the following purposes:

- The Basel Committee considered it imperative that the provisions of the proposed new capital framework be assessed and analysed prior to its finalisation and implementation, to ensure a proper understanding of its impact on both a bank's capital position and the drivers of a bank's capital calculation
- The Basel Committee also wished to avoid a situation where the implementation of Basel II caused a bank to raise capital at short notice.

The Department and certain banks combined to take part in three of the Basel Committee's initiated quantitative impact studies, namely QIS 3, QIS 4 and QIS 5. QIS 5 was the most recent impact study and, subsequently, was the only one based on the latest version of the Basel II framework, which captured trading book amendments and double-default effects.

Moreover, following QIS 5 during 2007, the Department requested locally incorporated banking groups targeting the advanced approaches for credit and/or operational risk to participate in QIS 5.5 (a follow-up to QIS 5, discussed in the Department's 2006 *Annual Report*). The Department also requested banks to complete a data quality questionnaire.

QIS 5.5 objectives

The objectives of QIS 5.5 included

- obtaining relevant information pertaining to the impact of implementing Basel II, in particular the impact on a banking group rather than the narrower bank legal entity reported in QIS 5.
- assessing the state of preparedness for Basel II implementation.
- testing and further developing guidance on relevant issues pertaining to Basel II. During QIS 5.5 key policy decisions and national discretion items, such as the

treatment of minority interests, excess capital from insurance entities and sovereign risk weightings, were tested.

- discussing the identification and implications of the status of an 'equivalent regulator' with the various banking groups.

Results

Based on the QIS 5.5 information received for the banking groups, the Department determined that the

increase in minimum required capital

- minimum required capital (MRC) in terms of Basel II, when compared with the MRC in terms of Basel I, would increase
 - by approximately 12 per cent for bank legal entities targeting the advanced approaches for credit and/or operational risk (around 1 per cent less than for QIS 5)
 - by approximately 13 per cent for banking groups targeting the advanced approaches for credit and/or operational risk; and
- updated QIS 5 and QIS 5.5 information reflected a marked improvement in the quality of the data, as reflected in the narrowing of dispersions and reduction of variances.

The above-mentioned increases in MRC refer to a monetary value and not the capital-adequacy ratio. The Department remains confident that the banking system is well capitalised.

Field tests

Banks that targeted the advanced approaches and participated in QIS 5 were requested to conduct informal field tests in respect of the proposed statutory returns and directives relating to credit risk (BA 200 series) as contained in draft 3 of the proposed amended Regulations, and financial information (BA 100 series), based on working documents of the Disclosure BA Returns Task Group.

banks requested to perform field tests

In addition, the remaining banks that targeted the base approaches for credit and operational risk were required to perform two formal field tests of selected proposed statutory returns. The purpose of the field test was to

- assist the Department in assessing the level of preparedness of banks and banking groups for the implementation of Basel II;
- ensure that the objectives in terms of the proposed amended Regulations could be met; and
- ensure that the proposed amended statutory returns would facilitate, and be effective and efficient for the implementation of Basel II.

The first formal field test was conducted from 15 September 2006 to 15 November 2006. Banks' submissions for the second formal field test were required to reach the Department by 30 April 2007.

Parallel runs

In terms of Banks Act Circular 5/2007, all banks were required to participate in the parallel-run process during the fourth quarter of 2007, by submitting, in accordance with the prescribed schedules, both the existing (Basel I-based) statutory returns and the proposed (Basel II-based) statutory returns. The submitted returns were assessed and analysed, and discrepancies and substantial variances in the capital calculations were followed up with banks.

parallel-run process during the fourth quarter of 2007

Consolidated supervision

Basel II requires consolidated supervision

Basel II requires that supervisors undertake consolidated supervision. In South Africa, the supervision of a banking group on a consolidated basis

- aims to capture all material risks to which the banking group may be exposed, and to preserve the integrity of the banking group's capital and reserve funds, *inter alia*, by eliminating any double or multiple gearing of capital and reserve funds;
- includes the accounting consolidation or sub-consolidation of financial information by a bank or controlling company;
- is an overall evaluation, both quantitative and qualitative, of the risks incurred by, and the strength of, a group to which a bank belongs, primarily to assess the potential impact of other group financial entities on the bank;
- means the supervision of a bank as part of a group of entities to which the bank belongs and therefore, as a minimum, includes all financial entities and all financial activities within the banking group (without the Department being responsible for the supervision of any non-bank entity), which entities or activities include
 - all banks in the banking group concerned
 - all related regulated or unregulated financial entities or financial activities conducted by such banks or any relevant subsidiary
 - all joint ventures or associates
 - the controlling company of such banks
 - all related regulated or unregulated financial entities or financial activities conducted by such controlling company or any relevant subsidiary
 - any other entity that may be specified; and
- serves as a complement to, instead of a substitute for, the solo supervision of a bank.

Home and host supervisor co-ordination and co-operation

co-operation with other regulators

Effective implementation of Basel II also requires co-operation with other regulators to ensure effective supervision of banking groups operating across borders. The Department's powers to share information with other supervisors are prescribed by section 89 of the Banks Act, 1990. The Department is fully committed to sharing information with other supervisors to facilitate the optimal effectiveness and efficiency of the supervisory process for all concerned.

In respect of home-host supervisory co-ordination and co-operation, the Department

MoUs

- is party to a number of memorandums of understanding (MoUs) with counterpart bank supervisory authorities in other relevant jurisdictions (see Appendix 10);
- facilitates access by home-country supervisors to local offices and subsidiaries of banks or banking groups domiciled in foreign countries, for appropriate supervisory purposes;
- subscribes to the Basel Committee's standards on home- and host-country co-operation, including standard procedures for cross-border inspections outlined in Annex A of the October 1996 report by a working group comprising members of the Basel Committee and the OGBS;
- is committed to adhering to the provisions contained in the Basel Committee's publication titled *Home-host Information Sharing for Effective Basel II Implementation*, issued in June 2006; and
- compiled a Home-Host Relationship and Communication Procedure Draft Policy that complies with the provisions of Core Principles 24 and 25.

The Department strongly believes that close co-operation and information sharing are prerequisites for effective consolidated supervision, and welcomes any contact with host or home-country supervisors. Accordingly, the Department has participated in supervisory colleges related to Basel II implementation that were organised by other supervisory authorities, such as the Financial Services Authority of the UK, The Netherlands Bank and the Bundesanstalt für Finanzdienstleistungsaufsicht of Germany, and, in turn, the Department organised a supervisory college that was attended by representatives of a number of African supervisory authorities.

prerequisites for effective consolidated supervision

The aims of a supervisory college include increasing the efficiency of supervision, reducing regulatory effort and reducing the associated regulatory burden on banks and banking groups.

aims of a supervisory college

Legislative framework

While the focus of the Department's efforts has been the incorporation of the Basel II regime into South African legislation, several other internationally agreed principles, standards, codes or practices directly impacting on regulatory and supervisory frameworks were developed or updated by various standard-setting bodies in recent years. The aforesaid principles, standards, codes or practices include

incorporation of the Basel II regime

- the Core Principles
- internationally agreed standards, codes or practices relating to corporate governance and internal controls
- IFRS
- International Accounting Standards (IAS)
- ISA.

In order to incorporate appropriately all the relevant internationally agreed principles, standards, codes or practices directly impacting on a bank or banking group, the South African regulatory framework was divided into three tiers.

regulatory framework divided into three tiers

1. The top tier is the Banks Act, 1990, which contains the enduring principles and overarching enabling framework. It is anticipated that amendments to this tier would be few and far between. Only Parliament is empowered to amend the Banks Act.
2. The middle tier is the Regulations relating to Banks, which contain the essence and bulk of the internationally agreed stipulations, requirements and standards. The Minister of Finance is empowered in terms of section 90 of the Banks Act, 1990, to promulgate these regulations.
3. The bottom tier will comprise directives, Banks Act circulars and guidance notes, and will be used in future to deal with operational matters that may change quite frequently or require immediate attention. The Registrar of Banks is empowered in terms of the Banks Act, 1990, to issue directives, Banks Act circulars and guidance notes.

The technical Basel II prescriptions were effected to the Regulations relating to Banks, however, amendments to the Banks Act, 1990 were required to enable amendments to these regulations. Following the submission of the finalised draft Banks Amendment Bill to the Minister of Finance for parliamentary approval, the Bill was considered and approved by the Portfolio Committee on Finance in June 2007. The National Assembly approved the Bill in August 2007, and approval was obtained from the National Council of Provinces in September 2007. The Bill was promulgated into law by the President of the Republic of South Africa in November 2007, enabling the Minister of Finance to promulgate the proposed amended Regulations. The proposed amended Banks Act, 1990 will become effective on 1 January 2008.

technical Basel II prescriptions

Regulations would be revised *in toto*

The Department took the in-principle decision that the Regulations relating to Banks would be revised *in toto*, in other words, even those regulations on which Basel II did not impact would be revised and updated where necessary. This enabled the recent amendments to the Core Principles, IFRS and IAS to be incorporated into the proposed amended Regulations.

draft one released during May 2005

Draft one of the proposed amended Regulations and of the proposed amended Exemption Notice was released during May 2005, with a request for comments by 31 August 2005. During the comment period, the respective committees, subcommittees, task groups and working groups of the AIF finalised their comments in respect of the draft and developed comprehensive financial returns and risk returns, and directives for its completion, based on, *inter alia*, the requirements of Basel II, the latest IFRS and best risk management practices.

second draft released January 2006

Owing to the extent and nature of the comments and proposed returns received by the Department in response to the drafts, a second draft was issued in a modular fashion as from the end of November 2005 up to the end of January 2006, with a request for comments by 30 June 2006. In the interim, the Basel Committee released further and updated information directly impacting on matters already dealt with in the first two drafts of the proposed amended Regulations and the proposed amended Exemption Notice. Accordingly, the Department updated and reissued all relevant modules by March 2006, with a request for comments by the beginning of July 2006.

third draft released October 2006

A substantial volume of comments was received on the second draft of the proposed amended Regulations and of the proposed amended Exemption Notice. The magnitude of further comments, proposals and amendments to these regulations, financial returns and risk returns received by the Department resulted in the release of a third draft of the proposed amended Regulations and of the proposed amended Exemption Notice by way of 25 modules, the first of which was released at the beginning of September 2006 and the last at the end of October 2006, with a request for comments by the end of November 2006.

Following the release of the third draft of the proposed amended Regulations and of the proposed amended Exemption Notice, banks, banking groups, the audit profession and the various committees, subcommittees, working groups and task groups of the AIF continued their respective processes, which included

- field testing the proposed amended returns and directives;
- further researching and debating international best practices in the various fields affecting the proposed amended Regulations and the proposed amended Exemption Notice; and
- engaging with other supervisory authorities and standard-setting bodies regarding their decisions and processes for the successful implementation of Basel II in their respective jurisdictions or regions.

Based on the further comments received during November 2006, the Department hosted separate meetings with the chairpersons of the respective committees, subcommittees, working groups and task groups of the AIF at the end of November 2006, and during the beginning of December 2006 to clarify and resolve outstanding matters.

fourth draft released January 2007

On 15 January 2007, the Department released the fourth draft of the proposed amended Regulations and of the proposed amended Exemption Notice for final consideration, with a request for comments thereon by the respective committees, subcommittees, working groups and task groups of the AIF by 15 March 2007.

On 9 March 2007, the Department hosted an integration workshop to clarify certain reporting requirements and to ensure a general alignment in, and between, all relevant components of the proposed amended legislation. During March and April 2007 the Department received and processed the further substantial comments received from the AIF structures subsequent to the integration workshop and the release of the fourth draft of the proposed amended Regulations and the proposed amended Exemption Notice for final consideration and comment by the respective committees, subcommittees, working groups and task groups of the AIF. Thereafter an updated version of the fourth draft of the proposed amended Regulations and the proposed amended Exemption Notice was released for public comment at the end of April 2007. Comments were requested by 25 June 2007.

integration workshop

Following the release of the fourth draft of the proposed amended Regulations and the proposed amended Exemption Notice for public comment at the end of April 2007 and the industry training sessions held during May, June and August 2007, further matters that required clarification or directives in respect of certain items or returns were brought to the attention of the Department. The Department subsequently considered these matters and further effected final amendments to the proposed amended Regulations and the proposed amended Exemption Notice where it was deemed necessary or appropriate to do so.

On 22 August 2007, a fifth draft of the proposed amended Regulations and the proposed amended Exemption Notice was presented to the Standing Committee for its consideration and approval. The Standing Committee unanimously approved this draft of the proposed amended Regulations and the proposed amended Exemption Notice, subject only to the finalisation of a number of minor administrative issues.

fifth draft released August 2007

On 19 September 2007, the Department presented a sixth draft of the proposed amended Regulations and the proposed amended Exemption Notice to the Minister of Finance for his consideration and approval.

sixth draft released September 2007

On 13 December 2007, following clarification of certain matters, the Minister of Finance granted his approval for the publication and the subsequent implementation on 1 January 2008 of the amended Regulations relating to Banks and the amended Exemption Notice.

Minister granted approval December 2007

The transparent, participative and consultative process conducted through the AIF for purposes of incorporating Basel II into, and updating, the regulatory framework entailed holding numerous meetings of the respective committees, subcommittees, working groups and task groups of the AIF during the three-year period preceding the finalisation of the amended legislation. The contents of all the AIF working documents developed during the period were taken into account in drafting the amended Regulations and amended Exemption Notice. This process enhanced the comprehensiveness and robustness of the amendments to the regulatory framework.

Supervisory framework

As part of the Basel II implementation process, the Department revisited its supervisory framework, now formally known as the 'SREP', and modifications were effected to the Department's supervisory process (which was previously outlined in the *2004 Annual Report*), resulting in an updated SREP.

revisited supervisory framework

Modifying the SREP

As a starting point, it was recognised that Basel II is more risk-sensitive than Basel I and that risk management practices in banks have evolved considerably over recent years.

four principals contained in Pillar 2

Furthermore, it was incumbent upon the Department to adopt the four principles contained in Pillar 2 of Basel II in the SREP, which are outlined below in relation to the Department's SREP.

Bank's responsibilities

- ICAAP
- A bank should have in place a process for assessing its overall capital adequacy in relation to its risk profile and a strategy for maintaining its capital levels (Principle 1).
 - A bank should operate above the minimum regulatory capital ratios (Principle 3); referred to as the 'buffer' requirement.

The above is generally known as the 'ICAAP'.

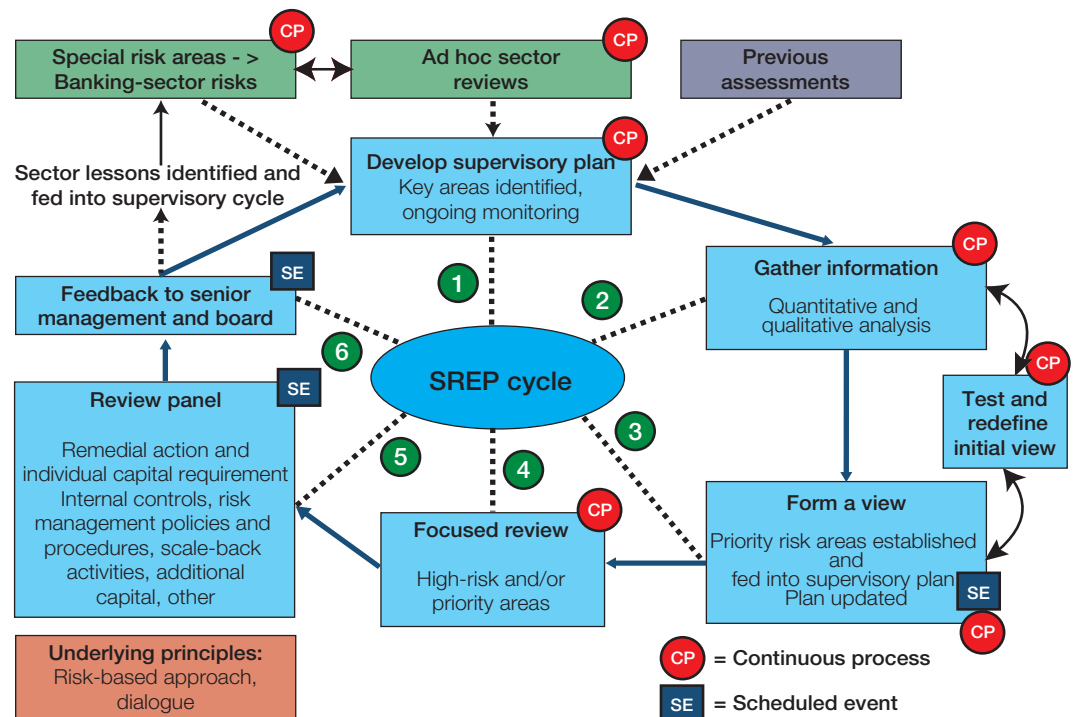
Supervisor's responsibilities

- evaluate bank's ICAAP
- A supervisor should review and evaluate a bank's ICAAP (Principle 2).
 - A supervisor should take appropriate action if not satisfied with the results of this process (Principle 2).
 - A supervisor should review and evaluate a bank's compliance with the regulatory capital ratios (Principle 2).
 - A supervisor should have the ability to require banks to hold capital in excess of the minimum (Principle 3).
 - A supervisor should seek to intervene at an early stage to prevent capital from falling below the minimum prescribed levels (Principle 4).
 - A supervisor should require rapid remedial action if capital is not maintained or restored (Principle 4).

The modified SREP process

The modified SREP process, which is to be implemented at the beginning of 2008, incorporating the above elements, is reflected in Figure 4.

Figure 4 Modified supervisory review process



The SREP cycle (the complete process that makes up the SREP) consists of various stages (Stages 1 to 6) that take place as an ongoing process with some specified scheduled events. The SREP cycle supports and enhances the Department's approach to risk-based supervision.

SREP cycle

Stage 1 – Develop supervisory plan

The process begins with the formulation by the analyst of a supervisory plan, which is captured in writing. A sound, robust and well-considered supervisory plan is a necessary prerequisite for an effective SREP.

well-considered
supervisory plan

In line with the Department's approach to risk-based supervision, the supervisory plan takes into account the systemic relevance and key risk areas identified in respect of the particular bank. In determining the systemic relevance and identification of the key risk areas, previous years' assessments are relied on. Banks are classified as high, medium or low risk and allocated to a 12-month, 18-month or 24-month supervisory cycle respectively. The supervisory plan is communicated to the bank at the start of the SREP cycle.

systemic relevance and
key risk areas identified

The main purpose of the supervisory plan is to ensure a disciplined, comprehensive and professional planning process that forms the foundation for supervisory actions, interactions and interventions.

Stage 1 is a continuous process (i.e., the supervisory plan will be updated as and when new information becomes available, and a change of the supervisory plan becomes warranted).

Stage 2 – Gather information

Throughout the SREP cycle, information is gathered by analysts and risk specialists. Information sources include the bank's annual report, financial statements, statutory supervisory returns, ongoing supervisory information collection, including, meetings between the Department and the bank's senior management and staff, and other stakeholders and market intelligence.

Stage 2 is also a continuous process.

Stage 3 – Form a view

Stage 3 entails the process in terms of which the information gathered by analysts and risk specialists in Stage 2 is assembled, analysed and synthesised in order to form a view of the bank. The focus is on materiality and risk.

information assembled,
analysed and synthesised

During this stage there are two distinct scheduled events that take place once during each SREP cycle:

1. The submission by a bank of its ICAAP report (the ICAAP report is submitted in a non-prescriptive free-format form by the bank to the Department).
2. The development of a supervisory perspective, which entails the gathering of information, the assembling of relevant information and the population of risk score sheets, and analysis of the risk review as prepared by the analyst. The score sheets, *inter alia*, cover Pillars 1 and 2 risks (e.g. risks not fully covered, risks not covered in Pillar 1 and external factors). Pillar 3 aspects are also considered.

It is envisaged that these two processes will enable a bank and the supervisory teams to compare findings, and constructively challenge one another's conclusions and recommendations. At this stage a pre-review panel meeting will take place to seek guidance on priorities, clarification of issues and further work to be done.

Stage 3 consists of both continuous processes and scheduled events.

Stage 4 – Focused review

detailed or specialist review

Depending on the outcome of Stage 3, the analysis team and the risk specialists could identify areas of a bank that may require a detailed or specialist review. This review may be carried out by the analyst, risk specialists, on-site review team, internal auditors, external auditors, external risk consultants, or other advisors (e.g. lawyers or actuaries). The resulting information gathered is incorporated into the SREP cycle and necessary consequential adjustments are effected.

Stage 4 is a continuous process.

Stage 5 – Review panel

panel review process

Stage 5 consists of the panel review process, which entails a review by the review panel (consisting of the Department's Executive Committee and risk specialists) of the procedural and substantive correctness of the SREP, as well as the conclusions reached and recommendations made during Stages 3 and 4, which form the basis for the panel review.

The review panel's recommendations may include remedial actions to be taken and adjustments to the individual capital requirement (ICR). It is important to note that the ICR should not be seen as the only tool, but that other recommendations, such as strengthening of internal controls or risk management policies and procedures, may in certain circumstances be more appropriate.

Stage 6 – Feedback to senior management and board

conclusions and recommendations

Stage 6 consists of the process in terms of which the conclusions and recommendations reached in Stage 5 are communicated to the bank's board of directors, risk committee, audit committee and senior management. Industry lessons identified are incorporated into the macro-surveillance cycle and report, and may warrant ad hoc sector reviews to be conducted.

Approval of banks' approaches to credit and operational risk

Background

In terms of Banks Act Circular 14/2003, banks were requested to indicate to the Department their anticipated intentions regarding the approaches to credit and operational risk available in terms of Basel II.

Since enabling legislation to approve these approaches was only to be effective as from 1 January 2008, banks were invited to apply for in-principle approval during 2007. These applications and any final decisions were to be converted into formal applications and responses when the legislation was enacted.

To ensure consistency in judgements on the applications received, the Department established decision-making panels consisting of members of the Department's Executive Committee and other members of senior management.

consistency in judgements

Credit risk

Following the receipt of updated information from banks on their intended Basel II approaches for purposes of determining their regulatory required minimum capital for credit risk during the course of 2006, the Department undertook on-site visits to banks intending to use the internal ratings-based (IRB) approach, which started in October 2006. The on-site verification and review work ended in May 2007.

The objective of the on-site visits was to perform verification work in establishing the nature and extent of compliance with the minimum IRB requirements and to review the model validation process in relation to certain credit models for significant portfolios.

perform verification work

In tandem with the above process, the Department developed a set of minimum requirements, issued as a working paper by the AIF, relating to an application by a bank intending to use the Basel II IRB approach for purposes of determining its required regulatory minimum capital in respect of its credit risk exposure. In terms of the working paper, banks that intended seeking approval for the use of the IRB approach as from 1 January 2008 were required to lodge their in-principle applications with the Department by the end of 2006.

All formal applications were considered individually and assessed against a clearly laid-out comprehensive set of criteria, which included the ability and capacity of the particular bank to adopt and implement the targeted approach(es) soundly, effectively and efficiently.

During the process of considering and reviewing IRB applications, technical reviews of the model build and validation process were undertaken, and the Department assessed the extent to which the bank had in place capable and independent validation teams, robust internal audits of the model validation process, and effective challenge by independent committees through the governance process, right up to the board-designated committee.

technical reviews of the model build and validation process

In addition to in-depth technical reviews of the banks' models, senior management understanding and use of the models in the banks' business were also viewed as paramount to IRB approval. To this end, the Department tested senior management and board understanding through a series of interviews with key personnel. This included business unit and risk management heads, up to the most senior executive management in banks. While different levels of understanding are required, depending on the degree of seniority, interviewees were expected to articulate their level of understanding and demonstrate it appropriately. Discussions were also held with the boards of all the banks intending to adopt the IRB approach. These discussions focused on directors' understanding of the IRB models and their perceived roles in the process. Interaction with senior management to assess their understanding will continue post implementation.

senior management and board understanding

Stress testing of the IRB output components under Pillar 1 is mandatory. Banks that adopted IRB with effect from 1 January 2008 were required to demonstrate their stress-testing methodologies ahead of IRB approval.

stress testing

IRB applications and the Department's views on them were assessed during June 2007 by the Department's internal review panel. Following these reviews, the applicant banks

concerned were informed of the in-principle decision of the review panel, which could range from approvals without conditions, conditional approval, minded to approve, to rejection.

Thereafter, over a period of four months, follow-up on-site work was undertaken to establish whether those banks that had received 'conditional approvals' or a 'minded to approve' had met the conditions to qualify for in-principle approval. The review panel reviewed the final recommendations on the applications during November 2007.

The following in-principle approvals were granted:

- One bank to use the foundation IRB approach
- Three banks to use the advanced IRB approach.

continues to monitor and assess the use of IRB models

The Department continues to monitor and assess the use of IRB models, and enhance outputs in specific areas, for example, encouraging banks to further their research on the procyclicality of IRB estimates. As regards appropriate stress testing for South African conditions, the Department organised an economic symposium in late 2007 that brought together economists and credit and risk specialists from the banks adopting the IRB approach. The objective was to promote discussion on the types of economic issues relevant to the South African environment and challenge the thinking on incorporating them into IRB model estimates and stress testing.

Focus areas for review during 2008 include ratings migration, credit risk mitigation, expected losses and provisions, database reviews and securitisation.

A separate, ongoing model monitoring programme has also been put in place that will complement an ongoing rolling self-assessment process that has been implemented.

Home-host involvement and reliance

Domestic banks

extensive information sharing

Extensive information sharing took place between the Department and sub-consolidating or other host supervisors in relation to applications to use the IRB approach before and during the review process. The Department thereafter formally informed the sub-consolidating supervisor of the decision taken on the application.

Extensive discussions were held and will continue to be held as part of the SREP cycle with the sub-consolidating supervisor or other host supervisors for domestic banks or banking groups with significant interests in entities registered, domiciled or operating in other jurisdictions. These supervisors had been, and will continue to be, invited to perform joint reviews of bank or banking groups concerned.

Specific examples in 2006/07 included joint reviews of one of South Africa's largest banks' IRB application in conjunction with the UK Financial Services Authority and the Hong Kong Monetary Authority.

College of African Banking Supervisors

In addition, in February 2007 the Department hosted the first-ever College of African Banking Supervisors to discuss ways of managing Basel II implementation in a South African bank. Even though not all the invited supervisors were intending to adopt Basel II at that stage, supervisors usefully discussed their various supervisory approaches and how home-host co-operation could be enhanced in line with the revised Core Principles. Information exchange and avoiding duplicative activities were high on the agenda and

the college set the scene for ongoing co-operation between the Department and fellow supervisors on the continent.

Foreign banks

A similar approach applies to a South African branch of a foreign bank operating in South Africa, subject to considerations of proportionality. Subject to an assessment of the nature and extent of compliance with the substance of Basel II, as well as considerations relating to reducing the regulatory burden, information may be shared among the home and host supervisors, and reliance may be placed on the home supervisor by the Department. The applicability of model assumptions, data and data history to the South African context is also taken into account.

similar approach applies

Operational risk

The Department developed the following documentation relating to the Basel II approaches available to a bank for purposes of computing its regulatory required minimum capital in respect of operational risk:

computing regulatory required minimum capital

- A self-assessment template, issued as a working paper by the AIF, to be completed by the following entities under the following circumstances:
 - a bank intending to seek formal approval to use the standardised approach (TSA) for purposes of determining its regulatory minimum capital requirement
 - a bank intending to seek formal approval to use the alternative standardised approach (ASA) for purposes of determining its regulatory minimum capital requirement
 - a foreign-controlled bank subsidiary or branch intending to seek approval to use the hybrid advanced measurement approach (hAMA) for purposes of determining its regulatory minimum capital requirement.
- A set of minimum requirements, issued by the AIF, relating to an application by a bank intending to use the Basel II advanced measurement approach (AMA) for purposes of determining its regulatory minimum capital in respect of its operational risk.

All formal applications were considered individually and assessed against a clearly laid-out comprehensive set of criteria, which included the ability and capacity of the particular bank to adopt and implement the targeted approach(es) effectively and efficiently.

Selective on-site visits were conducted at banks targeting TSA and ASA approaches. The main topics discussed were as follows:

TSA and ASA approaches

- Operational risk governance
- Gross income mapping
- Loss data collection
- Risk and control self-assessment
- Outsourcing, disaster recovery and business continuity planning
- The role of, and operational risk reviews performed by, internal audit
- Home-host issues and information sharing, where applicable.

The AMA application process was split into two stages. The first stage was the completion of the application pack by the bank. This required the bank to provide

AMA application process

- summary information on its plans for AMA implementation;
- its approach in a number of key areas such as governance;
- details on how the institution has met the AMA qualitative and quantitative requirements as contained in proposed legislation; and
- detailed information covering the specifics of the AMA model.

During Stage 2, the Department requested and analysed further detailed information on particular topics, based on Stage 1 reviews, which included on-site visits to the applicant bank.

senior management and board understanding

During the standardised and advanced approach on-site visits, the Department tested senior management and board understanding and involvement through a series of interviews with key personnel. This included business unit and risk management heads, and senior executive management in banks. Similar to the approach for credit risk, depending on the degree of seniority, banks were expected to articulate their level of understanding and to demonstrate it appropriately. Interaction with the board of directors and senior management, as appropriate, to assess their active involvement in the oversight of the operational risk management framework, will continue post implementation.

recommendations made

The applications made to, and recommendations made by, the Department were reviewed during July 2007 by a panel comprising the Department's senior management. Following the review panels, the respective applicant banks were informed of the in-principle decision made by the review panel, which could range from approvals without conditions, conditional approval, minded to approve, to rejection. At that stage one bank's application was rejected and one bank was informed that it needed to address various specific requirements before any form of approval could be considered. In-principle conditional approvals were granted to all other applicant banks.

Thereafter, over a period of three months, follow-up off-site and/or on-site work was undertaken to establish whether those banks that had received conditional approvals had met the conditions to qualify for in-principle approval. A similar process was followed for the one bank that was requested to meet specific requirements before any form of approval could be considered. Final recommendations were reviewed by the review panel during November 2007.

The following in-principle approvals were granted:

- One bank approved to use the AMA approach
- One bank approved to use the ASA
- Eleven banks approved to use TSA.

The remaining twenty banks did not lodge applications and, consequently, are by default opting to use the basic indicator approach.

Rating agencies

The amended Banks Act, 1990 will allow banks to choose between the IRB approach and the standardised approach for calculating regulatory capital requirements for credit risk.

extensive use of ratings

The standardised approach for credit risk and the treatment of securitisation exposures make extensive use of the ratings issued by external credit assessment institutions (ECAIs) (i.e., credit rating agencies) for determining the risk weights of exposures and ultimately the calculation of regulatory capital.

recognition as eligible ECAIs

In terms of section 85A of the Banks Act, 1990, credit rating agencies requiring recognition as eligible ECAIs would be required to obtain prior written approval from the Registrar of Banks. The Department will publish the criteria for recognition as eligible ECAIs on the website of the Bank, following which, ECAIs would be able to apply to the Department for such recognition.

During November 2007, after an extensive assessment process, the following ECAIs were recognised for regulatory capital purposes under the standardised approach for credit risk and the treatment of securitisation exposures:

- Fitch Ratings
- Moody's Investors Services
- Standard & Poor's Rating Services.

This list is subject to ongoing review by the Department and will be updated accordingly.

Pillar 3 – Market discipline

The purpose of Pillar 3, market discipline, is to complement the minimum capital requirements (Pillar 1), and the supervisory review and evaluation process (Pillar 2). Pillar 3 is a recognition that the market can play an important role in monitoring banks to ensure a sound and healthy banking system.

minimum capital requirements

From 1 January 2008 all banks operating in South Africa will be required to disclose to the public, on a regular basis, but not less frequently than once a year, specified qualitative information in respect of banks' risk management objectives and policies, reporting systems and general definitions.

Banks are also required to disclose to the public specified quantitative information on a quarterly basis in respect of: their primary capital, including their primary capital-adequacy ratio; the bank's total capital, including its total capital-adequacy ratio; the components of capital; the total required amount of capital and reserve funds; and any risk exposure or other item that is subject to rapid or material change.

Bank management is responsible for determining appropriate additional mediums by means of, and locations at, which to disclose the required information to the public.

Therefore, in order for banks to comply with the substance of the law, each bank should ensure that the required disclosures reach its particular client base and that the said disclosures enable the bank's clients to be informed about the bank's exposure to risks, and provides clients with a consistent and understandable disclosure framework that enhances comparability.

Policy process and forum

The process of producing policy in the form of directives and guidance notes has been facilitated by the implementation of a framework for policy processes and the establishment of a policy committee. The Department's Policy Committee consists of the members of the Department's Executive Committee as well as a number of other staff members. The Policy Committee has a formal mandate and is tasked with addressing and dealing with all policy issues relevant to the mandate of the Department.

Policy Committee has a formal mandate

The policy process is captured in a formal document and a flow chart. This framework prescribes a formal process that includes the registration of all issues; the planning of research and development of policy recommendations; and robust debating of the motivating memoranda and related evidence, public comment.

The final policy is disseminated in one of the following formats:

- Banks Act, 1990
- Regulations relating to Banks

- Banks Act circular, directive or guidance note
- Letter to the bank(s) or banking group(s)
- Training, where appropriate, for the market.

At present, the primary focus of the Policy Committee is on Basel II and, more specifically, on the development of guidance notes and directives related thereto.

Policy decision on minimum required regulatory capital requirement

Several years ago the South African minimum regulatory-required capital ratio, in relation to risk-weighted assets, was increased from the 8 per cent level, as specified in Basel I, to a level of 10 per cent, to ensure robust capital levels appropriate for banks operating in the South African environment.

An intense process was undertaken to consider whether a similar approach of increasing the minimum required capital would be appropriate under Basel II and, if so, what the quantum or ratio of the increase should be.

Pillar 2 requirements split

The ultimate outcome of the deliberations and interactions, which included the professional input from an international rating agency, was that the Basel II Pillar 2 requirement would be split into two distinct and separate components, namely a

1. Pillar 2a requirement, which seeks to cater for systemic risk; and
2. Pillar 2b requirement, which seeks to cater for idiosyncratic risk.

Pillar 2a

systemic risk

The identification, assessment, control and mitigation of, and reporting on, systemic risk are central to effective and efficient bank supervision. It is the responsibility of the Department to identify issues of a systemic risk nature and to act upon such systemic risks in a prudent and responsible manner.

After significant debate, the Department decided that Pillar 2a should be set at 1,5 per cent for systemic risk. That is, in addition to the 8 per cent under Pillar 1, an additional 1,5 per cent capital requirement would be imposed on all banks. In reaching this decision, cognisance was taken, *inter alia*, of the following:

South African banking system's specific economic and industry risk

- Basel II is highly formula-driven, so the relevance of the assumptions underlying the formulae should be carefully considered in relation to the South African economy.
- The South African banking system's specific economic and industry risk may not be captured in its entirety by the Basel II Pillar 1 requirements.
- The Basel II formula was calibrated in the context of large mature economies, and the correlation and volatility assumptions embedded in that formula may not capture sufficiently the specificities of the South African operating environment in a crisis scenario. (The Basel Committee, in its publication titled *An Explanatory Note on the Basel II IRB Risk Weight Functions*, dated July 2005, states that the degree of the obligor's exposure to a single systemic risk factor, which may be interpreted as reflecting the state of the global economy, is expressed by the asset correlation R).
- Operational risk is generally considered to be higher in South Africa (even though it might be argued that high credit spreads compensate for the increased risk in the regulatory capital requirement calculation).
- Structural issues in South Africa (such as low savings ratios and concentration on short-term (less than 32 days) deposits) exacerbate liquidity risk concerns relating to banks.

- Single-name and sector concentration is higher in South Africa than in mature economies.
- The 1,06 scaling factor for credit risk-weighted assets has been maintained by the Basel Committee as communicated in its press release dated 24 May 2006.

The above should not be regarded as an all-inclusive list of the systemic risk factors present in the South African economy, but rather as a demonstration of the types of issues considered in setting the Pillar 2a requirement.

The Department believes that the Pillar 2a systemic risk requirement of 1,5 per cent is appropriate in the South African context in terms of ensuring the soundness of the banking system.

Pillar 2b

Broadly speaking, the Pillar 2b idiosyncratic risk requirement will be based on the outcome of the Department's SREP in relation to each bank or banking group, which will include an assessment of that bank's or banking group's ICAAP. The SREP will include extensive and ample dialogue between the bank or banking group and the Department, and between host and home supervisors.

idiosyncratic risk

The aim of the Pillar 2b idiosyncratic risk requirement is to cater for bank- or banking group-specific exposures and factors, thereby contributing to the overarching aim of ensuring that a bank or banking group is adequately capitalised.

Capital should not be regarded as the ultimate, only or final outcome of the SREP. The SREP will, and should, include extensive dialogue between the bank or banking group and the Department, as well as between the home and host supervisors. Furthermore, supervisors have access to an assortment of supervisory tools, such as the power to require the strengthening of internal controls, risk management policies, and governance processes and procedures, to achieve their supervisory goals.

The setting of the Pillar 2b requirement will be a culmination of the aforementioned process. The Department will endeavour to avoid the duplication of capital requirements in respect of particular risk exposures.

Human resources and training

Context

The Department regards the concept of effective challenge as fundamental and indispensable to its approach to supervision. The Department would only be in a position to add value to the banking system if it is able to challenge effectively a bank or banking group on all material dimensions of its corporate governance, including risk management, capital management, internal controls, and such other checks and balances as may be required to lead, manage and conduct the business of a bank or banking group in a prudent and sound manner. Effective challenge is exercised both while conducting on-site visits and as part of the analysis and assessment of the statutory returns and other information received from banks. The SREP constitutes the formalised framework within which this effective challenge takes place.

effective challenge

For the Department to challenge banks, and thus duly to discharge its duties and responsibilities effectively, it is essential that it has the necessary ability and capacity, in terms of resources and knowledge, skills and experience.

ability and capacity

Training of departmental personnel

higher demands on human resources

The main implication for the Department arising from Basel II implementation was the higher demands on human resources and the demand for human resources with different skills, especially quantitative skills.

To date, much attention has been given to up-skilling and right-skilling the Department's professional staff, in anticipation of the implementation of Basel II; a process that will continue going forward.

significant training undertaken

Significant training was undertaken at both a theoretical and practical level. The former was provided by the Department's staff, external trainers and web-based training programmes, covering both the theory of Basel II and training on the new statutory returns and processes that the Department is implementing.

On the practical side, there was significant focus on case studies and on-the-job training as more experienced staff members devoted time to mentoring colleagues through processes such as assessing applications. The training made available included the following:

- presentations on the theory underlying Basel II
- working through examples and case studies
- involvement in assessing a bank's
 - gap analysis and readiness assessment
 - implementation plan
 - QIS submissions
 - parallel-run submissions.

The theoretical and practical training covered all risk areas – credit risk, market risk, operational risk and capital management – with all staff having to attend several days' training on supervisory returns related to these risk areas, while more intensive training was made available on a selective basis. In addition, significant efforts were made in 2007 to ensure that all staff concerned had appropriate skills to undertake Pillar 2 SREPs in line with the Department's revised supervisory cycle.

Industry training

With the finalisation of the fourth draft of the proposed amended Regulations and the proposed amended Exemption Notice during the first quarter of 2007, it became apparent that all material matters affecting the proposed amended legislation had either been resolved or were at an advanced stage of being resolved.

On 2 April 2007 the Department issued Banks Act Circular 2 of 2007, informing all key stakeholders that the Department recognised the need for training, particularly within the banking industry, given the significant amendments to the legal framework, and their scope and complexity.

three industry training sessions of three days each

In conjunction with the AIF, the Department hosted three industry training sessions of three days each; during May, June and August 2007 respectively. Sessions were led by members of the Department and a wide variety of industry specialists.

The purpose of the training was to

- provide attendees with a comprehensive overview of the proposed amendments to the Banks Act, 1990 and the proposed amended Regulations;
- bring to the attention of the attendees the most important principles or approaches followed by the respective structures of the AIF during the process of formulating the

proposed amendments to the Banks Act, 1990 and the proposed amended Regulations;

- highlight some of the major issues that were debated by the respective structures of the AIF during the process of formulating the proposed amendments to the Banks Act, 1990 and the proposed amended Regulations;
- highlight the scope of the proposed amendments to the Banks Act, 1990 and the proposed amended Regulations, and their impact on specific entities within banking groups or on key role players, such as the board of directors, senior management, independent risk control functions, compliance functions, internal audit and external audit; and
- highlight some of the most important reporting requirements or directives for the completion of the financial, risk or related statutory returns.

The three industry training sessions of three days each were attended by more than 850 attendees from the banking sector, the audit profession and other spheres of business, and the majority of the Department's staff.

more than 850 attendees

Information technology

During 2007 the Department upgraded its information technology (IT) database to accommodate the submission of the proposed Basel II regulatory returns. The implementation of the database caters for the additional requirements of the Basel II risk management returns, particularly the storage and processing of greater volumes of data.

upgraded its information technology database

The database was implemented in the first half of 2007 and the new BA risk returns, together with the validation and editing rules, were developed and implemented in the third quarter of 2007.

During the quarter ended 31 December 2007 a parallel-run exercise was undertaken, which entailed banks submitting the new BA returns (based on Basel II) and the existing DI returns (based on Basel I). In general, the parallel-run exercise served its purpose.

Business continuity and disaster recovery

During 2006, a disaster recovery site (DRS) was commissioned for the Bank. In 2007 the Department's IT systems were set up at the site. All the Department's systems are mirrored on the site, that is, in the event of a disaster it would be possible to continue with the Department's operations at the DRS with minimal loss of capacity or functionality.

minimal loss of capacity or functionality

Four tests were performed to assess the adequacy of the site during 2007, which consisted of three scheduled tests and one unscheduled or surprise test. All the tests were generally successful. However, the Bank has identified areas for improvement relating mainly to additional software that is required to be installed and tested during 2008.

Role of board of directors – meetings with boards

The implementation of Basel II within a bank or banking group is the responsibility of the board of directors of that bank or banking controlling company. At the meetings with the boards of directors of banks during the year under review, the Department discussed each board's involvement in the implementation of Basel II.

responsibility of board of directors

To facilitate the discussions, each board chairperson was required to make a presentation on the involvement of the board and its subcommittees in the following areas:

- Processes and programmes followed by the board to familiarise itself with Basel II and its implications and impact, and to apprise itself of the broader issues pertaining to Basel II
- Critical interventions and decisions by the board on the Basel II implementation process
- Progress made with the implementation of Basel II, including, but not limited to, critical areas identified that require further action.

Conclusion

An article written by the Chairperson of the Basel Committee and President of the Netherlands Bank, Dr Nout Wellink, first published in the *Financial Times* on 9 April 2008, appropriately encapsulates Basel II and its appropriateness for modern financial markets:

The current financial market turmoil underscores the importance of strongly capitalised banking systems. It also highlights the shortcomings of the Basel I capital regime, which has been in place since 1988 and has contributed in the past few years to the concentration of risk in the banking sector.

There is a strong consensus that the implementation of Basel II will put capital regulation on a sounder footing. Among other things, Basel II will enhance capital regulation, supervision, risk management and market transparency. All exposures, whether on or off the balance sheet, will be subject to regulatory capital charges. There will be greater differentiation in the capital requirements for high- and low-risk exposures. Basel II will create more neutral incentives between retaining exposures on the balance sheet and distributing them to investors through securitisations. It will introduce more robust capital requirements for banks' rapidly growing trading and derivatives activities. Supervisors will be given the tools to help strengthen banks' risk management and governance. Better disclosure of banks' risk profiles, including structured credit and securitisation activities, will be required.

These enhancements are achieved by reinforcing the basic building blocks of sound credit risk management practices, subject to rigorous internal controls and supervisory standards. The framework is therefore more adaptable to rapid innovation in financial markets and products. Moreover, the three pillars of Basel II (minimum capital, risk management and supervisory scrutiny, and market transparency) provide multiple perspectives on banks' risk profiles and capital cushions.

Recently this page has featured the arguments of a number of Basel II critics, primarily from the academic community. First, it has been argued that Basel II adopts the models that failed to perform in the recent turmoil. As a result, it is argued, the framework does not place constraints on bank risk-taking. This claim is based on a misunderstanding of what constitutes a model. Basel II does not allow banks to use the credit pricing models that failed to perform. Nor does it permit the modelling of correlations, which broke down under stress. Instead, the framework requires banks to develop robust data series on defaults, losses and recoveries that include an economic downturn. These data inputs are filtered through a prudential capital framework specified by supervisors. This will induce an important upgrade in banks' risk management systems that, had these enhancements been achieved before the crisis, would have helped put banks on to a sounder footing.

Second, it has been argued that Basel II is too procyclical, amplifying financial crises. However, it is not possible to have greater risk differentiation – a main objective of strengthening capital regulation – without some fluctuation in minimum capital requirements

as credit quality deteriorates. The Basel Committee has worked hard to introduce many safeguards across the three pillars of the framework to achieve a reasonable balance between risk sensitivity at banks and the stability of industry capital over the cycle. This includes the requirement that banks perform stress tests and demonstrate that they hold adequate cushions above the minimum during good economic conditions, in order to weather such stress.

The Basel II framework will change bank incentives and require them to develop more forward-looking approaches to assessing, managing and holding adequate capital for risks. Supervisors will have stronger tools to intervene early before capital minimums have been breached.

The Basel Committee has put into place a rigorous data collection framework to track the impact of Basel II across member countries. Where the framework proves to be too cyclical, the committee will take the necessary steps to achieve a better balance. But, whatever is done, we need to retain the benefits of risk differentiation across banks and over time to highlight supervisory attention on those banks that take on excessive risk for a given unit of capital.

There are no quick-fix, simple measures or ratios that will achieve our objective of a robust capital regime. Basel II is being implemented only now in most countries, but the market turmoil has already provided some important lessons that will help guide the Basel Committee in further strengthening the framework. Overall, it is the best practical approach we have that balances a range of objectives and trade-offs. I believe Basel II provides regulators with a better tool to ensure that capital cushions reflect banks' changing risk profiles in an environment of rapid financial market innovation.

While strong capital is a necessary condition for a stable banking and financial system, it is not sufficient. Sound, company-wide risk management, including prudent underwriting, strong supervision and robust liquidity cushions, is also a critical element. The committee's work agenda seeks to strengthen practice in these areas. It has been devoting particular attention to strengthening global standards for the management and supervision of liquidity risk, which it will issue for public comment in the coming months.

Application in terms of section 37 of the Banks Act, 1990 for the acquisition of shares in Standard Bank Group Limited (SBG), a bank controlling company

In 2005, South African regulatory approval was granted in terms of section 37 of the Banks Act, 1990 for the acquisition of a majority shareholding in Absa Group Limited (Absa), a bank controlling company, by Barclays Bank plc (UK) (Barclays). Barclays acquired 50,1 per cent of Absa shares for a total consideration of R33 billion.

Over the years, the international participation in the local banking industry has continued to increase, from 3,0 per cent at the end of December 1994 to 8,2 per cent by the end of December 2004 to 29,47 per cent at the end of December 2007. The increase since 2004 is the result of the Absa/Barclays transaction and the acquisition of a stake in the SBG by Industrial and Commercial Bank of China (ICBC) in 2007.

acquisition of a stake in the SBG

On 24 October 2007, South African regulatory approval was granted to ICBC, in terms of which ICBC could acquire up to 20,5 per cent equity in the SBG, a bank controlling company. The acquisition of the minority interest by ICBC resulted in R36,7 billion (approximately US\$5,5 billion) equity investment into the SBG. The transaction is the second international material investment in one of the largest banks in South Africa.

Background

The SBG is one of the largest banking groups in South Africa, with total assets of over R1,191 billion (approximately US\$175 billion) of which R659,1 billion was in South Africa as at 31 December 2007. The SBG has operations in 18 African countries and 20 countries outside Africa, has more than 950 branches, and employs more than 46 000 people.

ICBC is the People's Republic of China's largest bank, with 17,1 per cent market share in Chinese banking assets and one of the world's largest banks in terms of market capitalisation of approximately US\$319 billion at 22 October 2007. ICBC was listed in the largest initial public offering in history in October 2006, raising US\$21,9 billion in new equity. It is listed on the Hong Kong and Shanghai stock exchanges, has over 16 000 branches in China, nearly 100 branches elsewhere in the world, and 2,5 million corporate and 180 million personal bank customers. ICBC has branches in Hong Kong, Singapore, Tokyo, Kuala Lumpur, Seoul, Frankfurt, Luxembourg and London, and representative offices in New York, Moscow and Sydney. The US\$5,5 billion transaction with the SBG represents ICBC's largest investment outside China.

ICBC applied to the Department for approval in terms of section 37(2)(a)(i) of the Banks Act, 1990, to acquire more than 15 per cent, but not exceeding 24 per cent, of the issued shares of the SBG.

Approval in terms of section 37 of the Banks Act, 1990 requires the consent of the Registrar of Banks. Such consent shall not be granted unless the Registrar is satisfied that the proposed acquisition will not be contrary to the public interest, and the interest of the depositors of the bank and bank controlling company concerned.

Ownership

shareholder of reference

Prior to this transaction, the shareholder base of the SBG had been relatively widely dispersed. This transaction provided the SBG with a shareholder of reference. The foreign ownership in the SBG has increased from approximately 25 per cent to 40 per cent and the SBG will therefore still be majority-owned by South Africans. ICBC has committed itself to the broad-based economic empowerment targets set for the SBG in terms of the Financial Sector Charter.

Implications for the South African economy

ICBC's investment will result in an inflow of approximately US\$5,5 billion of foreign direct investment into South Africa, the largest inflow of direct investment capital since the second quarter of 2001.

This transaction confirms that South Africa is viewed as an attractive market for investment, and signals a vote of confidence in the soundness of South Africa's macroeconomic policy and its financial markets. Furthermore, this transaction will raise the profile of South Africa's capital markets as an investment location, particularly for the Asian market.

Benefits for Africa

strategic partnership

China and South Africa established a strategic partnership in 2004 and further cemented relationships at the African-Asian summit in Beijing in 2006. As trade and investment flows continue to develop between China, South Africa and other areas of

Africa, so too has the bilateral nature of such trade dramatically increased. ICBC's strategic alliance with the SBG will place both institutions in a position to capture the growth opportunities on the African continent.

strategic partnership

Implications for the South African banking industry

The magnitude of the investment is a strong endorsement of strength and profitability of the South African banks and of the quality of regulation of the South African banking industry. The inflow of capital will increase the tier one capital base of the SBG, which will further improve the banking sector's quality of capital. Banks that are adequately capitalised and well managed are essential for a healthy financial system.

inflow of capital

Conditions of approval

The transaction was subject to the approval of the Registrar of Banks, the China Banking Regulatory Commission, the JSE Limited (JSE), the Competition Commission, and the SBG and ICBC shareholders. All regulatory approvals were obtained, and the shareholders of the SBG and ICBC gave their support for the transaction.

The Registrar consented to the transaction subject to a number of conditions, among which is that the shareholding shall not exceed 20,5 per cent of the total nominal value of all issued shares of the SBG without the prior approval of the SBG Board of Directors and thereafter, consultation with the Registrar. The purpose of these conditions was to ensure ongoing maintenance of the soundness of the South African financial system and the prevailing policy objectives. ICBC accepted these conditions unequivocally.

Accordingly, after due consideration, regulatory approval for the acquisition by ICBC of more than 15 per cent, but not exceeding 24 per cent, of the shares in the SBG was granted by the Registrar in terms of section 37(2)(a)(i) of the Banks Act, 1990.

The future

The approval of this transaction and the conditions imposed on the SBG-ICBC transaction by the Registrar of Banks are specific to this transaction. Any future application by an international institution to acquire a majority shareholding in a major domestic bank would be considered on its own merits, taking into account the circumstances prevailing at that time.

Illegal deposit-taking

The Department is responsible for the administration of the Banks Act, 1990, in terms of which the Registrar of Banks is tasked with, *inter alia*, controlling certain activities of unregistered persons. During the year under review the Department received a number of complaints, with supporting documentary evidence, pertaining to certain business activities conducted by a number of institutions, which indicated that these institutions were accepting deposits from the general public as a regular feature of their business. The acceptance of deposits from members of the public as a regular feature of business is tantamount to conducting "the business of the bank", as defined in section 1 of the Banks Act, 1990. In terms of this Act, it is an offence for any person to conduct the business of a bank unless such person is a public company and is registered as a bank in terms of the Act.

activities of unregistered persons

As the institutions in question were not registered as banks or mutual banks in terms of the Banks Act, 1990 or Mutual Banks Act, 1993 (Act No. 124 of 1993), they were found to be taking deposits from the general public in contravention of section 11 of the Banks Act, 1990. Forensic auditors from a number of auditing firms were appointed as temporary inspectors to investigate such institutions and to provide the Department with reports on the activities of these institutions.

In general, when inspectors conclude that the activities of a certain institution are in contravention of the Banks Act, 1990, the inspectors are appointed as managers in terms of this Act. The purpose of the appointment is to take control of the funds that were illegally taken and liquidate any assets acquired by such institution in order to repay the depositors or investors all or part of their investments.

In cases where the institutions are liquidated prior to such an appointment and liquidators have been appointed to deal with the estate of the institution in respect of the Insolvency Act, 1936 (Act No. 24 of 1936), managers are not appointed. In such cases, the Insolvency Act takes precedence over the Banks Act and, hence, the managers are unable to conclude their mandate legally and the involvement of the Department in the repayment process is thereby ended.

Department reacts to complaints

The Department reacts to complaints from members of the public regarding the existence of suspected illegal deposit-taking schemes. However, by the time the Department receives a complaint and inspectors are appointed, the suspected illegal deposit-taking scheme has been in operation for some time and the perpetrators of such schemes have taken a sizeable amount of money from the public and have usually misappropriated such funds. It would appear that the investing public complains about such schemes only at the stage where the scheme is not able to pay them the exorbitant returns on their investments. When managers are appointed in such cases, the scheme usually has limited funds available for repayment. According to the Department's records, investors were refunded their entire capital investment in only one case. Usually, investors receive less than 50 per cent of their investment.

The activities of these unregistered persons are in direct competition with the legitimate business of registered banks. The proliferation of illegal deposit-taking schemes is not only detrimental to the banking system but also to the financial system and the South African economy in general. In some instances the funds are illegally transferred offshore in contravention of Exchange Control Regulations, 1961 (promulgated by Government Notice R1111 of 1 December 1961 and amended up to Government Notice No. R.885 in *Government Gazette* No. 20299 of 23 July 1999). Tax evasion by the operators of illegal deposit-taking schemes is also common.

inspection of 42 schemes

During the year under review, 18 new inspections, together with 24 inspections carried over from previous years, were undertaken. The inspection of these 42 schemes was delegated to 16 forensic auditing firms. Upon finalising an investigation into illegal deposit-taking schemes, the Department refers the matter to the South African Police Service (SAPS) and prosecuting authorities for further investigation into, and prosecution for, contraventions that may have been committed by the operators of these schemes, if and where appropriate.

The Department finalised five investigations during 2007. Two were reported to the SAPS Commercial Branch; two others were already under SAPS investigation; while the fifth scheme was found not to be conducting the business of a bank.

In addition to the above, the Department has enhanced its co-operation with the SAPS Commercial Branch by making staff available for training and guidance on matters pertaining to illegal deposit-taking.

Maintenance of a board directorship continuity programme

A topic selected as one of the flavour-of-the-year topics for discussion with banks at meetings with their boards of directors in 2007 dealt with the maintenance of a board of directors continuity programme. The selection of the topic was intended to enable the Department to gain insight into, and assess the following:

discussion with banks

- The robustness of the process followed by the directors' affairs committees of banks in assessing the skills, experience and other qualities of members of the board of directors to enable the effective functioning of the entire board of directors.
- The adequacy of the process followed in the selection and ongoing assessment of directors including
 - assessing whether directors possess the knowledge and skills that may reasonably be expected of directors
 - assessing whether non-executive directors have sufficient time available to carry out their duties and responsibilities to the banks properly and exercise the utmost good faith, honesty and integrity in all their dealings with, or on behalf, of the bank.
- The adequacy of the process followed in the induction of directors including
 - updating directors on the relevant laws and regulations
 - induction on their fiduciary duties and responsibilities
 - formal orientation to familiarise incoming directors with the bank's operations.
- The reasonableness of the process followed in the evaluation of directors performance covering various aspects.
- The adequacy of the process put in place to assess the following:
 - Each director's level of skill and efficiency
 - the comprehensiveness of the actions implemented to address identified shortfalls of skill and knowledge
 - monitoring and follow up on corrective actions implemented to address identified shortfalls of skills and knowledge.
- The process followed to ensure periodic replacement of non-executive directors and the adequacy of the formal succession plan for the boards and the executive.

selection and ongoing assessment

During the meetings held with the board of directors of the various banks, each chairperson gave a presentation covering the aspects listed above, leading to a discussion between the Department and the board.

The exercise proved invaluable to both the banks' board of directors and the Department. In a few instances, it became clear that an assessment of whether individual members of a board had sufficient time to prepare for meetings in order to enable them to contribute meaningfully to the deliberations at such meetings had never been made. In addition, instances where an analysis of the available information indicated that a board member did not have sufficient time to attend to the matters of the bank on account of board commitments to other institutions were referred, through the board chairperson, for review by the directors' affairs committee and subsequent report-back to the Department.

exercise proved invaluable

There have also been instances where, following the discussions that took place at the meeting with the board of directors, some directors had reconsidered their ability to discharge meaningfully their duties as directors of a bank or banking group and decided on either relinquishing some of their other board commitments or resigning from the board of the bank or banking group.

persons with a broad mix of skills

In the light of the onerous responsibilities resting on bank directors, as trustees who need to ensure that public deposits and savings are properly safeguarded, it is imperative that boards of directors of banks comprise persons with a broad mix of skills, competence, experience and available time to discharge the duty of trust imposed on them properly.

Consumer education

In 2001, the FSB – the non-bank financial services regulator – appointed the Consumer Education Review Committee (the Review Committee), to review and monitor the progress being made by the FSB to promote appropriate programmes and initiatives by the financial services industry to inform and educate users and potential users of financial services and products. The Department is represented on this committee, while other members of the committee are as follows:

- Association of Unit Trusts
- Black Brokers Forum
- Consumer Affairs Committee
- Department of Trade and Industry
- Financial Intermediaries Federation of South Africa
- Financial Services Board
- Fund Managers Association of South Africa
- Institute of Retirement Funds
- JSE
- Labour movements
- Life Offices Association
- National Consumer Forum
- South African Council of Churches
- South African Institute of Financial Markets
- South African Insurance Association
- The Banking Association South Africa.

development of a strategy document

The Review Committee was involved in the development of a strategy document that outlines the Consumer Education Initiative, the consumer education materials and the preparation for the implementation of broader sub-strategies contained in the Consumer Education Initiative.

The main objective of the initiative was to give consumers the ability and tools to make informed choices and help them minimise their exposure to costly mistakes. An informed consumer will be less exposed to fraudulent activities and the benefit of this will be a win-win situation for consumers, providers of different financial services and financial-sector regulators.

As the Department received reports of get-rich-quick and other illegal schemes, it continued to warn the public not to become involved in such schemes. The Department also contributed to a warning campaign launched in the print media and on radio by the Review Committee.

The Review Committee had previously recommended that other service providers be encouraged to participate in consumer education initiatives. The committee took a resolution to verify the type of consumer education the banks provided with a view to identifying collaborative measures that could be embarked on with the committee.

In the year under review banks, particularly in the Gauteng Province, conducted financial education drives. Some of these initiatives included information about the following:

initiatives

- *Identity theft* occurs when someone wrongfully acquires or uses another person's personal and financial data, typically for his or her own financial gain.
- *Phishing* is an impersonation of a corporation or trusted institution that aims to steal valuable information such as credit card details, user identity documents and passwords.
- *Card fraud and skimming* is the practice of extracting the information from the magnetic strip on a credit card with the intention of making a copy of the card.
- *Pharming* aims to redirect a website's traffic to another bogus website through domain spoofing to obtain confidential information such as passwords.
- *Security information management (SIM) swap fraud* occurs when fraudsters obtain and utilise the customer's replacement SIM card to acquire security messages and one-time passwords sent to the customer by the bank.
- *Cheque fraud* is the act of fraudulently obtaining and using cheques for financial gain.
- *Deposit slip scams* occur when deposit slips are used to trick people into transferring money into fraudsters' accounts.
- *Money laundering* is a process involving the concealment of the origin of funds generated by illegal means (i.e., drug trafficking, gun smuggling and corruption).
- *Nigerian scams/advanced fee fraud* occurs when perpetrators of 419 Nigerian scams operate by sending the victim an unsolicited letter, facsimile or electronic mail message containing either an illegitimate or illegal proposal.

Consumer education seems to have been instrumental in preventing some of these scams. However, several people still became victims.

Bank on-site visits

The function of the Review Team of the Department is to support the teams responsible for the supervision of assigned banks (the analysis teams) in the execution of their duties by performing on-site reviews. The Review Team is headed by a member of the senior management of the Department and reports to one of the deputy registrars.

function of the Review Team

Assignments for the Review Team are identified by the analysis teams and focus on aspects of a bank's operations about which the analysis team requires a better understanding or which may be of concern. The assignment is formulated in terms of reference, which form the basis for the review. At least one member of the analysis team usually accompanies the Review Team on the review. A review is concluded with an internal report, a feedback meeting with the bank, and formal written communication to the bank setting out the findings and recommendations.

The Review Team also participated in the assessment of banks' Basel II implementation initiatives.

Basel II implementation initiatives

During the year under review the credit-risk management process at one of the smaller banks was reviewed. The review focused on the assessment of the effectiveness of governance from board level to the level at which credit decisions were made. The policies governing the granting of loans, and the collections and writing-off processes were analysed and their practical application was reviewed. The review concluded that credit risk management was of an acceptable standard.

A joint venture finance company formed between one of the large banks and a private-sector company was reviewed to determine the effectiveness of the corporate governance structure and to assess the extent of the credit risk to which each of the joint venture partners was exposed. It was concluded that the banking partner was not exposed to credit risk above that associated with the normal course of business.

During the last quarter of 2007 the Review Team commenced with a review of the retail banking division of one of the large banks. The objective was to gain an understanding of the governance of the credit-granting process in the division and the adequacy of the policies that had been implemented. The application of the policies will be tested.

broadened scope to include operational risk

In the past the Review Team's assignments centred mostly on the governance of the credit-granting processes in banks and the quality of their lending books. With the implementation of Basel II, the team's activities will be broadened to include assisting the Department's operational risk-related reviews.

Update on the implementation of the revised Core Principles for Effective Banking Supervision

compliance improved

As reported in the 2006 *Annual Report*, the Department embarked on a project to reach an acceptable level of compliance with the revised Core Principles during 2006. The project team established for this purpose continued to monitor the Department's compliance status on a monthly basis throughout 2007. During the year under review, compliance with the Core Principles improved as the amendments to the Banks Act, 1990 and the Regulations relating to Banks progressed, and changes were made to the supervisory process to incorporate the new supervisory actions as stipulated in the Core Principles Methodology.

The Department's policies and processes have been updated, and implementation and execution of the revised supervisory processes will commence on 1 January 2008, together with Basel II implementation. Once the new supervisory process is well entrenched, the Department will be compliant with the criteria set out in the Core Principles Methodology.

Banking Code for Responsible Credit Extension

unscrupulous and unsolicited offers

An issue of concern to the Department was the seemingly unscrupulous and unsolicited offers of retail lending activities that were emerging from banks who utilised both mail and electronic (short message service (SMS)) means of communication. The Department was also receiving an increased level of complaints from members of the public concerned about aggressive and unprofessional conduct by bank personnel, which had resulted in their being harassed and inconvenienced by such bank personnel.

unveiled a code of conduct

The Department engaged with the industry in order to resolve what was clearly unacceptable conduct, not to mention inherent poor risk management practices that would evolve from such activities. The result was that in March 2007 The Banking

Association South Africa unveiled a code of conduct, agreed to by all major consumer lending banks, setting out a standard to which banks undertake to adhere with respect to lending practices.

In terms of the voluntary code the banks undertook, *inter alia*, to abide by the following principles:

principles of code

- Customer contact for credit selling purposes will only be made between 08:00 and 19:00 from Monday to Friday and from 08:30 to 13:00 on Saturday.
- The bank representative will advise a customer, at the start of a discussion, that he or she is about to offer the customer credit and ask whether the customer would like to continue with the discussion.
- The banks will only contact customers to offer credit where banks have assessed that, on the information available to them, the customer probably has the ability to repay the facility (on the basis contemplated in the NCA).
- The banks will inform such customers upon first contact that, based on the information available to them, the preliminary assessment indicated that they would probably qualify for the product that is being offered to them and that, should they accept, they would be taken through the appropriate credit vetting and FICA processes.
- Salespeople will endeavour not to contact the customer for purposes of selling the same lending product more frequently than once every two months (excluding one follow-up contact on an offer made), unless with the consent of the customer and subject to legal requirements, such as client confidentiality.
- Compliance with all relevant legislation and agreed codes of practice.

Following the signing of the code, some banks, however, continued with their forceful overselling practices and claimed that they had resorted to such practices on account of the selling practices adopted by their competitors. A matter that raised concern is the fact that, despite the chief executive officers of such banks having committed their banks to abiding by the above voluntary code, lower-level personnel in some of their line functions completely disregarded some of the principles embodied in the said code.

completely disregarded some of the principles

In an endeavour to retain public trust and respect in the banking sector, it is important that bank personnel conduct themselves in a professional and respectful manner when dealing with the public. The Department therefore wishes to urge the chief executives of all banks to ensure that high standards of moral conduct and respect are maintained by their staff at all times in dealing with the general public.

chief executives to ensure high standards

Market risk

Market risk arises from banks conducting proprietary trading or when they are exposed to markets through imperfectly hedging client transactions. In 2007, 11 banks in South Africa reported market risk under the prevailing regulations.

Three alternative reporting methods were available to banks, that is, the internal models approach (IMA), and two standardised approaches, namely the building block approach and the simplified approach. During 2007, the Department conducted renewal reviews on three banks employing the IMA. In addition, three banks applied for initial IMA approval. Apart from assessing the modelling attributes of applicant banks, the economic, organisational, technological and procedural-related elements also came under scrutiny.

three alternative reporting methods

annual review

Banks with IMA approval participate in an annual review in order to maintain the right to use the modelled method for reporting and a quarterly appraisal of their compliance with the conditions for approval. During this process, a bank's backtesting performance, available to the Department via monthly submissions, is a key indicator of the validity of its market risk models to measure the capital required to address potential losses. When backtesting data indicate that a bank's losses exceed modelled predictions above a tolerance level, the capital requirement is adjusted by means of a multiplier. Apart from examining backtesting, banks are also assessed against various qualitative factors published in the proposed amended Regulations. Several instances occurred where the multiplier was adjusted during the year under review for both backtesting and qualitative factors. One bank received a reduced multiplier, while the multiplier was increased for two other banks due to control deficiencies.

injection of capital

Continued increases in the local interest rate indices, as well as escalated activity in equities markets marked by continual record-breaking levels in the JSE all share index, coupled with a weakening in the dollar-rand exchange rate resulted in dramatic increases in volatility and the position risk of trading banks in the latter half of the year under review. The growth in risk necessitated a net injection of capital for market risk among trading banks – most banks had an increased capital requirement resulting from the volatility of their positions, while some banks reduced their positions and, consequently, their capital requirements.

Capital held for market risk made up about 4 per cent of the total capital requirement for banks during the year. Following implementation of the amended Regulations relating to Banks, the amount is expected to reduce to approximately 2,5 per cent due to the addition of operational risk to the total capital requirement, and as a result of capital held for concentration risk and counterparty risk arising from trading activities no longer regarded as being part of market risk. Under Basel II, market risk is limited to position risk, which arises from a bank's exposure to financial market movements and idiosyncratic price changes of exposure to individual companies.

As described earlier in this chapter, the Regulations relating to Banks were revised *in toto*, which included those applicable to market risk. In terms of the amended Regulations relating to Banks, five banks will report market risk according to the IMA, while the remainder will employ the standardised approaches.

Independent Regulatory Board for Auditors

As reported in the *Annual Report 2006*, the Auditing Profession Act, 2005 (Act No. 26 of 2005), was promulgated and assented to by the President of the Republic of South Africa in January 2006. In terms of this Act, the Independent Regulatory Board for Auditors (IRBA) was created.

All references in the Banks Act, 1990 to the Public Accounts' and Auditors' Act, and the Public Accountants' and Auditors' Board have been repealed and substituted with references to the Auditing Profession Act and the IRBA respectively by the proposed amended Banks Act, 1990, which will be effective from 1 January 2008.

represented on two committees

In terms of the Auditing Profession Act, the IRBA is required to establish committees to assist in the performance of its function and it may, at any time, dissolve or reconstitute any such committee. The Department is represented on two of the six permanent committees established in terms of section 20 of this Act, which are the

- Committee for Auditor Ethics established in terms of section 21(1)(b) of the Auditing Profession Act; and
- Committee for Auditing Standards established in terms of section 22(1)(h) of the Auditing Profession Act.

The National Credit Regulator

The National Credit Regulator (NCR) was established as the regulator under the National Credit Act, 2005 (Act No. 34 of 2005). The NCA was assented to by the South African President on 10 March 2006 and came into operation on 1 June 2007.

The NCR was established to promote a fair and non-discriminatory marketplace for access to consumer credit and to regulate the conduct of lenders in general. The NCR is responsible for the regulation of the South African credit industry. It is tasked with educating, researching, developing policy, registering industry participants, investigating complaints and ensuring enforcement of the NCA.

promote a fair and non-discriminatory marketplace

The NCA requires the NCR to promote the development of an accessible credit market, particularly to address the needs of historically disadvantaged persons, low-income earners and remote, isolated or low-density communities. The NCA generally applies to every credit agreement between parties dealing at arm's length and made or having an effect in South Africa.

The implementation of the NCA improved overall market conduct in terms of credit extension by credit providers. The way in which the introduction of the NCA impacted on the banking sector is difficult to determine amid the number of other local changes such as Basel II preparations and the turn in the interest-rate cycle. Banks incurred costs due to system changes, and had to adjust administrative and credit processes to accommodate the new credit extension practices.

The Department, as stipulated in the Banks Act, 1990, remains responsible for the risk management practices and prudential requirements of banks, whereas the NCR focuses on market conduct in terms of credit extension.

