



South African Reserve Bank

From the Office of
the Registrar of Banks

D3/2011

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

Directive 3/2011 issued in terms of section 6(6) of Banks Act, 1990

Investments and loans and advances by controlling companies: Section 50 of the Banks Act, 1990

Executive summary

In terms of the provisions of section 50 of the Banks Act, 1990, a controlling company investing money in, or providing loans or advances to, specified undertakings or in relation to specified assets or property shall manage its transactions in relation to such investments or loans or advances in such a manner that the related aggregate amount of the said investments or loans or advances does not exceed a prescribed percentage of a prescribed amount of the share capital and reserve funds of the controlling company, calculated on a consolidated basis as prescribed.

This directive specifies the said percentage, the said amount of the share capital and reserve funds of the controlling company and the said basis of consolidation.

This directive replaces Directive 2/2009, issued in February 2009, in terms of the changes made in paragraph 5.2.2 relating to the prescribed amount of share capital and reserve funds.

1. Introduction

- 1.1 In terms of the provisions of section 42 of the Banks Act, 1990 (Act No. 94 of 1990 – the Act), subject to the provisions of section 37 of the Act, no person other than a bank or an institution which has been approved by the Registrar of Banks (Registrar) and which conducts business similar to the business of a bank in a country other than the Republic may exercise control over a bank, unless such person is a public company and is registered as a controlling company in respect of such bank.

1.2 Previously, section 50 of the Act required controlling companies investing money-

1.2.1 in undertakings **other than** banks, institutions which conduct business similar to the business of a bank in a country other than the Republic, controlling companies or companies of which the main object is the holding or development of property which is used or intended to be used mainly for the purpose of conducting the business of a bank; or

1.2.2 in fixed property which is **not used or intended to be used** mainly for the purpose of conducting the business of a bank,

to manage their transactions in these investments in such a way that the amount of the investments does not at any time exceed 40 per cent of the sum of the share capital and reserve funds of the controlling company and any bank under its control, calculated on a consolidated basis in the manner prescribed.

1.3 In essence, based on the previous requirements of section 50 of the Act, the aggregate amount of a controlling company's investments in-

1.3.1 banks, institutions which conduct business similar to the business of a bank in a country other than the Republic, controlling companies or companies of which the main object is the holding or development of property which is used or intended to be used mainly for the purpose of conducting the business of a bank; or

1.3.2 fixed property that is used or intended to be used mainly for the purpose of conducting the business of a bank,

had to amount to no less than 60 per cent of the share capital and reserve funds of the controlling company.

1.4 The primary objective of the specific requirements specified in section 50 of the Act is to ensure, among other things,

1.4.1 that the activities, businesses or companies that are subject to the provisions of the Act and the Regulations relating to Banks (the Regulations), and therefore regulated and supervised by the Registrar, are primarily banking business or activities related to the business of a bank; and

1.4.2 that the primary concern of the board of directors and senior management of the relevant controlling company remain focused on the banks, or activities related to the business of a bank, structured under the controlling company.

1.5 Over time, given the primary objective specified in paragraph 1.4 above, various key players in the regulation and supervision of banks and banking groups questioned, among other things, whether:

1.5.1 the 60:40 split should be rigidly specified in the Act, or whether it should be contained in the Regulations or in a directive issued by the Registrar;

- 1.5.2 the aggregate amount envisaged in section 50 of the Act should only relate to the controlling company's investments, as previously stated, or whether other potentially material asset classes or further exposures of the controlling company, such as loans or advances, should be included.
- 1.6 Furthermore, with the recent adoption and implementation in South Africa of International Financial Reporting Standards (IFRS), and given the requirements contained in the document titled "International Convergence of Capital Measurement and Capital Standards", issued by the Basel Committee on Banking Supervision during June 2004 (generally referred to as Basel II), the relevant components of which standards or requirements, among other things, have been incorporated into the amended banking legislation, further issues were raised regarding the amount and nature of capital and reserve funds that should be used as the basis for the relevant calculation, and the relevant manner of consolidation or aggregation.

