



CHAPTER 4

DEVELOPMENTS RELATED TO BANKING LEGISLATION

One of the main functions of the Bank Supervision Department is to ensure that the legal framework in terms of which banking institutions and banking groups are regulated and supervised remains relevant and current. In order to ensure that the Banks Act, 1990, the Mutual Banks Act, 1993, and the respective Regulations thereto remain in line with the latest national and international developments and standards, the Department has to review and amend the legislation regularly. This chapter provides a brief overview of the most important envisaged amendments to the banking legislation.

AMENDMENTS TO THE BANKS ACT, 1990

additional proposed amendments

The Standing Committee for the Revision of the Banks Act, 1990, has approved the envisaged amendments described in the 1998 Annual Report, as well as the additional proposed amendments described below. All these proposed amendments to the Banks Act will now have to undergo a process of approval by the Standing Committee on Finance of Parliament, the Finance Committee of the National Council of Provinces and Parliament.

Definition of "banking group"

principle of consolidated capital adequacy and consolidated supervision

In line with the international principle of consolidated capital adequacy and consolidated supervision of banking groups, a definition of the term "banking group" has to be included in the Banks Act.

More than one Deputy Registrar of Banks

increased workload

Because of the increased workload of the Office for Banks, it has become necessary to provide for the appointment of additional deputy registrars to assist the Registrar of Banks in the fulfilment of the Registrar's responsibilities and obligations in terms of the Banks Act.

Curatorship and liquidation of banks

term judicial management deleted

As explained in Chapter 1 of this report, the judgement in the matter of New Republic Bank Limited, which pertained to the interpretation of sections 68 and 69 of the Banks Act, has caused a great deal of uncertainty with regard to the winding up and judicial management of a bank previously placed under curatorship. In order to prevent any further problems relating to the interpretation of the provisions in future, section 68 has to be amended to provide that it applies notwithstanding the provisions of section 69 of the Banks Act and that the term judicial management be deleted wherever it occurs in the said sections. Amendments to the provisions of section 69 of the Banks Act have also been proposed in order to set out the respective powers of the Minister of Finance, the Registrar of Banks and a curator to a bank more clearly and concisely.

set out powers more clearly and concisely

AMENDMENTS TO THE MUTUAL BANKS ACT, 1993

The most important amendments to the Mutual Banks Act are described below. The amendments have been promulgated as the Mutual Banks Amendment Act, 1999 (Act No. 54 of 1999), as published in *Government Gazette* No. 20727 of 15 December 1999 and effective from 20 March 2000.



Provisional or final registration

The two forms of registration - that is, provisional and final registration - as a mutual bank have resulted in considerable confusion in the market with regard to the status of provisionally registered mutual banks. In the Department's view, this confusion has caused such mutual banks some difficulty with attracting depositors. From a business perspective, however, there is no difference between the two forms of registration. Therefore, the Mutual Banks Act has been amended to provide for a single form of registration only. This amendment is also in line with the provisions of the Banks Act, which provides for a single form of registration as a bank.

single form of registration

Annual licence fees

In terms of an amendment to section 31 of the Mutual Banks Act, annual licence fees in respect of mutual banks will be payable to the South African Reserve Bank once the amendment becomes effective. Such fees were previously payable to the receiver of revenue of the district in which a mutual bank's head office was situated.

payable to the SARB

Board of directors

Section 37 of the Mutual Banks Act has always provided that the composition of the board of directors of a mutual bank should be such that not more than 49 per cent of the directors are employees of the mutual bank. In line with the recommendations of the report of the King Committee on Corporate Governance, the Mutual Banks Act has been amended to provide that not more than 49 per cent of directors may be employees of a mutual bank or any of its associates (as defined in section 1 of the Mutual Banks Act).

composition of board

External auditors

The principle of associate (as defined) has been extended to the external auditors of a mutual bank. Consequently, no officer of a mutual bank or any of its associates may be appointed as an external auditor of the mutual bank in question.

principle of associate extended to external auditors and audit committee

Audit committee

The principle of associate (as defined) has further been extended to the composition of the audit committee of a mutual bank. Consequently, the majority of members of the audit committee of a mutual bank have to be persons who are not employees of the mutual bank or of any of its associates.

Restrictions on investments

Sections 55 and 56 of the Mutual Banks Act explicitly provide for restrictions on a mutual bank's investments in immovable property or shares, or with certain associates, and on loans and advances to certain subsidiaries and associates. Changing market conditions, however, may compel the Registrar to amend the limits of the said restrictions. Therefore, it was decided to remove the explicit limitations from the Mutual Banks Act and to provide that the Registrar may prescribe such limitations by means of regulation.

amendment of limits

AMENDED REGULATIONS RELATING TO BANKS

The Bank Supervision Department issued draft Regulations relating to Banks, incorporating the envisaged amendments described in the 1998 Annual Report, for comment at the end of March 1999. The Department not only received valuable proposals and comments, but also held discussions and workshops with various key players in order to clarify and resolve



a number of matters. Following this process of consultation, it was agreed that the amended Regulations would be implemented with effect from 1 July 2000.

A brief overview of the most important amendments to the Regulations follows below.

Banks' trading and banking activities

CAR values

As previously reported, trading banks have been required to calculate and report their capital-adequacy requirements in terms of the Regulations relating to Capital-adequacy Requirements ("CAR") for Banks' Trading Activities in Financial Instruments, with effect from 1 October 1998. In addition, as reported in Chapter 2, banks have been required to submit certain CAR values to the Department on a daily basis since 1 May 1999. The Department has incorporated the provisions of the CAR Regulations into the statutory risk returns, in order to distinguish clearly between the trading and the banking activities of a bank.

Quantitative supervision of banking groups

consolidated information

As explained in Chapter 2 of this report, the Department has developed statutory returns for banks to report consolidated information on group capital adequacy, group large exposures, intragroup exposures and group currency risk on a regular basis.

Large exposures

compliance with Core Principles

The Banks Act and the Regulations have been amended in order to comply fully with the Core Principles for Effective Banking Supervision relating to large exposures. Consequently, a bank or a controlling company may not incur an exposure to a private-sector non-bank person that exceeds 25 per cent of the bank's or the controlling company's qualifying capital and reserve funds without the Registrar's approval. Furthermore, the total of all large exposures exceeding 10 per cent of the bank's or the controlling company's qualifying capital and reserve funds may not exceed 800 per cent of qualifying capital and reserve funds. The excess exposure will be subject to additional capital requirements, which effectively result in an impairment of capital.

Provisioning matrix in respect of credit risk

loan classification and provisioning rules

In order to ensure compliance with international practice, the Department has incorporated explicit and mandatory loan classification and provisioning rules into the Regulations. Because no single provisioning method is suitable for all banks, banks may approach the Registrar to approve provisioning methods that differ from the prescribed minimum provisioning rules contained in the Regulations if such methods can be shown to provide adequately for loan losses.

Enhancement of corporate governance in banks

chapter on corporate governance

Banking supervision cannot function if sound corporate governance is not in place. Consequently, banking supervisors have a strong interest in ensuring that there is effective corporate governance within every banking institution. Since the Department regards sound corporate governance in banks as crucial, it has incorporated a separate chapter on corporate governance into the Regulations.

compliance officer

A bank will have to maintain appropriate corporate governance, management, internal control and risk-management systems, including a compliance officer, in order to monitor and limit all risk exposures of the bank. The operating controls and risk-management procedures have to be consistent with the strategy of the bank. The bank has to be capable of producing all required statutory and prudential information in an accurate and timely fashion.



ion. The bank also has to identify timeously offences that may have a negative impact on the bank and the wider banking industry and has to report such offences to the Registrar.

Public disclosure

Market discipline can work only if market participants have access to timely and reliable information, which enables them to assess a bank's activities and the risks inherent in those activities. Improved public disclosure strengthens the ability of market participants to encourage safe and sound banking practices.

disclosure of timely information

The Department regards the complementary interaction of prudential supervision and market discipline as critical to the promotion of the long-term stability of both individual institutions and banking systems. Therefore, banks will be required to disclose, in their financial reports and other disclosures to the public, timely information that facilitates market participants' assessment of the banks. Since these requirements have also been incorporated in the Statements of Generally Accepted Accounting Practice in South Africa, banks and controlling companies should not find it difficult to comply with the requirements of the Regulations.

Net effective open position of banks

branches may base NOP on capital and reserves of parent

Banks will be required to manage their net effective open position in foreign currency, expressed as a percentage of such banks' qualifying capital and reserves funds, within a limit of 10 per cent, or such a lower percentage as the Registrar may specify, of qualifying capital and reserves funds. Since this amendment will allow branches of foreign banks, for example, to base their net effective open position in foreign currency on the capital and reserve funds of their parent bank, the amendment should serve to promote South Africa as a regional financial centre.

Auditor/regulator relationship

further reporting requirements

The financial statements of banks and controlling companies are subject to examination by external auditors, whose opinions lend credibility to such statements and, thereby, assist in promoting confidence in the banking system. Thus, there is no doubt that the roles of bank supervisors and the external auditors of banks are complementary. In order to remain at the forefront of international best practice and to enhance the level of compliance with the Basle Core Principles, the Department has incorporated further reporting requirements for external auditors to provide various levels of assurance.

Derivative instruments

Activities in derivatives generally involve types of risk that are similar to those associated with the more traditional activities of banks. The management of risks in derivative activities, however, is a highly dynamic process, which holds the potential for large gains and losses to be made in a short period of time. Timely and reliable information on these activities is essential for accurate assessments of a bank's condition, performance and risk profile.

separate reporting of derivative instruments

The amended Regulations require banks to report derivative instruments separately and to distinguish clearly between the following:

- ▲ Exchange-traded contracts and over-the-counter contracts.
- ▲ Derivative instruments relating to banking activities and those relating to trading activities.



- ▲ The fundamental markets, that is, interest-rate contracts, foreign exchange, equities and indices, and commodities.

Intervals at which banks have to submit risk-based returns

amended time intervals

In the current financial environment, the intervals at which banks, branches of foreign banks and controlling companies have to submit various risk returns had become inappropriate. The Department has therefore amended these time intervals in order to facilitate effective regulation and supervision of banks and banking groups in South Africa.

Calculation of averages

average daily balances will be the rule

Prudential requirements are currently based on month-end balances. This may result in prudential requirements being inadequate for the average risk profile of the banking sector in South Africa. Therefore, average daily balances will in future be the "rule", and month-end positions will be the "exception", instead of the reverse.

Banks will, however, be able to apply for permission not to calculate average daily balances for certain items. The Department will grant such approval on an ad hoc basis, for example, when the average daily balance for the month is not materially different from the month-end position, or when the risk profile of the bank concerned does not warrant the cost to the bank of implementing a system that calculates average daily balances. The Department will indicate the time for which such approval is granted to a bank and will continuously monitor such a bank's situation.