Chapter 3

Developments related to banking legislation

A key responsibility of the Department is to ensure that the legal framework for the regulation and supervision of banks and banking groups in South Africa remains relevant and current. Consequently, the legal framework pertaining to banking regulation has to take cognisance of local and international developments pertaining to markets and the regulatory standards applicable to them. The Department therefore has to review the banking legislation, that is, the Banks Act, 1990, the Mutual Banks Act, 1993, the Regulations relating to Banks issued in respect thereof and other pieces of related banking legislation – on an ongoing basis, and make the necessary amendments thereto.

The Banks Act, 1990

The proposed amended Banks Act, 1990 as assented to by the President of the Republic of South Africa was published as Notice No. 1080 in *Government Gazette* No. 30474 on 15 November 2007 for general information.

It is imperative that the legal framework is, *inter alia*, sufficiently robust to enable the Department to discharge properly its respective roles and responsibilities with regard to banks, controlling companies and banking groups on a solo, cross-border or consolidated basis.

amendments divided into two main themes

The proposed amended Banks Act will introduce a number of amendments to the Banks Act, 1990 which may be divided into two main themes, namely (1) those amendments that are deemed necessary to comply with the prescriptions of Basel II, and (2) those amendments that have been necessitated by changing supervisory policies, market developments and practical considerations.

prescriptions of Basel II

The amendments that are deemed necessary to comply with the prescriptions of Basel II are briefly the following:

1. *Supervisory responsibilities of the Registrar of Banks*

The proposed amended Banks Act, 1990 provides for various supervisory responsibilities contained in Basel II to be discharged by the Registrar, including

- co-operating and sharing information with other relevant supervisors;
- implementing and maintaining a supervisory review process;
- assigning eligible external credit assessment institutions' (eligible institutions) assessments to the risk weights available under the standardised risk-weighting framework, that is, deciding which assessment categories correspond to which risk weights;
- exercising discretion in respect of various items of national discretion; and
- disclosing specified information.

2. *Circulars, guidance notes and directives*

The proposed amended Banks Act, 1990 distinguishes between circulars, guidance notes and directives as follows:

- Circulars are issued by the Registrar of Banks to furnish banks with guidelines regarding the application and interpretation of the provisions of the Banks Act, 1990.
- Guidance notes are issued by the Registrar in respect of market practices that banks may consider in conducting their business and which are not mandatory for banks to implement but merely provide banks with further information.

- Directives are issued by the Registrar, after consultation with the affected parties, to prescribe certain processes or procedures to be followed by banks with regard to certain processes or procedures necessary in the administration of the Banks Act, 1990. The legal nature of directives is that it would be obligatory for banks to comply with their prescriptions.

3. *Publication of information by the Registrar of Banks*

The Registrar is required to keep a register of all registered banks, branches of foreign institutions, controlling companies and eligible institutions, and publish certain decisions relating to applications in terms of the Banks Act, 1990.

4. *Audit, risk and directors' affairs committees*

The requirements pertaining to the above-mentioned committees are made applicable to controlling companies.

The name of the risk committee is changed to the "risk and capital management committee".

5. *Minimum share capital and reserve funds*

The proposed amended Banks Act, 1990 provides that the capital requirements of Basel II be prescribed by the Regulations relating to Banks.

These requirements are also made applicable to controlling companies as Basel II, *inter alia*, clearly states that the framework will be "applied on a consolidated basis" to internationally active banks.

6. *Large exposures*

The proposed amended Banks Act, 1990 not only reflects the prescriptions of Basel II, but also takes into account the size of certain corporate conglomerates in relation to banks, the uniqueness of certain corporate structures and the extent of corporate concentration in South Africa. The Registrar of Banks, with the approval of the Minister of Finance, may exempt certain concentrations or exposures from the requirements of the proposed amended Banks Act, 1990 or the proposed amended Regulations, which exemption will be for such time and subject to such conditions as may be prescribed.

7. *Shares, debentures and negotiable certificates of deposit*

Following certain amendments to the Income Tax Act, 1962 (Act No. 58 of 1962) banks subsequently commenced issuing instruments such as promissory notes instead of negotiable certificates of deposit. As negotiable certificates of deposit (NCDs) and promissory notes are instruments of similar characteristics, the heading of section 79 and the content of section 79(1)(c) of the Banks Act, 1990 are amended to include the wording "negotiable certificates of deposit, promissory notes or instruments of similar characteristics".

These requirements are also made applicable to controlling companies.

The proposed amended Banks Act, 1990 refers to so-called hybrid instruments, which term is also defined.

8. *Approval of eligible institutions*

Credit rating agencies are to be approved by the Registrar of Banks before their ratings may be used by banks in their internal models to calculate regulatory capital.

9. *Verification of information*

The Registrar of Banks may request that certain information submitted in respect of a locally incorporated bank or controlling company and its foreign branches,

subsidiaries or joint ventures should be verified in such a manner and at such intervals as may be prescribed or specified in writing by the Registrar.

changing supervisory policies, market developments and practical considerations

The amendments necessitated by changing supervisory policies, market developments and practical considerations are the result of an ongoing programme employed by the Department to keep the Banks Act, 1990 up to date and relevant. They are briefly the following:

10. *Branches of foreign institutions*

To ensure legal certainty, provision is made for reference to “bank” in the Banks Act, 1990 or other legislation includes reference to a “branch”, unless expressly stated otherwise.

11. *Permission for acquisition of shares in bank or controlling company*

The acquisition of shares in a bank or controlling company has to be approved by the Registrar of Banks or the Minister of Finance, depending on certain thresholds. These thresholds are calculated on the nominal value of issued shares. The proposed amended Banks Act, 1990 extends this to apply to the voting rights that are exercisable by a person in respect of the issued shares of a bank or controlling company.

12. *Investments by controlling companies*

Investments, and loans and advances made by controlling companies shall be limited so that the majority of these transactions relates to banking business. The percentage and the accounting standards utilised in the calculation of the percentage are to be prescribed by the Regulations relating to Banks.

13. *Subsidiaries, branch offices, other interests and representative offices of banks and controlling companies*

The proposed amended Banks Act, 1990 provides for a prior approval process if banks or controlling companies wish to establish or acquire subsidiaries within or outside South Africa.

Furthermore, it provides for an application process for the establishment of divisions by banks. For the effective enforcement of the provision the term “division” has been defined.

14. *Compromises, amalgamations, arrangements and affected transactions*

The proposed amended Banks Act, 1990 contains a number of amendments to section 54 of the Banks Act, 1990 to address the practical and legal difficulties experienced in the enforcement of the section.

If a bank wishes to transfer more than 25 per cent of its assets, liabilities or assets and liabilities, it shall obtain the consent of the Minister of Finance in writing and this consent shall be conveyed through the Registrar of Banks. The transfer of assets, liabilities or assets and liabilities of 25 per cent or less requires the Registrar’s approval in writing. In the event that only assets that amount to less than 10 per cent of the total on-balance-sheet assets of the transferring bank are transferred, such a transfer is not subject to any approval, provided that the Registrar is informed thereof.

15. *Directors of a bank or controlling company*

The proposed amended Banks Act, 1990 contains provisions aimed at addressing the deficiencies in section 60 of the Banks Act, 1990.

Section 60(5) of the Banks Act, 1990 provided for two different procedures to be followed in a bank’s appointment of non-executive directors, on the one hand, and executive directors and officers, on the other. The section also provided for two different processes the Registrar of Banks could follow to object to the appointment of non-executive directors and executive directors, and executive officers. This

distinction proved to be impractical and resulted in legal uncertainty. The amendment now provides for a uniform procedure in this regard.

Section 60(6) of the Banks Act, 1990 provided for a procedure relating to the lodging of an objection to the appointment of executive directors and officers. The omission of non-executive directors was a drafting oversight and has been corrected.

16. *Control of certain activities of unregistered persons*

While a person operating an illegal scheme is under investigation or management in terms of the provisions of the Banks Act, 1990, such a person may not be liquidated or sequestrated by any person, save with the leave of the court and only once the Registrar of Banks has been notified of such an application.

The duly appointed manager should report to the Registrar on the solvency of the person operating the illegal scheme. When the person is found to be solvent, the manager may repay depositors as provided for in the Banks Act, 1990. When a person is found to be insolvent, the Registrar may apply for the liquidation of the person and will be able to recommend the liquidator to be appointed as well as agree to the liquidator's fee structure in this regard.

17. *Financial penalties and sanctions or fines for non-compliance*

The Registrar of Banks is vested with the power to impose substantial fines or sanctions on banks, including directors and executive officers of banks, for non-compliance with certain provisions of the Banks Act, 1990 or in respect of certain directives issued by the Registrar.

Any decision taken by the Registrar in terms of the Banks Act, 1990 may be taken on review to an independent Review Board established by this Act.

Regulations relating to the conditions for the conducting of the business of a bank by a foreign institution by means of a branch

The provisions of the Banks Act, 1990 as well as the Regulations relating to Banks apply equally to foreign branches, if and where relevant. The unique features of a branch have, however, necessitated the inclusion of certain unique prescriptions in a separate regulation, titled *Conditions for the Conducting of the Business of a Bank by a Foreign Institution by Means of a Branch* (the Branch Regulations).

unique features of a branch

The amendments have been brought about by the following factors:

- The calculation of the previous endowment capital requirement in respect of foreign branches has become problematic to both the foreign branches and the Department, mainly because of the volatility of its underlying components.
- A requirement that foreign branches may not invest more than 40 per cent of deposits obtained in South Africa offshore has been applied by the Registrar of Banks by agreement with the International Bankers Association. The amendments aim to regularise the situation.
- The amendments also aim to bring the Branch Regulations in line with the prescriptions of Basel II.

The amended Branch Regulations are arranged as follows:

1. Conditions for conducting the business of a bank by a foreign institution by means of a branch in South Africa:
 - (1) Definitions
 - (2) Conditions
 - (3) Prudential requirements

- (4) Management
 - (5) Business operations
 - (6) Supervisory obligations
 - (7) Name
 - (8) Application procedure, fees and annual licence.
2. Failure or inability to comply with provisions of these Regulations.
 3. Commencement.

The following amendments are contained in the Branch Regulations:

Clause 1(1) Definitions

“branch capital” – new insertion

“endowment capital” is replaced with “branch capital”

The regulatory framework for foreign branches was implemented in 1995 to enable larger foreign banks to gain access to the domestic banking system as participants. Owing to the difficulties in applying and complying with the “endowment capital” requirement, “endowment capital” is replaced with “branch capital”.

“Branch capital” is seed capital provided by the parent institution to the foreign branch for the establishment of a banking business in the Republic of South Africa. It is proposed that branch capital, together with any profits made by the branch, is to be set at a minimum of R250 million or 8 per cent of the risk-weighted assets of the branch, whichever is greater. This is also the current requirement for all other banks in the Republic

“endowment capital” – deleted

“Regulations relating to Banks” – deleted

Clause 1(3) Prudential requirements

International Financial Reporting Standards (IFRS)

The reference to “internationally generally accepted auditing standards” is replaced with “International Financial Reporting Standards”.

Rating agency

The reference to “rating agency” is to be replaced with “external credit assessment institution” as defined by Basel II and the latest amendments to the Banks Act, 1990.

Setting a higher capital requirement percentage

The provision that the Registrar of Banks may require a higher capital-adequacy percentage than the 8 per cent prescribed in consultation with the Minister of Finance is amended to replace the Minister of Finance with the Governor of the South African Reserve Bank in order to align it with the Regulations relating to Banks.

Registrar of Banks to allow capital requirement below a threshold of R250 million – new insertion

The Registrar is afforded the power, under certain specific circumstances, to allow a foreign branch that is currently registered to hold capital below the above-mentioned threshold of R250 million, subject to certain conditions.

Additional prudential requirement

A foreign branch is required to invest a substantial portion of its assets to the advantage of the local economy and not use the Republic of South Africa as a source of funds that are transferred and invested elsewhere.

This is an enabling provision, providing the Registrar of Banks with the discretion to determine the threshold. This is done to effectively and speedily accommodate any policy dispensation pertaining to foreign investments that may be afforded to banks. In the absence of any such directive, the Registrar is likely to uphold the current ratio of 60:40.

Net open foreign-currency position

The net open foreign-currency position of foreign branches is to be calculated in the manner prescribed in form BA 325 of the amended Regulations relating to Banks.

The current dispensation in terms of which foreign branches are permitted to calculate the 10-per-cent requirement on the capital base of their respective parents is retained.

Clause 1(4) Management

Reference to section 60 of the Banks Act, 1990

The fit-and-proper requirements and the approval process applicable to the appointment of executive officers as provided for in the Banks Act, 1990 are also applicable to executive officers of a foreign branch.

References to Regulations relating to Banks

As a result of the amendments to the Regulations relating to Banks, references to regulations 38 and 39 of these regulations in clause 1(4)(d) are changed to regulations 39 and 40 respectively.

Clause 1(5) Business operations

Acceptance of deposits

Reference to both juristic and natural persons in clause 1(5)(a) of the Branch Regulations is superfluous and it is deleted and replaced with "any person".

Clause 1(6) Supervisory obligations

Consolidating supervisor

As a result of the amendments to the Regulations relating to Banks to comply with the prescriptions of Basel II, the reference to "home-country supervisory authority" has been amended to "consolidating supervisor".

References to Regulations relating to Banks and DI forms to be replaced with corresponding regulations and BA forms of the proposed amended Regulations

As a result of the amendments to the Regulations relating to Banks, the references to regulations and DI forms are deleted and replaced with corresponding regulations and BA forms of the proposed amended Regulations in clauses 1(6)(e), (f) and (g).

A new clause 1(6)(h) is also inserted to align the Branch Regulations with the Basel II requirements relating to the disclosure of information.

Clause 1(8) Application procedure, fees and annual licence

References to regulations and DI forms to be replaced with corresponding regulations and BA forms of the proposed amended Regulations

As a result of the amendments to the Regulations relating to Banks, references to regulations and DI forms are deleted and replaced with corresponding regulations and BA forms of the amended Regulations relating to Banks in clauses 1(8)(a), (b), (c) and (d).

Clause 3 Commencement

The effective date of the Branch Regulations is 1 January 2008, to coincide with the amended Banks Act, 1990 and the amended Regulations relating to Banks.

Designation of an activity not falling within the meaning of “the business of a bank” (securitisation schemes)

Under paragraph (cc) of the definition of “the business of a bank”, in section 1 of the proposed amended Banks Act, 1990, the Registrar of Banks has, with the approval of the Minister of Finance, designated securitisation schemes as an activity that does not fall within the meaning of “the business of a bank”, provided such schemes adhere to the conditions prescribed in the Schedule.

Exemption Notice

The above-mentioned designation will be gazetted on 1 January 2008 and will generally be referred to as the ‘Exemption Notice relating to Securitisation Schemes’ (i.e., the proposed amended Exemption Notice).

The amendments contained in this Exemption Notice were brought about by the amendments effected to the Regulations relating to Banks which, in turn, were amended to comply with the prescriptions of Basel II.

amendments to Exemption Notice

The following amendments have been effected to the Exemption Notice:

The “Schedule” to the proposed amended Exemption Notice is arranged as follows:

1. Definitions
2. Designation of an activity
3. Interpretation
4. Traditional securitisation scheme
5. Synthetic securitisation scheme
6. Credit enhancement facilities
7. Liquidity facilities
8. Underwriting – new insertion
9. Servicing
10. Transactions in the trading book
11. Clean-up calls – new insertion
12. Securitisation of revolving assets
13. Early amortisation – new insertion
14. Issue of commercial paper
15. Appointment of auditor
16. Disclosure
17. Non-compliance
18. Short title and commencement – new insertion
19. Repeal of laws.

Clause 1 Definitions

definitions amended

The following definitions have been amended:

“*asset*” – the reference to “Accounting Statement AC. 000” has been replaced with “Financial Reporting Standards”.

“*associate*” – the reference to “Accounting Statement AC. 110 issued by SAICA” is replaced with “International Accounting Standard 28 (AC 110), Investments in Associates”.

“*credit rating*” – the reference to “credit-rating agency” has been replaced with “eligible institutions”, in line with the latest amendments to the Banks Act, 1990.

“*credit-rating agency*” – deleted.

“*domestic rating*” – definition has been itemised

“*originator*” – paragraph (c) has been deleted and the proviso has been renumbered.

“*sponsor*” – a new paragraph (c) has been inserted to define a sponsor in respect of an “*asset-backed commercial paper programme*”.

“*synthetic securitisation scheme*” – paragraph (b) has been amended to extend the meaning of “*credit-risk exposure*” and to renumber paragraph (c).

“*trading book of a bank*” – deleted.

“*traditional securitisation scheme*” – paragraph (c) has been renumbered and a new item (C) has been added to include facilities granted to an SPI as a source of repayment of commercial paper.

The following definitions have been added:

definitions added

“*asset-backed commercial paper (ABCP) programme*” – a programme in terms of which commercial paper is issued, predominantly with an original maturity of one year.

“*clean-up call*” – in terms of which the scheme makes provision for the commercial paper issued to be called or repaid before all the underlying exposures have been repaid.

“*credit-enhancing interest-only strip*” – means an asset represents a valuation of cash flows related to future income and that is subordinated.

“*excess spread*” – income received by an SPI, net of relevant costs and expenses.

“*implicit support*” – support to any party involved in a securitisation scheme in excess of a contractual obligation.

Clause 4 Traditional securitisation scheme

(1) *General*

Paragraph (a) has been renumbered and clarified.

Paragraph (c) has been deleted.

(2) *Conditions relating to limiting of association of assets*

The proviso in paragraph (a) has been expanded.

A proviso has been added to paragraph (b) to ensure that the transferor of the assets does not maintain any effective or indirect control over such assets, even in the event of bankruptcy or liquidation.

The wording of paragraph (c) has been amended, but in essence still provides that neither the SPI nor any of its creditors shall have a right of recourse against an institution acting in a primary role in respect of costs, expenses or losses incurred with the transfer of the assets to the SPI.

Paragraph (d) provides for circumstances under which paragraph (c) shall not apply. A proviso has been added setting out requirement pertaining to warranties.

A new paragraph (e) has been inserted providing that investors who invest in commercial paper of an SPI shall only have a claim in respect of the underlying pool of assets.

A new paragraph (f) has been inserted providing that when payments are made via an agency of an institution or bank, neither the institution nor any of its associated companies shall be obliged to remit funds to the SPI unless the payments are actually received from the obligor.

The previous paragraph (e) has been renumbered as paragraph (g).

A new paragraph (h) has been inserted providing for a clean-up call to comply with the provisions of clause 11.

The previous paragraphs (f), (g), (h), (i), (j) and (k) have been renumbered as paragraphs (i), (j), (k),(l), (m) and (n) respectively.

A new paragraph (o) has been inserted providing for certain clauses not to be included in a securitisation transaction.

The previous paragraphs (l), (m) and (n) have been renumbered as paragraphs (p), (q) and (r) respectively.

(3) Support beyond contractual terms

The term “support” has been replaced with the term “implicit support” and a number of implications relating to a bank’s capital have been prescribed in the case where a bank provides implicit support to a securitisation scheme.

Clause 5 Synthetic securitisation scheme

(1) General

Although this sub-clause has been amended and renumbered, the essence of its provisions remains unaltered as a general description of the features of a synthetic securitisation scheme.

(2) Conditions relating to the transfer of risk, including risk mitigation

Paragraph (a) has been amended to refer to the appropriate regulations of the amended Regulations relating to Banks concerning credit-risk mitigation instruments and to make such provisions applicable to synthetic securitisation schemes, subject to a number of provisos.

A new paragraph (m) has been inserted providing that a clean-up call should comply with the provisions of clause 11.

A new paragraph (n) has been inserted providing that parties involved in a synthetic securitisation scheme who wish to have their risk mitigation instruments recognised should obtain a legal opinion to that effect.

The previous paragraph (m) has been replaced with paragraph (o) and has been renumbered.

The previous paragraphs (n) and (o) have been renumbered as paragraphs (p) and (q) respectively.

(3) Support beyond contractual terms

The term “support” has been replaced with the term “implicit support” and a number of implications relating to a bank’s capital have been prescribed in the case where a bank provides implicit support to a securitisation scheme.

Clause 6 Credit-enhancement facilities*(1) General*

Although this sub-clause has been amended and renumbered, the essence of its provisions remains unaltered as a general description of the features of credit enhancement as it pertains to a synthetic securitisation scheme.

(2) Conditions relating to credit-enhancement facilities

The previous paragraphs (b), (c), (d) and (e) have been combined under the new paragraph (b) and reworded in order to provide for the circumstances under which a party to a securitisation scheme may provide a first-loss credit-enhancement facility and a second-loss credit-enhancement facility and the terms and conditions to which such facilities should adhere.

The previous paragraphs (f) and (g) have been renumbered as paragraphs (c) and (d) respectively.

A new paragraph (e) has been inserted providing that a bank shall in the calculation of its capital comply with such further conditions as may be prescribed by the Regulations relating to Banks.

Clause 7 Liquidity facilities*(2) Conditions relating to liquidity facilities*

Although this sub-clause has been redrafted and renumbered, it retains the essence of the previous sub-clause in providing for the conditions under which a liquidity facility may be provided as well as requirements pertaining to its termination, its enforcement and the content of the relevant disclosure document.

Clause 8 Underwriting – new insertion

The previous clause 8 (Purchase of senior commercial paper) has been deleted.

(1) Conditions relating to underwriting

Paragraph (b) provides that a bank acting as a sponsor or repackager may act as an underwriter, but prescribes that a bank shall be subject to the relevant provisions of the Regulations relating to Banks in determining the effect on a bank's capital.

Clause 9 Servicing*(1) Conditions relating to servicing*

Paragraph (c) provides that a bank acting as a servicer shall comply with the relevant provisions of the Regulations relating to Banks in respect of the provision of a short-term advance.

Clause 10 Transactions included in the trading book*(1) Conditions relating to transactions included in the trading book*

Paragraph (b) replaces the reference made to the "Regulations relating to Capital-adequacy Requirements for Banks' Trading Activities in Financial Instruments" with the "Regulations relating to Banks".

Paragraph (c) provides that a transaction included in the trading book that does not comply with paragraph (a) shall be regarded as a first-loss credit enhancement facility in terms of this schedule read with the provisions of the Regulations relating to Banks.

Clause 11 Clean-up calls (new)

(1) Conditions relating to clean-up calls

This is a new clause providing for the conditions relating to clean-up calls and the requirements pertaining to the calculation of capital by banks in this regard.

Clause 12 Securitisation of revolving assets

(1) General

Paragraphs (a) and (b) have been retained.

Paragraph (c) has been amended to state that securitisation schemes in respect of revolving assets often provide for early amortisation.

Paragraphs (d) and (e) have been deleted.

(2) Conditions relating to the securitisation of revolving assets

Paragraph (a) has been amended to include a reference to the Regulations relating to Banks in respect of the required capital to be held by a bank in this regard.

(3) Securitisation of revolving assets with no early amortisation features

This sub-clause has been amended to provide that the relevant requirements as specified in the Regulations relating to Banks shall apply in respect of a credit-conversion factor and the relevant risk weight attributable to the said revolving assets or risk concerned.

(4) Securitisation of revolving assets with early amortisation features

This sub-clause has been deleted.

Clause 13 Early amortisation – new insertion

(1) General

An early amortisation mechanism allows investors to be paid out prior to the originally stated maturity of the senior commercial paper. This partly shields investors from fully sharing in the losses of the underlying accounts because the early amortisation mechanism is usually triggered when there is a deterioration of the quality of the underlying assets.

(2) Conditions relating to a controlled early amortisation mechanism in respect of revolving assets

This sub-clause provides for certain conditions to be complied with in respect of a controlled early amortisation mechanism of revolving assets.

Clause 14 Issue of commercial paper

This clause has not been amended apart from some renumbering.

Clause 17 Non-compliance

Paragraph (c) of sub-clause (1) has been deleted and incorporated into a new sub-clause (2) entitled “Conditions relating to non-compliance by a special-purpose institution”.

Clause 18 Short title and commencement – new insertion

This is a new clause that provides that the proposed amended Exemption Notice shall be called the “Exemption Notice relating to Securitisation Schemes” and that it shall come into operation on 1 January 2008.

Chapter 4

Trends in the South African banking sector

This chapter contains an overview of banking-sector financial and risk information received from registered banks for 2007. Certain comparative figures in respect of 2006 may differ from those reported in the 2006 *Annual Report*, as some banking institutions subsequently submitted amended returns.

The reports and graphs presented in sections 4.1 to 4.7 are dominated by the size of the balance sheets and activities of the four largest banks, which constituted 85,1 per cent of the banking-sector assets in December 2007 (December 2006: 84,1 per cent). The five largest banks constituted 90,9 per cent of the banking-sector assets at the end of December 2007 (December 2006: 89,7 per cent). A list of the balance-sheet sizes of individual banks is available in Appendix 2.

four largest banks
constituted 85,1 per cent
of banking-sector assets

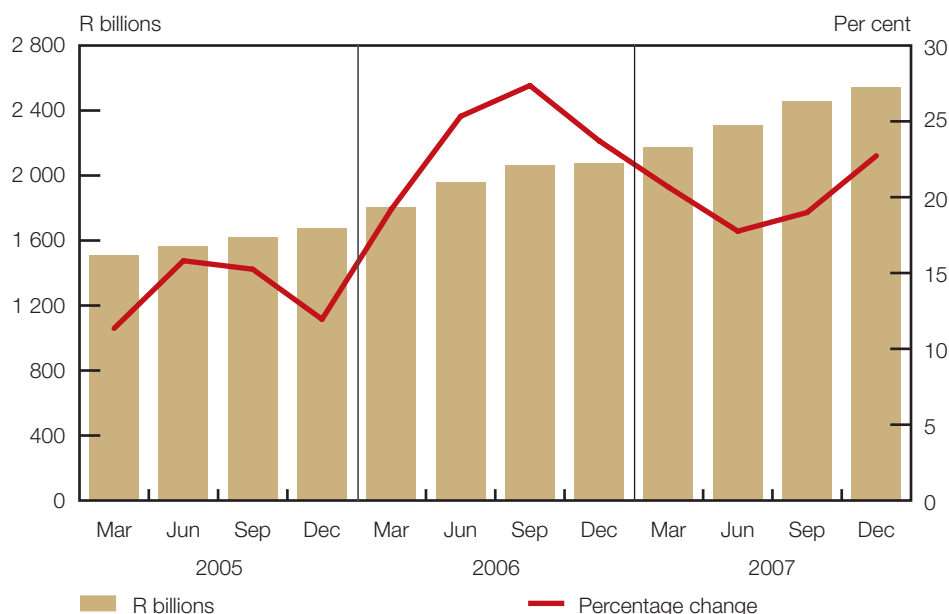
4.1 Balance-sheet structure

The balance sheet is analysed in terms of its composition to form an opinion on the type and spread of banking-sector activities. Changes in the composition of the assets and liabilities are analysed to assess their impact on the overall risk profile of the banking sector. As indicated in Figure 1, the aggregated balance-sheet size of the banking sector amounted to R2 547,0 billion as at 31 December 2007, compared with R2 075,3 billion as at 31 December 2006 and R1 677,5 billion as at 31 December 2005.

The year-on-year growth in the aggregated balance sheet of the total banking sector amounted to 23,7 per cent at the end of December 2006. It slowed down in the first two quarters of 2007, reaching 17,8 per cent at the end of June 2007, before recovering to end the year at 22,7 per cent. Loans and advances, and investment and trading positions were the main contributors to the increase in banking-sector assets during 2007.

22,7 per cent annual
growth in total banking-
sector assets

Figure 1 Aggregated balance sheet

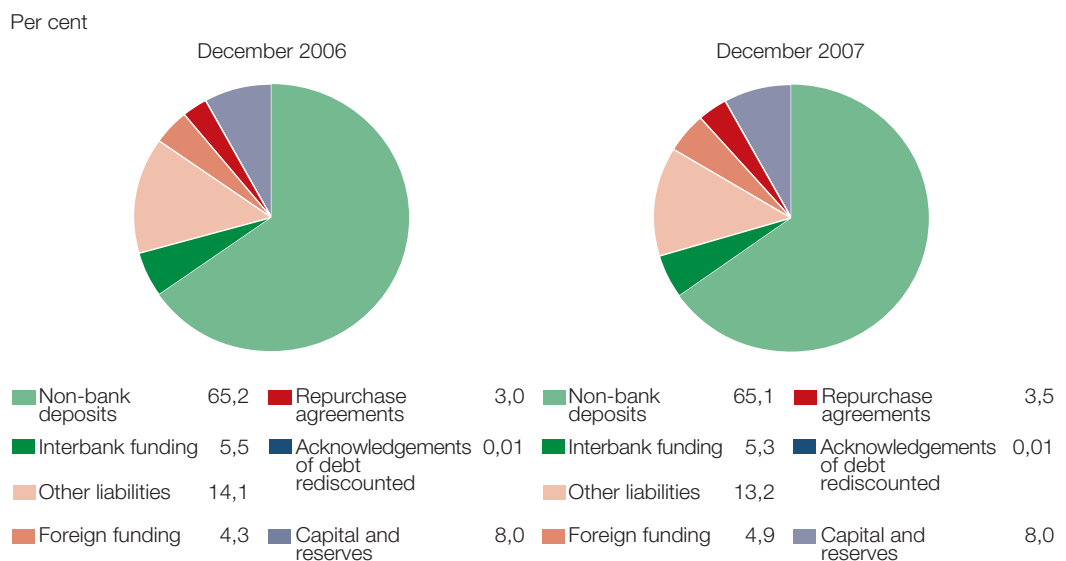


4.1.1 Liabilities and capital

non-bank deposits remained main source of funding

The composition of banking-sector liabilities and capital as portrayed in Figure 2, remained fairly stable between December 2006 and December 2007. By the end of 2007, total liabilities and capital amounted to R2 547,0 billion, compared with R2 075,3 billion at the end of 2006. Non-bank deposits remained the main source of funding for the banking sector throughout 2007 and represented 65,1 per cent of total liabilities and capital at the end of December 2007 (December 2006: 65,2 per cent). Other liabilities constituted 13,2 per cent of total liabilities at the end of 2007, compared with 14,1 per cent at the end of 2006. Interbank funding, foreign funding, repurchase agreements and acknowledgements of debt rediscounted represented 5,3 per cent, 4,9 per cent, 3,5 per cent and 0,01 per cent of total liabilities and capital respectively at the end of 2007. Capital and reserves remained unchanged at 8,0 per cent of total liabilities and capital.

Figure 2 Liabilities and capital (year-on-year comparison)



(Figures do not add up due to rounding.)

4.1.2 Non-banks deposits

demand deposits represented 44,1 per cent of non-bank deposits

By the end of 2007, total non-bank deposits increased to R1 657,8 billion from R1 353,2 billion at the end 2006. The composition of non-bank deposits is reflected in Figure 3. Demand deposits represented 44,1 per cent of non-bank deposits in December 2007 (46,1 per cent at the end of 2006). Fixed and notice deposits, and NCDs accounted for 32,7 per cent and 17,8 per cent of non-bank deposits respectively in December 2007 (December 2006: 33,4 per cent and 15,1 per cent). Savings deposits continued to constitute the smallest portion of non-bank deposits, representing 5,4 per cent at the end of both December 2006 and December 2007.

Figure 4 reflects the composition of non-bank deposits according to the maturities, respectively classified as either short term, medium term or long term. Short-term deposits are repayable on or before the thirty-first day from the reporting date. A medium-term deposit is repayable on or after the thirty-second day from the reporting date, but not later than the day on which a period of six calendar months from the reporting date expires. Long-term deposits are repayable after the expiration of more than six calendar months from the reporting date.

Figure 3 Composition of non-bank deposits

Per cent

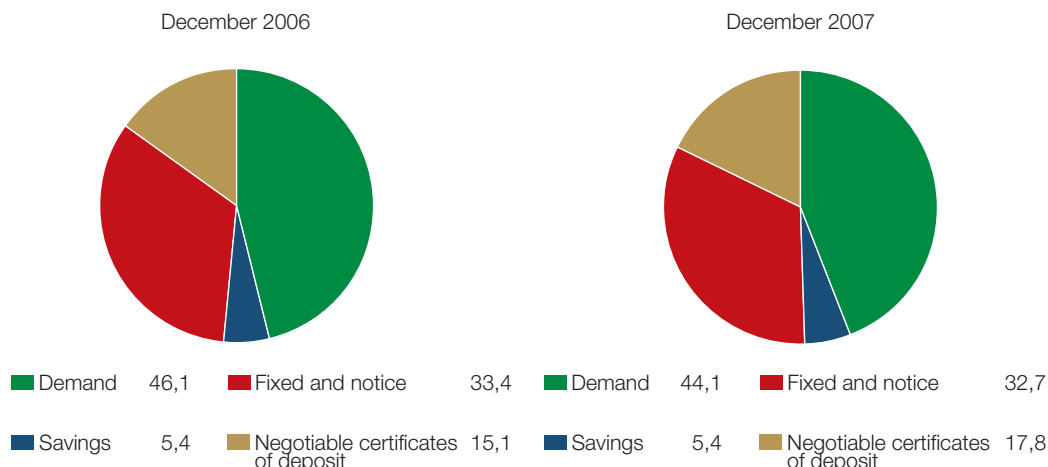
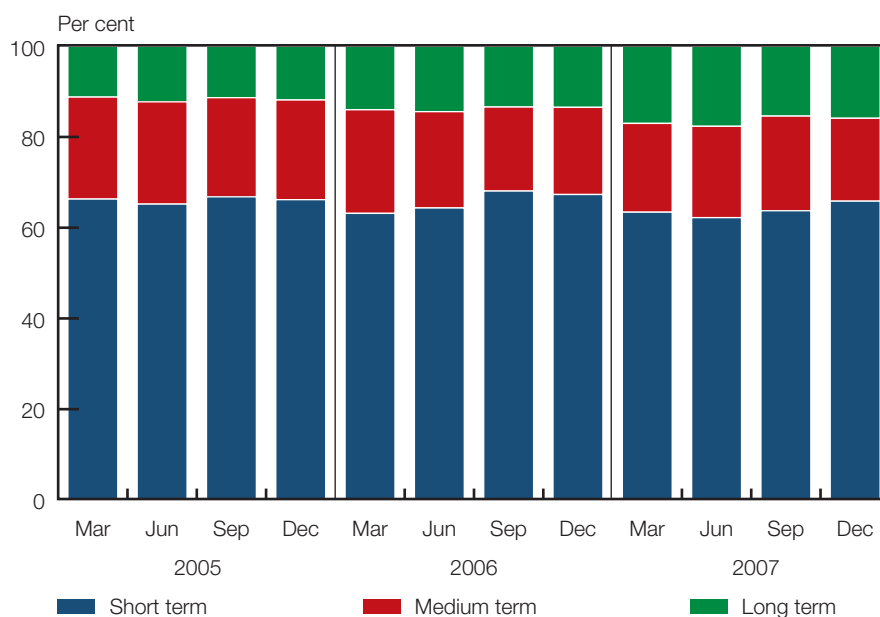


Figure 4 Composition of non-bank deposits according to maturity



Short-term non-bank deposits as a percentage of total non-bank deposits remained stable and thus continued to constitute the main source of funding for banks throughout 2007, representing 65,9 per cent of non-bank funding at the end of December 2007 (December 2006: 67,3 per cent). Medium- and long-term non-bank deposits constituted 18,3 per cent and 15,9 per cent of non-bank funding respectively at the end of December 2007 (December 2006: 19,2 per cent and 13,5 per cent).

non-bank deposits mainly short term

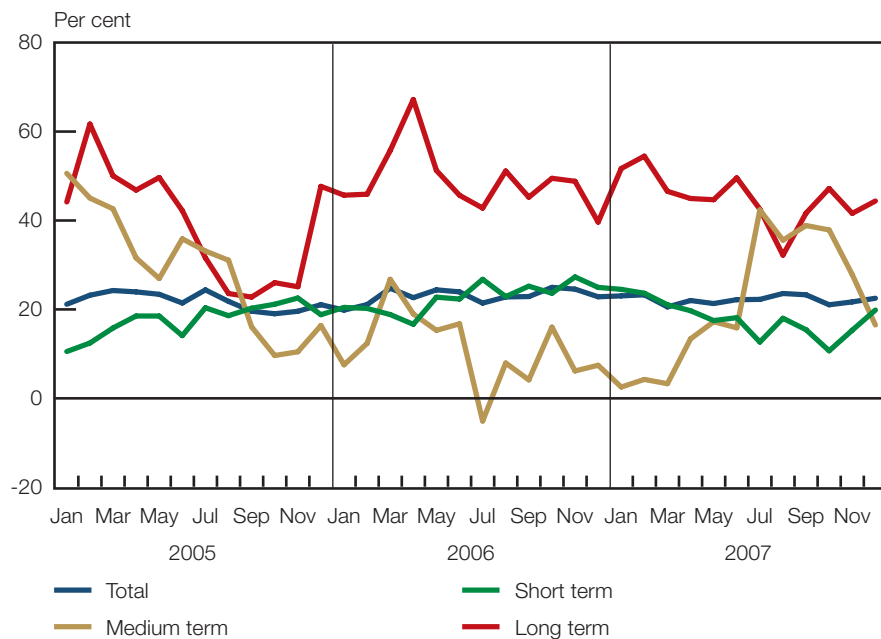
Year-on-year growth in non-bank deposits according to maturity is portrayed in Figure 5. Apart from a deceleration to 32,3 per cent at the end of August 2007, the growth in long-term deposits remained above 40 per cent throughout 2007. By the end of December 2007, growth in long-term deposits amounted to 44,4 per cent (December 2006: 39,6 per cent). Fixed and notice deposits and NCDs remained the main sources of long-term non-bank deposits for banks during 2007.

significant growth in long-term deposits

Growth in medium-term non-bank deposits was volatile during 2007, with a sharp increase over the first half of the year to a rate of 42,4 per cent at the end of July 2007, before declining to end the year at 16,5 per cent (December 2006: 7,4 per cent). Medium-term fixed and notice deposits and, to a lesser extent, NCDs were the main contributors to the higher growth rate in medium-term non-bank deposits during this period.

