



SOUTH AFRICAN RESERVE BANK  
Prudential Authority

## **DRAFT FOR CONSULTATION**

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

#### **Prudential Standard RA03 - Flac Instrument Requirements for Designated Institutions**

##### ***Objectives and key requirements of this Standard***

*This Standard sets out the principles and requirements for loss absorption and recapitalisation capacity, which must be complied with by the relevant designated institutions, in line with sound principles, practices and processes for the orderly resolution of a designated institution.*

*This Standard gives effect to the objective(s) and requirements of the Financial Sector Regulation, 2017 (Act No. 9 of 2017) relating to Flac instruments.*

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## 1 Commencement

1.1 This Standard comes into effect on 1 January 2025.

Version number	Commencement date
01	1 January 2025

## 2 Legislative authority

2.1 This Standard is made under section 105(2)(c) read with section 30(1A) of the Act.

## 3 Definitions and interpretation

3.1 In this Standard, **‘the Act’** means the Financial Sector Regulations Act, 2017 (Act No. 9 of 2017) as amended by Financial Sector Laws Amendment Act, 2021 (Act No.23 of 2021) and any word or expression to which a meaning has been assigned bears the meaning so assigned to it by the Act unless the context indicates otherwise -

**‘additional Flac requirement’** refers to the additional amount of Flac instruments (or other qualifying instruments) to be held over and above the minimum Flac requirement, in terms of this Standard or a Determination issued by the Prudential Authority or the Reserve Bank;

**‘bail-in’** refers to a resolution action taken by the Reserve Bank, in terms section 166S and section 166T of the Act, that results in the value of instruments and/or claims held by shareholders and creditors of the designated institution reduced, and/or the cancellation of instruments held by shareholders (without value);

**‘bail-in playbook’** refers to an operational document compiled by the designated institution, to document the relevant processes (including governance processes) that demonstrate the ability of their operations to support a bail-in;

**‘Banks Act’** refers to the Banks Act, 1990 (Act Non.94 of 1990);

**‘bank’s capital adequacy legislation’** refers to the Regulations relating to Banks or prudential standards that deal with the minimum capital and reserve funds (hereafter referred to as a bank’s capital adequacy), read with the relevant directives or determinations as may be issued from time to time;

**‘base Flac requirement’** refers to the required minimum amount of Flac instruments or other qualifying instruments, to be held by all the relevant designated institutions;

**‘board’** means board of directors;

**‘core business lines’** means business lines and associated services which represent material sources of revenue or profit and are essential for the overall sustainability of the designated institution;

**‘excess regulatory capital’** refers to the difference between the total minimum required amount of capital and reserve funds including countercyclical, conservation and Domestic Systemically Important Bank (DSIB) buffers) and the total qualifying amount of capital and reserve funds as specified in the bank’s capital adequacy legislation;

**‘external Flac instruments’** refers to Flac instruments that are issued by the holding company of the designated institution, to external counterparties, outside the group of which the designated institution is a member;

**‘Flac instruments’** refers to unsecured debt instruments issued by a designated institution or its holding company that meet the requirements set out in paragraph 8 of this Standard in line with section 30(1A) of the Act;

**‘holding company’** means a holding company as defined in terms of section 1 of the Companies Act, 2008 (Act No.71 of 2008);

**‘Insolvency Act’** means the Insolvency Act, 1936 (Act No.24 1936);

**‘internal Flac instruments’** refers to Flac instruments that are issued by a designated institution to its holding company;

**‘loss-absorbing capacity’** refers to the eligible instruments, minimum regulatory capital and instruments that otherwise qualify as regulatory capital held by designated institutions that are able to absorb losses in resolution;

**‘market confidence premium’** refers to an additional Flac requirement that a designated institution will need to hold to provide confidence to the market that it will continue to operate as a going concern after resolution;

**‘minimum capital adequacy requirement’** refers to the minimum required amount of capital and reserve funds (prior to buffers) as specified in the bank’s capital adequacy legislation. This is also known as the South African minima (prudential minima);

**‘minimum Flac requirement’** refers to the base Flac requirement plus the additional Flac requirement;

**‘netting arrangement’** refers to an arrangement in terms of an agreement entered into by the designated institution under which a number of claims or obligations can be converted into a single net claim or obligation;

**‘other qualifying instruments’** refers to the excess regulatory capital instruments, that designated institutions are allowed to use in addition to the minimum Flac instrument issuance requirement, in order to meet the minimum Flac requirement;

