South African Reserve Bank
Prudential Authority

DRAFT FOR CONSULTATION

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

Guidance Notice 2 of 2025

Guidance on Bail-in in relation to Flac instruments

Objective of this Guidance Notice
This Guidance Notice aims to provide clarity on the understanding and application of the requirements set out in the Prudential Standard RA03: Flac Instrument Requirements for Designated Institutions (Prudential Standard), specifically with regards to the bail-in resolution power and how it relates to the Flac instrument requirements. *This Guidance Notice makes reference to specific requirements within the Prudential Standard.*

1. Purpose

7.1 This Guidance Notice aims to clarify the application of statutory bail-in as a resolution tool and the application of certain requirements pertaining to bail-in, set out in the Prudential Standard RA03: Flac Instrument Requirements for Designated Institutions (Prudential Standard). This is to ensure alignment and consistency in the understanding and application of the requirements set out in the Prudential Standard.

2. Introduction

2.1 Chapter 12A of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act) sets out the resolution-related provisions that empower the South African Reserve Bank (Reserve Bank) to fulfil its mandate as the Resolution Authority (RA).

2.2 Section 30 of the FSR Act provides for the making of prudential standards to give effect to the provisions of the FSR Act by setting out detailed requirements for designated institutions. Therefore, the Prudential Standard must be read in conjunction with section 30(1A) and Chapter 12A of the FSR Act.

2.3 This Guidance Notice is issued in terms of section 141 of the FSR Act and must be read in conjunction with the FSR Act as well as the Prudential Standard.

2.4 The topics covered in this Guidance Notice include statutory bail-in, the difference between statutory bail-in and contractual bail-in, contractual recognition terms for Flac instruments, the positioning of Flac instruments in the creditor hierarchy and the order of write-off versus conversion of debt instruments.

3. Bail-in

3.1 The FSR Act empowers the Reserve Bank to perform the following actions:

(a) cancel shares as per section 166S(6)(a) of the FSR Act;

(b) issue new shares as per section 166S(6)(b) of the FSR Act;

DRAFT

(c) write-down liabilities as per section 166S(7) of the FSR Act, subject to certain exclusions listed in section166S(9) of the FSR Act as well as the exclusion of instruments issued by the Reserve Bank; and

(d) convert debt instruments into equity as per section 166T of the FSR Act.

3.2 The actions listed in paragraph 3.1 are collectively referred to as a statutory bail-in.

3.3 Therefore, the power of the Reserve Bank to conduct bail-in in a resolution (statutory bail-in) is not created by contractual terms for loss absorbency (contractual bail-in)[1] but it is provided for in terms of the FSR Act.

4. Statutory bail-in versus contractual bail-in

4.1 The bail-in provisions set out in the FSR Act constitute a statutory bail-in framework that empowers the Reserve Bank, as the RA, to conduct bail-in, in resolution. The statutory bail-in can be applied to all liabilities, except the liabilities set out in section 166S(9)[2] of the FSR Act read with the SARB Interpretation ruling on resolution actions or an instrument issued by the Reserve Bank. That means a statutory bail-in will include all debt instruments that qualify as regulatory capital and other debt instruments.

4.2 The Regulations relating to Banks issued in terms of section 90 of the Banks Act, 1990 (Act No. 94 of 1990) states that certain debt instruments may qualify as regulatory capital if they contain loss absorbing features specified through contractual bail-in. These features give the debt instruments that qualify as regulatory capital the ability to be written off or converted into equity outside the resolution framework.

[1] Contractual bail-in is a type of bail-in where losses are imposed on creditors because the creditors have contractually agreed to it. Directive D5/2024 sets out the loss absorbency requirements for contractual bail-in.

[2] The liabilities to be excluded from bail-in, as per section 166S(9) read with the Interpretation Ruling, include liabilities related to unsettled exchange traded transactions, derivative instruments including transactions concluded under master agreements as defined in subsection 35B(2) of the Insolvency Act, deposits where the deposit holder is the Corporation for Public Deposits or a transaction in the settlement system between two or more settlement system participants as provided for in the National Payment System Act.

4.3 The contractual terms and conditions of these instruments create the bail-in features. This is different to contractual provisions aimed at recognising the existence of a statutory framework.

5. Contractual recognition

5.1 In the Prudential Standard, the Reserve Bank requires designated institutions to include contractual terms that refer to the Reserve Bank's powers to conduct a resolution and the need for Flac instruments to be bailed in under South African law. Specifically:

(a) paragraph 8.5 of the Prudential Standard states that designated institutions must ensure that Flac instruments contain contractual terms that promote the ability of the Reserve Bank to conduct a resolution and for these instruments to be subject to bail-in under South African law; and

(b) paragraph 8.6 of the Prudential Standard states that external Flac instruments that are issued under foreign law must include provisions that allow for the bail-in of Flac instruments under South African law.

