Annual Report 2008

Bank Supervision Department

South African Reserve Bank

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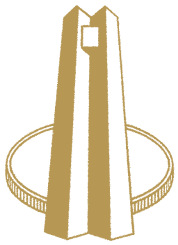

South African Reserve Bank

Mission

To promote the soundness of the banking system through the effective and efficient application of international regulatory and supervisory standards.

Business philosophy

Market principles underlie all our activities and decisions, and we strive to act with professionalism, integrity, credibility and impartiality at all times. We liaise with each individual bank through a single point of entry – a relationship manager, assisted by a team with diverse competencies. We follow a risk-based supervisory approach, not one of inspection, and our objective is to add value. Consequently, our role is that of a 'watchdog', not that of a 'bloodhound'. We place emphasis on empowering our staff to ensure that all interaction and service delivery is characterised by professionalism, and a high premium is placed on ethical behaviour at all levels of activity. A relationship of mutual trust between the Bank Supervision Department and all other key players is regarded as essential and is built up through regular open communication.

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Regulatory responses to the global financial market turmoil

The global financial market turmoil that emerged during 2007 and deepened to unprecedented levels during 2008 was the culmination of a period of exceptional credit growth and leverage in the international financial system. The background to the turmoil was discussed in the 2007 *Annual Report* (see pages 3–5 of the 2007 *Annual Report*). The disruptive effects of the turmoil, which included increased risk aversion, reduced liquidity, market uncertainty and tightened credit intermediation, prompted supervisory, regulatory and central bank bodies across the globe to reassess and enhance market and institutional resilience through appropriate policy responses to the turmoil.

The following summary of responses by certain of these standard-setting bodies is deemed appropriate to provide some insight into the key areas that regulators, supervisors and central banks across the globe will be focusing on in the future.

Financial Stability Forum (FSF)[1,2]

The Financial Stability Forum (FSF) was established to address vulnerabilities and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability. It comprises senior representatives of national financial authorities (central banks, regulatory and supervisory authorities and ministries of finance), international financial institutions, standard-setting bodies, and committees of central bank experts.

During the first quarter of 2008 the FSF completed an analysis of the causes and weaknesses that produced the turmoil. The FSF's final report, issued in April 2008, identified five key focus areas for regulators/supervisors to increase the resilience of financial markets and institutions in the future:

1. Strengthen prudential oversight of capital, liquidity and risk management
   - Raise capital requirements for certain complex structured credit products, introduce additional capital charges for default and event risk in trading books and strengthen the capital treatment of liquidity facilities to off-balance-sheet conduits.
   - Provide additional supervisory guidance regarding the supervision and management of liquidity risk.
   - Enhance oversight of banks' identification and management of group-wide risks, and banks' stress-testing practices, and ensuring the sound management and reporting of off-balance-sheet exposures.
   - Encourage market participants to ensure the soundness of the settlement, legal and operational infrastructure of over-the-counter derivatives.

2. Enhance transparency and valuation
   - Encourage financial institutions to make robust risk disclosures.
   - Issue further guidance under Pillar 3 of the *International Convergence of Capital Measurement and Capital Standards* to strengthen disclosure requirements.
   - Standard setters to improve and converge financial reporting standards for off-balance-sheet vehicles.
   - Expand the information provided about securitised products and their underlying assets.

3. Changes in the role and uses of credit ratings
   - Differentiate ratings on structured products from those on bonds and expand on the information provided.

- Regulators to review the roles given to ratings in regulatory and prudential frameworks.

4. Strengthen the authorities' responsiveness to risks
   - Translate risk analysis into actions to mitigate risks.
   - Improve information exchange and co-operation between authorities.
   - Enhance the speed, prioritisation and co-ordination of policy development work by international bodies.

5. Robust arrangements for dealing with stress in the financial system
   - Central banks to enhance their operational frameworks and authorities to strengthen their co-operation for dealing with stress in the financial system.

Group of 20 Finance Ministers and Central Bank Governors[3]

The Group of 20 (G-20), a forum that brings together systemically important industrialised and developing economies to discuss key issues in the global economy, noted at a meeting held in November 2008 that the financial crisis was largely the result of the following:

- Excessive risk-taking in financial markets
- Faulty risk management practices in financial markets
- Inconsistent macroeconomic policies
- Deficiencies in financial regulation and supervision.

The G-20 committed itself to implementing policies consistent with the following principles:

- Strengthen transparency and accountability in financial markets through enhanced disclosure requirements
- Enhance sound regulation of financial markets, products and participants (including rating agencies)
- Promote integrity in financial markets
- Reinforce co-operation between regulators, on a regional, national and international level
- Reform international financial institutions, *inter alia*, by means of the expansion of the membership of major standard-setting bodies such as the FSF.

The G-20 also requested the finance ministers of member countries to focus on the following key aspects:

- Mitigate against pro-cyclicality in regulatory policy
- Review and align global accounting standards, specifically with regard to complex securities in times of stress
- Strengthen the resilience and transparency of credit derivatives markets, including improvement of the infrastructure of over-the-counter markets
- Review compensation practices as they relate to incentives for risk taking and innovation
- Review the mandates, governance and resource requirements of international financial institutions
- Define the scope of systemically important institutions and determine their appropriate regulation or oversight.

Basel Committee on Banking Supervision[4]

The Basel Committee on Banking Supervision (Basel Committee) provides a forum for regular co-operation on banking supervisory matters. It seeks to promote and strengthen supervisory and risk management practices globally. As at 31 December 2008, the Basel Committee's members were from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States of America (USA).

On 20 November 2008 the Basel Committee announced its strategy to address the fundamental weaknesses revealed by the financial market turmoil related to the regulation, supervision and risk management of internationally active banks. The focus of the strategy was on strengthening capital buffers to contain leverage in the banking system, and stronger risk management and governance practices to limit risk concentrations in the banking sector. The strategy took account of the April 2008 recommendations of the FSF and its key building blocks included the following:

- Revising the *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (Basel II), with particular focus on risk capturing in respect of the trading book and off-balance-sheet exposures
- Enhancing the quality of Tier 1 capital
- Enhancing the capital framework to build in a capital cushion to be drawn upon during periods of market stress and also to dampen procyclicality
- Assessing the need to supplement risk-based measures with simple gross measures of exposure in both prudential and risk management frameworks to help contain leverage in the banking system
- Strengthening supervisory frameworks to assess funding liquidity at cross-border banks
- Strengthening counterparty credit risk capital, risk management and disclosure at banks
- Promoting globally co-ordinated supervisory follow-up exercises to ensure implementation of supervisory- and industry-sound principles.

The existing South African legal and regulatory framework already incorporates and/or makes provision for many of the items that have been highlighted above. However, the Bank Supervision Department of the South African Reserve Bank (the Department) continues to provide input to, and take cognisance of, comments and guidance papers issued by the relevant standard-setting bodies, and it continuously monitors developments within the domestic banking industry and international markets that could have an impact on South African banks and the domestic banking legislative and regulatory framework. Where necessary, adjustments will be made to ensure that the legal framework pertaining to domestic banking legislation reflects local and international market developments, and complies with the applicable international regulatory standards and best practice.

Notes

1 At the beginning of April 2009 the Financial Stability Forum was reconstituted as the Financial Stability Board.
2 http://www.financialstabilityboard.org.
3 http://www.g20.org.
4 http://www.bis.org.

Contents

Appendices

Annual Report for the calendar year ended 31 December 2008 in terms of section 10 of the Banks Act, 1990 (Act No. 94 of 1990) and section 8 of the Mutual Banks Act, 1993 (Act No. 124 of 1993).

This report presents an overview of the objectives and activities of the Bank Supervision Department of the South African Reserve Bank, with particular reference to the period 1 January 2008 to 31 December 2008.

Chapter 1

Registrar of Banks' review

The secondary effects of the international financial market turmoil, combined with cyclical economic developments in South Africa, worsened the operating environment of the banking sector during 2008, with a noticeable decline in the rate of growth in loans and advances. Furthermore, increasing pressure on consumers was clearly evident in the sharp increase in impaired advances and rising credit impairments, which impacted negatively on banks' earnings. However, notwithstanding the turmoil experienced in international financial markets and the domestic cyclical economic developments during 2008, the South African banking system again remained stable, and banks were adequately capitalised and profitable.

notwithstanding the turmoil experienced, the banking system remained stable

This chapter provides a high-level overview of, *inter alia*, the balance-sheet structure, capital adequacy, profitability and asset quality of the banking sector. Furthermore, it reviews the pilot study conducted by the International Monetary Fund (IMF) on the South African implementation of the *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (Basel II), the joint IMF/World Bank Financial Sector Assessment Program (FSAP) mission to South Africa and the IMF Article IV consultation. In addition, it provides an overview of banks' compliance with anti-money laundering (AML) legislation and the Bank Supervision Department's (the Department) skills development-related issues.

High-level overview of the banking sector

As at the end of December 2008 there were 33 banking institutions reporting data to the Office of the Registrar of Banks (excluding two mutual banks; however, including one institution conducting banking business in terms of an exemption from the provisions of the Banks Act, 1990 (Act No. 94 of 1990) (the Banks Act), namely, Ithala Limited) and 43 international banks with authorised representative offices in South Africa.

The South African banking sector's capital-adequacy ratio during 2008 remained above the minimum requirement of 9,50 per cent, reaching 13,0 per cent at the end of December 2008 (January 2008: 11,8 per cent). The tier 1 capital-adequacy ratio increased to 10,2 per cent at the end of December 2008, compared with 8,9 per cent at the end of January 2008.

tier 1 capital-adequacy ratio increased to 10,2 per cent

At the end of December 2008 total banking-sector assets amounted to R3 170 billion, representing an annual growth rate of 24,5 per cent year on year (January 2008: 27,0 per cent). Total assets of the four largest banks amounted to R2 676 billion and accounted for 84,4 per cent of total banking-sector assets. At the end of December 2008, gross loans and advances amounted to R2 316 billion (January 2008: R2 103 billion) and R2 276 billion net of credit impairments (January 2008: R2 077 billion). The growth in gross loans and advances (measured year on year) eased to 9 per cent at the end of December 2008, compared with 19,2 per cent at the end of January 2008.

growth in gross loans and advances eased

At the end of December 2008 banking-sector total liabilities amounted to R2 989 billion and total equity amounted to R181 billion. Deposits represented 79,6 per cent of total liabilities (January 2008: 84 per cent). The main contributors to total deposits were fixed and notice deposits (25 per cent), call deposits (22,1 per cent) and negotiable certificates of deposit (16,3 per cent). Deposits from retail and corporate customers were the primary sources of funding and represented 63,2 per cent of total banking-sector deposits at the end of December 2008. Total equity increased from R154,4 billion at the end of January 2008 to R181 billion at the end of December 2008.

Banks reported favourable profitability ratios throughout 2008, despite the turmoil experienced in international financial markets and the domestic cyclical economic developments. The banking sector's cost-to-income ratio (unsmoothed) was

favourable profitability ratios

42,2 per cent, compared with 47 per cent at the end of January 2008. At the end of December 2008 the return on equity amounted to 28,7 per cent (January 2008: 24,1 per cent) (unsmoothed) and return on assets to 1,62 per cent (January 2008: 1,39 per cent) (unsmoothed).

liquid assets exceeded statutory requirement

Liquid assets held exceeded the statutory liquid assets requirement throughout 2008. The liquid assets held, measured against the minimum liquid asset requirement, amounted to 115,5 per cent at the end of December 2008 (January 2008: 111,1 per cent).

credit risk ratios deteriorated

Credit risk ratios deteriorated during 2008. Impaired advances[1] continued to rise, reaching R87,3 billion at the end of December 2008 (January 2008: R47,6 billion). Expressed as a percentage of gross loans and advances, the ratio deteriorated from 2,3 per cent at the end of January 2008 to 3,8 per cent at the end of December 2008. The increase in interest rates, other cyclical economic developments in South Africa and the turmoil experienced in international financial markets contributed to the deterioration in credit risk ratios.

Concentration in the South African banking system

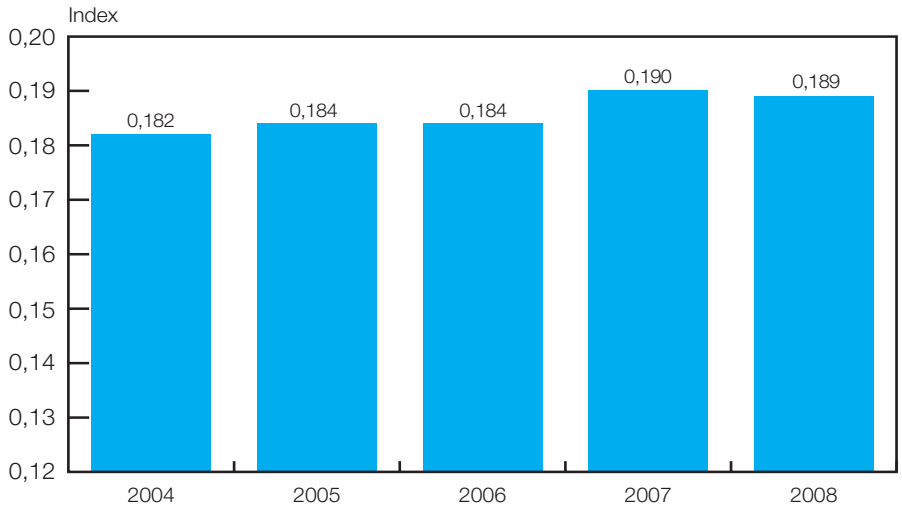
The Herfindahl–Hirschman Index (H-index) is a commonly accepted measure of market concentration in a banking system. The index is calculated by squaring the market share, in terms of total assets, of each bank in the system and subsequently summing the squares. It takes into account the relative size and distribution of the firms in a market, and approaches zero when a market consists of a large number of firms of relatively equal size. The index increases as the number of firms in the market decreases and as the disparity in size between those firms increases. The higher the index, the less competition exists in the market and vice versa.

An H-index below 0,1 indicates that there is no concentration in an industry, while an H-index between 0,1 and 0,18 is an indication of moderate concentration. An H-index above 0,18 represents a highly concentrated industry that indicates the presence of an oligopoly. An 'oligopoly' can be defined as an imperfectly competitive market structure in which a few institutions dominate the industry.

continued dominance of four largest banks

The level of concentration in the South African banking sector, measured using the H-index, is presented in Figure 1. The index amounted to 0,189 at the end of December 2008 (December 2007: 0,190 index). The high index in 2008 can be attributed to the continued dominance in terms of market share by the four largest banks. The total balance sheet of the four largest banks amounted to R2 676 billion and accounted for 84,4 per cent of banking-sector assets at the end of December 2008 (December 2007: 85,1 per cent).

Figure 1 H-index for the South African banking system (2004–2008)



International Monetary Fund Basel II assessment

Introduction

IMF pilot study

South Africa implemented Basel II with effect from 1 January 2008. During 2007, the IMF approached the Department with a request to conduct a pilot study on the South African implementation of Basel II, to which request the Registrar of Banks (the Registrar) acceded.

The purpose of the pilot study was twofold:

1. It would serve as an independent assessment and benchmarking of the South African implementation of Basel II
2. The IMF/World Bank wished to test and calibrate their joint approach to, and documentation of, the assessment of a country's Basel II implementation for FSAP and Article IV purposes.

The pilot study comprehensively covered the entire Basel II implementation process, and included visits to three banks and meetings with an auditing firm and a rating agency.

South Africa – one of only four countries

South Africa was most fortunate to be chosen as one of only four countries in respect of which the IMF/World Bank pilot study was conducted and gained much value through the effective challenge posed by the IMF/World Bank team (the study team). Canada, Peru and Spain also participated in the study.

Rationale for Basel II

Basel II has international ramifications

The implementation of Basel II by South Africa has international ramifications for the country, since the effective and efficient implementation of Basel II

- can contribute materially to the safety and soundness of a bank and banking system;
- would facilitate the access of local banks to banking markets in other jurisdictions; and
- could impact positively on the creditworthiness of South African sovereignty through the market discipline imposed on the country by the international capital markets.

Preparation

comprehensive and challenging questionnaires

The preparation for the study team's visit stretched over a number of months, and entailed the Department's respondent team studying detailed instructions, and completing two comprehensive and challenging questionnaires. In addition, the Department submitted extensive relevant information to the team during December 2007. The team used this information as the basis for their detailed desktop analysis completed prior to their visit to South Africa in January 2008.

Throughout the study team's visit to South Africa, they, at their own discretion, interviewed members of the Department intensively and tested them robustly on a range of aspects of the South African implementation of Basel II. From time to time the team called for additional supporting original evidence to substantiate statements made by members of the Department.

International Monetary Fund/World Bank report

The study team presented the Department with their final report during June 2008. The executive summary of the final IMF/World Bank report is introduced with the following

Basel II implementation process of high quality

statement: "Overall, the Basel II implementation process in South Africa has been of high quality, backed by professional and competent supervisory staff and a strong buy-in from the industry, and reflects a high degree of compliance with the criteria in the methodology."

The Department's staff members converted the recommendations contained in the IMF/World Bank report into action plans and are monitoring the implementation of these action plans on a monthly basis.

Securitisation

risk posed by securitisation vehicles, conduits and special investment vehicles

The turmoil in the financial markets, flowing from the collapse of the sub-prime market in the United States of America (USA) that started in 2007 (see pages 3–5 of the 2007 *Annual Report*), gathered momentum during 2008, resulting in large global corporate and banking failures, and unprecedented write-downs by a number of international financial institutions. Although the root cause of the crisis, in essence, derives from the risk-taking behaviour of investors, banks, consumers and other market participants, it, however, highlighted the risks posed to the soundness of financial institutions by securitisation vehicles, conduits and special investment vehicles due to the deterioration in the quality of assets housed in such vehicles. What essentially is a very useful tool to manage credit and bank funding became the largest threat to the banking sector.

independent review of all securitisation schemes

In the light thereof, and in the interest of the stability of the domestic banking sector, the Department deemed it necessary to commission an independent review of all securitisation schemes affecting banks, in order to determine whether or not such schemes were being managed proactively.

During April 2008, the Department directed all banks that were participating in securitisation activities, in terms of the provisions of section 7(1)(b) of the Banks Act, to furnish it with a report on the various risks facing banks that were involved in securitisation schemes. One of the large international locally based auditing firms was designated, in terms of the provisions of section 7(2) of the Banks Act, to compile the above-mentioned report.

"best practice" findings assist banks' management

The review of the securitisation market was akin to a due diligence exercise and provided factual evidence of the various risks facing entities that were participating in securitisation schemes. The review focused on banks participating in securitisation transactions in either a primary or secondary role. It was also intended that "best practice" findings be provided that could assist both banks' management and the Department going forward.

aspects relating to securitisation schemes

The following are some of the aspects relating to securitisation schemes and banks that were reviewed:

- Legal risk, including the potential practical ramifications for banks in the event of a premature termination of the fundamental obligations of the participants
- Accounting treatment, including valuation issues
- Regulatory compliance with the Exemption Notice relating to Securitisation Schemes (*Government Gazette* No. 30628, dated 1 January 2008), including capital requirements
- Risk management, covering, *inter alia*,
  - liquidity risk, including the maturity profile of commercial paper in issue, potential roll-over risk, risks relating to liquidity facilities and the quantification of liquidity risk under stressed scenarios;

- credit risk, including the extent of claims against credit enhancement facilities, credit risk mitigation plans, reviews of asset repurchases and replacements, and of the modelling of asset values in stressed scenarios;
- market risk, including a review of the daily market risk reporting framework and the stress-testing framework; and
- operational risk, including the governance structures and policies in place in both originating banks and special-purpose vehicles (SPVs).

The auditing firm furnished the Department with its report in November 2008. The report noted that securitisation in South Africa was not as complicated as in the USA and in European countries, and that the assets housed in South African schemes tended to have a high level of transparency. Furthermore, the assets securitised had been subjected to the same credit approval processes that applied to banks' own credit exposures. Some of the key observations included in the report are the following:

key observations relating to securitisation in South Africa

- Generally, risks related to securitisation schemes were appropriately managed by the banks reviewed.
- Top-tier South African banks, on average, sourced only 4 per cent of their total funding from securitisation, which was significantly less than those international banks that struggled during the liquidity crisis.
- In respect of accounting for securitisation schemes, the transparency of financial statements could be improved. In this regard, the developments in international accounting and disclosure requirements should continue to be monitored and followed.
- Regulatory compliance was generally acceptable.

various recommendations

The report made various recommendations for consideration in order to improve oversight and governance, and reduce risks that could arise with respect to securitisation schemes. These included recommendations

- in respect of the repurchase and replacement of assets;
- on the corporate governance role of issuer SPV directors;
- on improving reporting methodologies that would allow the Department to monitor risks faced by banks better;
- relating to liquidity risk management and stress testing; and
- on setting out areas in respect of which guidance and clarification of the regulatory requirements relating to securitisation were required.

The Department is in the process of studying the recommendations and will engage with the banking sector in a consultation process on areas where changes or amendments to legislation are considered necessary. Legislative amendments will only be effected after such consultation process.

Compliance with anti-money laundering and the combating of the financing of terrorism standards

Department committed to compliance with AML

As indicated in the 2007 *Annual Report*, this Department endorses the Core Principles for Effective Banking Supervision (Core Principles). In endorsing Principle 18 of the Core Principles, in particular, the Department continued its co-operation with the Financial Intelligence Centre (FIC). The Department remained committed to facilitating the optimisation of banks' compliance with AML and the combating of the financing of terrorism (CFT) measures.

Financial Intelligence Centre Amendment Act, 2008 (Act No. 11 of 2008)

The Financial Intelligence Centre Amendment Act, 2008 (Act No. 11 of 2008) (FICA) that was released for comment in November 2006 was assented to by the President of the

Republic of South Africa on 22 August 2008. FICA was published in *Government Gazette* No. 31365 on 27 August 2008 .

European Union Statement on Equivalence

AML/CFT measures equivalent to the EU

On 12 May 2008 the member states of the European Union (EU) participating in the EU Committee on the Prevention of Money Laundering and Terrorist Financing agreed to establish a list of countries whose application of AML/CFT measures could qualify those countries to be considered equivalent to the EU. The agreement to establish such a list was in compliance with the requirements of the Third Money Laundering Directive of the EU.

In terms of this directive, the inclusion of a jurisdiction on the list indicates that AML/CFT measures applied by a credit or financial institution based in that jurisdiction should be considered to be equivalent to those of the EU. The list is a voluntary, non-binding measure that nevertheless represents the common understanding of member states of the EU. In the United Kingdom (UK) the list is relevant to assessing whether a jurisdiction is equivalent to the extent that institutions in the UK can rely on customer due diligence practices of the institution based in the listed country.

South Africa is one of the countries outside the EU that is currently regarded as having AML/CFT systems that are equivalent to those of the EU. The listing of a country follows the results of public evaluation reports adopted by the Financial Action Task Force (FATF) on Money Laundering, FATF-style Regional Bodies (FSRBs), the IMF or the World Bank.

Anti-money laundering and the combating of the financing of terrorism evaluations

40+9 Recommendations recognised as global standard

The FATF is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering and terrorist financing. The Forty Recommendations of 2003 and the Nine Special Recommendations of 2001 of the FATF (the 40+9 Recommendations) (and issued by it) define criminal justice and regulatory measures that should be implemented to counter this problem. The 40+9 Recommendations also include international co-operation and preventative measures to be taken by financial institutions and others such as casinos, real-estate dealers, lawyers and accountants. The 40+9 Recommendations are recognised as the global AML/CFT standard.

AML/CFT evaluations are carried out according to the 40+9 Recommendations and methodology. The methodology follows the structure of the 40+9 Recommendations and is a key tool to assist assessors in preparing detailed AML/CFT assessment reports/mutual evaluation reports. The assessment of individual recommendations, as well as any findings, leads to broader conclusions on the global effectiveness of a country's AML/CFT system. The methodology assists assessment teams in identifying the systems and mechanisms developed by countries with diverse legal, regulatory and financial frameworks, in order to implement robust AML/CFT systems. The methodology is also useful for countries performing AML/CFT system self-assessments and is informed by the experience of the FATF and the FSRBs, based on historic mutual evaluations, the IMF and the World Bank.

Preparations for the Financial Action Task Force mutual evaluation

self-assessment

The Registrar invited a delegation from the Basel Institute on Governance (the consultant) in April 2008 to assist the Department in performing a self-assessment for compliance with the 40+9 Recommendations. The consultant provided the Department with an aide-memoire containing recommendations for consideration. The consultant

also provided the Department with comments and views on the interpretation of certain sections of the FATF AML/CFT Mutual Evaluation Questionnaire (MEQ).

The mutual evaluation procedure requires countries to submit a completed MEQ to the FATF Secretariat three months prior to the actual evaluation for review by an expert team of assessors. The Department assembled a team composed of personnel from its Analysis, Review, Legal and Support divisions to focus on the completion of the MEQ.

Stakeholder preparatory workshops for the Financial Action Task Force mutual evaluation

FIC hosted three preparatory workshops

The FIC arranged and hosted three preparatory workshops for the FATF mutual evaluation of South Africa's AML/CFT regime with supervisory bodies, law enforcement agencies and government departments.

The purpose of the workshops was to prepare participants for the joint FATF/Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) on-site mutual evaluation country assessment scheduled for August 2008. The key focus areas at the workshops were to

- inform all stakeholders of the status of the MEQ already submitted to the FATF Secretariat;
- afford participants the opportunity to consider and answer typical questions that could be expected from the assessment team (e.g., to participate in a dry-run of an actual on-site assessment); and to
- give workshop participants the opportunity to ask questions and interact with the FIC and one another.

new threshold for co-operation

The preparatory workshops signalled a new threshold for co-operation in terms of AML/CFT issues for South African law enforcement agencies, regulatory bodies and government departments. The current state of preparedness was conveyed to Cabinet by means of a Cabinet Memorandum drafted by the FIC. The issues highlighted during the workshops were addressed during the assessment meetings and interviews by the respective stakeholders. The important work conducted by way of preparation for this mutual evaluation process formed the basis of future work that South Africa would have to undertake in order to enhance its AML/CFT framework.

Joint mutual evaluation conducted by the Financial Action Task Force and Eastern and Southern Africa Anti-Money Laundering Group

South Africa's AML/CFT regime benchmarked against 40+9 Recommendations

During the mutual evaluation, assessors from the FATF and ESAAMLG benchmarked South Africa's AML/CFT regime against the international standards of the 40+9 Recommendations. The assessment included a visit by an assessment team to South Africa over a two-week period during which meetings with all public- and private-sector stakeholders were held. The FIC was mandated with responsibility for co-ordinating South Africa's participation in the mutual evaluation process.

