



South African Reserve Bank

From the Office of
the Registrar of Banks

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

Circular 5/2015 issued in terms of section 6(4) of the Banks Act 94 of 1990

Matters related to the use of support in a bank's credit risk rating process

Executive summary

It has come to the attention of the Office of the Registrar of Banks (this Office) that uncertainty exists in some banks regarding the appropriate use of explicit and implicit support in the calculation of minimum required capital and reserve funds. This Office hereby informs all relevant persons that the use of credit risk support not specifically provided for in regulations 23(7), 23(9), 23(12) or 23(14) of the Regulations relating to Banks (the Regulations) is prohibited in a bank's credit risk rating process and in the calculation of minimum required capital and reserve funds.

1. Introduction

- 1.1 Regulations 23(7), 23(9), 23(12) and 23(14) of the Regulations specify minimum requirements regarding support, such as guarantees, that have to be considered by a bank in its credit risk rating process (hereafter referred to as 'rating process') for the calculation of minimum required capital and reserve funds. Regulations 23(12) and 23(14) of the Regulations relate specifically to banks that have been approved to use the internal ratings-based (IRB) approach to measure their minimum credit risk capital requirement (hereafter referred to as 'IRB banks'), and this circular provides clarity specifically for these IRB banks.
- 1.2 The support provided for in the Regulations is termed 'explicit support' as the supporting entity is required to explicitly state (and document as such) the level of support it will provide for a specific transaction or entity. However, this Office, through its supervisory review process, has determined that certain banks also take into consideration what is termed 'implicit support' in the rating process. Implicit support refers to situations where a bank, in its rating process, takes into consideration support (either parental, governmental or otherwise) that was not explicitly provided and which is not legally enforceable.

1.3 The purpose of this Banks Act Circular is to provide clarity on the correct use of support in a bank's credit risk rating process.

2. Clarity regarding the correct use of support in a bank's rating process

2.1 This Office, through its supervisory review process, has determined that IRB banks use a varying degree of implicit support in the rating process. It was further determined that the level of implicit support used is based entirely on a bank's expert judgment.

2.2 Since neither the Basel capital framework nor the Regulations make provision for the use of implicit support, this Office is unable to permit banks to use implicit support in the rating process used for the calculation of minimum required capital and reserve funds. Furthermore, the use of implicit support is based purely on expert judgment and this Office does not consider it prudent for banks to retain lower amounts of capital and reserve funds by altering the rating of an entity based on assumptions.

2.3 However, the effects of support to a troubled entity, which was not explicitly provided for by a parent entity or the government, may be evident in a bank's data history. This circular does not require a bank to alter its data history for its exposures to an entity that received non-contractual support by a parent entity or the government.

2.4 This circular does not supersede, but reinforces, the requirements of regulations 23(7), 23(9), 23(12) and 23(14) of the Regulations relating to the use of explicit support in the rating process.

2.5 A bank is required to contact this Office, and provide the necessary details, should it be unable to meet the requirements of the Regulations read with this circular.

3. Acknowledgement of receipt

3.1 Two additional copies of this circular are enclosed for the use of your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the chief executive officer and the said auditors, must be returned to this Office at the earliest convenience of the aforementioned signatories.



N Maree
Acting Deputy Head

The previous circular issued was Banks Act Circular 4/2015, dated 10 April 2015.