CHAPTER 2

CURRENT ISSUES IN BANKING SUPERVISION

new Capital Accord remained an issue of great importance

As was the case in previous annual reports, this chapter deals with some of the most important regulatory and supervisory trends and developments, locally and internationally, during the year under review. Developments with the new Capital Accord remained an issue of great importance to the Bank Supervision Department and banks, as well as their external auditors. Among the other issues discussed are the impact of changes to accounting standards on banks, the potential impact of the proposed community-reinvestment legislation for housing purposes on the banking system, initiatives to provide broader access to finance and developments with measures to combat money laundering.

FURTHER DEVELOPMENTS WITH NEW CAPITAL ACCORD

The need for a new capital-adequacy framework was discussed in several previous annual reports and is now well entrenched. The proposed new Basel Capital Accord, generally referred to as Basel II, has been accepted as international best practice to align capital-adequacy assessment more closely with the key elements of banking risks and to provide for banks to enhance their risk-measurement and risk-management capabilities.

The 2001 annual report focused on the second consultative paper (CP2) on Basel II developed by the Basel Committee on Banking Supervision and highlighted the comments that the Committee had received from approximately 270 sources, including the Bank Supervision Department. Since then, interested stakeholders, including academics, bankers, supervisors, regulators and consultants, have debated a wide range of issues, among them procyclicality, the impact of Basel II on emerging markets, the credit-risk and operational-risk issues emanating from the prescribed standards and the complexity of Basel II.

International developments

agreement on a number of important issues

At a meeting on 10 July 2002, the Basel Committee reached agreement on a number of important issues, discussed briefly below.

Timetable for implementation

third quantitative impact study (QIS 3)

In order to perform a concrete and comprehensive assessment of the impact of the Basel II proposals on particular banks, the Basel Committee initiated a third quantitative impact study (QIS 3), discussed in more detail below. Assessment of the QIS 3 results will allow the Basel Committee to determine whether adjustments need to be made before the release of consultative paper 3 (CP3), for public comment, during the second quarter of 2003.

implementation delayed by a year

As a result of the additional step introduced by QIS 3 and the proposed CP3, the Basel Committee intends to finalise Basel II only during the fourth quarter of 2003, and no longer in 2002, as previously planned. Consequently, implementation of the new framework in each country was delayed by a year. Accordingly, Basel II is to be implemented on 31 December 2006. During the forthcoming three-year period, banks and supervisors are expected to develop the systems and processes necessary for compliance with the standards of Basel II. Banks adopting the internal ratings-based (IRB) approach to credit risk and the advanced measurement (AM) approach to operational risk will be required to perform

parallel calculations from 1 January 2006

parallel calculations in terms of Basel II and the 1988 Accord for one year prior to implementation, that is, from 1 January 2006.

QIS 3

field test of Basel II

The Basel Committee officially launched QIS 3, a field test of Basel II, on 1 October 2002, in the form of the:

- QIS 3 workbook – a series of spreadsheet-based questionnaires with embedded formulae for capital-adequacy calculation.
- QIS 3 instruction.
- QIS 3 technical guidance.

QIS 3 involved more than 200 banks from over 40 countries, including South Africa, and banks had to submit their responses by 20 December 2002. The study, which focused on the proposed minimum capital requirements under pillar one of Basel II, represents a significant step in the Basel Committee's efforts to develop an improved capital-adequacy framework. As indicated above, after assessing the results of QIS 3, the Basel Committee intends to refine its proposals, where appropriate, before issuing CP3.

Treatment of small and medium enterprises

The Basel Committee regards the small and medium enterprise (SME) sector as important for economic prosperity. Inherently, exposures to SMEs tend to be more risky for banks than exposures to larger corporates. Certain sectors raised a concern that a more risk-sensitive capital-adequacy framework might result in banks being unwilling to extend credit to SMEs, potentially hampering economic growth.

recognition of the different risks associated with SME borrowers

In recognition of the different risks associated with SME borrowers, banks will be permitted to distinguish loans to SME borrowers from loans to larger firms under the IRB approach to corporate credit. In terms of the proposed treatment, exposures to SMEs will attract a lower capital requirement than exposures to larger firms. A reduction of up to 20 per cent, depending on size of the borrower, and, on average, a reduction of approximately 10 per cent will apply. In addition, banks that manage SME-related exposures in a manner similar to retail exposures will be permitted to apply the retail IRB treatment to such exposures, provided that the total exposure of a bank to an individual SME is less than one million euros.

Retail framework

greater risk sensitivity in the treatment of non-mortgage retail lending

In an effort to achieve greater risk sensitivity in the treatment of non-mortgage retail lending, two distinct IRB risk-weighting curves will now be available for such exposures. The first curve, that for other retail lending, will produce capital requirements that are modestly higher than those that the Basel Committee proposed earlier and will apply to those exposures that do not qualify for use of the second curve. The second curve will apply to qualifying revolving exposures and will produce capital requirements that are materially below those previously proposed.

In an effort to maintain consistency with the likely changes in capital requirements under the retail IRB framework, risk weightings for residential mortgage exposures under the standardised approach will be reduced from 50 per cent to 40 per cent. Risk weightings for non-mortgage retail exposures will be reduced from 100 per cent to 75 per cent.

Operational risk

progress with the management of operational risk

The Basel Committee recognises that banks are continuing to make progress with the management of operational risk. In view thereof, as well as banks' development of better operational risk-management frameworks, the Basel Committee reaffirmed its intention to proceed with the pillar one approach to operational risk. In the light of the continuing evolution of analytical approaches to operational risk, the Basel Committee recognises the flexibility inherent in the AM approach to the measurement and management of operational risk and to the development of systems for such frameworks. Accordingly, the Basel Committee will no longer demand a floor capital requirement on operational risk in conjunction with the more advanced approach.

Procyclicality

credit-risk stress test

A concern that has been raised is that the increased risk sensitivity of Basel II will tend to reinforce behavioural patterns in banks that are likely to increase the cost of credit precisely when the supply of credit is falling, that is, during a downturn in the business cycle. In order to address this concern about procyclicality - the impact of stress in one cycle on another cycle - banks adopting the IRB approach to credit risk will be required to perform a meaningfully conservative credit-risk stress test of their own design. The aim is to estimate the extent to which such banks' IRB capital requirements could increase during stress scenarios. Banks and supervisors will use the results of these stress tests to ensure that banks hold a sufficient capital buffer under pillar two of Basel II.

