SOUTH AFRICAN RESERVE BANK
Prudential Authority

Statement of the need for the regulatory instruments, their expected impact and intended operation*

Draft Prudential Standard RA-04: Requirements for Valuators Appointed for Resolution Purposes

[Month Year]

(DRAFT)

* This statement is prepared and published in accordance with, and in fulfilment of, the requirements under sections 98 and 103 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017).

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1. Introduction

1.1 The Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (the Act), as amended by the Financial Sector Laws Amendment Act, 2021 (Act No. 23 of 2021), establishes the South African Reserve Bank (Reserve Bank) as the Resolution Authority (RA). The Act confers the necessary resolution functions and powers to the Reserve Bank. In performing its resolution functions, the Reserve Bank assists in maintaining financial stability and protecting the interests of depositors of banks through the orderly resolution of designated institutions.

1.2 As part of the resolution measures, before it takes a resolution action, the Reserve Bank must obtain a valuation of the assets and liabilities of the designated institution. The valuation must state the amount that would be realised from the assets and the amount that would be payable on the liabilities in a winding up of the designated institution. The purpose of the valuation is to comply with the requirements of section 166Q of the Act and to assist the Reserve Bank in deciding on the appropriate resolution action.

1.3 Once a designated institution ceases to be in resolution, the Reserve Bank must also obtain a valuation of the assets and liabilities that were dealt with in the resolution action.

1.4 Section 166Q of the Act requires that the Reserve Bank specifies assumptions that the valuator must make in conducting the valuation.

1.5 In addition, section 30(1A) read with section 166Q(4) of the Act states that the requirements for the valuator and for conducting a valuation in terms of section 166Q must be prescribed in a Prudential Standard. Accordingly, the draft Prudential Standard sets out these requirements. The requirements for a valuation conducted for resolution purposes is placed on the valuator in the event of a resolution. The draft Prudential Standard sets out the requirements for the valuator to conduct the valuation in a manner that is accurate, complete and timely.

1.6 In line with the requirements of section 98 of the Act that deals with the process of making Standards, the Prudential Authority (PA) in collaboration with the Reserve Bank in its capacity as the Resolution Authority, has prepared this statement that outlines the need for this Prudential Standard, its intended operation and the impact of the Prudential Standard being proposed.

1.7 In terms of section 98 of the FSR Act, a financial sector regulator must not make a regulatory instrument unless it has published the following documents:

(i) a draft of the regulatory instrument;

(ii) a statement explaining the need for and the intended operation of the regulatory instrument;

(iii) a statement of the expected impact of the regulatory instrument; and

(iv) a notice inviting submissions in relation to the regulatory instrument, stating where, how and by when submissions are to be made.

1.8 In fulfilment of the above-mentioned requirements, the Reserve Bank has prepared a statement of the need for, intended operation and expected impact of the draft Prudential Standard Resolution Valuation Requirements for Designated Institutions (the Statement). This statement is intended to communicate to all relevant stakeholders the policy context and intended application of the draft Prudential Standard, and to assist valuators in complying with the Prudential Standard.

2. Statement of need

2.1 Section 166Q of the Act requires the Reserve Bank to obtain a valuation of the assets and liabilities of a designated institution before taking certain resolution actions and the draft Prudential Standard is proposed as a regulatory instrument to give effect to the provisions of section 166Q of the Act.

2.2 The draft Prudential Standard provides the requirements for valuators to prepare a valuation of assets and/or liabilities of a designated institution.

2.3 In the absence of the draft Prudential Standard, the Reserve Bank will be unable to take resolution actions, which may, in turn, result in losses to creditors, shareholders and depositors, as well as spillover effects to the rest of the financial sector, causing harm to the financial system.

2.4 The draft Prudential Standard gives effect to the principles contained in the FSR Act by setting out the arrangements and capabilities that valuators will be required to adhere to, to enable the Reserve Bank to obtain valuations of assets and liabilities of a designated institution. Section 166Q of the Act requires that a valuation be conducted for resolution purposes.

2.5 The valuator is responsible for ensuring compliance with the requirements set out in this Standard. The valuator is also responsible for providing accurate, valid, complete and timely valuations in writing upon the written request of the Reserve Bank.

2.6 As a member of the G20, South Africa committed to implementing the Financial Stability Board's Key Attributes of effective resolution regimes (Key Attributes). The draft Prudential Standard would ensure that resolution valuations conducted in relation to designated institutions are appropriately regulated and that the financial stability risk is mitigated.

3. Objective of the draft Prudential Standard

3.1 The objective of the draft Prudential Standard is to give effect to the requirements in section 166Q of the Act. The purpose of a valuation is to obtain a valuation of the assets and liabilities of a designated institution prior to the Reserve Bank taking any resolution action and after a resolution has been completed. A valuation enables the Reserve Bank to execute orderly resolution, therefore the draft Prudential Standard setting requirements for valuators appointed for resolution purposes is proposed. In developing the draft Prudential Standard, the

Key Attributes, other publications and guidance documents were considered. Further considerations were jurisdictions with advanced resolution frameworks.

