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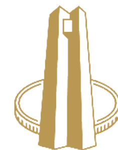

South African Reserve Bank
Prudential Authority

Ref.: 15/8/1/3

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

Proposed Directive issued in terms of section 6(6) of the Banks Act 94 of 1990

Matters related to the minimum leverage ratio buffer requirements.

Executive summary

The minimum leverage ratio buffer requirements represent a simple, transparent, non-risk-based leverage measure that acts as a credible supplementary backstop to the risk-based capital requirements.

The Basel Committee on Banking Supervision (BCBS) introduced the minimum leverage ratio buffer requirements through a document titled 'Basel III leverage ratio framework and disclosure requirements' published in January 2014. The disclosure requirements commenced on 1 January 2015 and the Pillar 1 minimum requirements commenced on 1 January 2018. Subsequent amendments to the leverage ratio framework were incorporated into the consolidated Basel framework, in particular the document titled 'LEV40 – Leverage ratio requirements for global systemically important banks' (LEV40), which also sets out the leverage buffer framework.

In addition to the minimum leverage ratio requirements, the BCBS introduced a leverage buffer requirement to further reinforce the resilience of the banking system. While the leverage ratio buffer framework was initially contemplated for global systematically important banks (G-SIBs), the Prudential Authority (PA) decided to extend the application of the framework to South African banks designated as domestic systemically important banks (D-SIBs).

The purpose of this Directive is to direct South African banks and controlling companies designated as D-SIBs to meet the minimum leverage ratio buffer requirements, equivalent to 50% of the respective bank or controlling company's higher loss-absorbency (HLA) requirement, in addition to the minimum leverage ratio requirement specified in regulation 38(15)(b)(iv) of the proposed amendments to the Regulations relating to Banks (Regulations).

1. Introduction

1.1 An underlying cause of the global financial crisis that commenced in 2007, was the build-up of excessive on- and off-balance sheet leverage in the banking system. In many cases, banks had built up excessive leverage while apparently maintaining strong risk-based capital ratios.

1.2 At the height of the crisis, financial markets forced the banking sector to reduce its leverage in a manner that amplified downward pressures on asset prices. This deleveraging process exacerbated the feedback loop between losses, reducing available bank capital and shrinking credit availability. [1]

1.3 The Basel III leverage ratio framework aims to restrict the build-up of excessive leverage in the banking sector, to avoid the destabilising deleveraging process that could damage the broader financial system and economy and reinforce the risk-based requirements with a simple, non-risk-based backstop measure.

1.4 Regulation 38(15)(b)(iv) of the Regulations states that a bank shall manage its business in such a manner that its leverage ratio is at no time less than 4% or that such a leverage ratio may be determined by the PA in consultation with the Governor of the South African Reserve Bank (SARB), which leverage ratio shall in no case be less than 3%.

1.5 LEV40 prescribes that a leverage ratio buffer will be set at 50% of a G-SIB's HLA requirement that is imposed on its common equity tier 1 (CET1) ratio. That is, a G-SIB with a 1% HLA requirement, imposed on its CET1 ratio, will be subject to a leverage ratio buffer requirement of 0.5% in addition to the specified minimum leverage ratio requirement.

1.6 The design of the leverage ratio buffer is akin to the capital buffers in the risk-weighted exposure framework. Accordingly, the leverage ratio buffer will include minimum capital conservation ratios divided into five ranges, with capital distribution constraints being activated when G-SIBs fail to meet the leverage ratio buffer requirement. The PA decided to extend the application of the leverage ratio buffer framework to South African banks and controlling companies designated as D-SIBs to maintain the intended constant backstop role of the leverage ratio requirement.

1.7 The capital distribution constraints on D-SIBs will depend on the bank or controlling company's CET1 ratio as well as the leverage ratio. That is, a bank or controlling company will be required to meet both its minimum CET1 requirement (including buffers) and its Tier 1 leverage ratio requirement (including buffers) in order to avoid the specified distribution constraints being imposed. A D-SIB that does not meet both these requirements fully will be subject to distribution constraints as per the ranges specified in Table 1 of paragraph 1.7.

1.8 Table 1 (below) illustrates the minimum capital conservation requirement imposed on the CET1 risk-based capital requirement in the first column (inclusive of a 4.5% minimum CET1 requirement, a 2.5% capital conservation buffer and a CET1 HLA requirement of 1%). The second column illustrates the concomitant Tier 1 leverage requirement.

[1] For further detail see: https://www.bis.org/bcbs/publ/d424.pdf

Table 1: Minimum capital conservation requirement imposed on D-SIBs' leverage buffer

CET1 risk-weighted ratio	Tier 1 leverage ratio	Minimum capital conservation ratio (expressed as a percentage of earnings)
4.5–5.375%	4% – (4% + 12.5% of HLA)	100%
> 5.375–6.25%	> (4% + 12.5% of HLA) – (4% + 25% of HLA)	80%
> 6.25–7.125%	> (4% + 25% of HLA) – (4% + 37.5% of HLA)	60%
> 7.125–8%	> (4% + 37.5% of HLA) – (4% + 50% of HLA)	40%
> 8%	> 4% + 50% of HLA	0%

1.9 Banks and controlling companies shall be subject to restrictions on distributions when they do not meet the relevant specified aggregate leverage ratio requirement. The items that are subject to restrictions on distributions are identical to those specified in regulation 38(8)(f)(iv) of the Regulations. Furthermore, banks and controlling companies that utilise their leverage buffers must consult with the Chief Executive Officer of the PA, as required in the proviso to regulation 38(8)(e) of the Regulations.

1.10 The decision to extend the application of the leverage ratio buffer framework to D-SIBs is consistent with the PA's intention to implement specific aspects intended for G-SIBs on South African D-SIBs. Furthermore, it is underpinned by the belief that such frameworks would enhance the safety and soundness of the local banking system.

2. Directive

2.1 Based on the aforesaid, and in accordance with the provisions of section 6(6) of the Banks Act 94 of 1990, banks and controlling companies are hereby directed:

2.1.1 To maintain a leverage buffer equal to 50% of their HLA requirement imposed on CET1 capital, where such a bank or controlling company is designated as a D-SIB, in addition to the minimum leverage ratio requirement as specified in regulation 38(15)(b)(iv) of the Regulations; and

2.1.2 To apply the capital distribution constraints when the leverage ratio declines below the minimum specified requirement. The capital distribution constraints will be undertaken in a manner that is aligned to the approach followed for the utilisation of the capital conservation buffer range in respect of the bank's risk-based capital ratios.

2.2 The implementation date for the minimum leverage ratio buffer requirements, together with the capital distribution constraints, shall be aligned to the implementation date of the revised leverage ratio requirements, in accordance with Guidance Note 4 of 2022 or any subsequent replacement thereof.

3. Invitation to comment

3.1 Banks and other interested persons are hereby invited to submit their comments on the proposed Directive to SARB-PA@resbank.co.za by 31 August 2023.

3.2 The comments received might be published on the PA’s website, unless a respondent specifically requests confidential treatment.

Fundi Tshazibana
Chief Executive Officer

Date: