



SOUTH AFRICAN RESERVE BANK
Prudential Authority

Statement* of the need for, expected impact and intended operation of the proposed prudential standard on the fund liquidity of the Corporation for Deposit Insurance's funding model

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(FOR CONSULTATION)

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List of Abbreviations

BASA	Banking Association of South Africa
CRR	Cash reserve requirements
G20	The Group of Twenty countries
DIF	Deposit Insurance Fund
DIS	Deposit Insurance Scheme
FSB	Financial Stability Board
FSLAA	Financial Sector Laws Amendment Act 23 of 2021
FSRA	Financial Sector Regulation Act 9 of 2017
HQLA	High-quality liquid assets
IADI	International Association of Deposit Insurers
LCR	Liquidity coverage ratio
NSFR	Net stable funding ratio
PA	Prudential Authority
RA	Resolution Authority
SAICA	South African Institution of Chartered Accountants
SARB	South African Reserve Bank
TBTF	Too-big-to-fail

1 Introduction

- 1.1 In January 2022 the President signed into law the Financial Sector Laws Amendment Act 23 of 2021 (the FSLAA), in terms of which the Corporation for Deposit Insurance (the Corporation) will be established. The Financial Sector Regulation Act 9 of 2017 (the FSRA), as amended by the FSLAA, provides the over-arching framework for the establishment of the Corporation, and secondary legislation will contain the details of the Corporation's functioning.
- 1.2 One of the Corporation's functions will be to establish, maintain and administer the deposit insurance fund (DIF) in the interest of the holders of covered deposits.
- 1.3 Section 166BH(1) of the FSRA requires that members of the Corporation that hold covered deposits maintain a minimum amount in the account of the DIF. The Corporation will specify the details of the requirement in a prudential standard (the fund liquidity standard).
- 1.4 Section 166BA of the FSRA further specifies that the financial sector regulators must comply with any reasonable request from the Corporation, including requests to:
- a) determine standards;
 - b) issue directives; and
 - c) promote awareness among financial customers of the protections afforded by the Corporation.
- 1.5 In terms of section 105(1) of the FSRA, the Prudential Authority (PA) may make prudential standards for, or in respect of:
- a) financial institutions that provide financial products or securities services;
 - b) financial institutions that are market infrastructures; and
 - c) key persons of such financial institutions.
- 1.6 Section 98 the FSRA requires the PA to publish the following documents before making a prudential standard (regulatory instrument):
- a) a draft of the regulatory instrument;

- b) a statement explaining the need for and the intended operation of the regulatory instrument;
- c) a statement of the expected impact of the regulatory instrument; and
- d) a notice inviting submissions in relation to the regulatory instrument, stating where, how and by when submissions are to be made.

1.7 In line with the above-mentioned legislative requirements for making regulatory instruments, the PA has prepared this 'Statement of the need for, expected impact and intended operation of the proposed fund liquidity standard'.

1.8 The statement considers industry feedback received from previous consultations through discussion papers relating to the DIF and a deposit insurance survey (the survey).

2 Background

2.1 In response to the financial and economic crises that erupted between 2007 and 2009, the role of a deposit insurance scheme (DIS) evolved in line with the bank resolution frameworks. The Group of Twenty (G20) countries tasked the Financial Stability Board (FSB) with developing policies to address the too-big-to-fail (TBTF) problem.

2.2 The FSB developed, among other standards, the Key Attributes of Effective Resolution Regimes for Financial Institutions (key attributes), which sets out the core elements that the FSB considers to be necessary for an effective resolution regime.

2.3 The elements of the key attributes require jurisdictions to have a privately funded depositor protection and/or resolution fund in place or, alternatively, arrangements to recover any public costs from the private sector, afterwards.

- 2.4 The International Association of Deposit Insurers' (IADI's) Core Principles for Effective Deposit Insurance Systems¹ (core principles) provide guidance on the desired design features of a DIS, including, funding arrangements.
- 2.5 Similar to the key attributes, the core principles recommend that funding for the DIS is provided by banks on an ex-ante basis and that funding arrangements should be clearly defined and established in law.
- 2.6 South Africa is the last G20 country to implement an explicit DIS. Because South Africa does not have an explicit and privately funded DIS, reimbursement of depositors in the event of a failed bank has in the past been funded by the government on a case-by-case basis. No explicit arrangements were in place to recover such compensation to depositors from the private sector, resulting in taxpayers ultimately funding the costs of bank failures.
- 2.7 Furthermore, the absence of an explicit and privately funded DIS in South Africa presented a gap in the design features of the financial safety net that is needed to promote financial stability. The financial safety net is aimed at protecting depositors and financial stability, and it typically includes a combination of the following: (1) a lender of last resort; (2) a national payment system; (3) prudential supervision of banks; and (4) a DIS.
- 2.8 As such, the National Treasury and the South African Reserve Bank (SARB) took an in-principle decision in 2015 that South Africa should establish a DIS to close the gap in the financial safety net to bring South Africa in line with international best practice and other G20 countries.

¹ International Association of Deposit Insurers (IADI). 2014. *Core Principles for Effective Deposit Insurance Systems*. Available at <https://www.iadi.org/en/assets/File/CorePrinciples/cprevised2014nov.pdf>

2.9 In May 2017, the SARB published a discussion paper titled *Designing a Deposit Insurance Scheme for South Africa – a discussion paper*² (the 2017 discussion paper) containing proposals for the key design features of a DIS for South Africa, including some initial options for the funding of the DIS.

2.10 Since the publication of the discussion paper, the initial funding proposals have been revised and consulted with banks, mostly through the Banking Association of South Africa (BASA), resulting in a more cost-effective funding model.

3 Consultation process on the Corporation's funding model

3.1 The 2017 discussion paper proposed two funding options for the DIS, with a clear indication that alternatives were still being explored, namely:

3.1.1 Option 1 - An interest-free loan from the SARB to the DIS which would be repaid by annual premiums from the banks over a period of 10 years;

3.1.2 Option 2 - A reduction in the cash reserve requirements (CRR) to 2% of liabilities, as adjusted, and using the released amount as a once-off mechanism for the funding of the DIS. This amount would be transferred to the DIS as initial funding, after which banks needed to maintain a 5% requirement of their covered deposits with the Corporation.

3.2 Between June 2017 and October 2017, a series of meetings were held with the BASA, the South African Institution of Chartered Accountants (SAICA) and bilaterally with individual banks. KPMG provided an expert opinion on the accounting treatment of the CRR funding option.

3.3 The deadline for responses to the 2017 discussion paper was 31 August 2017. In addition to verbal comments made in discussion fora, written responses were received from 6 institutions and 1 individual.

3.4 Option 1 was regarded as expensive by the banks. Option 2 had cash-flow benefits, however, the KPMG accounting opinion and discussions held with a

² South African Reserve Bank. 2017. 'Designing a deposit insurance scheme for South Africa – a discussion paper'. Available at <https://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf>

working group of technical accountants from the banks raised several issues that made this option less attractive. Some of the issues that were raised are discussed below:

3.5 Accounting issues

3.5.1 The most material issue regarding the cost of the DIS transpired to be whether the banks' contributions to the DIS could be structured in a manner that they would be accounted for as an asset on their balance sheets, rather than a direct expense through their income statements. The ability to report a bank's contribution to the DIS as an asset would lessen the impact on banks' profitability.

3.5.2 Option 2 had several constraints that reduced the probability that banks would be able to classify their contributions to the DIS as an asset. These constraints included the announcement of the targeted fund size placing a statutory obligation on banks to continue contributing to the DIS until the Corporation achieved its intended targeted fund size, no returns would be earned by banks on their contributions and the risk of losses because of another bank's failure.

3.5.3 Due to these constraints, option 2 did not meet the criteria to be reported as an asset and would have to be fully expensed upon the establishment of the DIS, which would have a larger once-off cost impact than option 1, which would have been expensed over time. The accounting treatment made both options unattractive and prompted the SARB, with the banks, to pursue alternative funding options.

3.6 Money-market liquidity impact

3.6.1 In both options presented in the 2017 discussion paper, the funding originated from within the SARB (loan or CRR balances, respectively). Therefore, any investment by the DIS in the market would have an expansionary impact on money-market liquidity, which the SARB would have to drain at a cost. The only way to avoid this cost would be by keeping the funds within the SARB Group, in which case the DIF would not earn any investment return on the banks' contributions.