**‘pillar 2A’** refers to the capital requirement for systemic risk (systemic risk add-on (Pillar 2A)) as specified in the bank’s capital adequacy legislation;

**‘pillar 2B’** refers to the capital requirement for idiosyncratic risk as specified in the bank’s capital adequacy legislation. This capital requirement is often referred to as the bank-specific individual capital requirement (ICR);

**‘point of resolution’** means the point at which the Minister of Finance makes a determination to place a designated institution into resolution as per section 166J of the Act;

**‘post-resolution or post-loss balance sheet’** means the designated institution’s balance sheet calculated by deducting the losses incurred (before and in resolution) from its assets, according to the risk weights assigned to the relevant assets in terms of the bank’s capital adequacy legislation;

**‘recapitalisation capacity’** refers to eligible instruments, regulatory capital and instruments that otherwise qualify as regulatory capital held by a designated institution that can be utilised during a resolution to recapitalise the designated institution;

**‘regulatory capital buffers’** refer to the capital buffers as specified in the bank’s capital adequacy legislation, which include the conservation buffer, countercyclical buffer and the D-SIB buffer;

**‘Reserve Bank’** means the South African Reserve Bank in its capacity as the resolution authority in terms of section 166A of the Act;

**‘resolvability rebate’** refers to a deduction that the Reserve Bank may consider to be applied against an additional Flac requirement, as a result of designated institutions removing barriers to resolvability (in line with the RAP), which may improve their probability to exit resolution and continue as a going concern;

**‘RAP’** means resolvability assessment process which refers to the process to be conducted by the Reserve Bank to assess the capability and/or capacity of a designated institution to be resolved in a manner that supports an orderly resolution in line with the resolution strategy determined by the Reserve Bank;

**‘risk-weighted exposures’** refer to the designated institution’s risk-weighted exposures calculated in terms of the bank’s capital adequacy legislation;

**‘SIFI’** means a systemically important financial institution as designated by the Governor in terms of section 29 of the Act;

**‘total loss absorbing capacity’** refers to the sum of the minimum required amount of capital and reserve funds (prior to buffers) and the minimum Flac requirement, used for loss absorption and recapitalisation capacity; and

**‘total minimum required amount of capital and reserve funds’** refers to the total capital requirements including the regulatory buffers (countercyclical, conservation and DSIB buffers) as specified in the bank’s capital adequacy legislation.

## **4 Roles and responsibilities**

- 4.1 The board is ultimately responsible for ensuring that, on a continuous basis, the designated institution has adequate measures in place to facilitate compliance with the requirements set out in this Standard and demonstrate the required capabilities.

## **5 Application**

- 5.1 This Standard applies to banks which have been designated as SIFIs and their holding companies.
- 5.2 Any reference to a designated institution in this Standard, only refers to institutions defined under paragraph 5.1.
- 5.3 This Standard must be read in conjunction with the Act, the Banks Act, other financial sector laws as well as other relevant laws.

## **6 Principles on loss-absorption and recapitalisation in resolution**

- 6.1 A designated institution must have sufficient loss-absorbing and recapitalisation capacity available to implement a resolution strategy that minimises the impact on financial stability, ensures the continuation of critical functions and avoids exposing taxpayers to loss.
- 6.2 To ensure the sufficiency of this loss absorption and recapitalisation capacity, the Act introduces a new class of instruments (unsecured subordinated debt instruments) termed Flac instruments.
- 6.3 These Flac instruments must be readily available for bail-in during resolution.
- 6.4 Statutory bail-in enables the Reserve Bank to perform the following actions, in a manner that respects the creditor hierarchy -
- (a) write-down shareholders' equity and unsecured subordinated debt instruments to the extent necessary to absorb losses; and
  - (b) convert all or parts of unsecured debt instruments into shareholders' equity to recapitalise the designated institution in resolution.

- 6.5 For a designated institution to cease to be in resolution, it must meet the minimum capital adequacy requirements, as stipulated in the bank's capital adequacy legislation and be sufficiently capitalised to restore market confidence.

## **7 Statutory powers**

- 7.1 Section 30(1A) of the Act empowers the Reserve Bank to give either or both of the following directives to the Prudential Authority -

- (a) a directive to make one or more prudential standards that specify the characteristics of Flac; and
- (b) a directive to issue a regulator's directive requiring the designated institution to hold Flac instruments to at least the value specified by the Reserve Bank.