The mutual evaluation was conducted by an assessment team, which consisted of members of the FATF Secretariat and FATF experts in criminal law, law enforcement and regulatory issues. The members of the assessment team were as follows:

- Ms Valerie Schilling and Mr Kevin Vandergrift, FATF Secretariat
- Ms Yotsna Lalji, ESAAMLG Secretariat

- Mr Hay Hung Chun, State Counsel, Criminal Justice Division, Attorney-General's Chambers, Singapore (legal expert)
- Dr Michalis Mersinis, Attorney at Law, Legal Department, Hellenic Capital Market Commission, Greece (financial expert)
- Ms Indira Crum, Senior Policy Advisor, Office of Terrorist Financing and Financial Crime, United States Department of the Treasury (financial expert)
- Mr Shi Yongyan, Anti-Money Laundering Bureau, People's Bank of China (financial intelligence unit (FIU) expert)
- Mr Joseph Jagada, Chief Law Officer, Attorney General's Office, Zimbabwe (law enforcement expert).

In November 2008 the FATF Secretariat presented South Africa with a first draft of the Mutual Evaluation Report (MER) based on the information submitted in the MEQ, as well as information gathered during the on-site assessment. The report described in detail the system in place in South Africa, and assessed and rated its effectiveness. The draft MER also included individual ratings of the 40+9 Recommendations. The FIC disseminated the draft MER to all stakeholders. The findings and recommendations contained in the MER, in so far as they are applicable to the Department and the banking sector, will be used as a guide to further improve overall compliance with the FATF AML/CFT requirements.

During December 2008 the FIC held another workshop to provide feedback on further developments following the publication of the first draft MER. The draft MER and responses to it were also discussed. A key outcome of the workshop was preparations for the meeting with the assessment team in Paris, scheduled for January 2009.

Guidance Note 8/2008

decision by FATF for enhanced scrutiny of transactions

The Registrar issued Guidance Note 8/2008 to inform banks and controlling companies of the decision made by the FATF for enhanced scrutiny of transactions with certain jurisdictions and of United Nations sanctions in relation to the proliferation of weapons of mass destruction.

In particular, the FATF called on its members to implement enhanced due diligence processes with respect to the northern part of Cyprus, the Republic of Uzbekistan and the Islamic Republic of Iran.

Southern African Development Community anti-money laundering workshop

During October 2008 the Southern African Development Community (SADC) Secretariat held an AML/CFT workshop at the South African Reserve Bank Conference Centre in Pretoria. The objective of the workshop was to create an opportunity for member countries of the ESAAMLG and SADC to develop and implement appropriate national AML/CFT legislation in their respective countries in accordance with international AML/CFT standards.

International Conference of Banking Supervisors

During September 2008, the Department was represented at the International Conference of Banking Supervisors (ICBS) held in Brussels, Belgium. This biennial event, which is arranged by the Basel Committee and hosted in a different country each time, attracted supervisors and central bankers from well over 100 countries. The ICBS focused on the following topical regulatory and supervisory issues:

Cross-border dimensions to liquidity risk

increase in cross-border flows

The increase in cross-border flows has resulted in more integrated and intermediated financial markets. Banking institutions have large operations outside their countries of origin, some of which are systemically important in the host countries. Some large global financial institutions have begun to manage their daily liquidity demands across several jurisdictions in a centralised manner. These cross-border interdependencies raise the prospect of liquidity disruptions that could impact financial markets and settlement systems.

Liquidity risk supervision and supervisory approaches

two forms of liquidity risk

Two forms of liquidity risk affect banking, namely (1) funding liquidity and (2) market liquidity. Funding liquidity refers to the risk that a bank will be unable to meet obligations as they become due, while market liquidity refers to the risk that a bank's assets, held as liquidity reserves, cannot be sold in a stressed situation without incurring unacceptable losses. It was highlighted that many banks failed to take account of several basic principles of liquidity risk management when liquidity was abundant. These inadequacies came to the fore during the international financial market turmoil. Supervisory approaches to liquidity risk have been developed mainly at a national level, thereby ensuring that each country's safety and soundness were preserved. Liquidity risk supervision in respect of internationally active banking groups has predominantly been in accordance with the principle of 'host country responsibility'.

Stress testing and contingency funding plans

weaknesses in stress testing and contingency funding plans

The international financial market turmoil has highlighted weaknesses in banks' liquidity stress testing and contingency funding plans. Banks did not perform stress tests that considered all relevant risks and their interaction in respect of liquidity risk. Furthermore, it was noted that banking groups were not able to aggregate risks across the group as more segregated approaches were followed. Off-balance-sheet items were not incorporated in stress testing, resulting in additional shortcomings in the overall liquidity risk management process. In addition, contingency funding plans were not appropriately linked to stress testing. The financial market turmoil highlighted that diversified contingency funding plans functioned most effectively under stressed conditions.

Liquidity risk disclosure

increasing pressure to disclose

Financial institutions, particularly those that have experienced financial difficulties in recent times, have been under increasing pressure from the market to disclose more information regarding positions held in the market and their risk management techniques. Despite these developments, it was noted that disclosure practices varied across banks and in certain instances were very limited. There is a general view that banks that disclose comprehensive, accurate, relevant and timely liquidity information are better able to access capital markets. In times of market disruptions, transparent liquidity disclosures enable market participants to distinguish banks with sound liquidity positions from those without, thereby mitigating unwarranted systemic effects.

Identification and measurement of liquidity risk

Sound liquidity risk management enables a bank to identify, measure, monitor and control liquidity risk. Effective liquidity risk management should include a framework that comprehensively projects cash flows arising from assets, liabilities and off-balance-sheet

incorporate all relevant time horizons

items. The framework should incorporate all relevant time horizons. Liquidity risk management should consider contractual, 'business-as-usual' and stressed scenarios. Finally, the liquidity risk management process should be cognisant of the business mix, complexity and risk profile of the particular bank.

Fair valuation issues

fair value increasingly applied

Fair value measurements have been increasingly applied in reported financial information. Standard financial instruments, as a result of their wide use and relatively simple structure, are reasonably straightforward to value. However, over the years financial instruments have become more complex in nature and, therefore, not as easy to value. Banks are expected to have documented policies in respect of the valuation and risk management of their financial instruments that are subject to fair valuing. Of particular importance is the valuation of these instruments during market illiquidity and, therefore, banks should apply robust valuation techniques that are able to function during stressed conditions.

Sound provisioning under International Accounting Standards Board standards

promote impairment guidance

From experience it has been noted that poor credit quality is one of the major drivers of the difficulties being experienced by banks. An inability or unwillingness to recognise deteriorating credit quality results in persistent high-risk lending by, and possible failure of, a bank. Accordingly, it is crucial to supervisors that accounting policies applied by banks reflect prudent and realistic measurements of loans and related income through adequate provisions and other accounting practices. Sound accounting standards are in the interest of better public disclosure, which aim to enhance transparency in respect of credit risk exposures, risk management practices and loan loss recognition. As a result of the concerns with banks' accounting practices, the Basel Committee had extensive dialogue with the International Accounting Standards Board (IASB) to promote impairment guidance in IASB standards that will support sound provisioning practices by banks.

Valuation, volatility and regulatory capital

challenges associated with valuing financial products

Considerable attention has been focused on bank valuations of complex or illiquid financial instruments, since inconsistency of valuations leads to increased volatility in earnings and regulatory capital. Valuation issues have several risk management implications. It is paramount that banks have robust valuation and accounting classification processes in place to address challenges associated with valuing financial products that are complex or illiquid. The key areas of focus should include governance and controls; risk management; valuation adjustments and uncertainty; and financial reporting.

Financial Sector Assessment Program

The FSAP is a joint IMF and World Bank attempt to increase the effectiveness of efforts to promote the soundness of financial systems in member countries.[2] The programme seeks to identify the strengths and vulnerabilities of a country's financial system; to determine how key sources of risk are being managed; to ascertain the sectors' developmental and technical assistance needs; and to help prioritise policy responses.

resilient and well-regulated financial system essential

Surveillance, one of the main functions of the IMF, involves the monitoring of economic and financial developments, and the provision of policy advice aimed specifically at crisis

prevention. In a world of increased capital flows, resilient and well-regulated financial systems are essential for macroeconomic and financial stability. The FSAP also forms the basis of Financial System Stability Assessments (FSSAs) in which the IMF addresses issues of relevance to IMF surveillance, including risks to macroeconomic stability stemming from the financial sector and the capacity of the sector to absorb macroeconomic shocks.

capital sufficient to absorb large shocks

A joint IMF/World Bank FSAP mission visited South Africa in May 2008 to conduct an FSAP update. The FSAP update included a stress-testing exercise that was performed by a selected number of banks (bottom-up stress testing) and the Department (top-down stress testing). The Department co-ordinated the stress-testing exercise with commendable support from the industry's banking participants. The results of the stress tests suggested that capital and reserve cushions at banks were sufficient to absorb large shocks.

FSAP's findings and recommendations

The FSAP's findings and recommendations were discussed with the South African authorities during the Article IV Consultation mission in June 2008. In short, the key findings from the FSSA[3] that have specific relevance to the Department are listed below, followed by the recommendations and some comments thereon.

Key findings

South Africa's financial system fundamentally sound

- South Africa's sophisticated financial system is fundamentally sound and has so far weathered the global financial market turmoil without major pressures. Banks and insurance companies have enjoyed good profitability, capitalisation levels and reserves.

increased macro-financial risks

- The system faces increased macro-financial risks and financial institutions are braced for a less-benign environment. Banks are exposed to increased credit risk, given record household indebtedness and the mounting debt-service burden, and are seeing some impairment of asset quality. As mentioned above, stress tests suggest that capital and reserve cushions at banks and insurance companies are adequate to absorb large shocks.
- Money, foreign-exchange and capital markets are relatively well developed, but may be subject to contagion risks, given their close linkages with offshore markets.
- The framework for contingency planning and emergency liquidity assistance has been strengthened.

strengthen supervision of conglomerates

- The financial-sector regulatory framework is modern and generally effective. There is a need to strengthen supervision of conglomerates, with a focus on risks that span more than one sector and further to promote co-operation, consistency and effectiveness among regulators.
- The extensive inter-linkages in the financial sector make supervisory co-operation critical.
- Access to financial services has improved markedly in recent years.

Recommendations relevant to the Department, with the Department's follow-up comments in square brackets, are highlighted below:

Financial stability

focus on stress testing

1. Strengthen the off-site stress-testing capacity and employ this capacity to inform the regular supervisory discussions.

   [A top-down stress-testing process has been adopted. More information on this topic is available under the heading "Stress testing the South African banking system" on page 31 of this report. The Department will make a concerted effort to focus on the stress-testing of individual banks and the total banking sector in the future.]

2. Remain vigilant on credit risk in banking, stemming from retail and concentrated corporate exposures and on funding risks, resulting from reliance on short-term domestic wholesale funding.

[Vigilant monitoring of credit risk forms part of the Department's risk-based supervisory review and evaluation process.]

Systemic liquidity and crisis management

focus on liquidity and funding issues

3. Enhance focus on liquidity and funding issues, and discuss medium-term strategies to reduce banks' dependency on wholesale market funding by analysing in a collaborative exercise between the Bank, the National Treasury and the Financial Services Board (FSB), for instance, in the context of a Basel II Pillar 2 exercise and in drawing on the results of the planned study of the effects of an eventual lifting of remaining capital controls.

   [Contingency plans to be developed in conjunction with the National Treasury and FSB should the further relaxation of exchange controls be considered.]

strategies regarding crisis management

4. Review all strategies regarding crisis management as part of the work of the Financial Sector Contingency Forum (FSCF) in the light of past crisis episodes experienced globally, and consider undertaking a crisis simulation exercise relating to a macro-financial shock, such as a capital outflow or distress in a large financial sector institution.

   [The Department is represented at the FSCF and will monitor progress closely. The FSCF was created to serve as a forum for open discussions regarding contingency planning and information sharing, and represents a co-ordinated network of key contacts throughout the financial services industry. The primary objective of the FSCF is to identify potential crisis events that may threaten the stability of the South African financial sector, and to propose and obtain approval for appropriate plans, mechanisms and structures to prevent the realisation of threats or to mitigate their consequences. In support of this objective, the FSCF has various constituent subcommittees and task teams whose individual composition and positioning facilitate its unique role in the forum.]

clarify bank resolution powers

5. Clarify bank resolution powers by authorising the Registrar, who has extensive powers to safeguard the soundness of the banking system, to appoint a curator directly, limiting the need for the Minister of Finance's intervention only in those cases requiring use of public funds.

   [A bank curator is appointed by the Minister of Finance after considering such a recommendation from the Registrar. The Department has responded to the IMF that this provision serves as a check and balance in the regulatory management of distressed banks and it would not be viewed as prudent should this "four-eyes" principle be removed.]

Financial sector supervision and regulation

sound and proactive collaboration

6. Enhance day-to-day collaboration among the staff of the different sectoral regulators in respect of individual institutions and emerging risk issues. Further develop risk assessment models taking a more consistent approach across sectors, and the creation of increased central capacity at the main regulators to identify risk and allocate resources flexibly to issues as they arise.

   [The Department experiences sound and proactive collaboration with cross-sectoral regulators, but will nevertheless review its current working relationship with the cross-sectoral regulators concerned. The current identification of risks across the sectors and the sharing of information will also be reviewed.]

7. Consider a mechanism for resolving policy disagreements among different regulators and departments, and assessing trade-offs among differing policy objectives. In this regard, the Policy Board for Financial Services and Regulation was created in terms of the Policy Board for Financial Services and Regulation Act, 1993 (Act No. 141 of 1993) to ensure better cross-sectoral co-ordination, and it stands in an advisory capacity to the Minister of Finance.

   [The Department will monitor developments and participate as the need arises.]

8. Consider a more risk-sensitive approach to loans where the borrower has contributed minimum (or zero) equity, including residential mortgage loans with very high loan-to-valuation ratios.

   [The Department is in the process of assessing the risk weightings applicable to various types of loans highlighted by the IMF. Different approaches are being investigated for future implementation.]

risk-sensitive approach to loans

International Monetary Fund Article IV Consultation

In terms of Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with member countries, usually on an annual basis. An IMF team visits the country, collects economic and financial information, and discusses the economic developments and policies with officials. A *Staff Report* is prepared by the IMF, which forms the basis for discussion by the IMF Executive Board, which is followed by the issue of a Public Information Notice (PIN) summarising the views of the Executive Board. PINs are issued with the consent of the country concerned.

IMF findings and recommendations applicable to the Department

Following the discussions held with the IMF during June 2008, the IMF Executive Board concluded an Article IV Consultation with South Africa (PIN No. 08/137) in October 2008.[4] The findings and recommendations from the *Staff Report*, under the heading "Enhancing the resilience of the financial system", specifically applicable to the Department are highlighted below, followed by the Department's comments in square brackets:

South Africa's financial system sound

1. A robust financial system is critical for maintaining macroeconomic stability and increasing the economy's resilience to shocks. South Africa's financial system is sound, underpinned by a well-established legal and financial infrastructure, and a generally effective regulatory framework. Financial institutions have enjoyed good profitability, capitalisation levels and reserves, and so far the system has weathered the global financial market turmoil without major pressures. The implementation of Basel II at the beginning of 2008 has proceeded smoothly and is largely capital-neutral for the largest banks.

forward-looking, proactive engagement

2. At present, financial institutions are, however, facing a less-benign environment, and are beginning to see the effects of slowing economic activity and rising interest rates on asset quality and returns. With households' indebtedness at record levels and their debt-service burden rising, the banking system is facing elevated credit risk in its household loan portfolio. Furthermore, the concentration of banks' deposits from relatively few large corporations makes their balance sheets sensitive to changes in sentiment about the relative strength of individual banks. In such an environment it is recommended that the Department continues its forward-looking proactive engagement with banks and use the scope available under Basel II to ensure that capital buffers in banks are adequate to cope with increasing risks. In addition, it would be important to monitor emerging risks closely through robust financial stability analysis, particularly regular off-site

integrated top-down and bottom-up stress testing, including adverse macroeconomic scenarios. Such tests of systemic stability, based on individual bank data, would allow the identification of tail risks that may not be evident in aggregate top-down exercises. It is also recommended that bank liquidity and funding risks be monitored closely.

stress testing part of ongoing activities

[As part of the Basel II implementation process, the Department has implemented a revised supervisory review and evaluation process (SREP) in which these aspects have been strengthened and updated. Stress testing now also forms part of the Department's ongoing activities and interaction with banks.]

3. The IMF welcomed the strengthening of the framework for contingency planning and emergency liquidity assistance as a bulwark for mitigating the fallout should an adverse event occur. The FSCF (refer to paragraph 4 of the FSAP Recommendations above) aims to facilitate inter-agency co-ordination and preparedness for addressing crises. It was suggested that the arrangements should be tested periodically and the authorities should consider undertaking a crisis simulation exercise relating to a macro-financial shock, such as a capital outflow or distress in a large financial sector institution.

   [The Department is represented at the FSCF and is an active participant.]

South Africa's regulatory framework is modern and generally effective

4. South Africa's regulatory framework for the financial sector is modern and generally effective. It was suggested that consolidated supervision of financial conglomerates could be strengthened further. This should be possible within existing organisational arrangements by combining strong sectoral supervision with a focus on risks that cut across intermediaries within a financial group. Co-ordination among regulators and policy-makers could be strengthened, with gaps and overlaps minimised, and respective responsibilities delineated clearly.

   [A memorandum of understanding that formalises the roles and responsibilities as far as the supervision of financial conglomerates is concerned exists between the Department and the FSB. The responsibility as the lead regulator for each of the relevant financial groups has been demarcated between the authorities. The working relationship entails meeting on a quarterly basis and sharing relevant information that is supplemented by ad hoc meetings when the need arises.]

ongoing enhancement of consolidated supervisory process

5. The authorities broadly agreed with the findings and recommendations of the FSAP update. The authorities indicated that they would continue to enhance their risk analysis, including by exploring ways to conduct systemic stress testing, while protecting the confidentiality of individual bank data. The IMF encouraged the authorities to explore mechanisms used by other countries to overcome this hurdle. The authorities noted that their crisis management systems had been tested to some extent by several actual (non-systemic) crises, but agreed to consider conducting further simulations, provided they could ensure that the simulation itself did not become a source of risk. The authorities indicated that they were exploring possibilities for consolidating supervision of financial conglomerates, for instance, by establishing supervisory 'colleges' (comprising supervisors from different agencies) for each conglomerate.

   [The Department will continue to engage with the FSB, and will endeavour to enhance the consolidated supervisory process and sharing of information even further.]

Finally, to ensure co-ordination and effective monitoring of the implementation of the recommendations from the FSAP update and the Article IV Consultation, the Department

established a project team that has created an all-encompassing project plan. The team meets on a monthly basis to monitor effective management of the project plan.

National Treasury initiative on Islamic financial services

regulatory framework facilitates Islamic banking

The South African banking sector is regulated by the Banks Act and the Regulations relating to Banks as published in *Government Gazette* No. 30629, dated 1 January 2008 (the Regulations relating to Banks). Notwithstanding the fact that there is no legislation dedicated solely to Islamic banking, South Africa's current banking regulatory framework facilitates Islamic banking and Islamic banking products. Banks that are registered in South Africa and provide Islamic banking products to their clients include Albaraka Bank Limited, Habib Bank Limited, HBZ Bank Limited, Absa Bank Limited and First National Bank, a division of FirstRand Bank Limited.

The National Treasury initiated a project named 'Gateway into Africa', the purpose of which was to explore the need for, and development of, Islamic financial services and instruments for southern Africa and Africa.

The Department was, along with other regulators and industry stakeholders, invited to attend an exploratory meeting that focused on the regulatory constraints to the development of Islamic financial services. This meeting resulted in the establishment of four industry-led working groups focusing on (1) Islamic banking; (2) pensions and collective investment schemes; (3) Islamic insurance; and (4) accounting and governance.

Although the project is in its infancy, the Department, along with The Banking Association South Africa and other industry players, has provided its full support. The Department is serving on the Islamic Banking working group and will consider any recommendations relating to regulatory constraints that may emerge from the aforementioned working groups.

Skills development

continuous improvement of skills base

Ensuring a workforce of adequate and appropriately skilled human resources is a challenge shared by supervisors around the world. Furthermore, with the implementation of Basel II, the need to train and retain staff with the necessary expertise and skills has been reconfirmed. The continuous improvement of the skills base of the Department is regarded as key to its success and, accordingly, considerable resources are allocated for this purpose. This includes the employment of appropriately qualified and skilled staff members, and enhancing training programmes as discussed in more detail below.

Staff training and development policy and framework

co-ordinated training plan

During the year under review, the Department further formulated its staff training and development policy and framework in order to facilitate and develop a structured and co-ordinated training plan in respect of every staff member and a training framework for the Department in general.

The policy was based on the following:

- The Skills Development Act, 1998 (Act No. 97 of 1998)
- The Human Resources Development Policy of the South African Reserve Bank (the Bank)
- The mission statements of both the Bank and the Department.

The policy objectives are to

- provide training and development opportunities to all staff members in the Department;
- structure and co-ordinate training and development in the Department in order to maximise its effectiveness and efficiency;
- establish a process in terms of which training and development in the Department would be managed effectively and would, *inter alia*,
  - reaffirm the role of line managers in controlling and managing the training plan of each staff member reporting to him or her; and
  - reiterate the importance of aligning each staff member's performance plan with his or her training plan;
- establish a Training and Development Committee (TDC) to co-ordinate, facilitate, manage and develop, on a regular basis, all education, training and development of staff in the Department, and to monitor and evaluate the general effectiveness of the various training interventions and functions;
- increase the skills of the staff in the Department to an appropriate level; and to
- use appropriate forms of training in order to achieve the above-mentioned objectives.

Guidelines and procedures for line managers on how to establish, monitor and manage training plans for staff members are included in the policy.

The TDC developed a Training and Development Framework. This framework sets out the various required skills categories, together with the criteria applicable to each skills category in relation to differentiated competency levels of staff members.

Training undertaken

During the year under review, the Department spent R2,4 million on the training of approximately 95 employees. This training enabled staff to

- implement sound global supervisory standards and practices;
- share supervisory practices and experiences; and to
- employ the practices and tools that would allow them to meet everyday demands and develop solutions to their multiple challenges.

training interventions

Training interventions consisted of, among other things, leadership and management courses, central banking seminars, and risk management workshops.

Graduate staff who joined the Department attended a week-long foundation course. The aim of this course was to provide a broad background on the following topics:

- An overview of the South African banking system
- South Africa's banking regulatory framework
- The principles of a risk-based supervisory approach.

This was also supplemented with training on specialised software programs used in the Department. Six of these courses were held during the year.

To ensure that staff members were kept abreast of the latest developments affecting the banking industry, interventions in the following areas were facilitated: accounting and auditing issues; risk management development; and fraud awareness.

International courses attended

international courses

By attending international courses, staff members were afforded the opportunity to be exposed to an international perspective on banking supervision and related topics. Furthermore, staff members were able to network with other members of the global

supervisory community and exchange ideas on current topics. During the year under review, staff members attended the following courses:

- Financial Stability Institute (FSI) Seminar on Liquidity Risk at the Bank for International Settlements (BIS), in Switzerland
- FSI Seminar on International Accounting and Auditing for Banks at the BIS, in Switzerland
- FSI High-Level Meeting on the Implementation of Basel II in Africa and Other Regional Supervisory Issues, in South Africa
- Toronto Centre Banking Supervision Seminar, in Canada
- Specialised Bank Supervision Course at the Federal Reserve Bank of New York, in the USA
- South East Asia Central Banks Regional Seminar on Practical Techniques for the Management and Measurement of Operational Risk, in Brunei
- Legal Risks and Good Governance for Central Banks and Supervisors, in the UK
- FSI 25th International Banking Supervision Seminar at the BIS, in Switzerland
- FSI Seminar on Pillar 2 Implementation Issues at the BIS, in Switzerland
- Toronto Centre Banking Leadership Programme, in South Africa
- Financial Services Authority Annual International Seminar, in the UK
- Meeting on Risk Minds, in Switzerland.

Basel II training

To ensure that the Department's staff is equipped to implement international regulatory and supervisory standards, together with the latest information on market products, practices and techniques, a number of initiatives were implemented.

in-house training sessions

The Department held in-house training sessions on the following:

- The amended Regulations relating to Banks that were promulgated on 1 January 2008
- Operational risk
- Market risk
- Credit risk.

The Department renewed its subscription to *FSI Connect*, a web-based information and learning resource for financial sector supervisors around the world, established by the FSI.

A specialised three-day training course consisting of tailor-made modules developed for bank supervisors on the internal capital-adequacy assessment process (ICAAP), and the SREP was presented by a reputable London-based consultancy. The training allowed the participants to experience the SREP as part of a case study incorporating the various steps of a SREP.

The United States Federal Deposit Insurance Corporation presented a four-day training programme on operational risk in relation to Basel II. The course content enabled the participants to examine operational management frameworks, understand the challenges associated with implementing such frameworks and how to promote sound operational risk practices in banks.

Issues to receive particular attention in 2009

focus during 2009

In addition to fulfilling its normal supervisory and regulatory tasks, the Department will focus specifically on the following issues during 2009:

- Continued refinement of the Department's supervisory review and evaluation processes to support the implementation of the amended regulatory framework, which encapsulates Basel II and the revised Core Principles

- Ongoing assessment and monitoring of the South African banking industry's initiatives to deal with the impact of the financial market turmoil
- Focused reviews of banks that make use of advanced approaches to calculate credit risk, market risk and operational risk capital requirements
- Ongoing enhancement of the Department's contingency arrangements regarding systemic liquidity and crisis management
- Continued dialogue with banks' board remuneration subcommittees to encourage the application of best practice principles with regard to banks' incentive schemes
- Continued monitoring of banks' compliance with AML/CFT legislation
- Ongoing monitoring of banks' approaches to stress testing and refinement, and strengthening of the Department's own stress-testing expertise
- Ongoing participation in the initiatives and activities of international and regional bank supervisory bodies
- Continued investigation and combating of illegal deposit-taking by unregistered institutions and persons, and participation in consumer education initiatives
- Ongoing training of staff to meet the challenges of an ever-changing regulatory and supervisory landscape, both locally and internationally
- Ongoing review and amendment of the banking legislative framework in South Africa to ensure that it reflects local and international market developments and complies with international regulatory standards
- Ongoing review of the recommendations flowing from the IMF/World Bank FSAP, and Article IV reviews and the FATF mutual evaluation.

Expression of gratitude

I wish to express my appreciation to the Minister and Deputy Minister of Finance for their ongoing valued input on requests not only in terms of statutory requirements, but also in terms of general counsel. To the Governor and deputy governors of the Bank, thank you for your continuous co-operation, guidance and support. My sincere thanks also to my fellow executive general managers with whom I serve on the Governor's Executive Committee.

The Department continued receiving the co-operation of several individuals and organisations, locally and abroad. These include, to name but a few, the Chief Executive of the FSB and his staff; the senior executives of banking institutions and their external auditors; The Banking Association South Africa; the Standing Committee for the Revision of the Banks Act; various individuals in the auditing profession; staff of other departments of the Bank; the Basel Committee; and central bankers and bank supervisors, both in southern Africa and elsewhere in the world.

Finally, my sincere appreciation also goes to the staff members in the Department for their continued perseverance, professionalism and enthusiasm, particularly during the period of heightened global market turmoil.

Errol M Kruger
Registrar of Banks and Executive General Manager: Bank Supervision Department

Notes

1 Advances in respect of which a specific credit impairment was raised.
2 Refer to the IMF's website: "What the IMF does" www.imf.org/external/np/fsa/fsap.asp.
3 For the full FSSA report, refer to the IMF website: www.imf.org/external/country/ZAF/index.htm.
4 As published on the IMF's website: www.imf.org/external/country/ZAF/.

Chapter 2

Current issues in banking supervision

This chapter reports on the key supervisory and regulatory developments during 2008, with specific focus on the revised regulatory and supervisory approach adopted by the Department subsequent to the implementation of Basel II. This includes the use of external audit; the ICAAP, focused or thematic reviews performed in respect of credit risk, market risk and operational risk; and the processing of applications by banks to use the advanced approaches to calculate their minimum capital requirements in respect of credit risk and operational risk. The assessment of boards' involvement in the oversight of banking institutions' operational risk framework is discussed, as well as consolidated supervisory developments and stress testing in respect of the South African banking system.

Revised regulatory and supervisory approach

Use of external auditors

accuracy and completeness of returns submitted

The implementation of Basel II resulted in a material revision of the information being submitted to the Department in terms of the regulatory returns prescribed by the Regulations relating to Banks. In line with Principle 20 of the Core Principles, one of the specific tools applied by the Department to determine the accuracy and completeness of returns submitted by banks, as well as to determine banks' level of compliance with the Banks Act and the Regulations relating to Banks, is the submission by the banks' external auditors of audit reports in terms of regulation 46 of the Regulations relating to Banks.

The Department commissioned an interim review by external auditors of banks' regulatory returns as at the June 2008 reporting month, to assess and report on the quality of banks' reporting to the Department. The reports were submitted during the fourth quarter of 2008 and they will enable the Department to follow up on critical reporting issues.

need for quality external audits to enhance supervision and market confidence

Furthermore, during December 2008, the Basel Committee released a publication[1] on the use of external auditors, which highlights the need for quality external audits to enhance supervision and market confidence. The paper summarises the steps that the Basel Committee plans to take regarding the following key issues:

- The increase in bankers' and supervisors' reliance on external auditors' expertise and judgements
- Enhanced market confidence resulting from high-quality audits, particularly in times of severe market stress
- An increase in the reliance on high-quality bank audits to complement supervisory processes
- The contribution that the globalisation of major external audit firms has made to the complexity of their structures and a lack of transparency regarding their governance.

The Department will monitor the outcome of the Basel Committee's work closely and align its efforts with the published outcomes.

Internal capital-adequacy assessment process

Introduction

banks required to perform ICAAPs

In terms of the Banks Act, banks are required to maintain, at all times, overall financial resources that are adequate in respect of both amount and quality to ensure that the risk that they cannot meet their liabilities as they fall due is minimised.

The adequacy of a bank's capital needs to be assessed by both a bank and the Department. In terms of the Banks Act and the Regulations relating to Banks,

- banks are required to perform an ICAAP; and
- the Department is required to perform a SREP.

Amendments to the regulatory framework

The process of incorporating Basel II into the regulatory framework included amendments to accommodate Pillar 2 requirements relating to capital management, ICAAP assessments and updating of the SREP. Most of the amendments relating to Pillar 2 are captured in regulation 39 of the Regulations relating to Banks.

Previous reviews/work undertaken

individual thematic reviews

Prior to the ICAAP reviews undertaken in 2008, thematic fact-finding reviews took place during 2006 and 2007. The purposes of these reviews were to

- gain an understanding of how banks perceived economic capital;
- gain an understanding of the level of development of banks' ICAAPs; and
- discuss, with banks, the Department's expectations and banks' concerns with regard to an ICAAP.

These reviews were undertaken at the five largest banks in South Africa.

For the smaller banks, individual thematic reviews have proven to be difficult. Consequently, the Department decided to facilitate an ICAAP workshop to discuss expectations and concerns with regard to ICAAPs for these banks. During 2009 the focus will shift to the review and development of ICAAPs for smaller banks.

ICAAP reviews: Key challenges faced by the Department

ICAAP reviews are "new"

review of banks' ICAAPs new

From a supervisor's perspective, prior to the implementation of Basel II, no ICAAP reviews had been undertaken. The review of banks' ICAAPs was, therefore, a new area that required innovative thinking. In addition, and for the same reason, limited global guidance was available.

The pre-ICAAP reviews undertaken in 2006 and 2007, therefore, played a central role in developing the Department's understanding of the subject matter, as well as informing banks what would be required of them. These reviews also contributed to the development of successful training interventions.

Training of the Department's staff

In order to upskill the Department's staff on the technical aspects of ICAAP, training had to be provided. International specialist consultants were contracted to provide training, and a successful training programme was undertaken and completed during February

2008. A key focus was that of tailoring the training to South Africa-specific needs and the country's SREP process.

Internal capital-adequacy assessment process reviews undertaken

initial focus on five largest banks

Following the development of the regulatory framework and the completion of training, formal ICAAP reviews commenced with an initial focus on the five largest banks in South Africa, representing 89,8 per cent of the South African banking-sector's assets at the end of December 2008.

Conclusions from the formal ICAAP reviews

differences between banks' approaches

It is clear from the ICAAP reviews undertaken in 2008 that the banking industry expended a significant amount of resources (i.e., effort and money) on the implementation of their economic capital frameworks and the development of their ICAAPs. When the results of the Department's initial ICAAP reviews undertaken during 2006 are compared with the reviews undertaken in 2008, it is clear that the industry has made significant progress. There were, however, substantial differences between banks' approaches and best practice standards applied with regard to specific elements of the economic capital frameworks and ICAAPs.

Future work to be undertaken

future work

Future work will focus on the following areas:

1. Initial ICAAP reviews were more holistic in nature and the intention is to focus on thematic reviews
2. Smaller locally registered banks will be subjected to the ICAAP review process during 2009
3. The ICAAP review process in respect of branches of international institutions is likely to commence during 2010.

Credit risk

more sophisticated approach to credit risk

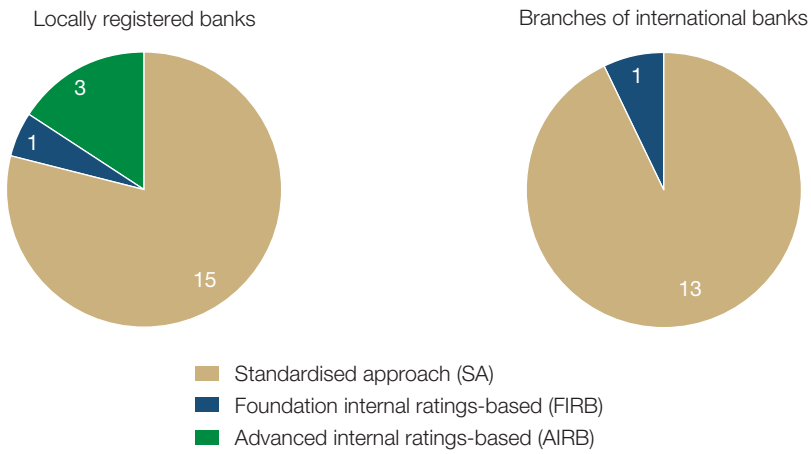
The introduction of Basel II, with its more sophisticated approach to credit risk, including the potential for banks to use models to calculate regulatory capital, combined with macroeconomic events of the past year placed significant demands on resources. Although South African banks have not experienced the same magnitude of impact as a result of the global financial market turmoil and downturn in economic conditions as banks in other parts of the world, the Department continued to monitor the impact of market conditions on South African banks' credit risk profiles and portfolios through quantitative analysis and focused reviews. Methodologies underpinning both quantitative analysis and focused reviews are aligned with Basel II and the Core Principles.

One of the main objectives of Basel II is that the level of regulatory capital held by banks should be commensurate with the risks involved in their businesses and should reflect how well those risks are managed. Under Pillar 1, banks in South Africa could implement the following approaches to determine the minimum required regulatory capital relating to credit risk with effect from 1 January 2008:

- The standardised approach (SA)
- Foundation internal ratings-based (FIRB) approach
- Advanced internal ratings-based (AIRB) approach.

South African banks implemented the following approaches:

Figure 1 Locally registered banks and branches of international banks as at December 2008



Quantitative analysis

appropriate analytical tools

To optimise the use of information available, quantitative analysis makes use of appropriate analytical tools and performs sectoral reviews on a regular basis. A rigorous process was followed by the Department for the development of reports containing key information depicting trends and peer-group analysis. In-depth working sessions were also held with selected banks to enhance the quality of internally developed management information reports.

Furthermore, quantitative analysis is used by the Department as a base for providing guidance or input in respect of identified uncertainties and inconsistencies in regulatory reporting with a view to enhancing the quality of statutory reporting.

Focused reviews of internal ratings-based requirements

focused reviews of banks' portfolios

In terms of the amended Regulations relating to Banks, which became effective on 1 January 2008, the Department expanded its supervisory activities to include focused reviews of banks' portfolios for which permission was granted by the Registrar to adopt the internal ratings-based (IRB) approaches to calculate their minimum required capital and reserve funds related to credit risk. Focused on-site reviews were held at all five of the banks that had obtained approval from the Registrar to adopt the IRB approaches.

The Department follows a risk-based approach in selecting portfolios to be reviewed. All asset classes are, however, assessed and analysed on an ongoing basis. Focused reviews commenced during the second quarter of 2008, and spanned selected retail and wholesale portfolios.

scoping on-site reviews

The prioritisation process for scoping on-site reviews is based on the elements outlined on the following pages.

Capital impact assessment

This step entails the assessment of the change in regulatory capital (e.g., with the change from the 1988 Basel Accord (Basel I) to Basel II or when a bank migrates from a simple approach, such as SA to a more advanced approach such as AIRB), to understand capital movements over time. An understanding of any significant changes in regulatory capital for each asset class needs to be obtained. During 2008, this was achieved by mining the data submitted by banks through various quantitative impact studies (QISs), regulatory reporting by banks during the parallel-run period and, finally, the reporting of risk and financial information on the required regulatory returns as from the reporting month of January 2008.

Model Monitoring System

purpose of the Model Monitoring System

A statistically based system was developed internally using information submitted by banks through the regulatory returns. The purpose of the Model Monitoring System (MMS) is to monitor the performance of banks' IRB credit models and includes the assessment of the following:

- Growth in portfolio assets
- Parameter outliers such as probability of default (PD), loss given default (LGD), exposure at default (EAD), and expected loss compared to peer groups and each bank's own historical trend
- Extent to which ratings are concentrated in particular rating grades
- Model performance tests for stability and accuracy of ratings.

Qualitative overlay

This prioritisation process takes account of various qualitative factors identified during the normal course of discharging supervisory responsibilities. Qualitative issues pertinent to each bank were identified to focus the reviews at banks and comprised, *inter alia*, the following:

- Concerns identified by the relationship team in the Department in their frequent interactions with the banks they supervise
- Issues arising from previous supervisory cycle work
- Matters that arose from the assessment of banks' modelling during the IRB application process.

Self-assessment templates submitted by banks

self-assessment templates completed by banks

As part of the IRB approval process and associated ongoing monitoring, the Department developed a series of self-assessment templates to be completed by a bank assessing its own compliance with the minimum IRB requirements. The template provides a standard and consistent manner in which banks' compliance with the Regulations relating to Banks could be assessed.

The Department received the first submission of the self-assessment templates from banks on 31 May 2008. The self-assessment templates of each of the IRB banks were assessed, reviewed, and gaps and exceptions were identified. The Department defined a 'gap' as a specific area where it believed that the information provided in the self-assessment templates was either incomplete or not completed at all. Exceptions were

areas where banks indicated their level of non-compliance with the Regulations relating to Banks. All exceptions to the Regulations relating to Banks were classified as either major or minor. In instances where exceptions were noted, banks were required to provide project plans and target dates for compliance with the Regulations relating to Banks.

Identified gaps

The following gaps were identified:

- In some instances banks did not pay sufficient attention to certain schedules of the templates, for example, some banks did not provide the required information on exemption waivers and extensions of the IRB roll-out within the banking group
- In other instances internal audit functions of banks neglected to complete the relevant schedule of the self-assessment templates requiring assurance of the work performed to date by the business units and risk management
- Some internal audit functions did not provide the audit status of their work completed and planned to date
- In some instances banks left certain sections of the templates unanswered.

Common exceptions in the self-assessment templates included the infancy of banks' capital-adequacy stress-testing processes.

The gaps and exceptions identified through the self-assessments will be addressed with the applicable banks as part of the Department's ongoing supervisory process.

The implementation of new or revised models and rating systems

implementation of new credit models

This step requires the Department's review of new or revised models and rating systems that were not reviewed as part of the original IRB application process. Banks that applied the advanced approaches were required to submit their own governance processes for the approval of new credit models to be used for regulatory capital purposes, accompanied by their communication policy with the Department in respect of the aforementioned. This process ensures that any material model changes are appropriately assessed by the Department without causing undue hindrance to banks' implementation of new or improved credit models.

technical reviews held

Technical reviews were held with model development staff, independent model validation units, internal audit functions and representatives of business units of the portfolios assessed. The reviews included the assessment of the following:

- The model-build documentation.
- Assumptions and methodologies applied.
- Independent model validation results.
- Management information reports tracking the ongoing performance of credit models.
- Findings of internal audit in respect of credit models used for regulatory capital purposes. Internal audit findings on rating systems in use ranged in some banks from process reviews only to in-depth technical challenge and review of IRB parameters at other banks.

Common findings of internal ratings-based reviews

weaknesses were identified

Banks were mainly in compliance with the minimum IRB requirements. The following weaknesses were identified for the attention of banks' management:

- *Staff retention:* Quantitative skills are a scarce commodity in South Africa. The Department noted the migration of model development and validation staff between the different banks. The impact was more visible at some banks than at others.

- *Model developments and recalibrations:* During the Department's ongoing engagement with banks during 2008, it observed that some banks made material changes to their models and methodologies without engaging with the Department. This led to the implementation by the Department of an amended system for model assessment and approval.

- *Ongoing monitoring of credit models:* Banks were in the process of continually improving and enhancing their management information relating to the ongoing monitoring of the performance of credit models.

- *Data cleansing:* In order to improve the quality of data that feed into the IRB credit models, data-cleansing projects received banks' further attention during 2008. In some cases banks appointed dedicated staff to oversee these separate projects.

- *Annual validation of models*: During on-site reviews the importance of annual validation was stressed, and in some instances banks were requested to improve their efforts and resources to ensure that this could be undertaken effectively.

Focused reviews of the standardised approach requirements for credit risk

assessment of accuracy of risk weights

During the last quarter of 2008, the Department commenced focused on-site reviews of those banks that had adopted SA to calculate their minimum required capital and reserve funds relating to credit risk. These reviews were risk-based and focused on banks' compliance with the minimum requirements of the provisions of the Regulations relating to Banks. More specifically though, the reviews included the assessment of the accuracy of risk weights applied in the calculation of banks' minimum required capital and reserve funds related to credit risk, the assessment of the eligibility of credit risk mitigation instruments recognised and the reasonableness of credit risk classifications.

Banks were generally in compliance with the Regulations relating to Banks. In those instances where non-compliance was observed, the respective issues were communicated to the management of the relevant banks for their attention and those issues are in the process of being addressed by the banks concerned.

Credit risk capital impact and credit quality outcomes

reduction in risk-weighted assets

A reduction in risk-weighted assets in respect of credit risk, from Basel I to Basel II, for retail exposures was mostly evident in retail mortgages, and vehicle and asset finance exposures. The aforementioned decrease could be attributable to the following:

- Lower risk weight assigned to qualifying residential mortgages in terms of SA, which changed from 50 per cent under Basel I to 35 per cent under Basel II
- Recognition of physical collateral and its eligibility for capital reductions under the IRB approach for Basel II, which was not available under Basel I.

A reduction in risk-weighted assets in respect of credit risk for wholesale-type exposures (e.g., corporates and banks) was also evident mainly owing to the following:

- Change of the Basel I 100 per cent standard risk weighting for all corporate exposures. Under SA for Basel II, risk weightings for wholesale exposures are dependent on the ratings assigned by eligible credit assessment institutions, which may range from a 50 per cent risk weighting assigned to an A+ international scale rating for a corporate exposure, to a 150 per cent risk weighting assigned to a rating

below B-. The average risk weightings assigned to corporate exposures under the IRB approach varied between 53 per cent and 60 per cent during the period under review.
- Recognition of physical and financial collateral as credit risk mitigants.

Credit quality for retail exposures had been on a deteriorating trend during 2008 as is evident in Figures 41 and 42 (see Chapter 4 of this report). The Department focused on monitoring impaired and defaulted advances within portfolios, as well as on security values and their impact on LGD estimates and adjustments. Focused reviews and other interactions with banks highlighted signs of early stress in certain industries of the banks' corporate exposures.

Areas of focus during 2009 based on the fundamental weaknesses revealed by the financial market crisis

strengthen capital buffers

During 2008, the Basel Committee announced a comprehensive strategy[2] to address the fundamental weaknesses revealed by the financial market crisis related to the regulation, supervision and risk management of internationally active banks. The primary objective of the Basel Committee's strategy is "to strengthen capital buffers and help contain leverage in the banking system arising from both on- and off-balance sheet activities".

The key building blocks of the Basel Committee's strategy that the Department will consider and incorporate in its risk-based supervisory framework from a credit risk perspective are the following:

- Building additional shock absorbers into the capital framework that can be drawn on during periods of stress and dampen procyclicality
- Evaluating the need to supplement risk-based measures with simple gross measures of exposure in both prudential and risk management frameworks to help contain leverage in the banking system
- Leveraging Basel II to strengthen risk management and governance practices at banks
- Strengthening counterparty credit risk capital, risk management and disclosure at banks.

Operational risk

The latest amendments to the Banks Act and the Regulations relating to Banks include requirements for risk management and public disclosure, as well as a regulatory capital charge for operational risk.

operational risk permeates all aspects of the risk universe

Operational risk is not a negligible factor in the field of financial services. It permeates all aspects of the risk universe, that is, operational risk overlaps and exacerbates all other types of risks, such as market, credit, liquidity and underwriting risk.

In its intermediary function as both borrower and lender, a bank has a central role to play in the allocation of capital in an economy. Therefore, the risk of mistakes, incompetence, criminal tendencies, loss or unavailability of employees, diverse process mistakes (e.g., account entries, settlement and valuation) or failure of technical systems, and the dangers resulting from external factors, such as violence and white-collar crime, physical threats or natural disasters and legal risks, have potential consequential effects. This potential is compounded by the increasing complexity of banking, for example, the uncertain role of information technology (IT) in overcoming old risks and creating new ones; the expanding and changing business activities of banks; progressive globalisation and automation; and more complex financial products (e.g., securitised products, credit derivatives and structured products).

Prominent international cases from the recent past illustrate how banks experience material, financial and/or reputational losses, which could threaten their existence when operational risks materialise.

risk-based approach to review operational risk

In line with the Department's SREP, a risk-based approach has been applied to the review of banks' operational risk. The Department recognises the principle of proportionality. In other words, the nature and extent of the operations and exposure of a bank or controlling company will influence the nature, timing and extent of operational risk management in a bank or banking group. The bank and controlling company should have in place risk management policies and processes to identify, assess, monitor and control or mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank and controlling company.

The work carried out during the year can be summarised in the following four categories:

1. Assessment of boards' involvement in the oversight of banking institutions' operational risk framework
2. Focused operational risk reviews
3. Processing of new applications by banks to apply the range of approaches for calculating their operational risk capital requirements
4. Participation in the 2008 loss data collection exercise (LDCE).

Each of the four categories is discussed below.

boards' involvement in operational risk framework

Assessment of boards' involvement in the oversight of banking institutions' operational risk framework

During the year under review, operational risk was one of the flavour-of-the-year topics for meetings with the boards of directors (boards) of banks.

Previously, operational risk was partly addressed in internal risk analyses. Depending on the size and complexity of a bank or controlling company, the responses to operational risks may require considerable changes, such as the adaptation of systems and processes, the further development and integration of risk management methods and, above all, the boards' active involvement in the oversight of the banks' and controlling companies' operational risk management frameworks. The board should, *inter alia*, ensure that the bank's and controlling company's operational risk management framework is subjected to an effective and comprehensive internal audit by operationally independent, appropriately trained and competent staff.

The boards were requested to demonstrate their active involvement in accordance with the following:

- Awareness of the major aspects of the bank's and controlling company's operational risks as a distinct risk category that should be managed.
- Approval and periodic review of the bank's operational risk management framework. The framework should provide a definition of operational risk and detail the principles of how operational risk is to be identified, assessed, monitored and controlled and/or mitigated.
- Involvement in ensuring that the bank's operational risk management framework is subject to effective and comprehensive internal audit by operationally independent, appropriately trained and competent staff. The internal audit function should not be directly responsible for operational risk management.

The Department also requested the boards to discuss the three most severe internal operational risk events experienced by the banks from 1 January 2007 under the following headings:

- Description of the operational risk event. (What happened?)
- Cause of the operational risk event. (Why did it happen?)
- Effect, financial and otherwise, of the operational risk event. (What was the impact thereof?)
- Action taken to remedy the operational risk incident and future strategies to prevent or detect and mitigate similar incidents of operational risk.

The Department was satisfied with the majority of the boards' demonstrations and discussions as mentioned above. In the few instances where the Department was concerned about the demonstration of boards' involvement in the oversight of banking institutions' operational risk frameworks, the boards were requested to review their effectiveness and to re-present to the Department. The inclusion of operational risk as one of the flavour-of-the-year topics was also aimed at enhancing the level of awareness of directors of banks regarding this risk type. The boards' oversight of the effective implementation and operational effectiveness of the board-approved operational risk framework is, and will be, an important function to be fulfilled on a regular basis.

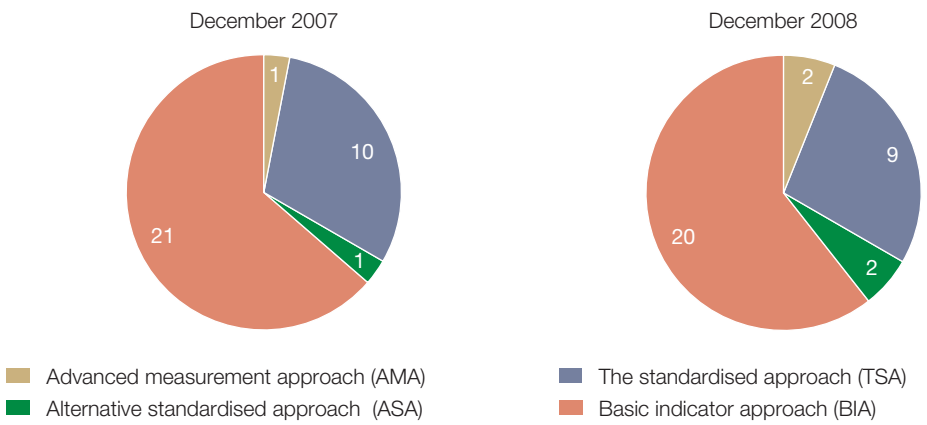
Focused operational risk reviews

focused operational risk reviews

A number of focused operational risk reviews were performed during the year. The purpose of the reviews was, *inter alia*, to determine whether or not the banks had in place risk management policies and procedures to identify, assess, monitor and control and/or mitigate operational risk, and if banks that were using one of the available approaches for calculating operational risk capital, namely the advanced measurement approach (AMA), the standardised approach (TSA), the alternative standardised approach (ASA) or the basic indicator approach (BIA), were meeting the qualifying criteria, and qualitative and quantitative standards.

The number of banks that are using the respective approaches for operational risk are as follows:

Figure 2 Status of banks per operational risk approach



The reviews were conducted in line with the risk-based supervision approach and principle of proportionality as discussed above. A high-level example of a typical review would cover the following:

- Risk governance and management information reporting
- Risk management activities, including progress made with the operational risk self-assessment and the resources available for operational risk management
- The use of data elements such as
  - risk and control self-assessment, key risk indicators, and the frequency of updating the business environment and internal control factors
  - internal loss data, external loss data and scenario analysis
  - relevant operational risk data, progress made with the collection and the systematic tracking of loss data, period of loss data tracking and the quality of loss data
- Disaster recovery plans and business continuity
- Progress made towards the potential migration to more advanced approaches and a target date for submitting an application
- Update on the roll-out of the operational risk management framework to other entities within the group (e.g., offshore subsidiaries)
- A high-level overview of the results of the review of certain critical processes and controls in the treasury areas, and progress made with actionable items identified in the review
- Internal audit's focus areas for the next 12 to 18 months, and the outcome of the independent review of the operational risk framework and operational risk function
- Progress made with operational risk-related disclosure.

Although the Department is satisfied with the management of operational risk from a sectoral perspective, there is room for improvement. Banks were encouraged to monitor whether the operational risk framework continued to move towards managing risk rather than just keeping score. Since operational risk is an evolving management science and the business environment is constantly changing, management should ensure that the operational risk framework, policies and procedures are sufficient and appropriate. A constant challenge for management is to validate that the necessary assurance can be placed on the design and operating effectiveness of the operational risk framework, policies, procedures and internal controls to identify, assess and/or measure, monitor and control and/or mitigate operational risk to which the entity is exposed.

For the limited number of cases where the Department was not satisfied with the level, status or sophistication of operational risk management, the banks were requested to address shortcomings or weaknesses and implement improvements. These banks provided feedback to the Department on a regular basis and the Department is comfortable with the progress made.

IT requires more attention

IT is an area that requires more attention. Banks are encouraged to review, on a regular basis, whether or not they have established appropriate IT policies and processes that address areas such as information security and system development relating to operational risk management, and that they have made investments in IT commensurate with the size and complexity of operations and operational risk management, and exposure to operational risk. This review should include the assessment of the bank's data maintenance incorporated within the operational risk data management process, including data collection, data processing, data access or retrieval and data storage or retention. Operational risk data integrity will have a group-wide impact on operational risk assessment,

monitoring and reporting. Banks are encouraged to continue with the process to ensure that the quality or condition of operational risk data is accurate, complete and valid, and that it has not been altered or destroyed in any unauthorised manner.

Processing of new applications

During 2008, the Department received two applications from banks, one for the ASA and the other for the AMA, to adopt a more appropriate or sophisticated approach in calculating operational risk exposure and regulatory capital. The application and approval processes were similar to those followed in the previous year.[3] Both banks were granted approval to adopt the mentioned approaches.

Loss data collection exercise for 2008

loss data collection exercise

The Operational Risk Working Group of the Accord Implementation Group (AIGOR) – a subgroup of the Basel Committee – conducted an LDCE during 2008. The Department has representation on the AIGOR and actively participates in its activities. While similar to two previous international LDCEs, which focused on internal loss data, this LDCE is the first international effort to collect information on all four data elements used in an AMA, namely (1) internal data, (2) external data, (3) scenario analysis and (4) business environment and internal control factors.

Participation was voluntary and the exercise was open to invited banking institutions at the group-wide level that were implementing or using one of the Basel II approaches for calculating operational risk capital, namely the AMA, the TSA, the ASA or the BIA. The exercise was designed to minimise the resources needed to participate. Banking institutions had the choice to participate in the full exercise or to submit information only for certain parts of the exercise. Five South African banks and the Department (in its capacity as supervisor) participated in the 2008 LDCE.

The objective of the exercise is to further the understanding of both supervisors and participating banking institutions regarding outstanding operational risk implementation issues, as well as to promote consistency in addressing these issues across jurisdictions. The exercise will facilitate comparative analysis across jurisdictions by benchmarking losses at the national/regional and international levels, and will provide data to assess capital levels relative to internal data and scenario analysis. Collecting data on the four elements of the AMA framework will provide benefits to participating banking institutions and national supervisors, which include the following:

- A greater perspective on the banking industry's loss exposure
- Insight into how banking institutions are using internal and external loss data, scenarios, and business environment and internal control factors for risk measurement and risk management
- Information on the four data elements and their influence on operational risk capital levels
- Updated range of practice and new cross-bank comparisons.

customised analysis

During 2009, participating institutions will receive a customised analysis comparing their data with industry data at the international and where possible, regional or national levels. The results will be used to benchmark a banking institution's loss experience and to gain a better understanding of the completeness of its data. In addition, participating institutions will receive an updated range of practice information on scenario analysis, external data, and business environment and internal control factors. This range of practice information can be used by participating institutions to assess and benchmark their practices against industry practices.

Consolidated supervision

The Regulations relating to Banks, which became effective from 1 January 2008, incorporated all the requirements in respect of consolidated supervision as envisaged in Basel II, as well as the revised Core Principles published in October 2006. Basel II introduced a three-pillar approach with all three pillars being applicable on a solo and consolidated basis.

changes to supervisory approach

Basel II introduced the following major changes to the Department's regulatory and supervisory approach:

- *The scope and application now specifically include any holding company that is the parent company within a banking group:* This is an important difference in Basel II when compared to Basel I. Although Basel I required the application of capital requirements on a consolidated basis, its focus was the capital adequacy of banks. Bank holding companies, which are commonly referred to as "bank controlling companies" in the Banks Act, were previously included in the calculation of group capital adequacy by this Department and the impact of this requirement was, therefore, minimal.
- *All internationally active banks should comply with Basel II:* All South African banks, whether or not they are internationally active, have to comply with Basel II. No distinction was made between local and internationally active banks.
- *The framework should now be applied to all internationally active banks at every tier within a banking group:* This means that sub-consolidation is required within a banking group on every level in that group where an international bank is active. This is a new requirement of Basel II. The Department incorporated this sub-consolidation requirement in the Regulations relating to Banks.
- *Insurance and commercial entities are now specifically excluded when calculating group capital adequacy*: Basel II recognises that a bank's capital rules do not appropriately capture insurance risk and the risk emanating from commercial entities. Basel II, therefore, provided a deduction approach for insurance and commercial entities in a banking group. This differs from Basel I requirements in terms of which the Department required that insurance entities and commercial entities be included in the calculation of a banking group's capital-adequacy ratio.
- *Only majority-owned and controlled banking, securities and financial entities, regulated or unregulated, should be included in the calculation of group capital adequacy:* Basel II requires that only majority-owned entities be included in the calculation of group capital adequacy. Banking groups may have subsidiaries that are not wholly owned. Bank supervisors are, however, given the option to include less than wholly owned subsidiaries in the calculation of group capital adequacy and to consider the inclusion of minority interests in group qualifying capital. Accounting consolidation practices result in third-party partial ownership of such subsidiaries being recorded as a minority interest in the consolidated financial statements. The Department opted to include minority-controlled financial entities in the calculation of group capital adequacy on a pro rata consolidated basis.

Stress testing the South African banking system

banks' stress-testing approaches

The purpose of this section is to outline the key developments that took place in banks' stress-testing approaches, to share some key supervisory observations on these approaches, and to outline the resulting supervisory actions designed to improve stress testing of South African banks and the South African banking system.

This section contains the following subsections:

- What is stress testing and why do it
- Supervisory approaches to stress testing
- Banks' progress in establishing their stress-testing frameworks
- The Department's observations on banks' stress testing
- Supervisory actions

What is stress testing and why do it

Stress testing, as defined by the BIS[4] is a risk management technique that is used to evaluate the potential effects on an institution's financial condition of a specific event and/or movement in a set of financial variables. As capital resources fall and as regulatory capital requirements are likely to rise in times of stress, stress testing is a key tool in understanding the appropriate level of regulatory capital to ensure that banks remain solvent during difficult times.

Banks in South Africa are required to undertake a wide variety of stress tests, which fall broadly into two categories: (1) scenario tests and (2) sensitivity analyses. Sensitivity analysis, which is generally less complex to carry out, assesses the impact on an institution's financial condition of a move in one particular risk driver. The source of the shock is not identified, for example, assessing the impact of a sharp sudden shift in interest rates on an institution's balance sheet.

scenario analysis

Scenario tests, however, consider the impact of simultaneous moves in a number of risk drivers, emanating from a well-defined stress event or scenario. Such scenarios tend to focus on the external macroeconomic environment, and banks are required to define clearly the relationship between the external risk drivers, the risk drivers relevant to the bank and the impact on its balance sheet.

Understanding the potential effects of a range of stress events and scenarios is key to effective risk management in banks, to understand the risks of business strategies in the context of the banks' stated risk appetite, to strengthen risk management processes and, if necessary, to hold capital against certain types of risks.

The appropriate severity of such scenarios tends to be discussed in terms of exceptional, but plausible, events if a bank is to look beyond its current and most recent experience. Defining appropriate severity in broad terms ensures that a scenario must be appropriate for the risks the bank is facing. However, with such a broad definition, very different interpretations can arise.

To assist banks in conducting or executing meaningful stress testing, both in form and in substance, and in particular in relation to appropriate severity, the Department undertook significant work during 2007 and 2008 to help banks understand and develop their stress-testing frameworks.

Owing to the international financial market turmoil experienced in 2008, stress testing has become a focus area for many supervisors internationally, with a view to understanding the risks that can still materialise during the current crisis and minimising the potential for a similar crisis in the future.

Supervisory approaches to stress testing

core regulatory stress-testing requirements

The Regulations relating to Banks set out the core regulatory stress-testing requirements for banks. These include sensitivity and scenario analysis covering individual risk areas

and whole-bank stress testing. Such stress tests are required under Pillar 1, which captures minimum regulatory capital requirements for the key risk areas, namely credit, market and operational risk, and under Pillar 2, which reviews whole bank risk in a SREP. Specific stress testing is required under Pillar 1 for advanced approaches to risk measurement of credit, market and operational risk. A more general requirement is made of all banks under Pillar 2 for holistic bank stress tests, as well as some individual risk area stress tests, such as interest rate risk in the banking book.

In terms of Pillar 1 IRB stress testing, regulation 23(11)(b)(ix) of the Regulations relating to Banks states:

> (ix) Stress testing
>
> As a minimum, a bank that adopted the IRB approach for the measurement of the bank's exposure to credit risk shall have in place a stress-testing process in respect of the bank's exposure to credit risk, which stress-testing process –
>
> - shall include an identification of possible events or future changes in economic conditions that may have an unfavourable effect on the bank's risk exposures and an assessment of the bank's ability to withstand such events or changes, which events or changes may include –
> - economic or industry downturns;
> - market-risk events;
> - liquidity constraints; and
> - mild recession scenarios
> - shall be meaningful, based on the environment in which the bank conducts business;
> - shall assess the effect of a recession on the bank's PD ratios, LGD ratios and EAD amounts;
> - shall make provision for an internal ratings migration in respect of at least some of the bank's exposure to credit risk; and
> - shall appropriately evaluate evidence of rating migration in respect of external ratings.

In terms of Pillar 2, Principle 3 of Basel II, a bank should operate above the minimum regulatory capital ratios and the regulator should have the ability to require banks to hold capital in excess of the minimum.

Regulation 39 of the Regulations relating Banks relates to corporate governance and contains a number of references such as

- regulation 39(6), which states that
  > [banks] shall, on a periodic basis, conduct relevant stress tests, particularly in respect of the bank's main risk exposures, in order to identify events or changes in market conditions that may have an adverse impact on the bank.

- regulation 39(8) which states that
  > [banks] shall have in place a routine and rigorous process or programme of stress testing the results of which stress-testing
  >
  > - shall periodically be reviewed by the senior management of the bank;
  > - shall be used in the bank's internal assessment of capital adequacy;
  > - shall be compared against the bank's measure of expected positive exposure and the related impact on the bank's capital adequacy;
  > - shall be duly reflected in the bank's policies and counterparty limits set by management and the bank's board of directors.

The stress-testing requirements referred to in the Regulations relating to Banks are a core part of the effective supervision of banks and set out the minimum regulatory expectations of banks' approaches to stress testing. While the Regulations relating to Banks outline the requirements for appropriate stress testing, banks are required to undertake significant additional work to ensure that this is effectively carried out.

Banks' progress in establishing their stress-testing frameworks

stress testing is a necessity

Notwithstanding the references in the Regulations relating to Banks setting out the requirements for banks' stress testing, it has long been a supervisory requirement. Supervisors around the world have maintained that a robust programme of stress testing is a necessity for effective risk management. Moreover, the appropriate time during which to ensure that stress testing is effective is in benign times, such as those experienced in the mid-2000s. During such periods, banks should ensure that they pay due attention to stress testing and to constructing scenarios that are appropriately severe to look beyond the recent benign experience.

In South Africa banks were formally required to implement the stress testing of risks other than market risk, as set out in the Regulations relating to Banks, for the first time in January 2008. However, banks' stress-testing programmes were already being enhanced ahead of the implementation of Basel II. In this context the Department saw a wide range of approaches to stress testing undertaken by banks in South Africa during the period 2007 to 2008.

stress testing of credit risk

All banks applying for the advanced approaches to credit risk had to submit proposals for effective stress testing of credit risk under Pillar 1, including stresses on all credit parameters, PD, LGD and EAD to understand how these factors changed in times of stress. Particular attention was paid to the migration of obligors through PD groupings as the economic environment changed.

market and operational risk stress tests

All banks currently pursuing the advanced approach to market risk have to undertake a series of stress tests. However, as the advanced approach to market risk was already in place before 2008, most banks to whom this requirement was relevant had previously implemented such stress testing. In addition, all banks implementing the advanced approach to operational risk were required to undertake operational risk stress tests. In both cases banks' approaches to stress testing were well advanced, more so than for credit risk; assisted perhaps by the greater supervisory prescription in both these approaches.

All banks were also required to commence work on their stress testing in terms of Pillar 2, that is, whole-bank stress tests in the face of adverse macroeconomic scenarios.

sophisticated multifactor macroeconomic stress tests

In terms of Pillar 2 stress testing, banks in South Africa, generally, had already undertaken a significant amount of work and had relatively sophisticated multifactor macroeconomic stress tests. Scenarios are devised, often but not always, with input from economic research, business units and senior management. In constructing scenarios, the combination of adverse developments in several macroeconomic variables must be checked for internal consistency and that the specified values of the macroeconomic variables constitute a realistic mix. These scenarios are then mapped on banks' balance sheets and risk drivers to assess the impact. The conventional approach is to devise scenarios that imitate historical episodes of tail events or to generate scenarios with the aid of a macro-econometric model. However, as history rarely repeats itself exactly and in order to ensure that scenarios are appropriate for the risk exposure of an individual bank, banks were required to understand hypothetical scenarios that would impact their balance sheets.

The Department emphasised at an early stage the importance of an appropriate governance framework for stress testing. Board approval, senior management oversight and internal audit involvement are all key, and governance was a focus of all discussions with banks regarding their stress-testing frameworks.

The Department's observations on banks' stress testing

The Department made a number of general observations under both Pillar 1 credit risk stress testing and the broader Pillar 2 stress-testing frameworks.

general observations under Pillar 1 and Pillar 2

Pillar 1 stress testing

Banks' credit risk stress testing under Pillar 1 varied. In relation to the stress testing of individual parameters the following was noted:

Governance: A number of banks left Pillar 1 stress testing to a specific group of people. Banks were advised to ensure that they involved business units and economists, and that there was effective senior management challenge. This follows international practice in stress testing.

Probability of default: In addition to ensuring that PD estimates for each PD band reflect long-run data, there is a requirement that banks should consider rating migrations between bands as part of their stress testing. Although the stress testing performed by banks generally allowed for some level of implicit rating migration, certain banks had difficulty in translating this into practical stressed outcomes (e.g., what their portfolio would look like in terms of movements in their rating distributions) and further work was required.

Loss given default: In some instances banks did not include LGD stress tests, indicating that they were already using downturn estimates of LGD in their regulatory capital calculations. In other instances the methodology and assumptions applied indicated that the severity of the LGD stress was not aligned to that of a severe scenario. The Department's view was that downturn LGD estimates usually referred to the LGD in a regular downturn and, consequently, it remained necessary to stress LGD estimates for more severe scenarios. This was a requirement for all IRB banks and further work was necessary in some instances.

Exposure at default stress testing: EAD stress testing was the least developed of all parameter methodologies, with the exception of some basic growth assumptions. If a bank believes that EAD estimates are not affected by the cycle, clear evidence must be presented to prove this fact. In most instances additional work was required in this area of stress testing.

More generally, the granularity at which stress testing was conducted for Pillar 1 varied greatly between banks. The Department highlighted to banks that the goal of Pillar 1 stress testing was to use it as a diagnostic tool and, as such, greater granularity was preferred. One way to consider the appropriateness of granularity was for senior management to consider whether they understood what a Pillar 1 stress meant for individual business units and resulting business actions.

Integration between Pillar 1 and Pillar 2 stress testing

In some instances there were significant differences between the approaches to Pillar 1 and Pillar 2 stress testing. Although it is not a requirement to have the same methodology and approach to Pillar 1 and Pillar 2 stress testing, it is useful to understand the similarities and differences between, and be able to use, the two approaches as benchmarks. In such instances banks generally found it difficult to explain the differences adequately.

differences between Pillar 1 and Pillar 2 stress testing

Pillar 2 stress testing

Supervisory assessment of banks' stress tests focuses on the buffer requirement that banks keep in order to avoid breaching the minimum required regulatory capital ratios. Stress testing in the Pillar 2 context, therefore, forms an important part of the assessment of the minimum capital requirement of banks.

From a supervisory perspective, given the plausibility of economic scenarios, management actions, diversification, time span covered and appropriateness of the multi-factor models, the stress-testing results and the capital impact are considered. In instances where the minimum required capital and reserve funds may be breached, the Department may consider a capital add-on.

plausibility of economic scenarios

The plausibility of the economic scenarios, notably in relation to the appropriate severity of the shock, was a key area of debate between banks and the Department in relation to the following:

- The relevance of the economic scenarios to the bank
- The appropriateness of the severity
- The appropriate time span (see the time frame of the scenario considered on page 37)
- The fact that the extent to which diversification was considered varied significantly from full consideration to no consideration
- The fact that the time frame of the scenario considered, and its impact, varied widely: in some instances only instantaneous shocks were considered, while in others the full five-year scenario and resulting impact were carefully drawn out
- The fact that the associated buffer requirement was not always well articulated in relation to the stress-testing results: in some instances, a flat buffer requirement was articulated that appeared to bear no relation to the stress test or the banks' stated risk appetite.

Key observations

Scenario severity and consistency: The Regulations relating to Banks require banks to consider a scenario that can be regarded as at least a mild recession. However, in relatively benign times, a mild scenario alone is unlikely to be sufficient. The Department asked that banks also consider a severe, but plausible, scenario. In this context banks were required to undertake further work to ensure that a suitably severe scenario that was appropriate for their bank was considered, that is, a bank should consider what issues would severely impact its business from both a South African and international perspective.

consistency is key to effective scenario stress testing

Many scenarios were formulated such that individual components of the scenario were more severe than others (e.g., a much larger shock to gross domestic product than to interest rates). Consistency is key to effective scenario stress testing. Banks were encouraged to follow appropriate governance structures (e.g., involvement of business units, economic research and senior management sign off) to achieve this.

correlations change in stressed conditions

Correlation factors: The correlations between counterparties or assets are estimated in a variety of ways. However, in most cases the correlations reported by banks were made over a long period and were not adjusted to be appropriate for a stress scenario. Correlations change in stressed conditions and the Department pointed out to banks that it would not be acceptable to use long-term correlations under relatively benign economic conditions.

Diversification and concentration: The extent to which Pillar 2 stress testing incorporates diversification within risk types (intra-risk) and between risk types (inter-risk), such as credit and market risk, is an area of significant debate between banks and supervisors. Banks must be able to demonstrate how their assumptions in respect of correlations are valid in stressed situations. The importance of this debate became clear during 2007 and 2008, and will be an area of focus in 2009.

assumptions in respect of correlations

In this context supervisors expect a discussion of diversification benefits in times of stress to be tempered by an analysis of the types of concentration risk that can arise. Again, this relates to the types of concentration that may materialise in stress situations in relation to specific risk types (e.g., in credit risk or intra-risk concentration), but also how concentrations between risk type (inter-risk concentrations) may be amplified in stressed situations, for example, in relation to counterparties in market and credit risk.

Time span covered: Banks should be able to demonstrate how Pillar 2 stress testing plays out over a period commensurate with the ICAAP outlook, which is around three to five years. It may very well be that the worst outcome (biggest impact on the capital structure of the bank) might only occur in years 3 and 4. It is also important that this be considered from a capital planning or management perspective.

Management actions: From a Pillar 2 perspective, it is imperative that management actions are considered when assessing the Pillar 2 stress test of a bank to understand its likely capital impact properly. Banks must be clear on what types of management actions are included in their stress-testing results and evidence the plausibility of such management actions in a period of stress. The Department drew banks' attention to the fact that further work had to be done in articulating the plausibility of management actions. In this regard, a conservative view of the plausibility of management actions without supporting evidence was taken by the Department.

plausibility of management actions

Assumptions/Methodology: All stress-testing methodologies contain assumptions. Nonetheless, where third parties are instrumental in the development of stress-testing frameworks, it is imperative that banks are able to explain their assumptions and their impact on stress-testing results. Greater engagement and questioning from business units, economic research and senior management is one way of ensuring that a "black box" approach to stress testing is not adopted.

Supervisory actions

The supervisory observations outlined above were communicated to banks and significant debate was held on how to address key challenges. While the Department noted that the Regulations relating to Banks contained the key elements relevant to stress testing, and their practical implementation was the banks' own responsibility, supervisors worked with banks to help them better interpret the intent of the Regulations relating to Banks in a way that would strengthen banks' own stress-testing practices. Supervisory actions included the following:

strengthen banks' own stress-testing practices

- Bilateral discussions
- Multi-bank symposiums
- General guidance
- Development of the Department's own stress-testing expertise.

Ongoing debate with, and feedback to, individual banks was the primary communication channel to help banks strengthen their stress-testing frameworks. Such communication took place throughout 2007 and 2008, and will continue into 2009.

The Department also organised a symposium that brought together banks' risk specialists, economists and stress-testing personnel to debate cyclicality and stress scenarios in a South African context. The objective was to share ideas, at a holistic level, about the types of stresses that might be seen in the South African context and the methodological approaches adopted in stress testing.

Guidance

more detailed guidance note

In addition to the actions above, the Department developed a more detailed guidance note to assist banks in taking forward their Pillar 1 and Pillar 2 stress testing in particular in relation to four key areas:

1. Differences between Pillar 1 and Pillar 2 stress tests
2. The appropriate severity of stress scenarios
3. The use of reverse stress testing
4. The role of senior management.

To assist in understanding the difference between Pillar 1 and Pillar 2 stress testing, Guidance Note 9/2008 explained that the focus of Pillar 1 stress testing was on credit risk (notably migrations between grades) while Pillar 2 focused on the holistic view of all risks. Furthermore, stress-testing time horizons under Pillar 1 were usually shorter term while under Pillar 2 the time horizon was at least three to five years. Finally, the Guidance Note highlighted the role of management actions in Pillar 2 as opposed to in Pillar 1 where it was not considered.

To assist in understanding the appropriate severity of stress scenarios, the Guidance Note – without removing the obligation on banks to determine scenarios appropriately severe for their business – outlined the type of one in twenty-five-year scenarios that would be seen as a minimum severity appropriate for effective stress testing.

Included in the guidance note was the potential use of reverse stress testing in ensuring that banks understood the risks to their business in times of severe stress and in complementing the one in twenty-five-year stress scenarios in Pillar 2 stress tests.

The Guidance Note sets out the key role of engaging senior management along with the importance of involving a range of people from around the business in drawing up the scenario(s), including economic research and the business units.

Senior management and other engagement is key to ensuring that stress-testing scenarios are appropriately severe and that analysis of stress testing is meaningful to the banks' business, including setting appropriate capital buffers in line with the banks' stated risk appetite.

The Department's own stress testing

the Department continued to develop its own stress-testing expertise

In order to ensure effective challenges to banks' own stress testing and to gain an effective macro-oversight of the banking system, the Department continued to develop its own stress-testing expertise by working in conjunction with other departments in the Bank and with international organisations.

For example, during 2008 the Department participated in the FSAP/Article IV Consultation by the IMF and the World Bank.[5] A component of these reviews was an excercise in stress testing the South African banking sector.

The stress testing consisted of both sensitivity and scenario analysis. The analysis was approached from both a bottom-up (estimated by the participating banks) and a top-down approach, based on the supervisory returns.

The methodology was based on standard IMF stress-testing methodology, albeit further enhanced by the Department, and was undertaken by joint teams consisting of members from the IMF and the Department. The report concluded, based on data available at the end of January 2008, that the South African banking sector was fundamentally sound, but that there were increasing macro-financial risks.

The ongoing availability of the stress-testing methodology, and the continued access to IMF staff for technical guidance and scenario formulation enable the Department to gain a better understanding of the banking system and to challenge the banks' own stress testing.

In addition, the Department co-operated with a visiting research fellow to refine the in-house stress-testing capacity. The research fellow was from the Centre D'Etudes Prospectives et D'Informations Internationales, an independent French institute for research into international economics. The aim of the fellowship programme was to develop a credit risk stress-testing model for the South African banking sector.

The Department worked closely with the research fellow to develop the methodology and build on existing work to enhance the ability to undertake system-wide stress tests. The main findings of this exercise, based on data up until June 2008, were that the South African banking sector was resilient against economic shocks.

The Department spent significant resources researching and building capacity for stress testing, enhancing its ability to understand systemic weaknesses in the banking sector better, and to provide a stronger base from which to challenge the output of banks' own stress testing more effectively.

Market risk

Following the revision of the Regulations relating to Banks in line with Basel II, the treatment of market risk changed. Banks are only required to hold capital to cover their position risk arising from exposure to financial markets and the risk of idiosyncratic change in value of financial assets with exposure to individual companies.

Banks are exposed to market risk when they retain a small proportion of residual risk from executing trades on behalf of their clients, or through proprietary trading. In 2008 the number of banks in South Africa reporting market risk increased to twenty-six, up from eleven in 2007 as a consequence of the introduction of the revised Regulations relating to Banks. All banks with exposure to foreign currencies are required to hold capital for the market risk associated with exchange rate fluctuations, whereas previously foreign-exchange risk could be reported as a component of credit risk. Counterparty risk emanating from trading activities was previously also a part of market risk capital requirements, but is treated as a component of credit risk under the revised Regulations relating to Banks. Furthermore, market risk no longer includes elements aimed at addressing concentration risk and operational risk arising from trading activities.

two alternative reporting methods for market risk

The revised Regulations relating to Banks include only two alternative reporting methods for market risk, namely the internal models-based approach (IMA), and the standardised approach (TSA), whereas under previous regulations a simplified

approach was also available to banks. Banks are also permitted to apply a combination of TSA and IMA reporting when required to do so or under circumstances approved by the Registrar. At present five of the twenty-six banks with market risk exposure have permission to report according to the IMA.

Banks with IMA approval are subjected to an annual review in order to maintain the right to use the modelled method for reporting. During 2008, the Department conducted evaluations and renewed its approval for all five banks that are currently permitted to use the IMA. In addition, IMA banks are subject to a quarterly appraisal of their compliance with the conditions of approval to use the IMA. During this process, a bank's back-testing performance, available to the Department via monthly submissions, is a key indicator of the validity of its market risk models to measure the capital required to cover potential losses. When back-testing data indicate that a bank's losses exceed modelled predictions above a tolerance level, the market risk capital requirement is increased by adjusting the value of a regulatory multiplication factor. Apart from examining back-testing, banks are also assessed against various qualitative factors stipulated in the Regulations relating to Banks. No adjustments were made to banks' capital multiplication factors during 2008 on the basis of back-testing performance. Some banks received adjusted multiplication factors following their annual assessment.

Extreme volatility in financial markets began in late 2007 and escalated in some sectors in 2008. Slumps in commodity prices, the rand exchange rate and South African equity markets resulted in banks' reducing their risk appetite; evident through a reducing sectoral market risk capital requirement in the latter half of the year. Despite market suppression, banks' trading book profitability saw both pronounced positive and negative impacts across the industry.

capital requirement for banks' exposure to equities

The revised Regulations relating to Banks also introduced a capital requirement for banks' exposure to equities that are generally held for investment purposes, and which are included in the banking book for accounting purposes. Fourteen banks reported exposures of this nature during the course of 2008. Capital charges under these regulations contributed to approximately 5,5 per cent of banks' total capital requirements. For supervisory purposes, equity risk is overseen alongside market risk.

Capital held for market risk made up about 2,6 per cent of the total capital requirement for the banking sector during 2008. The decrease from around 4 per cent in 2007 is attributable to the addition of operational risk and equity risk to the total capital requirement. Furthermore, capital held for concentration risk, operational risk and counterparty risk arising from trading activities is no longer regarded as being part of market risk.

Equity risk in the banking book

The revised Regulations relating to Banks also introduced a requirement that banks hold capital for their exposure to non-traded equities. These assets are usually held for investment purposes and are treated as banking-book entries for accounting purposes.

The Regulations relating to Banks require banks that report credit risk according to SA to report their equity risk according to a simplified framework, while banks with credit risk IRB approval may use a simple risk-weighted method, or they may seek approval to use a market risk value-at-risk (VaR) model method or a credit risk IRB method to report the risk.

