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SOUTH AFRICAN RESERVE BANK
Prudential Authority

Annexure to Proposed Directive: Introducing a PCN CCyB in South Africa

Resolutions on the CCyB

The SARB and the Prudential Authority (PA) agreed in principle to implement a positive cycle-neutral (PCN) countercyclical capital buffer (CCyB) for South Africa. Furthermore, it was resolved that:

1. the PCN CCyB for South Africa would be set at 1 per cent; and
2. the PCN CCyB would be phased in over a 12-month period, commencing on 1 January 2025 and be fully implemented by 31 December 2025.

Background

One of the key weaknesses revealed by the 2008 global financial crisis (GFC) was the lack of system-wide tools to mitigate broad financial sector risks (i.e. policy instruments aimed at both (i) mitigating systemic risk; and (ii) promoting financial stability). To this end, the Basel Committee on Banking Supervision (BCBS) introduced a number of capital buffers via the Basel III framework, including the capital conservation buffer (CCB) and the CCyB.

The CCB is a prudential capital adequacy requirement for all banks to build up an additional loss-absorbing capital cushion to improve their resilience to stress. The CCyB is an extension of the CCB and functions on the same principles, except that the CCyB is designed to be time-varying and responsive to the credit cycle, thereby addressing the pro-cyclicality of capital requirements. Although the CCyB is

considered to be an extension of the CCB, their design features position them as either micro- or macroprudential focused as set out in Table 1 below:

Table 1: CCB vs CCyB

CCB	CCyB
<ul style="list-style-type: none"> • The CCB is designed to be an additional layer of capital that is held at the maximum level (that is, 2.5% of RWA) that can be drawn down when losses occur. • In the event of a particular bank breaching its minimum capital levels (including buffers), and in the absence of remedial actions acceptable to the Prudential Authority (PA), the buffer falls below 2.5% and this triggers automatic constraints on discretionary distributions of earnings (such as dividends, share buy-backs, or bonus payments – here the purpose of the restriction on distributions is to give the bank the opportunity to rebuild its capital buffers from internal sources). • The distribution constraints increase as the bank’s capital ratio approaches the minimum capital requirement. • Use of the CCB requires engagement with the microprudential authority. • The design and level of the CCB are specified in the Basel capital framework.¹ Any deviation by the regulator (e.g. lowering the buffer to below 2.5%) would be contrary to BCBS guidance.² 	<ul style="list-style-type: none"> • The CCyB is designed to ensure that the banking sector in aggregate has readily available capital to maintain the flow of credit in the economy without impeding its solvency after a period of excess credit growth. • The CCyB is countercyclical by increasing capital requirements during times when credit growth consistently exceeds economic growth (i.e. the CCyB aims to ensure that banking sector capital requirements take account of the macro-financial environment in which banks conduct business). • The CCyB is the only capital requirement that is expected to be time-varying. • Generally the macroprudential and the microprudential authorities decide on the level of the CCyB. • The design of the CCyB is specified in the Basel capital framework.¹ The CCyB is recommended to range between 0% and 2.5% of CET1 capital. • The CCyB’s potential moderating effect on the build-up phase of the credit cycle should be viewed as a positive side benefit, rather than the only or primary aim of the CCyB regime.

The CCyB therefore reflects the state of the financial system, while the CCB is essentially a static buffer regardless of external factors.

The case for a PCN CCyB

At the onset of the COVID-19 pandemic in 2020, jurisdictions that had a positive CCyB lowered the capital buffer requirements for the banking sectors (in order to reduce heightened cyclical systemic risk). With the CCyB being 0% at the time,

¹ See RBC 30 - https://www.bis.org/basel_framework/chapter/RBC/30.htm and https://www.bis.org/publ/bcbs_nl30.htm.

² Banks themselves may, however, dip into the 2.5% CCB, but have historically been reluctant to do so due to negative perceptions around doing so.

South Africa did not have an available buffer to release to reduce systemic risk in the banking sector at the onset of the COVID-19-induced shock. The COVID-19 crisis therefore demonstrated that a 0% neutral level for the CCyB was ineffective in addressing cyclical systemic risk to the financial system from a shock.

In recent years, the BCBS has increasingly expressed support for a PCN CCyB as it promotes greater flexibility in implementing the Basel III framework. The international dialogue around a PCN CCyB has gained momentum in recent years, with several jurisdictions (e.g. the UK, Sweden, the Netherlands, Ireland and Lithuania) introducing a PCN CCyB.

