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South African Reserve Bank
Prudential Authority

Prudential Authority funding model: fees and levies

Introduction

On 21 August 2017, the Financial Sector Regulation Act 9 of 2017 (FSR Act) was signed into law. The passing of the FSR Act was a culmination of collaboration on financial sector reform by the National Treasury, South African Reserve Bank (SARB) and the then Financial Services Board (FSB) (now the Financial Sector Conduct Authority (FSCA)). This marked an important milestone on the journey towards a safer financial system to serve South Africa better.

The FSR Act gave effect to three important changes to the regulation of the financial sector. Firstly, it gave the SARB an explicit mandate to maintain and enhance financial stability. Secondly, it created a prudential regulator, the Prudential Authority (PA) within the administration of the SARB. Thirdly, the FSR Act established a market conduct regulator, the FSCA.

Background

One of the fundamental principles, as set out in government's policy document, *A safer financial sector to serve South Africa better*[1] on the regulation and supervision of the financial sector is that regulators should be appropriately and adequately funded to enable them to effectively execute their mandates. According to the policy document, a regulated sector should ideally fund the operational budgets of regulators in a way that eliminates conflict of interest.

The Core Principles for Effective Banking Supervision (Core Principle 2) by the Basel Committee on Banking Supervision (BCBS) requires regulators and supervisors to have operational independence. This includes availability of budgetary processes that do not undermine autonomy and availability of adequate resources. The Insurance Core Principles (ICP 2) by the International Association of Insurance Supervisors (IAIS) require that the supervisor has adequate resources, financial or otherwise, sufficient to enable it to conduct effective supervision.

The smooth functioning of the PA to discharge its duties and fulfil its mandate requires that the PA has adequate resources. The supervisor must have adequate financial resources that, among other needs, provides for:

a. a sufficient and skilled number of personnel, commensurate with the risk profile of the supervised financial institutions;
b. remuneration levels that that allow it to attract and retain qualified staff;
c. regular training and development of personnel;
d. sufficient technology to equip its personnel with the tools needed to conduct effective supervision and oversight of the supervised entities; and
e. the ability to commission external experts with the necessary professional skills and independence to conduct tasks as and when required.

[1] A safer financial sector to serve South Africa better

In line with the aforementioned BCBS and IAIS Core Principles, the PA will be funded from the levies which will be imposed on the supervised entities, as well as through fees which may be charged in relation to specific functions performed by the PA.

Funding of increased operational requirements

Chapter 16 of the FSR Act and the proposed Levies Bill provide for a funding mechanism of the PA and other relevant bodies. The imposition of the levies on the supervised entities is underpinned by a principle of cost recovery. The PA is not a profit-making organisation and only seeks to recover the direct costs of running its operations.

The implementation of a Twin Peaks approach to financial sector regulation from 1 April 2018 resulted in the PA assuming responsibility for the regulation and supervision of insurers, financial conglomerates, certain market infrastructures and well as co-operative financial institutions (CFIs). This was in addition to banks, mutual banks and co-operative banks that the then Bank Supervision Department (BSD) of the SARB was responsible for. To put this differently, the PA is now responsible for the prudential regulation and supervision of an additional 183 supervised entities, in addition to about 40 financial institutions that the BSD was responsible for prior to 1 April 2018. The increase in the number of the supervised entities meant an increase in personnel as well as the operational costs. Prior to the Twin Peaks implementation, the staff complement of the then BSD was about 139 and after the Twin Peaks implementation, the total staff complement of the PA (including current vacancies) is approximately 335.

Prior to the Twin Peaks implementation, the total cost – both direct and indirect costs – of running the then BSD was fully funded by the SARB. Banks did not pay any levy to the SARB. The cost carried by the SARB for running the BSD meant a reduction in the surplus declared by the SARB and consequently the amount paid over to the fiscus, as a surplus.

On the other side, insurers, market infrastructures and other supervised entities, with the exception of the deposit-taking institutions, were levied by the then FSB.

The proposed funding model

Similar to other supervised entities, under the proposed funding model, banks, mutual banks and co-operative banks will be required to pay levies to the SARB and FSCA − the Authorities. Insurers and market infrastructures will also be expected to pay a levy to the PA.

Under the proposed funding model that is envisaged to come into effect on 1 April 2022, the proposed levies to be paid by the supervised entities will cover only the direct costs of running the PA. The SARB will continue to fund the indirect costs[2] incurred by the PA which are estimated to account for about 40% of the PA's total expenses. Section 51 of the FSR Act requires the SARB to provide the PA with personnel, accommodation, facilities, use of assets, resources and other services that may be determined by the PA and agreed to by the SARB. In line with the provisions

[2] Incurred through the use of the various support departments of the SARB such as legal, risk management, compliance, internal audit, human resources, security as well as the use of SARB facilities.

of the FSR Act, the SARB will be contributing towards the indirect costs of running the PA while the industry will contribute towards the direct costs.

As it stands, the SARB has continued to fund the full cost of running the PA since its establishment on 1 April 2018. It will continue to do so until the commencement of Chapter 16 and the Levies Bill.

In terms of the FSR Act, for each financial year, the PA must prepare and adopt a budget that includes an estimate of its expenditure and projected estimates of expenditure for the next two financial years. On 24 November 2021, Cabinet approved the submission of the draft Levies Bill to Parliament. As part of that process, it is envisaged that the draft budget estimates of the Authorities, as well as responses to the comments received on the draft Levies Bill will be published.