3.6.2 The banking industry was in favour of a funding solution where the DIF could earn an investment return to ensure the funding base grows. To achieve this, the initial DIF funding should originate from the banks, rather than the SARB, to allow the DIF's funds to be invested in the market without impacting money-market liquidity.

3.7 Revised funding structure

3.7.1 Subsequent to the consultations with industry, the SARB published the paper titled '*The deposit insurance funding model and the implications for banks*'³ (the funding paper), which outlined the proposed revised funding model for the DIS.

3.7.2 The full amount of banks' contributions to the DIF could not be classified as an asset for the bank. However, from discussions with the banks and their accounting experts, it was concluded that it may be possible to account for part of the banks' contributions as an asset to reduce the impact on banks' profitability. The SARB decided to structure the DIF into a loss-absorbing capital tier and a liquidity tier that could be used to fund the initial reimbursement if a bank is placed into resolution, but which could be recovered from the liquidation proceeds. The SARB would provide emergency funding as part of the funding model, to the DIS in the event of a shortfall, to be refunded from ex-post premiums paid by banks and/or liquidation proceeds, depending on the circumstances.

3.7.3 Thus, the funding model for the DIS was revised and comprised the following tiers:

3.7.3.1 **The Corporation's own funds (equity):** This is a loss-absorbing tier, built through premiums⁴ by banks (annually 0.2% of covered deposits, payable monthly) until the target fund size has been achieved or the funding model is amended. Banks will have to expense the premiums through their income statements. Where a premium has already been paid in full for a premium

³ South African Reserve Bank. 2020. 'The deposit insurance funding model and the implications for banks'. Available at <https://www.resbank.co.za/en/home/publications/publication-detail-pages/media-releases/2020/10208>

⁴ Financial Sector and Deposit Insurance Levies (Administration) and Deposit Insurance Premiums Act 12 of 2022.

period during which a member of the Corporation ceases to be a member, the Corporation will provide the former member with a pro-rata refund of its premium after the cessation of membership.

3.7.3.2 **Liquidity tier:** In the funding paper, the liquidity tier consisted of interest-bearing deposits placed by banks with the Corporation. The Corporation will determine the size of the fund liquidity on an annual basis as a percentage of total covered deposits held by banks. The funds will be accounted for as an asset on the banks' balance sheet.

3.7.4 The liquidity tier was envisaged to be the primary source of funds for the Corporation to give covered depositors reasonable access to their covered deposits when a bank was placed into resolution for the first five years as the Corporation builds the tier consisting of its own funds. If the resolution strategy chosen was to reimburse covered depositors, the Corporation would utilise the liquidity tier for liquidity, in effect serving as an advance against the liquidation proceeds, to be recovered rather than representing a permanent loss of funds. Initially, the idea was that after the first five years of the Corporation's establishment, the Corporation would use the deposit of a bank in resolution and its own funds (equity) first to fund a resolution strategy before dipping into the liquidity tier.

3.7.5 During the consultation period for the funding paper, banks raised concerns about the form and structure of the liquidity tier affecting its accounting classification as an asset.

4 The terms and conditions of the liquidity tier

4.1 The Corporation subsequently reviewed its proposals and consulted with banks, through the BASA, to refine the form, structure, and terms and conditions for the liquidity tier to address the accounting concerns raised.

4.2 The SARB changed the form of banks' contributions to the liquidity tier from a deposit to a loan. The Corporation will enter into a loan agreement with each bank for their contribution to the liquidity tier. The liquidity tier standard specifies some of the terms and conditions while others will be contractually agreed with

banks. Banks confirmed that the loan proposal would address the concerns raised and facilitate an asset classification.