Accord Implementation Group

In recognition of the challenges that supervisors face in the implementation of Basel II, the Basel Committee announced the creation of the Accord Implementation Group. The Group will serve as a means for supervisors to share information on approaches to the implementation of Basel II. The Accord Implementation Group also has the potential to promote consistency in supervisors' implementation approaches.

Local developments

As mentioned above, Basel II has been adopted as the international standard for a capital-adequacy framework.

Position on Basel II

In furtherance of its mission to promote the soundness of banks through the effective application of international regulatory and supervisory standards, the Bank Supervision Department will require South African banks adopting the IRB approach to credit risk and the AM approach to operational risk to be Basel II compliant by 2006, as indicated above, and all banks by 1 January 2007, the official date for compliance. The Department is of the view that adoption of the Basel II standards is likely, amongst other benefits, to:

benefits

- Assist in the development of a safe and sound banking and financial system.
- Improve risk management within the system.
- Enhance ratings and international interest.
- Attract foreign funds to South Africa.
- Promote economic development.

- Make local banks more competitive internationally.
- Allow local banks to expand globally.

The Department has actively been engaging banks in discussions on Basel II implementation and believes that they are committed to implementing and complying with Basel II.

Participation in QIS 3

Local banks regarded QIS 3 as an important starting point in their initiatives to implement Basel II standards. Eight South African banks, covering approximately 80 per cent of the total South African banking sector, participated in QIS 3. Feedback from these banks suggests that the exercise was useful for the following reasons, amongst others:

useful for the following reasons

- QIS 3 allowed a comprehensive gap analysis, assisting banks to identify areas that required attention in order for them to be Basel II compliant by 2006/2007.
- Banks could conduct an assessment of the impact of Basel II on their institutions and plan appropriate responses. Typically, QIS 3 gave banks guidance on the approach that they had to adopt to the calculation of credit-risk and operational-risk capital charges.
- QIS 3 was resource intensive, helping banks to establish their permanent teams for Basel II implementation.
- QIS 3 was useful in identifying specific implementation issues. Once banks have considered these issues, they will be debated and discussed with the Department.
- Executive sponsorship ensured that the executive teams of banks became involved in the QIS 3 exercise. As a result, banks that participated in QIS 3 succeeded in making their executives aware of the implications of Basel II and what the implementation process would require.

The Bank Supervision Department is continuing to analyse the South African QIS 3 results in order to gain a thorough understanding of the impact of Basel II on particular banks and the banking sector as a whole. Upon completion of this analysis process, the Department will discuss the QIS 3 results with participating banks and release summarised results.

Accord Implementation Forum

The Department established the Accord Implementation Forum (AIF) by means of Banks Act Circular 5/2002. Subsequently, the Department received over 40 representatives from banks and auditors (in as far as their statutory duty was concerned). The AIF held its first meeting on 29 August 2002, at which a working structure was proposed. In essence, the proposal was that the AIF consist of a steering committee and four subcommittees, a structure accepted in November 2002. The Steering Committee, chaired by the Registrar of Banks, consists of some 16 members, representing the Bank Supervision Department, other regulatory bodies, The Banking Council South Africa, the five biggest local banks and three smaller ones, two branches of foreign banks, one representative office of a foreign bank and the South African Institute of Chartered Accountants. The four subcommittees are a risk-management subcommittee, with three groups (credit risk, operational risk and market risk), to address issues pertaining to pillar one of Basel II, a regulatory-framework subcommittee, a disclosure subcommittee to address issues pertaining to pillar three of Basel II and an economic-impact subcommittee.

steering committee and four subcommittees

The mission of the AIF is to promote the implementation of the prescribed Basel II standards, in co-operation with all relevant stakeholders, in a manner that promotes a sound banking and financial system. The specific objectives of the AIF are to:

specific objectives

- Work towards a safe and sound banking and financial system in pursuing the implementation of Basel II by the South African banking system.
- Represent the interests of stakeholders that will be affected by the adoption of Basel II.
- Identify all relevant issues associated with the implementation of Basel II and understand the consequences thereof.
- Reach consensus on issues identified and recommend solutions.
- Work with national and international bodies, in order to identify and formulate recommendations for the resolution of issues.
- Promote the development and adoption of sound risk-management practices.

The AIF is positioned to build a bridge between banks and the supervisor. The common goal is to align capital adequacy more closely with the key elements of banking risks and to provide incentives for enhanced efforts in risk measurement and management. The AIF will identify issues that require the formulation of policy and is expected serve as an effective platform for sharing scarce skilled resources.

platform for sharing scarce skilled resources

Supervisory developments

supervisors have to re-engineer their processes and tailor their organisational structures

Basel II will have a significant impact not only on banks, but also supervisors, who will have to re-engineer their processes and tailor their organisational structures to meet the Basel II standards. In collaboration with other supervisors, the Bank Supervision Department is currently developing its Basel II implementation strategy. This process requires, amongst other things, a thorough understanding of the provisions of Basel II, the design of appropriate supervisory processes and the development of complementary tools to discharge supervisory duties.

Representation on international bodies

The Bank Supervision Department represents South African interests at, and makes significant contributions to, the Basel II work of the following international bodies:

- Core Principles Liaison Group (CPLG) of the Basel Committee.
- Working Group on Capital, a subgroup of the CPLG that considers the interests of countries that do not form part of the Group of Ten (G10).
- QIS 3 Global Group, which consists of the supervisors of banks participating in the QIS 3 exercise.
- Non-G10 Accord Implementation Group.

Conclusion

Basel II holds great challenges for both banks and supervisors during the forthcoming number of years, and many issues have to be discussed and negotiated. Ultimately, however,

potential to improve risk management

the new capital-adequacy framework has the potential to improve risk management in banks and to align economic capital more closely with regulatory capital. Co-operation between banks and supervisors, between supervisors of different countries and between different banks is therefore essential for the successful implementation of Basel II.

