

South African Reserve Bank and Prudential Authority Annual Reports for 2019/20

Presentation to the Standing
Committee on Finance

08 October 2020



SOUTH AFRICAN RESERVE BANK

Outline of presentation



1. The role of the South African Reserve Bank (SARB)
2. Macroeconomic overview and outlook
3. Highlights from the SARB 2019/20 Annual Report
4. Highlights from the Prudential Authority (PA) 2019/20 Annual Report



The role of the SARB



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The Bank's mandate...

- To protect the value of the currency in the interest of balanced and sustainable economic growth
- Financial Sector Regulation Act, which came into effect in August 2017, mandates the SARB to maintain, promote and enhance financial stability in South Africa



The SARB's key functions include inter alia

- Issues banknotes and coin
- Regulates and supervises certain entities in the financial system
- Ensures the effective functioning of the National Payment System
- Manages the official gold and foreign exchange reserves of the country
- Administers the country's remaining exchange control regulations
- Acts as banker to the government



Shareholding structure, but public is the beneficiary

- The SARB is one of about 6 central banks that still have private shareholders participation
 - There are 2 million shares in issue
 - Dividends capped at 10 cents a share (maximum total payout of R200 000 a year)
 - 90% of any remaining surplus accrues to government, after setting aside contingencies, reserves, tax etc.

Shareholding provides members to a board with limited powers

- Since 1996, several legislative changes:
 - clarify the role of shareholders
 - limit the rights of foreign shareholders and
 - reduce how many shares each shareholder, together with their associates, is permitted to hold
- Board helps ensure good governance, but no role in policy or regulatory decisions
- Government appoints 8 members, including the four executives, while shareholders elect 7 members



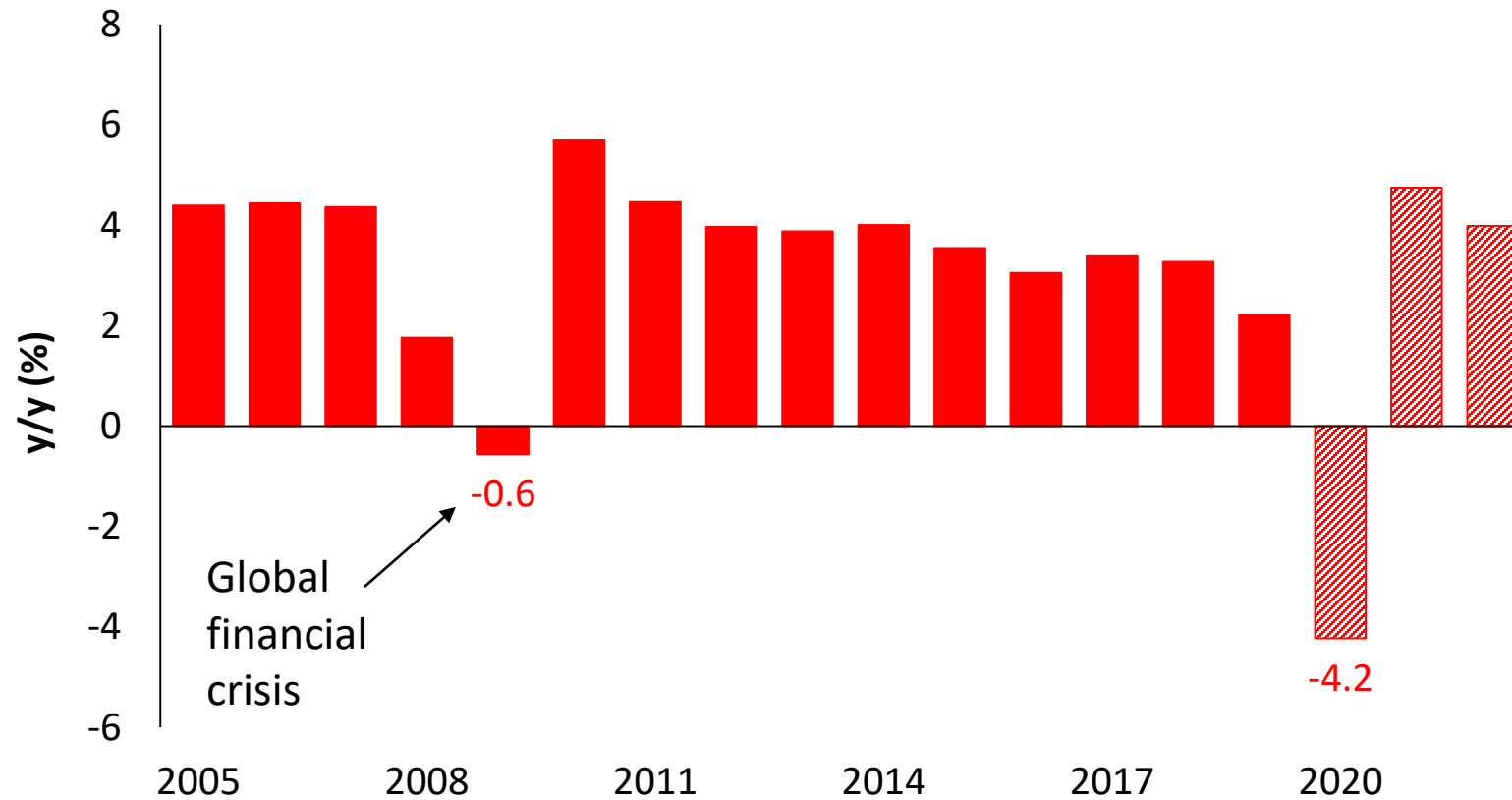
Macroeconomic overview and outlook



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COVID-19 a huge global shock

Growth in South Africa's major trading partners

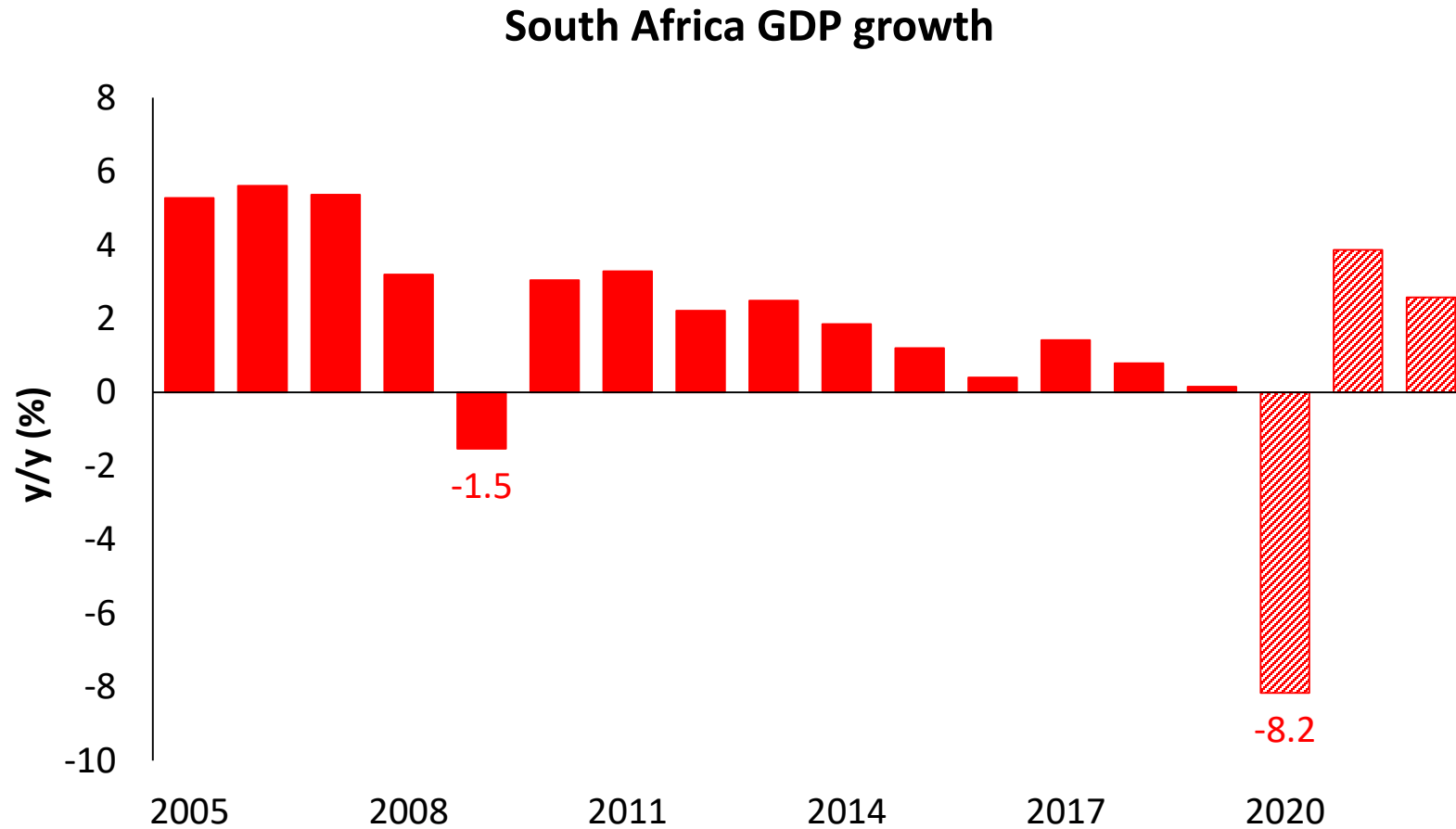


Source: SARB



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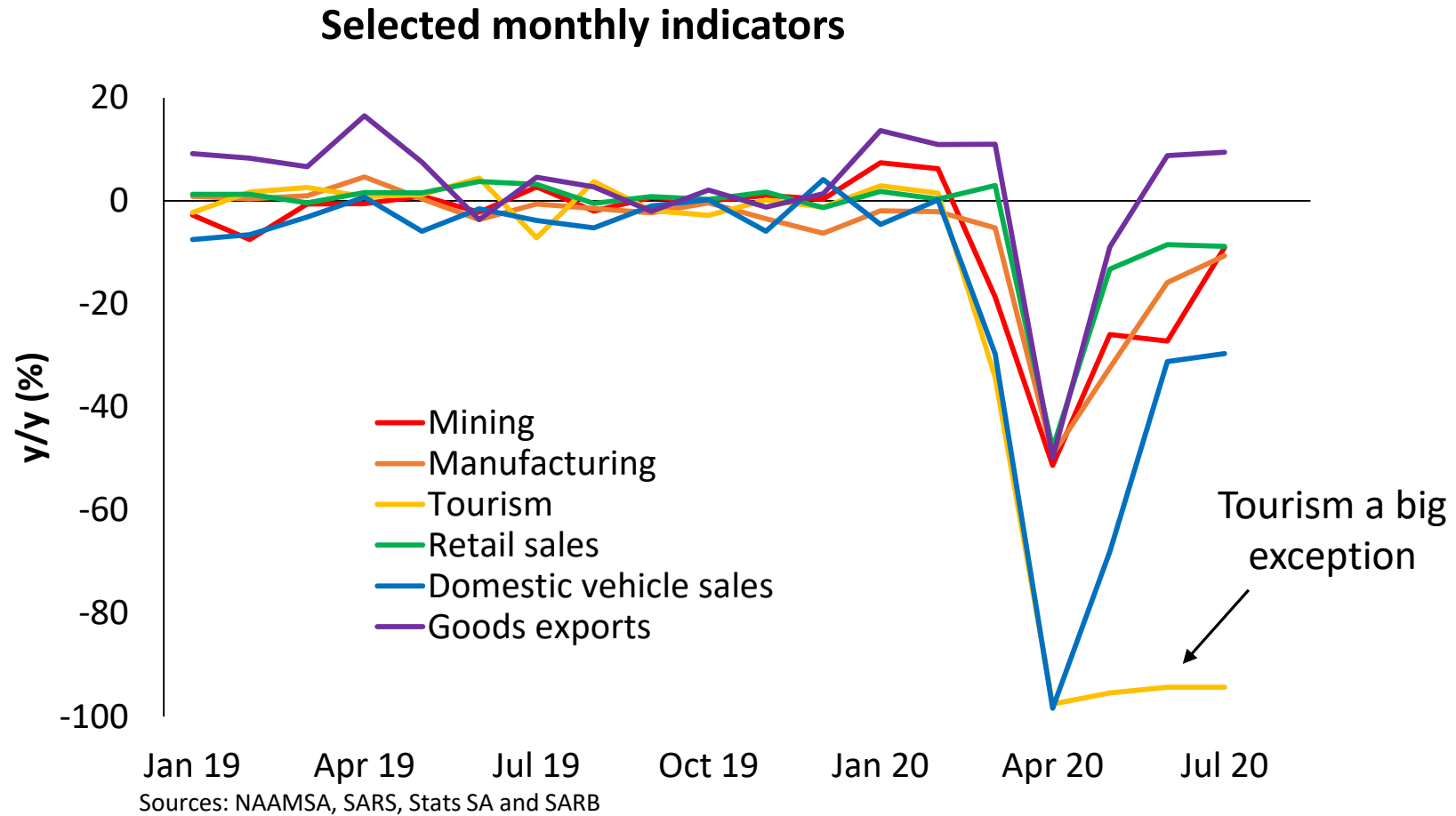
SA growth also much lower



