

Chapter 1

Registrar's review

During 2006, the South African banking system remained stable and banks were adequately capitalised. Banks continued to benefit from favourable economic conditions which resulted in strong asset growth, increased profitability and a decline in overdue ratios (as discussed below), notwithstanding the cumulative two-per-cent increase in the South African Reserve Bank's repurchase rate. However, the full impact of these increases needs to be monitored and managed by all stakeholders.

banking system remained stable

This chapter discusses the development of bank directors, international supervisory interaction, the biennial International Conference of Banking Supervisors that was held in Mexico, the proliferation of credit, and provides an update on the International Monetary Fund's Article IV consultation. A review of the Bank Supervision Department's (the Department) human resources developments is also presented.

Overview of the South African banking system

The South African banking system remained stable and banks were adequately capitalised, with the banking-sector's capital-adequacy ratio remaining above the minimum requirement of 10 per cent during the period under review. The capital-adequacy ratio declined from 12,7 per cent in December 2005 to 12,3 per cent at the end of December 2006.

banks were adequately capitalised

The aggregated balance sheet continued to grow strongly, but eased off towards the end of 2006. By the end of December 2006, the total assets of banks had increased by 23,7 per cent (measured over twelve months) to a level of R2 075,1 billion (December 2005: R1 677,5 billion). The five largest banks constituted 89,7 per cent of the total banking-sector assets at the end of December 2006 (December 2005: 89,6 per cent).

aggregated balance sheet continued to grow strongly

Non-bank deposits remained the main source of funding for the banking sector and constituted 65,2 per cent of total liabilities (2005: 65,7 per cent). Total non-bank deposits increased by 22,9 per cent (measured over twelve months) amounting to R1 353,2 billion, compared to the 21,1-per-cent growth in December 2005 (R1 101,5 billion). The composition of non-bank deposits remained fairly stable throughout 2006.

non-bank deposits remained main source of funding

Profitability ratios improved during 2006. By the end of December 2006, a return of 18,3 per cent on net qualifying capital and reserves (12-month smoothed average) was reported, compared to 15,2 per cent in December 2005. Return on assets (12-month smoothed average) amounted to 1,4 per cent at the end of December 2006 (December 2005: 1,2 per cent). The efficiency ratio of the banking sector displayed steady improvement, ending the year under review at 58,9 per cent (December 2005: 66,3 per cent).

profitability ratios improved

Throughout 2006, the banking sector maintained an adequate amount of liquid assets, exceeding the statutory liquid-asset requirement. In December, the average daily amount of liquid assets held by banks represented 111,2 per cent of the statutory liquid-asset requirement, compared to 119,7 per cent in December 2005.

excess liquid assets held

Non-performing loans continued to decline during 2006. This decline should, however, be seen against the backdrop that gross overdues in respect of mortgages deteriorated from R6,1 billion at December 2005 to R6,9 billion at December 2006 which was offset by an improvement in the gross overdues in respect of other loans and advances. Expressed

non-performing loans continued to decline

as a percentage of total loans and advances, gross overdues improved from 1,5 per cent in December 2005 to 1,1 per cent in December 2006. In terms of the minimum regulatory requirements, provisioning by banks remained adequate.