Growth in short-term non-bank deposits slowed down during 2007, and amounted to 19,9 per cent at the end of December 2007 (December 2006: 25 per cent). Demand deposits represented the largest portion of short-term non-bank deposits throughout 2007.

Figure 5 Growth in non-bank deposits according to maturity (change over 12 months)



other sources of funding

Furthermore, the following other sources of funding were reported by banks:

- Interbank funding amounting to R135 billion at the end of December 2007 (increased by 18,8 per cent during 2007)
- Foreign funding amounting to R124,5 billion at the end of December 2007 (increased by 39,0 per cent during 2007)
- Funding received under repurchase agreements amounting to R89,2 billion at the end of December 2007 (increased by 44,9 per cent during 2007)
- Other liabilities and acknowledgement of debt rediscounted amounting to R336,8 billion and R364 million at the end of December 2007 respectively (increased by 15,4 per cent and 23,8 per cent respectively during 2007).

4.1.3 Assets

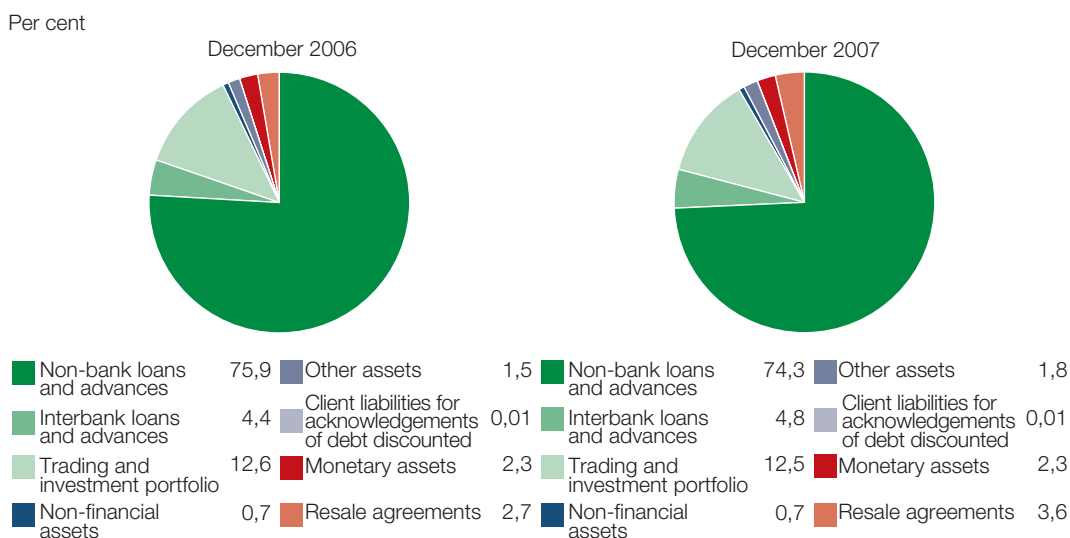
non-bank loans and advances remained largest portion of total banking-sector assets

The composition of total assets, amounting to R2 075,3 billion and R2 547,0 billion at the end of December 2006 and December 2007 respectively is portrayed in Figure 6. Non-bank loans and advances remained the largest portion of total banking-sector assets during 2007, constituting 74,3 per cent at the end of December 2007, compared with 75,9 per cent at the end of December 2006. Non-bank loans and advances increased from R1 575,3 billion at the end of December 2006 to R1 892,0 billion at the end of December 2007, representing an annual growth rate of 20,1 per cent.

The remaining 25,7 per cent of total banking-sector assets included the following:

- Monetary assets (which refer to legal tender in the Republic of South Africa, gold coin, bullion and non-South African currency holdings, and deposits with the Bank) increased from R47,2 billion in December 2006 to R58,6 billion in December 2007, representing an annual growth rate of 24,3 per cent.
- Interbank advances increased from R91 billion in December 2006 to R122,4 billion in December 2007, representing an annual growth rate of 34,5 per cent.
- Loans granted under resale agreements increased from R55,6 billion in December 2006 to R91,9 billion in December 2007, representing an annual growth rate of 65,4 per cent.
- Trading and investment assets increased from R261,1 billion in December 2006 to R319,4 billion in December 2007, representing an annual growth rate of 22,3 per cent.
- Non-financial assets increased from R14,7 billion in December 2006 to R17,5 billion in December 2007, representing an annual growth rate of 19,3 per cent.
- Client liabilities for acknowledgement of debt discounted increased from R293,9 million in December 2006 to R373,2 million in December 2007, representing an annual growth rate of 27,0 per cent.
- Other assets increased from R30,1 billion in December 2006 to R44,9 billion in December 2007 representing an annual growth rate of 49,2 per cent.

Figure 6 Total assets (year-on-year comparison)



(Figures do not add up due to rounding.)

Figure 7 depicts the year-on-year growth in total loans and advances. The growth in total loans and advances slowed down during 2007, reaching 19,8 per cent in June 2007 before recovering to end the year at 22,4 per cent (December 2006: 28,2 per cent).

growth in total loans and advances slowed

Total loans and advances amounted to R2 124,2 billion in December 2007, compared with R1 735,8 billion in December 2006. The increase in total loans and advances during 2007 can be attributed primarily to the increase in mortgage loans (24,7 per cent year-on-year increase) and overdrafts and loans (24,8 per cent year-on-year increase).

Loans granted under resale agreements and credit card debtors also increased significantly, with year-on-year growth rates amounting to 65,4 per cent and 25,5 per cent respectively. However, as a result of their relative size, the increase did not have a major impact on the growth in total loans and advances.

Figure 7 Total loans and advances

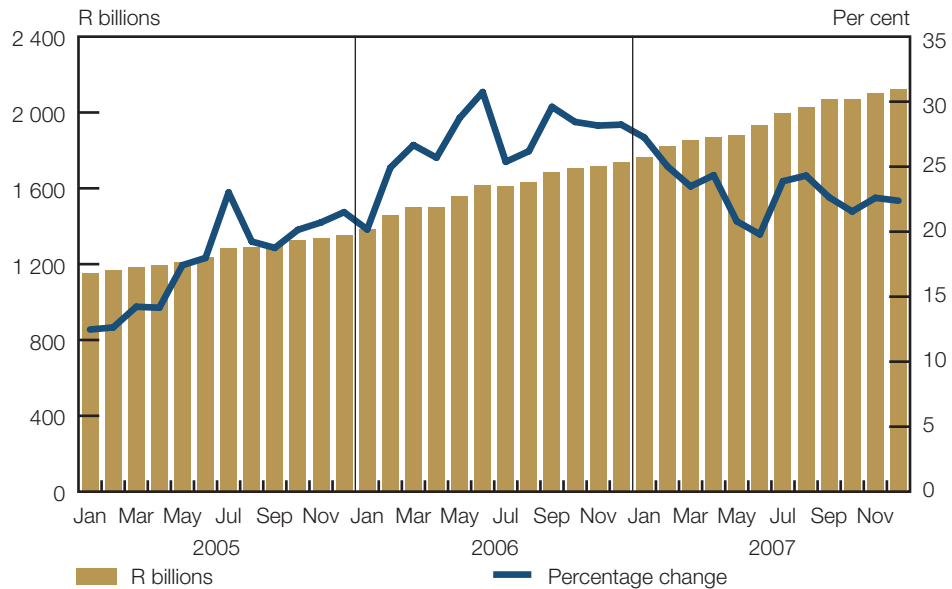
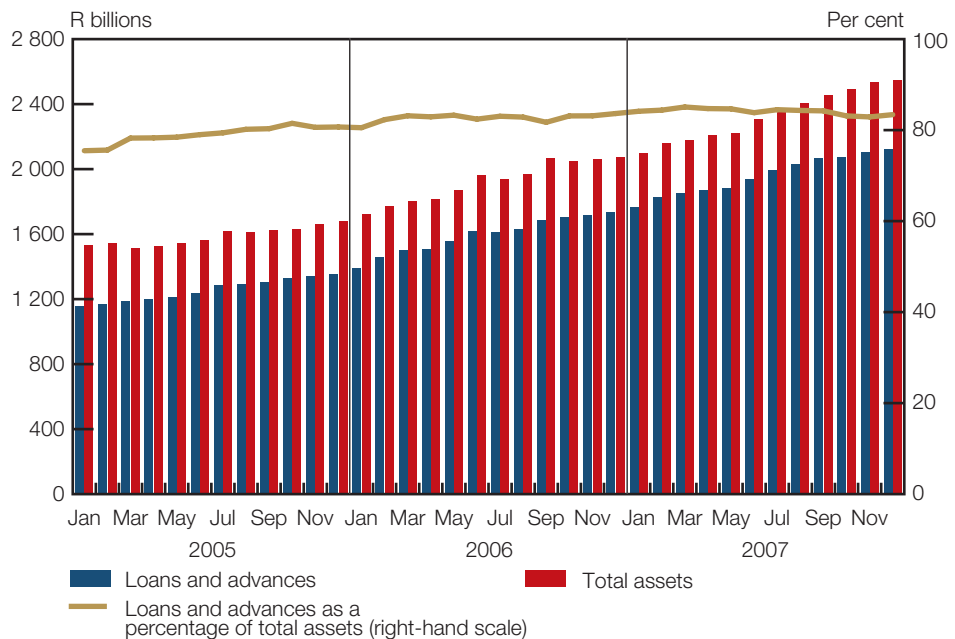


Figure 8 reflects loans and advances as a percentage of total banking-sector assets. Loans and advances represented more than 80 per cent of total banking-sector assets throughout 2007, amounting to 83,4 per cent at the end of December 2007, compared with 83,6 per cent at the end of December 2006.

Figure 8 Loans and advances as a percentage of total assets



4.1.4 Loans and advances

A comparison of the composition of loans and advances between December 2006 and December 2007 is illustrated in Figure 9. The differing growth rates of loans and advances (as depicted in Figure 10) resulted in the changes to the composition during 2007.

Figure 9 Composition of loans and advances (year-on-year comparison)

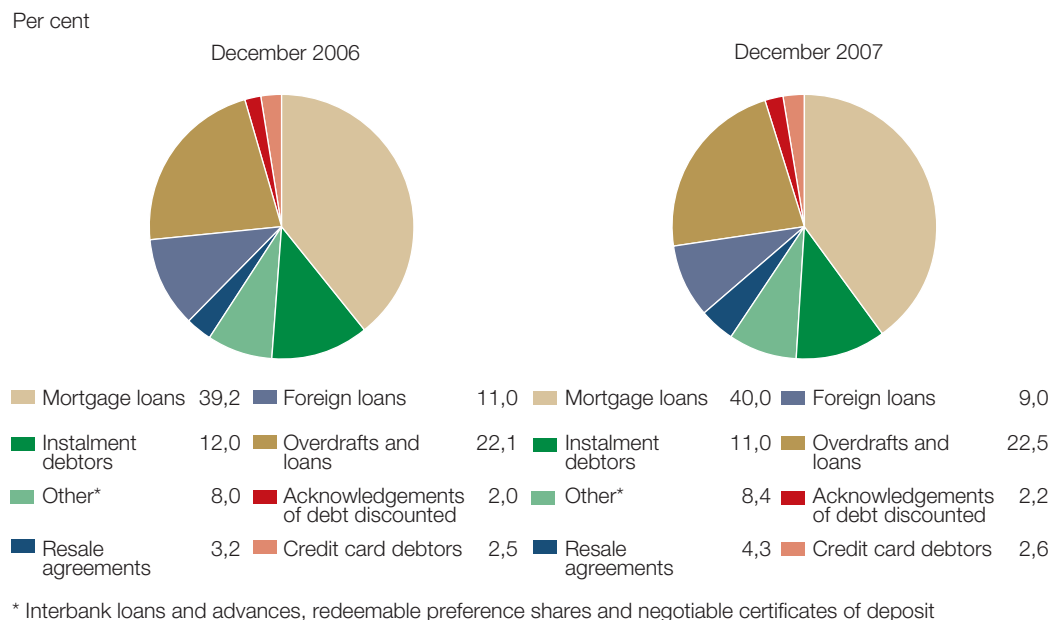
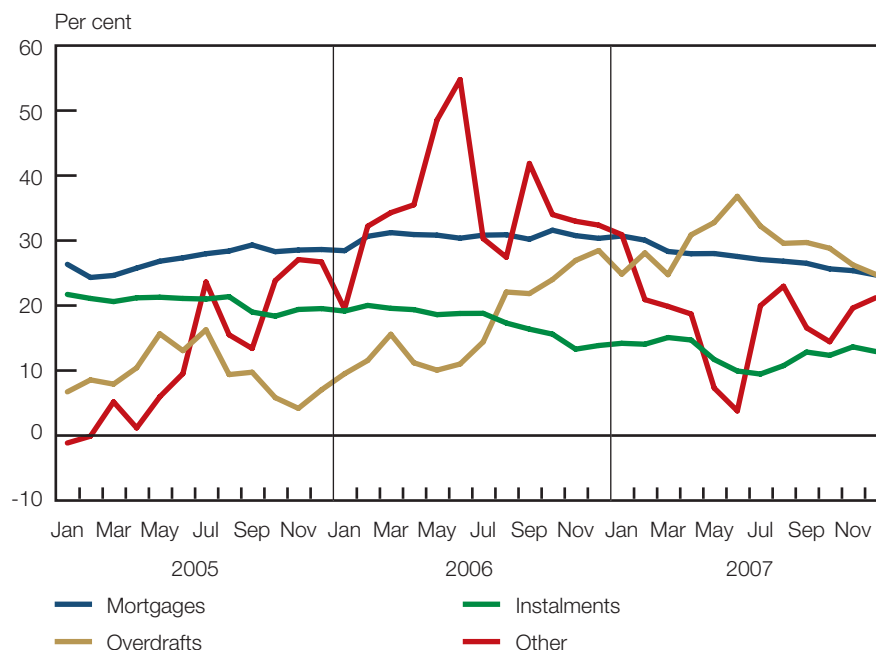


Figure 10 Growth in selected loans and advances (change over 12 months)



Mortgage loans, and overdrafts and loans represented the largest portions of loans and advances, amounting to 40,0 per cent and 22,5 per cent respectively at the end of December 2007 (December 2006: 39,2 per cent and 22,1 per cent).

mortgage loans represented the largest portions of loans and advances

Instalment debtors, foreign-currency loans and advances, and other loans (including interbank loans and advances, redeemable preference shares and NCDs) constituted 11,0 per cent, 9,0 per cent and 8,4 per cent of loans and advances respectively at the end of December 2007. Resale agreements, credit card debtors and acknowledgements of debt discounted represented smaller portions amounting to 4,3 per cent, 2,6 per cent and 2,2 per cent respectively at the end of December 2007.

growth rate of selected loans and advances

The year-on-year growth rates of selected components of loans and advances were as follows:

- Mortgage loans increased from R680,9 billion at the end of December 2006 to R849,0 billion at the end of December 2007, representing an annual growth of 24,7 per cent (December 2006: 30,3 per cent). Even though the growth rate in mortgage loans slowed down during 2007, mortgage loans as a percentage of total loans and advances increased slightly, indicating strong growth in comparison with other asset classes.
- Overdrafts and loans increased from R383,5 billion at the end of December 2006 to R478,5 at the end of December 2007, representing an annual growth of 24,8 per cent (December 2006: 28,5 per cent). The growth rate peaked at 36,8 per cent in June 2007 and subsequently began to decline.
- Instalment debtors increased from R207,4 billion at the end of December 2006 to R234,2 billion at the end of December 2007, representing an annual growth of 12,9 per cent (December 2006: 13,9 per cent). Instalment debtors grew at a steady pace during 2007. However, the growth was somewhat distorted by securitisation transactions that occurred during the year.
- Foreign-currency loans and advances decreased slightly from R191,7 billion at the end of December 2006 to R190,4 billion at the end of December 2007, representing a negative annual growth rate of 0,7 per cent. This asset class fluctuates on a monthly basis and is not trend specific.
- Interbank loans and advances increased from R91 billion at the end of December 2006 to R122,4 billion at the end of December 2007, representing an annual increase of 34,5 per cent (December 2006: 26,0 per cent).
- Credit card loans increased from R43,9 billion at the end of December 2006 to R55,1 billion at the end of December 2007, representing an annual growth of 25,5 per cent (December 2006: 40,8 per cent).

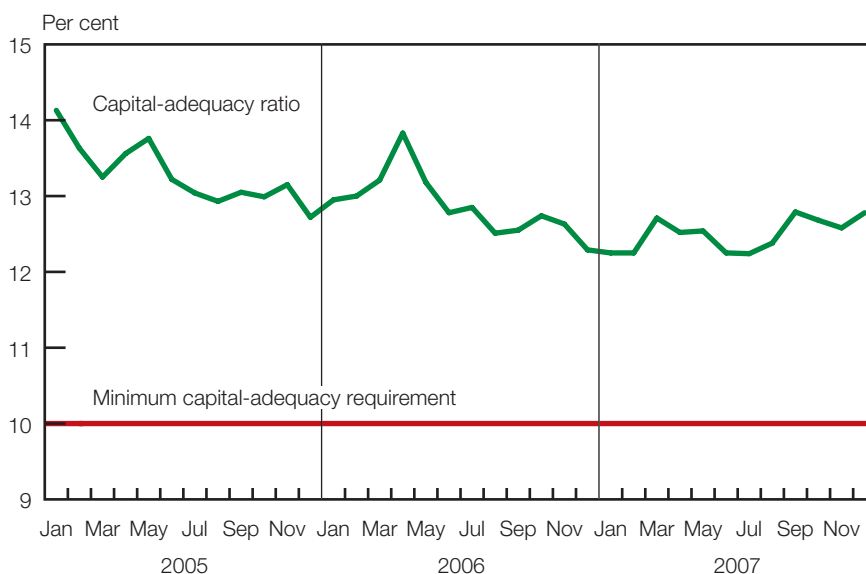
4.2 Capital adequacy

The capital-adequacy ratio, that is, the ratio of a bank's capital to its risk-weighted assets, for the banking sector remained fairly stable during 2007, fluctuating between 12,24 per cent at the lowest level (July 2007) and 12,79 per cent at the highest level (September 2007).

capital-adequacy ratio remained well above minimum requirement

The minimum required capital-adequacy ratio prescribed for South African banks and bank controlling companies was 10 per cent until the end of December 2007. Banks maintain a capital level to allow for some absorption of losses when they occur. As portrayed in Figure 11 the capital-adequacy ratio of the banking sector remained well above the 10 per cent minimum requirement during 2007, increasing from 12,29 per cent in December 2006 to 12,78 per cent in December 2007. The net qualifying capital increased from R153,5 billion in December 2006 to R196,1 billion in December 2007

Figure 11 Capital-adequacy ratio



(27,8 per cent annual increase), whereas the total risk-weighted assets (including assets and off-balance-sheet items) increased from R1 248 billion to R1 535 billion (22,9 per cent annual increase).

net qualifying capital increased by 27,8 per cent

An analysis of the percentage distribution of banks in terms of capital adequacy at the end of December 2007 (refer to Figure 12a) indicates that there were no banks that reported capital-adequacy ratios below the minimum requirement of 10 per cent. At the end of December 2007, 39,4 per cent of banking institutions had capital-adequacy ratios that exceeded 20 per cent (42,4 per cent at the end of December 2006). The percentage of banks with capital-adequacy ratios between 10 and 12 per cent remained at 21,2 per cent, that is, at the end of December 2006 and December 2007.

Figure 12a Distribution of banks in terms of capital adequacy

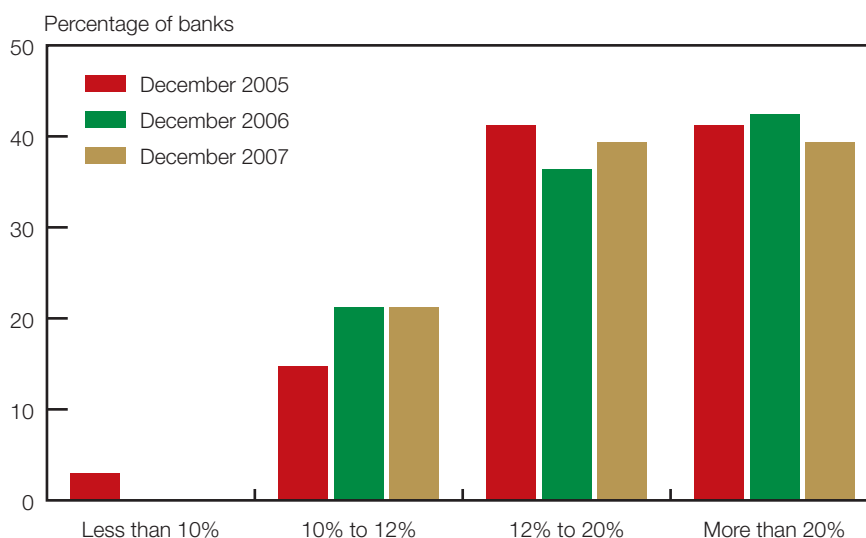


Figure 12b represents the sector distribution in terms of capital-adequacy ratios for December 2007. As a percentage of total banking-sector assets, 64,3 per cent of the assets belonged to banks that had capital-adequacy ratios between 10 and 12 per cent (21,2 per cent of banking institutions). Banks that reported capital-adequacy ratios between 12 and 20 per cent (i.e., 39,4 per cent of the institutions) held 30,9 per cent of the total banking-sector assets. Banks that reported capital-adequacy ratios above 20 per cent (i.e., 39,4 per cent of the institutions) owned 4,9 per cent of the total banking-sector assets.

Figure 12b Capital-adequacy ratios – sector distribution (December 2007)

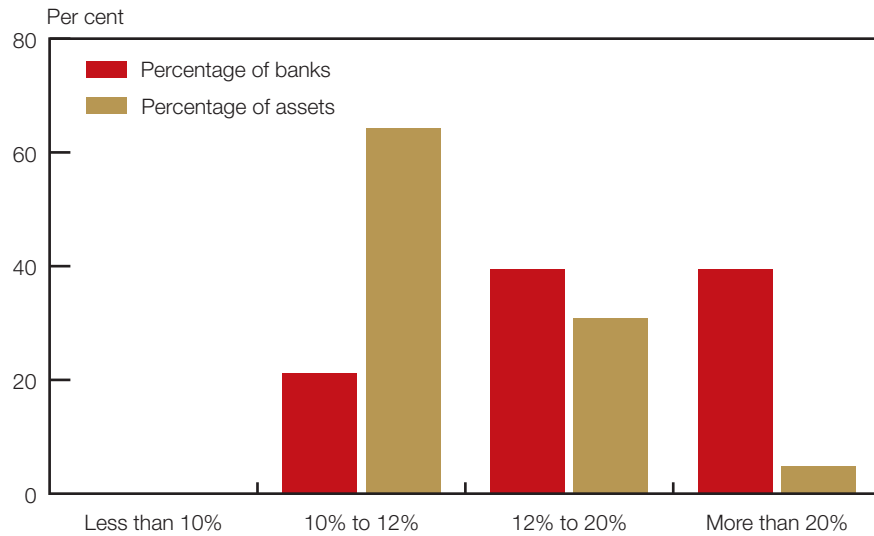
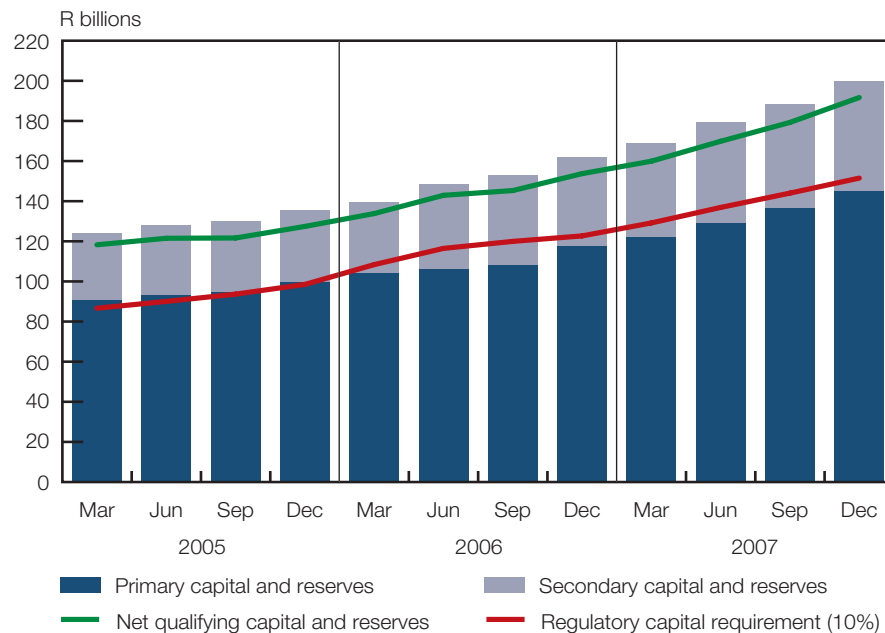


Figure 13 reflects the quarterly average monetary values of primary capital and reserves, secondary capital and reserves, net qualifying capital and reserves, and the regulatory capital requirement. Primary capital and reserves increased from R117,5 billion in

Figure 13 Qualifying capital and reserves



December 2006 to R145,0 billion in December 2007 (23,4 per cent annual increase) and constituted 72,6 per cent of total primary and secondary capital and reserves (before impairments) at the end of December 2007.

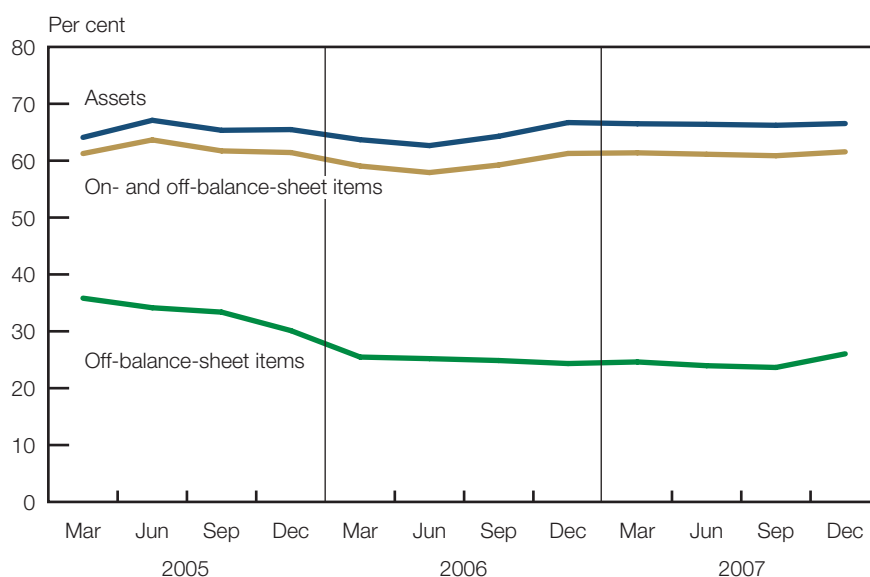
Secondary capital and reserves increased by 22,4 per cent to R54,7 billion at the end of December 2007 (R44,7 billion at the end of December 2006). Primary and secondary capital increased in line with total assets during 2007.

Figure 13 also confirms that the net qualifying capital and reserves exceeded the 10 per cent minimum requirement throughout the period under review.

4.2.1 Risk profile

Figure 14 displays the on- and off-balance-sheet items from a risk-weighted perspective. The risk-weighted percentage of total assets decreased slightly from 66,7 per cent in December 2006 to 66,5 per cent in December 2007. The risk-weighted percentage of off-balance-sheet items increased from 24,3 per cent in December 2006 to 26,0 per cent in December 2007, which resulted in a slight increase in the combined risk-weighted percentage of on- and off-balance sheet items from 61,3 per cent in December 2006 to 61,6 per cent in December 2007.

Figure 14 Risk profile of on- and off-balance-sheet items



4.3 Profitability

Banks' profitability remained favourable during 2007, due to strong asset growth.

profitability remained favourable

For 2007 the total income, an aggregation of net interest turn (interest income less interest expense) and non-interest income (income derived from investment and trading positions, from assets repossessed, net mark-to-market adjustments and fee income), amounted to R130,0 billion compared with R106,9 billion at the end of December 2006, representing an annual growth of 21,6 per cent. Total net income after taxation increased from R26,4 billion at the end of December 2006 to R31,8 billion at the end of December 2007 (20,6 per cent year-on-year increase).

income emanated primarily from intermediation

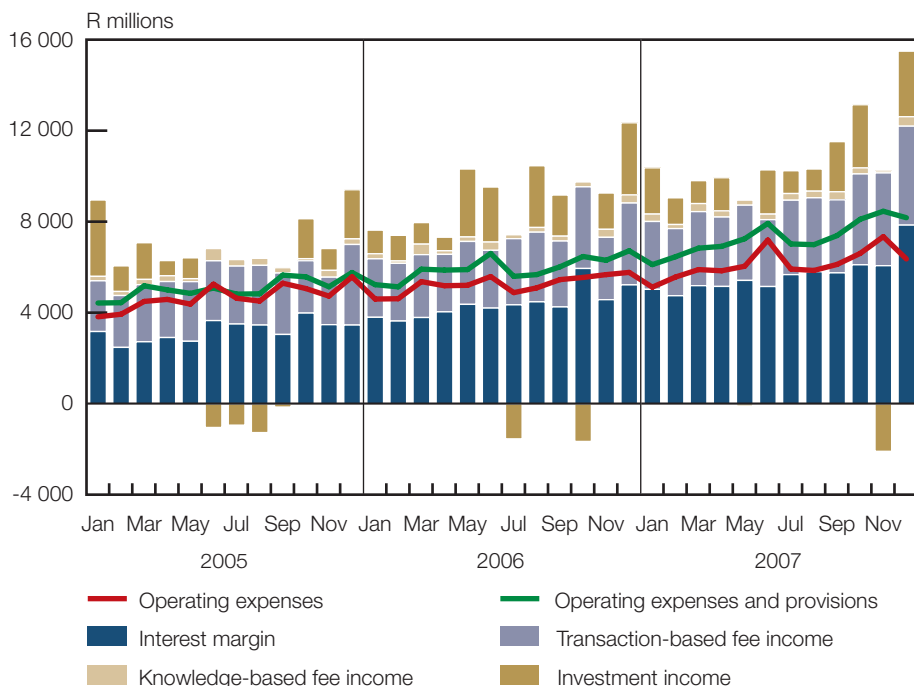
A breakdown of the main income statement components is presented in Figure 15. Income realised by banks during 2007 emanated primarily from the intermediation function. The intermediation function comprises interest margin and transaction-based fee income, and amounted to R108,5 billion at the end of December 2007 (December 2006: R87,1 billion). The interest margin increased from R52,6 billion at the end of December 2006 to R67,9 billion at the end of December 2007, representing 2,7 per cent of total assets at the end of December 2007. Transaction-based fee income increased by R6,1 billion, amounting to R40,6 billion at the end of December 2007 (December 2006: R34,5 billion). At the end of December 2007, transaction-based fee income constituted 1,6 per cent of total assets.

The income of R108,5 billion derived from the intermediation function during 2007 exceeded the sum of operating expenses and provisions, which amounted to R87,6 billion. Knowledge-based fee income, and investment and trading income amounted to R3,3 billion and R15,2 billion respectively at the end of December 2007, constituting 0,1 per cent and 0,6 per cent of total assets.

Interest income increased by 43,4 per cent at the end of December 2007 compared with the 28,6 per cent annual growth measured at the end of December 2006. The high growth in interest income during 2007 is attributable to the high interest income realised from mortgage loans and overdrafts and loans, constituting 40,1 per cent and 23,5 per cent of total interest income respectively at the end of December 2007 (December 2006: 38,7 per cent and 23,1 per cent).

The growth in interest expense also remained high during 2007. By the end of December 2007, interest expense had increased by 51,2 per cent compared with 24,7 per cent at the end of December 2006. The high interest expense is ascribed to the high interest paid on fixed and notice deposits, and demand deposits of 30,6 per cent and 29,1 per cent of total interest expenses respectively at the end of December 2007. The turn in the interest-rate cycle, following the 400-basis-point increase since the start

Figure 15 Composition of the income statement



of 2006, contributed considerably to the increasing trend in both interest income and interest expense.