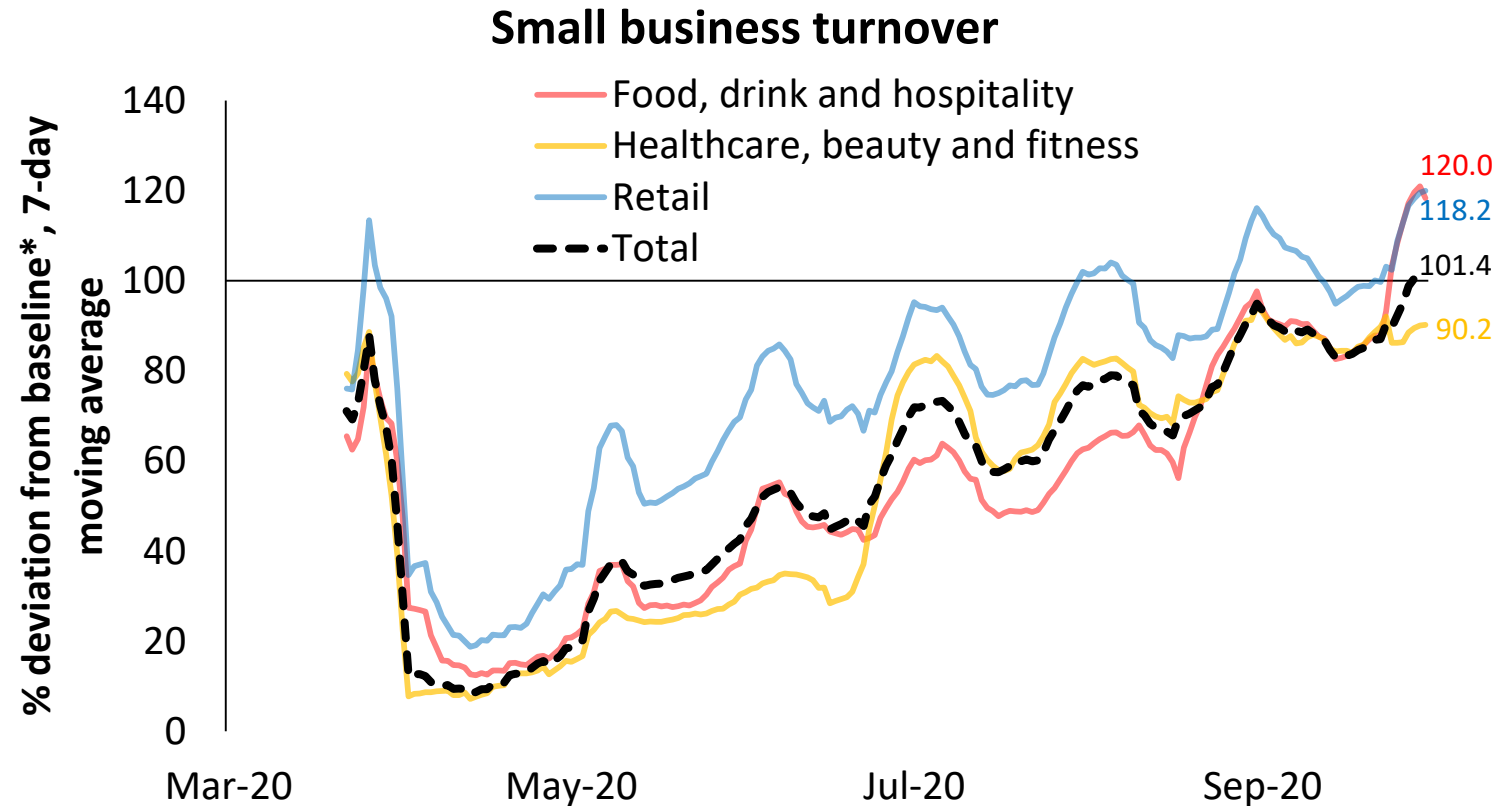
Sources: Stats SA and SARB



Recovery in progress, from very low starting point



Some indicators already back to pre-COVID-19 levels



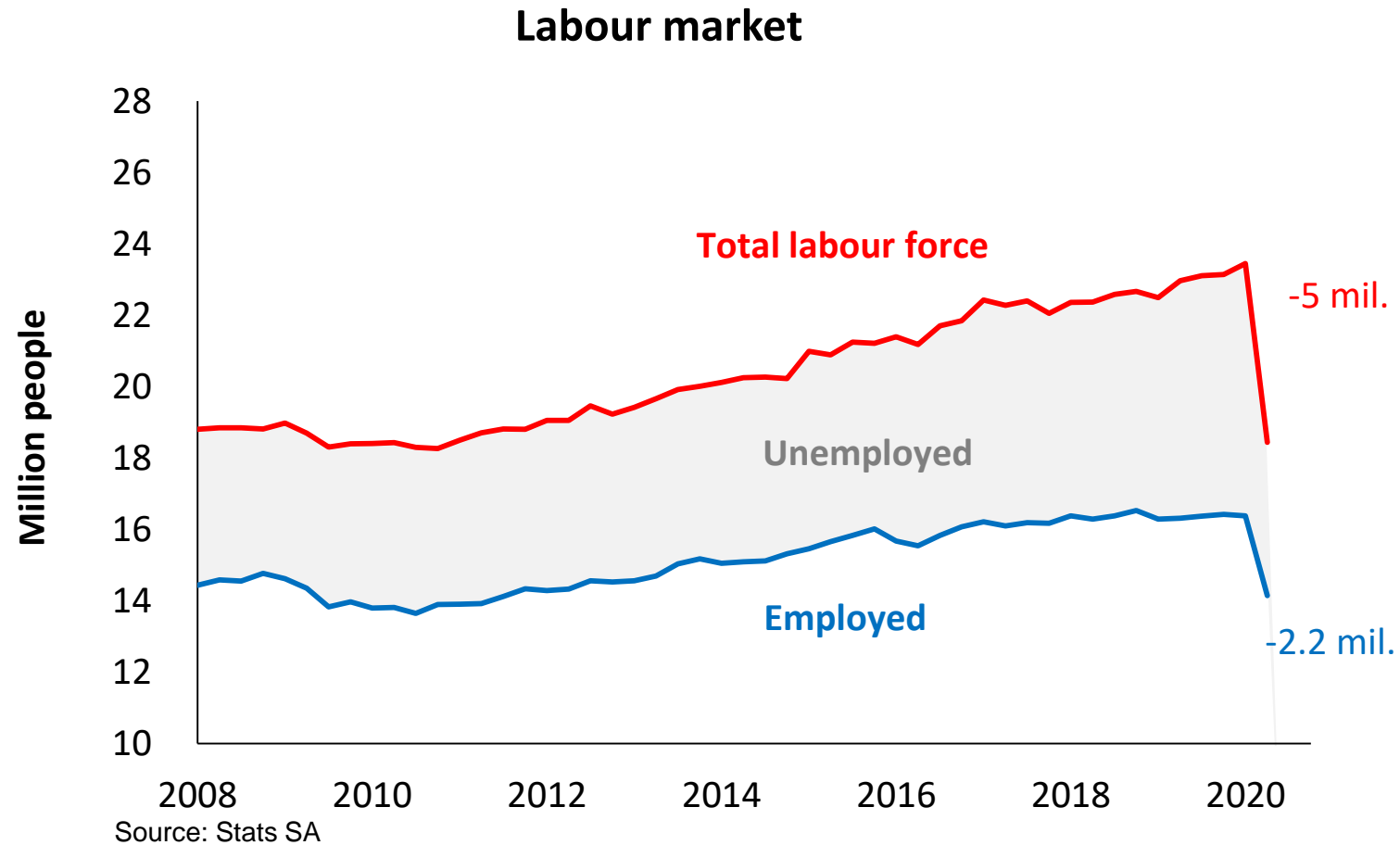
* Baseline = first two weeks of March

Sources: Yoco and SARB

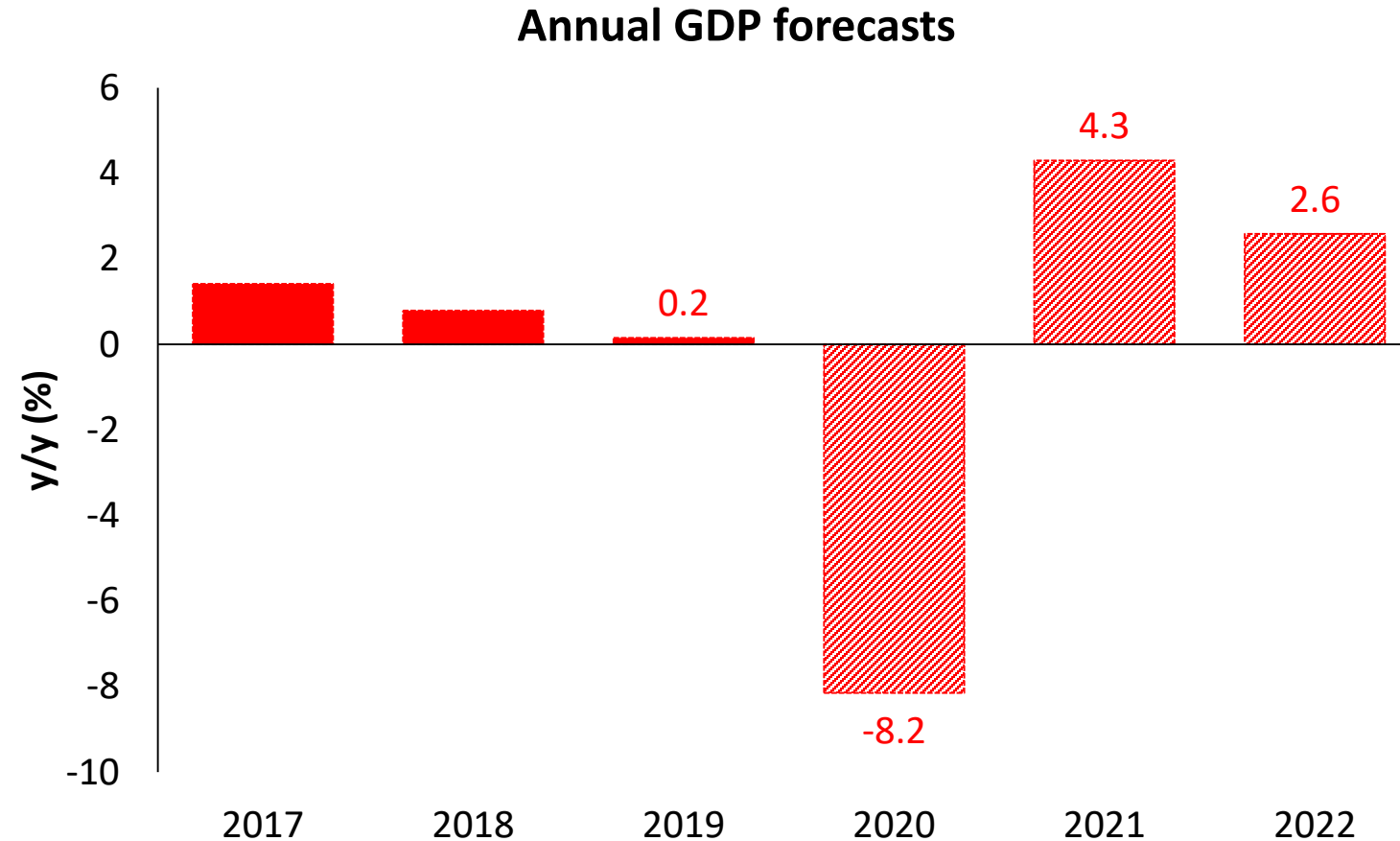


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Others suggest longer-term damage – major job losses



GDP growth faster in 2021 and 2022, after terrible 2020

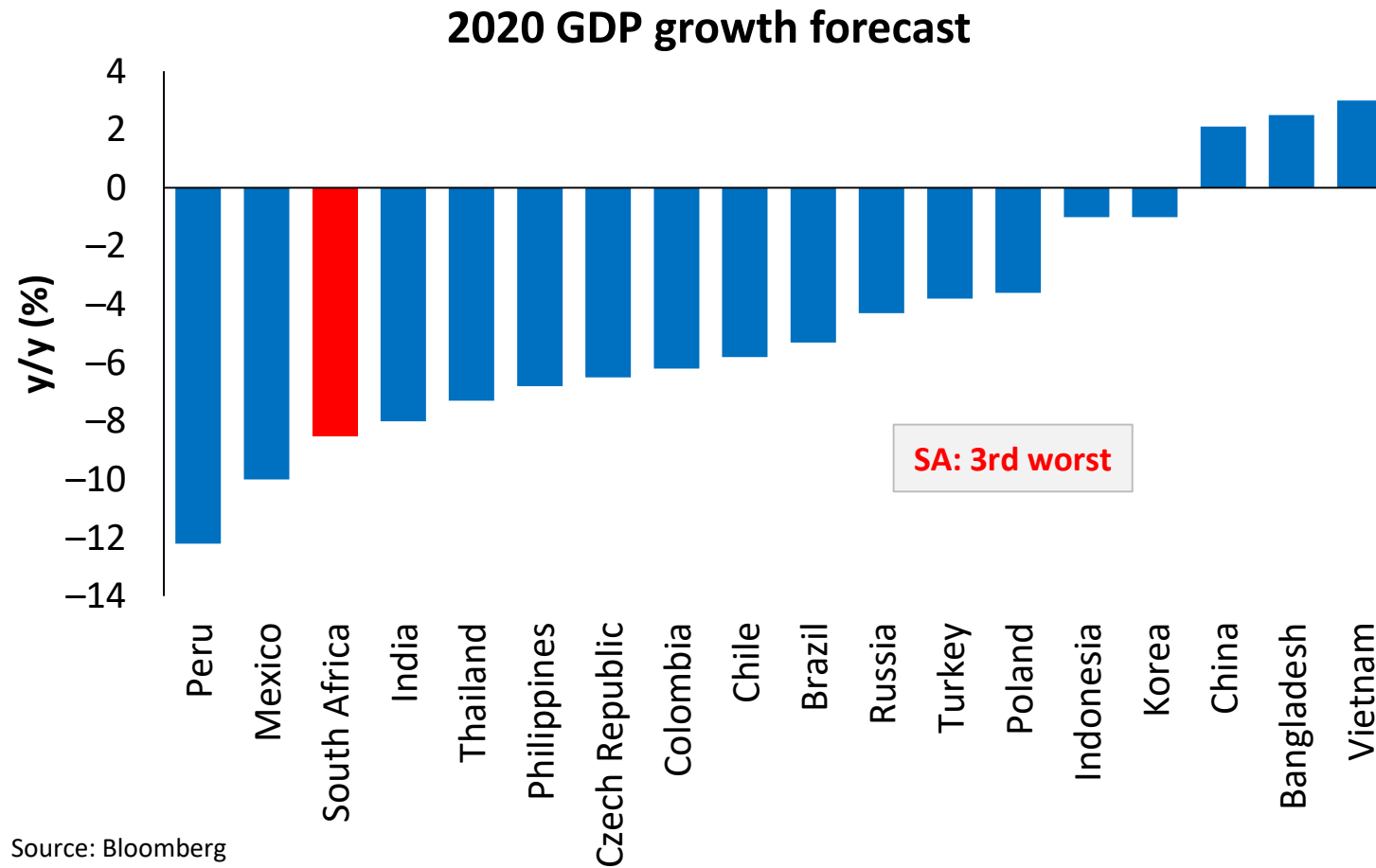


Sources: Stats SA and SARB



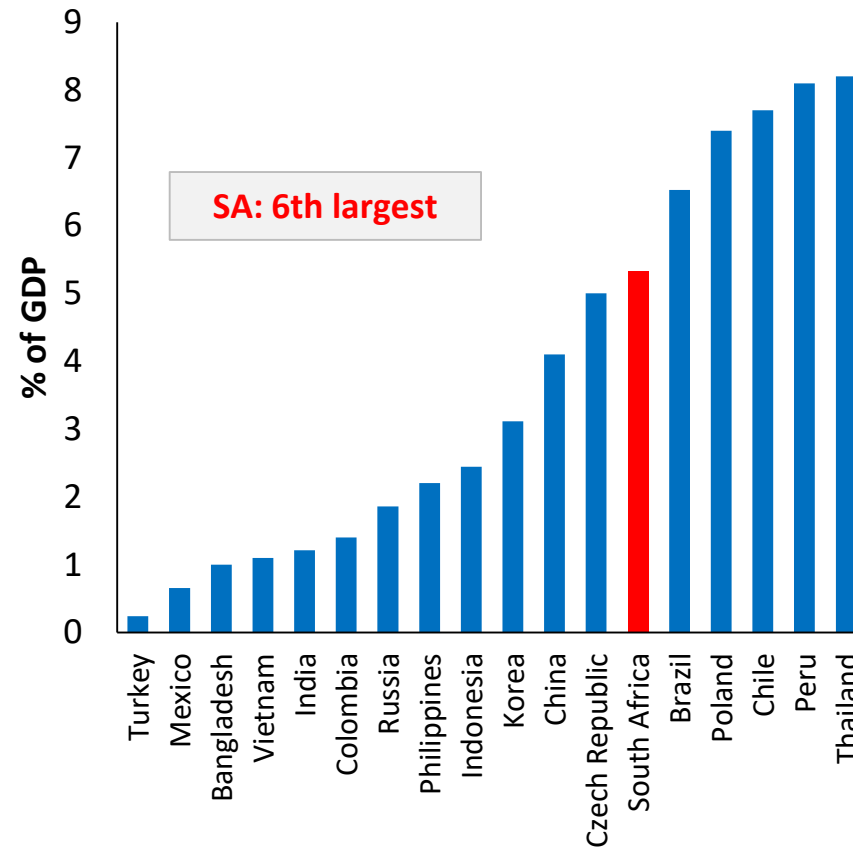
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SA growth weaker than for most peer countries



