South African Reserve Bank

Prudential Authority

**DRAFT FOR INFORMAL CONSULTATION – July 2021**

**Prudential Standard FC01**

**Capital requirements for financial conglomerates**

***Objectives and key requirements of Prudential Standard FC01***

*This Standard is made in terms of sections 105, 108 and 164 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) and requires the holding company of a financial conglomerate to operate within the principles and comply with the requirements relating to the calculation of available capital and required capital.*

*It is the responsibility of the board of directors of the holding company of a financial conglomerate to ensure that the financial conglomerate meets the requirements for capital on a continuous basis.*

*This Standard highlights the Prudential Authority's requirements in terms of capital and sets down the capital reporting requirements for financial conglomerates.*

**Table of contents**


1. Commencement ..... 2
2. Legislative Authority ..... 2
3. Application ..... 2
4. Definition and interpretations ..... 2
5. Roles and responsibilities ..... 3
6. Requirements and principles ..... 4
7. Reporting requirements in terms of capital adequacy ..... 7

## 1. Commencement

1.1. This Standard commences on 1 January 2025 (proposed).

| Version number | Commencement date |
|---|---|
| 1 | 1 January 2025 |

## 2. Legislative authority

2.1. This Standard is made under sections 105, 108 and 164 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act).

## 3. Application

3.1. This Standard applies to all holding companies of financial conglomerates as designated by the Prudential Authority in terms of section 160 of the FSR Act.

3.2. Where a responsibility is placed on the holding company in terms of this Standard, it must be appropriately discharged by the board of directors (board) of the holding company and in respect of all the entities within the financial conglomerate.

## 4. Definition and interpretations

4.1 The terms used in this Standard, unless indicated otherwise, are defined in the FSR Act and the respective financial sector laws, and have the same meaning in this Standard.

'**block'** means a solo entity, a controlling company, an unregulated entity or the remaining assets and liabilities of the holding company of the financial conglomerate that are not already allocated in another block;

**'board'** means the board of directors of the holding company of the financial conglomerate;

**'capital adequacy'** means eligible capital divided by required capital and is a solvency control level, above which the Prudential Authority is unlikely to intervene on financial soundness grounds;

**'controlling company'** means an entity licensed by the Prudential Authority, or by a similar regulator in an equivalent jurisdiction, that is subject to prudential supervision where the group of companies operates primarily in one industry for example in banking or insurance; in banking, this is referred to as the 'bank controlling company' and in insurance this entity is referred to as the 'controlling company';

**'eligible capital'** means the capital resources of the financial conglomerate that is eligible for determining its capital adequacy;

**'holding company'** means the holding company of the financial conglomerate as designated by the Prudential Authority in terms of section 160(1) read with section 160(2) of the FSR Act;

**'IFRS'** means the International Financial Reporting Standards;

**'intra-group transactions'** means any arrangement or agreement in terms of which an entity, directly or indirectly, relies on another person that is part of the financial conglomerate or a related or inter-related person of the aforementioned person, for the fulfilment of an obligation;

'**net asset value (NAV)'** means assets less liabilities;

**'required capital'** means the capital required of the financial conglomerate that is needed to determine its capital adequacy;

**'regulated entity'** means an eligible financial institution or an entity regulated by a similar regulator in an equivalent jurisdiction;

**'solo entity'** means a regulated entity on a stand-alone basis which is subject to prudential supervision (referred to as solo supervision). It is not subject to group supervision by the Prudential Authority;

**'significant entity'** means an entity that is scoped in the financial conglomerate as it may pose a material or significant risk and will be separately reported on for purposes of financial conglomerate supervision; and

'**unregulated entity'** means a significant entity that is not subject to solo or group supervision by the Prudential Authority or is not regulated by a regulator in an equivalent jurisdiction.

4.2 The Prudential Authority may elect to exclude certain entities for the purposes of calculating the capital of a financial conglomerate, where such entities do not pose significant or material risk to the financial conglomerate.

4.3 The exclusion as set out in paragraph 4.2 above is subject to the condition that the aggregate amount of net income after tax shall not exceed 20% of the said total net income after tax, or that the assets of all relevant entities deemed non-significant shall not exceed 10% of the total assets of the financial conglomerate.

4.4 The 'Objectives and key requirements of Prudential Standard FC01' that are italicised in the preamble of this Standard should not be used in the interpretation of any paragraph of this Standard.

## 5. Roles and responsibilities

5.1 The board is ultimately responsible for ensuring that the financial conglomerate complies with the principles and requirements of this Standard.

5.2 The board must ensure that the financial conglomerate maintains a capital adequacy ratio of greater than 1 at all times.

5.3 If the Prudential Authority is of the opinion that a financial conglomerate has failed or may fail to meet the capital requirement in the foreseeable future, it may exercise its powers to direct the holding company of the financial conglomerate to rectify the actual or potential breach in capital adequacy.

5.4 If the Prudential Authority is of the view that all risks are not adequately covered by the required capital of the financial conglomerate, the Prudential Authority may require the financial conglomerate to hold an additional amount of capital against such risks.

5.5 The Prudential Authority may by notice on its official website determine equivalent jurisdictions for the purposes of this Standard. The Prudential Authority may amend or repeal any such determinations from time to time.

## 6. Requirements and principles

6.1 The Prudential Authority in regulating and supervising financial conglomerates will require the holding company of the financial conglomerate to apply the building block approach to assess financial soundness. The building block approach entails the aggregation of the eligible and required amounts of capital of the respective blocks of the financial conglomerate.