- 4.3 The liquidity tier will be in place from the date that banks are required to maintain funds at the Corporation. A bank will transfer its initial loan amount for the liquidity tier to the Corporation on a date specified by the Corporation.
- 4.4 Initially, banks must maintain a loan of 3% of their covered deposits with the Corporation. The size of the liquidity tier may, however, range between 0% and 3.5% and the Corporation will specify the size annually, based on its funding requirements. The percentage determined by the Corporation will be published on the Reserve Bank's website to take effect on a date determined by the Corporation.
- 4.5 Banks' loans for the liquidity tier will be rolled monthly and adjusted to changes in their covered deposit balances. If a bank's covered deposit balance increases from one month to the next, the bank will need to top-up the loan amount with the Corporation. A decrease in the covered deposit balance will result in the bank receiving a refund from the Corporation. If a bank does not have covered deposits, it will not hold an amount in the liquidity tier.
- 4.6 In terms of the FSRA, the Corporation must pay interest to banks on the loan. The Corporation will determine the interest rate payable to banks based on the investment mandate developed by the Corporation's Investment Committee (Committee) and approved by the Corporation's board of directors. After this, the investment-related conditions will be finalised, and the Corporation will confirm the interest rate payable to banks. As agreed with banks, the interest earned by banks on the loan will not be set-off against their monthly loan adjustments. Banks confirmed that if the Corporation pays the same interest rate to all banks, the rate will be considered market-related.
- 4.7 The Corporation proposed that the loans will be repaid, gradually or in full, at the earlier of:

- 4.7.1 a decision by the Committee to repay the loan when the DIF's funds, collected as deposit insurance premiums and income on the Corporation's investments, has built up sufficiently; or
- 4.7.2 a bank's registration as a bank is cancelled for any reason in accordance with the provisions of the Banks Act 94 of 1990 (Banks Act).
- 4.8 Banks however suggested that the loan must have a firm maturity/repayment date or at least an annual repricing date. The Corporation will consider this proposal when finalising the contractual agreements with the banks.
- 4.9 The draft terms and conditions for the liquidity tier have been consulted with banks and updated to reflect the latest policy proposals. These terms and conditions, together with an indication of whether they will be included in the standard or the contractual agreements with the banks, are attached hereto as Appendix A.

5 Use of the liquidity tier to reimburse covered depositors

- 5.1 When the chosen resolution strategy for a bank in resolution is to reimburse its covered depositors, the Corporation will liquidate a portion of the DIF's investment portfolio to fund the reimbursement.
- 5.2 A reimbursement will be funded as follows:
 - 5.2.1 The liquidity tier standard and the contractual agreements between the Corporation and the banks will specify that, when a bank fails, its loan will be set-off against the amount the Corporation uses to pay out the bank's depositors. The Corporation's claim on the estate of the failed bank will be the amount it paid out, net of the failed bank's loan.
 - 5.2.2 The remainder of the funds for the reimbursement will come from the DIF, comprising the liquidity tier (i.e., loans from the other banks) and the DIF's own funds.
 - 5.2.3 Should the Corporation need more funds after depleting the DIF, it will obtain additional (emergency) funds from the SARB.

- 5.3 The SARB has agreed to guarantee the loans of banks to the Corporation to lower the risk-weighting and regulatory capital banks will have to hold against their loans to the Corporation for regulatory reporting to the PA. In terms of the contractual loan agreements with the banks, the Corporation will still owe the remaining banks their full loan amount while awaiting recoveries.
- 5.4 Example 1 demonstrates the use of this order in a reimbursement scenario.

Example 1: Example of the use of the DIF for reimbursement	
This fictional ¹ example illustrates how the Corporation will use the DIF for reimbursement. Assume Bank A fails, and the reimbursement of its covered depositors requires the use of all the tiers of the Corporation's funding model.	
	R'000
Total covered deposits	R 707 078 186
Equity tier premium %	0.20%
The net return earned by Corporation ² %	1.00%
Liquidity tier %	3.00%
When Bank A is placed into resolution, Corporation has the following funding available:	
	R'000
Total covered deposits	R 707 078 186
Total in the DIFs equity tier (collected as premiums)	R 1 414 156
DIF liquidity tier loans	R 21 212 346
DIF's net investment returns	R 311 043
DIF available for reimbursement	R 22 937 545
The following table shows that the failure of Bank A requires the Corporation to use the full DIF to pay out the covered deposits. The Corporation must access emergency funding from the SARB to have sufficient funds for the reimbursement.	

Although the Corporation will use its entire investment portfolio for reimbursement, the remaining banks' loan agreements remain intact in terms of the contractual loan agreement entered into with the banks. After the reimbursement, the Corporation awaits the liquidation proceeds from the estate of the failed Bank A.

