



South African Reserve Bank

From the Office of
the Registrar of Banks

G3/2011

2011-05-23

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

Guidance note 3/2011 issued in terms of section 6(5) of the Banks Act, 1990

Covered bonds

Executive summary

When implemented by a bank, a covered bond structure will subordinate the interests of depositors to the interests of the covered bond holders. A covered bond structure is regarded as materially inconsistent with the objectives, duties and responsibilities imposed on the Office for Banks. The current policy of this Office is not to allow banks or branches to issue covered bonds or engage in any synthetic or other structured transaction that in substance is equivalent to a covered bond structure.

1. Purpose

- 1.1 The purpose of this Guidance Note is to inform all banks, controlling companies and branches of foreign institutions of this Office's policy not to allow the use of covered bonds and similar structures by banks in South Africa.

2. Covered bonds

- 2.1 The mission of the Bank Supervision Department (BSD) of the South African Reserve Bank is to promote the soundness of the domestic banking system and to minimise systemic risk through the effective and efficient application of international regulatory and supervisory standards and best practice.
- 2.2 On 16 December 2010, as part of the new Basel III framework, the Basel Committee issued a document titled "International framework for liquidity risk measurement, standards and monitoring", which contains the details of global regulatory standards on bank liquidity.

The aforesaid document contains various references to covered bonds.

- 2.3 Normally the term "covered bond" refers to corporate bonds or debt securities backed by cash flows from mortgages or public sector loans. Covered bonds are similar in many ways to asset-backed securities created in a securitisation scheme. However, in a securitisation scheme the relevant assets or risk are

transferred from the balance sheet of the originator to an insolvency remote institution, whereas covered bond assets remain on the issuer's balance sheet.

- 2.4 An advantage to an investor investing in a covered bond is that the debt and the underlying asset pool remain on the issuer's balance sheet, and issuers have to ensure that the relevant asset pool consistently backs the covered bond. In the event of default, the investor has recourse to both the relevant asset pool and the issuer.
- 2.5 During the recent past the BSD received various enquiries regarding the possible use of covered bonds by banks in South Africa. The enquiries presumably emanate from the use of covered bonds in other jurisdictions and markets as well as the reference thereto in the Basel III framework.
- 2.6 Since a covered bond structure in terms of which covered bonds are issued by a bank will in essence subordinate the interests of depositors to the interests of the covered bond holders, a covered bond structure is regarded by the BSD as possibly being materially inconsistent with the objectives, duties and responsibilities imposed on the BSD in terms of the provisions of the Banks Act, 1990 (Act No. 94 of 1990 - the "Banks Act").
- 2.7 Therefore, after due consideration, and after taking into account the objectives, duties and responsibilities imposed on the BSD in terms of the provisions of the Banks Act, and after taking into account all relevant international standards and best practices, the BSD decided to inform all banks, controlling companies and branches of foreign institutions that the current policy of the BSD is not to allow banks or branches to issue covered bonds or engage in any synthetic or other structured transaction that in substance is equivalent to a covered bond structure.
- 2.8 In line with the mission of the BSD, all international regulatory and supervisory standards and best practices are duly considered, and the BSD will continue to monitor and appropriately consider all relevant international developments related to covered bonds.

3. Acknowledgement of Receipt

- 3.1 Two additional copies of this guidance note 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.



E M Kruger
Registrar of Banks

The previous guidance note issued was Guidance Note 2/2011, dated 13 May 2011.