South African Reserve Bank

Prudential Authority

Ref.: 15/8/1/3

D2/2020

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

**Directive 2/2020 issued in terms of section 6(6) of the Banks Act 94 of 1990**

**Matters related to temporary capital relief to alleviate risks posed by the Covid-19 pandemic**


**<u>Executive summary</u>**

**Regulation 38(8)(e)(ii) of the Regulations relating to Banks (the Regulations) states that a bank shall have in place robust policies, processes and procedures to ensure that the bank continuously maintains the relevant additional minimum required percentage specified in writing by the Authority from time to time for systemic risk of qualifying common equity tier 1 capital and reserve funds and additional tier 1 capital and reserve funds and tier 2 capital and reserve funds, to risk weighted exposure (that is, Pillar 2A).**

**Regulation 38(8)(e)(iv)(D) of the Regulations provides that the capital conservation buffer "is intended to ensure that banks build up capital buffers outside periods of stress identified in writing by the [Authority], which capital buffers may be drawn down as losses are incurred during the subsequent periods of stress, that is, a bank that writes off losses against its capital conservation buffer during a period of stress will be able to continue to conduct business with constraints being imposed in respect of specified potential distributions of available capital and reserve funds".**

**The spread of Covid-19 has reached a critical phase and is having an increasingly significant impact on global economic activity, which has placed the local economy under immense strain. As part of the measures employed to address the impact of Covid-19, government as well as business have called upon the banking sector to continue to extend credit to sectors in need, particularly households and small businesses, as well as provide relief measures to reduce the strain on these sectors in an effort to sustain the local economy and maintain financial stability. This, together with a slowdown in economic activity, is expected to reduce bank profitability, which is consequently expected to negatively impact capital supply and the ability of banks, branches of foreign institutions and controlling companies (hereinafter collectively referred to as 'banks') to meet their currently specified minimum required amount of capital and reserve funds, including the abovementioned buffers. As such, the Prudential Authority (PA) has decided to implement various**

**measures to provide temporary capital relief to banks during this time of financial stress, in a manner that ensures South Africa's continued compliance with the relevant internationally agreed capital framework.**

## 1 Introduction

1.1 In response to pressures on banks' capital supply brought about by the Covid-19 pandemic, the PA has decided to implement measures to reduce the currently specified minimum requirement of capital and reserve funds to be maintained by banks, in order to provide temporary capital relief to enable banks to counter economic risks to the financial system as a whole and to individual banks.

1.2 The Regulations provide that banks shall have in place robust policies, processes and procedures to ensure that the bank continuously maintains, in addition to the base minimum capital requirement of eight per cent of risk weighted assets, a systemic risk capital requirement (Pillar 2A), an idiosyncratic risk capital requirement (Pillar 2b), a capital conservation buffer, a countercyclical buffer (CCyB) and a domestic systemically important bank (D-SIB) buffer. Both the CCyB and D-SIB buffers, when imposed, are an extension of the capital conservation buffer.

1.3 The Pillar 2A capital requirement is maintained for systemic risk and is to be held over and above the relevant minimum internationally agreed requirement specified in the Basel III capital framework. The PA considers the Covid-19 pandemic to be a stress event posing risk to the entire financial system and believes that the temporary relaxation of the Pillar 2A capital requirement would assist the banking sector by reducing the minimum required amount of capital and reserve funds to be maintained by banks to facilitate banks' continued lending to the real economy.

1.4 To date, it has not been necessary for South Africa to implement a CCyB as there has not been any period of excess aggregate credit growth that has been associated with the build-up of systemic risk. Consequently, banks are not required to maintain capital to meet any CCyB requirement in respect of exposures to counterparties in South Africa.

1.5 South African banks did, however, build up a capital conservation buffer of 2.5 per cent and a loss absorbency requirement for D-SIBs as prescribed in regulations 38(8)(e)(iv) and 38(8)(e)(vi) respectively of the Regulations. The PA considers the current period to be a period of financial stress and therefore, banks will be allowed to draw down against the capital conservation buffer in the upcoming period. In the event that the capital conservation buffer is reduced, banks are required to consult the PA regarding the capital constraints that will be imposed in terms of Regulation 38(8)(f)(iii) of the Regulations.