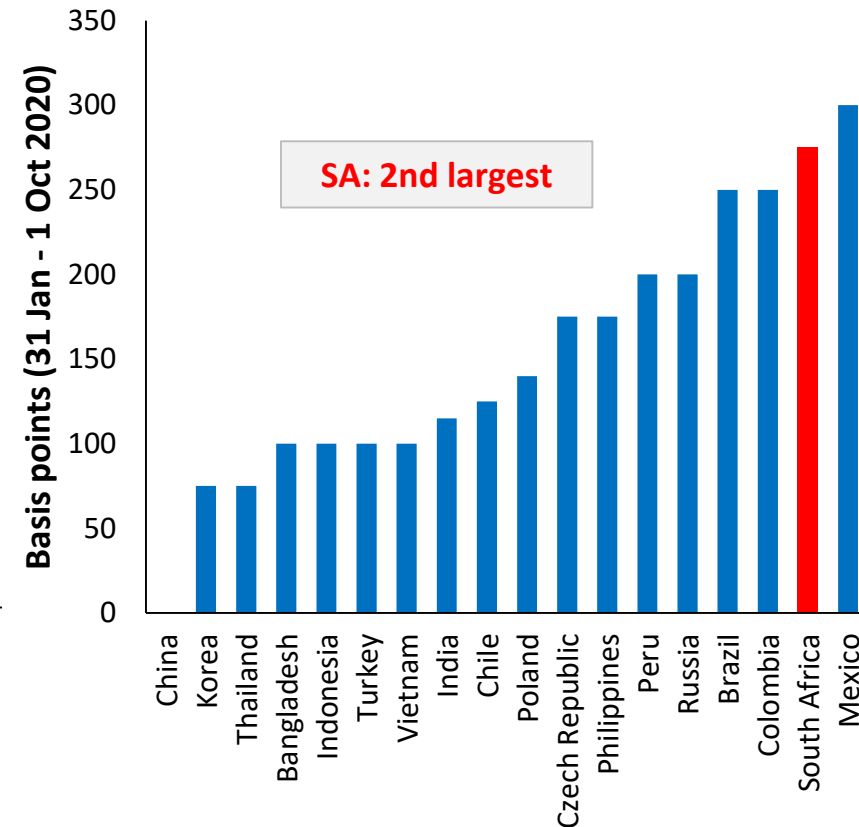
Despite lots of stimulus

Fiscal stimulus*



*Additional spending or foregone revenues
Sources: IMF

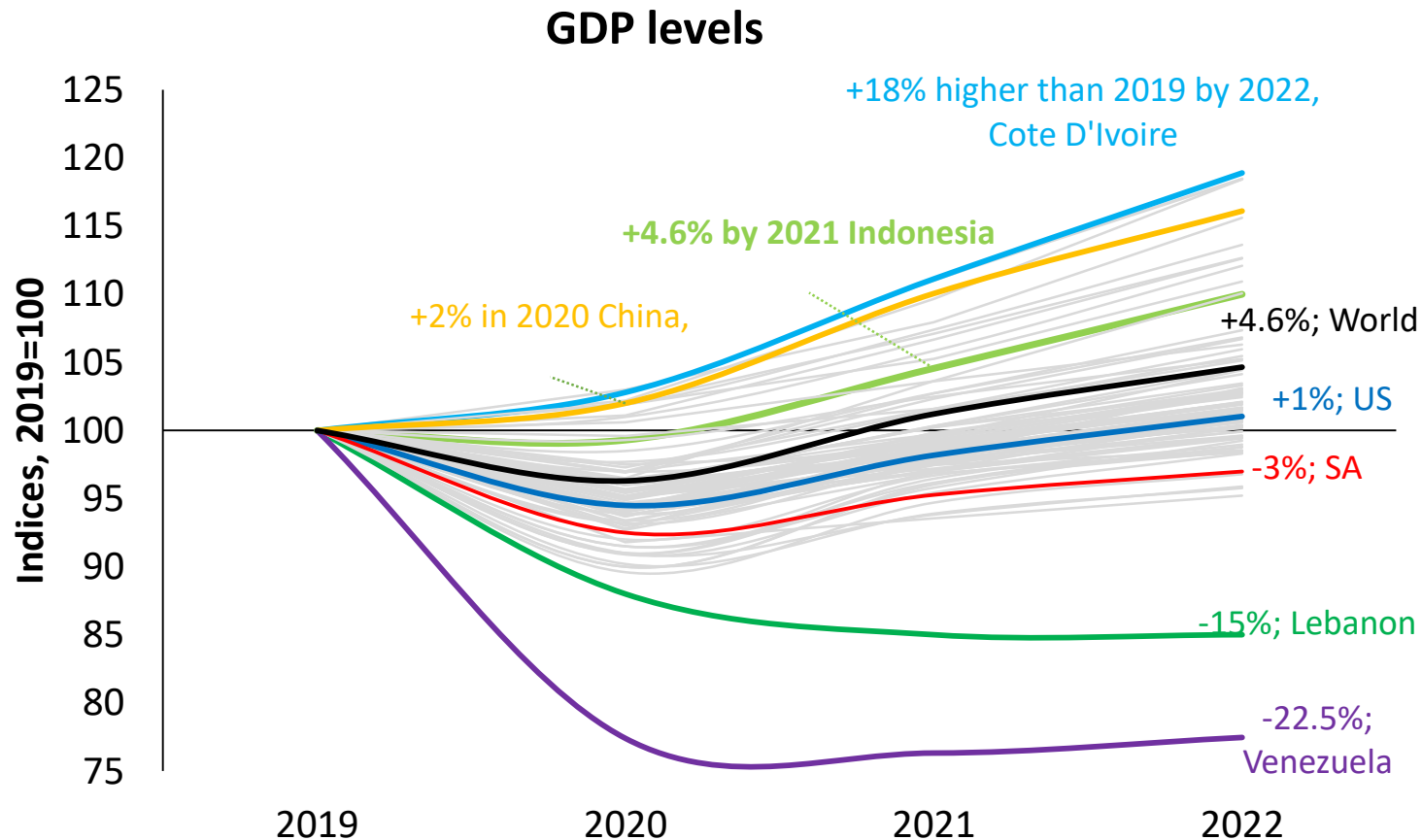
Policy rate cut



Source: Haver



And our recovery is also expected to be relatively slow

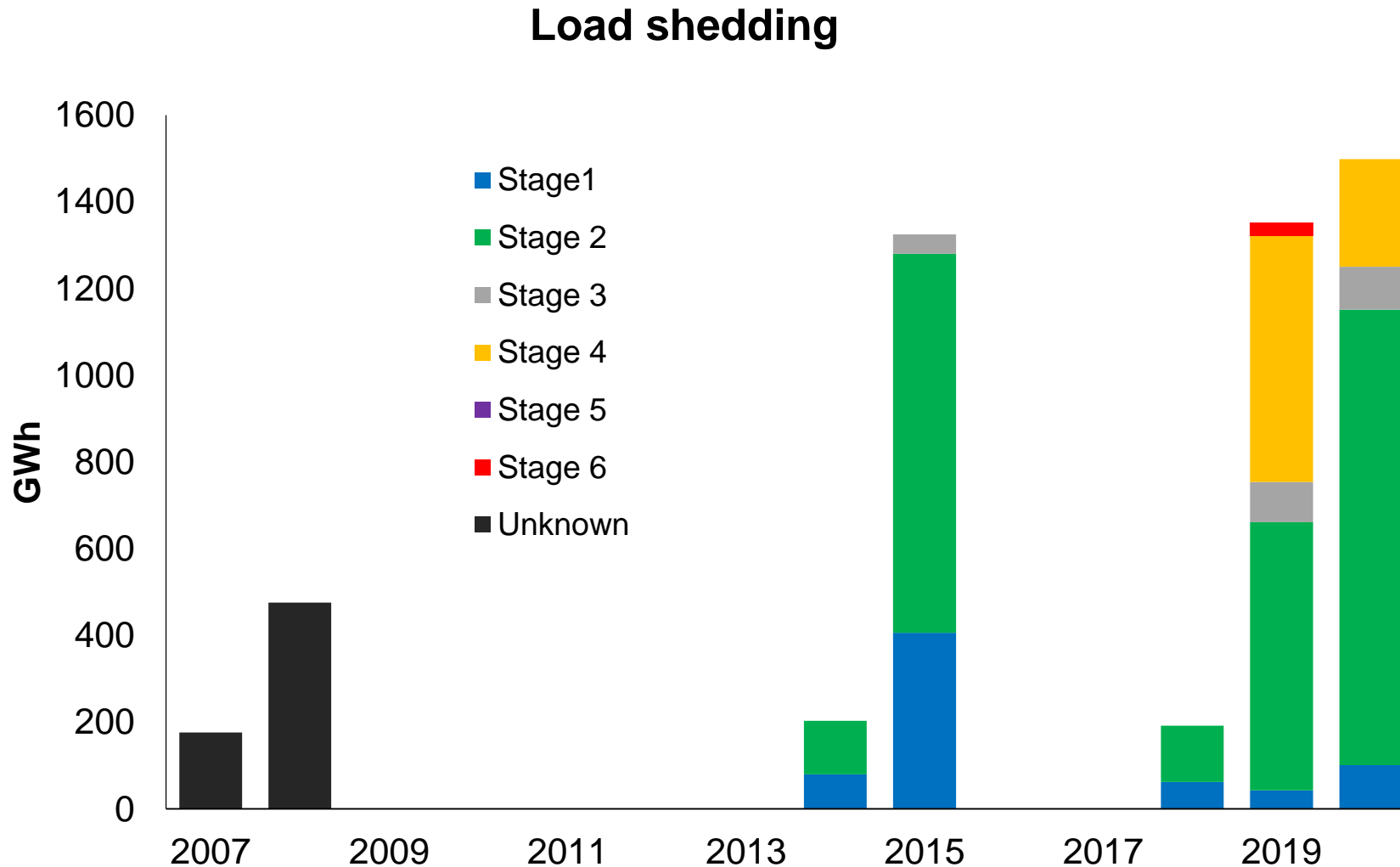


Sources: Bloomberg and SARB

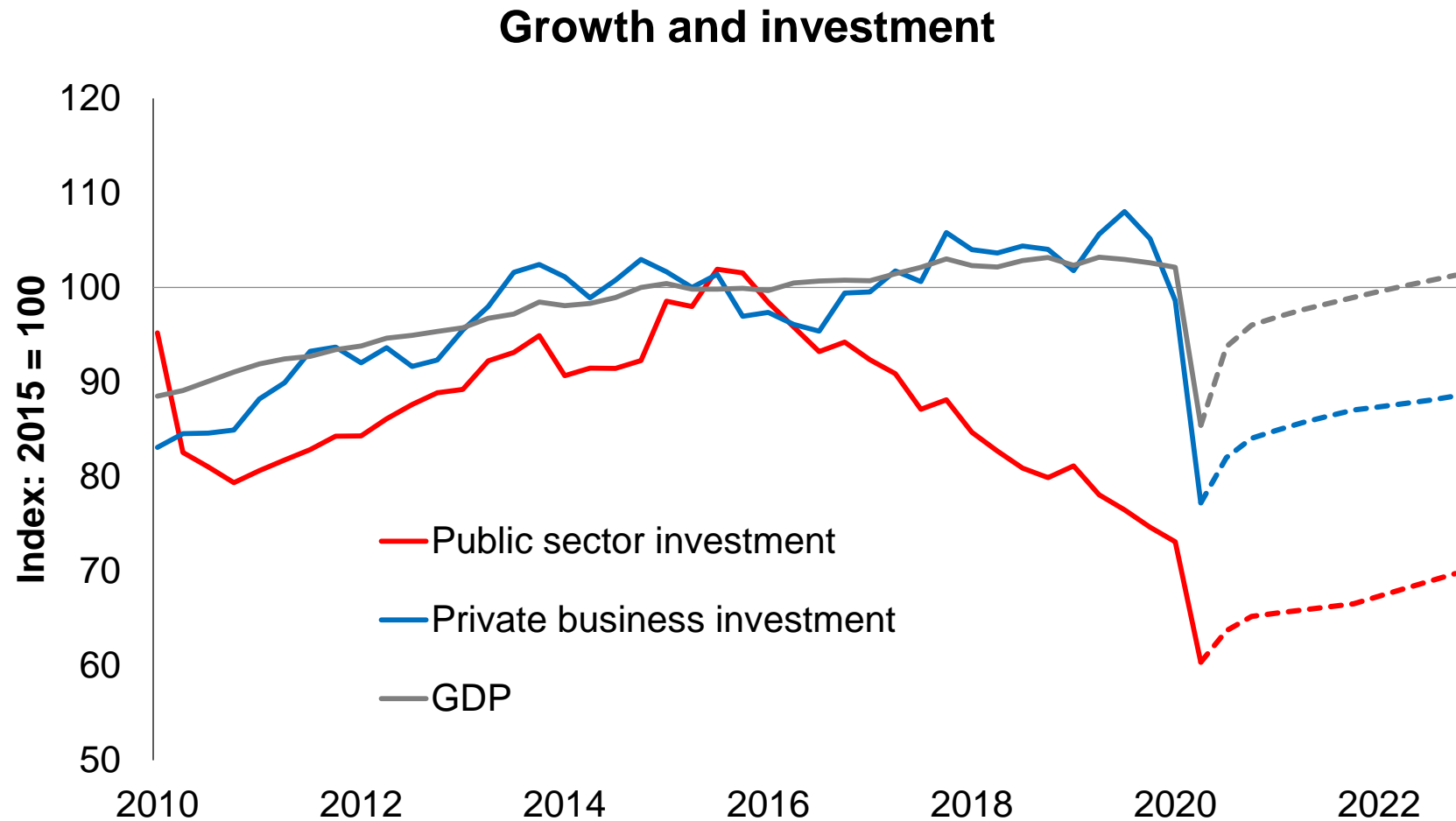


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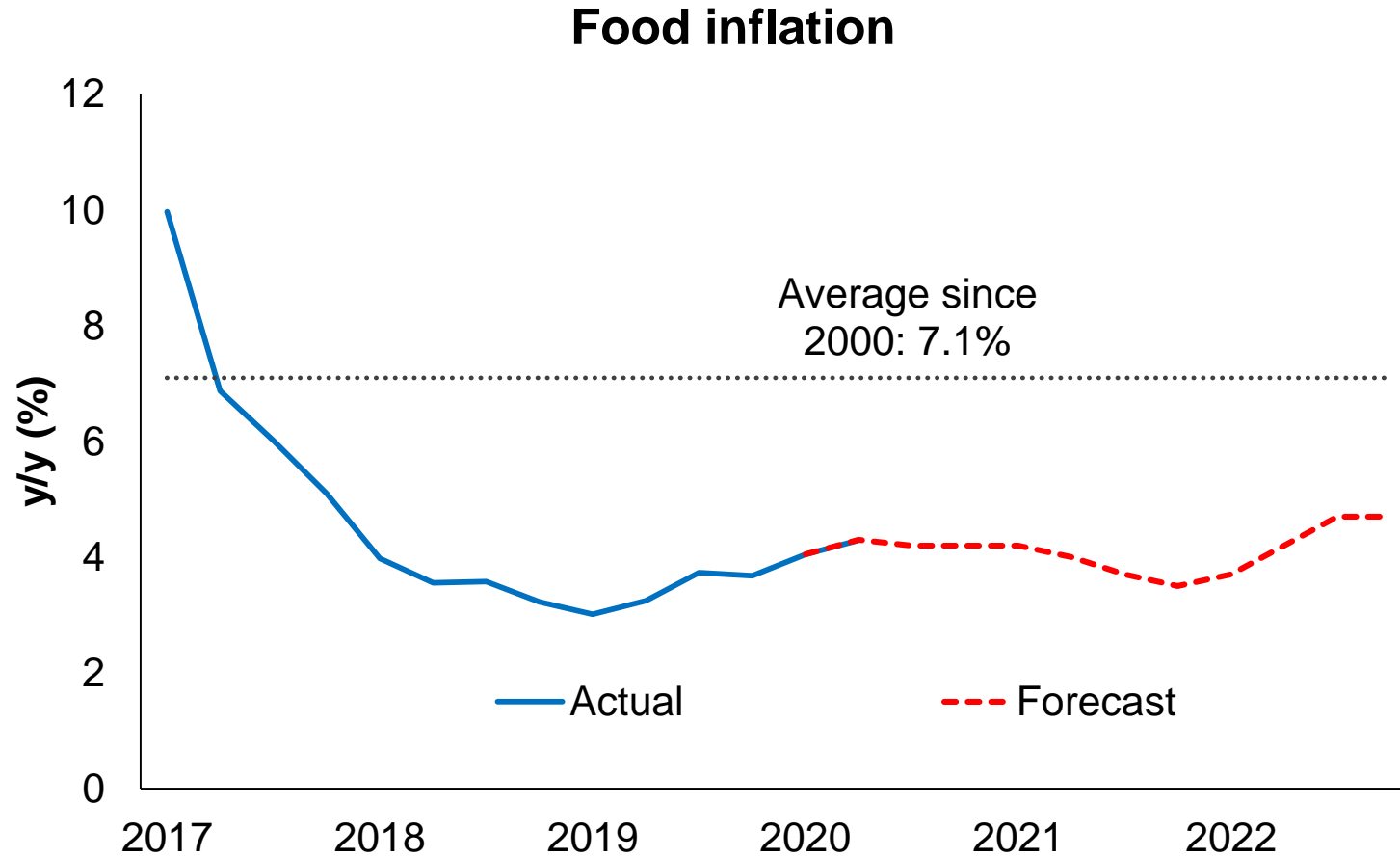
2020 worst ever load-shedding year, despite a weaker economy



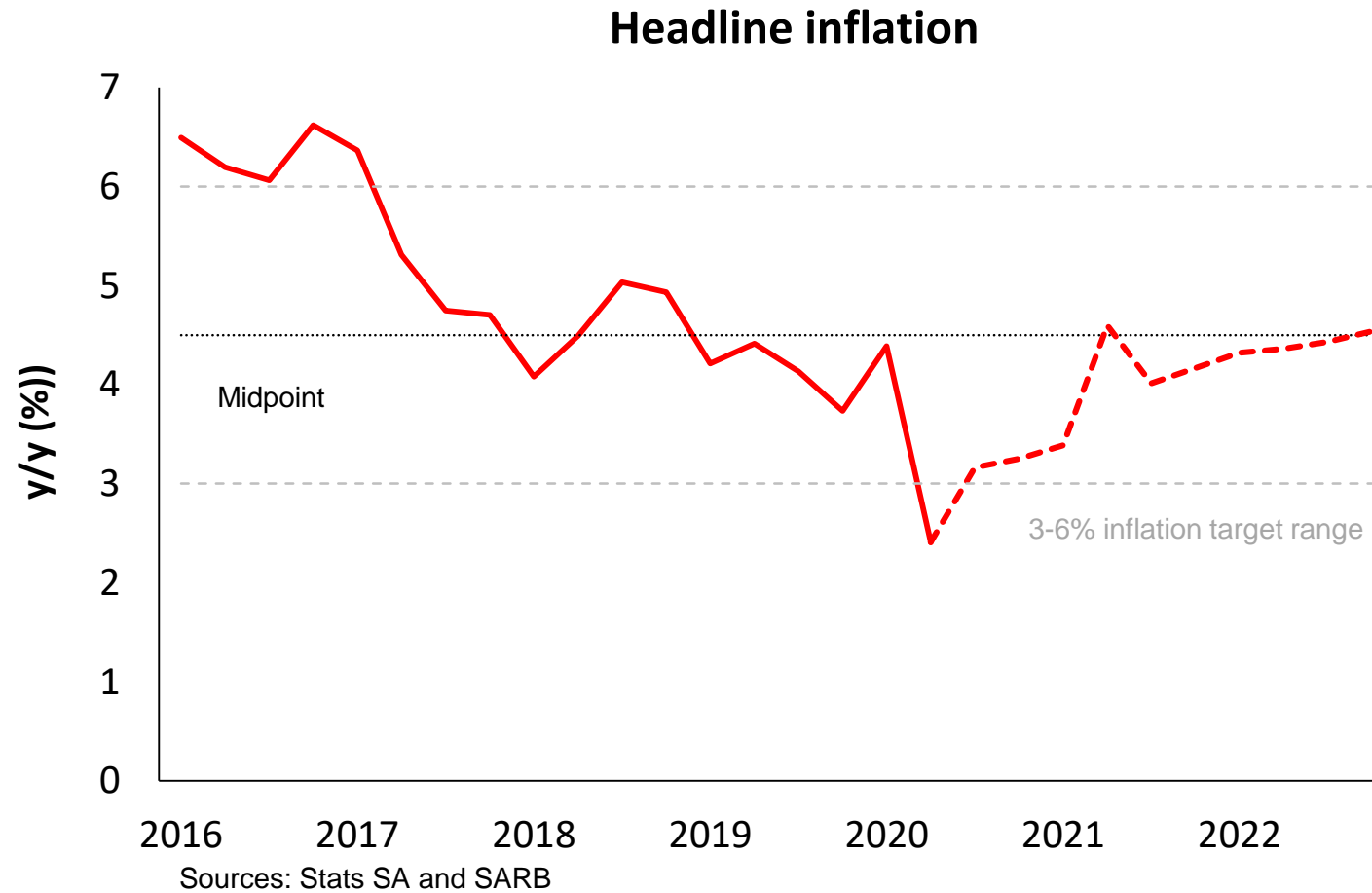
Investment falling, affecting our long-run growth capacity



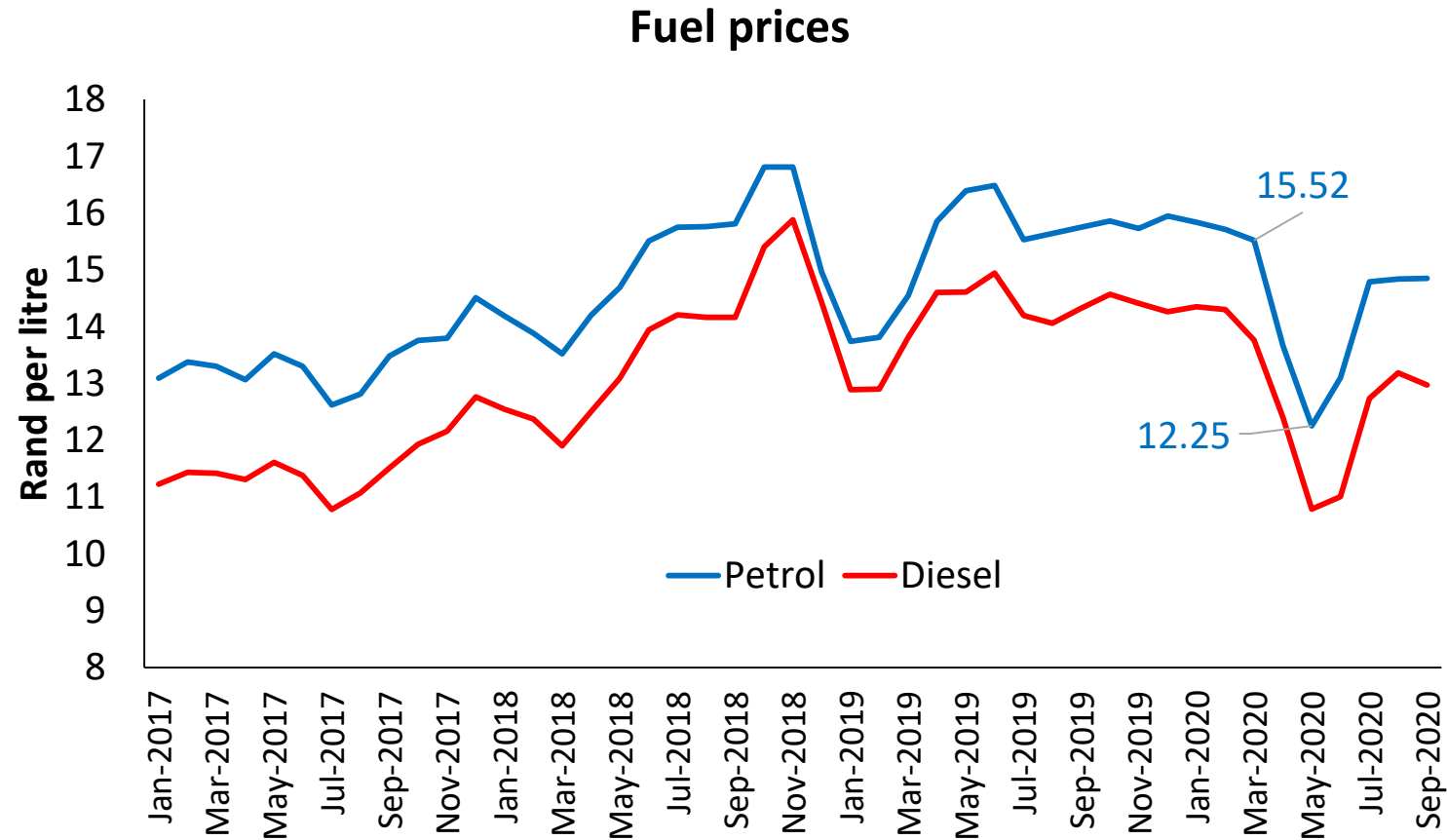
Food a bit higher than last year, but well below longer-run averages



Inflation is well controlled, which helps



Oil price collapse is important

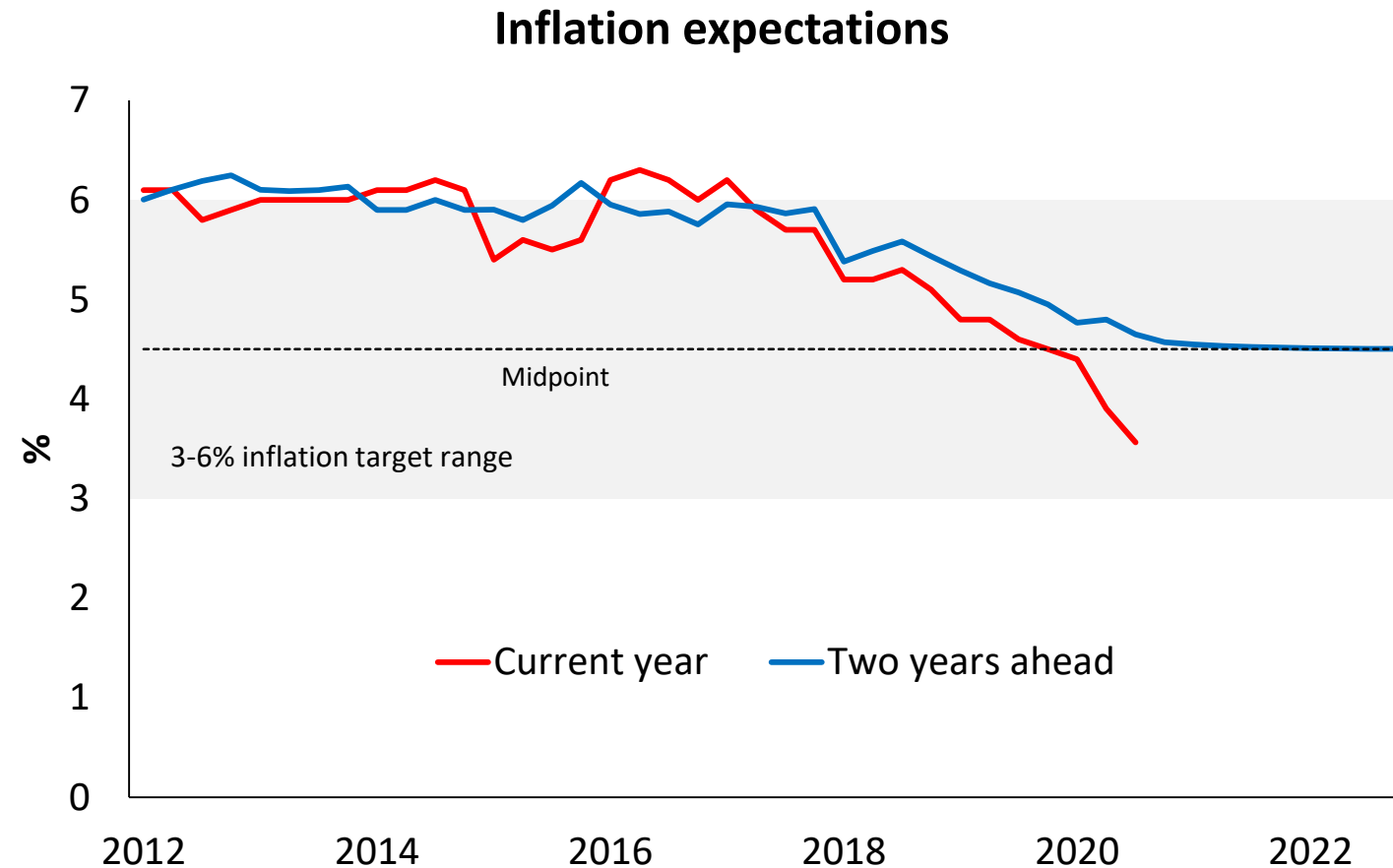


Source: Department of energy



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South Africans are now used to lower inflation

