

**DRAFT FOR CONSULTATION – NOVEMBER 2023**

**Financial Sector Regulation Act, 2017 (Act No. 9 of 2017)**

**Prudential Standard CBA-04**

**Financial soundness requirements for co-operative financial institutions and co-operative banks**

***Objective and Key Requirements of this Prudential Standard***

*This Standard is made in terms of sections 105 and 108 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (Financial Sector Regulation Act) read with section 46 of the Co-operative Banks Act, 2007 (Act No. 40 of 2007) (Co-operative Banks Act).*

*This Standard sets out the principles and requirements for financial soundness of co-operative financial institutions (CFIs) and co-operative banks registered in terms of the Co-operative Banks Act.*

*This Standard covers matters concerning the principles for financial soundness, minimum prudential requirements for CFIs and co-operative banks, reporting on financial performance, accounting framework, regulatory intervention, revocation and regulatory reporting.*

*Prudential Standard TCFI-01 and the Co-operative Banks Act Supervisors' Rules are revoked by this Standard.*

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## **1 Commencement**

- 1.1 This Standard commences on 1 July 2024 (proposed).

<b>Version Number</b>	<b>Commencement Date</b>
1	1 July 2024 (proposed)

## **2 Legislative authority**

- 2.1 This Standard is made in terms of sections 105 and 108 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) read with section 46 of the Co-operative Banks Act, 2007 (Act No. 40 of 2007).

## **3 Definitions and interpretation**

- 3.1 In this Standard, “the Act” means the Co-operative Banks Act and any word or expression to which a meaning has been assigned in the Act or the Financial Sector Regulation Act bears the meaning so assigned to it, unless the context indicates otherwise.

- 3.2 For purposes of this Standard –

‘**audit committee**’ means the audit committee for a CFI<sup>1</sup> and a co-operative bank;  
‘**auditor**’ means a registered auditor as defined in the Auditing Profession Act, 2005 (Act No. 26 of 2005);

‘**Authority**’ means the Prudential Authority established in terms of section 32 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017);

‘**board**’ means the board of directors of the CFI or co-operative bank as appointed by the members in accordance with the constitution of the CFI or co-operative bank;

‘**board and staff related loans**’ means loans granted to employees, officials and directors of the CFI and co-operative bank or their direct family members or business associates as defined in its lending policy, whereas direct family member in relation to any person, means -

- (a) a spouse;
- (b) a child, stepchild, parent or stepparent; and
- (c) the spouse of any of the persons mentioned in (b).

‘**CFI**’ means a co-operative financial institution as defined in the Act;

‘**co-operative bank**’ means a co-operative bank as defined in the Act;

‘**Co-operatives Act**’ means the Co-operatives Act, 2005 (Act No. 14 of 2005);

‘**donation**’ means any fixed asset or cash received free of any legal claim and irrespective of whether or not a CFI or co-operative bank must account for the use of the asset or cash in a specific manner;

‘**financial information**’ refers to the audited financial statements;

‘**Financial Sector Regulation Act**’ means the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017);

‘**fixed asset**’ means moveable and immovable property and includes land, buildings, vehicles, furniture, fixtures and equipment;

<sup>1</sup> In some instances, CFIs refer to the audit committee as the supervisory committee. It is advised that this audit committee should not be confused with audit committees that are appointed for companies.

**'IFRS'** means the International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB) from time to time;

**'level one high-quality liquid assets'** means-

- (a) cash;
- (b) financial co-operative retail bonds held with National Treasury after six months of investment; and
- (c) such percentage or amount of central bank reserves as may be determined by the Governor of the Reserve Bank from time to time;

**'management'** means the managing director and executive officers of the CFI or co-operative bank.

**'material asset'** means an asset, the acquisition or disposal of which:

- (a) impacts the risk profile of the CFI or co-operative bank;
- (b) impacts the profitability of the CFI or co-operative bank;
- (c) impacts on the safety and soundness of the CFI or co-operative bank, including the CFI or co-operative bank's ability to manage its risks and meet its legal and regulatory obligations;
- (d) increases the risk to financial customers;
- (e) impacts the ability of the Authority to monitor the CFI or co-operative bank's compliance with its regulatory obligations;

**'members'** means the members of the CFI or co-operative bank;

**'membership share'** has the meaning assigned to it in section 1 of the Co-operatives Act;

**'regulations'** means the regulations issued by the Minister of Finance under Section 86 of the Act and published under Government Notice R712 in Government Gazette 32357 of 1 July 2009;