CHANGES TO ACCOUNTING STANDARDS AND IMPACT ON BANKS

significant milestone in changing the reporting environment

The year under review marked a significant milestone in changing the reporting environment of all companies, including banks, in South Africa. The changes not only arose from the aftershock of Enron and other highly publicised corporate failures, but, more importantly, represented the outcome of several long-term projects that a number of public bodies had undertaken to improve corporate governance and the quality of financial reporting.

most notable change was the adoption AC 133

The most notable change was the adoption, following an 18-month postponement, of Accounting Standard AC 133 on financial instruments, recognition and measurement. Other significant developments included the draft Financial Reporting Bill, proposed amendments to the Companies Act, 1973, on which the Bank Supervision Department reported in its 2001 annual report, and the JSE Securities Exchange South Africa (JSE) and the South African Institute of Chartered Accountants (SAICA) establishing a panel to monitor compliance with generally accepted accounting practice (GAAP) – the JSE/SAICA GAAP Monitoring Panel.

draft Financial Reporting Bill

In its final report, the Commission of Inquiry into the Affairs of the Masterbond Group and Investor Protection in South Africa stated that "legal backing for accounting standards is recognised in many jurisdictions and is widely supported by professional organisations". In order to improve the quality of financial reporting in South Africa, the Minister of Finance presented the draft Financial Reporting Bill during 2002. The draft Bill includes legal backing for Statements of South African GAAP, the establishment of an investigative and an enforcement committee by the Financial Services Board (FSB) and proposals to address the onerous consequences of compliance with accounting standards for small and medium-sized entities.

GAAP compliance reviews

As part of its mandate, the proposed investigative committee will be tasked with performing GAAP compliance reviews of the financial statements of publicly listed entities, including banks. The committee will also be responsible for responding to and investigating public complaints about inappropriate accounting treatment by listed companies. If a contravention of GAAP is identified, the persons responsible for the preparation of the financial information may be required to take corrective action. The FSB may refer cases to the proposed enforcement committee, which may levy penalties and fines in the case of serious contraventions, or a refusal to implement corrective action. The activities of these committees are expected to place significantly greater pressure on the management, audit committees and auditors of affected entities in order to ensure that published financial information fairly presents the financial position, performance and activities of the entities.

JSE/SAICA GAAP Monitoring Panel

As mentioned above, the JSE/SAICA GAAP Monitoring Panel was established as an interim measure. Although the Panel is still in its infancy, provision is made for a group of independent people, selected from a panel of technical experts, to assess all complaints lodged with, or by, the JSE about a listed company's financial reporting. The JSE may then require such a company to restate the filed information. The Monitoring Panel is expected to operate alongside the committees envisaged by the draft Financial Reporting Bill so as to provide a more timely resolution process for listed companies.

two major developments

From an accounting perspective, there were two major developments during 2002. The first development resulted from the Improvements Project of the International Accounting Standards Board (IASB) and constituted a number of amendments in order to simplify,

consolidate and enhance the body of International Accounting Standards (IAS). Pursuant to SAICA's decision in 1993 to harmonise South African accounting standards with the IAS, the aforementioned amendments are expected to become effective locally in 2003 and to enhance the quality of financial reporting in South Africa.

The second development was the adoption and limited amendment of the comprehensive and complex AC 133. Based on International Accounting Standard IAS 39, AC 133 was initially effective from 1 January 2002. The Banking Council South Africa, however, made submissions to SAICA in 2001, and the effective date of AC 133 was delayed to enable banks to implement the necessary systems and required reporting changes. Accordingly, AC 133 became effective for the year-ends of companies, including banks, commencing on or after 1 July 2002.

Diverging from the provisions of IAS 39, SAICA already adopted certain of the amendments proposed by the IASB's Improvements Project in July 2002. This limited amendment resulted from the Banking Council making further submissions to SAICA, in a move to remove certain inconsistencies inherent within the standard and to alleviate certain of the practical implementation difficulties in AC 133.

impact of AC 133 will become evident in 2003

The impact of the implementation of AC 133 by banks in South Africa will become evident only in 2003, once they report their interim and annual financial statements on the basis of AC 133. Banks have indicated, however, that AC 133 is expected to have a pervasive effect. This effect will have an impact not only on the reported accounting results, but also the key operational and risk-management functions of banks and other entities.

classification framework

Arguably the most complex standard ever issued by SAICA, AC 133 follows a rules-based, financial-component approach to accounting for financial instruments and introduces a classification framework for all financial instruments. In view of this classification framework, AC 133 significantly alters the basis for measuring financial instruments, by moving away from the traditional basis of historical cost accounting to the greater use of fair values in reporting financial instruments in the balance sheet and income statement of banks and other entities. Financial instruments held for trading purposes will largely continue to be accounted for at market value, as in the past. AC 133, however, will improve the quality of financial reporting by obliging banks and other entities to record all derivative positions on the balance sheet and to reflect changes in the value of such positions through the income statement.

improve the transparency of financial statements

As a result of these and other changes to existing accounting practices, AC 133 is expected to improve the transparency of financial statements. A major consequence of the greater use of fair values, however, will be the introduction of greater volatility in the reported earnings and equity of banks and other entities. The Bank Supervision Department is actively involved in assisting banks in preparing for reporting in terms of AC 133 and is also determining the expected impact on regulatory reporting so as to ensure the stability of the banking sector during the transitional period.

The developments in the South African financial-reporting environment outlined above will improve the quality of publicly available financial statements and will result in positive, enduring benefits for companies, including banks, and the South African economy.

INTERNATIONAL CONFERENCE OF BANKING SUPERVISORS

As previously reported, the Bank Supervision Department was tasked with organising the twelfth International Conference of Banking Supervisors (ICBS) in conjunction with the Basel Committee on Banking Supervision. The ICBS, held at two-yearly intervals since 1979, is designed to promote cooperation among national authorities in the supervision of interna-

tional banking and to enable senior representatives of supervisory authorities from a large number of countries to exchange views on a range of current issues of common concern.

twelfth ICBS held

The twelfth ICBS was held from 16 to 20 September 2002, in Cape Town, at the invitation of the South African Reserve Bank The conference was attended by 270 delegates, mainly the heads and other senior staff of about 150 bank-supervisory authorities, from 134 countries.

premeetings for various regional groupings

Two days of premeetings for various regional groupings of bank supervisors, established under the auspices of the Basel Committee, were held on 16 and 17 September. At the end of the second day, the regional chairpersons reported on the status of bank supervision in their regions to a joint session, chaired by Mr William J McDonough, Chairman of the Basel Committee on Banking Supervision and President and Chief Executive Officer of the Federal Reserve Bank of New York.