2. Banks Act, 1990

- 2.1 Section 50 of the Act was subsequently amended to read as follows:

- 2.1.1 A controlling company investing money-

- 2.1.1.1 in undertakings **other than** banks, institutions which conduct business similar to the business of a bank in a country other than the Republic, controlling companies or companies of which the main object is the holding or development of property which is used or intended to be used mainly for the purpose of conducting the business of a bank; or

- 2.1.1.2 in fixed property which is **not used or intended to be used** mainly for the purpose of conducting the business of a bank,

shall manage its transactions in such investments in such a way that the amount of such investments does not at any time exceed a prescribed percentage of a prescribed amount of the share capital and reserve funds of the controlling company calculated on a consolidated basis as prescribed.

and,

- 2.1.2 a controlling company providing loans and advances-

- 2.1.2.1 to undertakings **other than** banks, institutions which conduct business similar to the business of a bank in a country other than the Republic, controlling companies or companies of which the main object is the holding or development of property which is used or intended to be used mainly for the purpose of conducting the business of a bank; or

- 2.1.2.2 in relation to fixed property which is **not used or intended to be used** mainly for the purpose of conducting the business of a bank,

shall manage its transactions in relation to such loans and advances in such a way that the amount of such loans and advances does not at any time exceed a prescribed percentage of a prescribed amount of the share capital and reserve funds of the controlling company and calculated on a consolidated basis as prescribed.

3. Regulations relating to Banks

- 3.1 Given the robust process of consultation that was followed involving all relevant persons regarding the matters referred to in section 50 of the Act, and based on the content of this directive, the relevant instructions regarding the percentage, amount and nature of the share capital and reserve funds of the controlling company, as well as the basis of consolidation, envisaged in section 50 of the Act, shall be incorporated into the Regulations during the next round of amendments thereto.

4. Other relevant references

- 4.1 In paragraph 21 of Basel II it is stated: "the scope of application of the Framework will include, on a fully consolidated basis, any holding company that is the parent entity within a banking group to ensure that it captures the risk of the whole banking group. Banking groups are groups that engage predominantly in banking activities and, in some countries, a banking group may be registered as a bank".
- 4.2 Furthermore, in footnote 4 of Basel II, which further explains the requirements of paragraph 21 of Basel II, it is stated: "a holding company that is a parent of a banking group may itself have a parent holding company. In some structures, this parent holding company may not be subject to this Framework because it is not considered a parent of a banking group".
- 4.3 Therefore, it may be possible that a controlling company, as defined in section 1 of the Act, is a member of a larger conglomerate of institutions, but that such institutions positioned higher up in the relevant structure do not exercise control over the bank as envisaged in section 42 of the Act, and are therefore not subject to the provisions or requirements of the Act and the Regulations.
- 4.4 Based on the above, it is clear that the concepts of "banking group" and "predominantly involved in banking activities" are fundamentally important, directly impacting the regulation and supervision of banks and banking groups up to the level of a controlling company.

5. Directive

- 5.1 Based on the aforesaid information, the Bank Supervision Department of the South African Reserve Bank hereby issues the directive specified below in respect of investments and loans and advances by controlling companies, as envisaged in section 50 of the Act.
- 5.2 The-
- 5.2.1 prescribed percentage shall be 40 per cent, and shall relate to the aggregate amount of investments and loans and advances envisaged in sections 50(1) and 50(2) of the Act, based on the unconsolidated or entity only balance sheet of the relevant controlling company;

- 5.2.2 prescribed amount of the share capital and reserve funds of the controlling company shall be the amount reported in item 23, column 2, of the form BA 700, duly adjusted by adding back for any relevant amount deducted from the controlling company's primary share capital and primary unimpaired reserve funds reported in line items 54, 57 or 58, column 2, of the form BA 700, and which amount relates to an investment already included in the aggregate amount calculated in terms of paragraph 5.2.1 above, or such other amount as might be specified by the Registrar;
- 5.2.3 consolidated basis as prescribed shall be the relevant consolidated basis specified in regulation 36 of the Regulations read with the relevant provisions or requirements specified in regulation 38 of the Regulations and in the form BA 700.

6. Acknowledgement of receipt

- 6.1 Two additional copies of this directive 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 of the institution and the said auditors, should be returned to this Office at the earliest convenience of the aforementioned signatories.



Adv M S Blackbeard
Registrar of Banks

The previous directive issued was Directive 2/2011 dated 5 August 2011.