The high growth in interest expense during 2007 slowed down the growth in interest margin somewhat. The interest margin increased by 29,1 per cent at the end of December 2007 compared to 36,4 per cent at the end of December 2006.

high growth in interest expense slowed down the growth in interest margin

Figure 16 depicts the interest margin of the banking sector whereas Figure 17 depicts the monthly percentage-point change in the components of the interest margin. As illustrated in Figure 16, the interest margin was steady in the region of 3 per cent throughout 2007. However, the interest margin increased from 3,3 per cent at the end of November 2007 to 4,3 per at the end of December 2007, due to a significant increase

Figure 16 Interest margin

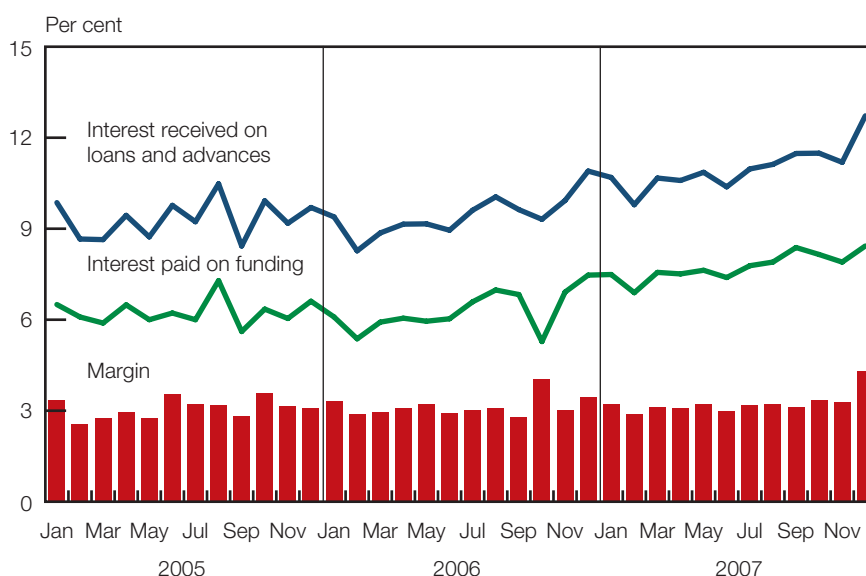
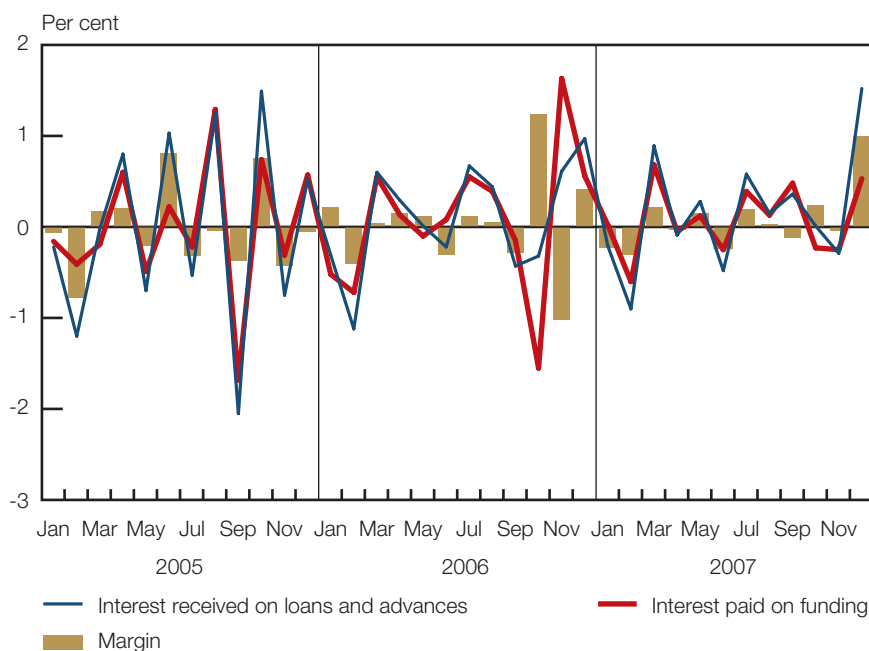


Figure 17 Percentage-point change in interest margin (month on month)



in interest income reported by a large bank, resulting from a reporting refinement exercise that occurred as a one-off year-end adjustment. The amount was reallocated from non-interest income and therefore had no impact on the net income after tax amount reported.

staff expenses accounted for 51,2 per cent of total operating expenses

Measured over a 12-month period, total banking-sector operating expenses (excluding bad debts written off) increased by 17,6 per cent at the end of December 2007 compared with 11,8 per cent at the end of December 2006, mainly as a result of an increase of 17,1 per cent in total staff expenses, which accounted for 51,2 per cent of total operating expenses in December 2007 (December 2006: 51,3 per cent).

Administrative and other expenses, and marketing and communications expenditure also contributed to the increase in operating expenses during 2007. Administrative and other expenses increased by 18,9 per cent and represented 38,8 per cent of total operating expenses at the end of December 2007. Marketing and communications expenses grew by 18,5 per cent at the end of December 2007 and contributed 5,5 per cent to total operating expenses.

Figure 18 depicts the percentage change (calculated on a 12-month smoothed average) in total staff expenses, the number of employees and branches for the past three years. The growth in staff expenses increased from 15,2 per cent at the end of December 2006 to 17,1 per cent at the end of December 2007. The annual growth rate in the number of employees in the banking sector increased from 5,9 per cent at the end of December 2006 to 7,3 per cent at the end of December 2007. However, the annual growth rate in the number of branches decreased from 8,6 per cent at the end of December 2006 to 4,3 per cent at the end of December 2007. The average number of branches for 2006 amounted to 3 019 and increased to an average of 3 149 for 2007.

Figure 18 Growth in staff expenses, number of employees and branches (12-month smoothed average)

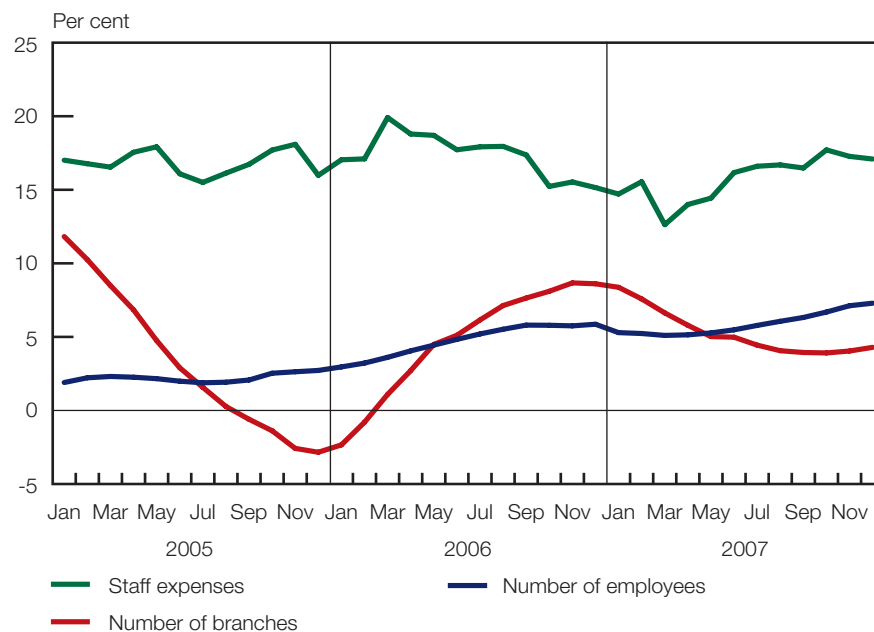


Figure 19 reflects the efficiency ratio of the South African banking sector (smoothed over a 12-month period). The efficiency ratio, also referred to as the 'cost-to-income ratio', is a measure that expresses the total operating costs incurred as a percentage of

operating income. The efficiency ratio of the banking sector improved from 58,8 per cent at the end of December 2006 to 56,9 per cent at the end of December 2007, owing to a continued increase in total income. However, the ratio deteriorated somewhat between May 2007 and August 2007, as a result of high operating expenses.

efficiency ratio improved

Figure 19 Efficiency ratio (12-month smoothed average)



The monetary values of, and the growth (12-month smoothed average) in, the determinants of the efficiency ratio are illustrated in Figure 20. The growth in total income slowed down during 2007, but remained at a higher level than the growth in operating expenses. Total income grew by 21,6 per cent at the end of December 2007, compared with 26,1 per cent at the end of December 2006. However, the growth in operating expenses increased during 2007, amounting to 17,6 per cent in December 2007 (December 2006: 11,8 per cent).

Figure 20 Determinants of efficiency ratio (12-month smoothed average)

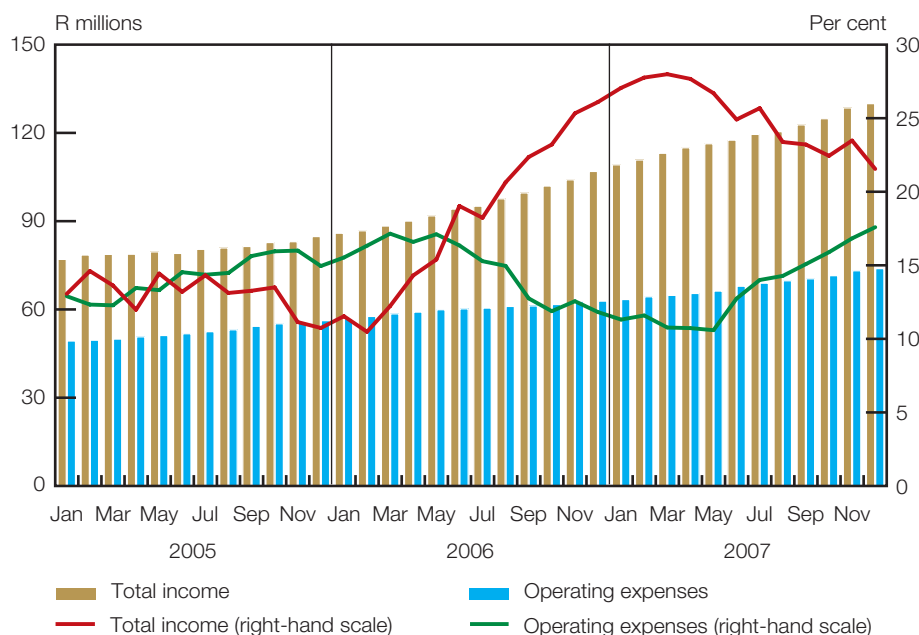
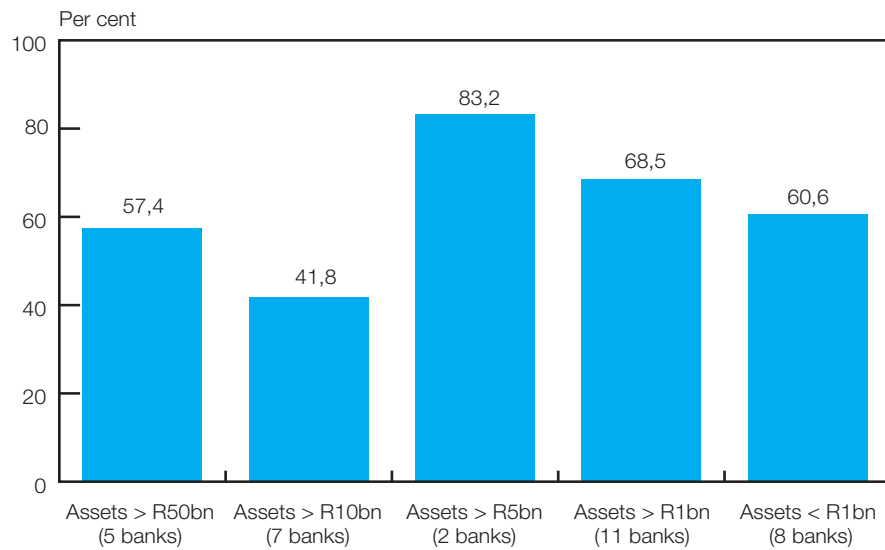


Figure 21 provides the efficiency ratio calculated for each asset-size category (12-month smoothed average). By the end of December 2007, banks with assets exceeding R10 billion, but below R50 billion, were the most efficient with an efficiency ratio of 41,8 per cent. Seven banks fell within this category. Banks with asset values greater than R50 billion (the five largest banks) had an efficiency ratio of 57,4 per cent at the end of December 2007. Banks with the asset values between R1 billion and R5 billion and asset values below R1 billion had efficiency ratios of 68,5 per cent and 60,6 per cent respectively. Two banks with asset values between R5 billion and R10 billion were least efficient, with an efficiency ratio of 83,2 per cent at the end of December 2007.

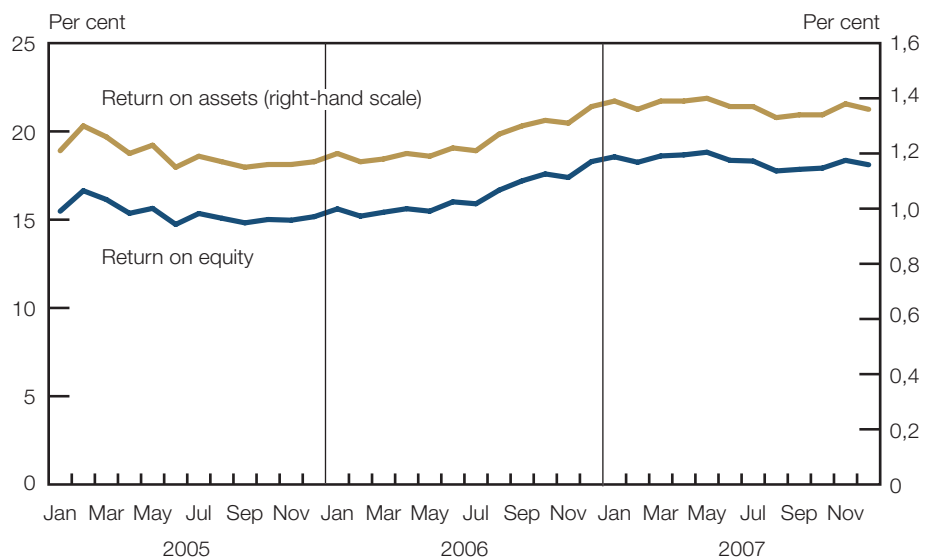
Figure 21 Efficiency of banking institutions according to asset value – 12-month smoothed average (December 2007)



ROE decreased slightly

Figure 22 portrays the profitability of banks using the return on equity (ROE) and return on assets (ROA) ratios. Both ratios remained favourable during 2007. The ROE

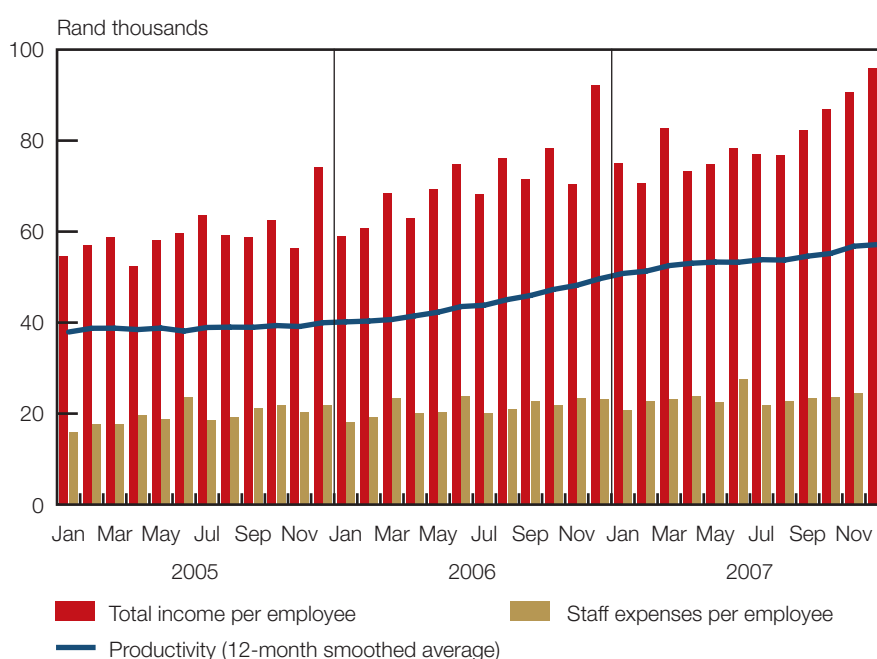
Figure 22 Profitability (12-month smoothed average)



decreased slightly from 18,3 per cent at the end of December 2006 to 18,1 per cent at the end of December 2007, while the ROA remained at 1,4 per cent at the end of December 2006 and December 2007. Total income continued to improve amid increasing operating expenses.

Figure 23 depicts the productivity of the banking sector measured by comparing the expenditure on employees to the amount of income generated. The total income generated per employee increased from R92 140 at the end of December 2006 to R96 017 at the end of December 2007. Total staff expenses per employee also increased from R23 224 at the end of December 2006 to R23 845 at the end of December 2007. The net income generated per employee, calculated on a 12-month smoothed basis increased to R57 142 at the end of 2007, compared with R49 650 for 2006.

Figure 23 Productivity



4.4 Liquidity risk

Liquidity – the ability to fund increases in assets and meet obligations as they become due – is crucial to the sustained viability of any banking institution. But the importance of liquidity transcends the individual bank as a liquidity shortfall at an individual bank can have systemic repercussions. The management of liquidity is therefore among one of the most important activities conducted at banks, and has gained increased attention as a result of the international sub-prime market turmoil and the effect it had on banks' liquidity.

liquidity is crucial to sustained viability

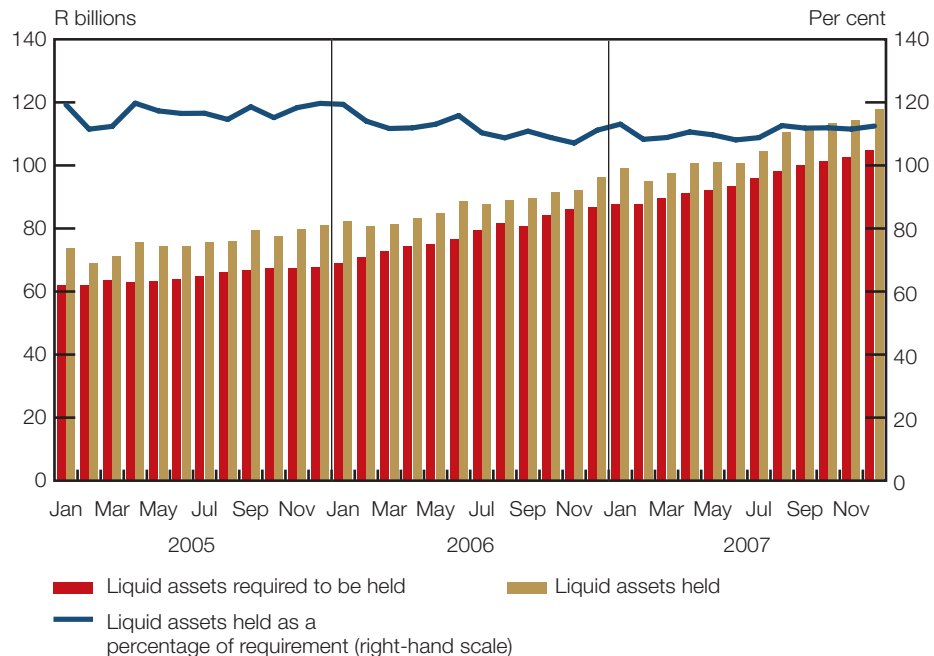
4.4.1 Statutory liquid-asset requirement

The statutory liquid-asset requirement is calculated as a percentage of adjusted liabilities. Refer to Appendix 6, Table 16, for the calculations of adjusted liabilities and the liquid-asset requirement.

banks' average liquid assets exceeded minimum requirement

Figure 24 presents the average daily amount of liquid assets held by banks compared with the statutory liquid-asset requirement. Throughout 2007, banks' average liquid assets exceeded the minimum liquid-asset requirement. The average daily amount of liquid assets held during December 2007 represented 112,5 per cent of the statutory liquid-asset requirement compared with 111,2 per cent held in December 2006.

Figure 24 Statutory liquid assets (actual versus required)



The liquid assets held consisted of the following assets:

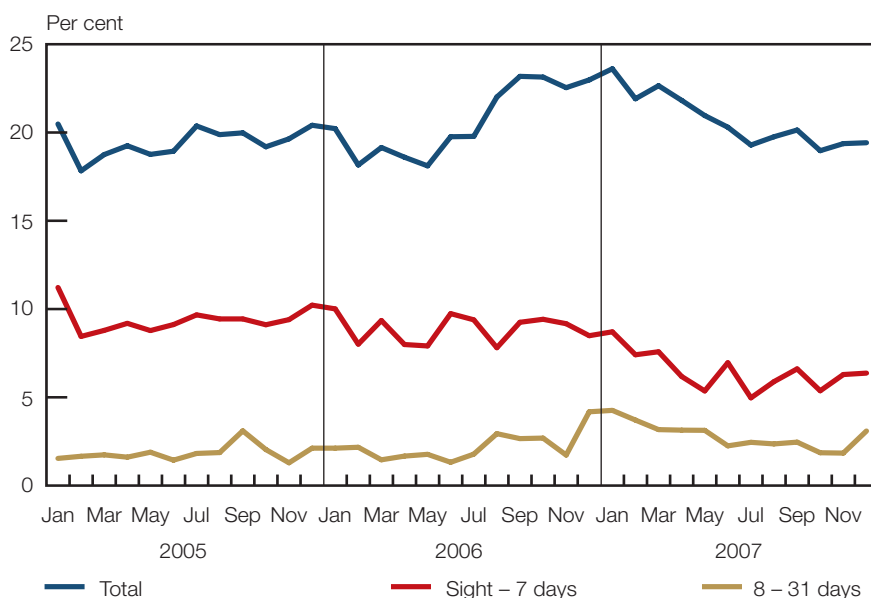
- Securities issued by virtue of section 66 of the Public Finance Management Act, 1999 represented 43,2 per cent of total liquid assets at the end of 2007, compared with the 45,6 per cent at the end of December 2006
- Treasury bills of the Republic of South Africa represented 38,9 per cent of total liquid assets at the end of December 2007, compared with 39,7 per cent at the end of December 2006
- Securities of the Bank amounted to 9,2 per cent of total liquid assets held at the end of December 2007, which is substantially higher than the 4,4 per cent reported at the end of December 2006
- South African Reserve Bank notes and coin held at the end of December 2007 constituted 8,3 per cent of total liquid assets held, compared with the 9,5 per cent held at the end of December 2006
- Short-term bills issued by the Land Bank represented 0,5 per cent of liquid assets at the end of December 2006 and December 2007.

Cash management schemes managed on behalf of bank clients increased by 13,6 per cent during 2007, amounting to R65,4 billion at the end of December 2007. Set-off increased substantially from R58,5 billion at the end of December 2006 to R131,3 billion at the end of December 2007 (annual increase of 124,7 per cent).

4.4.2 Volatility of funding

All banks are required to report the ten largest depositors on their respective balance sheets on a monthly basis. These amounts are aggregated and presented as a percentage of total funding in Figure 25.

Figure 25 Deposits from banks' ten largest depositors (as a percentage of total funding)

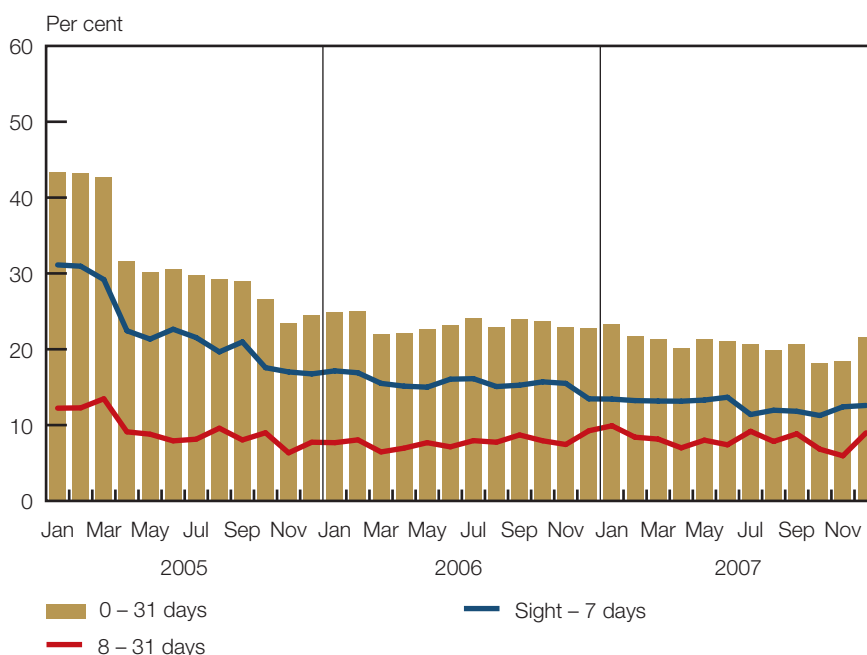


Growth in funding supplied by the ten largest depositors slowed down in 2007. The ten largest depositors represented 19,4 per cent of total funding at the end of December 2007 compared with 23 per cent at the end of December 2006. The largest depositors with a maturity within sight to 7 days and within 8 and 31 days constituted 6,4 per cent and 3,1 per cent of total funding respectively at the end of December 2007 (December 2006: 8,5 per cent and 4,2 per cent).

ten largest depositors represented 19,4 per cent of total funding

Figure 26 presents the maturity of short-term funding, as anticipated by the banks' ALCOs. The contractual maturities are adjusted by the ALCOs as an anticipated maturity per deposit.

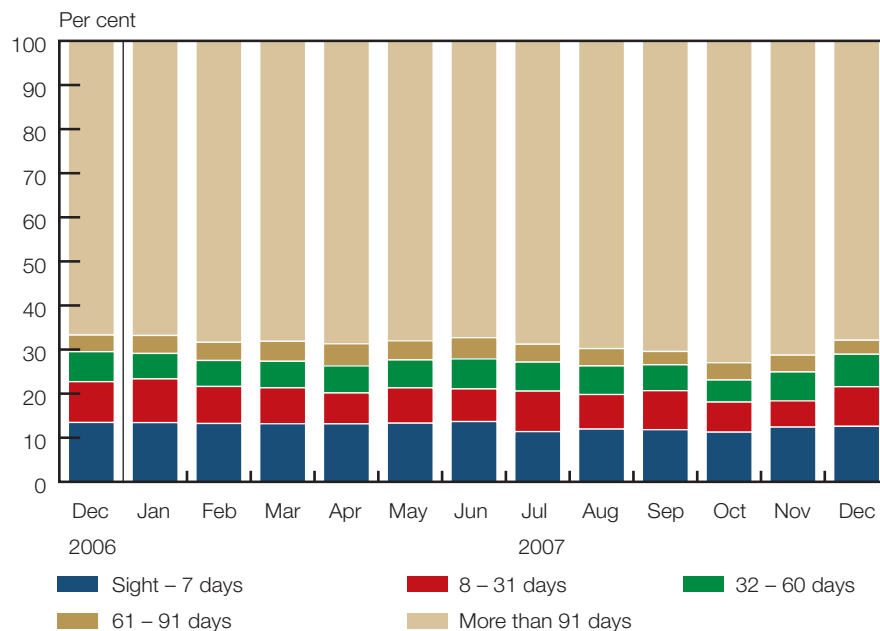
Figure 26 Anticipated maturity of short-term funding (as a percentage of total funding)



Total short-term funding (with an anticipated maturity of nil to 31 days) amounted to 21,6 per cent of total funding at the end of December 2007, compared with 22,7 per cent at the end of December 2006. Short-term funding with an anticipated maturity within sight to 7 days and within 8 to 31 days represented 12,6 per cent and 9,0 per cent of total funding respectively at the end of December 2007 (December 2006: 13,5 per cent and 9,3 per cent). Total short-term funding as a percentage of total funding declined at the end of October 2007, due to a decrease in short-term funding maturing within 8 to 31 days.

The anticipated maturity of total funding remained stable throughout 2007, as reflected in Figure 27. At the end of December 2007, deposits with an anticipated maturity longer than 91 days and deposits with an anticipated maturity shorter than 7 days constituted the largest portions of total funding, namely 67,9 per cent and 12,6 per cent respectively. Deposits with an anticipated maturity of 8 to 31 days constituted 9,0 per cent of total funding, with deposits with an anticipated maturity of 32 to 60 days, constituting 7,4 per cent. Deposits with an anticipated maturity of 61 to 91 days constituted the smallest portion of total funding, namely 3,2 per cent.

Figure 27 Anticipated maturity of total funding (composition)



4.5 Derivative contracts

Derivative contracts are financial instruments that derive their value from the value of underlying assets. The main types of derivative contracts are futures, options, forward contracts and swap agreements. Derivatives are mainly used as risk mitigants. Derivatives can be based on different types of assets such as commodities, equities, bonds, interest rates, exchange rates or indices.

Figure 28 portrays the turnover in derivative contracts in terms of the gross notional long and short positions. As depicted, the turnover in forward contracts is the main contributor to total derivative turnover in the banking sector and amounted to R2 189,5 billion for December 2007 (R1 879,0 billion for December 2006). The remainder of the turnover in derivative contracts amounted to R1 527,4 billion for December 2007 (R737,5 billion for December 2006).

Turnover in derivative contracts can fluctuate substantially from month to month. As can be seen in Figure 28, the turnover increased to higher levels for the period from June 2007 to October 2007 mainly due to an increase in trading volumes as a result of increased volatility, increased client demand, and market conditions such as anticipated interest-rate hikes and so forth.

turnover in derivative contracts fluctuated

Figure 28 Turnover in derivative contracts

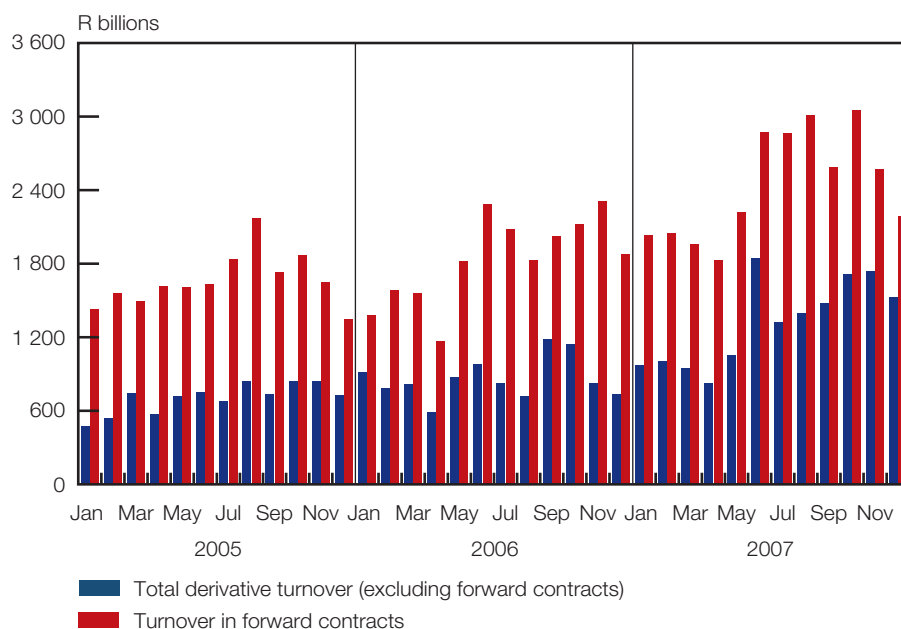
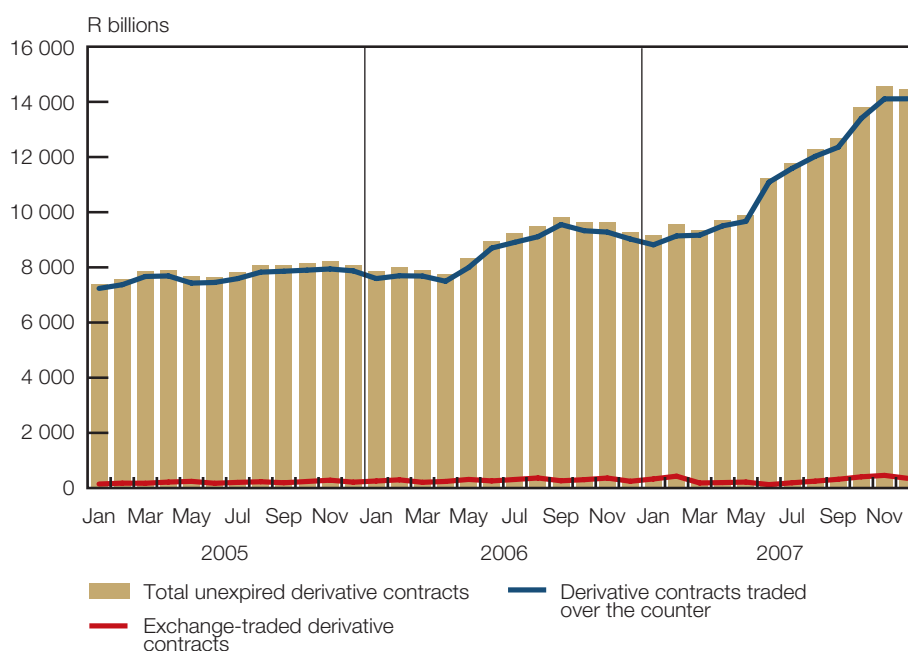


Figure 29 portrays the gross notional value of total unexpired derivative contracts. Derivative contracts traded over the counter (OTC) as a percentage of total unexpired contracts increased marginally from 97,4 per cent at the end of December 2006 to 97,6 per cent at the end of December 2007.

Figure 29 Total unexpired derivative contracts



Total unexpired derivative contracts increased from R9 270,7 billion in December 2006 to R14 463,2 billion in December 2007, amounting to a 56-per-cent annual increase as a result of the increase in OTC contracts. Total unexpired derivative contracts as a percentage of total banking assets increased from 446,7 per cent at the end of December 2006 to 567,9 per cent at the end of December 2007.

4.6 Credit risk

overdue ratios deteriorated

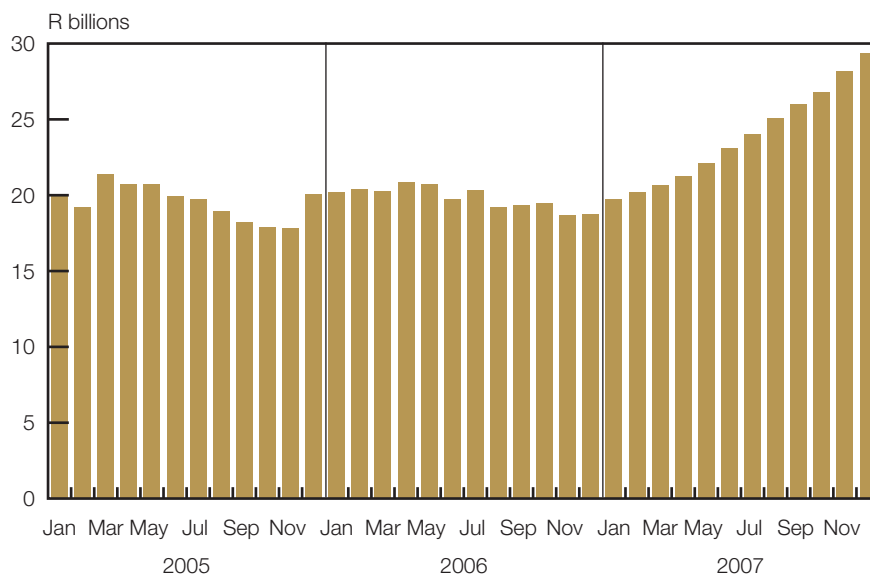
Credit risk was a key focus area for the banking sector throughout 2007. The growth in overdues exceeded the growth in total assets and, as a result, the overdue ratios deteriorated. The increase in interest rates, together with other adverse developments in the South African and international economic environments, contributed to the deterioration of the credit risk ratios. During 2007 the repurchase rate increased by 200 basis points (cumulatively) as announced by the Monetary Policy Committee of the South African Reserve Bank, following the cumulative 200-basis-point increase experienced in 2006. The impact of these interest-rate increases, together with the global credit turmoil will continue to be monitored closely by the Department during 2008.