- 7.2 The purpose of this Standard is to set out the requirements for designated institutions to comply with in relation to Flac instruments including the qualifying criteria for these instruments and calibration of the minimum amount of Flac to be held by designated institutions.

## **8 Qualifying criteria for Flac instruments**

- 8.1 Unsecured subordinated debt instruments shall qualify as Flac instruments, provided that they meet the eligibility criteria set out in paragraphs 8.2 to 8.6 below.

- 8.2 To qualify as Flac instruments, the unsecured subordinated debt instruments must meet the following criteria -

- (a) Issuer:
  - (i) external Flac instruments must be issued by the holding company of designated institutions;
  - (ii) internal Flac instruments must be issued by the designated institution to their holding companies, that have issued external Flac instruments;
- (b) funding:

- (i) external Flac instruments must not be funded, fully or partially, by the holding company of the designated institution, or any other entity within the group;
- (ii) internal Flac instruments must be fully funded by the holding company;
- (c) be fully paid;
- (d) be unsecured;
- (e) not be subject to set-off or netting arrangements;
- (f) have a minimum initial maturity of 24 months;
- (g) have a minimum remaining maturity of 12 months;
- (h) set out, in the contractual terms and conditions, the ranking of the instruments in line with the creditor hierarchy provided for in the Insolvency Act;
- (i) not contain any derivative-linked features;
- (j) not allow for early redemption, other than in the manner provided for in paragraph 8.3 below;
- (k) not contain any acceleration clauses in the contractual terms and conditions; and
- (l) be for a sum equal to or more than the prescribed minimum denomination, when converted to South African rands.

8.3 Flac instruments may only be subject to early redemption if -

- (a) the instrument ceases to qualify as a Flac instrument;
- (b) a designated institution obtains the prior written approval of the Reserve Bank -
  - (i) to repurchase any instruments of which the proceeds qualify as Flac instruments;
  - (ii) to repay any proceeds received from the issuance of Flac instruments;

- (iii) to redeem any instrument issuances that qualify as Flac instruments, before maturity thereof.
- (c) a written application in terms of paragraph 8.3(b), for the permission of the Reserve Bank for early redemption, must contain written confirmation by the board that -
  - (i) the remaining Flac instruments will be sufficient to ensure continued compliance with the relevant requirements of this Standard;
  - (ii) the repayment of Flac instruments is -
    - (aa) consistent with the designated institutions resolution strategy; and
    - (bb) takes into account the possible changes in the designated institutions' regulatory capital and Flac instrument requirements.

8.4 Designated institutions must ensure that Flac instruments contain contractual terms that promote the ability of the Reserve Bank to conduct a resolution and for these instruments to be subject to bail-in under South African law.

8.5 External Flac instruments that are issued under foreign law must include provisions that allow for the bail-in of Flac instruments under the SA law.

8.6 Designated institutions must submit the initial terms of these Flac instruments, or any amendments thereto, to the Reserve Bank for approval prior to issuance. The Reserve Bank will need to assess the terms of the Flac instruments to determine whether they meet the minimum requirements. Any subsequent issuance on the approved terms will only require notification to the Reserve Bank prior to issuance.

## **9 Location of Flac instruments**

- 9.1 Designated institutions must ensure that all issuances of Flac instruments to external counterparties are issued by the holding company of the designated institution and all Flac instrument issuances to internal counterparties are issued by the designated institution to the holding company.
- 9.2 Each designated institution that falls within the scope of this Standard must calculate its minimum Flac requirement as set out in paragraph 11, then -
- (a) the holding company must issue the total required Flac instruments, to external counterparties, to meet the sum of these requirements; and
  - (b) the designated institution must issue the required internal Flac instruments, to the holding company, to enable the investment of these Flac instruments from the holding company to the designated institution.
- 9.3 The designated institutions must ensure that the internal Flac instruments referred to in paragraph 9.2(b) above are pre-funded to secure the ex-ante adequacy of loss-absorbing and recapitalisation capacity on the designated institutions' balance sheet, before a resolution scenario.

## **10 General requirements**

- 10.1 Designated institutions must provide counterparties and market participants with sufficient information on the nature and contractual terms of Flac instruments to enable them to make informed decisions on the risk profile of these instruments.
- 10.2 Designated institutions must ensure that their operations will support the bail-in of their Flac instruments in a resolution and document the relevant processes (including governance), in a bail-in playbook.
- 10.3 Designated institutions must update and maintain their management information systems to be able to provide the Reserve Bank with all relevant information regarding all liabilities that may be subject to bail-in.