Failure of Bank A	R'000
Bank A's covered deposits	R 27 894 522
Pay-out required	R 27 894 522
Bank A's contribution to the liquidity tier (forfeited)	R 836 836
A portion of the DIF liquidated	R 22 100 710
SARB emergency funding	R 4 957 977

¹This fictional example illustrates the use of all the funding tiers, but the need for SARB emergency funding is expected to be a rare exception.

²Section 166AD of the FSRA: Corporation substituted for a depositor in respect of claims.

6 Objectives of the proposed fund liquidity standard

6.1 According to the FSRA⁵, the Corporation must specify the minimum amount that members of the Corporation that hold covered deposits must maintain in the account of the DIF. The draft fund liquidity standard sets out the proposed requirements.

7 Statement of the need — context and definition of the policy problem

7.1 In terms of the FSRA, the Corporation's objective, is to support the SARB in fulfilling its objective of, and responsibility for, protecting and enhancing financial stability. To fulfil this objective, one of the Corporation's functions will be to establish, maintain and administer the DIF in the interest of the holders of covered deposits.

⁵ Section 166BH of the FSRA: Fund liquidity

- 7.2 The Corporation must have adequate funds readily available to give covered depositors access to their funds should the SARB, as the Resolution Authority (RA), place a bank in resolution and require funding from the Corporation.
- 7.3 Funding arrangements are important for the success of any DIS. According to the core principles, member banks should pay for the costs of deposit insurance since they and their clients directly benefit from having an effective DIS. Most DISs typically build a fund over a few years to a targeted size through the collection of premiums from banks.
- 7.4 The establishment of a pre-funded DIF can contribute to public confidence in the DIS if depositors know that funds are available for reimbursement, the DIF is well-managed and the uses of the DIF are clearly defined and limited in law.
- 7.5 The funding model proposed for South Africa is designed to ensure that the Corporation has adequate funds readily available to fulfil its obligations in a bank's resolution while reducing the direct financial impact of the Corporation's funding requirements on banks.

8 Statement of expected impact – mitigations and benefits of proposed fund liquidity standard

8.1 This section of the statement analyses the impact, and mitigations around the costs and benefits of the fund liquidity standard. A survey was distributed to the industry, and responses have been analysed and incorporated into this statement of expected impact.

8.2 Financial impact

8.2.1 On 3 September 2021, the Corporation distributed a deposit insurance survey (the survey) to banks. One purpose of the survey was to obtain estimates of banks' covered deposit balances. The Corporation will calculate a bank's financial contributions to the Corporation, including its fund liquidity tier loan amount, using the bank's monthly covered deposit balance.

Table 1: The fund liquidity tier contributions to the DIF by type of bank

R'000	Commercial banks	Mutual banks	Co-operative banks	Local branches	Total for the industry
Covered deposit balance	590,292,340	578,157	2,834,847	19,940,301	613,645,645
Liquidity tier (contribution)	17,746,700	17,345	85,042	560,280	18,409,369

Source: SARB (2022), extracted from the results of the deposit insurance survey

8.2.2 The PA is of the view that entering into a loan agreement with the Corporation to comply with the requirements of the fund liquidity standard will result in administrative costs on the members of the Corporation, however, this is not expected to be significant as banks grant loans to individuals and businesses daily, as part of their business.

8.2.3 Banks may need to make systems changes to provide the Corporation with their covered deposit balances, used for calculating a bank's financial contributions to the Corporation.

8.3 Money market liquidity impact

8.3.1 When the Corporation becomes operational, expected by 1 April 2024, approximately R18.6 billion will flow from banks to the Corporation's DIF which may only have a temporary impact on the liquidity in the money market as the DIF may be invested back in the market in suitable investment products. The Corporation will consider mitigants to this impact and the impact on money market liquidity during a bank failure and depositor payout nearer to the effective date of the draft standard.

8.4 Regulatory reporting impact

8.4.1 The loans from the banks to the Corporation for the liquidity tier will have a regulatory reporting impact from, at least, a credit and a liquidity risk perspective.