4.6.1 Analysis of amounts overdue (non-performing loans)

gross overdues increased by 56,4 per cent

The monetary value of gross overdues (non-performing loans that have been overdue for a period longer than 180 days) is reflected in Figure 30. Gross overdues increased by 56,4 per cent, from R18,8 billion in December 2006 to R29,4 billion in December 2007.

Figure 30 Total overdues



Net overdues (gross overdues less specific provisions) as a percentage of net qualifying capital and reserves increased from 5,6 per cent in December 2006 to 8,3 per cent in December 2007 (refer to Figure 31). The higher ratio was mainly owing to the substantial increase in gross overdues during 2007. At the end of December 2007 net overdues amounted to R16,2 billion, up from the R8,6 billion at the end of December 2006. Specific provisions increased from R10,2 billion at the end of December 2006 to R13,2 billion at the end of December 2007, amounting to a 28,7 per cent annual increase at the end of December 2007.

Figure 31 Net overdues as a percentage of net qualifying capital and reserves

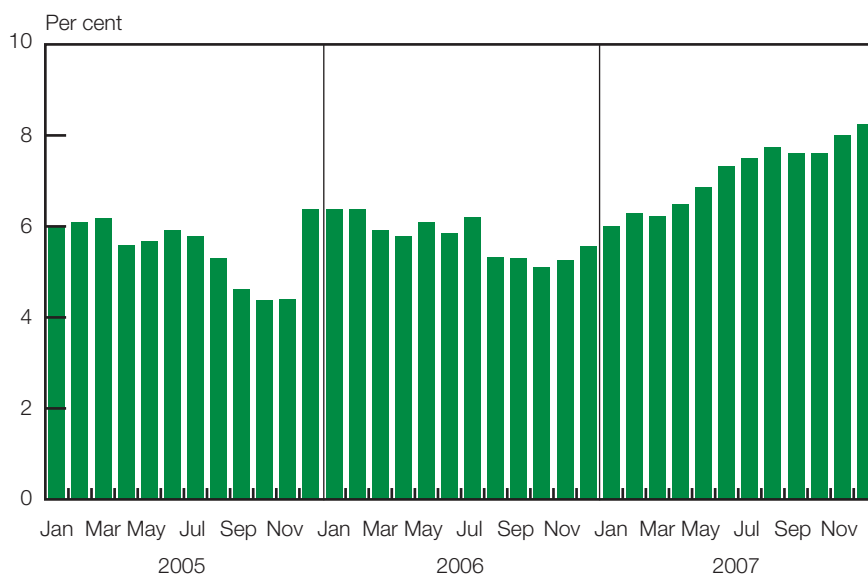
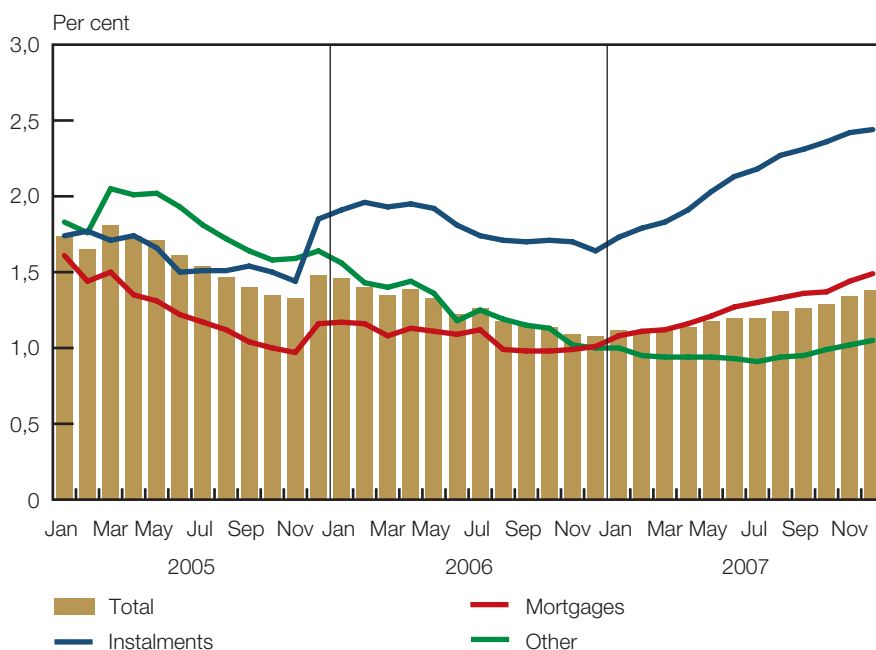


Figure 32 depicts that gross amounts overdue as a percentage of total loans and advances increased from 1,1 per cent at the end of December 2006 to 1,4 per cent at the end of December 2007.

Figure 32 Composition of overdues (as a percentage of loans and advances)



Overdue amounts in respect of mortgage loans and instalment debtors were the main contributors to the higher total overdue ratio as outlined below:

- Mortgage loans overdue expressed as a percentage of total mortgage loans deteriorated from 1,0 per cent at the end of December 2006 to 1,5 per cent at the end of December 2007

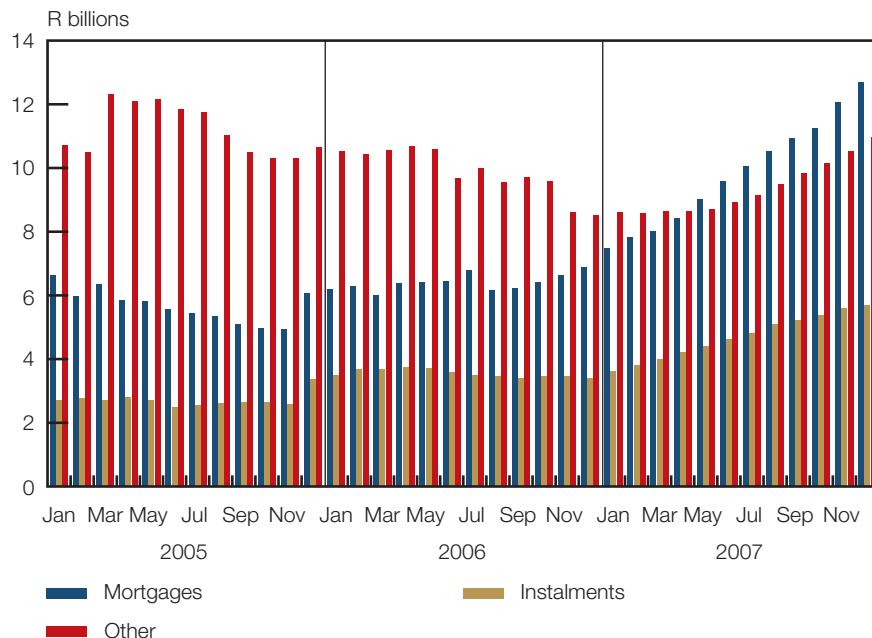
- Expressed as a percentage of total instalment debtors, instalment debtors overdue increased from 1,6 per cent at the end of December 2006 to 2,4 per cent at the end of December 2007
- Other loans and advances overdue expressed as a percentage of total other loans and advances increased slightly from 1,0 per cent at the end of December 2006 to 1,1 per cent at the end of December 2007.

monetary value of gross overdues

A breakdown of the monetary value of gross overdues according to the different asset categories is presented in Figure 33. Gross amounts overdue in respect of mortgage loans increased significantly from R6,9 billion in December 2006 to R12,7 billion in December 2007, now exceeding other loans and advances overdue. The increase in the mortgage loans overdue was mainly a result of increased interest rates.

Other loans and advances overdue increased from R8,5 billion at the end of December 2006 to R11,0 billion at the end of December 2007, while instalment debtors overdue increased from R3,4 billion in December 2006 to R5,7 billion in December 2007.

Figure 33 Analysis of overdues



4.6.2 Provisioning

banking sector adequately provided

In terms of the minimum regulatory provisioning requirements, the banking sector was adequately provided for throughout 2007.

Specific provisions and the market value of security held expressed as a percentage of gross overdues decreased from 100,7 per cent in December 2006 to 93,7 in December 2007 (refer to Figure 34) owing to the substantial increase in gross overdues as discussed above. Specific provisions as a percentage of gross overdues decreased from 54,5 per cent in December 2006 to 44,9 per cent in December 2007.

Specific provisions, expressed as a percentage of gross overdues per asset category, amounted to the following at the end of December 2007:

- Mortgage loans: 21,0 per cent (30,2 per cent on 31 December 2006)

- Instalment debtors: 45,7 per cent (57,7 per cent on 31 December 2006)
- Other loans and advances: 72,0 per cent (72,9 per cent on 31 December 2006).

Figure 34 Specific provisions and the market value of security held as a percentage of gross overdues

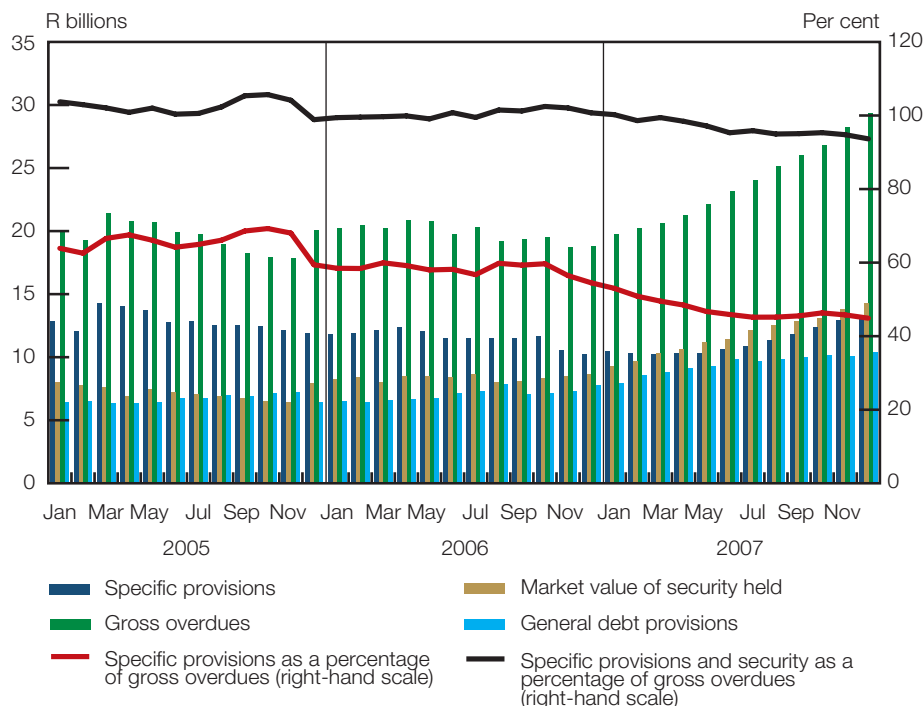
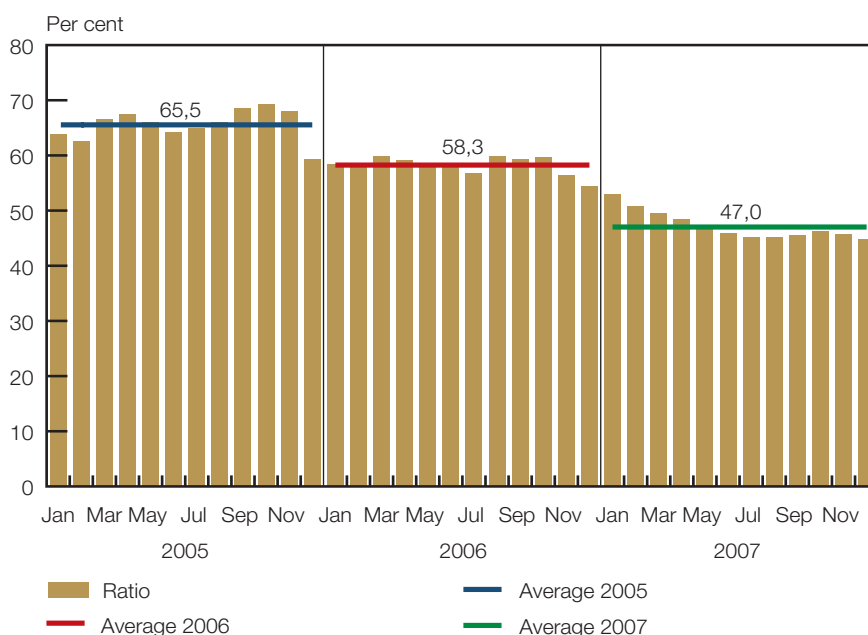


Figure 35 depicts specific provisions as a percentage of gross overdues from January 2005 to December 2007. On average, specific provisions as a percentage of gross overdues declined from an average of 65,5 per cent in 2005 to 58,2 per cent in 2006 and, thereafter, to 47,0 per cent in 2007. The ratio deteriorated sharply during the first

specific provisions as percentage of gross overdues declined

Figure 35 Specific provisions as a percentage of gross overdues



half of 2007 as specific provisions increased at a lower rate than that of gross amounts overdue. The main contributor to the deterioration was mortgage loans. The accounting impairments in terms of IFRS also contributed to the reduction in the specific provisioning ratio.

4.6.3 Large exposures

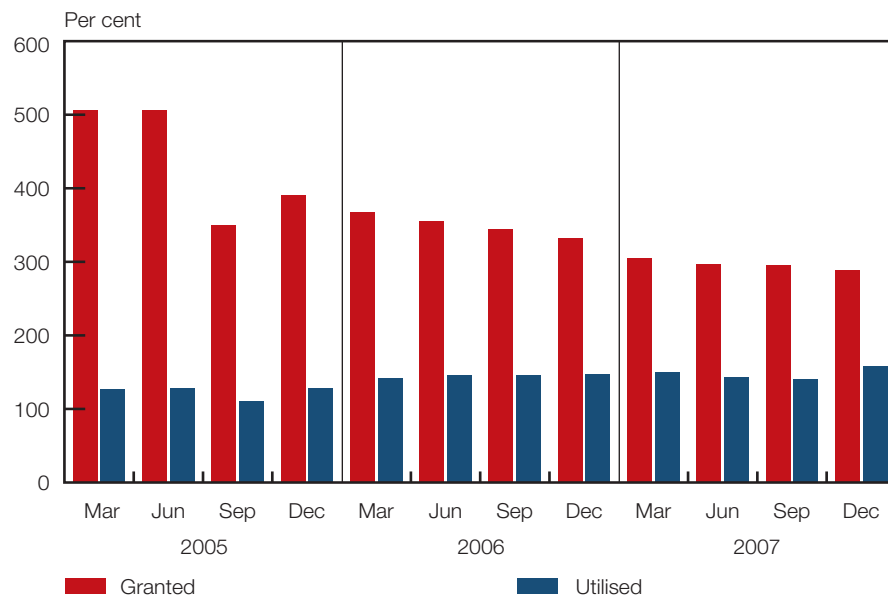
In terms of section 73(1)(b) of the Banks Act, 1990, exposures granted that exceed 10 per cent of qualifying capital and reserves (referred to as 'large exposures') should not exceed, in total, 800 per cent of qualifying capital and reserves, and any single exposure granted exceeding 25 per cent should be an impairment against the capital of a bank. This requirement only refers to large exposures to private-sector non-bank borrowers. The total of the large exposures analysed in this report includes, *inter alia*, exposures to government and other banking institutions.

As shown in Figure 36, large exposures granted as a percentage of net qualifying capital decreased from 332,9 per cent at the end of December 2006 to 288,4 per cent at the end of December 2007.

large exposures utilised increased

Large exposures utilised as a percentage of net qualifying capital and reserves increased from 147,2 per cent at the end of December 2006 to 157,9 per cent at the end of December 2007, mainly due to an increase in 'other exposures' (consists of exposures to government, public-sector exposures and exposures secured by cash deposits) and an increase in exposures to banks or regulated securities firms.

Figure 36 Large exposures as a percentage of net qualifying capital and reserves

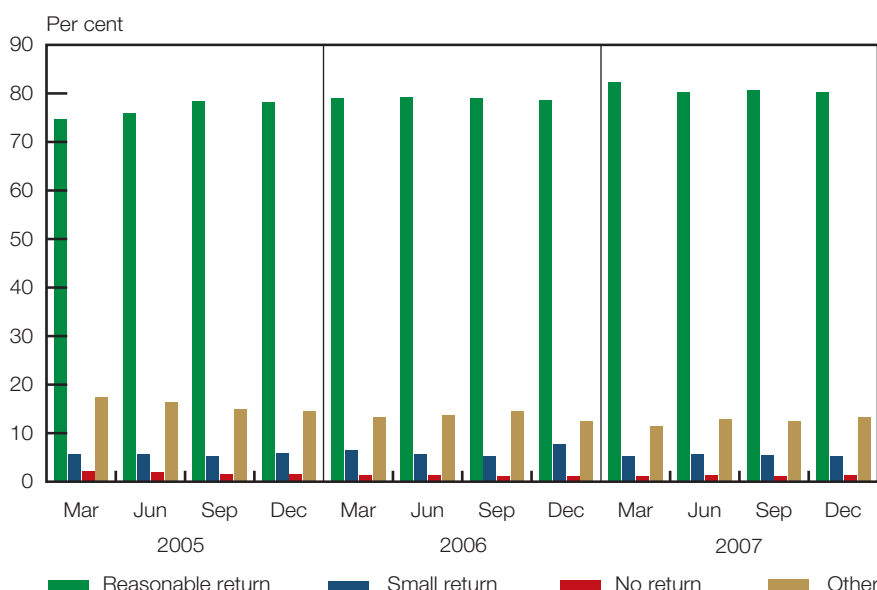


4.6.4 Quality of assets

Figure 37 indicates that 80,2 per cent of banking-sector assets earned a reasonable return at the end of December 2007, compared with the 78,6 per cent at the end of December 2006. The percentage of assets that earned a small return declined from 7,8 per cent at the end of December 2006 to 5,3 per cent at the end of December 2007, whereas 1,3 per cent earned no return (1,2 per cent at the end of December 2006).

Assets classified as 'other' amounted to 13,3 per cent of total assets at the end of December 2007 (12,5 per cent at the end of December 2006).

Figure 37 Asset performance

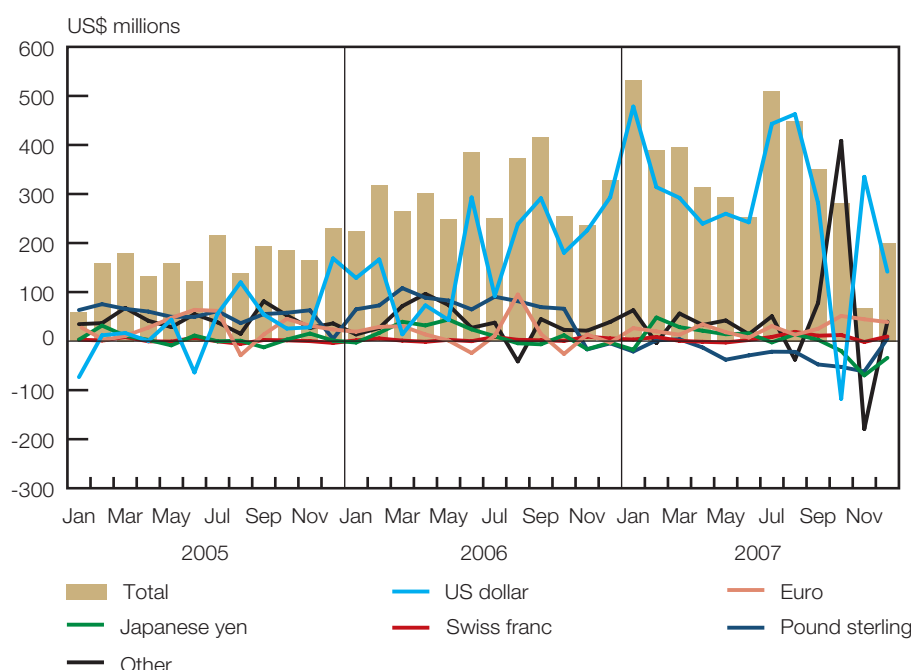


4.7 Currency risk

Figure 38 illustrates the total aggregated effective net open foreign-currency position, as well as the net open positions per currency. In general, the total aggregated effective net open foreign-currency position was higher during 2007 than in previous years, with substantial US dollar and 'other currency' fluctuations reported in October 2007 and November 2007. The US dollar positions continued to be the main contributors to the larger aggregated effective net open foreign-currency position.

US dollar positions continued to be main contributors

Figure 38 Aggregated effective net open foreign-currency position (all currencies converted to US dollar)



The total aggregated effective net open foreign-currency position increased from US\$327,2 million in December 2006 to US\$532,0 million in January 2007, its highest level reported in 2007, due to the US dollar positions increasing as a result of favourable market conditions. The lowest level was reported in November 2007 at US\$66,6 million.

In October 2007 the net open position in 'other' currencies increased to US\$408,3 million due to a transaction in Taiwanese dollar by one bank. The US dollar net open position equalled -US\$117,7 million (short position) at the end of October 2007. The year ended with a total aggregated effective net open foreign-currency position amounting to US\$200,2 million.

During 2007 the maximum effective net open foreign-currency position as a percentage of net qualifying capital and reserves remained well within the 10 per cent statutory limit, but generally fluctuated above the levels reported during 2006 (refer to Figure 39). As a percentage of net qualifying capital and reserves, the maximum effective net open foreign-currency position declined from 1,5 per cent in December 2006 to 1,1 per cent in December 2007, reaching its highest ratio at the end of April 2007, amounting to 3,3 per cent.

Figure 39 Maximum effective net open foreign-currency position as a percentage of net qualifying capital and reserves

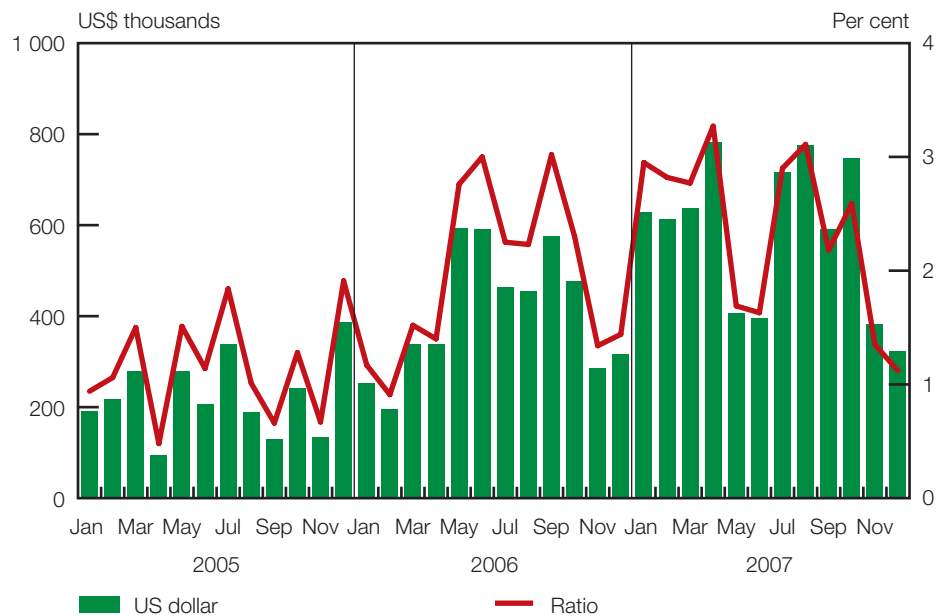
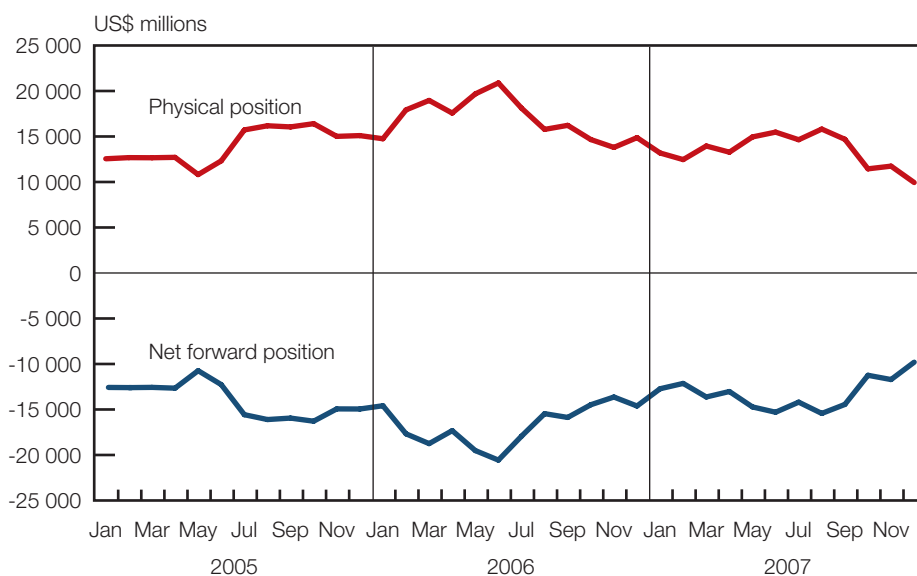


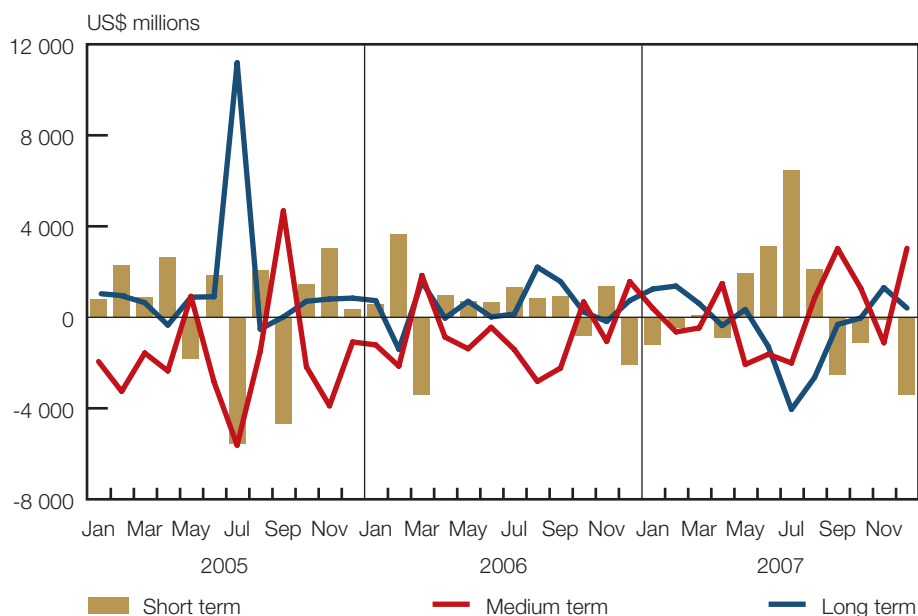
Figure 40 presents the position in foreign-currency instruments. The physical position equals the difference between foreign assets and foreign liabilities, whereas the net forward position is the difference between commitments to sell foreign currency and commitments to purchase foreign currency. The physical position decreased from US\$14,9 billion in December 2006 to US\$9,9 billion in December 2007, whereas the net forward short position decreased from US\$14,6 billion in December 2006 to US\$9,8 billion in December 2007. The physical position mirrored the movements of the forward position in order to maintain the overall net open position within the regulatory limit of 10 per cent of qualifying capital.

Figure 40 Position in foreign-currency instruments



The liquidity-maturity structure of foreign assets, liabilities and commitments is portrayed in Figure 41. During 2007, as in previous years, the net impact of the maturity ladder was small.

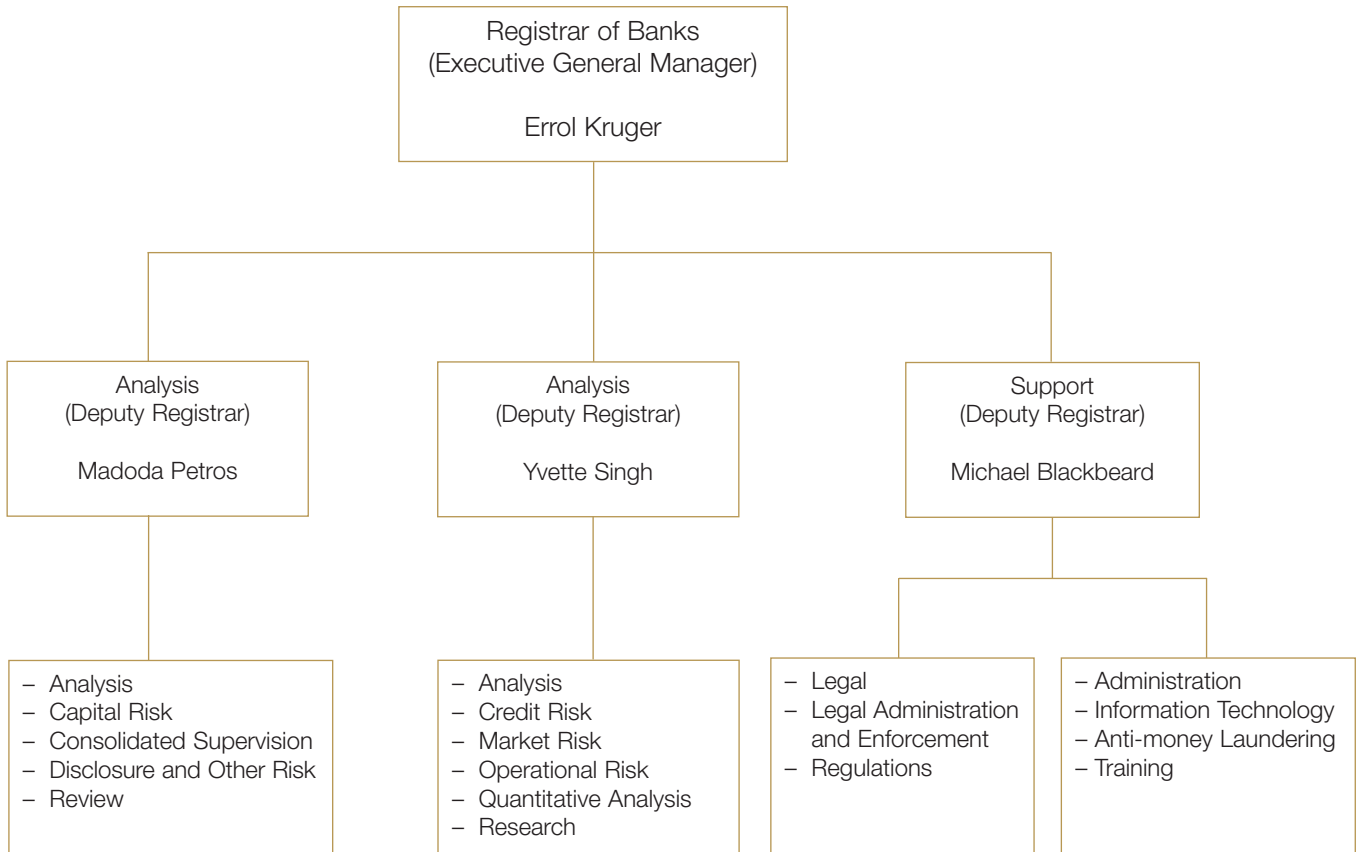
Figure 41 Maturity structure of forward contracts denominated in US dollar



Appendices

Appendix 1

Organisational structure of the Bank Supervision Department



Appendix 2

Registered banks, mutual banks and local branches of foreign banks as at 31 December 2007

Registered banks

Institution	Address	Total assets at 31 December		Annual growth Per cent
		2006 R million	2007 R million	
1 Absa Bank Limited	P O Box 7735, Johannesburg, 2000	446 402	579 199	29,75
2 African Bank Limited	Private Bag X170, Halfway House, 1685	8 353	11 762	40,81
3 Albaraka Bank Limited	P O Box 4395, Durban, 4000	1 441	1 681	16,61
4 Bidvest Bank Limited	P O Box 185, Johannesburg, 2000	561	767	36,78
5 Capitec Bank Limited	P O Box 12451, Die Boord, Stellenbosch, 7613	1 810	2 730	50,78
6 FirstRand Bank Limited	P O Box 786273, Sandton, 2146	388 171	492 760	26,94
7 Grindrod Bank Limited	P O Box 1, Durban, 4000	1 000	1 734	73,32
8 Habib Overseas Bank Limited	P O Box 62369, Marshalltown, 2107	485	538	11,06
9 HBZ Bank Limited	P O Box 1536, Wandsbeck, 3631	1 195	1 321	10,57
10 Imperial Bank Limited	P O Box 6093, Rivonia, 2128	30 862	37 534	21,62
11 Investec Bank Limited	P O Box 785700, Sandton, 2146	117 836	146 394	24,24
12 Mercantile Bank Limited	P O Box 782699, Sandton, 2146	4 497	4 751	5,64
13 Nedbank Limited	P O Box 1144, Johannesburg, 2000	379 331	436 698	15,12
14 Sasfin Bank Limited	P O Box 95104, Grant Park, 2051	1 158	1 568	35,38
15 TEBA Bank Limited	Private Bag X101, Sunninghill, 2157	2 349	2 579	9,79
16 The South African Bank of Athens Limited	P O Box 7781, Johannesburg, 2000	835	1 149	37,63
17 The Standard Bank of South Africa Limited	P O Box 7725, Johannesburg, 2000	530 761	659 110	24,18

Appendix 2

Registered banks, mutual banks and local branches of foreign banks as at 31 December 2007 (continued)

Bank (with effect from 1 July 1996) in terms of the Supervision of Financial Institutions Rationalisation Act, 1996 (Act No. 32 of 1996)

Institution	Address	Total assets at 31 December		Annual growth Per cent
		2006 R million	2007 R million	
1 MEEG Bank Limited	P O Box 429, East London, 5200	937	1 057	12,86

Registered mutual banks

Institution	Address	Total assets at 31 December		Annual growth Per cent
		2006 R million	2007 R million	
1 GBS Mutual Bank	P O Box 114, Grahamstown, 6140	571	651	14,01
2 VBS Mutual Bank	P O Box 3618, Makhado, 0920	228	234	2,63

Registered local branches of foreign banks

Institution	Address	Total assets at 31 December		Annual growth Per cent
		2006 R million	2007 R million	
1 ABN AMRO Bank NV	P O Box 78769, Sandton, 2146	16 009	21 951	37,12
2 Bank of Baroda	91/121 Cowey Road, Cowey Park, Berea, Durban, 4001	258	285	10,65
3 Bank of China Limited Johannesburg Branch (trading as Bank of China Johannesburg Branch)	P O Box 782616, Sandton, 2146	502	927	84,64
4 Bank of Taiwan South Africa Branch	P O Box 1999, Parklands, 2121	362	365	0,92
5 Calyon (trading as Calyon Corporate and Investment Bank)	P O Box 527, Melrose Arch, 2076	22 139	19 814	-10,51
6 China Construction Bank Corporation – Johannesburg Branch	Private Bag X10007, Sandton, 2146	1 453	2 644	81,96
7 Citibank NA	P O Box 1800, Saxonwold, 2132	36 241	34 141	-5,79
8 Commerzbank Aktiengesellschaft	P O Box 860, Parklands, 2121	6 369	10 145	59,28
9 Deutsche Bank AG	Private Bag X9933, Sandton, 2146	17 730	16 069	-9,37