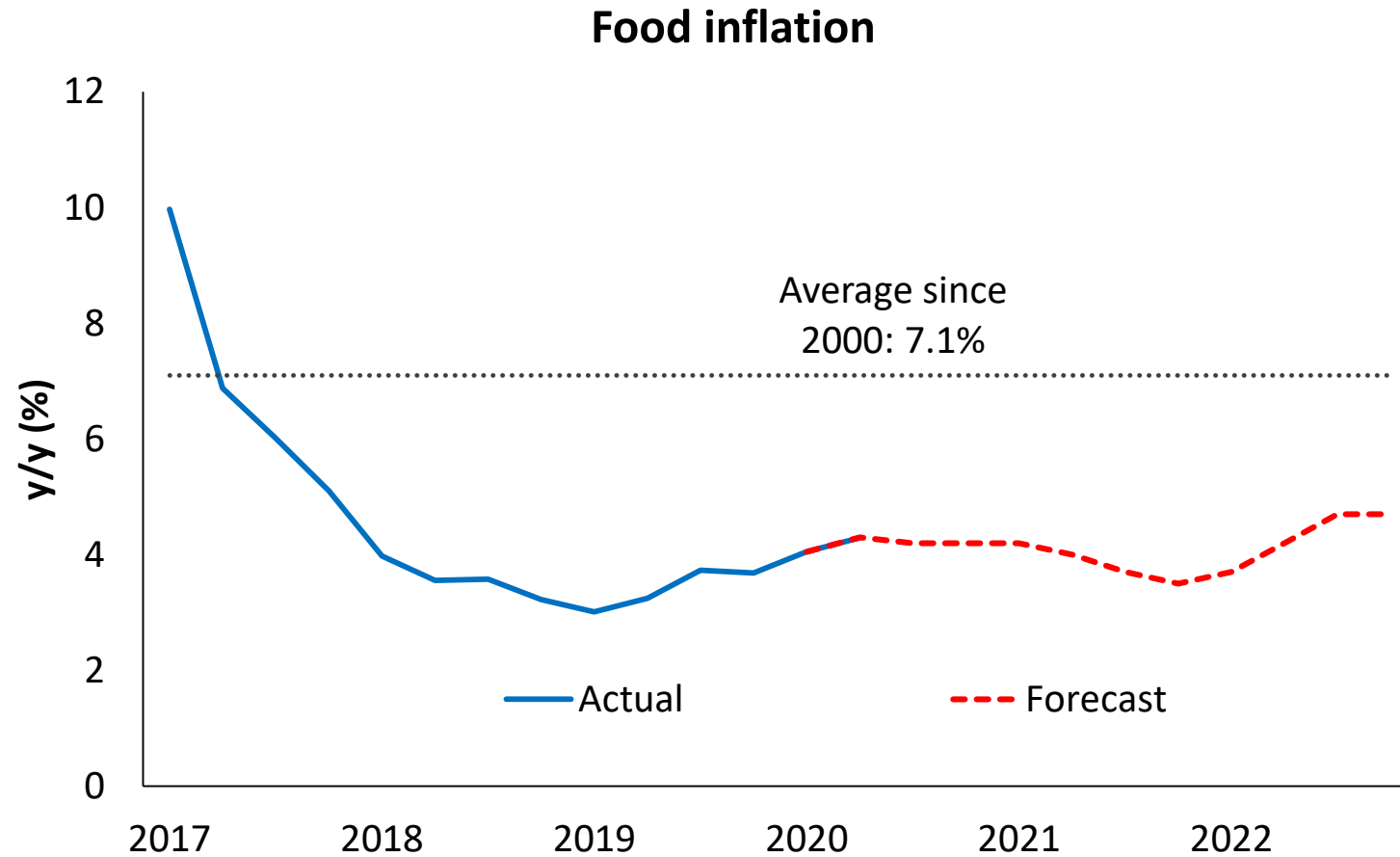


Sources: BER and SARB

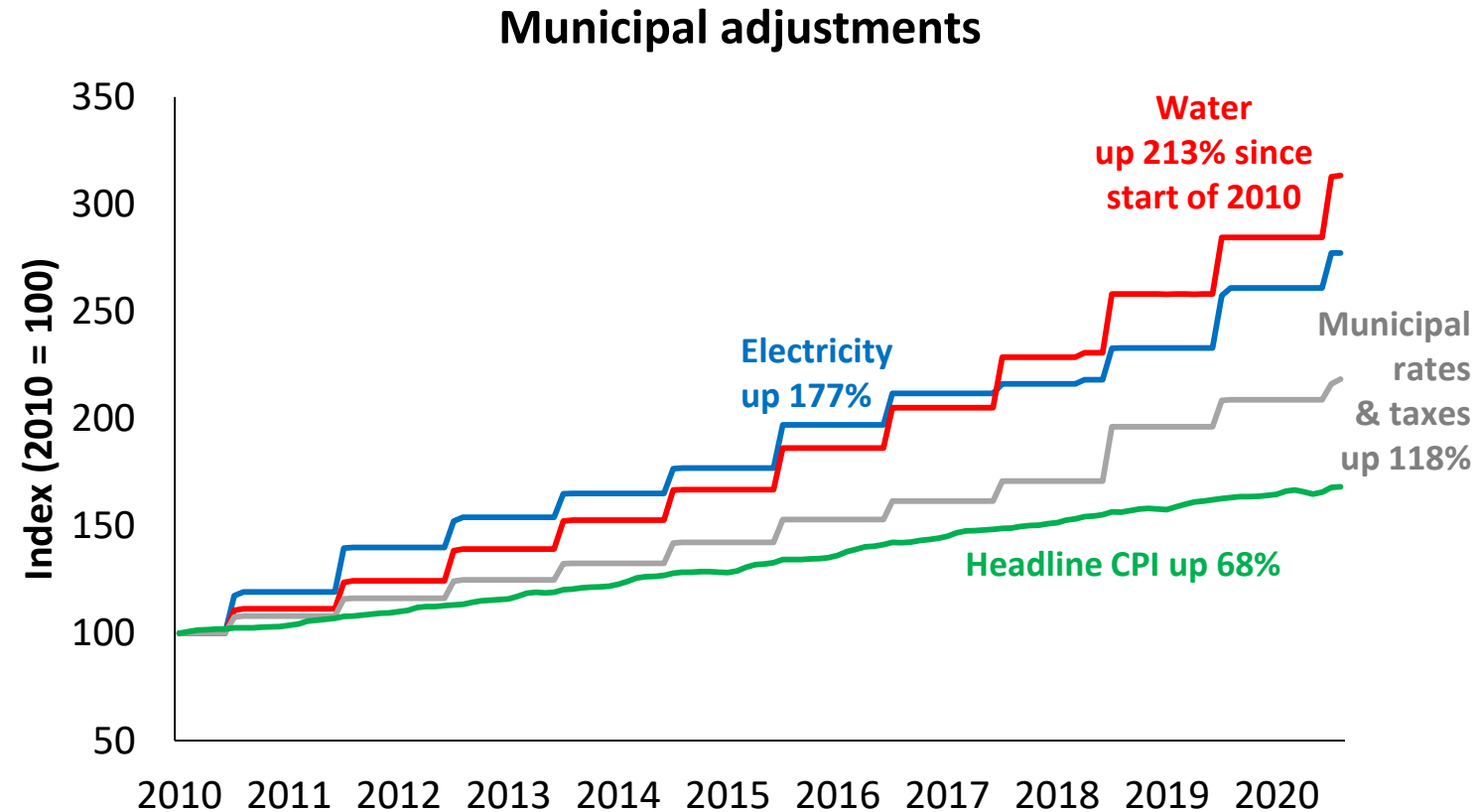


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Food a bit higher than last year, but well below longer-run averages



Admin prices continue to be higher than rest of CPI basket



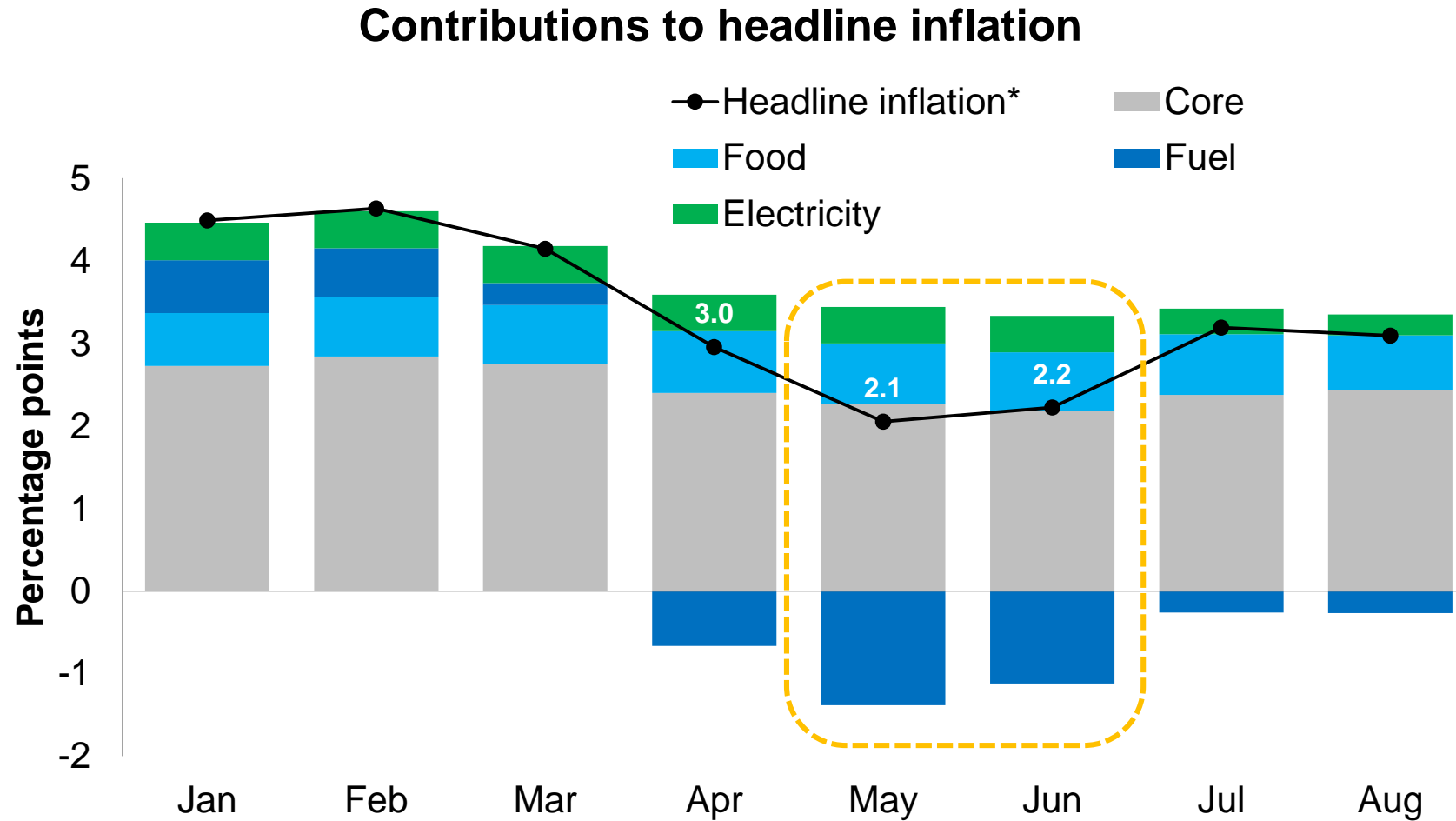
Adjustments are surveyed in July and Aug of each year. Source: Stats SA and SARB

	<u>Electricity</u>	<u>Water</u>	<u>Rates and taxes</u>	<u>Headline</u>
Latest (Aug-20)	6.2%	10.1%	4.6%	3.1%

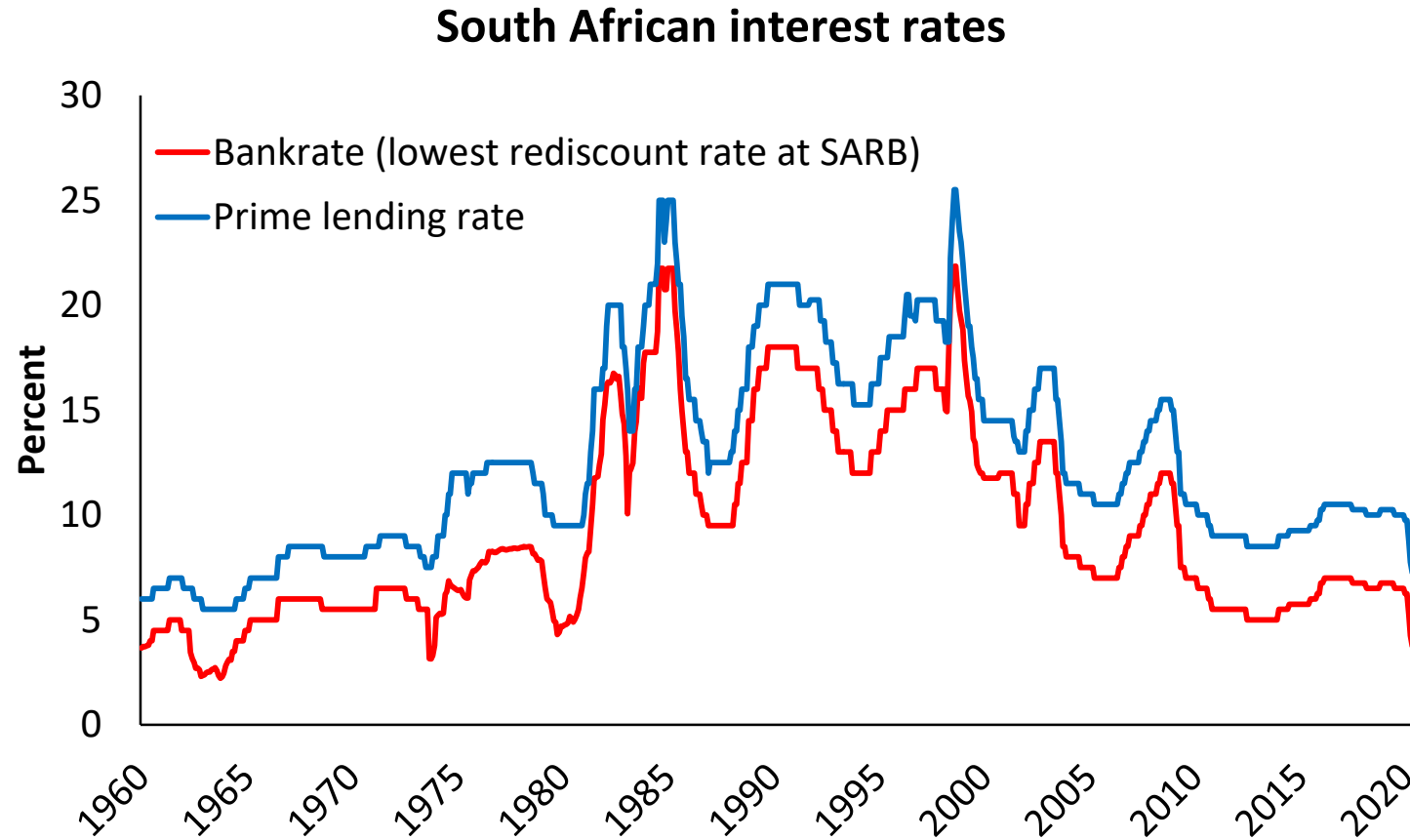


Inflation back in the target range now, barely

May and June were below 3% due to fuel deflation



Prime at a 55-year low

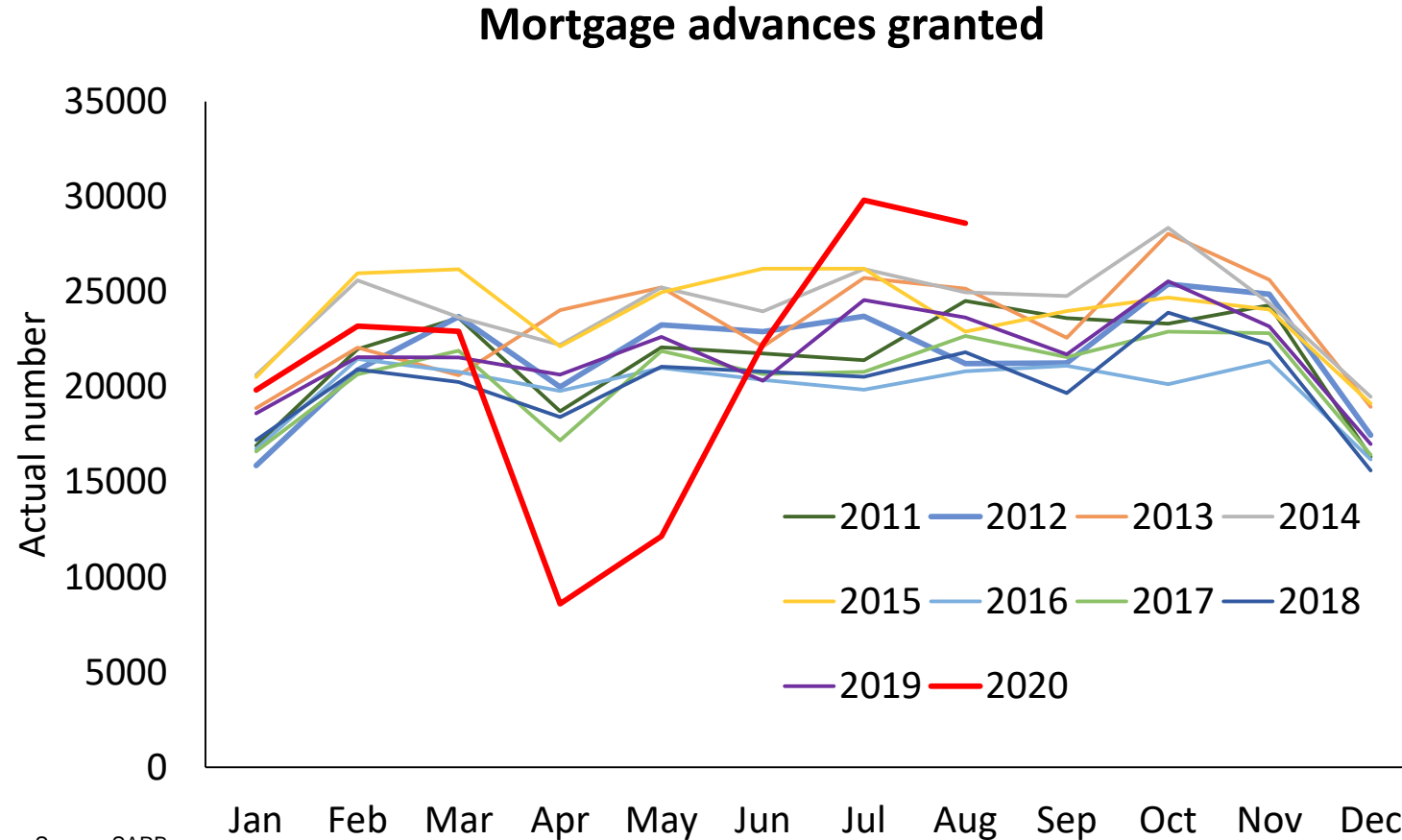


Source: SARB



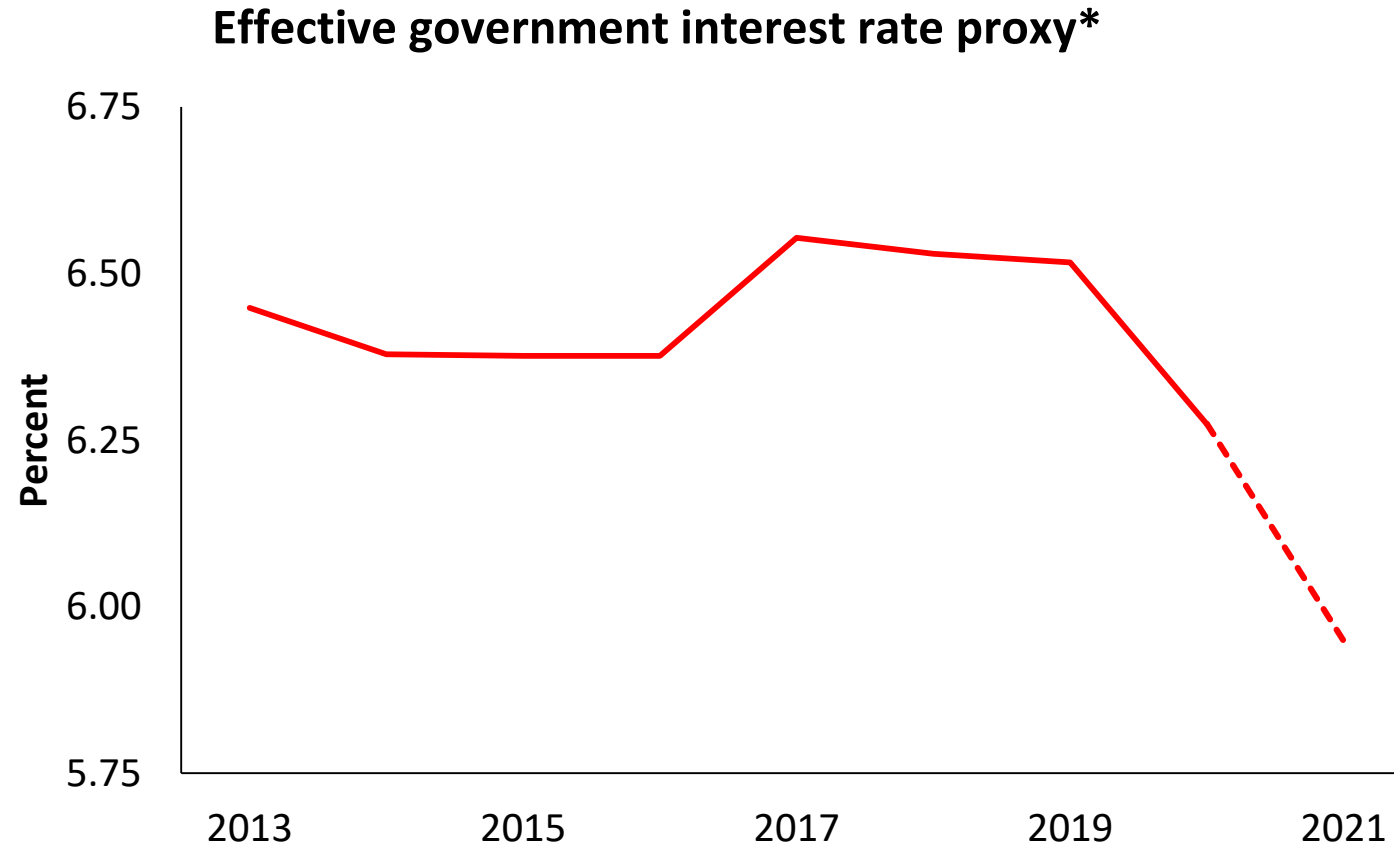
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Repo effects showing up in household credit



Low repo also helping with gov. borrowing costs

- debt is higher but average interest rate actually lower



* Interest-debt ratio
Source: SARB



Highlights from the SARB 2019/20 Annual Report



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About the SARB Annual Report 2019/20

- The Annual Report provides readers with:
 - SARB's response to the Covid-19 pandemic
 - a concise account of the SARB's strategy
 - performance; and
 - impact on society
- It focuses on material financial and non-financial information



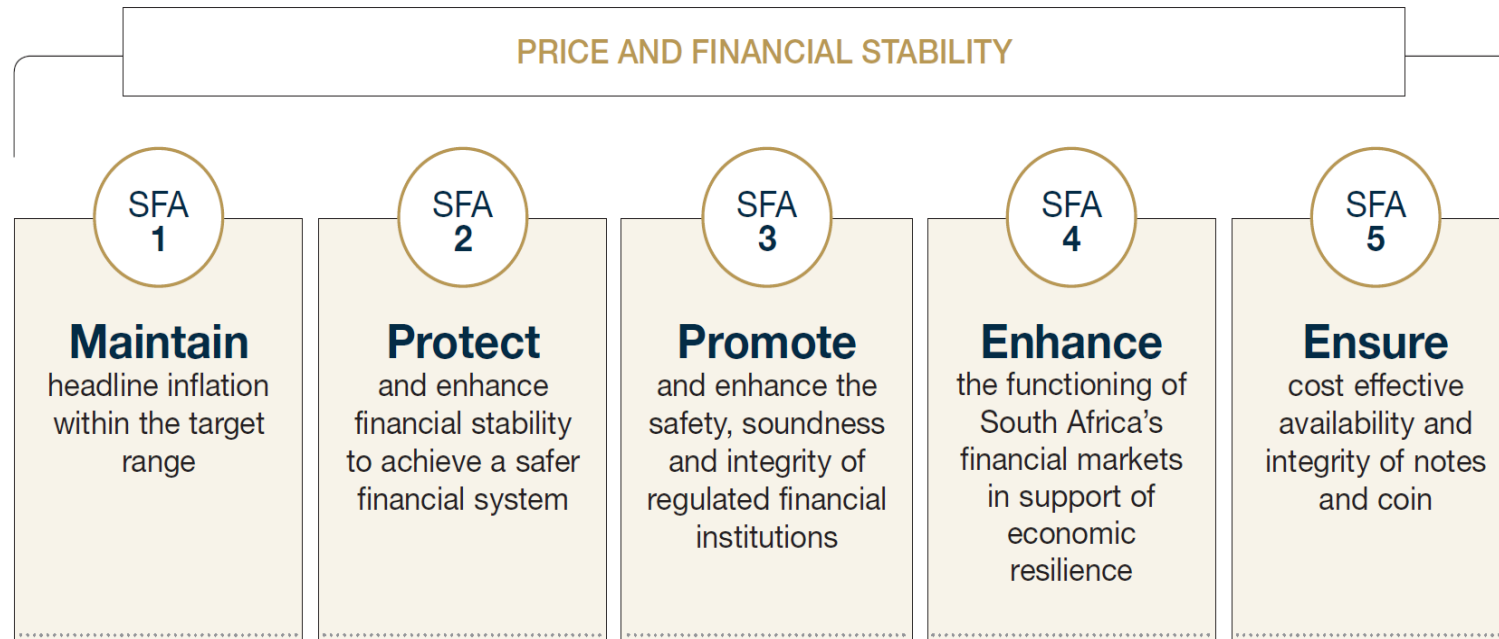
SARB response to the COVID-19 pandemic

- Lowered interest rates by 300 basis points since January and the repo rate is now at its lowest level on record;
- Made liquidity available to banks, through a range of facilities in addition to our usual weekly repo auctions;
- Provided regulatory relief to the financial sector, to help maintain the flow of credit in the economy;
- Supported the Treasury loan guarantee scheme for funding for small and medium enterprises (SMEs), starting at R100 billion, with an option to scale up to R200 billion over time; and
- Buying government bonds in the secondary market, to improve the functioning of the South African market.



The mandate expressed operationally in a strategic plan

- Five strategic focus areas



- Together unique strategic internal process objectives
- Cross-cutting objectives
- Building blocks



2019/20 strategic performance

SFA	Performance
SFA 1 Maintain headline inflation within the target range	<p>Inflation has remained firmly within the target range during the reporting year and is projected to remain within the target range over the two-year forecast horizon. This aligns with forward-looking inflation expectations which are closer to the mid-point of the target range.</p>
SFA 2 Protect and enhance financial stability to achieve a safer financial system	<p>No systemic risk events occurred in the financial system during the reporting year; however, the COVID-19 pandemic will have major implications for the economy and financial system and may develop into a systemic risk event. The SARB finalised and published its methodology to determine whether a bank is systemically important and communicated this to designated banks and the public in the Financial Stability Review.</p>
SFA 3 Promote and enhance the safety, soundness and integrity of regulated financial institutions	<p>There were no failures of SIFIs during the reporting year, although some smaller institutions were placed under specific regulatory action. All regulated financial institutions are being closely monitored in terms of governance and risk management practices, and the Prudential Authority is leveraging technologies to enhance its supervision capabilities.</p>
SFA 4 Enhance the functioning of South Africa's financial markets in support of economic resilience	<p>The strategic objectives and key purpose of this SFA have been defined; however, work to develop the practical formulation of the SFA was achieved late in the reporting year. A strong foundation has been laid for further progress in the coming year.</p>
SFA 5 Ensure cost-effective availability and integrity of notes and coin	<p>The currency-producing subsidiaries delivered all notes and coin orders effectively, both for the SARB and the international export market. The quality standard for notes in circulation is being redefined.</p>



Financial highlights

- SARB group net profit after tax of R2.85 billion was lower than prior year's group net profit after tax of R5.82 billion. This was mainly due to a loss in the CPD of R2.77 billion.
- CPD loss of R2.77 billion is mainly due to the expected credit loss allowance of R2.3 billion and an impairment loss on the Land Bank promissory notes of R0.6 billion.
- SARB group net profit after tax of R2.85 billion includes an impairment loss on African Bank Limited of R2.3 billion.
- SA Mint net profit after tax of R0.9 billion, increased by 42.2% compared to prior year net profit after tax of R0.7 billion. This is largely attributable to strong Krugerrand sales.

Profit/(loss) breakdown

	Group (R'm)	
	2020	2019
CPD	(2 769)	92
SA Mint (attributable to parent)	947	666
SABN	106	156
Subsidiaries' profit contribution	(1 716)	914
Share of profit attributable to associate	280	547
Less intercompany dividends	(1 400)	(250)
SARB's net profit after taxation	6 385	4 610
Total Group profit attributable to the parent	2 851	5 821

- Dividend of R0.2 million was paid to shareholders as required by the SARB Act.



Social investment and support

The SARB's corporate social investment continues its focus on education with the MPC Schools Challenge its flagship programme. The MPC Schools Challenge was piloted with 70 schools in 2012 and has grown sustainably over the past four years, reaching over 3 200 learners in over 400 schools annually. SARB provides bursaries, supports academic institutions and schools for the disabled.

Monetary Policy Committee (MPC) Schools Challenge

A partnership with the Department of Basic Education to communicate and deepen understanding of the SARB's mandate among Grade 12 Economics and Accounting scholars.