6.2 The holding company of the financial conglomerate should first be consolidated in terms of IFRS.

6.3 The IFRS values of the different blocks must be deducted from this consolidated value.

### 6.4 Initial eligible and required capital calculations for each block

6.4.1 Solo entities and controlling companies must calculate eligible capital and required capital as prescribed by the respective applicable regulatory framework.

6.4.2 An unregulated entity must calculate required capital using the equity shock (as set out in Prudential Standard FSI 4.1 - Market Risk Capital Requirement) and the eligible capital using NAV.

6.4.3 All remaining assets and liabilities of the holding company of the financial conglomerate must be valued at arms-length. The relevant stresses as set out in Prudential Standard FSI 4.1 - Market Risk Capital Requirement must be applied to calculate the required capital for these assets and liabilities.

### 6.5 Elimination of intra-group transactions

6.5.1 All intra-group transactions not already eliminated within the respective blocks, must be eliminated when calculating the capital adequacy of the financial conglomerate, where such transaction may result in double counting.

6.5.2 In order to eliminate the potential for multiple usage of eligible capital and required capital, the effect of all intra-group transactions on the eligible capital

and required capital of each significant entity within the financial conglomerate as set out in paragraphs 6.4.1 to 6.4.3, must be eliminated.

6.5.3 The types of intra-group transactions that must be eliminated from the eligible capital and required capital used in the financial conglomerate calculation may include, but are not limited to:

(a) holdings of own capital instruments;
(b) cross holdings and holdings of capital instruments that was issued by the holding company of the financial conglomerate, by any of its subsidiaries ;
(c) loans;
(d) guarantees and off-balance sheet transactions;
(e) capital investments;
(f) reinsurance;
(g) cost-sharing arrangements; or
(h) risk-transfer transactions.

6.5.4 The method for eliminating the effect of intra-group transactions on eligible capital and required capital will typically involve removing the value of the arrangement from the balance sheets of both entities in the transaction, then recalculating the eligible capital and required capital of each relevant block excluding these amounts. For example, the effect of intra-group loans can be eliminated from the eligible capital and required capital calculations by both the borrower and lender first removing the value of the loan from their respective balance sheets.

## 6.6 Fungibility

6.6.1 The financial conglomerate must consider if any of the eligible capital emanating from each of the different blocks is not fungible and adjust the eligible capital accordingly.

6.6.2 There may be restrictions on the availability of certain solo eligible capital that must be considered when assessing the availability of eligible capital at financial conglomerate level. In particular, financial conglomerates must consider the fungibility and transferability of eligible capital recognised for a block before including it in eligible capital for the financial conglomerate. In this regard:

(a) Fungibility refers to the ability of eligible capital to absorb losses of any kind within the financial conglomerate, taking into account whether the eligible capital is dedicated for a specific purpose; and
(b) Transferability refers to the ability of one entity within the financial conglomerate to transfer assets to another entity within the financial conglomerate.

6.6.3 Eligible capital that is non-fungible or non-transferable across the financial conglomerate must not be considered to be fully available at a financial conglomerate level. However, the non-fungible portion of such eligible capital

should be recognised but limited to the lower of the capital requirement exceeding the fungible portion and the non-fungible portion (after elimination of intra-group transactions).

6.6.4 Unless otherwise approved by the Prudential Authority, eligible capital that should be regarded as non-fungible and/or non-transferable includes:

(a) Eligible capital that may be restricted due to legal or regulatory requirements (refer to paragraph 6.7 below);

(b) Ancillary eligible capital and encumbered assets of participations within the financial conglomerate (such eligible capital is typically only available to absorb losses of the relevant participation and not the wider financial conglomerate);

(c) Hybrid capital instruments and subordinated liabilities that are not issued or guaranteed by the holding company of the financial conglomerate; and

(d) Eligible capital related to deferred tax assets.

6.6.5 For the purposes of paragraph 6.6.4(c) above, any hybrid capital instrument and subordinated liability not issued or guaranteed by the holding company of the financial conglomerate, that was issued prior to the commencement date of this Standard, may be regarded as fungible and/or transferable until that instrument or liability is varied, renewed or expires,

6.6.6 Eligible capital that may be restricted due to legal or regulatory requirements includes eligible capital that is:

(a) Dedicated to absorb only certain losses as prescribed by national legal or regulatory requirements (e.g. ring-fenced funds);

(b) Unable to be transferred to any other entity within the financial conglomerate due to national legal or regulatory requirements (e.g. exchange controls); or

(c) Otherwise unable to be made available to the financial conglomerate within a period of less than nine months.

## 6.7 Other considerations

6.7.1 Where a portion of required and/or eligible capital in a block has been recognised in any other block, provided the block is not a solo entity or a controlling company, the portion of required and/or eligible capital must be eliminated in order to avoid double counting.

6.7.2 Goodwill and intangibles must be deducted for each block that is not a solo entity or a controlling company.

## 6.8 Aggregation

6.8.1 The eligible capital and required capital as set out in this Standard for each block, must be aggregated on a pro-rata basis based on the economic interest of the holding company of the financial conglomerate, after eliminating certain transactions as prescribed in paragraph 6.7 above.

## 7. Reporting requirements in terms of capital adequacy

7.1 The holding company of a financial conglomerate must submit regulatory reporting returns on a six monthly basis in June and December. The returns must be submitted within 60 days after the relevant reporting date.

7.2 The Prudential Authority may, in order to fulfil its regulatory and supervisory duties in respect of the financial conglomerate, request additional information from the holding company of the financial conglomerate in respect of members of the group of companies.

7.3 The form and manner of regulatory reporting returns will be determined by the Prudential Authority and published on its website.