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SOUTH AFRICAN RESERVE BANK
Prudential Authority

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

Circular issued in terms of section 6(4) of the Banks Act, 1990 (Act No. 94 of 1990)

Matters relating to the incorporation of implicit support assumptions in external credit ratings and banks' internal credit risk-rating processes

Executive summary

The Regulations relating to Banks (Regulations) do not make any provision for the use of implicit support assumptions in the calculation of a bank, controlling company or branch of a foreign institution's (hereinafter collectively referred to as 'banks') risk-weighted exposure (RWE) or minimum required capital and reserve funds.

Implicit support assumptions are being incorporated into external credit ratings or banks' internal credit risk-rating processes where there is no explicit or formally documented commitment or guarantee to provide such support.

The risk weights used in terms of the standardised (STA) approach for credit risk rely on external credit ratings produced by eligible external credit assessment institutions (ECAIs). Banks using the STA approach rely on these ratings to infer the appropriate risk weights applicable to the various entities to which they have credit exposures. These risk weights, in turn, feed into the determination of regulatory minimum required capital and reserve funds. Some of these external credit ratings include an implicit support assumption.

The internal ratings-based (IRB) approach for credit risk allows banks to develop and use internal models and other internal assignment processes to assign risk ratings and risk parameters to determine regulatory minimum required capital and reserve funds for their various credit exposures. Similarly, some of these internal risk-rating assignment processes include implicit support assumptions.

The purpose of this Circular is to provide clarity to banks, controlling companies and branches of foreign institutions (hereinafter collectively referred to as 'banks') on the use of external credit ratings and internal credit risk-rating processes that incorporate implicit support assumptions in the determination of regulatory minimum required capital and reserve funds.

This Circular replaces Circular 5 of 2015 dated 20 May 2015, with effect from 30 June 2030.

1. Introduction

1.1 South Africa implemented the Basel II framework with effect from 1 January 2008 and the subsequent enhancements to the Basel II framework with effect from 1 January 2012.

1.2 Following the Global Financial Crisis (GFC) which started in 2007, and based on the lessons learnt from the GFC, the Basel Committee on Banking Supervision (BCBS) incorporated due diligence requirements relating to credit ratings issued by eligible external credit assessment institutions into the Basel II framework.

2. Circular 5 of 2015

2.1 On 21 May 2015, the Prudential Authority (PA) issued Circular 5 of 2015[1], informing all banks of the following matters, among other things:

2.1.1 The support provided for in the Regulations regarding credit risk is, in essence, 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.

2.1.2 Since neither the Basel framework nor the Regulations make provision for the use of implicit support assumptions, the use of such assumptions in the rating process of banks that have adopted one of the IRB approaches in respect of their exposures to credit risk is prohibited when those banks calculate their minimum required capital and reserve funds.

2.1.3 The use of implicit support is based purely on expert judgement, and the PA 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.

3. Basel III post-crisis reforms

3.1 On 7 December 2017, the BCBS issued the final components of the Basel III post-crisis reforms.

3.2 In the case of exposures to banks:

3.2.1 paragraph CRE 20.18[2] of the Basel framework states, among other things, that banks incorporated in jurisdictions that allow the use of external ratings for regulatory purposes must assign to their rated bank exposures the corresponding 'base' risk weights determined by the external ratings according to Table 6. Such ratings must not incorporate assumptions of implicit government support, unless the rating refers to a public bank owned by its government;[3] and

3.2.2 footnote 13 to paragraph CRE 20.18 of the Basel framework gives national supervisors a five-year transition to allow banks to use external ratings that

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[1] Available online at: Matters related to the use of support in a bank's credit risk rating process

[2] Bank for International Settlements (BIS), CRE 20.18 under the External Credit Risk Assessment Approach: Basel framework, June 2025.

[3] Implicit government support refers to the notion that the government would act to prevent bank creditors from incurring losses in the event of a bank default or bank distress.

incorporate assumptions of implicit government support from the date of implementation of the internationally agreed Basel III post-crisis reforms.

3.3 Furthermore, paragraph CRE 20.4 of the Basel framework states, among other things, that banks are required to perform due diligence to ensure that they have an adequate understanding, at origination and thereafter on a regular basis (at least annually), of the risk profile and characteristics of their counterparties. In cases where ratings are used, due diligence is necessary to assess the risk of the exposure for risk management purposes and whether the risk weight applied is appropriate and prudent.

4. Interpretation and application of the Regulations as amended

4.1 South Africa implemented amendments to the Regulations that incorporated the Basel III post-crisis reforms with effect from 1 July 2025.

4.2 The PA has observed that implicit support assumptions are being incorporated into external credit ratings or banks' internal credit risk-rating processes where there is no explicit or formally documented commitment or guarantee to provide such support.

4.3 The risk weights used in terms of the STA approach for credit risk rely on external credit ratings produced by eligible ECAIs. Banks using the STA approach rely on these ratings to infer appropriate risk weights applicable to the various entities to which they have credit exposures. These risk weights, in turn, feed into the determination of regulatory minimum required capital and reserve funds. Some of these external credit ratings include an implicit support assumption.

4.4 The IRB approach for credit risk allows banks to develop and use internal models and other internal assignment processes to assign risk ratings and risk parameters to determining regulatory minimum required capital and reserve funds for their various credit exposures. Similarly, the PA has also observed that some of these internal and risk-rating assignment processes include implicit support assumptions, which is in non-compliance with the regulatory requirements.

4.5 Regulation 23(8), 23(11) and 23(13) of the Regulations specify the requirements for the determination of regulatory minimum required capital and reserve funds in respect of credit risk for banks that have adopted the STA and IRB approaches respectively.

4.6 As stated above:

4.6.1 the Regulations do not make any provision for the use of implicit support assumptions in the calculation of a bank's RWE amount or minimum required capital and reserve funds; and

4.6.2 regulation 39(5) of the Regulations requires banks to duly assess whether the risk weight applied to their exposure is appropriate and sufficiently prudent when they make use of eligible external credit ratings.

4.7 Banks that have adopted the STA approach in respect of their exposures to credit risk and use eligible external ratings that incorporate assumptions of implicit government support in respect of their exposures to banks may continue to use such ratings until 30 June 2030. Banks may be required to demonstrate to the satisfaction of the PA that they duly assess, as part of their internal capital adequacy assessment process, whether the risk weights applied to their bank exposures are appropriate and sufficiently prudent.

4.8 Banks that have adopted one of the IRB approaches in respect of their exposures to credit risk must not incorporate assumptions of implicit support in any of their credit risk-rating processes when determining their RWE amount or calculating any related minimum required amount of capital and reserve funds.

5. Acknowledgement of receipt

5.1 Kindly ensure that a copy of this Circular is made available to your institution's auditors. The attached acknowledgement of receipt, duly completed and signed by both the Chief Executive Officer of the institution and the auditors, should be returned to the PA at the earliest convenience of the signatories.

Fundi Tshazibana

Fundi Tshazibana
Chief Executive Officer

Date: 31/07/26

The previous Circular issued was Banks Act Circular C1 of 2026 dated 06 March 2026.