Reaching
3200 beneficiaries

External bursaries, including arts and culture

Funding of bursaries for young people studying at tertiary institutions.
Funding for two arts and culture bursaries. Recipients are from underprivileged communities.

Reaching
78 beneficiaries

Support to universities for research and skills development

Partnerships with universities known as Chairs, to drive skills in finance, economics, and central banking, as well as support for financial and economic journalism students - at UCT, Wits, Rhodes and UP

Reaching
98 beneficiaries

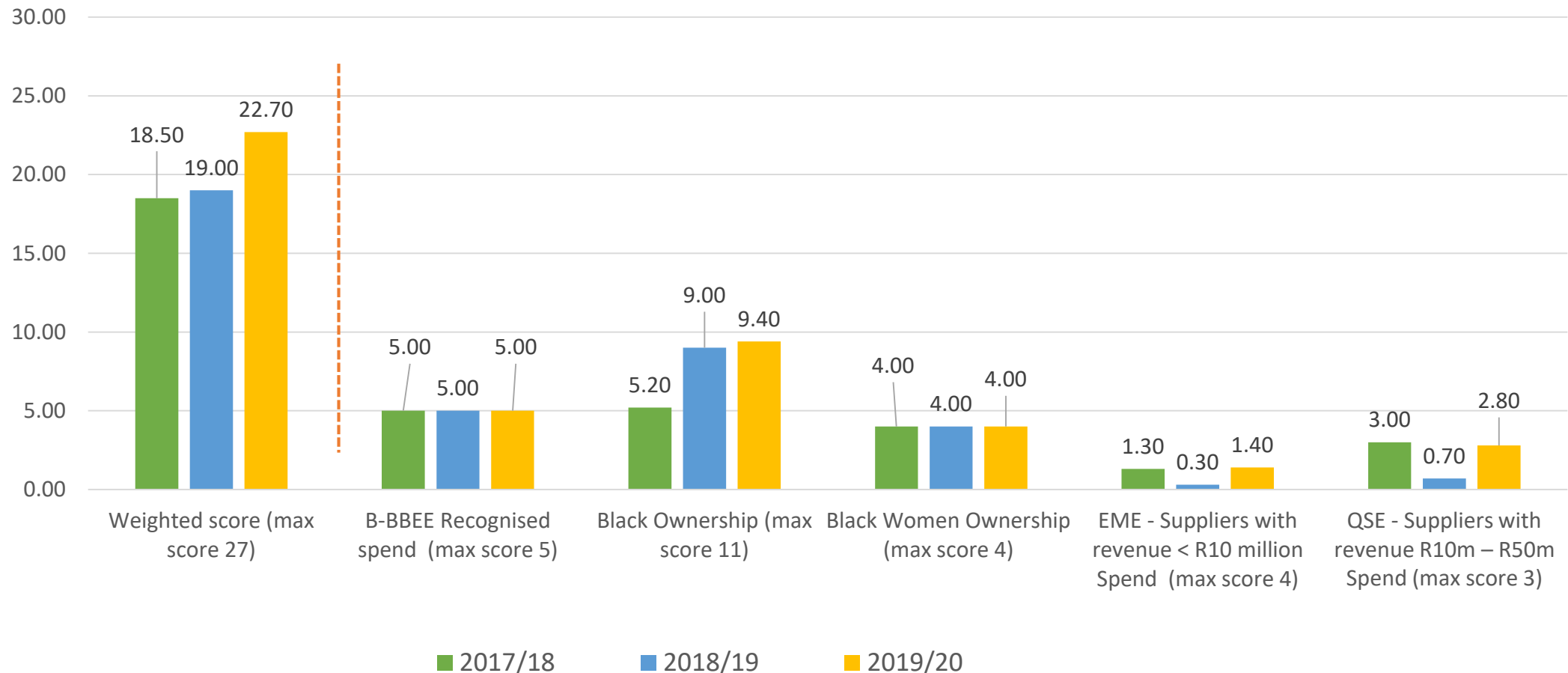
SARB Employee Volunteer programme

Staff participate in activities at schools for the disabled in areas where it has offices. Support provided to schools in provinces where SARB does not have a presence.

Reaching
12 schools



Preferential procurement

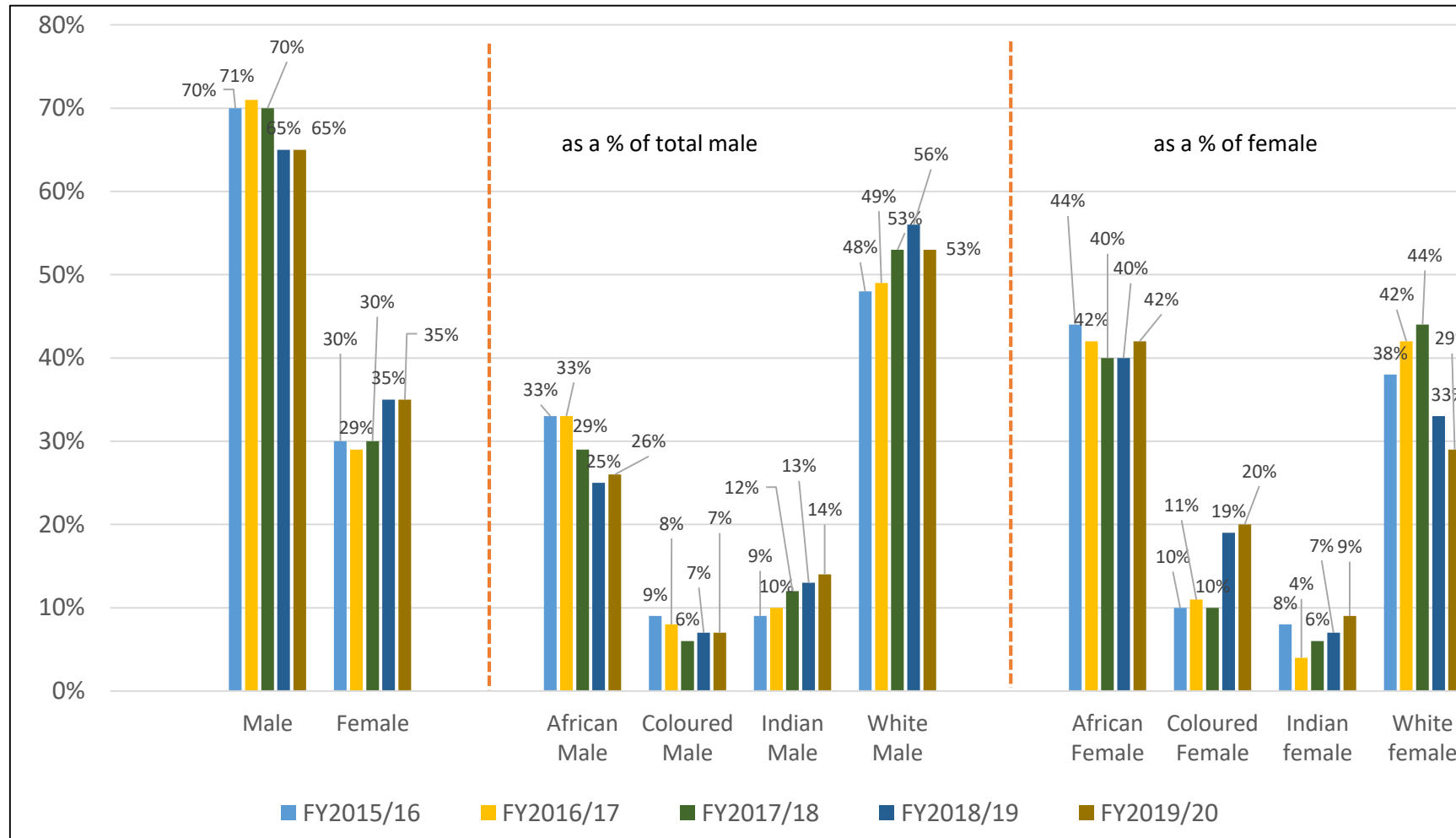


**Reflected as scores*

- B-BBEE performance progressed well from 19.0 points in FY2018/19 to 22.7 points in FY2019/20.
- The 3.7 point increase is mainly attributable to:
 - Increased use of technology in managing B-BBEE accreditation information from suppliers.
 - widening of the base to include BO, BWO and EME suppliers.
 - Focussing awards of commoditised items and small-scale consulting services to EME suppliers.



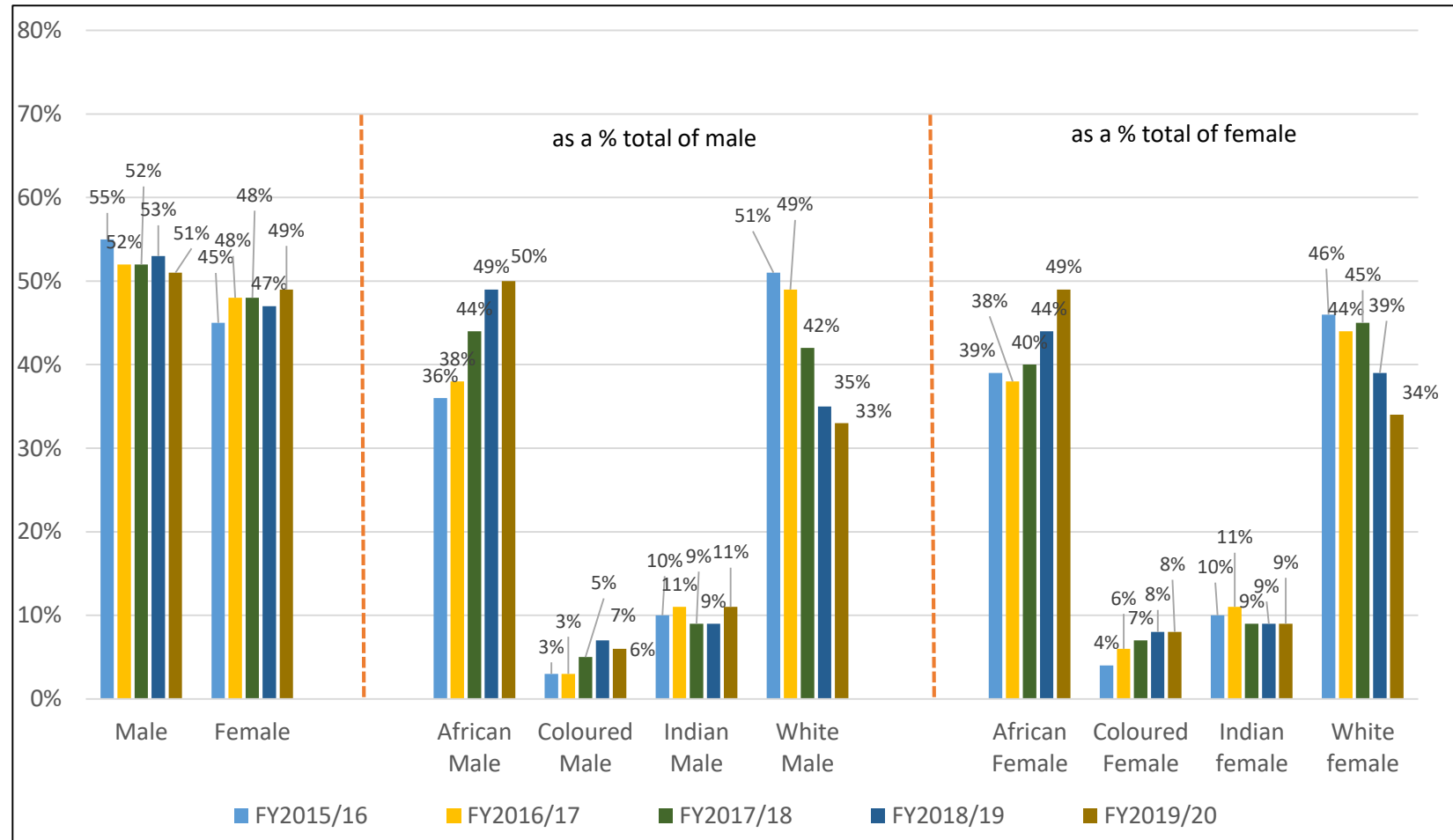
Staff composition – Top management



- Female representation increased steadily from 29% in FY2016/17 to 35% in FY2019/20.
- Indian male has been increasing by a small margin from 10% in FY2016/17 to 14% in FY2019/20.
- White female decreased from 42% in FY2016/17 to 29% in FY2019/20.



Staff composition – Senior management



- African male increased from 36% in FY2015/16 to 50% in FY2019/20.
- White male decreased from 51% in FY2015/16 to 33% in FY2019/20.
- African female increased from 39% in FY2015/16 to 49% in FY2019/20.
- White female decreased female from 46% in FY2015/16 to 34% in FY2019/20.



Human resources highlights

- The SARB has conducted three (3) employee engagement surveys to gain insight on how it can improve employee experience. There has been a positive year on year movement in all fourteen dimensions assessed in the employment engagement survey.
- The SARB's total staff composition is 76% Black and 24% White
 - Executive management 100% Black
 - Top management is 55% Black and 45% White
 - Senior management is 66% Black and 34% White
- The SARB spent R63.6 million on training and development. This equates to 1 909 employees (87.2%) attending a training intervention in FY2019/20.
- The coverage ratio of critical roles declined to 82% in FY2019/20
 - (2018/19: 91%)
- Regrettable turnover ratio is 1.10% in FY2019/20
 - (2018/19: 1.32%)

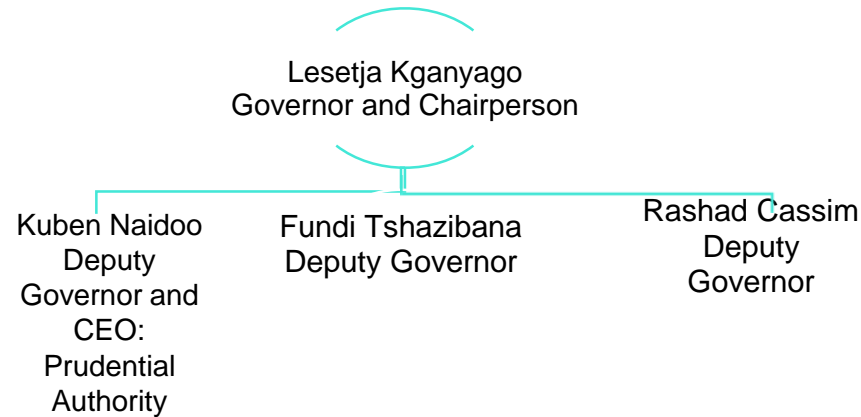


Highlights from the Prudential Authority Annual Report 2019/20



The Prudential Authority: Governance structures

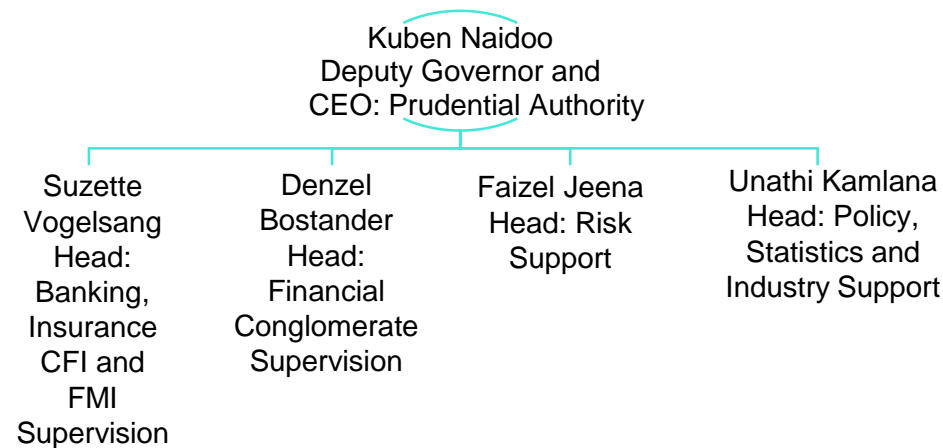
Prudential Committee



Responsibilities

- Provides oversight on the management and administration of the PA to ensure that it is efficient and effective.
- Oversees the implementation of key matters assigned to the PA by various laws pertaining to the financial sector.
- Authorises the CEO of the PA to sign memorandums of understanding with other international regulators.
- Approve prudential and joint standards as well as other regulatory instruments in terms of various laws pertaining to the financial sector.
- Approves the *Prudential Authority Annual Report* for tabling at the National Assembly.