8.4.2 During the consultation process, banks wanted clarity on the regulatory treatment of the liquidity tier concerning the following:

- a) regulatory capital requirements because of the credit risk-weighting of the loans to the Corporation;
- b) liquidity coverage ratio (LCR) and net stable funding ratio (NSFR); and
- c) whether the asset will be considered a high-quality liquid asset (HQLA).

8.4.3 As part of the deposit insurance survey, banks had to submit information to allow the PA to determine the impact of the fund liquidity tier on the LCR and NSFR. The PA is working towards determining the regulatory treatment of the liquidity tier.

8.5 Mitigations around costs

8.5.1 The Corporation has developed a unique funding model aimed at reducing the burden on the banking sector. The fund liquidity tier requirement specifically reduces the direct impact of the Corporation's funding requirements on banks' profitability by allowing a portion of their funding contributions to be accounted for as an asset on their balance sheets. The previous funding proposal was based on a reliance on premiums, which was in line with DISs in other jurisdictions, but would have resulted in a direct expense through banks' income statements.

8.5.2 In terms of section 166BH(2) of the FSRA, the Corporation will pay interest to banks on their fund liquidity contributions. Once the Committee has been established and its board has finalised the investment mandate, the Corporation will determine the interest rate payable to banks. This will offset some of the banks' loan costs.

8.5.3 Banks' loans will be rolled and adjusted according to their covered deposit balances. If a bank did not report covered deposits in its deposit insurance submission, no amount will be required in the liquidity tier. A decrease in the covered deposit balance will result in the Corporation refunding the bank with the difference.

8.5.4 The SARB has agreed to guarantee the loans that banks will place with the Corporation for the liquidity tier of the DIF to reduce the risk-weighting of banks' loans to the Corporation for regulatory reporting purposes and, subsequently,

the regulatory capital that banks will have to hold against it. The risk-weighting of the loans with the Corporation will depend on whether the bank uses the standardised approach for credit risk reporting to the PA or the foundation or advanced internal-ratings-based approaches.

8.6 **Benefits of the proposed standard**

8.6.1 The fund liquidity tier will be the biggest component of the DIF. It will give the Corporation a sizeable amount (approximately R18,4 billion) in the DIF from its date of operationalisation, meaning the Corporation will immediately have the funds to give depositors access to their funds when their bank is placed into resolution.

8.6.2 When the Corporation gives covered depositors access to their funds when a bank has been placed in resolution, the Corporation will liquidate a portion of the DIF's investment portfolio to fund the resolution strategy. The Corporation will set-off the loan from the failing bank against the funds it uses, resulting in the failing bank bearing the first loss. The remainder of the funds provided in support of the resolution strategy will come from the DIF, comprising the liquidity tier and the DIF's own funds. In terms of the contractual loan agreement entered into with the banks, the Corporation will still owe the remaining banks their full loan amount while awaiting recoveries after supporting a resolution.

8.6.3 In terms of the FSRA, the Corporation may assume and exercise the rights and remedies of the covered depositors against the bank to the extent of the payment made from the DIF. When the Corporation uses the DIF to give covered depositors access to their funds when a bank has been placed in resolution and liquidated, the Corporation will take the covered depositors' place in the creditor hierarchy⁶ in the liquidation process. The standard and the contractual agreements between the Corporation and the banks will specify that when a bank has been placed in resolution, its loan will be set-off against the amount the Corporation uses to give the bank's covered depositors access to their funds. In a reimbursement scenario, the Corporation's claim on the estate of the bank in resolution will be the amount it paid out, net of the failed bank's

⁶ Contained in the Insolvency Act 24 of 1936 and in section 166W of the FSRA.

loan. This reduces the Corporation's claim against the estate of the failed bank and possible losses from recoveries.

9 Statement of intended operation

- 9.1 The fund liquidity standard is intended to become effective on 1 April 2024 when the Corporation becomes operational⁷. The fund liquidity standard applies to all the banks and branches registered in terms of the Banks Act, Mutual Banks Act 124 of 1993 and the Co-operative Banks Act 40 of 2007. This includes banks and branches operating within the borders of South Africa that are regulated and supervised by the PA as a home or host supervisor.
- 9.2 Following the implementation of the fund liquidity standard, the PA will assess and evaluate the effect of the standard continuously as part of the regulators' supervisory responsibility to ensure that any unintended consequences of the standard on the industry are adequately addressed.