Fourteen banks reported a capital requirement for equity exposures in their banking book in 2008. One bank received approval to report equity risk according to the credit risk IRB method, while three others used the simple risk-weighted method. The remaining ten banks report according to the simplified framework.

risk-based assessments

As part of its SREP, the Department conducted risk-based assessments in order to gain greater insight into the sources of risk and management controls of banks. During 2008, two banks were assessed on equity risk in their banking book. Each assessment encompassed an off-site evaluation of a documented submission by the bank elaborating the framework in use for identifying, measuring, monitoring, reporting and controlling the risks. This was followed by an on-site review to gain a first-hand perspective on the banks' operational conduct and risk management. Banks are primarily measured against compliance with the Regulations relating to Banks, but the tenets of the Core Principles developed and published by the Basel Committee are also used as a yardstick for basic minimum standards.

Notes

1 http://www.bis.org/press/p081202.htm.
2 http://www.bis.org/press/p081120.htm.
3 Bank Supervision Department, *Annual Report 2007* (Pretoria: South African Reserve Bank, 2007), 33, 34.
4 http://www.bis.org/publ/cgfs24.pdf.
5 The FSAP report can be found at http://www.imf.org/external/pubs/ft/scr/2008/cr08349.pdf and the Article IV report at http://www.imf.org/external/pubs/ft/scr/2008/cr08348.pdf.

Chapter 3

Developments relating to banking legislation

A key responsibility of the Department is to ensure that the legal framework for the regulation and supervision of banking groups in South Africa remains relevant and current. Consequently, the legal framework pertaining to banking regulation has to reflect local and international market developments, and has to comply with the applicable international regulatory standards and best practices. The Department is, therefore, required to review the banking legislation, that is, the Banks Act, the Mutual Banks Act, 1993, the Regulations relating to Banks issued in respect thereof and other pieces of related banking legislation on an ongoing basis, and to make recommendations to the Minister of Finance to effect the necessary amendments thereto.

The Banks Act, the Regulations relating to Banks, the Branch Regulations and the Securitisation Notice

The Banks Act was substantially amended during the period under review, in the main, to comply with the principles of Basel II. After an extensive consultation process involving all stakeholders and the requisite parliamentary process, the Banks Amendment Act, 2007 (Act No. 20 of 2007) was assented to by the President of the Republic of South Africa and published as Notice No. 1080 in *Government Gazette* No. 30474 on 15 November 2007. The provisions of the Banks Amendment Act, 2007 became effective on 1 January 2008, which amendments were discussed in detail in the Department's *Annual Report* 2007.

subordinate legislation amended

The following pieces of subordinate legislation were also amended during the period under review, in the main, to comply with the principles of Basel II:

- The Regulations relating to Banks, 2008 were published in *Government Gazette* No. 30629 dated 1 January 2008
- The "Conditions for the conducting of the business of a bank by an international institution by means of a branch in the Republic" (Branch Regulations) were published in *Government Gazette* No. 30627 dated 1 January 2008
- The Notice for the "Designation of an activity not falling within the meaning of 'the business of a bank' (securitisation schemes)" was published in *Government Gazette* No. 30628 dated 1 January 2008.

The provisions of the above-mentioned regulations and notice became effective on 1 January 2008.

identify possible amendments to the legal framework

As part of an ongoing project to keep the legal framework for the regulation and supervision of banks relevant and current, however, the Department will be researching the areas and/or developments described below in order to identify possible amendments to the legal framework.

During 2006 the Basel Committee substantially amended the Core Principles. The Department subscribes to the Core Principles, which is also reflected in the legal framework (effective 1 January 2008) for the regulation and supervision of banks. Ongoing reviews by the Department of the legal framework may reveal certain areas where further amendments to the framework are necessary in order to be fully compliant with the Core Principles as amended.

During 2008 the Department was subjected to, or involved in, the following international assessments (also referred to, and explained in more detail, in Chapter 2 of this report):

- A voluntary pilot project by the IMF/World Bank to assess the Department's implementation of Basel II
- A scheduled FSAP by the IMF/World Bank
- An IMF/World Bank Article IV Consultation
- A scheduled assessment of the Department's compliance with AML/CFT recommendations made by the FATF.

some areas may need to be amended

Although the reports pertaining to the assessments above have been favourable in general as they relate to the legal framework for banking regulation and supervision, there are some areas that may need to be amended.

Following the sub-prime crisis in the USA and the resultant crisis in the securitisation markets in Europe, the Financial Stability Board, a standard-setting body comprising senior representatives of national financial authorities, international financial institutions and committees of central bank experts, issued a paper on the causes, effects and regulatory response to the crisis. The Department is studying the recommendations of the Financial Stability Board report in order to augment the legal framework where necessary or appropriate. Further recommendations by the Basel Committee and the G-20 will also have to be considered in this regard.

Apart from the international developments, the Department has also taken cognisance of the developments within the banking industry, the markets and new or amending legislation that might have an effect on banks and/or banking regulation or supervision.

On 1 January 2008 the Department reissued a number of previously issued Circulars as Directives, Circulars or Guidance Notes in terms of the amended Banks Act. These, together with newly issued Directives, Circulars or Guidance Notes, will also be studied and considered for inclusion in the legal framework for the regulation and supervision of Banks.

Chapter 4 Banking-sector overview

1. Introduction

This chapter provides an overview of the financial and risk information submitted by registered banks during 2008. In previous reports comparative information represented the two years prior to the year to which the report related. However, the implementation of Basel II with effect from 1 January 2008 entailed, *inter alia*, a radical change in reporting methodology, revised regulatory returns and greater alignment of regulatory reporting requirements with International Financial Reporting Standards (IFRSs). Consequently, other than Figures 3 and 4, no comparative information prior to 1 January 2008 is available and thus all data presented in this chapter relate to the period 1 January 2008 to 31 December 2008, and all ratios have been calculated on an unsmoothed basis. With additional historic data becoming available in ensuing reporting periods, the format of future reports will be adjusted accordingly.

The banking-sector data are compiled by way of aggregation of individual South African registered banks' data (i.e., on a solo basis). Branches and subsidiaries of South African banks operating in international jurisdictions are excluded. However, for information purposes, the global presence of South African banks is depicted in Figure 2, which includes subsidiaries, branches and representative offices.

four largest banks constituted 84,4 per cent of banking-sector assets

The reports and graphs presented in this chapter are mainly reflective of the size of the balance sheets of the four largest banks, which constituted 84,4 per cent of banking-sector assets at the end of December 2008. A list of the size of the individual banks' balance sheets is provided in Appendix 2.

Basel II introduced a menu of approaches

The implementation of the Basel II framework introduced a menu of approaches to banks for calculating minimum capital-adequacy requirements for credit risk, market risk and operational risk, which form the basis for the completion of banks' prescribed risk returns. Banks are required to obtain prior approval from the Registrar to apply the more advanced approaches for calculating capital requirements for these specific risk areas. Consequently, it is not possible in certain instances to aggregate the data for a specific risk area due to the differences in approaches applied. In such instances, the discussion, graphs and reports of a specific risk area will be based on the relevant approach followed.

2. Structural features of the banking sector

2.1 Shareholding structure

international shareholders accounted for 46 per cent of banking-sector shares

The shareholding structure of the South African banking sector (Figure 1) shows that international shareholders accounted for 46 per cent and domestic shareholders for 32 per cent of the banking-sector shares in issue at the end of December 2008. Minority shareholders (i.e., shareholders with individual shareholdings to the value of less than 1 per cent) accounted for 22 per cent of the banking-sector shares in issue.

2.2 Banking sector global presence

international banking presence

South African banks have expanded their international banking presence through subsidiaries, branch networks and representative offices. Figure 2 represents the main geographical areas in which banking groups are represented.

Figure 1 Shareholding structure of the South African banking sector (nominal value of shares) (per cent)

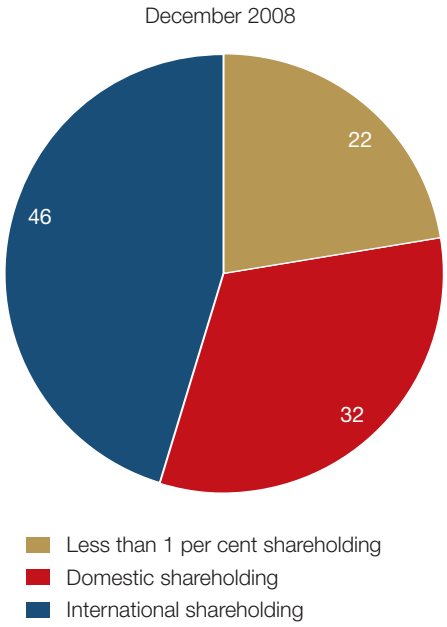
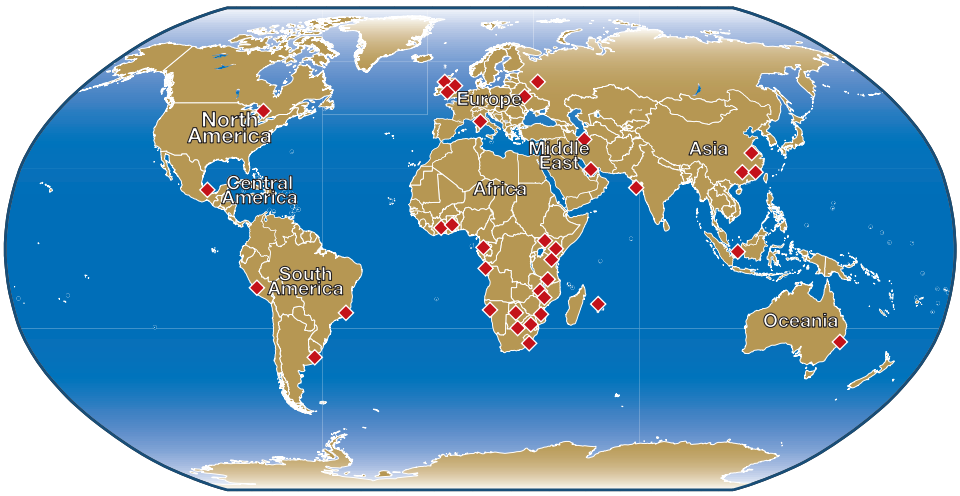


Figure 2 Global presence of South African banks



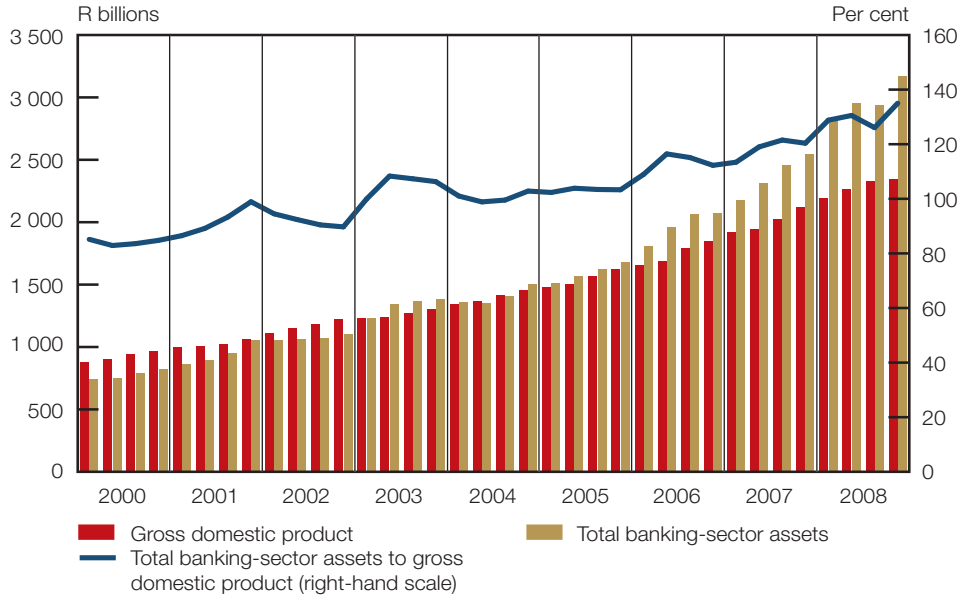
2.3 Banking-sector assets to gross domestic product

The banking-sector's assets measured in relation to the size of the domestic economy, when compared with those of other economies, provides some insight into the developmental stage of a banking sector. As the current international financial market crisis unfolded, increased attention has been paid to the size of individual banks in relation to their domestic economy. In many jurisdictions governments had to provide guarantees and/or capital injections as part of rescue resolution plans to individual banks considered "too big to fail" or systemically relevant.

banking sector has experienced strong growth

Measured since the start of 2000, the South African banking sector has experienced strong annual growth rates, exceeding that of the gross domestic product[1] (GDP). As a result, the ratio of banking-sector assets to GDP increased to 135,0 per cent at the end of December 2008, up from 120,4 per cent at the end of December 2007 (March 2000: 85,1 per cent), as illustrated in Figure 3.

Figure 3 Total banking-sector assets to gross domestic product

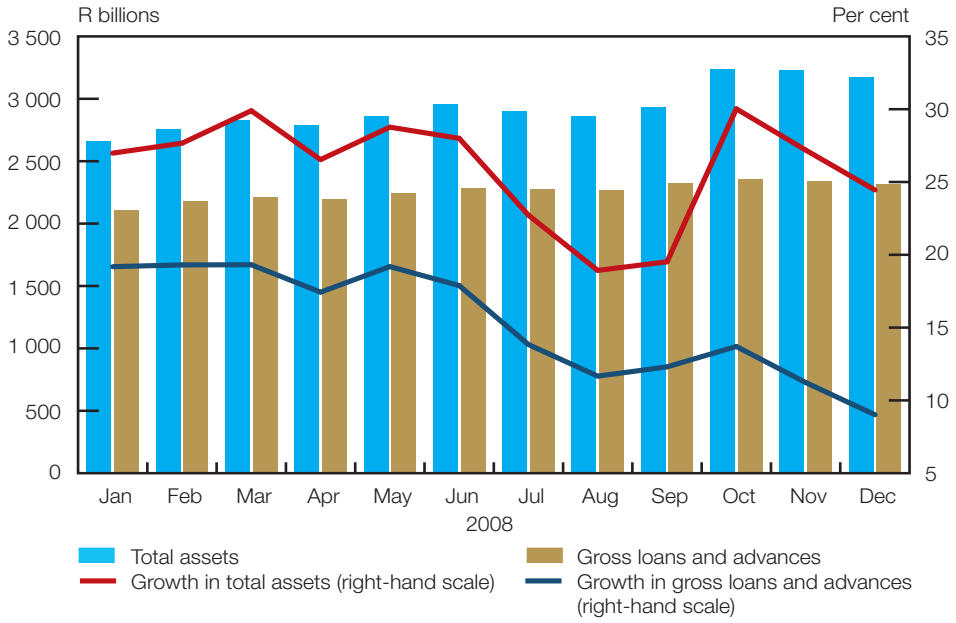


3. Balance sheet

3.1 Assets

Figure 4 illustrates the growth in banking-sector assets, and gross loans and advances during 2008 (measured year on year). During the first half of 2008, banking-sector assets

Figure 4 Total assets, gross loans and advances and the respective growth rates (year on year)



grew at a rate in excess of 25 per cent (March 2008: 29,9 per cent). The growth rate slowed down in the third quarter of 2008 to 18,9 per cent at the end of August 2008, but subsequently increased to 30,0 per cent at the end of October 2008 (the highest level recorded during 2008). At the end of 2008, banking-sector assets amounted to R3 170 billion, representing an annual growth rate of 24,5 per cent year on year (January 2008: 27,0 per cent). The increase in the growth rate at the end of October 2008 was mainly due to a substantial increase in derivative financial instruments to R507,3 billion at the end of October 2008 (September 2008: R244,7 billion). The increase was reported mainly by the five largest banks and some registered branches of international banks.

however, growth rate slowed in the third quarter of 2008

The growth in gross loans and advances eased to 9 per cent at the end of December 2008 compared with 19,2 per cent at the end of January 2008. The lower growth rate in gross loans and advances during 2008 may be attributed to a tighter monetary policy stance and the implementation of more stringent risk-based lending criteria by banks.

growth in gross loans and advances eased

The composition of banking-sector assets at the end of both January 2008 and December 2008 is reflected in Figure 5. Loans and advances to customers remained the largest portion of banking-sector assets, amounting to R2 276 billion at the end of December 2008 (71,8 per cent of banking-sector assets), compared with R2 077 billion at the end of January 2008 (78 per cent of banking-sector assets). Derivative financial instruments, the second-largest constituent, increased from R228,5 billion at the end of January 2008 to R455,5 billion at the end of December 2008, representing 8,6 per cent and 14,4 per cent of banking-sector assets respectively.

loans and advances largest portion of banking-sector assets

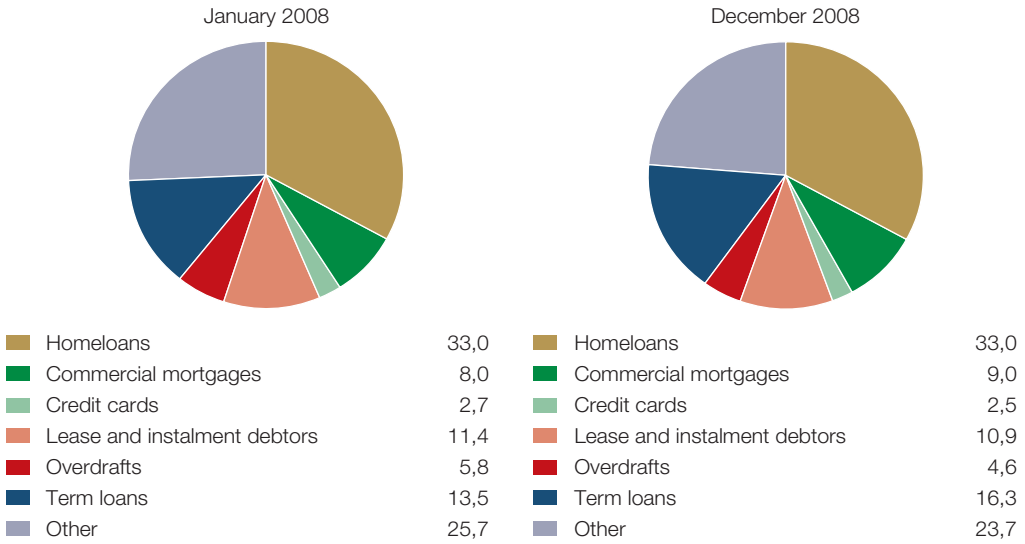
Figure 5 Composition of total assets (per cent)

	January 2008	December 2008
Cash and balances with central bank	2,1	2,1
Short-term negotiable securities	3,5	3,9
Loans and advances to customers	78,0	71,8
Investment and trading securities	4,4	5,3
Derivative financial instruments	8,6	14,4
Other	3,4	2,5

The composition of loans and advances to customers amounting to R2 276 billion at the end of December 2008 remained fairly stable throughout 2008. As illustrated in Figure 6, homeloans and other loans represented the main portions of loans and advances to customers, with the former amounting to R763,5 billion (January 2008: R693,5 billion) and the latter amounting to R549,6 billion at the end of December 2008 (January 2008: R540,3 billion).

The main contributors to 'other' loans were loans and advances to banks (R333,3 billion) and foreign-currency loans and advances (R177,5 billion), and to a lesser extent, repurchase agreements.

Figure 6 Composition of loans and advances to customers (per cent)



inter-bank market continued to function as normal

Figure 7 depicts loans and advances to banks expressed as a percentage of gross loans and advances. The loans and advances to banks, amounting to R333,3 billion, represented 14,4 per cent of gross loans and advances at the end of December 2008 (January 2008: 17,3 per cent). The loans and advances to banks as a percentage of gross loans and advances fluctuated between 14,4 per cent and 18,8 per cent during 2008, which shows that the inter-bank market continued to function as normal throughout the year.

Figure 7 Loans and advances to banks

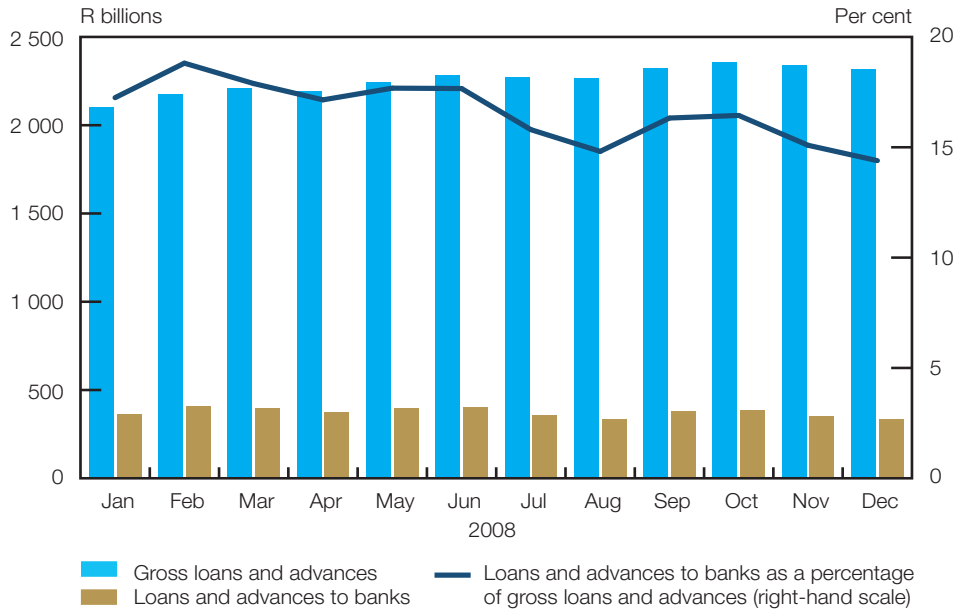
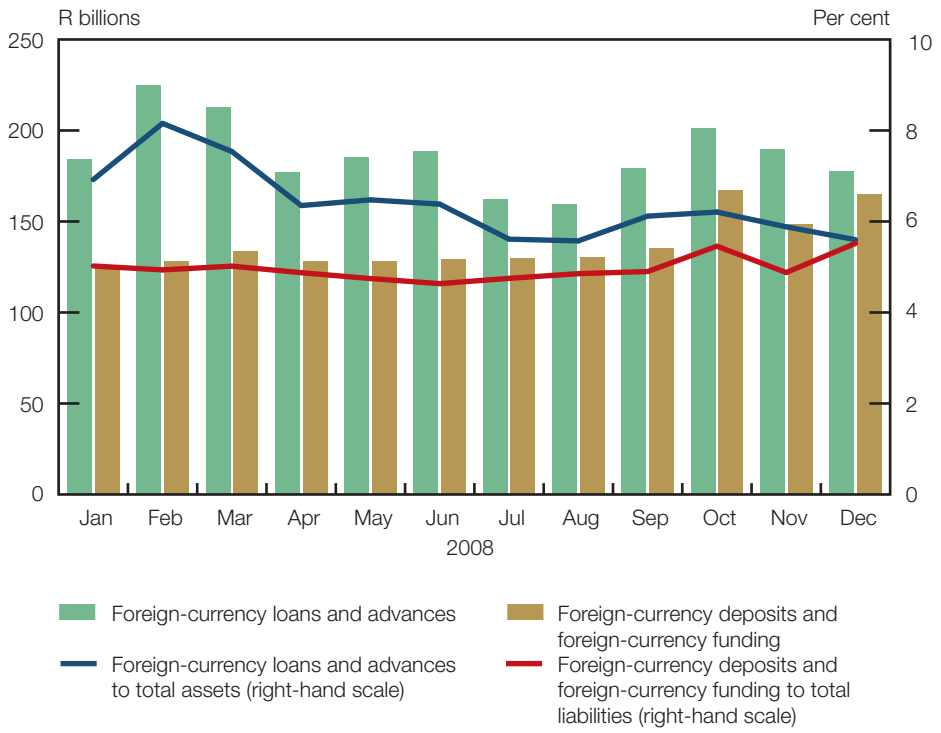


Figure 8 shows foreign-currency loans and advances, and foreign-currency deposits and funding. Expressed as a percentage of banking-sector assets, foreign-currency loans and advances accounted for 5,6 per cent of banking-sector assets at the end of 2008 (January 2008: 6,9 per cent). Foreign-currency loans and advances at a total of R224,9 billion reached its highest level for the year at the end of February 2008, mainly due to an increase reported by one of the large banks. At the end of December 2008 foreign-currency loans and advances amounted to R177,5 billion (January: R184,3 billion).

Foreign-currency deposits and foreign-currency funding increased from R126 billion at the end of January 2008 to R165 billion at the end of December 2008. However, expressed as a percentage of total liabilities, foreign-currency deposits and foreign-currency funding remained fairly stable during 2008, reaching 5,5 per cent at the end of December 2008 (January 2008: 5 per cent).

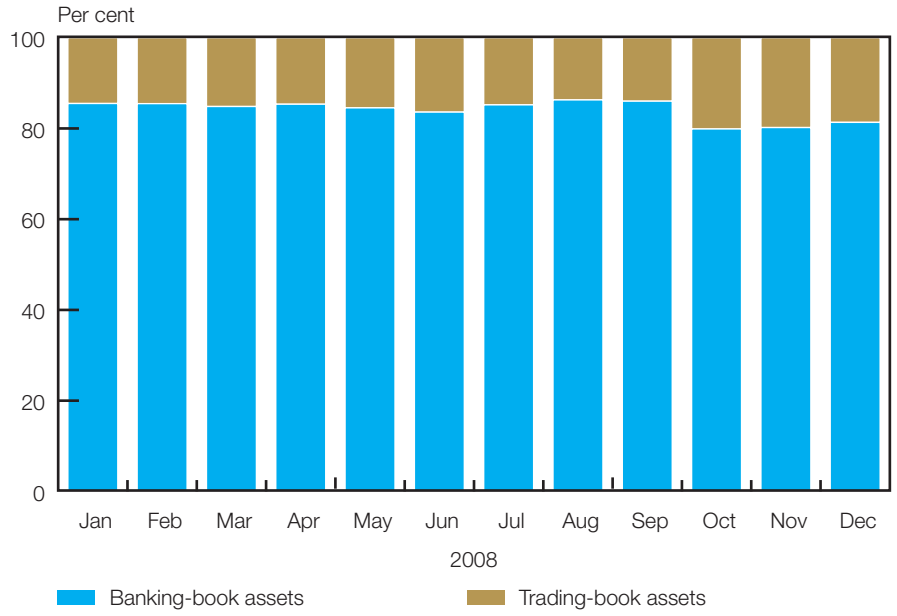
Figure 8 Foreign-currency loans and advances (as a percentage of total assets) and the total of foreign-currency deposits and foreign-currency funding (as a percentage of total liabilities)



banking-book assets 81,3 per cent of banking-sector assets

As reflected in Figure 9, throughout 2008 banking-book assets represented a large portion of banking-sector assets compared to trading-book assets. At the end of December 2008, banking-book assets amounted to 81,3 per cent of banking-sector assets (January 2008: 85,5 per cent). During the fourth quarter of 2008, trading-book assets increased, reaching 18,7 per cent of banking-sector assets at the end of December 2008 (January 2008: 14,5 per cent).