**'related person'** means:

- (a) a person or member who is directly or indirectly controlled by the same person or member; and
- (b) a person or member who is so interconnected with another person or member that should one of them experience financial difficulties, one or all of them would be likely to experience a lack of liquidity; and

**'total assets'** includes:

- (a) fixed assets;
- (b) non-earning assets;
- (c) deposits held with a bank registered in terms of the Banks Act, 1990 (Act No. 94 of 1990);
- (d) deposits held with secondary or tertiary co-operative banks of which a co-operative bank is a member;
- (e) financial co-operative retail savings bonds with 1, 2 or 3 year maturity dates, and treasury bills issued under the Public Finance Management Act, 1999 (Act No. 1 of 1999);
- (f) participatory interests in portfolios of collective investment schemes approved by the Registrar of Collective Schemes and administered by a manager registered under the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002) as determined by the Authority by notice on its official website;
- (g) bonds and debentures determined by the supervisor by notice on its official website issued by:
  - (i) national government;
  - (ii) public entities listed under the Public Finance Management Act, (Act No.1 of 1999); or
  - (iii) the South African Reserve Bank;
- (h) loans.

- 3.3 The 'Objectives and key requirements of this Prudential Standard' in the preamble of this Standard must not be used in the interpretation of any section of this Standard.

#### **4 Application**

- 4.1 This Standard applies to all CFIs and co-operative banks registered under the Act, irrespective of its categorisation under a specific tier, unless explicitly provided for in this Standard.
- 4.2 This Standard applies in addition to the requirements of the Co-operatives Act and the Principles of Good Governance for Co-operatives issued under the Co-operatives Act.

#### **5 Roles and responsibilities**

- 5.1 The board of a CFI or co-operative bank is ultimately responsible for the prudent management of the financial affairs of a CFI or a co-operative bank to ensure financial soundness, and also ensure that the CFI or co-operative bank complies with the principles and requirements of this Standard.
- 5.2 The respective regulatory minimum financial soundness requirements must always be met by the CFIs and co-operative banks according to its respective designated tier.
- 5.3 The management must ensure that financial information submitted to the Authority is accurate and reliable, at all times.
- 5.4 Financial information prepared by the CFI or co-operative bank should be supported by adequate records, which the financial institution is required to maintain, in accordance with accepted accounting policies and procedures.
- 5.5 The audit committee must ensure that financial information of the CFI or co-operative bank is prepared and presented in line with the applicable accounting frameworks.
- 5.6 The management and the audit committee of the CFI or the co-operative bank is responsible for monitoring whether the financial institution meets its regulatory requirements at all times and that information reported to the Authority on a monthly or quarterly basis (as per paragraph 7 below) is a true reflection of the financial institution's financial position.
- 5.7 The board and the audit committee must notify the Authority in writing of any matter they become aware of in the performance of their functions that has or may contravene the principles and requirements of this Standard.
- 5.8 An auditor of a CFI or co-operative bank is required to report to the board, a representative of the financial institution (if applicable) and the Authority in writing of any matter they become aware of in the performance of their functions that has or may contravene the principles and requirements of this Standard.

#### **6 General principles for financial soundness**

- 6.1 Early detection of potential financial distress in a CFI or a co-operative bank is critical to the Authority's mandate of promoting the safety and soundness of financial

institutions. In this regard, it is crucial for the Authority to continually monitor the financial soundness of a CFI or a co-operative bank using a pre-emptive, outcomes focused and risk-based approach.

6.2 Financial soundness indicators are used as instruments by the Authority to measure the state of a CFIs or co-operative bank's financial position in general. In principle, these core indicators should signal potential vulnerability of capital adequacy, solvency, asset quality, profitability, financial reporting and liquidity of a financial institution.

6.3 The financial soundness indicators<sup>2</sup> encompass the management of liquidity, capital adequacy, profitability, solvency risks and financial reporting to the extent deemed safe and sound by the Authority. The Authority requires CFIs and co-operative banks to develop and implement appropriate mechanisms that adequately identify, measure, monitor and control the risks relating to financial soundness.