3.2 The Draft Prudential Standard is intended to address the following—

(i) general matters to be considered by the valuator;
(ii) valuation assumptions provided by the Reserve Bank;
(iii) valuation models, ranges and buffers;
(iv) factors that may affect valuation;
(v) treatment of creditors and shareholders;
(vi) valuation requirements in the event of bail-in; and
(vii) valuation requirements for establishing a bridge institution

3.3 The Draft Standard expands on the South Africa's resolution framework to enhance resolvability of designated institutions.

3.4 The draft Prudential Standard, as required by the Act, outlines requirements for valuators conducting valuations for resolution purposes.

4. Statement of intended operation

4.1 The draft Prudential Standard RA-04 applies to valuators appointed for resolution purposes

4.2 The Prudential Standard is being processed as a regulatory instrument in terms of section 98 of the Act. It is anticipated that the Standard will come into effect as soon as all the processes required for making regulatory instruments have been completed.

4.3 The form, manner and period for reporting in terms of this Standard will be determined by the Prudential Authority as directed by the Reserve Bank.

5. Statement of impact — costs and benefits of implementing the framework

5.1 The PA published the 'Draft Prudential Standard on Requirements for Valuators Appointed for Resolution Purposes' for public comment, together with a questionnaire to assess the expected impact of the draft Prudential Standard. The draft Prudential Standard with related documentation allowed for a period of 6 weeks to submit comments

5.2 A total of 55 (fifty-five) comments were received from the Banking Association of South Africa (BASA) and the JSE Group. The comments related to concerns over skills shortages and a lack of independence of potential valuators. Further concerns were raised regarding the availability of a local pool of valuators. Commentators also raised the need for further guidance on clear, practical independence criteria. They further raised the need for recognition of specialist expertise, as well as practical implementation challenges. Suggestions for phased implementation and clear guidance were also raised.

5.3 In the context, the PA and the Reserve Bank are of the view that the overall impact would not significantly hinder the ability of valuators to comply with the requirements of the draft Prudential Standard. In addition, the PA and the Reserve Bank are of the view that any potential additional costs are justified in order to comply with the Act, to ensure orderly resolution of designated institutions and to fulfil the financial stability mandate of the Reserve Bank.

5.4 The Standard is intended to ensure that, in the event of resolution of a designated institution, the valuation of assets and liabilities is credible and support the Reserve Bank to undertake an orderly resolution. The draft Prudential Standard implements the Key Attributes, which call for clear requirements on valuations to support resolution, safeguarding creditors' rights and ensure fair treatment of shareholders and creditors. This Prudential Standard is designed to meet the principles contained in the Key Attributes.

5.5 The absence of this Prudential Standard may pose a risk to financial stability. If the Reserve Bank is unable to take adequate measures in a timely manner,

this may have a negative impact on financial stability as outlined in section 6 below.

5.6 The Prudential Standard sets out the key requirements and factors that need to be considered when conducting valuations for resolution purposes.

6. Motivation for proposal to issue the draft Prudential Standard

6.1 Section 166Q of the Act requires the Reserve Bank to obtain a valuation before taking certain resolution actions and the Prudential Standard is proposed as a regulatory instrument to fulfil this requirement.

6.2 The current absence of this Standard pose prejudice to financial customers as it hampers the Reserve Bank's ability to conduct orderly resolutions.

6.3 The draft Prudential Standard assists in maintaining financial stability.

6.4 The draft Prudential Standard is to be made in terms of section 105(1) read with sections 105(2)(c), 30(1A)(a)(ii) and 166Q of the Act to provide for a valuation of the assets and/or liabilities of a designated institution.

6.5 If this Prudential Standard is not put in place, the Reserve Bank will be unable to take resolution actions, which may, in turn, result in losses to creditors, shareholders and depositors as well as spillover effects to the rest of the financial sector, causing harm to the financial system.

7. Conclusion

7.1 This statement is compiled in terms of section 98 of the Act.

7.2 This draft Prudential Standard sets requirements for the appointment of valuators and for valuations conducted by valuators for resolution purposes. In particular, the draft Prudential Standard is required in terms of section 166Q. The absence

of this draft Prudential Standard prohibits the Reserve Bank from taking any resolution action. This Prudential Standard will assist the Reserve Bank in fulfilling its resolution functions.

7.3 This Statement is prepared and published in terms of section 98 of the FSR Act. The PA has followed a public consultation process, which afforded the public (six) 6 weeks to consider and comment on the draft Prudential Standard and related documents., The PA have updated the draft Prudential Standard and this statement accordingly. A comments report has also been prepared and is available.