Concentration in the South African banking system

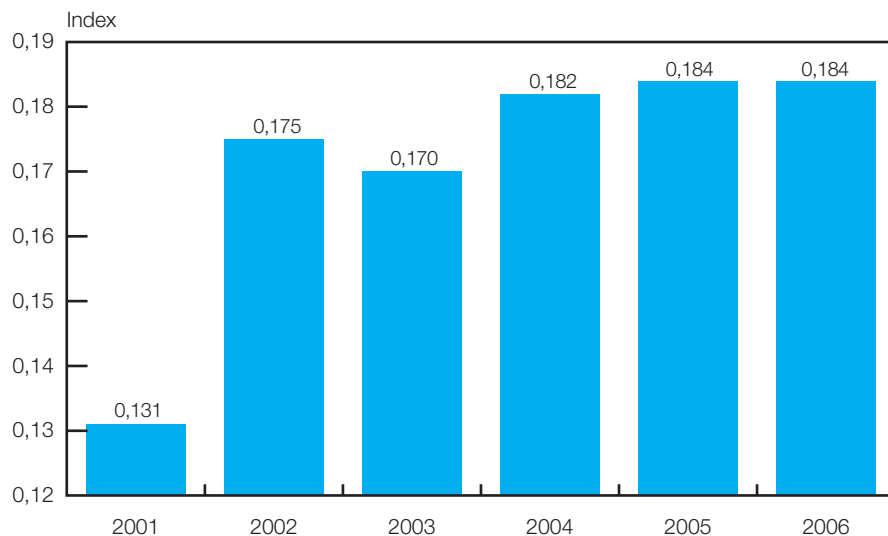
H-index The Herfindahl-Hirschman Index (H-index) is a commonly accepted measure of market concentration in a banking system. The index is calculated by squaring the market share of each bank in the system and subsequently summing the squares. The higher the index, the less competition exists in the market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

continued dominance by four largest banks

The concentration in the South African banking system is portrayed in Figure 1. An H-index of 0,184 was recorded in December 2006 and can be attributed to the continued dominance by the four largest banks which constituted 84,1 per cent of banking-sector assets (December 2005: 83,8 per cent). At the end of December 2006 there were 33 banking institutions reporting data to the Department (excluding two mutual banks, however, including one institution doing banking business in terms of an exemption from the provisions of the Banks Act, 1990, namely Ithala Limited).

Figure 1 H-index for the South African banking system (2001 – 2006)



Development of bank directors

Corporate governance received much attention in the 2004 and 2005 *Annual Reports* of the Department (*Annual Reports*). In 2006 the Department continued to monitor the corporate-governance practices of banks and focused mainly on the induction and development of individual directors.

principles for sound corporate governance in banks

The document *Enhancing Corporate Governance for Banking Organisations*, published by the Basel Committee on Banking Supervision (Basel Committee) in February 2006, recommends the following eight principles for sound corporate governance in banks:

- Board members should be qualified for their positions, have a clear understanding of their role in corporate governance and be able to exercise sound judgement about the affairs of the bank.
- The board of directors should approve and oversee the bank's strategic objectives and corporate values that are communicated throughout the banking organisation.
- The board of directors should set and enforce clear lines of responsibility and accountability throughout the organisation.
- The board should ensure that there is appropriate oversight by senior management consistent with board policy.
- The board and senior management should effectively utilise the work conducted by the internal audit function, external auditors and internal control functions.
- The board should ensure that compensation policies and practices are consistent with the bank's corporate culture, long-term objectives and strategy, and control environment.
- The bank should be governed in a transparent manner.
- The board and senior management should understand the bank's operational structure, including where the bank operates in jurisdictions, or through structures that impede transparency (i.e. "know-your-structure").

It is clear from the above principles that directors have a demanding role to fulfil in the corporate-governance processes of banks. Directors are not prevented from delegating certain responsibilities to management. However, the ultimate accountability for ensuring that management acts in accordance with these responsibilities remains with the board of directors.

ultimate accountability remains with board of directors

In Banks Act Circular 5/2006, which was released in April 2006, banks were requested to provide, *inter alia*, the following information:

banks were requested to provide information

- Details of induction programmes for new directors.
- Details of continuous training and updating of skills of all directors.
- Methods by which directors are kept abreast of changing banking trends and dynamics.

The analysis of the above-mentioned information confirmed that the induction and training programmes of banks diverged significantly. The Department acknowledges the uniqueness of banks' operations and therefore anticipated that these programmes would differ. However, with regard to director development, the Department is of the view that directors of all banks, particularly non-executive directors, should be exposed to homogenous development programmes that will equip them to perform their fiduciary duties.

induction and training programmes of banks diverged significantly

After its findings, the Department brought the matter of inadequate development of directors to the attention of The Banking Association South Africa. Subsequently, it was agreed that the association would pursue the matter. Its efforts culminated in the identification of a local tertiary institution that was tasked to develop a suitable programme for directors of banks. The director development programme which has

develop a suitable programme for directors of banks

been compiled by the institution consists of three courses, namely: Introductory course; Banking Board Leadership Programme; and Banking Board Leadership Forum.

introductory course

The introductory course will familiarise participants with the regulatory environment in which banks operate, and introduce the key concepts and principles. The topics include the following:

- Banks and banking.
- The South African regulatory framework.
- The international regulatory framework.
- The Banks Act and Regulations relating to Banks.
- Internal audit/compliance.
- Other legislation affecting banks.
- The legal position of bank directors.