Levies payable by a supervised entity to the PA will be calculated in accordance with the formula specified in the relevant schedule of the Levies Bill. As per the draft Levies Bill, different types of supervised entities have a specified formula for calculating the levy payable. The levies have been determined in a manner that ensures proportional contributions based on the size of the financial institution. CFIs are exempt from paying levies. The draft Levies Bill exempts small co-operative banks with total liabilities of less than R2 million from paying levies. On the basis of the levy formulae contained in Schedule 1 of the draft Levies Bill, the estimated levy (including a special levy) and fee income will amount to about R511 million.

A special levy must be charged in accordance with the provisions of the draft Levies Bill in order to provide for the initial costs associated with the establishment of the Authorities. This is estimated to amount to about R35 million. This special levy is payable for the first two levy periods immediately following the date of commencement of the Levies Act. The special levy payable to the authorities amounts to 7.5% of the amount of the financial sector levy payable by the supervised entity in respect of Schedule 1.

An estimated 61% of the total levies will be raised from the deposit-taking institutions, while insurers will contribute about 31% and other supervised entities will contribute the remainder to the total levies.

Charging of fees

In addition to levies, the PA will charge fees for the performance of specific functions under the FSR Act and the relevant financial sector laws.

Despite Chapter 16 of the FSR Act not having commenced, the provisions of the relevant financial sector laws enabling the PA to charge fees are operational under the relevant sectoral laws. The current fees for banks, mutual banks, co-operative banks and CFIs, which are prescribed through either Regulations or Supervisory Rules, have not been reviewed in several years. The implementation of Chapter 16 of the FSR Act presents an opportunity for the PA to update the prescribed fees across all the financial institutions supervised by the PA. The fees for deposit-taking institutions will be adjusted for inflation. The PA proposes to maintain the current fees charged to insurers, given that these fees were reviewed and adjusted in the recent past. The principle of proportionality will continue to be applied in the determination of fees for the different types or categories of entities supervised by the PA. This is aimed at supporting financial inclusion and financial sector transformation.

Once a fees determination is put in place in terms of the process outlined under the FSR Act, the current prescribed fees in terms of the relevant financial sector laws will be repealed and be replaced by a fees determination. The PA envisages to embark on this process as soon as Chapter 16 of the FSR Act comes into effect. The industry will be engaged on this process as required in terms of the law.

With the introduction of the levies, the PA proposes to do away with the charging of an annual licence fee, currently applicable to banks and mutual banks.

Operational and administrative matters

The PA is finalising the preparatory work required to collect levies once the legislative framework comes into effect. Following the commencement of Chapter 16 of the FSR Act and the Levies Bill, the PA will issue to each supervised entity that is liable to pay a levy for the financial year, an assessment of a levy that is payable by the supervised entity. The assessment notice will contain information as to the amount of the levy as well as when the levy is due and must be paid. Where necessary, the PA will request supervised entities to provide information relevant to any assessment of the levy payable by the supervised entity.

A supervised entity charged a levy may offer to pay the fee or levy by specified instalments, and if the offer is made, the PA will either accept the offer, accept a modified offer or reject the offer and communicate to the supervised entity.

In anticipation of the commencement of Chapter 16 and the Levies Bill, the PA is establishing processes and systems required for the collection of levies. With regard to the collection of fees, the expectation is that a supervised entity will login to a Portal to directly submit any application and notifications. A key feature of this functionality is that it is greatly geared towards a self-service offering provided to the supervised entity. During the submission process, the Portal user will be presented with options to select the appropriate fee payable for the relevant application. Once submitted, the PA will then automatically send to the supervised entity an invoice indicating the relevant amount payable as well as the relevant banking details. Once payment is made and confirmed internally, a receipt will be issued and the application will be processed.

For the collection of levies, on a scheduled basis within the Portal, the supervised entity will be presented with a form to capture the applicable thresholds used within the levy formula. This form will be submitted to the PA, and once received, the relevant levy calculation will be automatically performed. Once the calculated levy payment amount is verified internally, an assessment notice will be sent to the supervised entity. The assessment notice will contain the relevant levy amount payable as well as banking details of the PA.
An important note is that, as an interim measure, at the commencement of the Levies Bill, the thresholds used within the levy calculation will initially be a manual input field which is required to be completed by the supervised entity. Going forward, there are plans to ensure that the variable amount will be obtained automatically from the relevant regulatory returns submitted to the PA.

With regard to the special levy collection, this amount will be charged for the first two years following the commencement of the Levies Bill and will be based on a percentage of the supervised institutions' calculated levy amount as prescribed by the FSR Act. Once calculated, the PA will automatically send an invoice to the industry user, indicating the relevant special levy amount payable as well as banking details. The applicable receipts will be issued to the supervised institution to confirm payments received for levies and special levies.

Conclusion and next steps

Soon after the announcement of the 2021 Budget in February, the National Treasury released the draft Levies Bill for public consultation. The closing date for public comments was 31 March 2021.

Cabinet has since approved the submission of the draft Levies Bill to Parliament. This is a National Treasury process, and the PA will play a supporting role. As per the FSR Act, Chapter 16 is envisaged to come into effect on 1 April 2022. The SARB will continue to fully fund the operations of the PA until the PA is in a position to collect levies from the supervised entities.

Once the Levies Bill has been enacted, the PA will start engaging with the industry during the second quarter 2022 on the process for collecting the levies and consult on the proposed fees determination. The industry will be kept informed on all the developments around these matters. For more information on FSR Act's Chapter 16: levies and fees implementation, please contact Henna.Strijdom@resbank.co.za