## **7 Financial soundness - minimum prudential requirements for CFIs and co-operatives banks**

7.1 Attachment A prescribes the minimum financial soundness requirements for CFIs and co-operative banks per tier.

7.2 A CFI or co-operative bank must notify the Authority within 24 hours of non-compliance with the financial soundness requirements in the form and manner determined by the Authority and advise the Authority of measures put in place to rectify the non-compliance.

7.3 For purposes of calculating the minimum capital adequacy ratio as referred to in Attachment A, only the following qualify as capital:

7.3.1 mandatory shares as required by the constitution to qualify as a fully paid up member;

7.3.2 voluntary membership shares issued by the CFI and a co-operative bank over and above the mandatory shares which are permanent in nature and loss absorbing;

7.3.3 investment shares as approved by the Authority;

7.3.4 indivisible reserves as required in terms of section 3(1)(e) of the Co-operatives Act;

7.3.5 non-distributable reserves created or increased by appropriations of surpluses (retained earnings); and

7.3.6 any other non-distributable funds of a permanent nature held by a CFI and a co-operative bank not subject to a legal claim by any person and must be approved by the Authority in writing.

7.4 A CFI or a co-operative bank must maintain, at all times, a minimum capital adequacy ratio of at least 6%. The formula used for calculating the afore-mentioned capital adequacy ratio is as follows:

$$\text{Capital adequacy ratio} = \frac{\text{Qualifying capital}}{\text{Total assets}}$$

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<sup>2</sup> The basis for monitoring these indicators is founded on the Basel report: Microfinance activities and the Core Principles for Effective Banking Supervision. Available at: <https://www.bis.org/publ/bcbs167.htm>

- 7.5 The indicators cited under Attachment A are not exhaustive tools for determining the required financial soundness of a CFI and co-operative banks, in some instances the Authority may employ other additional measures as mandated by the relevant legislation for CFIs and co-operative banks.
- 7.6 A CFI or co-operative bank must apply to the Authority prior to the acquisition or disposal of a material asset.
- 7.7 In addition to paragraph 7.6 above, the Authority prescribes that the acquisition or disposal of any of the following constitutes the acquisition or disposal of a material asset:
- 7.7.1 any asset which value is in excess of 5% of the total assets of the CFI or co-operative bank; or
  - 7.7.2 an asset with a net income after tax in excess of 5% of the total net income after tax of the CFI or co-operative bank, at acquisition or disposal or within the projected business plan period.

## **8 Reporting on financial performance**

- 8.1 The financial year-end for all registered CFIs and co-operative banks is the last day of February of each year.
- 8.2 Reporting for Tier 1
- 8.2.1 All Tier 1 CFIs and co-operative banks must report to the Authority on their financial performance on a quarterly and cumulative basis at the end of May, August, November and February each year.
- 8.3 Reporting for Tier 2 and Tier 3
- 8.3.1 All Tier 2 and Tier 3 CFIs and co-operative banks must report to the Authority on their financial performance on a monthly basis.
- 8.4 The reports referred to in paragraphs 8.2 and 8.3 as well as regulatory returns must be made in the form and manner determined by the Authority.
- 8.5 A CFI or co-operative bank must disclose in its audited annual financial statements the total number and total amount of Board and Staff Related Loans granted during the financial year and confirm that such loans have been granted in accordance with the loan policy of the CFI or co-operative bank.
- 8.6 The loan records of the CFI or co-operative bank must clearly designate such loan accounts as Board and Staff Related Loans for purposes of on-site inspections by the Authority.
- 8.7 The Authority may require a CFI or co-operative bank irrespective of their categorisation to submit information and reports on a more frequent basis.

## **9 Accounting framework**

- 9.1 The preparation of the annual financial statements and regulatory reporting returns of a CFI or co-operative bank must be done in accordance with:

- 9.1.1 IFRS for Tier 3 CFIs and co-operative banks;
  - 9.1.2 IFRS for Small and Medium Sized Entities (SMEs) or IFRS for Tier 2 CFIs and co-operative banks; and
  - 9.1.3 IFRS for Small and Medium Sized Entities (SMEs) for Tier 1 CFIs and co-operative banks.
- 9.2 The Authority may, depending on the nature, size, complexity and risk profile of a CFI or co-operative bank, require the application of full IFRS in the preparation of the annual financial statements of the CFI or co-operative bank irrespective of the categorisation.

