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SOUTH AFRICAN RESERVE BANK
Prudential Authority

Prudential Communication 18 of 2023

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

Notice of invitation to comment – Draft Prudential Standard RA03 – Flac Instrument Requirements for Designated Institutions

Objective of this Prudential Communication

This communication relates to the provisions of section 98 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act) which requires the Prudential Authority in terms of the process for making regulatory instruments, such as a Prudential Standard, to publish a notice inviting submissions in relation to the regulatory instrument as well as the other documentation stipulated herein.

1. Application

1.1 This Prudential Communication is applicable to all interested persons.

2. Purpose

2.1 This Prudential Communication serves to fulfil the requirements of section 98 of the FSR Act. In terms of the process for making regulatory instruments, the Prudential Authority is required to publish documentation stipulated herein as well as a notice inviting submissions in relation to the regulatory instrument and stating where, how and by when submissions are to be made.

3. Notice of invitation for comment

3.1 The Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes) set out the core elements that the Financial Stability Board (FSB) considers necessary for an effective resolution regime.

3.2 The overarching objective of these core elements is to enable an orderly resolution that minimises impact on financial stability and avoids exposing taxpayers to loss, while ensuring the continuity of critical functions.

3.3 One of the tools that can be used to achieve this core objective includes the requirement for designated institutions (DIs) to have adequate loss absorption and recapitalisation capacity. This capacity enables the DIs to absorb losses and be recapitalised in resolution using resources from within the DI (through the write-off and/or conversion of shareholders and creditors claims) instead of relying on public funds. This tool is a statutory bail-in process that respects the creditor hierarchy.

- 3.4 The power to perform a bail-in extends to all liabilities (including depositors and operational creditors), except those specifically excluded by section 166S(9) of the FSR Act or an instrument issued by the Reserve Bank. Therefore, to mitigate the potential negative effects and systemic risk that could be posed by such a bail-in, the FSR Act introduces a new class of instruments, termed Flac instruments.
- 3.5 In terms of the creditor hierarchy in the Insolvency Act, as amended by the Financial Sector Laws Amendment Act of 2021, these instruments will rank senior to shareholders' equity and other regulatory capital instruments but subordinated to other unsecured liabilities.
- 3.6 The purpose of the draft Prudential Standard is to set out the following:
- 3.6.1 the qualifying criteria for Flac instruments to ensure that they are available for bail-in during a resolution; and
- 3.6.2 the quantum of Flac instruments (and other eligible instruments) that DIs are required to build-up, to ensure sufficient loss absorption and recapitalisation capacity. In terms of the creditor hierarchy in the Insolvency Act, as amended by the Financial Sector Laws Amendment Act of 2021, these instruments will rank senior to shareholders' equity and other regulatory capital instruments but subordinated to other unsecured liabilities.
- 3.7 In consideration of the aforementioned, the PA publishes the following documentation in accordance with the requirements of section 98 of the FSR Act:
- 3.7.1 Annexure A – the draft Prudential Standard on Flac;
- 3.7.2 Annexure B – the Statement of Need, Intended Operation and Expected impact;
- 3.7.3 Annexure C – Guidance Notice providing guidance on the calculations set out in the Draft Prudential Standard on Flac; and
- 3.7.4 Annexure D – Comments template.

4. Submission requirements

- 4.1 Comments and any enquiries on the aforementioned documentation must be made using the Comments Template and submitted for the attention of Ms Linah Masoha or Mr Jacques Botes on or before 19 February 2024, at the following email address FST-RPD@resbank.co.za.

Fundi Tshazibana
Chief Executive Officer

Date: