



South African Reserve Bank

Prudential Authority

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Statement of the need for an urgent regulatory instrument, its intended operation and expected impact*

Proposed Prudential Standard for Co-operative Financial Institutions

31 August 2018

*This statement is drafted in fulfilment of the requirements under section 100(1)(a)(iii) of the Financial Sector Regulation Act 9 of 2017

Table of Contents

1. Introduction	2
2. Justification for issuance of proposed standard on an urgent basis.....	3
3. Statement of need	3
4. Objective of the proposed Prudential Standard	4
5. Salient features of the proposed Prudential Standard	4
6. Statement of expected impact	6
7. Statement of intended operation.....	6
8. Conclusion	6

1. Introduction

- 1.1 The Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (“FSR Act”), with effect from 1 April 2018, amended the Co-operative Banks Act, 2007 (Act No. 40 of 2007) (Co-operative Banks Act) by –
- extending the scope of the Co-operative Banks Act to include the regulation and supervision of co-operative financial institutions; and
 - providing for the Prudential Authority to be the responsible authority for the Co-operative Banks Act.
- 1.2 These amendments to the Co-operative Banks Act effected by the FSR Act, commenced on 1 April 2018, save for chapter VIIA that commenced on 1 August 2018. Chapter VIIA provides, among others, for the registration of co-operative financial institutions, requirements for registration, suspension of registration and de-registration of co-operative financial institutions. With effect from 1 August 2018, existing co-operative financial institutions will have a period of 12 months within which to register under the amended Co-operative Banks Act. The Prudential Authority is currently developing a new regulatory and supervisory regime for co-operative financial institutions, including prudential standards.
- 1.3 Currently, the regulatory framework governing co-operative financial institutions is captured under the Co-operative Banks Development Agency Rules (CBDA Rules). The Prudential Authority has no jurisdiction over the CBDA Rules and the proposed standard seeks to convert the CBDA Rules into a prudential standard under which the Prudential Authority will be able to register, regulate and supervise co-operative financial institutions.
- 1.4 The proposed Prudential Standard seeks to address this regulatory gap and caters for transitional arrangements for co-operative financial institutions. The proposed Prudential Standard incorporates the CBDA Rules and also includes the following thresholds:
- an obligation for a co-operative financial institution that has, for a period of six consecutive months, sustained a deposit value of at least

R5 million (previously R1 million) to apply to be registered as a co-operative bank; and

- a maximum deposit threshold of R50 million (previously R30 million) for co-operative financial institutions.

1.5 In line with the requirements under FSR Act (section 100) for making regulatory instruments, the Prudential Authority has prepared this statement that outlines the need for the urgent Prudential Standard and its intended operation.

2. Justification for issuance of proposed standard on an urgent basis

The Prudential Standard is proposed as an urgent regulatory instrument in terms of section 100 of the FSR Act given that the Prudential Authority requires a regulatory framework in order to regulate and supervise co-operative financial institutions. The regulatory gap (identified in paragraph 1) poses prejudice to financial customers who are currently members of a co-operative financial as well as financial customer that may deposit funds with these institutions. Against this background, should the Prudential Authority follow the normal process for making prudential standards as set out in section 98 and 99 of the FSR Act, the implementation of regulation, registration of co-operative financial institutions and supervision of the sector by the Prudential Authority will be delayed.

3. Statement of need

3.1 Co-operative financial institutions were previously regulated and supervised by the CBDA in terms of an exemption notice issued in terms of the Banks Act, 1990 (Act No. 94 of 1990), under Government Notice No. 620 and published in Government Gazette No. 37903 of 15 August 2014. Under the FSR Act and the consequential amendments to the Co-operative Banks Act, the regulation and supervision of co-operative financial institutions now falls within the ambit of the Prudential Authority. The supervision staff from the CBDA were transferred to the South African Reserve Bank, and seconded to the Prudential Authority on 1 April 2018.

3.2 This proposed Prudential Standard is made in terms of sections 46(1) read with 44(4)(b) of the Co-operative Banks Act 40 of 2007 and sections 100, 105 and 108 of the Financial Sector Regulation Act 9 of 2017 and provides for transitional arrangements for co-operative financial institutions until the finalisation of operational, prudential and governance standards under the new co-operative financial institutions regulatory and supervisory framework by the Prudential Authority.