## **10 Regulatory intervention**

- 10.1 The breach of the financial soundness criteria indicates a trigger point for regulatory intervention.
- 10.2 If the Authority becomes aware that a CFI or co-operative bank has failed or may fail to maintain the required financial soundness standards it may:
- 10.2.1 direct the CFI or co-operative bank to rectify the actual or potential breach;
  - 10.2.2 require the CFI or co-operative bank to hold additional capital;
  - 10.2.3 add or amend existing conditions for the CFI or co-operative bank to comply with; or
  - 10.2.4 take appropriate steps to suspend or withdraw the licence of the CFI or co-operative bank.
- 10.3 The Authority may impose stricter prudential requirements on the CFI or co-operative bank where the Authority is of the view that the financial soundness indicators are:
- 10.3.1 not adequately catering for the risk that the CFI or co-operative bank is exposed to; and/or
  - 10.3.2 such activities conducted by the CFI or co-operative bank may negatively affect the financial soundness of the CFI or co-operative bank.

## **11 Revocation of a Prudential Standard and Rules**

- 11.1 In terms of section 108(3) of the Financial Sector Regulation Act, this Standard revoke:
- 11.1.1 Prudential Standard TCFI-01 – Transitional Arrangements for Co-operative Financial Institutions and the Supervisors' Rules for co-operative banks; and
  - 11.1.2 The Co-operative Banks Act Supervisors' Rules.

## **12 Regulatory reporting**

- 12.1 The form, manner and period of regulatory reporting on this Standard will be determined by the Authority and published on its website.
- 12.2 The Authority may specify with the relevant CFI or co-operate bank, other areas of reporting when it becomes necessary based on the nature, size, complexity and risk profile of the CFI or co-operative bank.

### **13      Short title**

- 13.1      This Standard shall be called ‘Prudential Standard CBA-04 – Financial soundness requirements for CFIs and co-operative banks.’





SOUTH AFRICAN RESERVE BANK  
Prudential Authority

### Attachment A – Minimum regulatory prudential requirements for CFIs and co-operatives banks

Description	Basis for the requirement	Financial Soundness Indicator Tier 1	Financial Soundness Indicator Tier 2	Financial Soundness Indicator Tier 3
Minimum capital adequacy ratio  Total Capital/ Total assets	CFIs and co-operative banks are required to maintain the required level of capital adequacy as a buffer against any unexpected financial shocks.	A minimum of R100 000 in share capital or 6% of total of assets held. The higher of the two is applicable.	A minimum of R100 000 in share capital or 6% of total of assets held. The higher of the two is applicable.	A minimum of R100 000 in share capital or 6% of total of assets held. The higher of the two is applicable.
Liquidity  Liquid Assets/Total Savings	Indicate the CFIs or co-operative bank's ability to honour its short-term obligations, which are mainly members' saving deposits.	<p>(i) A minimum of 10% of total deposits must be held in investments referred to in regulation 3.2 with a tenure not exceeding 32 days and convertible into cash at any time, without incurring any penalty or being subject to a discount rate substantially higher than the average rate that applies to liquid assets with a similar term;</p> <p>(ii) A minimum of 2.5% of total deposits must be deposited with a higher tier co-operative bank, in addition to the deposits referred to in paragraph 4(c)(ii) of the regulations;</p> <p>(iii) The balance of deposits not held or deposited in accordance with paragraphs 4(c)(ii) and 4(c)(iii) the regulations -</p>	<p>(i) Minimum holding of level 1 high quality liquid assets of 10% or as specified by the chief executive officer of the Authority must be held in investments referred to in regulation 3.2 with a tenure not exceeding 32 days and convertible into cash at any time, without incurring any penalty or being subject to a discount rate substantially higher than the average rate that applies to liquid assets with a similar term;</p> <p>(ii) a minimum of 2.5% of total deposits must be deposited with a higher tier co-operative bank, in addition to the deposits referred to in paragraph 4(c)(ii) of the regulations;</p> <p>(iii) the balance of deposits not held or deposited in accordance with</p>	<p>(i) Minimum holding of level 1 high quality liquid assets of 10% or as specified by the chief executive officer of the Authority must be held in investments referred to in regulation 3.2 with a tenure not exceeding 32 days and convertible into cash at any time, without incurring any penalty or being subject to a discount rate substantially higher than the average rate that applies to liquid assets with a similar term;</p> <p>(ii) a minimum of 2.5% of total deposits must be deposited or a higher tier co-operative bank, in addition to the deposits referred to in paragraph 4(c)(ii) of the regulations;</p> <p>(iii) the balance of deposits not held or deposited in accordance with</p>