## **11 Minimum Flac requirement**

- 11.1 Principles for the Minimum Flac Requirement (MFR)

- (a) Designated institutions must maintain a sufficient level of Flac instruments or other qualifying instruments that will be available during resolution for bail-in, to enable the designated institution to be recapitalised to a level that meets its minimum capital adequacy requirement (minCAR) as determined by the Prudential Authority.
- (b) The minCAR comprises of the following elements -
  - (i) the relevant specified base requirement of no less than 8% of the risk-weighted exposures (baseCAR), standard for all banks; plus
  - (ii) the relevant specified Pillar 2A requirement for systemic risk, standard for all banks; and
  - (iii) the relevant specified Pillar 2B requirement for idiosyncratic risk, which is institution specific.
- (c) Designated institutions must increase their ability to obtain funding in the market after resolution, which will require the market to have confidence in the designated institution's ability to continue operating as a going concern. This will attract a market confidence premium (Pm), which will fall within a range of 0-25 percentage points, as determined by the Reserve Bank for each specific designated institution. This Pm will constitute firm-specific, additional Flac above the minCAR.
- (d) Designated institutions must take the steps specified by the Reserve Bank to remove barriers to resolvability, subject to the review in the RAP. The Reserve Bank will consider the resolvability rebate (Rr) of each designated institution as a deduction to the additional Flac, which will fall within a range of 0-15 percentage points.

## 11.2 Calibration of the MFR

- (a) Designated institutions must hold sufficient Flac instruments and other qualifying instruments to meet their MFR which comprises the following two components -
  - (i) the base minimum Flac requirement (bMFR); and

- (ii) the institution-specific, additional Flac requirement (iMFR), as specified by the Reserve Bank.

Therefore  $MFR = bMFR + iMFR$

- (b) The bMFR shall comprise of the components of the minCAR that are standard for all banks (when applicable) which is the baseCAR plus the relevant specified Pillar 2A capital requirements. The bMFR must be calculated using the post-loss balance sheet. Therefore, the post-loss(pr) baseCAR shall be denoted as baseprCAR and the post-loss Pillar 2A shall be denoted as prPillar 2A.

Therefore  $bMFR = baseprCAR + prPillar2A$

Where -

- (i) baseprCAR equals the minimum required percentage of 8% risk-weighted exposures, using a post-loss balance sheet; and
  - (ii) prPillar 2A equals the relevant additional minimum requirement for systemic risk, using a post-loss balance sheet.
- (c) The iMFR shall comprise of the components of the minCAR which are idiosyncratic to the designated institution (which is the relevant specified Pillar 2B requirement) as well as additional Flac. The iMFR must also be calculated using the post-loss balance sheet. Therefore, the post-loss Pillar 2B shall be denoted as prPillar 2B.
  - (d) Additional Flac comprises of the Pm and the Rr, expressed as a percentage of the bMFR plus prPillar 2B (which together form the total minCAR). The sum of the post-loss bMFR plus prPillar 2B is denoted as minprCAR.

Therefore  $iMFR = minprCAR (Pm - Rr) + prPillar2B$

where -

- (i) MinprCAR is the sum of bMFR and prPillar 2B;
- (ii) Pm for each designated institution will range between 0-25 percentage points, as determined by the Reserve Bank;
- (iii) Rr for each designated institution will range between 0-15 percentage points, as determined by the Reserve Bank; and

- (iv) prPillar 2B equals the additional bank-specific minimum requirement for idiosyncratic risk, using a post-loss balance sheet.

### 11.3 Incorporation of losses incurred before and in resolution

- (a) To determine the post-loss balance sheet, losses that may be incurred before and after resolution must be taken into account. Therefore, designated institutions must perform the following -
  - (i) Estimate losses at resolution: assume that the amount it currently holds towards meeting minCAR is equal to the amount of losses it may suffer at the point of resolution and after entering resolution.
  - (ii) Estimate its resolution post-loss (pr) balance sheet: deduct the estimated losses from the relevant asset class according to the current risk weighting assigned to these assets.
  - (iii) The residual values, after taking the losses into account, represents the resolution (post-loss) balance sheet.
  - (iv) Post-loss calculations: using the resolution (post-loss) balance sheet, determine the amount of its baseprCAR, prPillar 2A and prPillar 2B using its current minCAR capital requirements and current risk weightings.