Appendix 2

Registered banks, mutual banks and local branches of foreign banks as at 31 December 2007 (continued)

Registered local branches of foreign banks (continued)

10	JPMorgan Chase Bank, NA (Johannesburg Branch)	Private Bag X9936, Sandton, 2146	32 110	24 778	-22,84
11	Société Générale	P O Box 6872, Johannesburg, 2000	4 380	7 212	64,66
12	Standard Chartered Bank (Johannesburg Branch)	P O Box 782080, Sandton, 2146	4 040	7 723	91,18
13	State Bank of India	P O Box 2538, Saxonwold, 2132	592	1 470	148,40
14	The Hongkong and Shanghai Banking Corporation Limited	Private Bag X785434, Sandton, 2146	13 456	14 371	6,80

Banks in final liquidation

Institution	Liquidator	Date of order
1 Islamic Bank Limited	Mr A D Wilkins of Deloitte & Touche	13 January 1998
2 Regal Treasury Private Bank Limited	Mr T A P du Plessis of D&N Trust and Mr J Pema of Sekela Antrust (Pty) Limited	10 February 2004

Appendix 3

Name changes and cancellation of registration of banks and branches of foreign banks during the period 1 January 2007 to 31 December 2007

Name changes

Previous name	New name	Date of change
1 Rennies Bank Limited	Bidvest Bank Limited	1 August 2007

Appendix 4

Registered controlling companies as at 31 December 2007

Institution	Address
1 ABSA Group Limited	P O Box 7735, Johannesburg, 2000
2 African Bank Investments Limited	Private Bag X170, Halfway House, 1685
3 Bidvest Bank Holdings Limited	P O Box 185, Johannesburg, 2000
4 Capitec Bank Holdings Limited	P O Box 12451, Die Boord, Stellenbosch, 7613
5 FirstRand Bank Holdings Limited	P O Box 786273, Sandton, 2146
6 Grindrod Financial Holdings Limited	P O Box 1, Durban, 4000
7 Investec Limited	P O Box 785700, Sandton, 2146
8 Mercantile Bank Holdings Limited	P O Box 782699, Sandton, 2146
9 Nedbank Group Limited	P O Box 1144, Johannesburg, 2000
10 Sasfin Holdings Limited	P O Box 95104, Grant Park, 2051
11 Standard Bank Group Limited	P O Box 7725, Johannesburg, 2000
12 TEBA Bank Controlling Company Limited	Private Bag X101, Sunninghill, 2157

The following institutions are deemed to be controlling companies in terms of section 42 of the Banks Act, 1990:

1 Albaraka Banking Group (in respect of Albaraka Bank Limited)	P O Box 1882, Manama, Kingdom of Bahrain
2 National Bank of Greece (in respect of The South African Bank of Athens Limited)	86 Eolou Street, Athens TT 121, Greece
3 Pitcairn's Finance (in respect of Habib Bank Limited)	121, Avenue de la Faiencerie, L-1511 Luxemburg, RCS Luxemburg, B nr 33 – 106

Appendix 5

Foreign banks with approved local representative offices

Institution	Address
1 American Express Bank Limited	P O Box 651, Parklands, 2121
2 Banco BPI, SA	P O Box 303, Bruma, 2026
3 Banco Espirito Santo e Comercial de Lisboa	P O Box 749, Bruma, 2026
4 Banco Privado Português, SA	P O Box 78407, Sandton, 2146
5 Banco Santander Totta SA	P O Box 309, Bruma, 2026
6 Bank Leumi Le-Israel BM	Private Bag X41, Saxonwold, 2132
7 Bank of Cyprus Group	P O Box 652176, Benmore, 2010
8 Bank of India	P O Box 653589, Benmore, 2010
9 BNP Paribas Johannesburg	Postnet Suite 508, Private Bag X9, Benmore, 2010
10 Barclays Bank plc	P O Box 1542, Saxonwold, 2132
11 Barclays Private Clients International Limited	P O Box 1542, Saxonwold, 2132
12 Bayerische Hypo- und Vereinsbank AG	P O Box 1483, Parklands, 2121
13 Crédit Industriel et Commercial	302 Portofino, 30 9th Street, Killarney, 2193
14 Credit Suisse	Private Bag X9911, Sandton, 2146
15 Credit Suisse Securities (Europe) Limited	Private Bag X9911, Sandton, 2146
16 Dresdner Bank AG	P O Box 413355, Craighall, 2024
17 Dresdner Kleinwort Limited	P O Box 413355, Craighall, 2146
18 Export-Import Bank of India	P O Box 2018, Saxonwold, 2132
19 Fairbairn Private Bank (Isle of Man) Limited	P O Box 787549, Sandton, 2146
20 Fairbairn Private Bank (Jersey) Limited	P O Box 787549, Sandton, 2146
21 First Bank of Nigeria	P O Box 784796, Sandton, 2146
22 Fortis Bank (Nederland) NV	P O Box 652065, Benmore, 2010
23 Hellenic Bank Public Company Limited	P O Box 783392, Sandton, 2146
24 HSBC Bank International Limited	Private Bag X785434, Sandton, 2146
25 Icici Limited	P O Box 78261, Sandton, 2146
26 ING Bank (Switzerland) Limited	P O Box 650660, Benmore, 2010
27 LSCB IMEX Bank	P O Box 31262, Tokai, 7966
28 Lloyds TSB Offshore Limited	Private Bank X25, Northlands, 2116
29 Marfin Popular Bank	Suite 199, Private Bag X9916, Village Walk, Sandton, 2146
30 Millenium BCP	P O Box 273, Bruma, 2026
31 Natexis Southern Africa Representative Office	Postnet Suite 352, Private Bag X1, Melrose Arch, 2057
32 National Bank of Egypt	P O Box 55402, Northlands, 2116
33 Rothschild Bank International Limited	P O Box 411332, Craighall, 2024
34 Royal Bank of Canada Europe Limited	P O Box 784568, Sandton, 2146
35 Société Générale Representative Office for Southern Africa	P O Box 2805, Saxonwold, 2132
36 Sumitomo Mitsui Banking Corporation	Private Bag X134, Bryanston, 2021

Appendix 5

Foreign banks with approved local representative offices (continued)

Institution	Address
37 The Bank of New York, Johannesburg Representative Office	Postnet Suite 100, Private Bag X43, Sunninghill, 2157
38 The Bank of Tokyo-Mitsubishi, UFJ Limited	P O Box 78519, Sandton, 2146
39 The Representative Office for Southern and Eastern Africa of the Export-Import Bank of China	Postnet Suite 158, Private Bag X91, Benmore, 2010
40 The Royal Bank of Scotland	3 Merchant Place, 1 Fredman Drive, Sandton, 2146
41 UBS AG	P O Box 652863, Benmore, 2010
42 Union Bank of Nigeria plc	P O Box 653125, Benmore, 2010
43 Vnesheconombank	P O Box 413742, Craighall, 2024
44 Wachovia Bank, NA	P O Box 3091, Saxonwold, 2132
45 WestLB AG	P O Box 786126, Sandton, 2146
46 Zenith Bank plc	P O Box 782652, Sandton, 2146

Appendix 6

Trends in South African banks

The following tables have been selected for publication because they disclose the following:

- The most important industry trends.
- Industry statistics that facilitate banks' evaluation of their own positions.

Note: Certain of the comparative figures in respect of 2005 and 2006 may differ from those reported in the 2005 and 2006 Annual Reports since banks had submitted their amended returns after publication of these reports.

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Table 1**Composition of balance sheet – liabilities**

	Interbank funding R million	Non-bank funding R million	Foreign funding R million	Loans received under repurchase agreements R million	Other liabilities R million	Acknow- ledgements of debt R million	Capital and reserves R million	Total liabilities R million
Average month-end balance for quarter								
2005:01	83 317	940 484	46 996	53 429	278 443	270	125 927	1 528 867
2005:02	80 915	980 976	49 743	54 801	251 400	255	126 294	1 544 385
2005:03	86 348	1 036 035	53 665	48 564	262 387	173	129 626	1 616 798
2005:04	82 634	1 077 432	55 737	57 010	248 957	597	132 685	1 655 052
2006:01	97 138	1 146 621	61 003	62 834	261 082	285	137 085	1 766 047
2006:02	103 974	1 213 106	72 988	63 437	278 756	108	148 428	1 880 796
2006:03	107 437	1 267 829	88 797	60 866	310 134	247	155 221	1 990 532
2006:04	112 594	1 337 173	89 613	62 545	298 636	573	161 363	2 062 497
2007:01	117 137	1 401 861	93 884	69 671	288 681	483	173 040	2 144 758
2007:02	130 404	1 477 982	100 591	58 538	296 631	355	180 614	2 245 115
2007:03	132 508	1 559 966	120 382	75 720	331 211	293	187 205	2 407 285
2007:04	135 535	1 628 022	123 752	84 359	356 738	306	196 166	2 524 879
Month-end balance for year								
Dec 2005	85 611	1 101 532	56 822	54 307	244 957	1 004	133 308	1 677 541
Dec 2006	113 665	1 353 166	89 542	61 543	291 899	294	165 143	2 075 252
Dec 2007	135 004	1 657 796	124 480	89 187	336 792	364	203 357	2 546 980
Average for 12 months								
2005	83 304	1 008 732	51 535	53 451	260 297	324	128 633	1 586 275
2006	105 286	1 241 182	78 100	62 421	287 152	303	150 524	1 924 968
2007	128 896	1 516 958	109 652	72 072	318 315	359	184 256	2 330 509
Annual growth								
	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
2005	17,7	21,1	24,2	4,8	-16,3	108,7	6,7	12,0
2006	32,8	22,8	57,6	13,3	19,2	-70,7	23,9	23,7
2007	18,8	22,5	39,0	44,9	15,4	23,8	23,1	22,7

Table 2

Composition of balance sheet – assets

	Money R million	Interbank advances R million	Non-bank advances R million	Loans granted under resale agreements R million	Investment portfolio R million	Non- financial assets R million	Clients' liabilities for acknow- ledgements of debt discounted R million	Other assets R million	Total assets R million
Average month-end balance for quarter									
2005:01	31 475	69 229	1 047 284	35 409	298 967	11 582	270	34 651	1 528 867
2005:02	33 010	62 112	1 095 289	38 529	272 285	11 948	255	30 956	1 544 385
2005:03	33 659	73 193	1 168 549	34 397	262 368	12 125	173	32 334	1 616 798
2005:04	37 350	68 066	1 217 221	38 306	247 043	13 262	571	33 233	1 655 052
2006:01	37 859	80 641	1 303 491	48 672	246 166	13 448	272	35 499	1 766 047
2006:02	37 200	92 573	1 390 506	59 793	252 855	13 535	108	34 225	1 880 796
2006:03	40 859	90 023	1 477 790	59 536	272 669	13 784	247	35 624	1 990 532
2006:04	45 046	98 201	1 545 119	60 190	265 181	14 231	573	33 956	2 062 497
2007:01	46 852	98 761	1 634 663	65 854	246 559	14 626	483	36 960	2 144 758
2007:02	47 933	99 933	1 725 209	55 345	256 757	14 934	355	44 649	2 245 115
2007:03	51 734	114 130	1 825 010	75 730	275 829	15 745	296	48 810	2 407 285
2007:04	54 991	122 140	1 876 605	83 082	319 472	16 702	315	51 571	2 524 879
Month-end balance for year									
Dec 2005	38 338	72 245	1 231 409	34 648	254 282	13 841	962	31 816	1 677 541
Dec 2006	47 163	91 021	1 575 347	55 581	261 110	14 652	294	30 083	2 075 252
Dec 2007	58 619	122 378	1 891 965	91 917	319 380	17 478	373	44 869	2 546 980
Average for 12 months									
2005	33 874	68 150	1 132 086	36 660	270 166	12 229	318	32 794	1 586 275
2006	40 241	90 359	1 429 227	57 048	259 218	13 750	300	34 826	1 924 968
2007	50 378	108 741	1 765 372	70 003	274 654	15 502	362	45 497	2 330 509
Annual growth									
	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
2005	18,6	31,9	21,4	19,2	-23,2	18,9	99,8	27,2	12,0
2006	23,0	26,0	27,9	60,4	2,7	5,9	-69,4	-5,4	23,7
2007	24,3	34,5	20,1	65,4	22,3	19,3	27,0	49,2	22,7

Table 3

Composition of selected liabilities

	Deposits					Loans under repurchase agreements				Foreign funding		
	Demand R million	Savings R million	Fixed and notice R million	Negotiable certificates of deposit R million	Total R million	SARB and Corporation for Public Deposits R million	Banks R million	Non-banks R million	Total R million	Banks R million	Non-banks R million	Total R million
Average month-end balance for quarter												
2005:01	431 912	50 518	333 830	124 224	940 484	13 934	27 079	12 416	53 429	24 955	22 040	46 996
2005:02	443 557	51 933	355 450	130 035	980 976	14 118	26 987	13 697	54 801	26 530	23 213	49 743
2005:03	475 021	53 934	364 538	142 541	1 036 035	14 085	19 790	14 688	48 564	27 415	26 250	53 665
2005:04	499 587	57 070	371 517	149 258	1 077 432	12 225	24 996	19 789	57 010	26 917	28 820	55 737
2006:01	515 360	60 958	399 842	170 461	1 146 621	12 869	29 103	20 863	62 834	34 662	26 341	61 003
2006:02	536 170	65 329	427 864	183 742	1 213 106	13 162	30 161	20 115	63 437	46 837	26 151	72 988
2006:03	583 196	69 396	441 686	173 550	1 267 829	12 939	29 179	18 749	60 866	60 739	28 059	88 797
2006:04	610 710	72 332	455 279	198 852	1 337 173	12 768	25 831	23 946	62 545	58 255	31 358	89 613
2007:01	626 134	73 374	467 299	235 055	1 401 861	14 128	30 629	24 914	69 671	60 440	33 444	93 884
2007:02	636 405	78 708	491 797	271 073	1 477 982	13 302	21 887	23 349	58 538	65 264	35 327	100 591
2007:03	669 670	83 651	510 659	295 985	1 559 966	12 644	41 719	21 357	75 720	84 143	36 239	120 382
2007:04	702 050	88 566	534 436	302 969	1 628 022	13 442	45 322	25 595	84 359	84 051	39 701	123 752
Month-end balance for year												
Dec 2005	511 728	57 870	380 353	151 581	1 101 532	11 909	23 465	18 934	54 307	27 100	29 722	56 822
Dec 2006	624 409	72 799	451 696	204 262	1 353 166	12 484	24 208	24 851	61 543	57 102	32 441	89 542
Dec 20 07	730 426	90 226	542 459	294 685	1 657 796	11 964	51 551	25 672	89 187	80 255	44 225	124 480
Average for 12 months												
2005	462 519	53 364	356 334	136 515	1 008 732	13 591	24 713	15 148	53 451	26 454	25 081	51 535
2006	561 359	67 004	431 168	181 651	1 241 182	12 934	28 569	20 918	62 421	50 123	27 977	78 100
2007	658 565	81 075	501 048	276 271	1 516 958	13 379	34 889	23 804	72 072	73 475	36 178	109 652
Annual growth	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
2005	19,4	13,3	18,8	38,0	21,1	-11,4	-3,4	34,5	4,8	31,4	18,2	24,2
2006	22,0	25,8	18,8	34,8	22,8	4,8	3,2	31,3	13,3	110,7	9,1	57,6
2007	17,0	23,9	20,1	44,3	22,5	-4,2	112,9	3,3	44,9	40,5	36,3	39,0

Table 4

Composition of loans and advances to non-banks

	Negotiable certificates of deposit R million	Instalment debtors R million	Mortgage loans R million	Credit cards R million	Acknow- ledgements of debt R million	Redeem- able preference shares R million	Overdrafts and loans R million	Foreign- currency loans and advances R million	Less: specific provisions R million	Total R million
Average month-end balance for quarter										
2005:01	21 123	156 678	417 061	23 531	24 319	15 396	287 312	118 521	16 656	1 047 284
2005:02	22 564	164 133	443 934	25 427	25 135	17 817	290 663	123 323	17 707	1 095 289
2005:03	24 793	171 876	477 237	27 289	24 924	18 275	287 709	153 143	16 698	1 168 549
2005:04	22 477	179 251	509 984	29 969	26 370	17 767	295 616	151 556	15 770	1 217 221
2006:01	26 187	187 356	542 653	32 950	28 562	19 149	322 426	159 768	15 561	1 303 491
2006:02	25 746	195 170	580 218	35 523	30 237	22 209	321 921	195 112	15 630	1 390 506
2006:03	21 302	201 932	623 438	38 230	34 522	23 980	343 556	206 233	15 402	1 477 790
2006:04	23 938	204 773	667 485	42 236	32 635	23 666	373 905	191 060	14 578	1 545 119
2007:01	27 327	214 416	703 659	47 037	37 609	24 768	405 905	187 913	13 971	1 634 663
2007:02	28 389	218 764	741 741	51 010	42 717	26 501	429 647	200 874	14 435	1 725 209
2007:03	28 036	224 182	790 506	53 584	46 076	27 717	448 263	222 199	15 553	1 825 010
2007:04	30 756	231 322	835 886	54 919	47 557	28 194	473 295	191 989	17 314	1 876 605
Month-end balance for year										
Dec 2005	21 225	182 165	522 416	31 207	27 461	18 258	298 509	145 497	15 331	1 231 409
Dec 2006	24 382	207 401	680 892	43 944	34 087	23 311	383 492	191 679	13 840	1 575 347
Dec 2007	26 970	234 192	849 046	55 135	47 196	28 489	478 526	190 352	17 941	1 891 965
Average for 12 months										
2005	22 740	167 985	462 054	26 554	25 187	17 314	290 325	136 636	16 708	1 132 086
2006	24 293	197 308	603 448	37 235	31 489	22 251	340 452	188 043	15 293	1 429 227
2007	28 627	222 171	767 948	51 638	43 490	26 795	439 278	200 744	15 318	1 765 372
Annual growth										
2005	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
2005	27,0	19,5	28,6	47,4	22,1	16,2	7,0	24,7	-5,2	21,4
2006	14,9	13,9	30,3	40,8	24,1	27,7	28,5	31,7	-9,7	27,9
2007	10,6	12,9	24,7	25,5	38,5	22,2	24,8	-0,7	29,6	20,1

Table 5

Funding maturity structure

	Short term Per cent	Medium term Per cent	Long term Per cent
Average month-end ratio for quarter			
2005:01	64,7	21,7	13,6
2005:02	63,9	21,4	14,6
2005:03	64,0	20,7	15,3
2005:04	64,3	20,5	15,2
2006:01	63,5	20,4	16,1
2006:02	62,9	19,8	17,3
2006:03	65,7	17,2	17,1
2006:04	64,6	18,1	17,3
2007:01	63,8	17,5	18,8
2007:02	61,5	19,0	19,5
2007:03	62,3	19,0	18,7
2007:04	62,3	18,7	19,0
Month-end ratio for year			
Dec 2005	64,6	20,6	14,8
Dec 2006	65,6	17,4	17,0
Dec 2007	64,9	16,5	18,6
Average for 12 months			
2005	64,2	21,1	14,7
2006	64,2	18,8	17,0
2007	62,4	18,6	19,0

Table 6

Analysis of capital and reserves

	Primary capital and reserves R million	Secondary capital and reserves R million	Tertiary capital and reserves R million	Total capital and reserves R million	Less: impairments R million	Net qualifying capital and reserves R million	As a percentage of total risk exposure		
							Primary capital and reserves Per cent	Impairments Per cent	Secondary capital and reserves Per cent
Average month-end balance for quarter									
2005:01	90 371	33 687	1 891	125 948	7 266	118 682	11,1	0,9	4,1
2005:02	93 087	34 869	1 602	129 558	7 542	122 017	11,0	0,9	4,1
2005:03	94 506	35 490	1 499	131 495	9 192	122 302	10,6	1,0	4,0
2005:04	99 242	36 028	1 437	136 707	8 661	128 045	10,6	0,9	3,9
2006:01	103 961	35 553	1 234	140 747	6 470	134 277	10,6	0,7	3,6
2006:02	105 890	42 812	1 413	150 115	6 621	143 493	10,3	0,6	4,1
2006:03	108 011	45 133	1 506	154 650	8 596	146 054	9,7	0,8	4,1
2006:04	117 519	44 654	1 381	163 555	9 216	154 339	10,0	0,8	3,8
2007:01	121 863	47 345	1 035	170 243	10 010	160 233	9,8	0,8	3,8
2007:02	129 110	50 382	1 156	180 647	10 406	170 241	9,8	0,8	3,8
2007:03	136 132	52 193	1 211	189 536	9 891	179 645	9,9	0,7	3,8
2007:04	145 040	54 671	2 009	201 720	9 577	192 143	10,0	0,7	3,8
Average for 12 months									
2005	9 301	35 018	1 607	130 927	8 166	122 761	10,8	0,9	4,0
2006	108 845	42 038	1 384	152 267	7 726	144 541	10,2	0,7	3,9
2007	133 036	51 148	1 353	185 536	9 971	175 565	9,9	0,8	3,8
Annual growth	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent			
2005	9,8	1,4	-21,9	7,0	-8,5	8,0			
2006	18,5	28,9	-7,3	20,9	36,3	20,0			
2007	25,8	25,3	49,5	25,9	-2,0	27,6			

Table 7

Risk profile of assets

	Risk category							Total R million	Risk-weighted assets R million	Risk-weighted assets as a percentage of total average assets Per cent
	0 per cent R million	10 per cent R million	20 per cent R million	50 per cent R million	100 per cent R million	150 per cent R million	Impair- ments R million			
Average month-end balance for quarter										
2005:01	247 037	9 782	101 323	292 385	621 312	93	3 532	1 275 464	824 207	64,6
2005:02	241 379	8 472	102 953	307 861	648 896	0	4 294	1 313 855	867 203	66,0
2005:03	254 692	8 193	120 576	331 319	666 436	3	5 120	1 386 339	908 237	65,5
2005:04	251 372	9 705	133 066	351 122	704 550	30	4 969	1 454 814	957 429	65,8
2006:01	277,003	10,421	134 699	377 215	743 688	61	3 755	1 546 843	997 919	64,5
2006:02	302,157	8,625	158 082	407 864	774 573	72	3 914	1 655 287	1 050 234	63,4
2006:03	323,284	9,023	168 068	435 672	818 023	133	5 601	1 759 803	1 126 578	64,0
2006:04	312,865	10,596	163 323	466 931	876 691	162	6 568	1 837 135	1 209 801	65,9
2007:01	318 507	10 244	157 644	493 587	933 069	208	6 901	1 920 160	1 281 733	66,8
2007:02	327 553	9 024	170 522	514 425	986 765	291	6 853	2 015 433	1 347 948	66,9
2007:03	348 488	9 152	182 503	544 361	1 041 426	254	6 288	2 132 471	1 414 284	66,3
2007:04	361 705	9 919	176 851	573 515	1 101 943	198	6 051	2 230 180	1 485 869	66,6
Month-end balance for year										
Dec 2005	260 898	9 470	125 490	360 454	718 413	60	4 357	1 479 142	968 344	65,5
Dec 2006	305 362	10 699	159 658	477 629	896 690	187	6 993	1 857 216	1 238 712	66,7
Dec 2007	374 982	10 037	174 591	581 048	1 115 958	170	6 301	2 263 086	1 505 671	66,5
Average for 12 months										
2005	248 620	9 038	114 480	320 672	660 299	31	4 479	1 357 618	889 269	65,5
2006	303 827	9 666	156 043	421 920	803 244	107	4 959	1 699 767	1 096 133	64,5
2007	339 063	9 585	171 880	531 472	1 015 801	238	6 523	2 074 561	1 382 458	66,7
Annual growth										
2005	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
2005	7,6	14,1	31,6	26,1	17,9	-100,0	-0,1	18,8	18,7	
2006	17,0	13,0	27,2	32,5	24,8	210,6	60,5	25,6	27,9	
2007	22,8	-6,2	9,4	21,7	24,5	-9,1	-9,9	21,9	21,6	

Table 8

Risk profile of off-balance-sheet items

	Risk category								Total** R million	Risk-weighted off-balance-sheet items R million	Risk-weighted items as a percentage of total average off-balance-sheet items Per cent
	0* per cent R million	5 per cent R million	10 per cent R million	20 per cent R million	50 per cent R million	100 per cent R million	150 per cent R million	Impairments R million			
Average month-end balance for quarter											
2005:01	49 762	248	9 290	8 929	57 259	13 739	16	547	2 082 625	50 590	2,4
2005:02	54 155	401	10 106	11 982	61 245	10 708	0	750	2 113 880	52 254	2,5
2005:03	61 431	479	14 655	12 878	68 064	11 202	0	683	2 459 051	56 133	2,3
2005:04	72 930	321	17 188	11 294	71 277	11 975	0	590	2,689,922	57 504	2,1
2006:01	93 902	464	22 660	11 958	67 525	10 892	0	587	3 164 255	55 207	1,7
2006:02	112 718	218	23 295	11 656	74 275	11 956	0	627	3 203 997	60 034	1,9
2006:03	129 927	333	19 226	14 654	80 890	15 854	0	614	3 277 613	67 309	2,1
2006:04	134 045	279	21 764	16 884	85 098	11 854	0	620	3 653 110	66 172	1,8
2007:01	135 960	175	17 465	15 417	90 259	12 016	0	540	4 079 274	67 381	1,7
2007:02	139 786	267	14 549	16 330	96 060	11 884	0	409	4 255 663	68 745	1,6
2007:03	153 144	313	19 075	16 710	103 885	14 630	0	164	4 244 586	73 474	1,7
2007:04	153 420	640	20 325	17 275	111 030	15 514	0	164	4 486 277	78 183	1,7
Month-end balance for year											
Dec 2005	75 595	279	19 806	11 706	70 699	11 865	0	583	2 849 462	57 380	2,0
Dec 2006	135 636	207	22 415	17 759	84 062	12 425	0	620	3 814 331	66 460	1,7
Dec 2007	144 038	299	20 245	18 975	116 192	16 932	0	164	4 334 164	82 497	1,9
Average for 12 months											
2005	59 570	362	12 810	11 271	64 461	11 906	4	642	2 336 370	54 120	2,3
2006	117 648	323	21 736	13 788	76 947	12 639	0	612	3 324 744	62 181	1,9
2007	145 578	349	17 854	16 433	100 308	13 511	0	319	4 266 450	71 946	1,7
Annual growth											
2005	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
2005	70,1	64,9	134,1	12,3	24,6	8,8	-100,0	56,3	42,0	24,9	
2006	79,4	-25,8	13,2	51,7	18,9	4,7	-100,0	6,3	33,9	15,8	
2007	6,2	44,6	-9,7	6,8	38,2	36,3	-100,0	-73,6	13,6	24,1	

* 0 per cent risk category = total off-balance-sheet activities *minus* central securities depository participation

** Total includes central securities depository participation

Table 9(a)

Risk profile of loans and advances

	0 per cent R million	10 per cent R million	20 per cent R million	50 per cent R million	100 per cent R million	150 per cent R million	1 000 per cent R million	Total R million	Risk- weighted loans and advances R million	Risk-weighted loans and advances as a percentage of total loans and advances Per cent
Month-end balance for year 2005										
Intragroup bank advances	28 784	0	0	0	1 674	0	0	30 458	1 674	5,5
Interbank advances	3	0	35 499	0	0	0	1	35 504	7 113	20,0
Negotiable certificates of deposit	0	0	18 702	0	204	0	0	18 906	3 945	20,9
Instalment debtors	13	1 059	9	0	177 803	0	0	178 884	177 911	99,5
Mortgage loans	2	0	0	357 800	160 636	0	0	518 438	339 536	65,5
Credit card debtors	0	0	0	0	30 634	0	0	30 634	30 634	100,0
Acknowledgements of debt discounted	20 106	38	822	385	4 549	61	16	25 976	5 157	19,9
Redeemable preference shares	0	0	1 277	0	16 516	0	54	17 847	17 311	97,0
Overdrafts and loans	8 455	4 752	404	0	274 163	0	1 802	289 576	292 739	101,1
Foreign-currency loans and advances	71 700	74	59 092	0	9 925	0	519	141 311	26 945	19,1
Loans granted under resale agreements	1 608	1 883	5 800	0	6 603	0	0	15 893	7 951	50,0
– SARB and Corporation for Public Deposits	51	0	0	0	0	0	0	51	0	0,0
– Banks	1 199	0	5 800	0	0	0	0	6 998	1 160	16,6
– Non-banks	358	1 883	0	0	6 603	0	0	8 844	6 791	76,8
Total loans and advances	130 670	7 805	121 605	358 186	682 706	61	2 392	1 303 426	910 915	69,9
Less: specific provisions	7	166	0	0	15 086	0	0	15 259	15 102	99,0

Table 9(b)

Risk profile of loans and advances

	0 per cent R million	10 per cent R million	20 per cent R million	50 per cent R million	100 per cent R million	150 per cent R million	1 000 per cent R million	Total R million	Risk- weighted loans and advances R million	Risk-weighted loans and advances as a percentage of total loans and advances Per cent
Month-end balance for year 2006										
Intragroup bank advances	41 575	0	0	0	2 023	0	0	43 608	2 123	4,9
Interbank advances	194	0	43 730	0	0	0	1	43 924	8 746	19,9
Negotiable certificates of deposit	0	0	22 763	0	0	0	0	22 763	4 553	20,0
Instalment debtors	2	57	1	0	203 574	0	0	203 635	203 580	100,0
Mortgage loans	0	0	0	472 928	202 252	0	0	675 181	438 717	65,0
Credit card debtors	0	0	0	0	42 429	0	0	42 429	42 429	100,0
Acknowledgements of debt discounted	26 967	64	783	520	4 079	187	171	32 771	6 493	19,8
Redeemable preference shares	0	0	1 277	0	22 724	0	12	24 013	23 104	96,2
Overdrafts and loans	9 029	6 737	504	0	349 565	0	2 892	368 727	379 256	102,9
Foreign-currency loans and advances	90 259	81	74 026	0	14 079	0	1 416	179 861	43 052	23,9
Loans granted under resale agreements	1 906	2 129	12 302	0	6 489	0	0	22 826	9 163	40,1
– SARB and Corporation for Public Deposits	44	0	0	0	0	0	0	44	0	0,0
– Banks	1 402	0	12 258	0	0	0	0	13 660	2 452	17,9
– Non-banks	460	2 129	45	0	6 489	0	0	9 122	6 711	73,6
Total loans and advances	169 932	9 068	155 386	473 449	847 213	187	4 501	1 659 737	1 161 215	70,0
Less: specific provisions	10	125	0	1	14 282	0	0	14 417	14 295	99,2

Table 9(c)

Risk profile of loans and advances

	0 per cent R million	10 per cent R million	20 per cent R million	50 per cent R million	100 per cent R million	150 per cent R million	1 000 per cent R million	Total R million	Risk- weighted loans and advances R million	Risk-weighted loans and advances as a percentage of total loans and advances Per cent
Month-end balance for year 2007										
Intragroup bank advances	54 868	0	1	0	1 477	0	10	56 356	1 577	2,8
Interbank advances	194	0	57 363	0	2	0	0	57 365	11 475	20,0
Negotiable certificates of deposit	0	0	27 010	0	0	0	0	27 010	5 402	20,0
Instalment debtors	19	96	6	0	230 997	0	0	231 098	230 988	100,0
Mortgage loans	0	0	0	577 201	267 856	0	0	845 058	556 457	65,8
Credit card debtors	0	0	0	0	55 158	0	0	55 158	55 158	100,0
Acknowledgements of debt discounted	41 333	387	528	743	3 920	156	107	47 173	5 736	12,2
Redeemable preference shares	57	0	1 261	0	26 216	0	12	27 546	26 593	96,5
Overdrafts and loans	18 017	7 289	1 200	0	433 099	0	2 277	461 881	456 835	98,9
Foreign-currency loans and advances	111 016	81	65 736	0	16 904	0	1 435	195 172	44 414	22,8
Loans granted under resale agreements	4 547	801	13 545	0	9 079	0	0	27 972	11 868	42,4
– SARB and Corporation for Public Deposits	679	0	0	0	0	0	0	679	0	0,0
– Banks	3 853	0	13 479	0	0	0	0	17 332	2 696	15,6
– Non-banks	14	801	67	0	9 079	0	0	9 961	9 172	92,1
Total loans and advances	229 856	8 654	166 650	577 944	1 044 688	156	3 841	2 031 789	1 406 502	69,2
Less: specific provisions	129	0	0	1	17 404	0	0	17 534	17 405	99,3

Table 10

Capital adequacy

	Banking book					
	Total risk exposure R million	Counterparty risk exposure R million	Risk-weighted assets and off-balance-sheet items R million	Required capital R million	Net qualifying primary capital and reserves R million	Primary capital adequacy ratio Per cent
Quarter-end balance						
2005:01	821 627	8 934	812 693	82 270	82 382	10,0
2005:02	859 451	8 143	851 308	86 055	84 607	9,8
2005:03	896 683	8 711	887 973	89 799	87 075	9,7
2005:04	949 685	9 296	940 389	95 120	92 194	9,7
2006:01	996 912	10 590	986 322	99 846	99 748	10,0
2006:02	1 047 996	10 216	1 037 780	112 490	94 657	9,0
2006:03	1 117 491	8 159	1 109 332	111 986	103 830	9,3
2006:04	1 197 107	9 677	1 187 430	119 930	107 664	9,0
2007:01	1 270 256	10 240	1 260 016	127 249	118 231	9,3
2007:02	1 338 962	11 320	1 327 642	134 152	119 477	8,9
2007:03	1 399 737	7 556	1 392 181	140 269	134 004	9,6
2007:04	1 467 065	10 093	1 456 972	147 045	139 098	9,5
Average for 12 months						
2005	870 465	8 864	861 602	87 169	86 727	10,0
2006	1 069 162	9 643	1 059 518	111 833	101 780	9,5
2007	1 347 126	9 851	1 337 274	134 980	124 144	9,2
Annual growth						
	Per cent	Per cent	Per cent	Per cent	Per cent	
2005	19,7	-13,6	20,1	19,7	10,9	
2006	26,1	4,1	26,3	26,1	16,8	
2007	22,6	4,3	22,7	22,6	29,2	

Table 11(a)

Composition of income statement

	Average monthly balance for quarter 2005				Average monthly balance for quarter 2006			
	Mar R million	Jun R million	Sep R million	Dec R million	Mar R million	Jun R million	Sep R million	Dec R million
Interest income	8 811	9 422	10 105	10 716	10 657	11 796	13 367	14 388
Interest expense	6 023	6 322	6 772	7 080	6 919	7 596	9 010	9 144
Interest margin	2 788	3 100	3 333	3 636	3 738	4 200	4 357	5 244
Less: specific provisions on loans and advances	617	347	335	411	600	649	694	633
Less: general debt provisions	68	3	58	78	71	182	59	300
Other	-5	-5	0	-5	8	88	2	25
Adjusted interest margin	2 108	2 755	2 940	3 153	3 059	3 059	3 281	4 286
Add: transaction-based fee income	2 340	2 570	2 623	2 643	2 623	2 610	2 955	3 309
Income from management of funds	4 447	5 325	5 563	5 796	5 683	5 891	6 558	7 596
Less: operational expenses	4 076	4 732	4 808	5 117	4 854	5 320	5 137	5 659
Net income from management of funds	371	593	755	679	829	571	1 421	1 937
Add: investment and trading income	2 031	178	-788	1 623	1 035	1 999	991	1 035
Less: specific provisions – investment	-1	0	9	-5	0	-1	0	0
Add: knowledge-based fee income	202	308	276	213	264	240	197	308
Net income before taxation	2 021	1 689	2 126	2 463	2 370	2 466	3 227	3 670
Taxation	444	454	563	646	493	691	809	953
Net income after taxation	1 577	1 235	1 563	1 818	1 878	1 775	2 418	2 717