Banking Board Leadership Programme

The Banking Board Leadership Programme will be aimed at providing participants with a broad understanding of risk management in banks at a governance level. In addition, the objective is to equip participants with the skills to apply their knowledge in the fulfilment of their statutory and fiduciary duties. Topics included in this course are as follows:

- Risk management, regulation and corporate governance.
- Risk management structures.
- Board dynamics.
- Solvency and liquidity risk.
- Market risk.
- Credit risk.
- Basel II.
- Operational risk.

In addition to the above, a case study will be included.

Banking Board Leadership Forum

The Banking Board Leadership Forum will endeavour to instil a deeper understanding of the principles covered in the first two courses and the application thereof. The issues will be covered through the sharing of views in discussion groups. The focus will be on “real-life” experiences and the development of “best-practice” approaches.

needs of both new and experienced directors

In developing the programme, the Department believes that the institution has filled a void that will meet the needs of both new and experienced directors. The programme is comprehensive enough to provide new directors with a solid foundation to comfortably enter the banking arena, and for experienced directors to stay abreast of current developments in banking products, practices and risk management.

chairpersons encouraged to utilise the programme

In Banks Act Circular 9/2006, which was released in November 2006, chairpersons of banks were encouraged to utilise the programme to ensure that proposed directors have a basic understanding of banking. It was also emphasised that this development programme should be considered supplementary to internal induction and development programmes, and not as an alternative thereto.

International supervisory interaction

During the year under review, the Department continued to interact with other global national supervisors and international institutions such as the Basel Committee, the International Monetary Fund (IMF) and the World Bank.

National supervisors

Argentina

The Department received an application from the Standard Bank Group Limited for its subsidiary, Standard Bank Argentina Société Anonyme, to acquire certain assets and liabilities of BankBoston N.A. Argentina Branch (BankBoston Argentina). As a result of the transaction broadening the risk profile of Standard Bank Argentina, it was important for the Department to gain an understanding of the nature of supervision in Argentina as well as of the banking operations of both Standard Bank Argentina and BankBoston Argentina.

understanding of supervision in Argentina

In view of the above, meetings were held with the Regulatory Authority of the Central Bank of Argentina in Buenos Aires, Argentina in August 2006 to discuss the transaction, as well as matters affecting the mutual understanding and co-operation with respect to home/host issues. In addition, relevant discussions were held with the executive management of Standard Bank Argentina.

discuss the transaction

Indonesia

In September 2006 the Department was invited to attend a seminar hosted by Bank Indonesia. The objectives of the seminar, attended by approximately 175 participants from central banks, commercial banks and academic institutions, were to:

objectives of the seminar

- share knowledge on different aspects of Basel II and its implementation challenges in emerging and developed economies;
- explore in detail the Basel II capital-adequacy regime for promoting financial stability;
- address the challenge of devising a supervisory response to Basel II implementation for the benefit of financial stability; and
- discuss the implications of Basel II namely the potential impact of the new framework, both on capital flows and global competition.

At the seminar, the Department shared its experiences on the policy and practical challenges of implementing Basel II from both regulatory and banking industry perspectives, as well as their impact on financial stability in South Africa.

shared experiences

Mauritius

In October 2006 discussions were held with supervisors from the Bank of Mauritius (BOM) in Port Louis, Mauritius. The meeting afforded an opportunity to discuss the working relationship between the Department and the BOM. In particular, a Memorandum of Understanding and its practical effectiveness were discussed. The Department was also updated on the supervisory framework, practices and resources of the BOM.