Governor Tito Mboweni of the South African Reserve Bank officially opened the conference on 18 September 2002. In his address, Governor Mboweni briefly outlined the conference topics and sketched, amongst other issues, the challenges facing the South African economy. He also assured the delegates that South Africa would be ready to implement the new Capital Accord, or Basel II, by 2006.

keynote speech: four main topics

In his keynote speech on completing the journey to Basel II, Mr McDonough discussed four main topics - the milestones that had been achieved, the status of Basel II, what supervisors were doing to prepare for implementation and application of Basel II in non-group-of-ten countries, as outlined earlier in this chapter. At the end of the day, the South African Minister of Finance, Mr Trevor Manuel, delivered a dinner address on global financial developments and how South Africa had fared.

two main themes of the conference

The two main themes of the conference were a review of Basel II and how to create a stable financial environment in emerging-market economies. Plenary and panel sessions on these topics were chaired by Mr Claes Norgren, Chairman of the Basel Committee Task Force on the Future of Capital Regulation and Director General of Financial Inspection in Sweden, and Mr Tommaso Padoa-Schioppa, Member of the Executive Board of the European Central Bank and a former Chairman of the Basel Committee. A number of working sessions on these two topics were chaired by Mr McDonough and Deputy Governor Gill Marcus of the South African Reserve Bank.

special panel sessions

Two special panel sessions on topical issues were also held. The first session addressed customer due diligence and terrorist financing, a topic of particular significance in the light of the increased worldwide need to combat the scourge of money laundering, as discussed later in this chapter. This session was chaired by Mr Jochen Sanio, President of the German financial supervisory authority and current President of the intergovernmental Financial Action Task Force. At the close of the session, participants resolved to declare, in a separate press communiqué, their commitment to adopting the standards set out in the Basel Committee's 2001 paper on customer due diligence for banks. The second special panel session, chaired by Mr Arnold Schilder, Executive Director of the Netherlands Bank, was devoted to loan accounting.

Mr Stanley Fischer, Vice Chairman of Citigroup and former First Deputy Managing Director of the International Monetary Fund, delivered a lecture in memory of William Taylor, a former head of bank supervision at the Federal Reserve Board and former chairman of the Federal Deposit Insurance Corporation in the United States of America. Mr Fischer addressed the topical issue of risk management and the implications of Basel II for banking in emerging-market countries.

Besides an active sight-seeing programme for delegates' partners, the conference programme included social events at well-known Western Cape venues, such as the Arts Cape Theatre, the Companje Garden's Museum and the Botanical Gardens. An excursion to the Cape Winelands and Franschoek Valley on the final day offered some welcome relaxation and fun for delegates and their partners.

Overall, participants regarded the conference as a great success. The next ICBS will be held in 2004, in Madrid, Spain, at the invitation of the Bank of Spain.

BANK-SUPERVISORY ACTIVITIES AT REGIONAL LEVEL

At the regional level, the Bank Supervision Department continued to participate in the initiatives of the East and Southern Africa Banking Supervisors Group (ESAF). As stated in previous annual reports, the objectives of ESAF are to promote the standard and quality of banking supervision in ESAF member countries, in line with international best practice, and to harmonise bank-supervisory philosophies and practices in the region.

In order to ensure a focused approach to bank-supervisory training for ESAF member countries and optimal use of available resources, all such training is organised and coordinated by the ESAF Secretariat. The Department has been fulfilling that role since 1999 and will continue to do so until 2004.

During 2002, the Republic of Rwanda, represented by the National Bank of Rwanda, was admitted as the seventeenth ESAF member country.

Bank supervision harmonisation project: Business-process models and supporting information systems

second phase of the project was completed

The second phase of the project to provide harmonised bank-supervisory legislation, regulations, procedures and systems at a national and regional level, within the ESAF region, was completed. The design and specification document was signed off by all members of the Project Steering Committee, on the recommendation of the Project Management Committee. The specification document has since been translated into Portuguese and will also be translated into French.

The Bank Supervision Application (BSA) system consists of six integrated modules for the management of the supervisory infrastructure, licensing of banks, off-site analysis, on-site investigation, enforcement action and risk analysis. Implementation of a pilot scheme at the Bank of Mozambique was scheduled for February 2003, and the BSA system is expected to be installed in other participating ESAF member countries within the forthcoming two years.

Courses in bank supervision

two regionally focused seminars

During the year under review, the Financial Stability Institute of the Bank for International Settlements presented two regionally focused seminars for ESAF members. The first seminar, which covered the new Capital Accord (Basel II) and interest-rate risk, was held in Kampala, Uganda, and was attended by 30 participants from nine ESAF countries. The second seminar, which covered Basel II, measures to combat money laundering and corporate governance, was held in Livingstone, Zambia, and was attended by 38 participants from 14 ESAF countries.

objectives

The objectives of the seminars were to:

- Provide an overview of the latest developments with Basel II.

- Update participants on current best practices in interest-rate risk management.
- Provide a forum for the exchange of ideas on common problems, such as combating money laundering, and the implementation of best supervisory practices, such as improving corporate governance in banks.
- Provide the Financial Stability Institute with useful information on the most important needs in the ESAF region.

The Bank Supervision Department successfully hosted another intermediate course in banking supervision, attended by 38 participants from 14 of the 17 ESAF member countries, in Pretoria, from 22 July to 2 August 2002.

As part of its ongoing initiative to work with central banks in Southern Africa on technical bank-supervisory training, the South African Reserve Bank has indicated its willingness to host further courses in bank supervision in 2003.

PROPOSED LEGISLATION ON COMMUNITY REINVESTMENT IN HOUSING

Community Reinvestment (Housing) Bill (CR Bill) proposes minimum targets

During the year under review, the Department of Housing published the Community Reinvestment (Housing) Bill (CR Bill) for comment. The CR Bill, which is regarded as a sequel to the Home Loan Mortgage Disclosure Act, 2000 (Act No. 63 of 2000 - the HLMD Act), proposes the implementation of a programme of minimum targets and standards for lending for the purpose of housing at low- and medium-income levels. The stated goal of the CR Bill is to encourage innovation and prudent risk-taking in expanding access to housing finance.

The Minister of Housing would be responsible for setting targets for such lending as a proportion of overall housing lending. The Office of Disclosure, to be established under the HLMD Act, would be responsible for assessing the performance of housing lenders against the prescribed targets and other criteria specified in the CR Bill.

most housing lenders are banks

The CR Bill provides for the principles applicable to community reinvestment for housing and proposes that all housing lenders share in this task proportionately, but not necessarily through directed lending. In this regard, it should be noted that most housing lenders, by volume and value, are banks. The Bill encourages lenders to meet the prescribed targets by channelling funds either directly to low-income niche lenders, or through the National Housing Finance Corporation.

In addition to prescribed targets for such lending, the CR Bill provides restrictions on redlining and a number of other practices. The Bill also requires greater communication and disclosure to potential borrowers by lenders. Failure by lenders to meet the targets or transgression of other provisions of the CR Bill may result in a fine.

The CR Bill is an admirable attempt to further the cause of creating broader access to housing finance. Certain provisions of the current approach, however, may undermine this objective. Some of the concerns and issues in this regard are highlighted below.

Some concerns

The Bank Supervision Department is well aware of the housing shortage in South Africa and fully supports the ideals and prescriptions embodied in the Constitution. The Department, however, is concerned that the CR Bill may be seen an attempt to oblige pri-

vately owned financial institutions that are entrusted with the savings of the general public – that is, banks - to resolve the housing crisis in the country. This perception could also have a negative impact on the investment rating of South Africa.

Although bank loans and advances are made to borrowers from both shareholders' capital and depositors' funds, most loans are made from depositors' funds. Potential consequences of a statute (such as the CR Bill) directing banks to provide loans to persons falling outside the acceptable credit-risk profile of banks include the following:

potential consequences

- Depositors and shareholders may find the utilisation of their deposits and capital to fund riskier loans by banks unacceptable and may wish to invest or place their funds elsewhere.

- A statutory obligation on banks to fund loans perceived to be riskier might have a severe impact on the effectiveness of banking regulation in general. The fundamental principle of banking legislation is to oblige banks to manage the risks inherent in banking business.

- Should banks be encouraged to provide riskier loans, such services would inevitably have to be provided at a higher than normal cost to the borrower. The resultant higher interest rates charged on riskier loans might thus defeat the purpose and aims of the CR Bill.

- Borrowers falling within the category prescribed by the CR Bill may in certain instances regard the statutory obligation placed on banks to grant riskier loans to certain borrowers as an invitation to obtain funding from banks without having to repay such loans.

Market distortion and role of Government

The CR Bill was designed to respond to the lack an effective mechanism to provide low-income individuals with access to credit and the excessive and unaffordable price of credit.

A market distortion is created when demand is not sufficiently met by supply. Although the aim of the CR Bill is to address the market's failure to promote broader access to finance, the focus is on the supply side, while ignoring the demand side. Government could address this by:

competition

- Increasing competition so as to allow prices to adjust to levels that more accurately reflect underlying risks. This would include measures designed to remove barriers to entry, facilitate the entry of firms by increasing the rate of return that can be earned in the market and improve information dissemination so that price signals are transmitted efficiently.

special-purpose vehicles

- Creating special-purpose vehicles (SPVs) that require a lower return on, or have a higher risk tolerance of, the credit extended to certain markets, or which provide a service that reduces the costs to private firms of extending credit to those markets. Such SPVs would in effect represent an implicit Government subsidy to low-income earners.

direct incentives

- Providing direct incentives to private firms to encourage them to enter a particular market.

Scope of the CR Bill

likely to impact on participation of foreign banks

Section 2 of the CR Bill indicates that the provisions thereof apply equally to all financial institutions, both large and small, as well as foreign and domestic. Although it is equitable that the CR Bill encompasses all banks, the Bill is likely to impact adversely on the participation of foreign banks in the local market. It is difficult to predict the consequences of the CR Bill in this regard.

survival of small banks likely to be affected

Furthermore, the survival prospects of small banks, already operating under difficult circumstances, as indicated in chapter 1 of this annual report, are likely to be affected under the prescriptions of the CR Bill. The further demise of small banks would lead to even more consolidation and reduced competition in the banking sector.

Pressures on banking sector

As indicated in chapter 1 of this annual report, there are already pressures on the South African banking sector, in the face of adverse economic circumstances, domestically and internationally. Introduction of further pressures on banking assets could severely harm the financial system. Furthermore, many major banks have strained their resources to assist failing and failed banks, in order to prevent such systemic risk, in the national interest. Data indicate that banks are already serving microborrowers, micro-enterprises and the low-cost housing market, as also indicated later in this chapter.

does not provide for safety mechanisms

The CR Bill does not provide for safety mechanisms or allowances to protect a bank's assets or depositors' funds. The effect of redistribution of income from savings surplus entities to savings deficit entities can be achieved without any threat to the financial sector, through redistributive taxation measures.

BROADER ACCESS TO FINANCE

As indicated in previous annual reports, there is a need in South Africa to facilitate and extend access to banking and financial services on a wider basis than is currently possible. The Bank Supervision Department, therefore, envisages amending the regulatory framework in order to allow for the establishment of different classes of banking institution, such as second-tier and third-tier banks.

Narrow and core banks

objective

A project to consider the establishment of narrow and core banks was initiated during the year under review. The objective is to increase competition in the banking sector, whilst also creating greater access to basic banking services, such as savings accounts and housing and educational loans, to the under- and unbanked.

The Bank Supervision Department proposes that such banks be subject to lower entry criteria, but that their business scope be limited. In order to safeguard the stability of the banking system, it is envisaged that narrow and core banks would be subject to strict conditions, such as being permitted to take retail deposits, but not to trade or invest in, for example, derivatives. Draft legislation is expected to be made available for comment in 2003.

Community deposit-taking institutions

Research undertaken by the Bank Supervision Department has indicated that, in some Central and South American countries, the provision of credible and safe deposit-taking institutions, convenient service and market returns have helped lower income individuals to increase their savings deposits substantially.

two requirements

The fulfilment of two requirements is essential to the credibility and success of such community deposit-taking institutions – firstly, a sound regulatory framework and, secondly, fair and affordable access to basic banking services for small, medium and micro-enterprises (SMMEs) and individuals for specific purposes, such as housing. In addition, services such as payment and transmission services and savings and lending services should be provided, particularly in rural areas.

To achieve this in South Africa, changes to the legal framework to provide for such community deposit-taking institutions may be an appropriate starting point. New legislation could borrow heavily on the legislation developed by Uganda, as well as the community-bank legislation in the United States of America, to facilitate community-development lending opportunities. A typical example is lending for the purpose of serving the need for affordable housing. The objective of such lending is to provide housing to individuals, such as the homeless, low- to medium-income earners and the elderly, who cannot afford market interest rates on bonds. In each instance, however, the cost of providing facilities for housing exceeds the client population's ability to pay for housing. There is thus an important need for Government or other third-party resource support, as also indicated earlier in this chapter.

need for resource support

Similarly, many small business-development initiatives require outside intervention before a bank loan can be obtained. Many new and small businesses without working capital may find it difficult to obtain bank credit without a Government loan guarantee or a second mortgage from a Government agency. Community deposit-taking institutions could be used to facilitate these processes.

regulation and supervision

Adequate regulation and supervision of such community deposit-taking institutions, possibly separately from that of traditional banking institutions, would also be essential. New legislation in that regard should therefore provide for ensuring that the business of such institutions is conducted in a safe and sound manner, conducive to the orderly growth of the financial sector, whilst contributing to poverty reduction in both rural and urban areas.

level of service could be coupled to capital requirement

The regulatory framework might also prescribe that community deposit-taking institutions hold different levels of minimum capital. The level of service rendered to the clients of such an institution could be coupled to the capital requirement. At the lowest level of capital requirement, basic services, such as deposit-taking and extension of loans, could be allowed. At the next level of capital requirement, such an institution could be allowed to offer not only the aforementioned services, but also transmission and account-payment services. At yet a further level of capital requirement, an institution could be allowed to offer its clients participation in clearing and settlement services in the National Payment System. An important advantage of such a regulatory framework would be its flexibility, enabling it to cater for the growing needs of clients at the lower level. Such a framework would also have to provide clarity on the level of supervisory capacity required, as well as the cost and funding of such supervision.

From a regulatory perspective, community deposit-taking institutions at the lower level of capital requirement might be allowed to operate and, possibly, fund themselves through wholesale deposits with minimal intervention and a low regulatory burden. When such institutions, however, increase in size to the extent of being able to impact on the stability of the financial system, they should be required to comply with higher levels of prudential, governance and risk-management standards. Supervision to the extent of at least enabling the regulator to monitor the growth of such institutions would therefore be essential.

self-regulation not very successful

Currently, stokvels, credit unions and financial-service cooperatives operate under exemptions from the provisions of the Banks Act, 1990, and are self-regulated. The exemptions allow these institutions to take deposits without having to register as a bank. Self-regulation, however, has not proved to be very successful, as discussed below. As indicated in

previous annual reports, the Mutual Banks Act, 1993, has also not lived up to expectations, and only two mutual banks are still registered.

different regulatory treatment is required

The problem appears to be that when the regulatory framework deals with an institution by way of an exemption, the institution tends to be regarded as not being mainstream and as not sufficiently significant to be included in the relevant legislation. If exempted institutions are to be regarded as stable, permanent and safe, a different regulatory treatment is required. The exemptions referred to above limit the growth of credit unions and financial-service cooperatives to a maximum deposit base of R9,9 million. This amount has already proved to be inadequate.

Evidently, different financial-service providers require supervisory approaches that differ in focus and intensity, in accordance with the role of these players in the market and the manner in which they are funded. The problem of institutions operating under exemptions from the Banks Act could be addressed by allowing such institutions to register with the Registrar of Banks. The supervision implied thereby, however, would require increased supervisory capacity.

Problems in the financial-service cooperative market

self-regulators ceased to operate

In the 2000 annual report, it was reported that the Registrar of Banks had appointed FinaSol and the Financial Services Association as approved self-regulators to regulate and supervise financial-service cooperatives (FSCs) established under an exemption from the Banks Act, 1990. During 2002, however, both self-regulators ceased to operate, because the donor money and Government grants on which they were dependent had been terminated and they could no longer perform their task.

Subsequently, it was revealed that neither of these self-regulatory bodies had records of audits of the FSCs under their control. As a first step to determine the financial position of these FSCs, the 33 FSCs under the control of FinaSol were audited between July and December 2002. The problems exposed at some of these FSCs will receive attention in 2003.

Broader issues in microfinance

As indicated in chapter 1 of this annual report, two bank microlenders experienced problems with their microlending business during the year under review. These problems were institution specific and were due mainly to these banks having underestimated the high risk of entering a new market and of coping with high volumes in a market that they did not fully understand. Since non-bank lenders did not face the same problems, they could not be ascribed to a general weakness in the microlending sector.

main problem facing the non-bank microfinance sector

The main problem facing the non-bank microfinance sector remains access to loan capital. When the Micro Finance Regulatory Council (MFRC) was established in 1999, it was envisaged that access to loan capital by means of wholesale, not retail, deposits would be addressed through an appropriately worded provision in the Banks Act, 1990, or the Regulations thereto. The problem has not yet been resolved, mainly because of the potentially problematic consequences inherent in inserting such a provision in the Banks Act or the Regulations thereto, since non-bank microlenders are not registered in terms of the Banks Act.

lack of access to loan capital

Lack of access to loan capital is increasing the cost of capital for non-bank lenders. Most non-bank microlenders use their own capital to fund loans, which contributes to the high cost of lending. The lack of access to loan capital is not only hampering development of the microfinance industry, but also limiting the ability of microlenders to originate loans for micro-enterprises and low-cost housing.

provisions of the Usury Act

Another problem relates to the provisions of the Usury Act, 1968 (Act No. 73 of 1968). The intention of the Usury Act is to provide protection to consumers against usurious charges on lending products. The effectiveness of the Usury Act as a consumer-protection measure, however, is questionable on two fronts. Firstly, from a consumer-protection perspective, the use of an interest-rate ceiling and disclosure have not achieved the desired effect – the ceiling is circumvented, and the disclosure requirements are out of step with the market that the Usury Act serves to protect. Secondly, economic consequences arise from supply-side market distortions and inefficiencies created by the interest-rate ceiling, as well as the exemption of certain categories of loan and different treatment of different types of lender.

competition

A third important problem for the microfinance industry is that as more players enter the market, competition increases, exacerbating the problem of access to loan capital. Microfinance will inevitably have to move away from the current supply-led approach, whereby a narrow range of services is offered, towards a demand-driven, client-orientated approach, to the benefit of both microfinance institutions and their clients. As indicated earlier, however, amendments to the regulatory framework and adequate supervision would be required to facilitate such a development.

Current status of microfinance business of South African banks

growth in bank microloans and micro-advances slowed

44 per cent of total was overdue

According to the data that the banks conducting microfinance business in South Africa submitted to the Bank Supervision Department, growth (measured over a 12-month period) in microloans and micro-advances slowed down from 46,6 per cent in 2001 to 0,1 per cent in 2002. As at the end of December 2002, total microloans and micro-advances granted by banks amounted to R13,6 billion. About 44 per cent of that total was overdue by the end of December 2002, compared to 15,7 per cent in the previous year. Specific provision was made for about 38 per cent of total microloans in 2002, compared to 13 per cent in 2001. In terms of profitability, the results of these banks varied widely, from a positive return on equity of 23 per cent to negative returns of nearly 100 per cent in certain instances.

growth in micro-homeloans improved

Growth in micro-homeloans improved by 24,6 per cent (R21,5 billion) in 2002, compared to a contraction in growth of about 19,5 per cent in 2001. Amounts overdue remained fairly stable at R1,4 billion, compared to R1,1 billion in 2001. Expressed as a percentage of the total micro-homeloan book, the asset quality of banks conducting microfinance business deteriorated only marginally, from 6,3 per cent in 2001 to 6,5 per cent in 2002. Specific provision was made for 1,9 per cent of micro-homeloans in 2002, compared to 1,7 per cent in 2001.