Table 11(b)

Composition of income statement

	Average monthly balance for quarter 2007				Results for 12 months			Average for year		
	Mar R million	Jun R million	Sep R million	Dec R million	2005 R million	2006 R million	2007 R million	2005 R million	2006 R million	2007 R million
Interest income	15 684	16 753	18 935	20 646	117 162	150 626	216 057	9 764	12 552	18 005
Interest expense	10 699	11 514	13 195	13 975	78 591	98 005	148 149	6 549	8 167	12 346
Interest margin	4 985	5 240	5 740	6 671	38 571	52 620	67 908	3 214	4 385	5 659
Less: specific provisions on loans and advances	918	837	1 353	1 403	5 132	7 729	13 532	428	644	1 128
Less: general debt provisions	123	279	-51	205	619	1 836	1 666	52	153	139
Other	24	29	11	24	-44	369	264	-4	31	22
Adjusted interest margin	3 920	4 095	4 428	5 039	32 865	42 687	52 447	2 739	3 557	4 371
Add: transaction-based fee income	3 063	3 099	3 243	4 140	30 527	34 495	40 635	2 544	2 875	3 386
Income from management of funds	6 983	7 194	7 671	7 671	9 179	31 747	34 352	2 646	2 863	3 257
Less: operational expenses	5 522	6 353	5 960	6 764	56 199	62 907	73 797	4 683	5 242	6 150
Net income from management of funds	1 461	841	1 711	2 415	7 193	14 275	19 285	599	1 190	1 607
Add: investment and trading income	1 403	1 099	1 392	1 187	9 134	15 182	15 245	761	1 265	1 270
Less: specific provisions – investment	0	0	0	0	9	-2	0	1	0	0
Add: knowledge-based fee income	287	246	314	258	2 996	3 027	3 313	250	252	276
Net income before taxation	3 404	2 693	3 619	4 436	24 899	35 202	42 454	2 075	2 934	3 538
Taxation	965	636	948	1 003	6 319	8 837	10 656	527	736	888
Net income after taxation	2 438	2 057	2 671	3 433	18 580	26 365	31 799	1 548	2 197	2 650

Table 12

Profitability: Operating ratios

	Interest income to loans and advances Per cent	Interest expense to funding Per cent	Interest margin Per cent	Provisions to loans and advances Per cent
Average month-end balance for quarter				
2005:01	9,0	5,8	3,2	0,6
2005:02	9,3	5,9	3,4	0,2
2005:03	9,4	6,0	3,4	0,3
2005:04	9,6	6,0	3,6	0,3
2006:01	8,8	5,6	3,3	0,5
2006:02	9,1	5,8	3,3	0,6
2006:03	9,8	6,5	3,2	0,5
2006:04	10,0	6,3	3,7	0,6
2007:01	10,4	7,1	3,3	0,6
2007:02	10,6	7,3	3,3	0,6
2007:03	11,2	7,8	3,4	0,7
2007:04	11,8	7,9	3,9	0,8
Average for the 12 months				
2005	8,7	5,5	3,2	0,3
2006	8,7	5,6	3,1	0,5
2007	10,2	6,9	3,3	0,6

Table 13

Profitability ratios

Stated as a percentage of total assets

	Net income after taxation to total assets Per cent	Net income after taxation to net qualifying capital and reserves Per cent	Interest income Per cent	Interest expense Per cent	Interest margin Per cent	Operating expenses Per cent	Fee income Per cent	Investment and trading income Per cent
Average month-end balance for quarter								
2005:01	1,2	16,0	6,9	4,7	2,2	3,2	2,0	1,6
2005:02	1,0	12,2	7,3	4,9	2,4	3,7	2,2	0,1
2005:03	1,2	15,4	7,5	5,0	2,5	3,6	2,2	-0,6
2005:04	1,3	17,1	7,8	5,1	2,6	3,7	2,1	1,2
2006:01	1,3	16,8	7,2	4,7	2,5	3,3	2,0	0,7
2006:02	1,1	14,8	7,5	4,8	2,7	3,4	1,8	1,3
2006:03	1,5	20,0	8,1	5,4	2,6	3,1	1,9	0,6
2006:04	1,6	21,2	8,4	5,3	3,1	3,3	2,1	0,6
2007:01	1,4	18,3	8,8	6,0	2,8	3,1	1,9	0,8
2007:02	1,1	14,5	9,0	6,2	2,8	3,4	1,8	0,6
2007:03	1,3	17,8	9,4	6,6	2,9	3,0	1,8	0,7
2007:04	1,6	21,5	9,8	6,6	3,2	3,2	2,1	0,6
Average for the 12 months								
2005	1,1	14,5	7,0	4,7	2,3	3,4	2,0	0,5
2006	1,3	17,2	7,3	4,7	2,5	3,0	1,8	0,7
2007	1,2	16,2	8,5	5,8	2,7	2,9	1,7	0,6

Table 14

Percentage composition of interest income

	Interbank loans Per cent	Instal- ment debtors Per cent	Mortgage loans Per cent	Credit cards Per cent	Acknow- ledgements of debt Per cent	Redeem- able pref- erence shares Per cent	Over- drafts and loans Per cent	Foreign- currency loans and advances Per cent	Loans under resale agree- ments Per cent	Negotiable certificates of deposit Per cent	Interest income from invest- ments Per cent
Average month-end balance for quarter											
2005:01	5,9	15,6	36,2	2,9	2,2	1,0	24,6	3,0	1,9	1,4	5,3
2005:02	6,0	15,0	36,7	3,0	2,0	1,3	25,3	3,5	1,9	1,5	3,8
2005:03	9,0	14,5	35,7	3,1	1,8	1,3	25,5	4,4	1,6	1,3	1,7
2005:04	5,3	15,8	37,4	3,4	1,8	1,3	24,8	4,9	1,8	1,3	2,4
2006:01	5,0	15,1	38,3	3,6	1,9	1,2	24,5	5,4	1,6	1,4	2,0
2006:02	5,4	14,4	37,3	3,6	1,7	1,0	23,4	6,5	1,9	1,2	3,5
2006:03	4,7	14,1	38,5	3,7	1,9	1,2	23,7	6,8	1,9	0,9	2,8
2006:04	6,6	13,3	40,4	3,5	1,8	1,3	21,1	5,3	3,7	1,1	1,7
2007:01	5,8	14,0	39,5	3,7	1,7	1,1	22,9	5,3	2,2	1,3	2,5
2007:02	5,7	13,6	39,7	4,3	1,7	1,3	22,7	5,2	1,8	1,1	2,8
2007:03	6,4	12,8	40,1	4,1	1,8	1,1	23,2	5,1	1,5	1,3	2,5
2007:04	7,0	12,8	40,8	4,1	1,9	1,0	24,8	3,7	1,3	1,3	1,3
Average for the 12 months											
2005	6,6	15,2	36,5	3,1	1,9	1,2	25,1	4,0	1,8	1,4	3,2
2006	5,5	14,2	38,7	3,6	1,8	1,2	23,1	6,0	2,4	1,1	2,5
2007	6,3	13,3	40,1	4,1	1,8	1,1	23,5	4,8	1,7	1,2	2,2

Table 15

Percentage composition of interest expense

	Intra- group funding Per cent	Interbank funding Per cent	Demand deposits Per cent	Savings deposits Per cent	Fixed and notice deposits Per cent	Negotiable certificates of deposit Per cent	Loans under re- purchase agree- ments Per cent	Other funding Per cent	Foreign funding Per cent	Transfer cost of trading activities Per cent	Debt instru- ments Per cent
Average month-end balance for quarter											
2005:01	3,9	4,8	29,0	2,0	31,2	12,3	4,7	5,4	1,5	-0,5	5,7
2005:02	3,9	4,8	26,1	1,9	33,5	13,0	4,0	6,5	1,6	-0,3	5,0
2005:03	4,1	4,2	25,6	1,9	30,5	12,2	3,2	12,1	1,8	-0,2	4,6
2005:04	2,8	3,8	29,0	1,9	31,8	12,9	3,8	7,1	2,2	0,0	4,7
2006:01	3,5	4,1	28,3	2,0	31,4	14,1	4,1	6,8	2,7	-1,0	3,9
2006:02	5,6	3,6	27,0	1,9	30,5	13,2	3,6	5,8	5,3	-0,5	4,0
2006:03	3,2	4,0	28,3	2,1	30,0	12,0	3,3	6,0	8,0	-0,5	3,7
2006:04	5,2	4,4	31,6	2,5	32,6	15,2	2,9	4,0	-0,2	-1,7	3,5
2007:01	3,6	4,0	29,9	2,3	30,8	15,7	3,1	4,8	3,6	-0,8	3,1
2007:02	3,7	4,4	28,8	2,4	30,8	16,1	2,3	5,6	3,6	-0,8	3,0
2007:03	3,5	4,1	28,0	2,6	30,0	18,2	2,4	4,9	4,1	-0,6	2,8
2007:04	3,7	4,4	29,7	2,8	30,8	17,8	2,5	2,9	3,6	-1,1	2,9
Average for the 12 months											
2005	3,6	4,4	27,4	1,9	31,7	12,6	3,9	7,9	1,8	-0,2	5,0
2006	4,4	4,0	28,9	2,1	31,2	13,6	3,4	5,5	4,0	-1,0	3,8
2007	3,6	4,2	29,1	2,5	30,6	17,1	2,6	4,5	3,7	-0,8	2,9

Table 16(a) Calculation of liquid-asset requirement

	Average month-end balance for quarter 2005				Average month-end balance for quarter 2006			
	Mar R million	Jun R million	Sep R million	Dec R million	Mar R million	Jun R million	Sep R million	Dec R million
Liabilities including capital and reserves	1 499 696	1 521 030	1 589 575	1 633 571	1 730 964	1 834 674	1 956 409	2 041 118
Less: capital and reserves	124 193	124 220	128 628	131 508	134 536	145 423	154 119	159 796
– average daily amount of funding from head office or branches	8 674	9 940	10 714	8 726	11 484	12 792	14 737	11 153
– average daily amount owing by banks, branches and mutual banks	110 106	106 054	113 441	132 179	131 063	135 820	142 718	133 754
Liabilities as adjusted	1 256 724	1 280 817	1 336 791	1 361 158	1 453 880	1 540 640	1 644 834	1 736 415
Liquid-asset requirement	62 836	64 041	66 839	68 058	72 694	77 032	82 242	86 821
Liquid assets held	71 437	74 732	76 962	79 548	81 441	85 611	88 756	93 382
SARB notes and coin	8 882	8 686	8 223	8 480	9 458	9 945	8 615	8 895
Gold coin and bullion	0	0	0	0	0	0	0	0
Clearing-account balances	4	10	7	1	0	-1	91	157
Treasury bills of the Republic of South Africa	21 967	24 841	24 668	26 164	31 149	32 500	37 595	37 757
Stock issued – Exchequer Act, 1975								
Securities issued – Public Finance Management Act, 1999	33 634	34 563	36 094	37 393	35 024	36 019	37 544	41 945
Securities of the SARB	6 137	5 872	7 274	6 779	5 149	6 631	4 351	4 072
Land Bank bills	812	760	696	731	660	517	559	555
Memorandum items								
Cash-management schemes	53 708	51 006	50 719	54 014	54 404	53 348	53 436	54 266
Set-off	117 238	125 384	130 896	52 262	69 882	83 341	61 784	67 434
Ratios	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
Liquid assets held to liquid assets required	114,4	117,8	116,6	117,7	115,1	113,6	110	109

Table 16(b) Calculation of liquid-asset requirement

	Average month-end balance for quarter 2007				Year-end balance			Annual growth		
	Mar R million	Jun R million	Sep R million	Dec R million	2005 R million	2006 R million	2007 R million	2005 Per cent	2006 Per cent	2007 Per cent
Liabilities including capital and reserves	2 107 529	2 210 800	2 363 994	2 488 705	1 654 353	2 054 996	2 523 915	11,6	24,2	22,8
Less: capital and reserves	170 885	180 566	186 232	195 987	131 806	163 109	199 039	7,8	23,7	22,0
– average daily amount of funding from head office or branches	11 476	11 085	13 530	18 029	11 695	9 883	20 554	51,6	-15,5	108,0
– average daily amount owing by banks, branches and mutual banks	135 618	143 472	167 467	183 723	133 297	128 582	181 753	17,5	-3,5	41,4
Liabilities as adjusted	1 789 550	1 875 677	1 996 765	2 090 965	1 377 555	1 753 422	2 122 569	11,2	27,3	21,1
Liquid-asset requirement	89 477	93 784	99 839	104 548	68 878	87 671	106 128	11,2	27,3	21,1
Liquid assets held	97 207	100 908	108 901	115 318	81 176	96 334	117 954	14,9	18,7	22,4
SARB notes and coin	10 052	9 473	9 058	9 511	8 728	9 129	9 786	9,5	4,6	7,2
Gold coin and bullion	0	0	0	0	0	0	0	0	0	0
Clearing-account balances	50	1	44	49	-45	271	3 -959,6	-707,4	-98,8	
Treasury bills of the Republic	40 932	44 491	48 228	46 741	27 496	38 272	45 863	42,3	39,2	19,8
Stock issued – Exchequer Act, 1975										
Securities issued – Public Finance Management Act, 1999	40 502	38 393	42 715	47 230	38 661	43 880	50 911	3,3	13,5	16,0
Securities of the SARB	5 134	8 024	8 327	11 255	5 650	4 260	10 851	9,9	-24,6	154,7
Land Bank bills	536	528	528	532	684	521	540	-15,3	-23,9	3,6
Memorandum items										
Cash-management schemes	55 280	59 628	58 676	62 486	58 534	57 578	65 389	-13,2	-1,6	13,6
Set-off	65 315	81 980	107 140	125 835	58 289	58 452	131 337	-48,8	0,3	124,7
Ratios	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent			
Liquid assets held to liquid assets required	110,1	109,5	111,1	112	119,7	111,2	112,5			

Table 17

Analysis of overdue accounts

	Mortgage loans R million	Instalment finance R million	Other loans and advances R million	Total R million	Specific provisions R million	Market value of security held R million
Average month-end balance for quarter						
2005:01	6 330	2 732	11 183	20 245	13 041	7 788
2005:02	5 751	2 678	12 044	20 473	13 503	7 192
2005:03	5 299	2 612	11 093	19 003	12 637	6 878
2005:04	5 330	2 865	10 427	18 622	12 165	6 968
2006:01	6 166	3 623	10 512	20 300	11 964	8 246
2006:02	6 421	3 693	10 332	20 446	11 954	8 472
2006:03	6 404	3 464	9 763	19 632	11 501	8 270
2006:04	6 646	3 445	8 907	18 998	10 815	8 516
2007:01	7 778	3 820	8 618	20 216	10 331	9 766
2007:02	9 007	4 421	8 754	22 182	10 422	11 078
2007:03	10 504	5 050	9 492	25 047	11 344	12 524
2007:04	11 997	5 563	10 561	28 120	12 836	13 755
Month-end balance for year						
Dec 2005	6 061	3 373	10 654	20 087	11 933	7 926
Dec 2006	6 887	3 397	8 505	18 789	10 242	8 682
Dec 2007	12 686	5 708	10 979	29 372	13 185	14 322
Average for 12 months						
2005	5 677	2 722	11 187	19 586	12 837	7 206
2006	6 409	3 556	9 878	19 844	11 558	8 376
2007	9 822	4 714	9 356	23 891	11 233	11 781
Annual growth						
	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
2005	-11,5	28,9	-2,8	-1,7	-9,1	-4,5
2006	13,6	0,7	-20,2	-6,5	-14,2	9,5
2007	84,2	68,0	29,1	56,3	28,7	65,0

Table 18

Analysis of overdue accounts: Selected ratios

	Specific provisions as a percentage of total overdues Per cent	Specific provisions and securities held as a percentage of total overdues Per cent	Overdues as a percentage of advances Per cent	Specific provisions as a percentage of advances Per cent	Net overdues* as a percentage of net qualifying capital and reserves Per cent
Average month-end balance for quarter					
2005:01	66,6	102,1	1,8	1,2	6,2
2005:02	64,2	100,4	1,6	1,0	5,9
2005:03	68,6	105,4	1,4	1,0	4,6
2005:04	59,4	98,9	1,5	0,9	6,4
2006:01	60,0	99,7	1,4	0,8	5,9
2006:02	58,2	100,8	1,2	0,7	5,9
2006:03	59,3	101,2	1,1	0,7	5,3
2006:04	54,5	100,7	1,1	0,6	5,6
2007:01	49,5	99,4	1,1	0,6	6,2
2007:02	45,9	95,3	1,2	0,5	7,3
2007:03	45,5	95,1	1,3	0,6	7,6
2007:04	44,9	93,7	1,4	0,6	8,2
Average for 12 months					
2005	64,6	101,6	1,6	1,0	5,8
2006	58,0	100,6	1,2	0,7	5,7
2007	46,3	95,6	1,2	0,6	7,4

* Net overdues = gross overdues / less specific provisions

Table 19

Large credit exposures

	Granted R million	Utilised R million	Utilised as a percentage of loans and advances Per cent	Utilised as a percentage of net qualifying capital and reserves Per cent	Granted as a percentage of net qualifying capital and reserves Per cent
Balance at quarter ended					
2005:01	587 373	147 696	12,5	127,4	506,8
2005:02	611 373	155 481	12,6	128,9	507,0
2005:03	435 380	137 477	10,6	110,7	350,5
2005:04	501 417	164 914	12,2	128,8	391,5
2006:01	504 657	195 478	13,0	142,4	367,7
2006:02	499 801	204 934	12,7	145,5	354,8
2006:03	510 724	216 893	12,9	146,2	344,3
2006:04	511 076	225 999	13,0	147,2	332,9
2007:01	511 784	251 374	13,6	149,9	305,2
2007:02	506 892	245 733	12,7	143,9	296,8
2007:03	550 656	261 902	12,7	140,6	295,6
2007:04	566 040	309 894	14,6	157,9	288,4
Average for 12 months					
2005	533 886	151 392	11,9	123,9	436,9
2006	506 564	210 826	12,9	145,4	349,4
2007	533 843	267 226	13,4	148,3	296,2
Annual growth					
	Per cent	Per cent			
2005	-8,3	23,2			
2006	1,9	37,0			
2007	10,8	37,1			

Table 20

Profitability of assets

	Advances				Investments		Non-financial and other assets R million	Total R million
	Money R million	Reasonable return R million	Small return R million	No return R million	Profitable R million	Non- profitable R million		
Average month-end balance for quarter								
2005:01	31 475	1 141 819	80 052	30 776	185 311	12 908	46 502	1 528 844
2005:02	33 494	1 163 140	89 418	33 486	165 938	16 453	42 678	1 544 607
2005:03	33 659	1 250 480	91 926	26 082	153 520	16 699	44 623	1 616 987
2005:04	37 350	1 302 403	89 942	26 087	129 703	22 524	46 987	1 654 996
2006:01	37 853	1 387 486	108 165	23 695	126 676	32 672	49 182	1 765 730
2006:02	37 191	1 497 704	103 925	26 529	147 100	20 968	47 679	1 881 096
2006:03	40 858	1 582 559	107 720	25 409	162 732	21 452	49 559	1 990 289
2006:04	45 045	1 645 905	125 351	23 519	147 133	26 878	48 663	2 062 494
2007:01	47 323	1 751 657	114 604	24 064	128 008	27 358	55 590	2 148 605
2007:02	47 933	1 825 143	120 499	27 751	134 014	29 903	59 873	2 245 115
2007:03	51 734	1 939 244	139 548	29 863	147 930	34 232	64 747	2 407 297
2007:04	54 991	2 022 128	129 117	31 679	182 670	35 768	68 508	2 524 861
Month-end balance for year								
Dec 2005	38 338	1 311 686	98 015	24 657	124 139	34 166	46 619	1 677 620
Dec 2006	47 161	1 630 598	161 263	23 876	142 783	24 649	44 918	2 075 248
Dec 2007	58 619	2 042 490	134 261	32 540	176 602	39 734	62 681	2 546 927
Average for 12 months								
2005	33 995	1 214 460	87 835	29 108	158 618	17 146	45 198	1 586 358
2006	40 237	1 528,414	111 291	24 788	145 910	25 493	48 771	1 924 902
2007	50 495	1 884 543	125 942	28 339	148 156	31 815	62 179	2 331 470
Annual growth								
	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
2005	18,7	19,5	23,7	-21,1	-40,3	170,6	25,6	12,0
2006	23,0	24,3	64,5	-3,2	15,0	-27,9	-3,6	23,7
2007	24,3	25,3	-16,7	36,3	23,7	61,2	39,5	22,7

Table 21

Open position in foreign currency

	Total foreign-currency assets US\$ million	Total foreign-currency liabilities US\$ million	Net spot position US\$ million	Commitments to purchase foreign currency US\$ million	Commitments to sell foreign currency US\$ million	Mismatched forward commitments US\$ million	Foreign branches and subsidiaries US\$ million
Average month-end balance for quarter							
2005:01	20 724	8 094	12 630	149 700	162 282	-12 582	84
2005:02	19 859	7 912	11 947	163 656	175 543	-11 887	78
2005:03	24 531	8 548	15 983	177 178	193 053	-15 874	74
2005:04	24 384	8 877	15 506	189 805	205 194	-15 390	77
2006:01	27 521	10 308	17 213	193 169	210 175	-17 006	62
2006:02	30 775	11 396	19 379	192 170	211 305	-19 135	68
2006:03	29 142	12 436	16 706	212 137	228 559	-16 422	62
2006:04	27 379	12 934	14 445	207 654	221 896	-14 242	70
2007:01	26 547	13 347	13 200	188 976	201 804	-12 828	66
2007:02	29 154	14 586	14 568	210 266	224 616	-14 349	67
2007:03	32 589	17 540	15 049	241 273	255 965	-14 691	79
2007:04	29 964	18 922	11 042	269 715	280 633	-10 918	59
Month-end balance for year							
Dec 2005	24 462	9 363	15 098	184 287	199 232	-14 946	78
Dec 2006	28 197	13 324	14 873	189 219	203 836	-14 617	71
Dec 2007	28 742	18 800	9 942	262 923	27 725	-9 802	60
Average for 12 months							
2005	22 374	8 358	14 017	170 085	184 018	-13 933	78
2006	28 704	11 769	16 936	201 283	217 984	-16 701	65
2007	29 564	16 099	13 465	227 558	240 755	-13 197	68
Annual growth							
	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent	Per cent
2005	11,4	10,5	11,9	29,9	28,3	11,6	0,5
2006	15,3	42,3	-1,5	2,7	2,3	-2,2	-9,2
2007	1,9	41,1	-33,2	39,0	33,8	-32,9	-14,8

Appendix 7

Circulars sent to banking institutions during 2007

Banks Act Circular 1/2007	Annual withdrawal and retention of circulars
Banks Act Circular 2/2007	Basel II – Industry training
Banks Act Circular 3/2007	Meetings with boards of directors to be held during the 2007 calendar year
Banks Act Circular 4/2007	Trilateral discussions to be held during the 2007 calendar year
Banks Act Circular 5/2007	Basel II – Final arrangements for parallel-run and other implementation issues
Banks Act Circular 6/2007	Consultation with banks, controlling companies and branches of foreign banks in respect of directives, circulars and guidance notes that will be effective as from 1 January 2008 in terms of the amended Banks Act, 1990
Banks Act Circular 7/2007	Recognition of eligible external credit assessment institutions in terms of the amended Banks Act, 1990
Banks Act Circular 8/2007	Amendments to the legal framework relating to banks

Appendix 8

Exemptions and exclusions from the application of the Banks Act, 1990

Section 1(cc): Exemptions by the Registrar of Banks

<i>Government Gazette</i>		<i>Topic</i>	<i>Expiry</i>
<i>Date</i>	<i>Number</i>		
2006/12/01	29412	A group of persons between which a common bond exists	Indefinite
1994/12/14	16167	Commercial paper	Indefinite
2006/01/27	28414	"Ithala Limited" A wholly owned subsidiary of Ithala Development Finance Corporation Limited	2008/12/31
1994/12/14	16167	Mining houses	Indefinite
1994/12/14	16167	Trade in securities and financial instruments	Indefinite
2008/01/01	30628	Securitisation schemes	Indefinite

Section 1(dd): Exemptions by the Minister of Finance

<i>Government Gazette</i>		<i>Topic</i>	<i>Subparagraph</i>	<i>Expiry</i>
<i>Date</i>	<i>Number</i>			
1991/01/31	13003	Participation bond schemes	(dd)(ii)	Indefinite
1991/01/31	13003	Unit trust schemes	(dd)(ii)	Indefinite

Section 1(gg): Exemptions by the Registrar of Banks

<i>Government Gazette</i>		<i>Topic</i>	<i>Expiry</i>
<i>Date</i>	<i>Number</i>		
1998/09/22	19283	Members of the Johannesburg Stock Exchange as persons authorised to accept money as mandatories and to deposit such money into banking accounts maintained by them	Indefinite

Section 2(vii): Exclusions by the Minister of Finance

<i>Government Gazette</i>		<i>Topic</i>	<i>Expiry</i>
<i>Date</i>	<i>Number</i>		
1992/01/24	13744	Post Office Savings Bank	Indefinite
1994/12/14	16167	Industrial Development Corporation of SA Limited	Indefinite

Section 78(1)(d)(iii): Exemptions by the Registrar of Banks

<i>Government Gazette</i>		<i>Topic</i>	<i>Expiry</i>
<i>Date</i>	<i>Number</i>		
1997/05/02	17949	Category of assets of a bank held in the name of a person other than the bank concerned	Indefinite

Appendix 9

Approval of acquisition or establishment of foreign banking interests in terms of section 52 of the Banks Act, 1990, from 1 January 2007 to 31 December 2007

Name of bank/ controlling company	Date of approval	Name of interest (and percentage interest held, if not 100 per cent)	Country
Absa Group Limited	2007/08/17	Master Card Incorporated (minority non-voting interest)	United States of America
Absa Group Limited	2007/12/07	Bongwe Consortium (Pty) Limited (15 per cent)	Botswana
FirstRand Bank Holdings Limited	2007/03/22	FirstRand Bank Limited Brazil Representative Office	Brazil
FirstRand Bank Holdings Limited	2007/03/30	Banco Desenvolvimento e Comercio SARL	Mozambique
FirstRand Bank Limited	2007/07/17	FirstRand Bank Limited India Representative Office	India
Investec plc*	2007/04/17	IASL Nominees Limited	Guernsey
Investec plc*	2007/04/17	IASL Directors 1 Limited	Guernsey
Investec plc*	2007/04/17	IASL Directors 2 Limited	Guernsey
Investec plc*	2007/01/17	Blackfish–Investec Natural Resources Special Situation Fund (50 per cent)	United Kingdom
Investec plc*	2007/04/17	Nua Mortgages Limited	Ireland
Investec plc*	2007/06/06	Revo (Pty) Limited (5 per cent)	Australia
Investec plc*	2007/05/09	Investec Wind Holdings (Pty) Limited	Luxemborg
Investec plc*	2007/05/15	Investec GLL Fund Management Company SA (50 Per cent)	Luxemborg
Investec plc*	2007/06/12	Gerrard Leasing Partnership (95 per cent)	United Kingdom
Investec plc*	2007/05/15	Investec Portfolio Services Limited	Ireland
Investec plc*	2007/07/13	Investec North America Limited	Canada
Investec plc*	2007/08/21	McGregor Syndicate Partnership (25 per cent)	Australia
Investec plc*	2007/07/09	Perkins Group Holdings (Pty) Limited (9 per cent)	Australia
Investec plc*	2007/07/13	Kensington Group Plc	United Kingdom
Investec plc*	2007/12/05	CEA (H) NZ Limited	Switzerland
Investec plc*	2007/09/20	Experien (Pty) Limited	Australia
Investec plc*	2007/12/05	Castle Minerals Limited (3,6 per cent)	Australia
Investec plc*	2007/12/05	Investec (Australia) Investment Management (Pty) Limited	Australia
Investec plc*	2007/12/05	Investec Australia Funds Management Limited	Australia
Investec plc*	2007/11/21	Amior Films Inc.	United Kingdom
Nedbank Group Limited	2007/02/06	Railway Systems of Zambia (Pty) Limited (1,25 per cent)	Zambia
Nedbank Group Limited	2007/02/22	D4 Power Limited (10 per cent)	United Kingdom
Nedbank Group Limited	2007/09/11	Alliance Investments Limited	Mauritius
Sasfin Bank Limited	2007/07/20	SasCred Financial Services Limited	Asia
Standard Bank Group Limited	2007/02/02	Inversora Diagonal Société Anonyme (70 per cent)	Argentina
Standard Bank Group Limited	2007/02/05	1784 Sociedad Anonima Sociedad Gerente de Fondos Comes de Inversion (70 per cent)	Argentina
Standard Bank Group Limited	2007/03/02	Bolo Zambia Limited	Zambia
Standard Bank Group Limited	2007/03/26	Standard Ukraine LLC	Ukraine
Standard Bank Group Limited	2007/04/13	SB Tokyo – Branch	Japan
Standard Bank Group Limited	2007/05/23	BTC Chartered Bank plc – up to (55 per cent)	Nigeria

Appendix 9

Approval of acquisition or establishment of foreign banking interests in terms of section 52 of the Banks Act, 1990, from 1 January 2007 to 31 December 2007 (continued)

Name of bank/ controlling company	Date of approval	Name of interest (and percentage interest held, if not 100 per cent)	Country
Standard Bank Group Limited	2007/07/17	Dundas Ünlü Menkul Degerler A.S. (68,86 per cent)	Turkey
Standard Bank Group Limited	2007/07/17	Dundas Ünlü Partners Société Anonyme (68,86 per cent)	Turkey
Standard Bank Group Limited	2007/07/17	Standard Ünlü Private Equity Management Limited (68,86 per cent)	Isle of Man
Standard Bank Group Limited	2007/07/17	DU Finansal Danismanlik	Turkey
Standard Bank Group Limited	2007/07/17	DU Portofoy Yometimi	Turkey
Standard Bank Group Limited	2007/07/25	Standard Securities Asia Limited, Tokyo Branch	Japan
Standard Bank Group Limited	2007/07/25	Standard Capital Japan Limited	Japan
Standard Bank Group Limited	2007/08/22	Image Ambassadors (Pty) Limited	Botswana
Standard Bank Group Limited	2007/10/23	Standard Bank plc – Singapore Branch	Singapore
Standard Bank Group Limited	2007/10/23	Standard Varlik Yonetim Anonim Sirketi (99 per cent)	Turkey
Standard Bank Group Limited	2007/11/02	Stanbic Management Services Limited	Ghana
Standard Bank Group Limited	2007/12/21	Burnet Investments Limited (51 per cent)	Zambia
Standard Bank Group Limited	2007/12/19	Standard Bank SARL, Angola	Angola

* Applications in respect of Investec plc to establish or acquire foreign interests or subsidiaries were noted in terms of the conditions of approval of the dually listed company structure.

Appendix 10

Memorandums of Understanding concluded between the Bank Supervision Department of the South African Reserve Bank and foreign supervisors as at 31 December 2007

Name of foreign supervisor (listed alphabetically)	Country of foreign supervisor	Effective from
Australian Prudential Regulation Authority	Australia	4 July 2007
Bank of Mauritius	Mauritius	25 January 2005
Bank Supervision Department of the Bank of Namibia	Namibia	27 September 2004
Bundesanstalt für Finanzdienstleistungsaufsicht	Germany	13 August 2004
Financial Services Authority	United Kingdom	21 July 2006
Financial Supervision Commission of the Isle of Man	Isle of Man	13 August 2001
Irish Financial Services Regulatory Authority	Ireland	21 July 2004
Monetary Authority of Hong Kong	Hong Kong	12 December 2006
Superintendencia de Entidades Financieras y Cambiarias	Argentina	18 July 2007

Abbreviations

ABS	asset-backed security
AIF	Accord Implementation Forum
AIG	Accord Implementation Group
ALCO	asset and liability committee
AMA	advanced measurement approach
AML	anti-money laundering
ASA	alternative standardised approach
BANKSETA	Banking Sector Education and Training Authority
BCBS	Basel Committee on Banking Supervision
BEE	black economic empowerment
BESA	Bond Exchange of South Africa
BIS	Bank for International Settlements
BSD	Bank Supervision Department
CDO	collateralised debt obligation
CEBS	Committee of European Banking Supervisors
CFT	combating of the financing of terrorism
DRS	disaster recovery site
EAG	Electronic Advisory Group
ECAI	external credit assessment institution
FATF	Financial Action Task Force on Money Laundering
FIC	Financial Intelligence Centre
FICA	Financial Intelligence Centre Act
FSB	Financial Services Board
FSI	Financial Stability Institute
hAMA	hybrid advanced measurement approach
H-index	Herfindahl–Hirschman index
IAS	International Accounting Standards
ICAAP	internal capital adequacy assessment process
ICBC	Industrial and Commercial Bank of China
ICR	individual capital requirement
IFRS	International Financial Reporting Standards
IMA	internal models approach
IRB	internal ratings based
IRBA	Independent Regulatory Board for Auditors
ISA	International Standards on Auditing
IT	information technology
JSE	JSE Limited
KYC	know your client
MoU	Memorandum of Understanding
MRC	minimum required capital
NCA	National Credit Act
NCD	negotiable certificate of deposit
NCR	National Credit Regulator
OTC	over the counter
QIS	quantitative impact study
ROA	return on assets
ROE	return on equity
SAPS	South African Police Service
SARB	South African Reserve Bank
SBG	Standard Bank Group Limited

SIDA	Swedish International Development Co-operation Agency
SIM	security information management
SIV	structured investment vehicles
SME	small and medium enterprise
SMS	short message service
SPI	special-purpose institution
SPV	special-purpose vehicle
SREP	supervisory review and evaluation process
TSA	standardised approach
UK	United Kingdom
US	United States

Glossary

40 + 9 FATF Recommendations	Forty Recommendations of 2003 and Nine Special Recommendations of 2001 of the Financial Action Task Force on Money Laundering
Basel I	<i>International Convergence of Capital Measurement and Capital Standards</i>
Basel II	<i>International Convergence of Capital Measurement and Capital Standards: A Revised Framework</i>
Basel Committee	Basel Committee on Banking Supervision
Branch Regulations	<i>Conditions for the Conducting of the Business of a Bank by a Foreign Institution by Means of a Branch</i>
Core Principles	Core Principles for Effective Banking Supervision
Guidance paper	'Guidance on the Risk-based Approach to Combating Money Laundering and Terrorism'
proposed amended Exemption Notice	proposed amended Exemption Notice relating to Securitisation Schemes
proposed amended Regulations	proposed amended Regulations relating to Banks
Review Committee	Consumer Education Review Committee
Standing Committee	Standing Committee for the Revision of the Banks Act, 1990
the Bank	South African Reserve Bank
the Charter	Financial Sector Charter
the Department	Bank Supervision Department