Memorandum of Understanding

During the visit, the Department also held prudential meetings with the local executive management teams of two South African banks operating in that country. In that way the Department was updated on the strategies, business activities and risk-management frameworks of the respective entities.

held prudential meetings

Namibia

During August 2006 a meeting was held with the Bank of Namibia (BON) in Windhoek, Namibia to enhance relationships between the BON and the Department. The

enhance relationships

Department gained an understanding of the nature of supervision by the BON over the Namibian operations of South African banks. Furthermore, prudential meetings were held with the local executive management of three South African banks. During these meetings, the Department was updated on the management structures, strategic objectives, business plans, risk management issues, regulatory reporting and these banks' relationships with the BON.

Basel Committee on Banking Supervision

participation in working groups, seminars and training initiatives

The Department has over the years participated in the initiatives of the Basel Committee, either by direct participation in its working groups, seminars and training initiatives, or by providing input on draft publications and information-gathering exercises. The four main working groups of the Basel Committee are the Accord Implementation Group (AIG), the Policy Development Group, the Accounting Task Force, and the International Liaison Group (ILG). These working groups have several subgroups that focus on specific matters as prescribed by their various working groups.

The Department's participation in the Basel Committee's working groups is described below.

International Liaison Group

interact with broad group of supervisors

The ILG consists of eight Basel Committee member countries (France, Germany, Italy, Japan, the Netherlands, Spain, the United Kingdom and the United States of America) and Argentina, Australia, Brazil, Chile, China, the Czech Republic, Hong Kong, India, Korea, Mexico, Poland, Russia, Saudi Arabia, Singapore, South Africa, the West African Monetary Union, the European Commission, the IMF, the World Bank, and the Financial Stability Institute. The ILG provides a forum for the Basel Committee to interact with a broader group of supervisors on various regulatory and supervisory matters.

The ILG was previously known as the Core Principles Liaison Group (CPLG) with a subgroup, the CPLG Working Group on Capital (CPWG). During 2006 the CPLG's main focus was on the revision of the Core Principles for Effective Banking Supervision (Core Principles), while the CPWG continued to deal with issues related to the implementation of Basel II.

Validation Subgroup of the Accord Implementation Group

validation of systems

The Validation Subgroup of the AIG deals with matters related to the validation of systems used to generate the ratings and parameters that are used in the internal ratings-based (IRB) approaches to credit risk within Basel II. The subgroup consists of supervisors from fifteen jurisdictions and held four meetings during 2006. The main issues that the subgroup focused on during 2006 are, *inter alia*, the use test for the IRB approach and the use of vendor products within the IRB approach.

Operational Risk Subgroup of the Accord Implementation Group

advanced measurement approaches for operational risk

The Operational Risk Subgroup of the AIG, which consists of supervisors from seventeen jurisdictions, focuses on issues related primarily to the implementation of Basel II's advanced measurement approaches for operational risk in banks. The subgroup has explored the practical challenges associated with the successful development, implementation and maintenance of an operational risk framework addressing the requirements and expectations of Basel II. Subgroup members have identified certain operational risk implementation challenges within their respective jurisdictions and participated actively in developing resolution plans. In addition, the

subgroup continued to facilitate the resolution of issues associated with the cross-border supervision of international banking groups under Basel II, particularly those related to operational risk. The subgroup held four meetings during 2006.

International Monetary Fund and World Bank

Kenya

In November 2006 the IMF hosted a seminar in Nairobi, Kenya. The Department, other African supervisors, representatives from the Bank for International Settlements and commercial banks attended the seminar. Participants were updated on the preparations for Basel II in South Africa and the Department advised on the ways in which implementation challenges were being addressed. In addition, there were sessions on supervisory colleges, where supervisors from individual countries held informal discussions with supervisors from the United Kingdom, France and South Africa, in their capacity as home country supervisors.

preparations for Basel II

United States of America

In May 2006 the Department was represented at the IMF's Expert Forum on advanced techniques on stress-testing applications for supervision. The Department chaired a session on liquidity risk management which focused on the following: National approaches to stress test liquidity; cross-border issues in stress testing; and contagion in payment and settlement systems.

advanced techniques on stress testing

In June 2006 the Department was invited to participate in a seminar hosted by the IMF, the World Bank and the Federal Reserve Board of the United States of America. The focus of the seminar was on policy challenges for the financial sector.

policy challenges for financial sector

The objective was to provide a balanced discussion on cross-border supervisory co-operation – issues and challenges – including the following:

cross-border supervisory co-operation

- Cross-border supervisory co-operation under Basel II and the (draft) revised Core Principles;
- how to supervise internationally active banks – key challenges and practical solutions;
- building practical arrangements for cross-border supervisory co-operation;
- cross-border supervisory co-operation – a host country perspective;
- cross-border crisis management; and
- cross-border supervisory co-operation – regional developments.