10 Conclusion

The draft fund liquidity standard and this statement are prepared and published in terms of section 98 of the FSRA, taking into consideration all submissions received during the consultation processes of the discussion papers, the quarterly BASA DIS task group meetings, the ad hoc accounting sub-group meetings as well as the deposit insurance survey results.

⁷ The Corporation will only become operational once its secondary legislation has been promulgated.

Appendix A: Draft terms and conditions for the fund liquidity tier

The following is an extract from the Financial Sector Regulation Act 9 of 2017 (FSRA):

Fund liquidity

Section 166BH:

(1) Members of the Corporation for Deposit Insurance (the Corporation) that hold covered deposits must maintain a minimum amount in the account of the DIF⁸ as specified by the Corporation in a standard.

(2) The Corporation must pay interest to members on the amount referred to in subsection (1), which interest must be specified in the standard.

Draft terms and conditions

Table 1 below contains the draft terms and conditions for the fund liquidity tier, together with an indication of their inclusion in either the standard or contractual agreements between the Corporation and its members.

Table 2: Draft terms and conditions for the fund liquidity tier

	Proposed condition/terms	Standard	Contractual
Transfer, maintenance, and calculation of minimum amount			
1.	A bank must grant a loan to the Corporation under a standardised contract, developed and managed by the Corporation, for its fund liquidity contribution for as long as it is required by the Corporation.	X	
2.	Where applicable, banks whose banking activity must comply with Sharia law and its practical application must enter into transactions with the Corporation the characteristics of which are	X	

⁸ Means the Deposit Insurance Fund established by section 166BD of the FSRA.

	comparable with those of the loans specified in paragraph (1).		
3.	The Corporation will determine the size of the fund liquidity on an annual basis by no later than 28 February of each year as a percentage of total covered deposits held by banks.	X	
4.	The percentage determined by the Corporation must be published on the Reserve Bank's website and will take effect on a date determined by the Corporation.	X	
5.	<p>The minimum amount to be maintained by each member in the account of the DIF will be calculated monthly, as follows:</p> <p>P x A where:</p> <p>P = percentage of total covered deposits held by banks in the account of the DIF as determined by the Corporation and published on the Reserve Bank's website; and</p> <p>A = member's total covered deposits as reported at the last reporting date.</p> <p><i>(Consultation comment: The amount will be linked to an external input. This will need to be clearly defined in the contract. Growth in covered deposit balances will require the bank to disburse additional funds whereas reductions in balances or a change in the percentage (P) will require the Corporation to repay part of the loan.)</i></p>	X	X – Contract to refer to the standard
6.	<p>The minimum amount to be held by each member must be transferred to the account of the DIF on the date specified by the Corporation.</p> <p><i>(Consultation comment: Numbers 6, 7 and 8 should be in the contract as well as this will be disbursement dates/prepayment dates (where required).)</i></p>	X	X

7.	<p>Member's funds held in the account of the DIF must be rolled and adjusted monthly with changes in the bank's total covered deposits.</p> <p><i>(Consultation comment: The loan in respect of the liquidity tier is linked to the bank's cover pool which is expected to increase (on balance). As such the legal terms of the loan will be quite bespoke in that the bank will be required to "top-up" the loan in relation to its obligation each month. The legal terms governing this process needs to be carefully worded to ensure we have the correct treatment.)</i></p>	X	X
8.	<p>The Corporation will:</p> <ul style="list-style-type: none"> (a) calculate a bank's monthly fund liquidity contribution adjustment based on the total covered deposits submitted to it by the bank; and (b) issue a statement to the bank for the fund liquidity contribution adjustment by the end of the month following the month to which the submission relates. 	X	X
9.	<p>If a member's total covered deposits decreased from one month to the next, the member must pay its fund liquidity contribution adjustment to the Corporation by no later than the end of the month following the month when the statement issued.</p>	X	X
10.	<p>If a member's total covered deposits decreased from one month to the next, the Corporation must refund the member with the difference by no later than the end of the month following the month when the statement was issued.</p>	X	X
Interest			
11.	<p>The Corporation will pay interest or profit-share to members on the amount held in the DIF in terms of</p>	X	