3.3 While comprehensive prudential standards on the new framework for the regulation and supervision of co-operative financial institutions are being developed, the proposed Prudential Standard has been identified as the most expedient and efficient approach to give the Prudential Authority the regulatory and supervisory powers to oversee the sector.

4. Objective of the proposed Prudential Standard

The objective of the proposed Prudential Standard is to give effect to the requirements of the FSR Act which stipulates that the Prudential Authority is the responsible authority for co-operative financial institutions. As such, the Prudential Authority must ensure that there is appropriate regulation and supervision of co-operative financial institutions. Given that the prudential standards for co-operative financial institutions are still being developed, the proposed Prudential Standard will ensure that the sector is prudentially regulated and supervised on a similar basis to the supervision under the CBDA Rules.

5. Salient features of the proposed Prudential Standard

5.1 The Co-operative Banks Act requires that any prescription that is required to be made by the Prudential Authority be made in prudential standards. Additionally, the Prudential Authority had to elect whether to convert the CBDA Rules into the proposed Prudential Standard verbatim or to also include the provisions relating to the thresholds.

5.2 The Prudential Authority elected to include the provisions relating to thresholds for two reasons. Firstly, the threshold in terms of which a co-operative financial

institution that attains a deposit value of R5 million must apply to be registered as a co-operative bank is market based and is the amount required to sustain a co-operative bank. Secondly, the threshold that sets a maximum deposit value for a co-operative financial institution is inserted in the light of the fact that there are currently existing co-operative financial institutions that hold deposits in the region of R40 million.

- 5.3 These options have been selected by virtue of the fact that they assist in ensuring the safety and soundness of co-operative financial institutions and assist in ensuring that these institutions are able to meet their obligations.
- 5.4 The proposed Prudential Standard provides for the registration of co-operative financial institutions as well as basic principles relating to the maintenance of effective risk management by co-operative financial institutions.
- 5.5 The proposed Prudential Standard covers:
- Commencement and transitional provisions
 - Legislative authority
 - Application
 - Roles and responsibilities
 - Application to register as a co-operative financial institution under the Act
 - Reporting on financial performance
 - Application to be a co-operative bank and thresholds for co-operative financial institution
 - Changes to the constitution of co-operative financial institution
 - Financial soundness requirements
 - Fit and proper directors and management
 - Inspections of co-operative financial institutions
 - Non-compliance with standards and requirements of the Prudential Authority
- 5.6 The CBDA rules have been converted into the proposed Prudential Standard with the removal of procedural guidance which will be issued as either guidance notes or circulars to the sector by the Prudential Authority.

6. Statement of expected impact

- 6.1 The impact of the proposed Prudential Standard and its members will be minimal, as the existing regulatory and supervisory rules for co-operative financial institutions are being converted to a different instrument. The thresholds are now reflecting the current market requirements.
- 6.2 The effect of not making the proposed Prudential Standard will be that co-operative financial institutions will continue to be unsupervised and may lead to adverse consequences to vulnerable members of the society who may deposit their savings with these financial institutions. Loss of such savings may lead to unnecessary suffering.

7. Statement of intended operation

- 7.1 The proposed Prudential Standard will be issued pursuant to the powers of the Prudential Authority under the Co-operative Banks Act and FSR Act.
- 7.2 The proposed Prudential Standard is an interim measure to ensure that the sector is sufficiently regulated and supervised while more comprehensive prudential standards for co-operative financial institutions are still being developed.
- 7.3 The proposed Prudential Standard will be withdrawn and replaced once the Prudential Authority issues new prudential standards for co-operative financial institutions under the new framework.

8. Conclusion

Apart from the thresholds introduced in the proposed Prudential Standard, the proposed Prudential Standard is a conversion of the current CBDA Rules. As such, the proposed Prudential Standard is intended to ensure the continued regulation and supervision of co-operative financial institutions and is not intended to materially change the existing framework created under the CBDA Rules.