The Department delivered a presentation on the last topic.

International Conference of Banking Supervisors

The Department attended the fourteenth International Conference of Banking Supervisors (ICBS), which was hosted by the National Banking and Securities Commission, Mexico, in the city of Mérida in Mexico from 2 to 6 October 2006. The ICBS, held biennially since 1979, is designed to promote co-operation among national authorities in the supervision of international banking and to enable senior representatives of supervisory authorities to exchange views on a range of current issues of common concern.

Department attended ICBS hosted in Mexico

During the first two days, pre-meetings were held by the various regional groupings of bank supervisors established under the auspices of the Basel Committee.

During the afternoon of the second day, on 3 October 2006, a special address was delivered by Ms Susan Schmidt Bies, Governor: Board of Governors of the Federal Reserve System, United States of America. In her address she highlighted the following issues:

- In the United States of America exposures to real estate were double those in the 1980s when the country went through a real-estate crisis. Consequently, a need exists to ensure that the exposures are monitored and managed on a portfolio basis with limits in place on the extent of risks taken or to be taken in order to effectively manage concentrations.
- The risks of entering into new lines of business need to be carefully assessed as new product developments tend to progress at a fast pace while back-office developments of internal controls are falling behind.
- The challenge revolved around ways to keep staff skills upgraded in order to be able to anticipate new areas of stress that arise as well as recalling the way in which previous crises had been handled.
- The new Basel Capital Accord (Basel II) would tie capital requirements to risk appetite more efficiently, and regulators need to understand how banks manage capital including how they anticipate future capital needs.

On 4 October 2006, the conference commenced with a welcome message and an opening speech delivered by Mr Jonathan Davis, President of the National Banking and Securities Commission, Mexico.

Chairman of the Basel Committee opened the conference

Mr Nout Wellink, Chairman of the Basel Committee and President of De Nederlandsche Bank, officially opened the conference. In his address, Mr Wellink touched on the following issues:

- Supervisors face the ever-growing challenge of devising appropriate prudential structures for a financial industry that is in a constant state of change. Such changes require supervisors to design flexible standards and regulations that ensure a safe and sound banking system while still allowing for continued innovation in bank practices. The Basel II framework is designed to achieve this balance. It represents a fundamental paradigm shift on how regulators have, to date, thought about capital regulation. The advanced approaches to credit and operational risk rely on banks' own assessments of risks as input to capital calculations, a recognition that banks are best positioned to understand and measure the risks that they face. In addition, because the quantitative and qualitative parameters for using the advanced approaches are intended as a baseline of sound practices, they can accommodate continued innovation by firms. Combined with the role assigned to supervisory review and market discipline, these features of the framework represent a more forward-looking approach to capital regulation, with the flexibility to evolve over time.
- Since the previous ICBS held in Madrid, Spain in 2004, the Basel Committee had achieved much to be proud of. On completion of the rules relating to Basel II implementation issues and updating the Core Principles, the Basel Committee had pursued approaches that have flexibility to accommodate the continued evolution of bank and supervisory practices. It had also recognised the critical contributions from

the broader supervisory community, the industry and other standard-setting bodies and all these efforts amounted to significant contributions for ensuring the robustness of a financial system to withstand possible future shocks.

- The role of banks is changing. Banks increasingly originate loans and other types of credit instruments with the intent of securitising them and selling them to other market participants. This has resulted in banks, as well as securities firms, being at the centre of a new intermediation landscape that is increasingly based on traded products, where they are actively involved in the origination, securitisation and management of credit exposures.
- The greater reliance on capital markets in credit origination and distribution has also served to unlock the creative potential of market participants. While these changes have made the banking system more resilient, they also pose a range of risks that supervisors and the industry both need to monitor.
- Globalisation is another important trend in the banking sector. Cross-border mergers and acquisitions have resulted in a number of banking markets having a significant foreign bank presence and, consequently, a local financial system could conceivably be disproportionately dependent on the safety and soundness of a handful of foreign banks. This potentially has significant implications for the way in which banks in these markets are supervised. One of the greater challenges arises from the fact that, while the operations and management frameworks of many banks are becoming increasingly global, the supervisory structures remain along national borders.
- The future work of the Basel Committee, Basel II, remained a key item on the Basel Committee's agenda. Regarding Basel II implementation challenges, home-host issues are a challenge for both supervisors and the industry. In addressing this issue every effort should be made to achieve as much cross-border consistency as possible on key elements of the framework. While recognising that both home and host had legitimate interests that needed to be met and national implementation would vary in relation to local needs, the tension inherent in applying a global standard within national supervisory regimes would never fully dissipate. An understanding of the impact of Basel II on banks and markets is vital. Many banks, and market participants more broadly, had voiced concerns that the new framework could have unintended consequences on banks' risk-taking and capital allocation in both the short and long term. There could also be consequences for banks' activities relative to those of securities firms. Supervisors have to be attuned to the risk that these consequences could have from inconsistent application across banks or sectors, particularly for rules related to risk assessment and quantification.
- In light of the increasing tension between regulatory structures, which remain structured on national lines, and banks' operations and risk-management structures which are increasingly becoming global, cross-border information sharing is of the utmost importance. Supervisors would need to depend increasingly on information provided by their colleagues in other jurisdictions. This requires the setting up of appropriate mechanisms to facilitate the deepening and broadening of information sharing that does not impose a burden on one another or on the industry.

The themes for the first day of the conference were centred on the Core Principles and governance issues and the panel session on these themes was chaired by Ms Bies.

Core Principles and
governance issues

keynote address	<p>The keynote address was delivered by Mr Francisco Gil Diaz, Minister of Finance and Public Credit, Mexico. His address gave a broad outline of the Mexican economy and its challenges.</p>
working group discussions	<p>The following topics were discussed by different working groups during the afternoon of 4 October 2006:</p> <ul style="list-style-type: none">- The main changes to the updated Core Principles- Stress testing as a regulatory tool- Corporate governance of banks- Governance and accountability of financial supervisors- Risk-based supervision <p>The working groups were respectively chaired by Göran Lind (Chairperson of the Basel Core Principles Reference Group and Advisor to the Executive Board: Sveriges Riksbank, Sweden); John Dugan (Comptroller of the Currency, United States of America); Danièle Nouy (Secretary General: Banking Commission, France); Andreas Ittner (Director: Financial Institutions and Markets, Austrian National Bank); and John Laker (Chairman of the Australian Prudential Regulation Authority).</p>
international banks in domestic markets	<p>The theme for the second day was "International banks in domestic markets" and the keynote address titled "International banking participation in emerging economies" was delivered by Mr Guillermo Ortiz (Governor, Central Bank of Mexico).</p>
working group discussions	<p>The topics discussed by the working groups on 5 October 2006 were the following:</p> <ul style="list-style-type: none">- Multilateral information sharing based on AIG/EMEAP (Executives' Meeting of East Asia-Pacific Central Banks) experience;- IRB (internal ratings-based approach) data issues including data pooling and validation;- listed and non-listed subsidiaries;- home-host information sharing under Basel II; and- cross-border co-operation in a problem bank situation. <p>The working groups were respectively chaired by Teo Swee Lian (Deputy Managing Director: Prudential Supervision, Monetary Authority of Singapore); Gerhard Hofmann (Head: Banking and Financial Supervision Department, Deutsche Bundesbank, Germany); Gustavo Arriagada (Superintendent of Banking and Financial Institutions, Chile); William Ryback (Deputy Chief Executive: Hong Kong Monetary Authority); and Arnold Schilder (Executive Director: De Nederlandsche Bank).</p>
press statement by the Basel Committee	<p>On 5 October 2006, a press statement was issued by the Basel Committee announcing the endorsement, by bank supervisors from central banks and supervisory agencies from 120 countries who attended the ICBS in Mérida, Mexico, of the updated version of "Basel Core Principles for Effective Banking Supervision and its Methodology" as well as its continued support for the implementation, by all countries, of international minimum standards on banking supervision.</p>
conference formally closed	<p>The conference was formally closed by Mr Jonathan Davis, President: National Banking and Securities Commission, Mexico.</p>