	section 166BH(1) of the FSRA for as long as the funds are maintained in the account of the DIF.		
12.	The Corporation will determine the interest or profit-share payable to members based on methodology approved by the Corporation's Investment Committee and specify the interest rate in the contractual loan agreement.	X – General principle	X – Percentage itself
13.	Interest earned by members will not be set-off against fund adjustments.		X
Use of the funds			
14.	If a member is placed in resolution, the Corporation will set-off the member in resolution's fund liquidity contribution against the funds used to reimburse the member's depositors in respect of their covered deposits.	X	X
15.	The Corporation will claim the amount paid out of the DIF to the depositors of the member in resolution, less the member in resolution's fund liquidity contribution, from the estate of the member in accordance with section 166AD of the Act.	X	X
16.	Where requested by the Resolution Authority, the Corporation may set-off a member in resolution's fund liquidity contribution against the funds used to support a non-payout resolution strategy.	X	X
17.	If the Corporation did set-off a member in resolution's fund liquidity contribution against the funds used to support a non-payout resolution strategy, the Corporation will subsequently claim the amount contributed from the DIF, less the member in resolution's fund liquidity contribution, from the estate of the member in resolution in accordance with section 166AD of the Act.	X	X
18.	The funds held in the account of the DIF in terms of section 166BH of the FSRA may be used for liquidity purposes where the funds must be used to reimburse the covered depositors of the member in resolution or where the Corporation is requested to		X

	support a non-payout resolution strategy. Repayment of a particular member's funds will be guaranteed in terms of another agreement between the member and the SARB.		
Fund adjustments, non-payment, and repayment			
19.	The loan must be maintained for as long as a bank remains a member of the Corporation or until no longer required by the Corporation.	X	
20.	If a member fails to pay its loan adjustments to the Corporation within 30 days after the Corporation issued a statement, it will be considered as non-compliance with the provisions of the standard.	X	
21.	The Corporation will gradually repay a loan granted by a member to the Corporation for its fund liquidity contribution in line with the build-up of the DIF and in accordance with the terms specified in the contractual loan agreement.	X	
22.	<p>The loan must be repaid by the Corporation, gradually or in full, at the earlier of:</p> <ul style="list-style-type: none"> i. a decision by the board to repay the loan when the DIF's own funds, collected as deposit insurance premiums as envisaged in section 166BG of the FSRA and income on the investments made with the money of the DIF, has built up sufficiently; or ii. a member bank's registration as a bank is cancelled for any reason, in accordance with the provisions of the Banks Act 94 of 1990. <p>(Consultation comments:</p> <ul style="list-style-type: none"> • <i>Typically, a loan will have a firm maturity/repayment date or at least an annual repricing date.</i> • <i>Clarification/tweaking is necessary in that the loan should have some termination date with renewal options.</i> • <i>Where a bank ceases to be a member, the loan becomes immediately due and</i> 		X

	<i>payable as long as no covered deposits remain.))</i>		
23.	The Corporation may, at any stage, repay the loan when the DIF's own funds, collected as deposit insurance premiums as envisaged in section 166BG of the FSRA and income on the investments made with the money of the DIF, has built up sufficiently.		X
Inability to comply			
24.	If a member fails to comply with the provisions of section 166BH(1) of the FSRA or is unable to comply with any such provision or the standard, it must, in writing, report its failure or inability to the Corporation and the Prudential Authority, stating the reasons for such failure or inability and request more time to become compliant.	X	
25.	The Prudential Authority may, with the concurrence of the Corporation and in accordance with section 279 of the FSRA, afford the bank more time to comply with the relevant requirements, subject to conditions specified by the Corporation.	X	
26.	The Prudential Authority may, with the concurrence of the Corporation, and in accordance with section 281 of the FSRA, exempt the member from complying with section 166BH(1) of the FSRA's requirement to maintain a minimum amount in the account of the DIF in respect of a particular reporting period.	X	
27.	When a member continually fails to comply with the requirements of the standard, the Corporation may consider imposing an administrative penalty on the bank, through the Prudential Authority, in accordance with section 167 of the FSRA.	X	

Additional conditions to include because of consultation with banks			
28.	Arrear interest payable by the Corporation where repayment is not made in terms of the agreement or where the bank returned its banking license and the amount due from the Corporation is not received on time.		X