Description	Basis for the requirement	Financial Soundness Indicator Tier 1	Financial Soundness Indicator Tier 2	Financial Soundness Indicator Tier 3
		<p>(a) in relation to a co-operative bank that provides saving services only, must be held in investments referred to in regulation 3.2(a)(i) to (v); and</p> <p>(iv) In relation to a co-operative bank that provides saving and loan services, must be held in investments referred to in regulation 3.2(a)(i) to (v) and may be granted as loans up to a maximum of 80% of total assets;</p> <p>(v) In relation to a co-operative bank that provides saving and loan services, loans granted to members that are sourced from cash donations may not exceed 15% of total deposits.</p>	<p>paragraphs 4(c)(ii) and 4(c)(iii) the regulations -</p> <p>a. in relation to a co-operative bank that provides saving services only, must be held in investments referred to in regulation 3.2(a)(i) to (v); and</p> <p>b. in relation to a co-operative bank that provides saving and loan services, must be held in investments referred to in regulation 3.2(a)(i) to (v) and may be granted as loans up to a maximum of 80% of total assets;</p> <p>(iv) In relation to a co-operative bank that provides saving and loan services, loans granted to members that are sourced from cash donations may not exceed 15% of total deposits.</p>	<p>paragraphs 4(c)(ii) and 4(c)(iii) the regulations -</p> <p>a. in relation to a co-operative bank that provides saving services only, must be held in investments referred to in regulation 3.2(a)(i) to (v); and</p> <p>b. in relation to a co-operative bank that provides saving and loan services, must be held in investments referred to in regulation 3.2(a)(i) to (v) and may be granted as loans up to a maximum of 80% of total assets;</p> <p>(v) In relation to a co-operative bank that provides saving and loan services, loans granted to members that are sourced from cash donations may not exceed 15% of total deposits.</p>
Non-performing loans ratio	Measures the quality of the CFI's and co-operative banks outstanding loans.	Maximum of 7.5%.	N/A	N/A
Portfolio quality	Loan loss provisions	<p>The higher requirement between application of IFRS for SMEs and the following bucketing approach for loan loss provisioning:</p> <p>1-6 months – 35% 6-12 months – 50% 12 months and above – 100%</p> <p>When the Authority is of the opinion that the policies and procedures applied by a bank during its assessment of asset quality, risk mitigation and related credit impairment are inadequate, the Authority</p>	<p>According to IFRS for SMEs or IFRS 9.</p> <p>When the Authority is of the opinion that the policies and procedures applied by a bank during its assessment of asset quality, risk mitigation and related credit impairment are inadequate, the Authority may require the relevant bank to raise a specified credit impairment amount against potential credit losses, for example, by requiring in writing the said bank to transfer a specified amount from retained earnings or distributable reserves to a non-distributable reserve.</p>	<p>According to IFRS 9.</p> <p>When the Authority is of the opinion that the policies and procedures applied by a bank during its assessment of asset quality, risk mitigation and related credit impairment are inadequate, the Authority may require the relevant bank to raise a specified credit impairment amount against potential credit losses, for example, by requiring in writing the said bank to transfer a specified amount from retained earnings or distributable reserves to a non-distributable reserve.</p>

Description	Basis for the requirement	Financial Soundness Indicator Tier 1	Financial Soundness Indicator Tier 2	Financial Soundness Indicator Tier 3
		may require the relevant bank to raise a specified credit impairment amount against potential credit losses, for example, by requiring in writing the said bank to transfer a specified amount from retained earnings or distributable reserves to a non-distributable reserve.		
Concentration risk- deposits	Hold no deposit from any one member or related person, which deposit, alone or together with all existing deposits received from that member or related person, exceeds the specified value	20% of total assets.	15% of total assets.	10% of total assets.
Large Exposures (Investments)	An investment with any one person or related person, which investment, alone or together with all existing investments made.	Does not exceed 50% of total assets.	Does not exceed 30% of total assets.	Does not exceed 25% total assets.
Large Exposure (loans)	Grant a loan to any one member or related person, which loan, alone or together with all existing loans made or granted to that member and related person.	Does not exceed 25% of capital or 10% of total assets, whichever is the lesser.	Does not exceed 25% of capital or 10% of total assets, whichever is the lesser.	Does not exceed 25% of capital or 10% of total assets, whichever is the lesser.