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

unique features 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).

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.