5.2 The contractual terms referred to in paragraph 5.1 are for contractual acknowledgement (contractual recognition) of South Africa's legislative framework for resolution. They are not intended to create loss absorbency features in the contracts (which is related to contractual bail-in).

5.3 Statutory bail-in is provided for in the FSR Act and, therefore, the Reserve Bank does not need contractual terms to empower it to conduct a resolution and a bail-in.

5.4 The purpose of a contractual recognition is for the investor to acknowledge that they are investing in a Flac instrument that is subject to statutory bail-in powers (i.e. this instrument can be written off or converted) by the Reserve Bank in accordance with the provisions of the FSR Act.

5.5 This contractual acknowledgment creates further legal certainty for the parties as the investor confirms that they are aware of the resolution framework and the Reserve Bank's bail-in powers.

DRAFT

5.6 Furthermore, Flac instruments may also be subject to foreign laws. Therefore, the requirement set out in paragraph 8.6 of the Prudential Standard emphasises the need for the investors in the Flac instruments to recognise and acknowledge that Flac instruments will be subject to resolution and bail-in under South African law.

5.7 This is to provide clarity and transparency that, even though the instrument is governed by a foreign law, it cannot be subject to any law that will impede the ability of the Reserve Bank to conduct a resolution and bail-in under South African law.

6. Creditor hierarchy and subordination

6.1 The creditor hierarchy as per the Insolvency Act, 1936 (Act No. 24 of 1936) (Insolvency Act) classifies creditors into three main categories: secured[3] (compensated from their security), preferent[4] and concurrent[5] creditors (both compensated from the free residue[6]).

6.2 Preferent creditors are specified by the law and include certain tax obligations, employee benefits and covered depositors. No instrument issued by any corporate can rank as a preferent creditor as provided for in the Insolvency Act.

6.3 The concurrent creditors are further divided into three broad sub-categories: unsecured creditors, Flac instruments and debt capital instruments[7]. See Box 1 for the illustration of the creditor hierarchy.

[3] Secured creditors have recognised security (as defined in the Insolvency Act) and preference to other claims as regards their compensation.

[4] Preferent creditors are specified by the Insolvency Act and their claims would be prioritised to be compensated first from the proceeds that form part of the free residue.

[5] Concurrent creditors are last in line in terms of being compensated from the free residue.

[6] Free residue (as defined in the Insolvency Act) in relation to an insolvent estate refers to that portion of the estate which is not subject to any right of preference.

[7] Debt instruments that qualify as regulatory capital (Additional Tier 1 (AT1) and Tier 2 (T2) instruments).

Box 1: Simplified creditor hierarchy in insolvency

Classification of creditors	Sub-categories	Additional notes
Secured creditors	Secured creditors *(up to the value of their security)*	
Preferent creditors	Preferent creditors *(as outlined in the Insolvency Act)*	
Concurrent creditors	Unsecured creditors *(including uncovered deposits and non-qualifying debt instruments)*	Sub-category 1
	Flac instruments	Sub-category 2
	Debt capital instruments *AT1 and T2 instruments)*	Sub-category 3

6.4 Section 166W(2)(b) of the FSR Act states that, after the payment of any unsecured creditors, the balance of the free residue in liquidation should be applied in the payment of any claims in connection with Flac instruments as defined in the FSR Act. Section 166W(2)(c) further states that only after the payment of Flac instruments can the balance of the free residue be applied to payments in connection with debt instruments designated as regulatory capital.

6.5 Therefore, within the concurrent creditors category, Flac instruments are senior to debt capital instruments AT1 and T2; however, they are subordinated to other unsecured creditors (sub-category 1 in Box 1). It is in this context that Flac instruments are referred to as unsecured and subordinated debt instruments in the Prudential Standard.

7. Write-off versus conversion in a statutory bail-in

7.1 Adequate loss absorption and recapitalisation capacity allows the designated institution to absorb all losses incurred, before and at the point of resolution, and be recapitalised using resources within its own balance sheet.

7.2 In a bail-in scenario, the RA would need to ensure that all the losses are absorbed first (which involves the write-down of instruments) before the recapitalisation of the designated institution (which involves the conversion of debt instruments into equity) can take place.

DRAFT

7.3 Therefore, the quantum of losses will determine the amount of write-down that will be required, and only then can the remaining instruments be used to recapitalise the designated institution. In terms of the safeguard in section 166U (1) and (2) of the FSR Act, each tranche of equity or debt has to be depleted before losses can be imposed on a more senior tranche, in accordance with the creditor hierarchy. The SARB will not be selective regarding which instruments are subject to bail-in but will follow the provisions of the FSR Act.

Fundi Tshazibana

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