1.6 The aforementioned measures are intended to provide relief to banks in response to the Covid-19 pandemic by enabling banks to continue to provide credit to the real economy during this period of financial stress through reduced minimum required capital and reserve funds. However, these measures are not intended to allow banks to distribute earnings in the form of dividends on ordinary shares or bonuses. Instead, the intention is to assist banks to continue to serve their clients under very difficult circumstances and to ensure that their capital positions remain healthy and compliant with the relevant internationally agreed capital requirements, and can recover in a short period of time in the event of significant losses. Furthermore, the onus remains on banks to appropriately conserve their capital and reserve funds during the Covid-19 stress period. Therefore, to contribute to the conservation of capital, distributions such as bonuses, dividends on ordinary shares or ordinary share buy backs are discouraged by the PA.

1.7 Banks are, however, expected to take cognisance of the recommendations contained in Guidance Note 4 of 2020 in that capital resources must continue to be available to support the real economy and to absorb losses and should take priority over the payment of dividends on ordinary shares and bonus payments to executive officers and material risk takers.

1.8 It is the PA's intention to reinstate the minimum Pillar 2A capital requirement following the Covid-19 stress period. However, the relevant details of such reinstatement would be communicated at an appropriate time, giving sufficient notice of the reinstatement, including any transitional arrangements that may apply.

## 2 Directive relating to minimum required capital and reserve funds

Based on the aforesaid and in accordance with the provisions of section 6(6) of the Banks Act 94 of 1990, banks are hereby directed as follows, with effect from the date of this Directive until such time as the PA directs otherwise in writing:

2.1. The Pillar 2A minimum capital requirement as set out in regulation 38(8)(e)(ii) of the Regulations is temporarily reduced to zero; that is, banks will be allowed to conduct business with a zero per cent Pillar 2A capital requirement.

2.2. Furthermore, in the calculation of adjustments to or deductions from capital and reserve funds in terms of regulation 38(5)(a)(i)(K), the minimum capital requirement as at the applicable reporting date must be applied, reflecting the relief measures on the Pillar 2A requirement in place during the Covid-19 stress period, and the subsequent transitional period.

2.3. The aforementioned adjustment shall accordingly result in an adjustment to qualifying capital and reserve funds. Therefore, limits making reference to qualifying capital and reserve funds, such as large exposures and threshold deductions, should be calculated on the adjusted amount of qualifying capital and reserve funds.

2.4. Banks will be allowed to utilise the capital conservation buffer, as specified in Regulation 38(8)(e)(iv)(D) of the Regulations. Furthermore, the additional loss absorbency requirement that was built up by D-SIBs in terms of regulation 38(8)(e)(vi) of the Regulations shall serve as an extension of the capital conservation buffer as specified in Directive 6/2016. The temporary relaxation of the Pillar 2A capital requirement will make capital and reserve funds available to banks before any need to draw down against the capital conservation buffer.

2.5. In the event that the capital conservation buffer must be utilised, banks must individually consult the PA, as envisaged in terms of the proviso to regulation 38(8)(e) read with regulation 38(8)(f)(iii) of the Regulations.

2.6. The fully phased-in Pillar 2A capital requirement, following the Covid-19 stress period, must be applied in the following calculations:

2.6.1 The calculation of the surplus amounts of common equity tier 1 capital and related premium (CET1), additional tier 1 capital and related premium and tier 2 capital and related premium in terms of regulation 38(14) of the Regulations.

2.6.2 The conservation ratios that shall apply when the capital conservation buffer falls below 2.5 per cent. With reference to paragraph 1.6 above, Table 1 below sets out the ranges at which restrictions on discretionary distributions will be imposed. These ranges are to be calculated on CET 1, tier 1 and total qualifying capital and reserve funds. However, for illustrative purposes only, the CET 1 ranges are shown in Table 1 below. Banks are to note that different individual capital requirements and D-SIB requirements are specified for each bank and these must be reflected in addition to the ranges detailed in Table 1 below. These requirements are communicated individually to each bank, but shall not at any time be less than the higher of the requirements communicated and the range specified in Table 1:

**Table 1**

| **Common equity tier 1 capital and reserve funds ratio** | **Minimum required capital conservation ratios expressed as a percentage of earnings** |
|---|---|
| 5.0% - 5.625% | 100% |
| >5.625% - 6.25% | 80% |
| >6.25% - 6.875% | 60% |
| >6.875% - 7.5% | 40% |
| > 7.5% | 0% |

## 3 Acknowledgement of Receipt

3.1. Kindly ensure that a copy of this Directive is made available to your institution's external auditors. The attached acknowledgment of receipt duly completed and signed by both the chief executive officer of the institution and the said auditors should be returned to the PA at the earliest convenience of the aforementioned signatories.

**Kuben Naidoo**
**Deputy Governor and CEO: Prudential Authority**

**Date:** 6 April 2020

Encl. 1

The previous directive issued was Directive 1/2020 dated 31 March 2020