



South African Reserve Bank

Prudential Authority

Financial conglomerate designation criteria

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1. Introduction

The Financial Sector Regulation Act 9 of 2017 (FSR Act) was enacted on 1 April 2018, and creates an enabling framework for the regulation and supervision of financial conglomerates in South Africa. A financial conglomerate is a group of companies designated in terms of section 160 of the FSR Act.

From 1 March 2019, the FSR Act enabled the Prudential Authority (PA) to designate¹, regulate and supervise members of a group of companies as a financial conglomerate, in addition to the regulation and supervision of solo entities or sub-groups within a group on a consolidated basis in terms of, inter alia, the Banks Act 94 of 1990 (Banks Act), and the Insurance Act 18 of 2017 (Insurance Act). A financial conglomerate, in terms of the FSR Act², must include an eligible financial institution and a holding company of the eligible financial institution, but need not include all the members of a group of companies.

In terms of section 1 of the FSR Act, an 'eligible financial institution' means each of the following:

- a. a financial institution licensed or required to be licensed as a bank in terms of the Banks Act;
- b. a financial institution registered as a long-term insurer in terms of the Long-term Insurance Act 52 of 1998 or a short-term insurer in terms of the Short-term Insurance Act 53 of 1998 or licensed or required to be licensed in terms of the Insurance Act;
- c. a market infrastructure; or
- d. a financial institution prescribed in Regulations³ for the purposes of this definition.

The requirements contained in the Banks Act, Insurance Act and FSR Act provide for three levels of regulation and supervision, namely:

- Level 1:** Regulation and supervision of a licensed entity on a stand-alone basis, which is referred to as solo supervision.
- Level 2:** Specialist group supervision where the supervised group operates primarily in one industry (e.g. banking or insurance groups), which is referred to as consolidated or group supervision.
- Level 3:** Regulation and supervision of a financial conglomerate, where the group of companies generally operates in one or more industries (i.e. insurance, banking or securities services) and where the group includes unregulated entities that are not subject to a Level 2 supervisory framework or Level 2 supervision has not adequately captured all risks to which the group is exposed.

¹ Section 160(1) of the FSR Act.

² Section 160(2) of the FSR Act.

³ Regulations designating other eligible financial institutions have not been promulgated.

The objective of the designation criteria is to provide clarity on the factors that the PA will take into consideration when designating financial conglomerates. The designation criteria may change and evolve as the regulation and supervision of financial conglomerates in South Africa matures.

2. Financial conglomerates in South Africa

The South African financial system is dominated by a small number of large financial institutions. This has resulted in a highly concentrated market with a high level of interconnectedness, which poses contagion risk in the financial system and increases concerns related to the 'too-big-to-fail' concept.

Prior to the enactment of the FSR Act and consequent adoption of the Twin Peaks approach to financial sector regulation, the South African financial sector was fragmented – with different sectoral laws being applied by different regulatory authorities of specified financial institutions, which increased the risk of regulatory arbitrage as well as the risk that certain exposures to risk incurred by entities within a wider group of entities were not adequately taken into consideration.

The FSR Act promotes a more harmonised, consistent, comprehensive and streamlined approach to the regulation and supervision of financial institutions by introducing, inter alia, financial conglomerate supervision (Level 3) as a supplementary level of supervision to the existing solo supervision (Level 1) and consolidated or group supervision (Level 2).

The primary purpose of financial conglomerate regulation and supervision is to strengthen prudential oversight of eligible financial institutions (e.g. banks and insurers), and to capture risks that may not be adequately addressed under Level 1 and/or Level 2 supervision.

3. Identification of a group

A group, in its entirety, may be diversified to the extent that the financial products and services provided by the group may constitute only a minority portion. In designating a financial conglomerate, the PA should ascertain the relative size and complexity of the business operations of the group being considered for designation.

A group's activities would generally be deemed to be mainly in the financial sector if total assets, revenue, gross written premiums or whichever relevant measure applied to the financial entities in the group represents more than an aggregate of 50% of the total group. For example, if total assets are used, then the aggregate amount of assets of all the financial entities must be more than 50% of the total assets of the holding company or total assets of the group of companies being considered for designation.

The determination of the total assets of financial entities must include both regulated and unregulated entities.

The type of activities that unregulated financial entities may be involved in may include financial leasing, issuing of credit cards, portfolio management, investment advisory, custodial and safekeeping services, and other similar activities, as may be determined by the PA.

Taking into consideration the risks which members of a group of companies may pose to effective prudential regulation and supervision of the eligible financial institution(s), the PA may, however, still designate a group of companies with activities below the 50% threshold in the financial sector as a financial conglomerate – if such designation will facilitate effective prudential regulation and supervision of the eligible financial institution(s) within the group.

4. Designation of a financial conglomerate

A financial conglomerate means a group of companies designated in terms of section 160 of the FSR Act.

The National Treasury has embarked on a process of updating the financial market legislation in the context of the Twin Peaks reforms, international developments and South Africa's Group of Twenty commitments. In light of these developments and the embedding of the prudential regulation and supervision of market infrastructures, market infrastructures will not, for the time being, be considered for designation as a financial conglomerate. However, the PA will keep developments relating to market infrastructures under review, including in respect of the application of chapter 12 of the FSR Act to market infrastructures as eligible financial institutions.

As its current approach, the PA intends to identify a financial conglomerate as a candidate for Level 3 supervision if:

- the group of companies (group) conducts material activities in at least one or more of the following regulated industries: banking, securities services⁴ and/or insurance ;
- the group contains unregulated entities that perform material activities not subject to the Level 2 supervisory framework; and/or

⁴ In terms of section 1 of the Financial Markets Act 19 of 2012, 'securities services' means-

- a. the buying or selling of securities for own account or on behalf of another person as a business, a part of a business or incidental to conducting a business;
- b. the use of the trading system or infrastructure of an exchange to buy or sell listed securities;
- c. the furnishing of advice to any person;
- d. the custody and administration of securities by a participant or nominee;
- e. the management of securities and funds by an authorised user;
- f. clearing services; or
- g. settlement services.

- the PA does not consider the risks associated with, and the oversight of, the group as being adequately captured under the Level 1 and/or Level 2 supervisory frameworks.

In terms of bullet point one above, the PA intends to, for now, only focus on groups that have material activities in:

- banking and insurance;
- banking and securities services;
- insurance and securities services; or
- any combination of banking, insurance and securities services.

Without providing a strict definition of the term 'material activities', the PA will assess materiality by considering, inter alia, the following:

- the risk to effective prudential regulation and supervision of eligible financial institutions from the structure of the group;
- the significance of a particular entity or sub-group to the financial safety and soundness of the group;
- an entity or sub-group that is significant to the group, but is not subject to Level 2 supervision;
- the extent of cross-border operations of the group;
- any material risk that a group entity might introduce to the safety and soundness of an eligible financial institution;
- the extent of intragroup transactions and exposures between different entities in the group; and/or
- any other factors that the PA may consider relevant.

The PA will consider, inter alia, the following criteria when considering the significance of an entity (including unregulated entities) that potentially constitutes a material or significant risk to the relevant group:

- any relevant entity subject to the regulation or supervision of any other supervisor and which entity is subject to separate prudential requirements;
- any relevant entity with assets in excess of 1% of the consolidated assets of the group;
- any relevant entity with a net income after tax in excess of 5% of the consolidated net income after tax amount of the group; or
- any relevant entity with intragroup exposure or other financial relationship with the group in excess of 2% of the consolidated amount of group exposure,

provided that in no case shall the aggregate amount of net income after tax of all relevant entities deemed non-significant exceed 20% of the said consolidated net income after tax, or the assets of all relevant entities deemed non-significant exceed 10% of the said consolidated assets of the group.

The impact of the quantitative criteria on designated financial conglomerates will be reviewed by the PA in terms of paragraph 7 below.

5. Characteristics of the group or eligible financial institution that will be considered when designating a financial conglomerate

The PA will consider the characteristics noted hereunder when designating a financial conglomerate. A financial conglomerate may be designated if the group or eligible financial institution satisfies one or more of the following characteristics:

5.1 Size

The size of the group or eligible financial institution will be measured in terms of total assets, revenue, gross premiums, market share, materiality or any other measure that the PA may consider.

5.2 Interconnectedness of a bank, insurer or a securities services provider with other entities within the group

Interconnectedness serves as a conduit for contagion risk. When designating conglomerates, the PA will consider the level of interconnectedness between regulated and unregulated entities within a group.

5.3 The complexity of the financial group, its business model and group structure

The PA will consider the relative complexity of the business and structure of a financial group, and the impact thereof on the adequacy and effectiveness of the prudential regulation and supervision of the eligible financial entities in the group, in order to determine whether there is a need for Level 3 supervision due to the likelihood that the risk exposures of such respective business units and entities in the group are not adequately captured under Levels 1 or 2 supervision.

5.4 The number and materiality of unregulated entities

The number and materiality of unregulated entities within a group and their contribution to the risk profile of the group will be considered.

5.5 Domestic systemically important financial institutions

A group, which includes a systemically important financial institution designated in terms of section 29 of the FSR Act will be considered for designation as a financial conglomerate.

5.6 Other

Any other criteria that the PA considers appropriate to capture risks that are best addressed through financial conglomerate regulation and supervision.

6. Final designation of a financial conglomerate group

The PA will notify⁵ the holding company of a financial conglomerate of the proposed designation, which notification will include a statement of the purpose of, and the reasons why the designation is proposed. The PA will invite the holding company to make submissions on the matter.

When designating a financial conglomerate, the PA will take into account at least the following⁶:

- the risk to effective prudential regulation and supervision due to the structure of the group of companies;
- submissions made by, or for the holding company; and
- any other matters that may be prescribed by regulation.

The process for designating a financial conglomerate is outlined in Annexure A.

The PA may require the holding company of a financial conglomerate to be licensed in terms of the FSR Act⁷, if not already licenced in terms of a financial sector law, for the purpose of enabling the PA to exercise its powers with respect to the financial conglomerate, and to enhance the safety and soundness of the eligible financial institution(s).

7. After the designation of a financial conglomerate and the ongoing supervision of groups

The PA must continually reassess⁸ designations made, or any decision not to make a designation, in terms of section 160(1) of the FSR Act. The PA must consider making a designation or reconsider the terms of any decision made if the PA becomes aware of a potential material change in the risk profile of the members of a group of companies or the financial conglomerate.

The PA may amend or revoke a designation⁹ by notice¹⁰ to:

- the holding company of a financial conglomerate; and/or

⁵ Section 160(3) of the FSR Act.

⁶ Section 160(6) of the FSR Act.

⁷ Section 162 of the FSR Act.

⁸ Section 160(9) of the FSR Act.

⁹ Section 160(10)(a)

¹⁰ Section 160(10)(b) states that the notice must include a statement of the purpose of and the reasons why the amendment to or revocation of the designation is proposed; and invite the entities to make submissions on the matter.

- any companies that are not currently designated as part of a financial conglomerate, but which are proposed to be included as part of a currently designated financial conglomerate.

In terms of section 160(11) of the FSR Act, each designation, amendment to or revocation of a designation must be published by the PA.

8. Exemptions

Any exemptions relating to financial conglomerates will be dealt with in terms of the provisions of section 281 of the FSR Act.

Issued by the Prudential Authority

Date: 2020-09-23

Annexure A: Process of designation