Problems identified by the Microlenders Association

In order to keep abreast of problems in the microfinance industry, the Bank Supervision Department has established a regular discussion forum with the Microlenders Association (MLA), which represents the interests of microlenders nationally. Since the inception of the MLA in the mid-1990s, the level of professionalism in the industry has increased markedly.

inadequate access to the National Payment System

An important problem for members of the MLA is inadequate access to the National Payment System. The MLA's initiatives to develop a viable option in conjunction with consultants and big banks have not yet borne fruit.

unregistered lenders

Another problem is the large number of unregistered lenders. As a consequence, the MLA is finding it increasingly difficult to motivate, firstly, lenders to register with the MFRC and, secondly, its members to comply with the MFRC's rules. The market perception is that the MFRC prosecutes only registered lenders that transgress rules, whereas unregistered lenders go unpunished. The MLA believes that the Department of Trade and Industry (DTI) could play a role in ensuring that the playing-field is levelled.

high level of administration orders

Also of concern to the MLA is the high level of administration orders against borrowers. The MLA believes that individuals who have been placed under administration find it difficult to escape their financial woes and that the DTI could assist in creating an environment with a realistic cost structure for debt collection.

important development, aimed at containing borrowers' overindebtedness

In the above regard, there was an important development, aimed at containing borrowers' overindebtedness, during the year under review. The MFRC's rules on reckless lending and on the National Loans Register (NLR) came into effect in July 2002. These rules make it compulsory for all registered microlenders (including banks) to provide information on all their loans to the NLR and to assess the affordability of new loan applications by obtaining information on the indebtedness of an applicant from the NLR. Use of the NLR by all microlenders should substantially alleviate the problem of overindebtedness and decrease the credit risk in the microlending industry. The NLR already contains over four million records, and over one and a half million enquiries had been made by the end of 2002. In order to assess compliance, the MFRC is conducting inspections of microlenders, including bank microlenders.

Process of the National Economic Development and Labour Council

In 2000, the South African Communist Party and the Congress of South African Trade Unions tabled a demand at the National Economic Development and Labour Council (Nedlac) for Government and financial institutions to address deficiencies in the financial sector. In subsequent discussions, in which the Bank Supervision Department participated, all parties agreed on the need for all participants to ensure that the financial sector contributed more to development. There was also agreement on the need to maintain the long-term viability of the financial sector and that the problems identified were in large part due to external constraints.

agreements reached

Some of the agreements reached at the Financial Sector Summit in August 2002 and to be implemented during 2003 related to the following:

- Regulation of credit bureaux. These bureaux should improve the flow of information, supporting more equitable and efficient financial markets. In this way, credit bureaux should reduce the scope for discrimination in decisions about credit. It was also agreed that it was important to establish a regulatory framework for credit bureaux to ensure that they fulfilled their developmental role and did not wrongly deny people access to credit.

- Elements for legislation on cooperative banks. Legislation should be developed to give cooperative banks legal status with limited liability for both the organisation and members.

- Support for financial cooperatives and non-profit microlending schemes. The development of third-tier community-based financial organisations was regarded as an important route to extend credit to and support savings by poor households and micro-enterprises.

- Cessation of discrimination in the financial sector. Access to financial services was regarded as differing substantially by race and gender.

- Capital markets and investment. Ways should be found to ensure that the financial sector as a whole gave more support to economic and social development.

- Savings initiative. It was agreed that South Africa required increased investment in production capacity at all levels in order to generate the necessary levels of growth and employment. There was thus a need to increase measures to mobilise local savings and investment.

ILLEGAL DEPOSIT-TAKING

duties include acting against illegal deposit-takers

Persons and institutions that take deposits whilst not registered as a bank or not operating in terms of the various exemptions and exclusions from the Banks Act, 1990 (Act No. 94 of 1990), are acting illegally, since they are contravening the provisions of that Act. The duties of the Bank Supervision Department include acting against such illegal deposit-takers.

In terms of the banking legislation, registered banks have to comply with certain minimum prudential requirements. Illegal deposit-takers are obviously not subject to these requirements and, through their various illegal schemes, enter into direct competition with registered banks, to the detriment of the banking and financial system and, ultimately, the investors in such schemes once their deposits cannot be recovered.

inspections

In an effort to counter the activities of unscrupulous individuals that operate schemes designed to defraud others of their funds, 26 new inspections, together with 23 inspections carried over from the previous year, were undertaken during 2002. The Bank Supervision Department also actively continued to encourage members of the public to come forward with information on possible contraventions of the Banks Act.

communication

Communication with the public included input to various articles in popular lifestyle magazines, featuring, amongst others, Governor Tito Mboweni. Other communication measures included active liaison with newspapers, as well as participation in a number of radio interviews by members of the Department and appointed inspectors. The Department also delegated some of its members to act as expert witnesses in court proceedings during the year under review.

interaction with other key players

The Bank Supervision Department believes that its interaction with other key players, such as the Department of Trade and Industry, the Financial Services Board, the South African Police Service and the South African Revenue Service, has served to assist in the discharge of the Department's duty to act against illegal deposit-takers. The Department also increased its human-resource capabilities in that regard.

Miracle 2000 pyramid scheme

As reported in the previous annual report, Mr S M Radebe, an integral figure in the operation of the Miracle 2000 pyramid scheme, was charged and found guilty of contravening both the Banks Act and the Harmful Business Practice Act, 1988 (Act No. 71 of 1988). He was sentenced to one year in prison, or a fine of R50 000, for contravening the Banks Act, as well as three years in prison, or a fine of R150 000, for contravening the Harmful Business Practice Act. In view of the magnitude of Mr Radebe's crimes, and the amount money involved in the Miracle 2002 scheme, his sentence was not regarded as a deterrent for prospective criminals. The State, therefore, appealed against his sentence. On 12 December 2002, the High Court upheld the appeal and sentenced Mr Radebe to an effective four years' imprisonment.