Prudential Authority Management Committee



Responsibilities

- The general operations and management of the PA regarding policy as well as regulatory and supervisory matters.
- Provides advisory, technical and administrative support to the Prudential Committee.

The Prudential Authority: Response to the COVID-19 pandemic

During the last two weeks of the financial year, economic activity slowed sharply due to the impact of COVID-19. The PA acted speedily to monitor the impact of the virus and the lockdown on all regulated institutions, provided regulatory relief to banks and offered guidance on how to manage the crisis from regulatory and accounting perspectives.

In addition to the deployment of the SARB monetary policy tools, the PA implemented measures to provide temporary capital and liquidity relief to banks during this time in a manner that complied with the internationally agreed framework. This was approved by the Prudential Committee during the stress period.

Reducing the systemic risk add-on, commonly referred to as the Pillar 2A add-on, from 1% of total capital to 0%

Providing clear criteria on how banks can utilise their capital conservation buffer, i.e. the loss absorbing capital built up by banks for periods of economic stress

Reducing the minimum liquidity coverage ratio requirement from 100% to 80%

Amending a Directive whereby loans that were restructured as a result of the impact on COVID-19 will not attract a higher capital charge relating to the resultant credit exposures

The PA issued guidance to the banking sector on factors to consider in accounting for and calculating the expected credit losses over its business cycle during this time

The PA issued guidance with recommendations for payment of bonuses for material risk takers and executives; and the distribution of dividends on ordinary shares

The Prudential Authority: Insurance sector

In addition to the 170 insurance entities registered and being supervised, the PA also supervised Lloyds and the Road Accident Fund.

Following the promulgation of the Insurance Act, the PA was required to convert all registered insurers by no later than 30 June 2020. During the financial year, insurers submitted workbooks that were reviewed in detail. The conversions were completed by 30 June 2020.

Life insurers: the 2019 calendar year saw an exceptional equity performance, resulting in higher investment incomes

The non-life insurance industry also benefitted from higher than normal investment income, resulting in higher operating income

	Assets R millions		Liabilities R millions	
	2018	2019	2018	2019
Life insurers	3 011	3 144	2 638	2 761
Non-life insurers	197	207	115	117
Composite reinsurers	34	37	24	26



The Prudential Authority: Administrative sanctions and penalties

An administrative penalty of R1 million was imposed in terms of section 167(1) of the FSR Act on BrightRock Life Limited for underwriting fund policies for which it was not licensed. A penalty of R25 000 was also imposed in terms of section 68 of the Insurance Act regarding the late submission of regulatory returns.

Financial penalties for non-compliance with the Financial Intelligence Centre Act 39 of 2001 were imposed on seven banks amounting to R38.4 million, of which R14.5 million was suspended for three years

Name of institution	Administrative sanction
Sasfin Bank Limited	A financial penalty of R500 000 and a directive to take remedial action.
Bank of Baroda	A financial penalty of R400 000.
The Standard Bank of South Africa Limited	A financial penalty of R30 million and a directive to take remedial action (R7.5 million of the R30 million suspended for three years).
GroBank Limited	A financial penalty of R5 million and a caution not to repeat the conduct which led to non-compliance (the financial penalty suspended for three years).
Bank of China – Johannesburg Branch	A financial penalty of R2 million and a directive to take remedial action (the financial penalty suspended for three years).
Ubank Limited	A financial penalty of R500 000 and a directive to take remedial action. A reprimand and a caution not to repeat the conduct which led to non-compliance.
HBZ Bank Limited	A caution not to repeat the conduct which led to non-compliance.

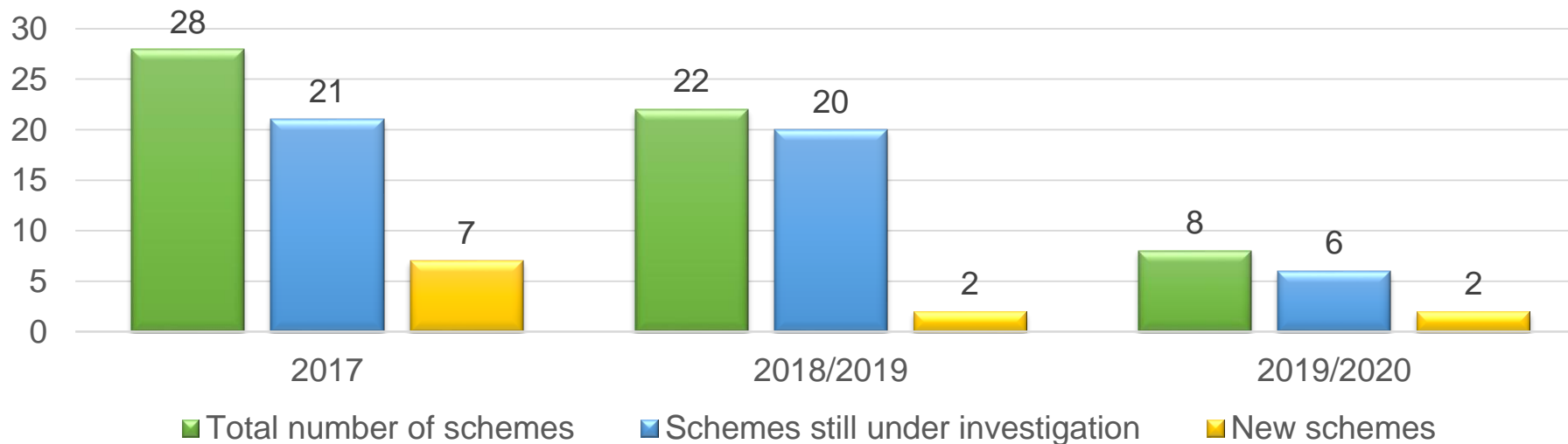


The Prudential Authority: Additional information

Licence applications

	Received	Licensed	In progress	Cancelled
Banks	2	-	2	-
Representative offices	1	-	1	-
Insurers	31	1	26	4
CFIs	30	-	30	-

Illegal deposit-taking schemes



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Additional Slides



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Prudential Authority



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The Prudential Authority: Strategic focus for the year

Value proposition: Promote and enhance the safety, soundness and integrity of regulated financial institutions

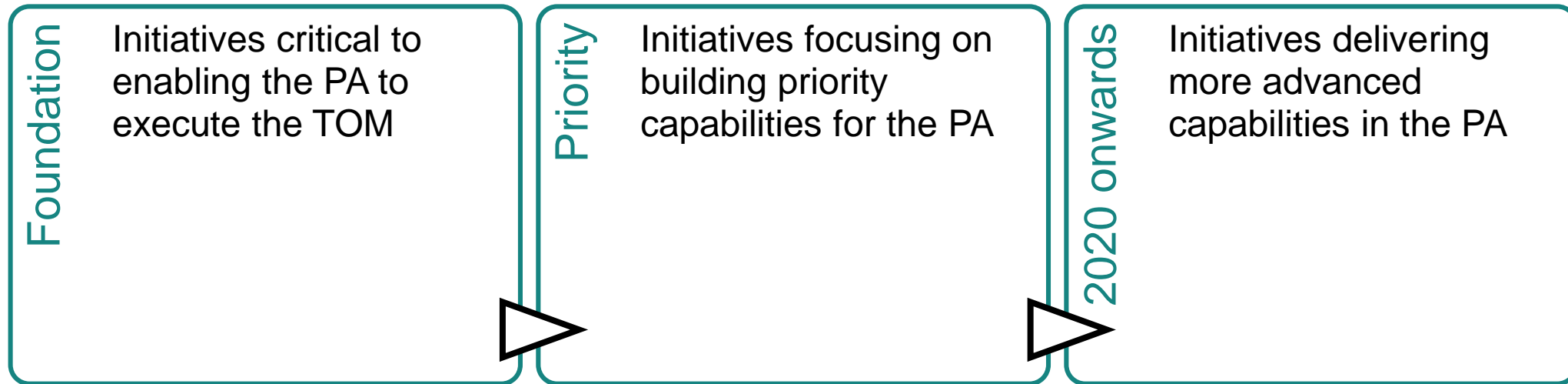
Progress made during the year: To embed the PA while enhancing risk-based, outcomes-focused and forward-looking supervision

- Strengthened integrated regulatory and supervisory approach
- Leveraged technologies to enhance supervision
- Enhanced relationships with external stakeholders through formal, structured workshops and engagements
- Published joint standards on trade repositories and margin requirements for non-centrally cleared derivatives
- Issued supervisory guidelines



The Prudential Authority: Target Operating Model

The PA has designed its target operating model (TOM) and identified three initiatives for implementation over a five-year period:



The implementation of the TOM will be supported by:

- the delivery of an industry data taxonomy, allowing for both the PA and industry to have a shared understanding of the data terms used in the various returns the PA collects from supervised entities;
- the review and improvement of internal PA processes to enhance supervisory practices and efficiencies; and
- the implementation of IT solutions to enhance and transform regulatory processes.



The Prudential Authority: Overview of regulated sectors

Registered entities*	Number of entities
Banks (including local branches of foreign banks)	36
Mutual Banks	4
Co-operative banks	4
Co-operative financial institutions	23
Life insurers	76
Non-life insurers	83
Reinsurers	9
Market infrastructures	9**

* There is a timing difference in the availability of data for banks, insurers and CFIs

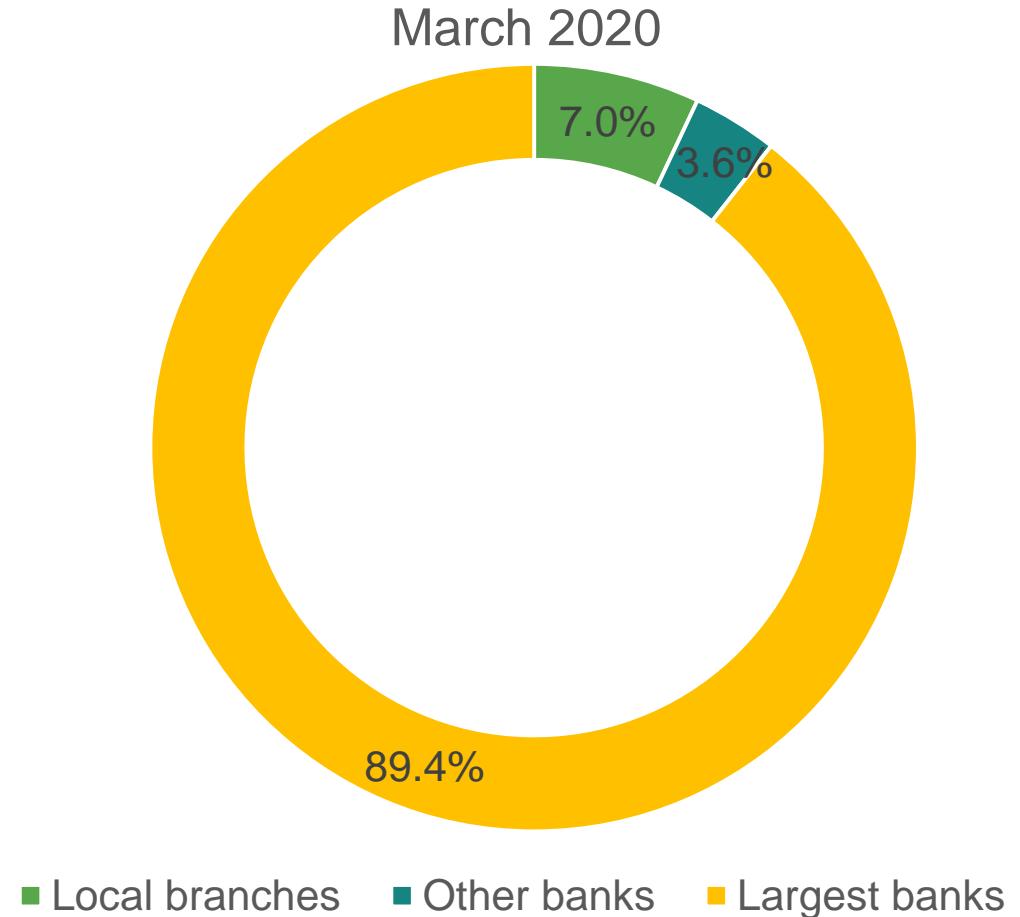
** Although there are 8 entities, Strate is counted twice as it is licenced both as a central securities depository and an associated clearing house



The Prudential Authority: Deposit taking financial institutions

South Africa's banking sector is dominated by the five largest banks, which collectively held 89.4% of the total banking sector assets as at 31 March 2020 (March 2019: 90.5%).

Local branches of international banks accounted for 7.0% of banking sector assets at the end of March 2020 (March 2019: 5.8%) while other banks represented 3.6% at the end of March 2020 (March 2019: 3.7%).



The Prudential Authority: Co-operative sector

February*	Number		Members		Deposits R millions		Assets R millions	
	2019	2020	2019	2020	2019	2020	2019	2020
Co-op banks	4	4	4321	4280	145	174	177	210
CFIs	22	23	23 170	25 911	149	175	192	213
Total	26	27	27 491	30 191	294	349	369	423

* The financial year-end for the sector is 29 February

Total assets in respect of CFIs continued to grow in 2020, ending the financial year-end of February 2020 at an annualised growth rate of 11%.

The overall growth in the co-operative banking sector is attributable to the registration of a fourth co-operative bank during 2018. Net loans for the period under review amounted to R156 million, a **15.74%** increase from February 2019 due to higher loan issuance across the portfolio.



The Prudential Authority: Market infrastructures

The PA is responsible for the prudential supervision of market infrastructures. This category includes: Exchanges, Central securities depositories, Clearing houses, Central counterparties and Trade repositories

Exchanges

JSE Limited

A2X

ZAR X

4 Africa Exchange

Equity Express Securities
Exchange

Central security depositories

Strate

Granite

Clearing houses

Strate

JSE Clear

Total assets amounted to R40 billion
as at the end of December 2019
(2018: R42 billion)



*4.8% reduction
from the previous year*



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