Proliferation of credit in South Africa

Members of the public lately have been exposed to a proliferation of new names linked to banking services. The term "bank" has always been perceived to be used sparingly. However, it appears of late that many institutions that provide some form of financial service to the public have banking connotations and names attached to them.

proliferation of new names

With South Africa always au fait with developments in the banking arena, it is not surprising that new innovations in the provision of banking services to the public are emerging from the marketplace. These new developments could prove to be confusing to the public in that banking names are now being linked to retail outlets, cellular telephone service providers and other such companies.

developments in banking arena

The connection between the name of a bank and the confidence placed in such a bank by the public has always been of critical importance. In cases where problems with financial matters were experienced in the past, the first port of call for the public was the "name" that was entrusted with a person's financial matters. This fact will probably not change as the reliance on an institution handling a person's financial matters will always be regarded with seriousness.

confidence placed in a bank

The introduction of new names in banking is based largely on the exponential developments in technology over the past decade which created possibilities that were only a dream a few years ago. The integration of retail outlets through banks into the payment system, as well as the vast developments in cellular telephone technology have enabled several developments that drastically improved the lives of the public in terms of utilising existing infrastructure and communication facilities in conducting banking business. These developments also paved the way for solutions to issues such as bringing banking to the unbanked, as well as other advantages.

developments in technology

Furthermore, these technological advancements created the opportunity for the cross-utilisation of different service providers or retail outlets' client bases. Certain service providers have developed strong client bases over time and the utilisation of available information pertaining to potential cross-marketing of clients is an area worth exploring from a business point of view. Therefore, it is no coincidence that, in a fairly captured market such as South Africa, alliances will develop to optimise the utilisation of shared client bases.

cross-utilisation of service providers

In certain media circles, however, the proliferation of new names that have entered the banking market might cause uncertainty in the mind of the public as to the origin and soundness of such initiatives. New banking services are portrayed as being stand-alone initiatives, but this does not reflect the true state of affairs. Whereas the new banking initiatives are undertaken as joint ventures with, or as divisions of currently registered banking institutions, they are portrayed as being provided and supported by the retail outlet or cellular telephone service provider only.

uncertainty in the mind of the public

From a supervisory point of view, the Department ensures that the risk management pertaining to such joint ventures or divisions of banking institutions is of the highest standard and in so doing, endeavours to ensure that these business initiatives and the proliferation of banking services will not dilute the public's trust in the banking system. Furthermore, the supervisory process will be strengthened by proposed changes to the

risk management

Banks Act that will ensure that any variations on the joint venture themes by retailers or service providers on the provision of banking services will have to be pre-approved by the Department. The proposed changes will also ensure that a “fit and proper” vetting process is applied to the management of such joint ventures, as is the case for the management of banks.

2006 International Monetary Fund Article IV consultation

sound macroeconomic and financial policies

The 2005 staff report produced by the International Monetary Fund (IMF) following its Article IV consultation commended the South African authorities for their continued implementation of sound macroeconomic and financial policies as well as their increased focus on social spending and on addressing the many challenges facing the country. Note was also taken of the serious economic challenges that remained, including persistently high unemployment, widespread poverty and large wealth disparities.

comments by IMF

The 2006 Article IV discussions with the IMF were held in Pretoria and Cape Town during the period 10 – 14 May 2006. In its 2006 staff report, the following comments were made:

- The IMF expressed support for the South African authorities’ overall strategy that seeks to spur growth and address social concerns while preserving macroeconomic stability.
- Plans to boost investment infrastructure and selected social programmes over the next few years, which would imply a moderate expansionary fiscal impulse to the economy, were supported.
- The IMF also concurred with the South African Reserve Bank’s assessment of upside risks to inflation and expressed the view that the inflation-targeting regime continued to gain effectiveness and credibility.
- The IMF believed that the South African authorities remained committed to a flexible exchange rate, intervening only to increase reserves at times of rand strength.
- The view was expressed that the South African banking sector was sound and well regulated. Near-term prospects were favourable, but pressures, which the South African authorities were fully aware of, could emerge if interest rates rose markedly. It was observed that intense competitive pressures and narrowing margins were encouraging innovation and presenting new challenges for regulators. These innovations include cellular telephone banking, alliances with retailers, increased credit card issuance and the emergence of asset-backed securities. It was noted, however, that the regulators had been assessing the risks of these new products and markets and introducing appropriate regulations and legislation. The IMF noted also progress being made in improving access to banking services for the poor and aligning regulations with international standards.
- The IMF expressed support for the South African authorities’ efforts to identify and address constraints on economic growth through the emerging Accelerated and Shared Growth Initiative for South Africa as well as the efforts made to increase

banking sector sound and well regulated

employment. It favoured further discussions among stakeholders to revise those labour-market regulations and practices that may limit job creation.

- The IMF further expressed its support for official programmes to address wide income and wealth disparities including the broad-based economic empowerment and land reform initiatives.

Human resources issues

The Department prides itself in the quality of its human resources. The appointment of the three deputy registrars of banks and the 21 promotions which were effected during 2006 were some of the highlights. The continued scarcity of human resources in the industry as well as the staff turnover rate of 14 per cent in 2006, contributed to a decline in the Department's progress towards employment equity. At the end of 2006, 46 per cent of the Department's workforce was black and in terms of gender, 49 per cent was female. The Department focused much of its human resources efforts on the training and development of its current staff members, which are outlined in Chapter 2 of this report.

quality of human resources

Issues to receive particular attention in 2007

Besides fulfilling its normal supervisory and regulatory tasks, the Department will particularly focus on the following issues during 2007:

focus areas

- Continued preparations for the effective implementation of Basel II by January 2008. This includes the finalisation of the amended regulatory framework, ongoing assessments of the impact of Basel II and the state of readiness of banks as well as interaction with other supervisors.
- Updating of the Department's regulatory framework and supervisory processes to ensure full compliance with the Core Principles for Effective Banking Supervision.
- Continued monitoring of banks' corporate-governance processes, with particular focus on the development of directors.
- Ongoing monitoring of banks' compliance with anti-money laundering legislation.
- Continued participation in the initiatives and activities of international and regional bank-supervisory bodies, such as the Basel Committee on Banking Supervision and the Subcommittee of Bank Supervisors of the Southern African Development Community.
- Ongoing combating and investigation of illegal deposit-taking by unregistered institutions and persons.
- Continued training of staff to meet the challenges posed by developments in regulatory and supervisory standards, both locally and internationally.

Expression of thanks

I wish to express my appreciation to the Minister and Deputy Minister of Finance for their valued input on requests in terms of statutory requirements. Sincere thanks also go to the Governor and deputy governors of the South African Reserve Bank for their continuous co-operation, guidance and support. I further wish to thank my fellow executive general managers with whom I serve on the Governor's Executive Committee.

The Department continued to benefit from the resolute relationships it has with numerous individuals and organisations, locally and abroad. These include, to name but a few, the Chief Executive Officer of the Financial Services Board (FSB) and his staff, the

Director of the Financial Intelligence Centre, the Chief Executive Officer of the National Credit Regulator, senior executives of banking institutions, The Banking Association South Africa, the Standing Committee for the Revision of the Banks Act, 1990, the auditing profession, the Basel Committee on Banking Supervision, the central bankers and bank supervisors, both in Southern Africa and elsewhere in the world, and staff of other departments of the South African Reserve Bank, with whom the Department has ongoing interaction.

Finally, I wish to thank my staff members for continuing to fulfil their tasks with dedication, enthusiasm and professionalism.

Errol M Kruger

Registrar of Banks and Executive General Manager: Bank Supervision Department