Krion

A scheme that received much adverse publicity and extensive media coverage during the year under review was that of Ms Marietjie Prinsloo (née Pelser), namely, Krion Financial Services Limited (Krion). There were numerous rumours of the involvement of an amount of up to R1 000 million and 30 000 investors. During June 2002, Krion was placed into liquidation, and Ms Prinsloo and her associates were arrested. The Bank Supervision Department is closely monitoring developments in the case.

motivation of the public

The motivation of the public when investing in such schemes also deserves mention. Many members of the public invest in illegal schemes because of greed or ignorance. Although many greedy investors are aware of the illegality of such schemes, they raise the alarm only once a scheme fails and they are unable to access or recover their investment.

penalties not sufficiently severe

The Department is of the opinion that the penalties prescribed by the Banks Act are not sufficiently severe to deter contraventions of the Act. Consequently, proposed amendments to the Act were drafted, as mentioned in chapter 4 of this annual report.

foreign-exchange schemes

Recently, the Department noted that illegal schemes were becoming more complex and diverse in nature, which might add to the problems facing investors when trying to distinguish between products that offer a *bona fide* return on their investments and illegal schemes. In particular, the Department has been receiving reports of so-called foreign-exchange (forex) schemes, generally involving speculation against, amongst others, the South African rand, the United States dollar and the British pound sterling. Most notable among these schemes were the Equilibrium and Merces Cura schemes.

A typical forex scheme promises to take deposits from the public to buy and sell foreign-currency options. In practice, however, these schemes turn out to be normal pyramid schemes, whereby Peter's money is used to pay Paul, with no or negligible forex trades.

Intervention in forex schemes has been more difficult than in more traditional pyramid schemes, because the investors are required to participate actively in laundering the money to offshore accounts. As a result of their involvement, few such investors are willing to come forward or to cooperate with the Department in its efforts to eradicate such schemes. Since bank accounts in foreign countries are used, jurisdictional and cost concerns also arise.

liquidation

Another growing concern is the number of illegal deposit-taking schemes that were placed into liquidation during the past year. Although this is not necessarily an undesired phenomenon at first sight, early indications are that liquidation proceedings are seldom the best alternative for investors. The process is often more costly, since some liquidators tend to duplicate, at additional cost, the work already done by the inspectors appointed in terms of the South Reserve Bank Act, 1989. In a bid to protect the funds of investors in such schemes or, at least, the percentage remaining for distribution, the Department is considering amending the Banks Act to provide for such administrative considerations.

MONEY LAUNDERING

The events of 11 September 2000 in the United States of America placed a renewed worldwide focus on a variety of criminal activities. Although various supervisory, governmental and enforcement bodies have been addressing the crime of money laundering for a number of years, the events surrounding 11 September emphasised the need for anti-money-laundering (AML) measures to be implemented without delay.

anti-money-laundering (AML) measures

Financial Intelligence Centre Act

reporting suspicious transactions

In its 2001 annual report, the Bank Supervision Department reported on the progress made in South Africa with the implementation of AML measures. The provisions of the Financial Intelligence Centre Act (FIC Act), which was promulgated on 1 January 2002 and which established the FIC and the Money Laundering Advisory Council (MLAC), came into effect in February 2002. As a result of further progress with the development of regulations under the FIC Act and a process of consultation with all affected parties, the FIC Regulations were gazetted in December 2002. The regulations on the reporting of suspicious transactions require accountable institutions, which include banks, to start reporting suspicious transactions that may involve money laundering to the FIC as from February 2003. In addition, accountable institutions have to implement all required know-your-customer (KYC) and record-keeping measures by June 2003.

In order for the Bank Supervision Department to determine the status of the implementation of AML measures by banks in South Africa, the Department issued an assessment questionnaire late in 2002. The results of the questionnaire will give the Department an

indication of the extent to which banks have already implemented the necessary measures and which areas require improvement in order for all banks to comply fully with the requirements of the FIC Act and the FIC Regulations.

implementation of AML measures

The Bank Supervision Department regards the implementation of AML measures by banks in South Africa as an issue of high priority for 2003. Therefore, the Department intends using the information obtained as the basis for supervisory discussions with each bank during 2003. The Department will require banks that have not made sufficient progress towards full implementation of AML measures to submit detailed plans in that regard.

AML training

Another initiative undertaken by the South African Reserve Bank during 2002 was the development of several curricula for AML training. The intention is that the South African Reserve Bank College will present the training needed by the Bank Supervision Department, other regulators and enforcement agencies to fulfil their supervisory and inspection duties with regard to money laundering.

evaluation processes

In May 2002, South Africa applied for membership of the Financial Action Task Force (FATF), an intergovernmental body that develops and promotes policies, nationally and internationally, to combat money laundering. The AML measures of and the actions taken by South Africa to combat terrorist financing (CTF) will be subject to two separate evaluation processes in March/April 2003. The first evaluation will be conducted by an FATF team, on which the International Monetary Fund (IMF) and the World Bank may have observer status. The second evaluation team will be drawn together by the Eastern and Southern African Anti-money Laundering Group (ESAAMLG), with which South Africa signed a memorandum of understanding in April 2002. Both evaluations will be undertaken in accordance with the common methodology recently agreed by the FATF, the IMF and the World Bank for assessments of compliance with AML and CTF requirements by individual states.

FIC Regulations – four components

The standards against which South Africa will be measured are the FATF Forty Recommendations with regard to AML and the Eight Special Recommendations relating to CTF. A number of basic legislative and administrative arrangements have to be in place for this purpose, including commencement of the implementation of AML measures. Such implementation has to be based on the FIC Regulations, the four components of which are KYC requirements, record-keeping obligations, suspicious transaction reports (STRs) and provision for training and compliance.

South Africa will have to demonstrate that accountable institutions are submitting STRs to the FIC by March 2003 and are putting into place the capacity to apply KYC and associated verification procedures by June 2003. The maintenance of records, training of staff and monitoring of compliance by South African accountable institutions will also be reviewed.

monitoring programme

Supervisory bodies will have to demonstrate a knowledge and understanding of the various implementation plans geared towards full compliance with AML and CFT obligations and drawn up by the respective supervised institutions. Supervisors will also need to have in place trained capacity and a monitoring programme. Furthermore, supervisors will have to demonstrate the steps that they have taken to provide guidance and advice to accountable institutions.

It is clear that the various key players in South Africa have a serious responsibility to take the necessary measures towards compliance with both the local and the international requirements imposed on the banking and financial system. The Bank Supervision Department is confident that the coordinated efforts of all key players will help to the prevent the misuse of the banking and financial system by criminal elements.