### 11.4 Composition of the Minimum Flac Requirement

- (a) The MFR must comprise of a minimum amount of Flac instrument issuances and excess regulatory capital can be used to contribute to the MFR to top-up the minimum Flac instrument issuances required.
- (b) Flac instrument issuances that contribute to the MFR -
  - (i) must meet the criteria stipulated under paragraph 8 above; and
  - (ii) must, at a minimum, equal one third (33.333%) of the total loss absorbing capital (TLAC) at the end of the phase-in period.

Therefore  $TLAC = minCAR + MFR$

- (c) Designated institutions must apply a corresponding deduction approach to their holdings of Flac instruments (or similar debt instruments) issued by another designated institution (or any other financial institution that is subject to a bail-in regime). That means designated institutions must deduct from their Flac issuances -
  - (i) the relevant amount related to any investment in, or reciprocal cross holding of, instruments that qualify as Flac instruments (or similar debt instruments) issued by another designated institution (or any other financial institution that is subject to a bail-in regime).
- (d) Excess regulatory capital -
  - (i) can be used as a top-up to meet the MFR, after taking into account the minimum Flac instrument issuances required to contribute towards the MFR (as set out in paragraph 11.4(b)(ii) above); and
  - (ii) must absorb losses ahead of Flac issuances in line with the creditor hierarchy envisaged in the Insolvency Act.

#### 11.5 Relationship with regulatory capital requirements

- (a) The MFR is an additional requirement to the MinCAR.
- (b) Any excess regulatory capital used to contribute towards the MFR, must not be used simultaneously to meet the total minimum required amount of capital and reserve funds.

## 12 Governance requirements

- 12.1 A designated institution must have in place clearly defined policies and procedures, documented practices as well as internal system capabilities for monitoring and ensuring compliance with the requirements in this Standard.
- 12.2 These policies, procedures and capabilities must be established as part of resolution planning obligations, irrespective of whether an actual resolution is foreseen, and must be embedded in designated institutions' internal governance framework and risk management processes.

- 12.3 The development, monitoring, review and approval of the requirements set in this Standard, must be subject to an appropriate governance process with clearly assigned roles and responsibilities for operational staff, senior management and the board.

### **13 Compliance requirements**

- 13.1 The Reserve Bank will, on an ongoing basis, assess a designated institution's compliance with the requirements herein and failure by a designated institution to comply with this Standard may result in one or more of the following actions being taken by the PA against such designated institution -
- (a) an increase in a designated institution's Flac instrument requirement;
  - (b) an increase in a designated institution's required regulatory capital;
  - (c) restrictions on distributions as envisaged in the bank's capital adequacy legislation; and
  - (d) any other action that the Reserve Bank or the Prudential Authority may be empowered to take.

### **14 Reporting requirements**

- 14.1 The form, manner and period for regulatory reporting related to this Standard, where such requirements have not been specified in this Standard, will be determined by the Prudential Authority as directed by the Reserve Bank and published on the Prudential Authority's website.
- 14.2 Minimum reporting requirements will include the disclosure of granular information on all liabilities that may be subject to bail-in, according to the creditor hierarchy.
- 14.3 Designated institutions must perform ongoing reviews of information requirements and testing of management information systems to be able to provide the Reserve Bank with all the relevant required information in an accurate and timely manner.

### **15 Transitional arrangements**

- 15.1 The phase-in period for the two components of the MFR will be as follows:

- (a) bMFR will be phased in, from the effective date, as per table A below

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Table A: Phasing in of the bMFR

Effective date	End of year 3	End of year 4	End of year 5	End of year 6
0%	60%	80%	90%	100%

- (i) The composition of the bMFR must reflect the required composition of the MFR. Therefore, the required minimum Flac issuances which contributes to the bMFR, will be phased in, from the effective date, as per table B below -

Table B: Phasing in of the minimum Flac issuances that contribute to the bMFR

Effective date	End of year 3	End of year 4	End of year 5	End of year 6
0%	20%	27%	30%	33.33%

- 15.2 iMFR will be effective and phased in when the RAP for the designated institutions have been performed. The Prudential Authority will communicate the effective date and the phase-in period for this component, as directed by the Reserve Bank.