Given the inherent uncertainty in assessing the degree of risk and the time lags in implementation, authorities that introduced a PCN CCyB found it helpful for banks in their jurisdictions to have macroprudential capital buffers in place that can be released in the event of sudden shocks (including those unrelated to the credit cycle, such as the impact of the COVID-19 pandemic). This approach can help address concerns that banks in some jurisdictions may be reluctant to cross regulatory buffer thresholds in times of stress, but may be more willing to use their capital to support lending when buffers are explicitly released by authorities.

Impact of a PCN CCyB on the current South African minimum bank capital requirements

South Africa's banking regulatory framework for capital, which is aligned to the Basel III framework, distinguishes between a permanent capital requirement (the South African base minima capital regulatory requirement which includes a Pillar 2A requirement) and a buffer component. As detailed in Directive 5 of 2021,³ the buffer component consists of three distinguishable segments, namely the domestic systemically important bank (D-SIB) buffer, the CCB and the CCyB (Table 2). The impact of a 1% PCN CCyB is highlighted in Table 2.

³ Available at [Banks Directives \(resbank.co.za\)](https://resbank.co.za/Banks-Directives)

Table 2: Capital framework for South Africa based on the Basel III framework, with effect from 1 January 2026

Capital tiers	Reference in the proposed amended Regulations	CET 1 Capital Requirement	Tier 1 Capital Requirement	Total Capital Requirement
BCBS Basel III minima		4,5%	6,0%	8,0%
South African minima	Reg 38(8)(b) & Reg 38(8)(e)(i)	4,5%	6,0%	8,0%
Systemic risk add-on ⁴ (Total Pillar 2A range 0,5% to 2,0%)	Reg 38(8)(e)(ii)	$A_1 \geq 50\%$ of P2A	$A_2 \geq 75\%$ of P2A	P2A ($\leq 2.0\%$)
South African base minima	Reg 38(9)(a)(i) to (iii)	4,5% + A_1	6,0% + A_2	8,0% + P2A
Bank-specific ICR add-on (Pillar 2B)	Reg 38(8)(e)(iii) & Reg 38(4)	$B_1 = 50\%$ of ICR	$B_2 = 75\%$ of ICR	ICR
South African minima (prudential minima)		4,5% + A_1 + B_1	6,0% + A_2 + B_2	8,0% + P2A + ICR
Domestic Systemically-Important Bank capital add-on ¹ (0% to 2.5%)	Reg 38(8)(e)(vi)	$C_1 =$ up to the first 1%	$C_2 =$ up to the first 1,5%	DSIB (max of 2,5%)
Conservation buffer range (0% to 2.5%)	Reg 38(8)(e)(iv) & Reg 38(8)(f)	$D_1 = 100\%$ of CB	$D_2 = 100\%$ of CB	CB ($\leq 2.5\%$)
Countercyclical buffer range ⁵ (0% to 2.5%)	Reg 38(8)(e)(v) & Reg 38(8)(g)	$E_1 = 100\%$ of CCyB	$E_2 = 100\%$ of CCyB	CCyB
SA minima including countercyclical buffer, conservation buffer and D-SIB requirements⁶		8,0% + B_1 + the lower of (2,0% or ($A_1 + C_1$))	9,5% + B_2 + the lower of (2,5% or ($A_2 + C_2$))	11,5% + ICR + the lower of (3,5% or (P2A + DSIB))

⁴ The aggregate requirement for Pillar 2A and D-SIB will not exceed 2,0 per cent for CET1, 2,5 per cent for Tier 1 and 3,5 per cent in respect of the total capital-adequacy ratio.

The combined capital buffer regime (D-SIB buffer, CCB and CCyB) was phased in between 1 January 2016 and 1 January 2019. During the phase-in period, the Pillar 2A requirement was adjusted to ensure that factors relating to systemic risk were not double counted. The Pillar 2A requirement is calibrated primarily to address the systemic and domestic concentration risk. In South Africa, the CCyB:

- was phased in between 2016 and 2019 (although it was introduced at 0% and kept at that level since – see e.g. Banks Act D5/2021 and C8/2015); and
- is incorporated into the Regulations relating to Banks (Regulations) as an extension of the CCB (please see below), consistent with the Basel framework (regulations 38(8)(e) & 38(8)(g) of the Regulations).

After deciding in principle to implement a PCN CCyB, it was resolved that the PCN CCyB would be set at 1 per cent, over a 12-month implementation lead time, commencing on 1 January 2025 and ending on 31 December 2025. Practically, this means that the range for the CCyB remains between 0 and 2.5% as highlighted in Table 2, but that the CCyB requirement would be increased from 0% to 1% with effect from 1 January 2026.