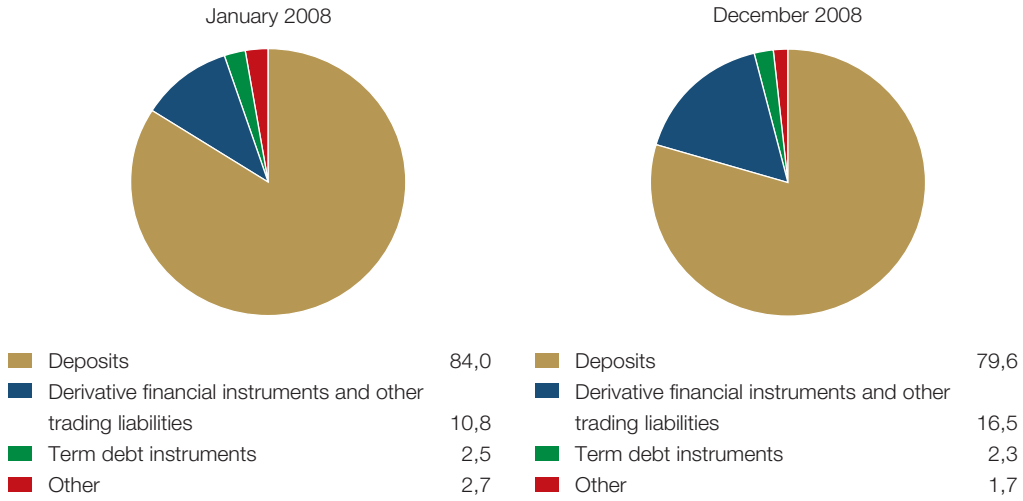
Figure 9 Banking-book versus trading-book assets (as a percentage of total assets)



3.2 Liabilities

The composition of total liabilities of the banking sector (not including equity) is depicted in Figure 10. At the end of 2008, banking-sector liabilities amounted to R2 989 billion (January 2008: R2 509 billion), of which R2 379 billion was made up of deposits (January 2008: R2 108 billion), while derivative financial instruments amounted to R492 billion at the end of December 2008 (January 2008: R271 billion).

Figure 10 Composition of liabilities (per cent)

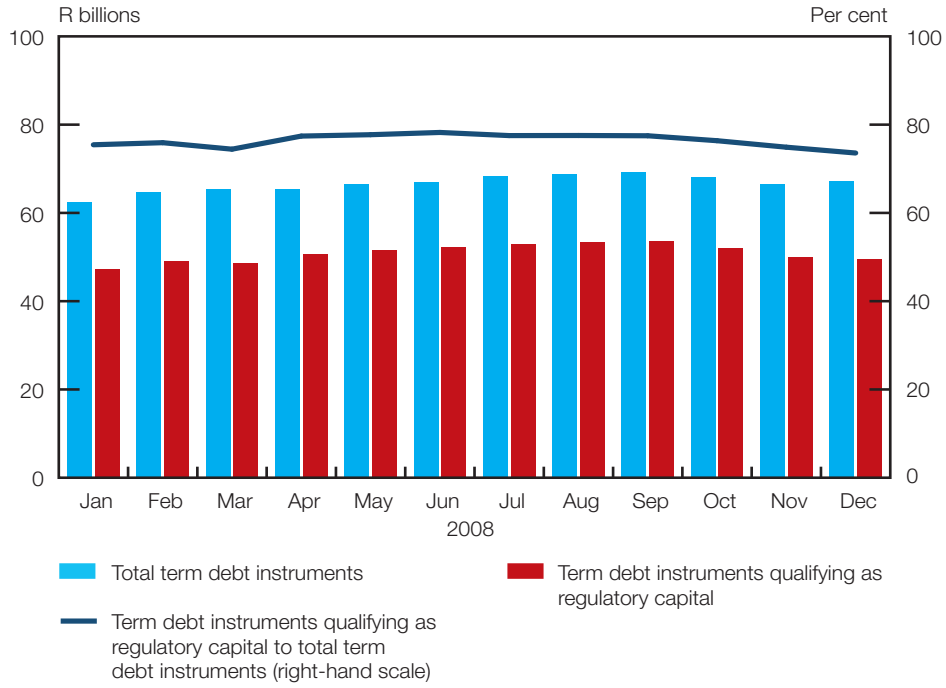


Total equity, which amounted to R181 billion at the end of December 2008, is discussed in more detail in paragraph 3.3 on page 52 (also refer to Figure 14).

Term debt instruments amounted to R67,3 billion

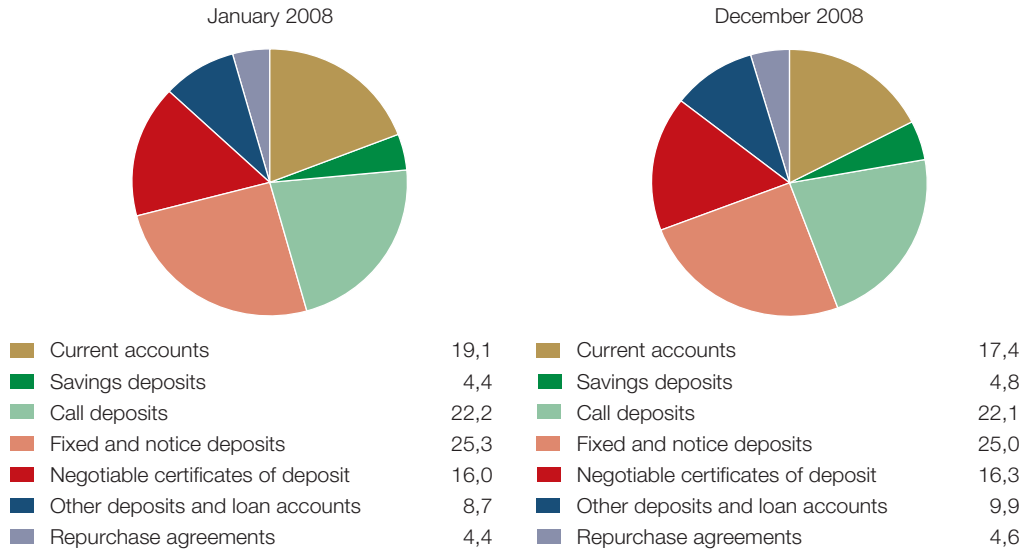
Term debt instruments amounted to R67,3 billion at the end December 2008, representing 2,3 per cent of banking-sector liabilities (January 2008: 2,5 per cent). Of the term debt instruments, 73,6 per cent qualified as regulatory capital at the end of December 2008 (January 2008: 75,4 per cent) (Figure 11).

Figure 11 Term debt instruments qualifying as regulatory capital (as a percentage of total term debt instruments)



An analysis of banking-sector deposits, as reflected in Figure 12, reveals that the composition remained fairly stable during 2008. Total deposits amounted to R2 379 billion at the end of December 2008 (January 2008: R2 108 billion), of which, fixed and notice

Figure 12 Composition of deposits (per cent)

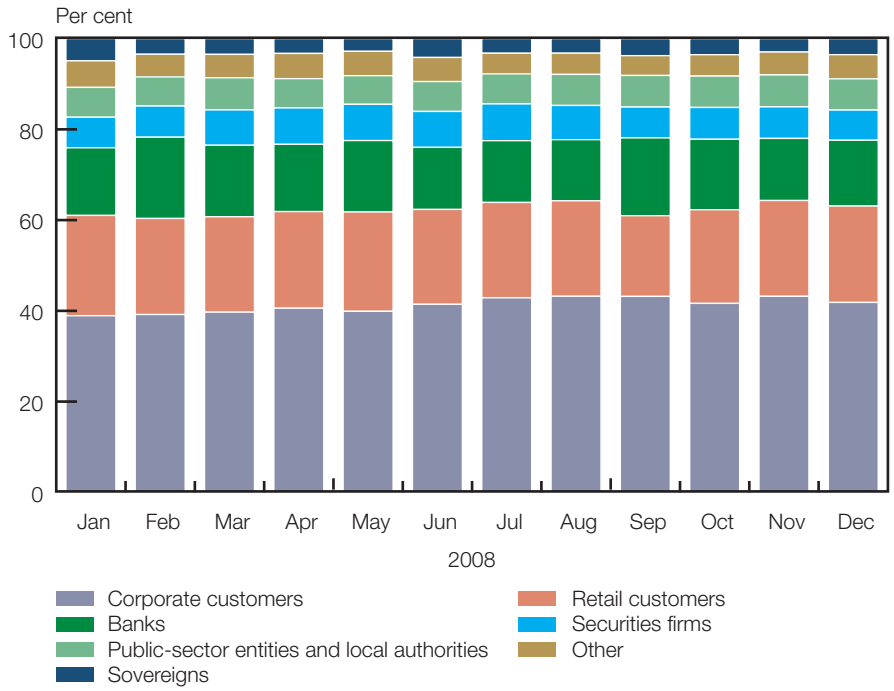


deposits, call deposits and current accounts were the main contributors. At the end of December 2008, fixed and notice deposits amounted to R593 billion (January 2008: R533 billion), call deposits to R525 billion (January 2008: R467 billion), and current accounts to R415 billion (January 2008: R403 billion).

corporate and retail customer deposits represented a significant portion of funding

The sources of banking-sector deposits are outlined in Figure 13. Expressed as a percentage of total deposits, corporate and retail customer deposits represented a significant portion of the funding of the banking sector throughout 2008 (63,2 per cent at the end of December 2008). At the end of 2008, corporate and retail customer deposits represented 41,9 per cent and 21,3 per cent respectively of total deposits. Bank deposits represented 14,5 per cent of total deposits at the end of December 2008 and has remained stable throughout the year. In addition to the aforementioned, the banking sector sourced deposits from securities firms (6,7 per cent), public-sector entities and local authorities (6,9 per cent), as well as from other depositors (5,3 per cent). Furthermore, sovereign deposits accounted for 3,5 per cent of banking-sector deposits at the end of December 2008.

Figure 13 Sources of deposits (as a percentage of total deposits)

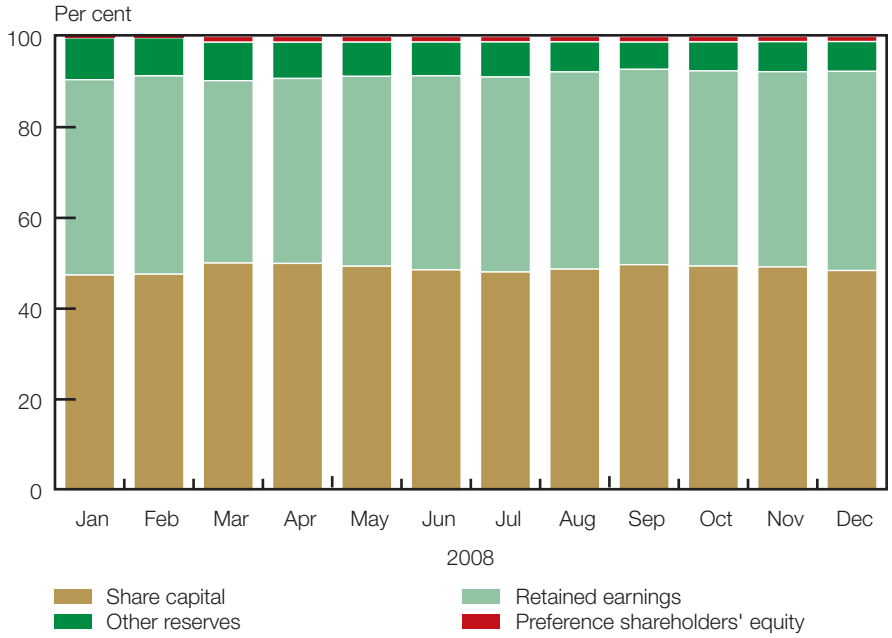


3.3 Equity

total equity amounted to R181 billion

A breakdown of total equity is shown in Figure 14. Total equity amounted to R181 billion at the end of 2008, compared with R154,4 billion at the end of January 2008. Share capital and retained earnings comprised a significant portion of total equity throughout 2008 (approximately 90 per cent), increasing from R73,2 billion and R66,5 billion respectively at the end of January 2008 to R87,6 billion and R79,5 billion respectively at the end of December 2008. Other reserves and preference shareholders' equity accounted for a small portion throughout 2008, amounting to R11,9 billion (January 2008: R14,3 billion) and R2 billion (January 2008: R452,7 million) respectively at the end of December 2008.

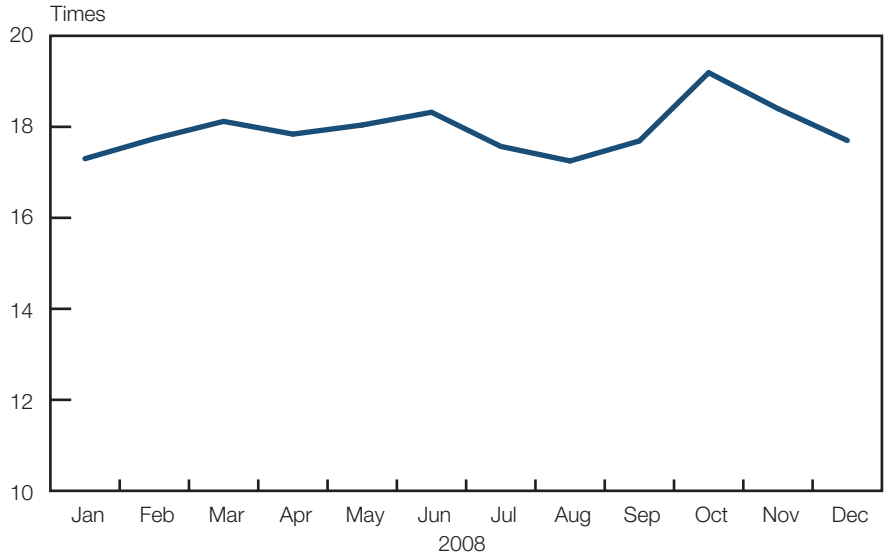
Figure 14 Composition of total equity



The financial leverage ratio for the banking sector is portrayed in Figure 15 and is derived by dividing banking-sector assets by total equity attributable to equity holders. A paper by the World Bank titled 'Banking and the leverage ratio'[2] sheds more light on the leverage ratio. According to this paper, there is now a growing consensus that, among other factors, the excessive leverage of banks contributed to the global financial crisis. This has intensified the debate among policy-makers on the benefits of a simple measure of leverage complementing the existing risk-sensitive capital requirements. Figure 15 illustrates that during 2008 the financial leverage ratio fluctuated between 17,3 times and 19,2 times. At the end of December 2008, the financial leverage ratio for the domestic banking sector amounted to 17,7 times (January 2008: 17,3 times). In comparison, many large global banking institutions reflected leverage ratios in excess of 30 times and, in certain instances, as high as 60 times.

financial leverage ratio amounted to 17,7 times

Figure 15 Financial leverage ratio



4. Off-balance-sheet activities

off-balance-sheet items represented 11,6 per cent of banking-sector assets

Figures 16 and 17 provide an analysis of off-balance-sheet activities of banks. Off-balance-sheet items amounted to R366,3 billion at the end of December 2008 compared with R340,8 billion at the end of January 2008. Off-balance-sheet items remained below R400 billion and varied between R340,8 billion and R375,4 billion throughout the year. Expressed as a percentage of banking-sector assets, off-balance-sheet items represented 11,6 per cent of banking-sector assets at the end of December 2008 (January 2008: 12,8 per cent). The ratio remained slightly above 12 per cent during the first three quarters of 2008 and dropped slightly in the fourth quarter due to an increase in banking-sector assets.

Figure 16 Total off-balance-sheet items to total assets

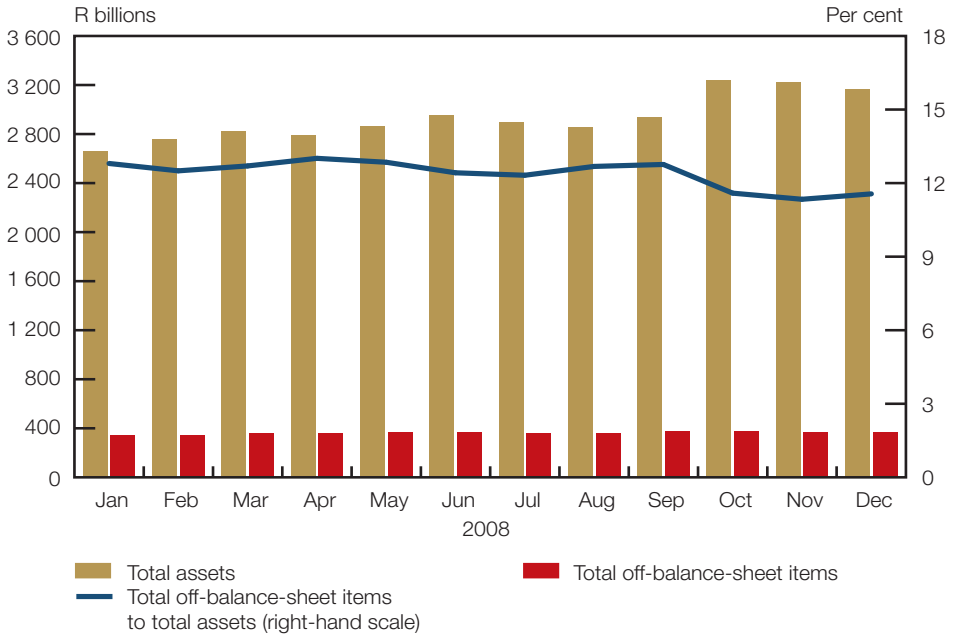
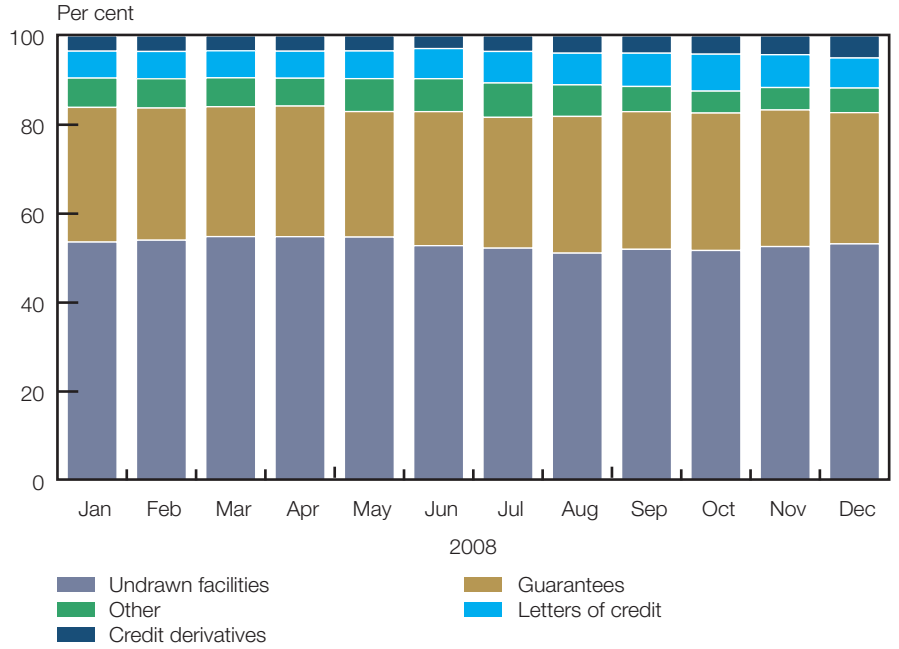


Figure 17 Composition of total off-balance-sheet items



The composition of off-balance-sheet items is depicted in Figure 17 and there has been no significant change in the structure during the period under review. Undrawn facilities and guarantees constituted a large portion of off-balance-sheet items and amounted to 53,2 per cent (January 2008: 53,6 per cent) and 29,5 per cent (January 2008: 30,3 per cent) respectively at the end of December 2008. Letters of credit amounted to 6,8 per cent, other to 5,5 per cent and credit derivatives amounted to 5 per cent at the end of December 2008.

5. Profitability

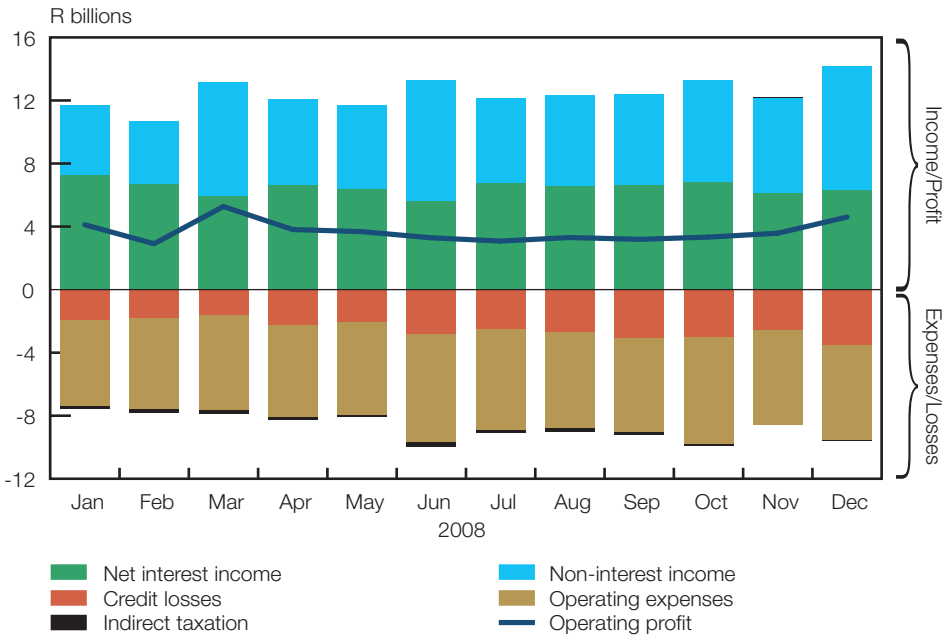
As mentioned in the introductory remarks to this chapter, the implementation of Basel II on 1 January 2008 encompassed, *inter alia*, a radical change in reporting methodology, revised regulatory returns and greater alignment of regulatory reporting requirements with IFRSs. As a result of these changes, all profitability ratios are calculated on an unsmoothed basis, since comparison with previous years is not possible.

Banks reported favourable profitability ratios throughout 2008, despite the global financial market turbulence.

total profit (after tax) amounted to R35 billion

The composition of the banking sector's income statement is presented in Figure 18. Gross operating income, that is, the sum of net interest income (R77,7 billion for the year ending December 2008) and non-interest income (R71,4 billion for the year ending December 2008) amounted to R149,1 billion for the year ending December 2008. Banks generated operating profit for the year of R44,2 billion (i.e., gross operating income less credit losses, operating expenses and indirect taxation) and the total profit (after tax) for the year amounted to R35 billion.

Figure 18 Composition of the income statement



Non-interest income was derived mainly from net fee and commission income, and to a lesser extent from net trading income, amounting to R46,8 billion and R14 billion respectively for the year ending December 2008. As illustrated in Figure 18, two significant increases in non-interest income occurred at the end of March 2008 and

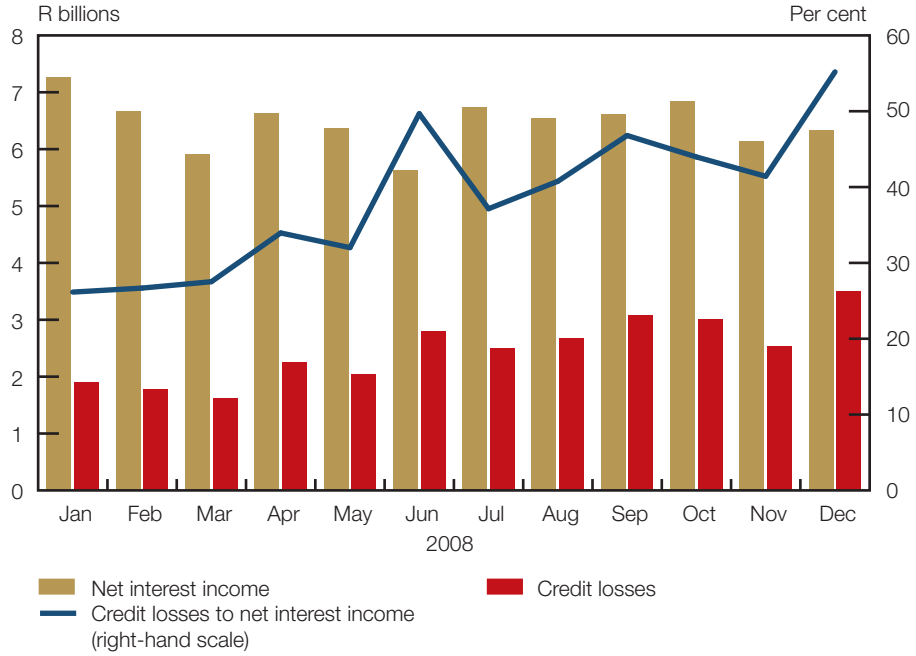
December 2008. The increase for March 2008 was due to an increase in other gains and other operating income reported by two large banks, and the increase reported for December 2008 was due to a number of reasons, namely increases in dividends from subsidiary companies, fair value gains, net fee and commission income, trading income and other operating income.

Operating expenses for the year ending December 2008 amounted to R73,1 billion, while credit losses[3] totalled R29,7 billion. Credit losses increased during 2008, while operating expenses remained relatively stable. Indirect taxation amounted to R2,1 billion for the year ending December 2008.

credit losses increased sharply

Credit losses and net interest income are depicted in Figure 19. Expressed as a percentage of net interest income, credit losses deteriorated during 2008 and remained above 40 per cent in the second half of 2008. At the end of December 2008, the ratio of credit losses to net interest income was 55,2 per cent, compared with 26,2 per cent at the end of January 2008. At the end of June 2008 and December 2008, credit losses increased sharply. The upward trend in the ratio reflects the deterioration in the asset quality experienced by banks.

Figure 19 Credit losses to net interest income (unsmoothed)



A breakdown of gross operating income is reflected in Figures 20 and 21. For the reporting month of December 2008 net interest income and net fee and commission income amounted to R6,3 billion and R4,9 billion respectively (January 2008: R7,3 billion and R3,3 billion respectively). Other income amounted to R2,1 billion for the reporting month of December 2008 (January 2008: R283 million) and consisted of dividend income, other gains less losses (mainly fair value gains and losses) and other operating income, and these items fluctuated considerably on a month-to-month basis during 2008. Net trading income equalled R806 million for the reporting month of January 2008 and R831 million for December 2008, but also fluctuated during the period under review.

Figure 20 Composition of gross operating income (unsmoothed) (per cent)

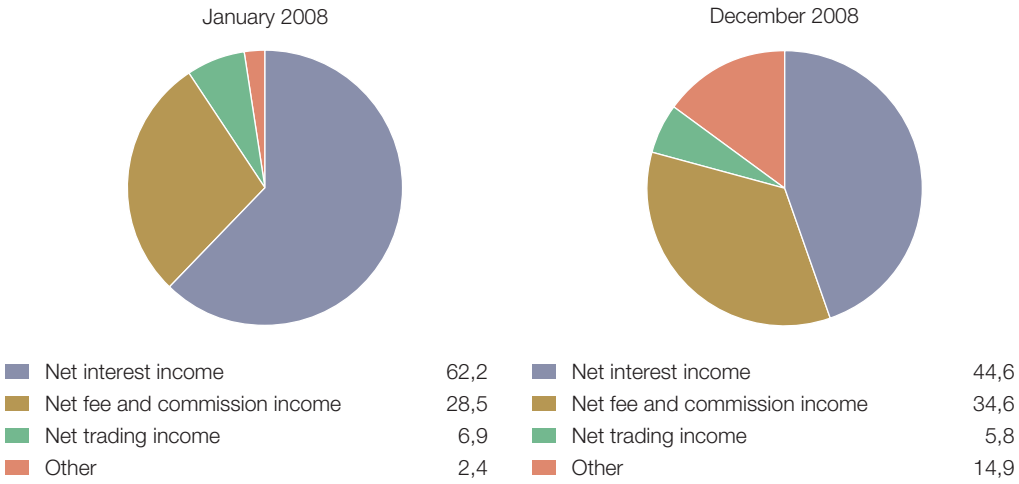
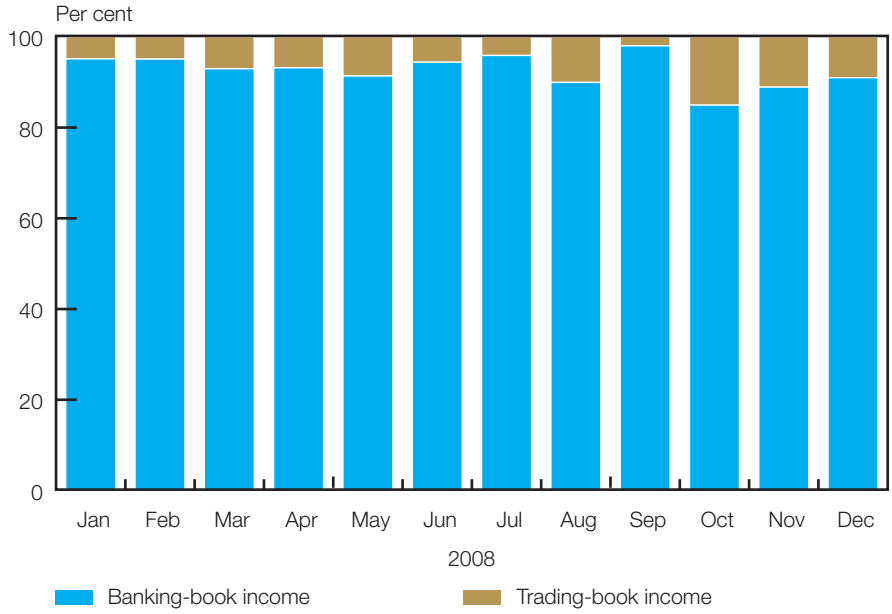


Figure 21 illustrates that more than 80 per cent of gross operating income was derived from banking-book income during 2008. At the end of December 2008 banking-book income represented 91 per cent of gross operating income (January 2008: 95,1 per cent) and trading-book income contributed 9 per cent to gross operating income (January 2008: 4,9 per cent). Trading-book income declined substantially during September 2008 due to lower levels of trading income reported by three of the large banks and a registered branch of an international bank. However, trading-book income improved again during October 2008, and remained higher during the final quarter of 2008 as a result of the large fluctuations in exchange rates and increased volatilities in the financial markets.

80 per cent of gross operating income derived from banking-book income

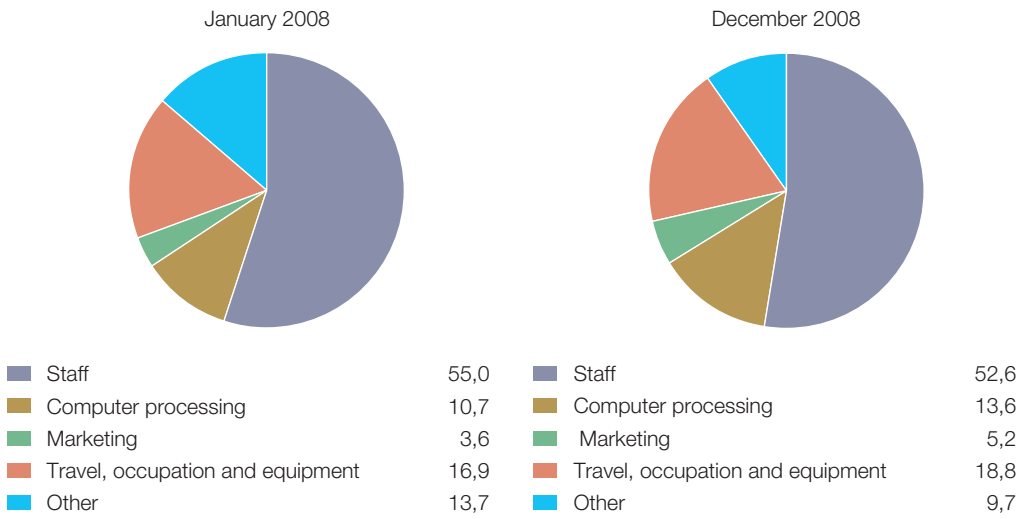
Figure 21 Banking-book income versus trading-book income (as a percentage of gross operating income)



The structure of operating expenses (Figure 22) was relatively stable during the period under review. Staff expenses continued to be the main contributor to operating expenses, amounting to R39,7 billion for the year ending December 2008. For the

reporting month of December 2008, staff expenses amounted to R3,2 billion (January 2008: R3,0 billion). For the year ending December 2008, expenses relating to travel, occupation and equipment amounted to R12,1 billion, 'other' amounted to R10,3 billion and computer processing amounted to R7,7 billion. 'Other' expenses comprised fees and insurances, auditors' remuneration and other expenses. Marketing amounted to R3,5 billion for the year ending December 2008.

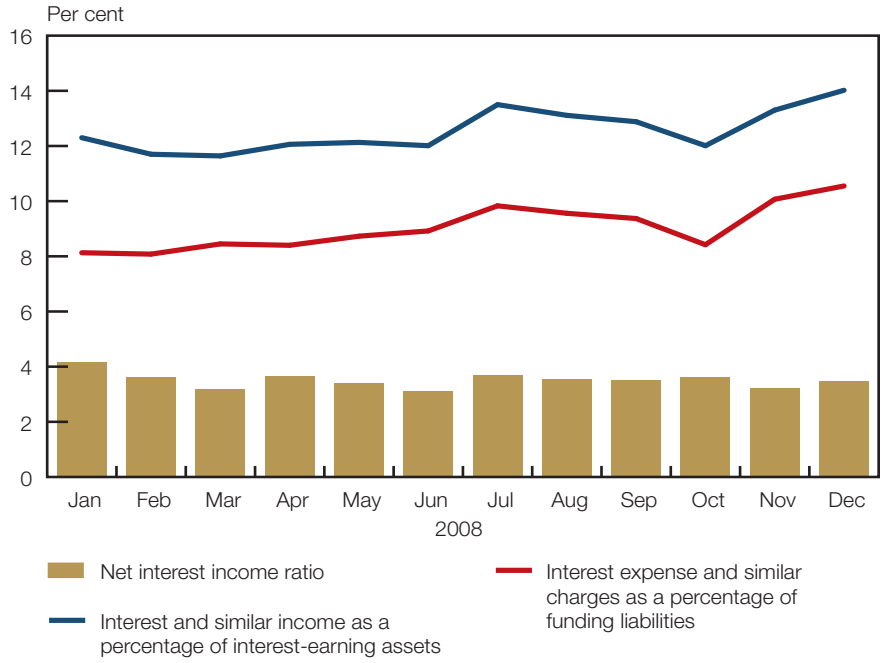
Figure 22 Composition of operating expenses (unsmoothed) (per cent)



net interest income ratio equalled 3,5 per cent

The net interest income ratio (spread), which is the difference between "interest and similar income as a percentage of interest-earning assets" and "interest expense and similar charges as a percentage of funding liabilities", is depicted in Figure 23. At the end of December 2008, the ratio equalled 3,5 per cent (January 2008: 4,2 per cent). Expressed as a percentage of interest-earning assets, interest and similar income increased to 14 per cent at the end of December 2008 (January 2008: 12,3 per cent).

Figure 23 Net interest income ratio (unsmoothed)

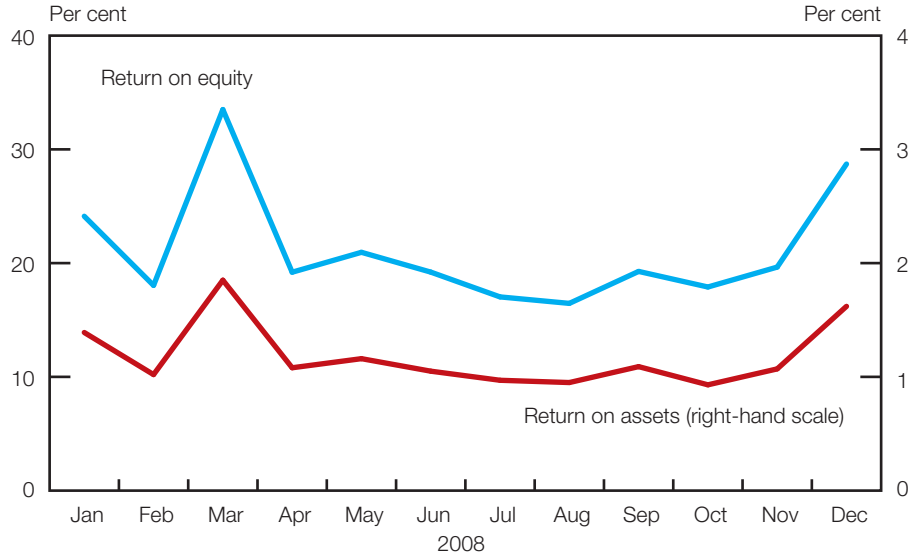


The ratio remained fairly stable during the first half of 2008, and fluctuated between 12 per cent and 14 per cent during the second half of 2008. It increased from 12,0 per cent at the end of June 2008 to 13,5 per cent at the end of July 2008, mainly due to an increase in interest and similar income from government and other dated securities, and loans and advances to customers. The increase in government and other dated securities was reported by three of the large banks at the end of July 2008. Interest expense and similar charges as a percentage of funding liabilities increased from 8,1 per cent at the end of January 2008 to 10,6 per cent at the end of December 2008. The ratio increased to 10,1 per cent at the end of November 2008 (October 2008: 8,4 per cent), mainly due to an increase in interest expense and similar charges on other deposits and loans (reported mainly by one large bank), and term debt instruments.

ROE ratio amounted to 28,7 per cent and ROA ratio amounted to 1,62 per cent

Figure 24 presents the return on equity (ROE) ratio and the return on assets (ROA) ratio. Considerable increases in non-interest income during March 2008 and December 2008 respectively (refer to Figure 18 for an explanation) resulted in increases in both the ROE and ROA ratios during the aforementioned reporting months. At the end of December 2008 the ROE ratio amounted to 28,7 per cent and ROA ratio amounted to 1,62 per cent (January 2008: 24,1 per cent and 1,39 per cent respectively).

Figure 24 Profitability ratios (unsmoothed)

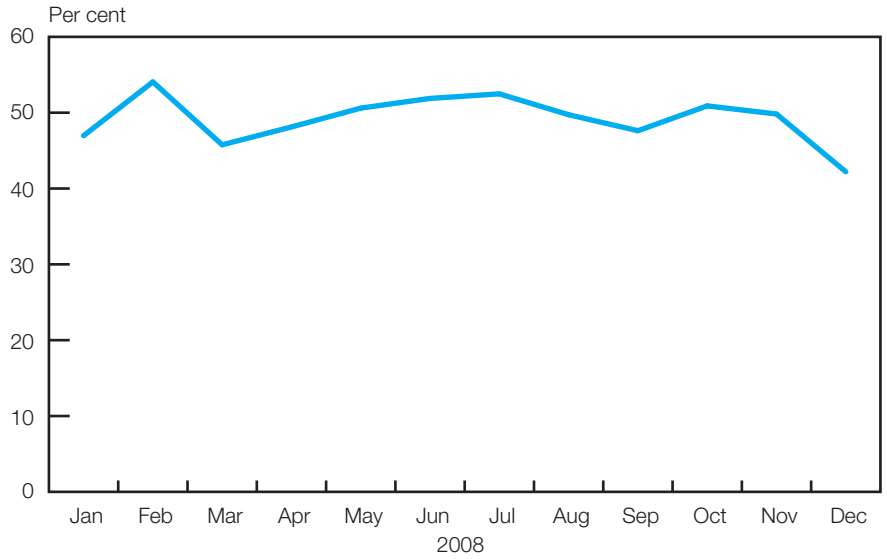


the cost-to-income ratio amounted to 42,2 per cent

The cost-to-income ratio (unsmoothed), that is, operating expenses as a percentage of gross operating income, is illustrated in Figures 25 and 26. The ratio fluctuated between 42,2 per cent and 54 per cent during 2008 (Figure 25). At the end of 2008, the cost-to-income ratio amounted to 42,2 per cent compared with 47 per cent at the end of January 2008. The ratio improved to 45,8 per cent at the end of March 2008 and 42,2 at the end of December 2008 due to the increases in non-interest income as illustrated in Figure 18.

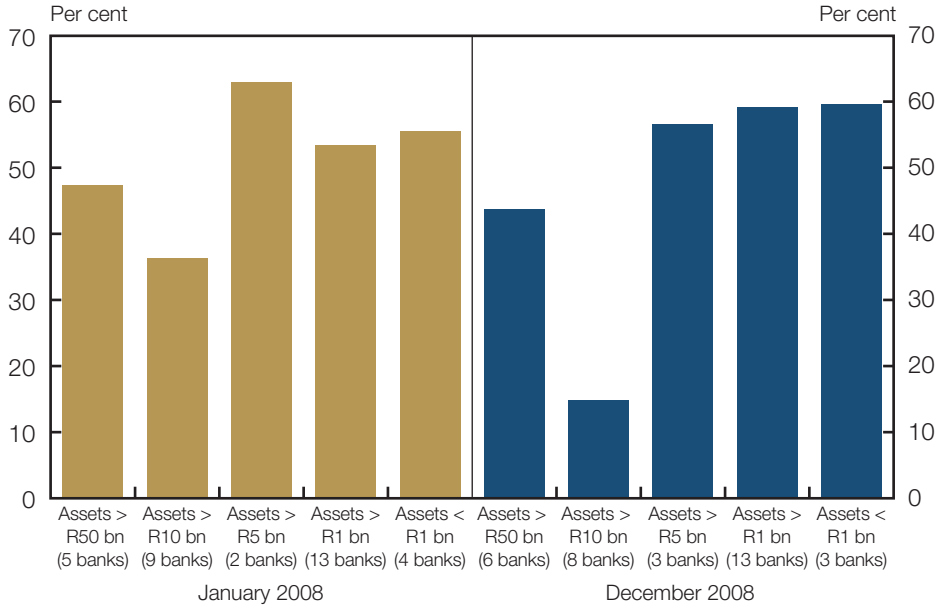
The analysis of the cost-to-income ratio of individual banks (grouped by the asset value of the individual banks) for January 2008 and December 2008 is presented in Figure 26. At the end of January 2008, banks with assets greater than R10 billion, but below R50 billion, reported a ratio of 36,4 per cent and banks with assets greater than R50 billion reported a ratio of 47,4 per cent. The remaining banks reported a

Figure 25 Cost-to-income ratio (unsmoothed)



cost-to-income ratio above 50 per cent at the end of January 2008. At the end of December 2008, the cost-to-income ratio of banks with assets greater than R10 billion, but below R50 billion (eight banks), was 14,8 per cent. Their low ratios are mainly due to high gross operating income and relatively lower operating expenses. Banks with assets greater than R50 billion reported a ratio of 43,7 per cent at the end of December 2008. The cost-to-income ratio for the remaining banks varied between 56,6 per cent and 59,5 per cent at the end of December 2008.

Figure 26 Cost-to-income ratios of individual banks (categorised by the asset value of each bank) (unsmoothed)



6. Capital adequacy

The prescribed minimum capital-adequacy ratios for banks on a solo and consolidated basis are 7 per cent in respect of tier 1[4] capital and an overall 9,5 per cent as the total minimum capital-adequacy ratio (i.e., including tier 2[5] capital). However, the required minimum capital-adequacy ratio applicable to individual banks (and banking groups) may be higher due to additional add-ons that are specified by the Registrar, based on each bank's (or banking group's) risk profile. In this section, the discussion on capital adequacy will go beyond that of individual banks (solo reporting) to include information relating to banking groups (consolidated banking group reporting).

Figure 27 presents the capital-adequacy ratios for the banking sector on a solo and consolidated basis.

capital-adequacy and tier 1 capital-adequacy ratios improved throughout 2008

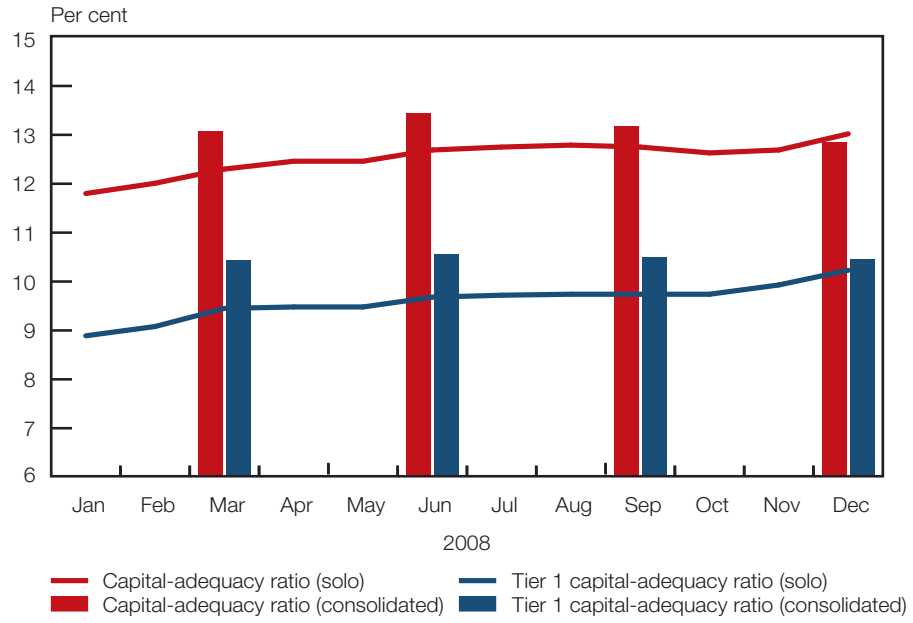
For banks, from a solo reporting perspective, both the total capital-adequacy and the tier 1 capital-adequacy ratios improved throughout 2008 from 11,8 per cent and 8,9 per cent respectively at the end of January 2008 to 13,0 per cent and 10,2 per cent respectively at the end of December 2008. The two key reasons for the improving trends were (1) the increase in qualifying primary capital and (2) the slowdown in asset growth.

From a consolidated banking group perspective, data are reported on a quarterly basis. Total qualifying capital and reserve funds (from a consolidated banking group perspective) increased by 3,8 per cent over the period, amounting to R245 billion at the end of December 2008 (March 2008: R236 billion) and primary capital and reserve funds increased from R188 billion at the end of March 2008 to R199 billion at the end of December 2008, representing a 5,8 per cent increase during the period.

consolidated tier 1 capital-adequacy ratio was 10,5 per cent

However, owing to an increase in risk-weighted exposure during the period under review, the total consolidated capital-adequacy ratio representing banking groups declined slightly from 13,1 per cent at the end of March 2008 to 12,8 per cent at the end of December 2008. The total risk-weighted exposure increased by 5,6 per cent, reaching R1 909 billion at the end of December 2008 (March 2008: R1 808 billion). At the end of December 2008 the consolidated tier 1 capital-adequacy ratio was 10,5 per cent (January 2008: 10,4 per cent).

Figure 27 Capital-adequacy ratios (solo and consolidated)



qualifying regulatory capital and reserve funds increased by 17,8 per cent

Figure 28 provides the composition of qualifying regulatory capital and reserve funds for banks (reported on a solo basis). Total qualifying regulatory capital and reserve funds increased by 17,8 per cent during 2008, reaching R202,6 billion at the end of December 2008 (January 2008: R172 billion), as a result of an increase in primary capital and reserve funds during the period. Primary capital and reserve funds increased by 22,9 per cent during the period, amounting to R159,2 billion at the end of December 2008 (January 2008: R129,6 billion). Secondary capital and reserve funds increased marginally by 2,9 per cent during 2008 and amounted to R43,1 billion at the end of December 2008 (January 2008: R41,9 billion). Tertiary capital decreased from R593 million to R300 million during the period under review, representing a decline of 49,4 per cent.

Figure 28 Composition of qualifying regulatory capital and reserve funds (solo)

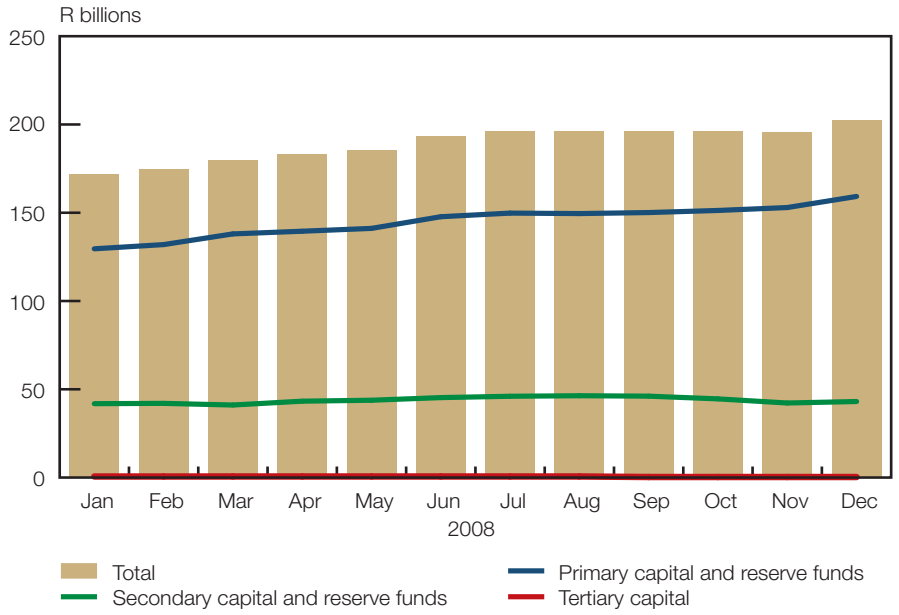
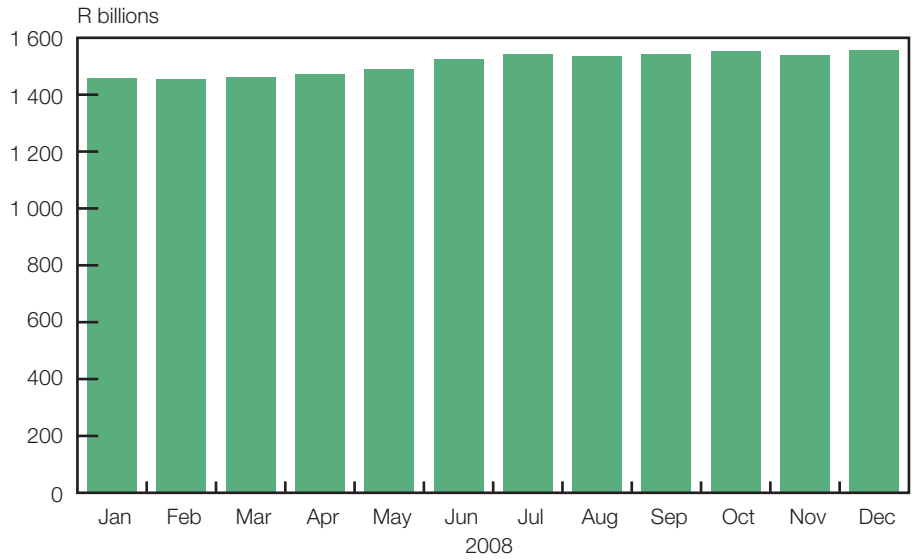


Figure 29 illustrates that the total risk-weighted exposure for banks on a solo basis increased by 6,8 per cent during the period under review, amounting to R1 556 billion at the end of December 2008 (January 2008: R1 457 billion).

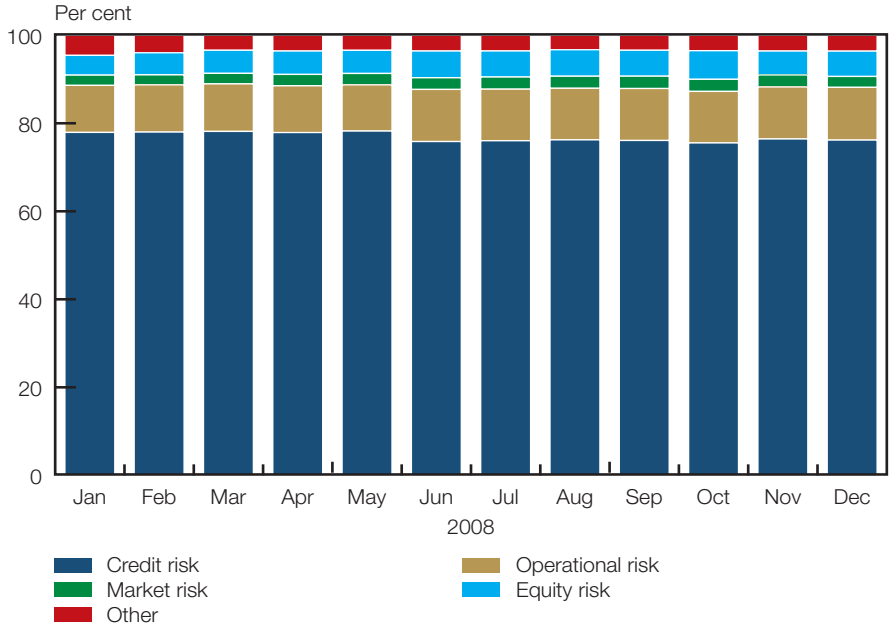
Figure 29 Total risk-weighted exposure (solo)



credit accountable for 76,2 per cent of the total regulatory capital requirement

The composition of the total regulatory capital requirement for 2008 is presented in Figure 30 (solo reporting). Credit risk was accountable for 76,2 per cent of the total regulatory capital requirement at the end of December 2008 (January 2008: 77,9 per cent), followed by operational risk at 12,0 per cent (January 2008: 10,7 per cent), equity risk at 5,8 per cent (January 2008: 4,5 per cent), other risk at 3,6 per cent (January 2008: 4,6 per cent) and market risk at 2,5 per cent (January 2008: 2,3 per cent).

Figure 30 Composition of total regulatory capital requirement (solo)

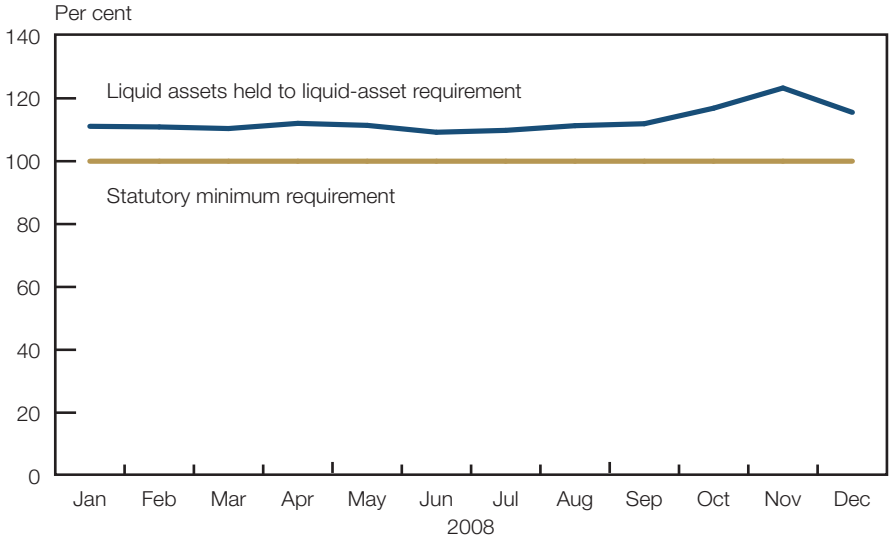


7. Liquidity risk

liquid assets held by banks consistently exceeded the minimum regulatory requirement

In terms of the provisions of section 72(1) of the Banks Act, banks are required to hold an average daily amount of liquid assets that shall not be less than 5 per cent of adjusted liabilities.[6] Figure 31 illustrates the average liquid assets held as a percentage of the regulatory liquid-asset requirement. During 2008, the average liquid assets held by banks consistently exceeded the minimum regulatory requirement by an increasing margin.

Figure 31 Statutory liquid assets (actual versus required)



The liquid assets held, measured against the minimum liquid asset requirement, increased from 111,1 per cent at the end of January 2008 to 115,5 per cent at the end of December 2008. The ratio for November 2008 increased to 123,3 per cent due to a large bank temporarily increasing its liquid assets during the month, whereafter it reverted to previous levels.

maturity profile of liabilities

Figures 32 and 33 provide information on the maturity of liabilities as a percentage of total liabilities (not including equity). The maturity buckets include maturity within the next day, 2 to 7 days, 8 to 31 days, more than one to two months and, finally, more than two to three months. The difference between the two illustrations is that Figure 32 relates to the contractual maturities and Figure 33 reflects the so-called "business-as-usual" maturities, taking into consideration historic behaviour and assumptions built into banks' asset-and-liability models.

Figure 32 Contractual maturity of liabilities (as a percentage of total liabilities)

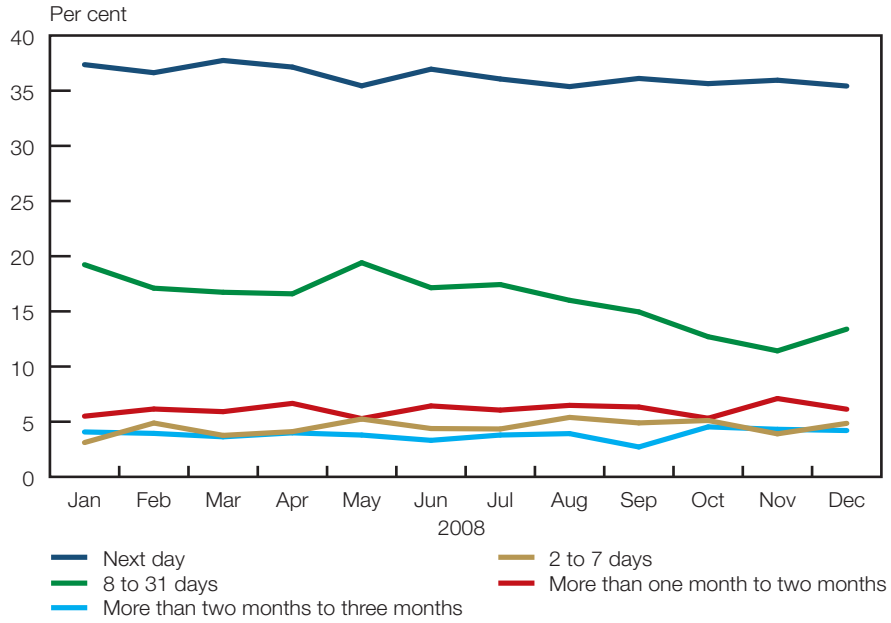
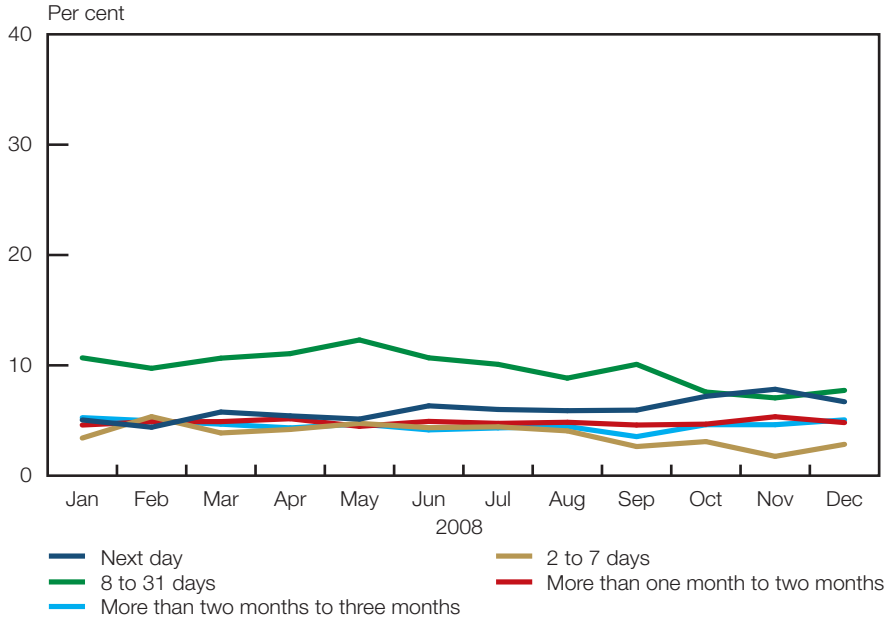


Figure 33 "Business-as-usual" maturity of liabilities (as a percentage of total liabilities)



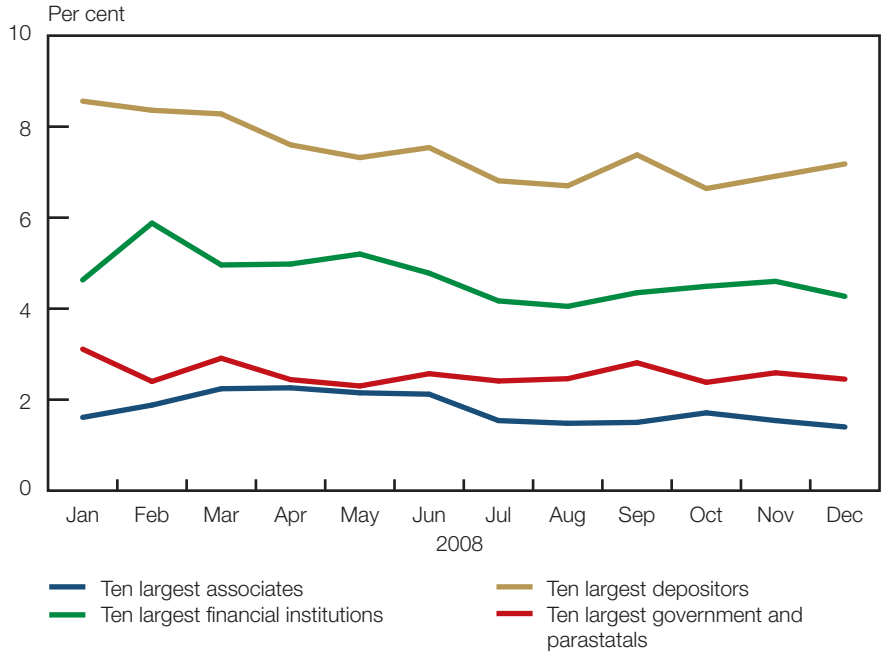
Total short-term liabilities (the sum of liabilities contractually maturing within one month) as a percentage of total liabilities improved from 59,7 per cent at the end of January 2008 to 53,7 per cent at the end of December 2008. The "business-as-usual" maturity ratios in Figure 33 are more favourable than the ratios in Figure 32 as a result of the ability of banks to retain funding or deposits, notwithstanding the actual contractual arrangements pertaining to such funding or deposits.

Short-term liabilities, as mentioned above, represented a large portion of total liabilities (53,7 per cent at the end of December 2008). An analysis of the main sources of the short-term deposit funding could identify possible funding concentration risk. Figure 34 provides a summary of total short-term deposit funding received from the ten largest depositors. It also provides detail of short-term deposit funding received from the ten largest financial institutions, the ten largest government and parastatals, and the ten largest associates.

ten largest short-term depositors declined

The ten largest short-term depositors as a percentage of total liabilities (not including equity) declined from 8,6 per cent at the end of January 2008 to 7,2 per cent at the end of December 2008. Similarly, as a percentage of total liabilities, deposit funding received from the ten largest financial institutions decreased from 4,6 per cent, the ten largest government and parastatals from 3,1 per cent, and associates from 1,6 per cent at the end of January 2008 to 4,3 per cent, 2,5 per cent and 1,4 per cent respectively at the end of December 2008.

Figure 34 Concentration of short-term deposit funding (as a percentage of total liabilities)



8. Credit risk

During 2008, credit risk remained a key focus area of the Department, considering the challenging local and international economic developments. The implementation of Basel II on 1 January 2008 introduced new methodologies, terminologies and a menu of approaches for the measurement of banks' exposure to credit risk for the calculation of minimum capital requirements. In this section the aim is to discuss the developments in credit risk exposure during 2008 and to familiarise the reader with the Basel II terminology or concepts.[7]

The credit risk section is introduced by a summary of salient reporting items in Table 1, followed by more detailed discussions on specific credit risk areas. Where appropriate, a distinction will be made between banks that report in terms of SA and banks that report exposure to credit risk in terms of the IRB approach.

SA for the measurement of credit risk exposures is conceptually similar to the measurement applied by banks under Basel I (prior to the implementation of Basel II). Under SA, banks are required to match the credit exposures with a selection of supervisory risk categories based on observable characteristics of the exposures.[8]

internal measures for key risk drivers of credit risk

Under the advanced IRB approach, banks are allowed to use their own internal measures for key risk drivers of credit risk (i.e., PD, LGD, EAD, effective maturity of the exposure) as primary inputs to the capital calculation, subject to strict methodological and disclosure standards, as well as explicit supervisory approval. These risk measures are converted into risk weights and regulatory capital requirements by means of risk weight formulae as specified by the Basel Committee.[9]

Table 1 Salient banking-sector credit risk information

	January 2008 (R billions)	December 2008 (R billions)
Gross loans and advances (on-balance sheet)	2 103,2	2 315,9
Gross credit exposures (including on- and off-balance-sheet exposures, repurchase/resale agreements and derivative instruments)	3 327,2	3 767,5
Risk-weighted exposures (credit)	1 135,5	1 185,5
Impaired advances	47,6	87,3
Specific credit impairments	17,6	28,5
	(Per cent)	(Per cent)
Average risk weight of gross credit exposures	34,1	31,5
Impaired advances to gross loans and advances	2,3	3,8
Specific credit impairments to impaired advances	37,0	32,7
Specific credit impairments to gross loans and advances	0,8	1,2

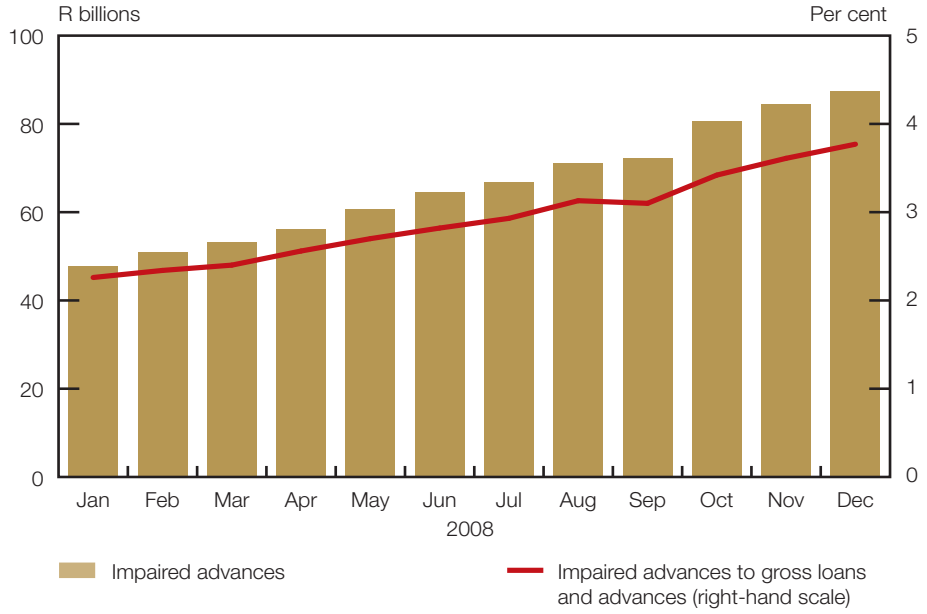
8.1 Total impaired advances

'Impaired advances' is defined in the Regulations relating to Banks as advances against which a specific credit impairment has been raised. Impaired advances as a percentage of gross loans and advances (as reported on the balance sheet) is one of the measures of credit quality or credit performance of the banking sector, especially from a trend analysis perspective. As stated above, this ratio is calculated for the total banking sector, that is, representing all approaches for reporting credit risk.

total impaired advances increased

Figure 35 presents total impaired advances, and impaired advances as a percentage of gross loans and advances. Total impaired advances increased from R47,6 billion at the end of January 2008 to R87,3 billion at the end of December 2008, representing an increase of 83,4 per cent for the period. Coupled with the slowdown in the growth of gross loans and advances, the ratio of impaired advances to gross loans and advances increased from 2,3 per cent at the end of January 2008 to 3,8 per cent at the end of December 2008. The main contributor to this deterioration during 2008 was the delinquencies experienced in the retail asset class, with specific reference to mortgage loans (homeloans) and revolving credit, a more detailed discussion of which will follow.

Figure 35 Impaired advances to gross loans and advances



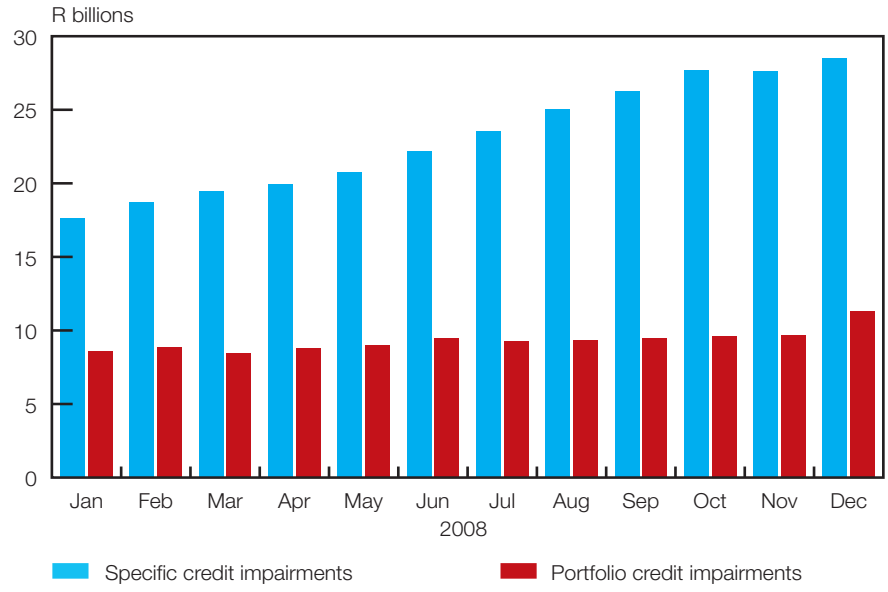
Among other things, the cumulative 500 basis point increase in the repurchase rate since mid-2006 had an influence on the increase in credit risk for the South African banking sector. The repurchase rate, as announced by the Monetary Policy Committee of the Bank, increased by 200 basis points (cumulatively) during 2006, followed by a 200 basis point cumulative increase in 2007. During the first half of 2008, the repurchase rate continued to increase by two consecutive 50 basis point increases, whereafter a 50 basis point decline followed on 15 December 2008.

8.2 Credit impairments

credit impairments increased during 2008

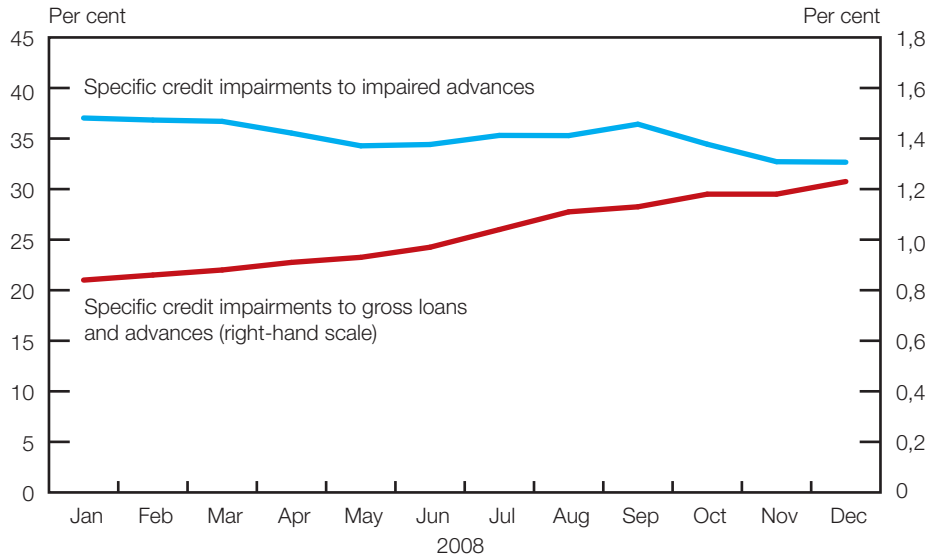
Credit impairments comprise specific and portfolio impairments, as defined in the Regulations relating to Banks. Credit impairments increased during 2008 mostly owing to defaults. As shown in Figure 36, specific and portfolio credit impairments increased

Figure 36 Specific and portfolio credit impairments



by 61,6 per cent and 32 per cent respectively, reaching R28,5 billion and R11,3 billion at the end of December 2008. As discussed earlier in this chapter under profitability, these increases impacted profits negatively, being included under the collective income statement line description "credit losses". Expressed as a percentage of impaired advances, specific credit impairments decreased from 37,0 per cent at the end of January 2008 to 32,7 per cent at the end of December 2008 (refer to Figure 37). The decline was caused by larger defaults occurring in the residential mortgage asset class, which is secured borrowings. Expressed as a percentage of gross loans and advances, specific credit impairments increased from 0,8 per cent at the end of January 2008 to 1,2 per at the end of December 2008.

Figure 37 Specific credit impairment ratios



8.3 The standardised approach banks

average risk weighting increased

At the end of 2008, banks that utilised SA for reporting exposure to credit risk represented 15,6 per cent of the banking sector's gross on-balance-sheet exposures (January 2008: 15,8 per cent). Figure 38 illustrates the risk weight distribution of credit exposures of SA banks. The average risk weighting of the gross credit exposures increased from 39,8 per cent at the end of January 2008 to 45,2 per cent at the end of December 2008 owing to an increase in exposures reported as "past due".

8.4 The standardised approach banks: Classification of credit risk exposures

Figure 39 provides a breakdown of the credit risk exposure classification categories for 2008. The total classified credit exposures increased from R10,4 billion at the end of March 2008 to R16 billion at the end of December 2008, representing a 53,2 per cent increase.

Figure 38 Risk-weighting distribution of credit exposures under the standardised approach

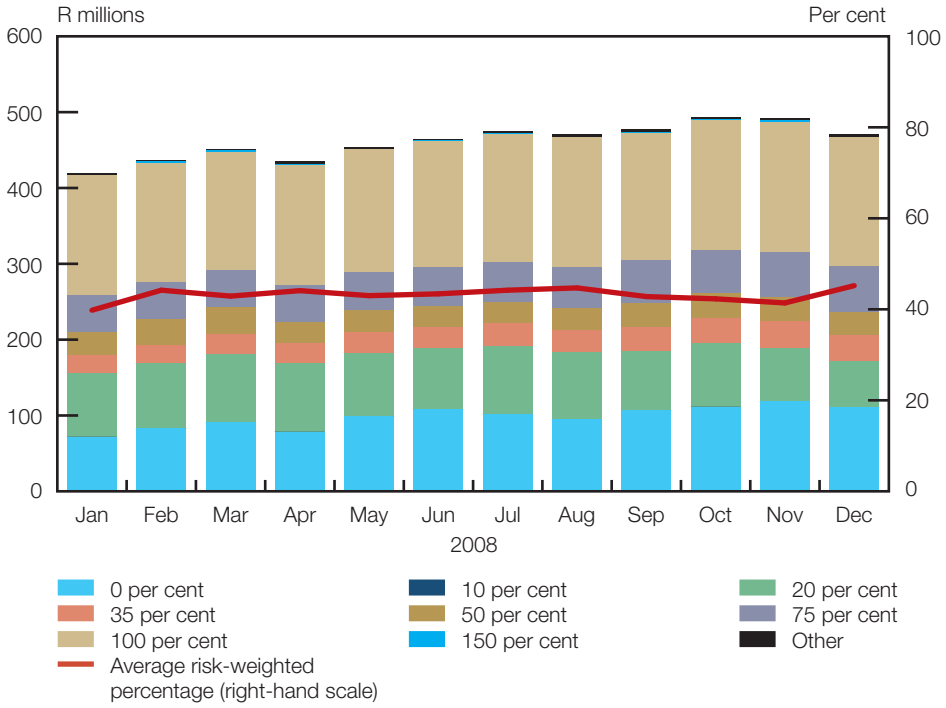
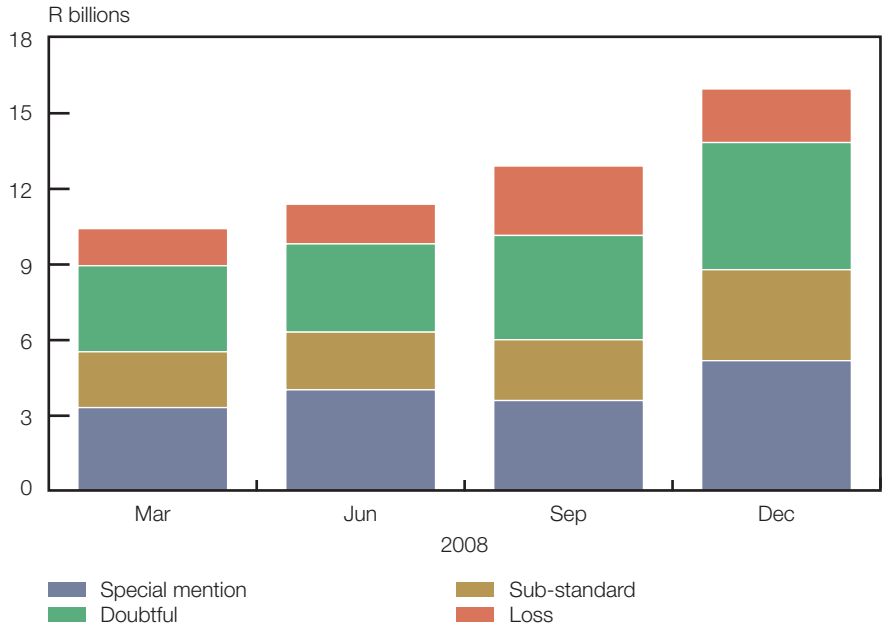


Figure 39 Classification of credit risk exposures under the standardised approach



8.5 Internal ratings-based banks[10]

At the end of 2008, banks that reported exposure to credit risk utilising the IRB approach represented 84,4 per cent of the banking sector's gross on-balance-sheet exposures (January 2008: 84,2 per cent).

key features of credit risk

Table 2 provides a summary of the key features of credit risk as reported by IRB banks as at the end of December 2008. The average PD reported by the IRB banks at the end of December 2008 implies that IRB banks expect that it is probable that, on average, 5,9 per cent of borrowers will default within the next 12 months, considering the ability and willingness of borrowers to repay their debt. In the event of such borrowers actually defaulting, it is estimated further that IRB banks will suffer an average economic loss, that is, an LGD of close to 28 per cent of defaulted exposures. The average PD and average LGD are applied against the bank's total estimated gross exposure to borrowers, which is the EAD. The EAD is measured gross of any specific credit impairment raised or partial write-offs made. The requirements for the measurement of EAD are outlined in regulation 23 of the Regulations relating to Banks.

The aforementioned key features of credit risk translate to an expected loss of 1,6 per cent of defaulted exposures, which IRB banks will cover, *inter alia*, through pricing and the raising of impairments. It also translates to a capital requirement through an average risk weighting of 35,6 per cent.

Table 2 Key features reported by internal ratings-based banks

Feature	December 2008
Exposure at default (R billions)	2,577
Average probability of default (per cent)	5,9
Average loss given default (per cent)	27,8
Expected loss as a percentage of exposure at default (per cent)	1,6
Risk-weighted exposure as a percentage of exposure at default (per cent)	35,6
Advances in default as a percentage of exposure at default (per cent)	3,1

The remainder of the credit risk section will focus on defaults experienced in relation to the EAD.

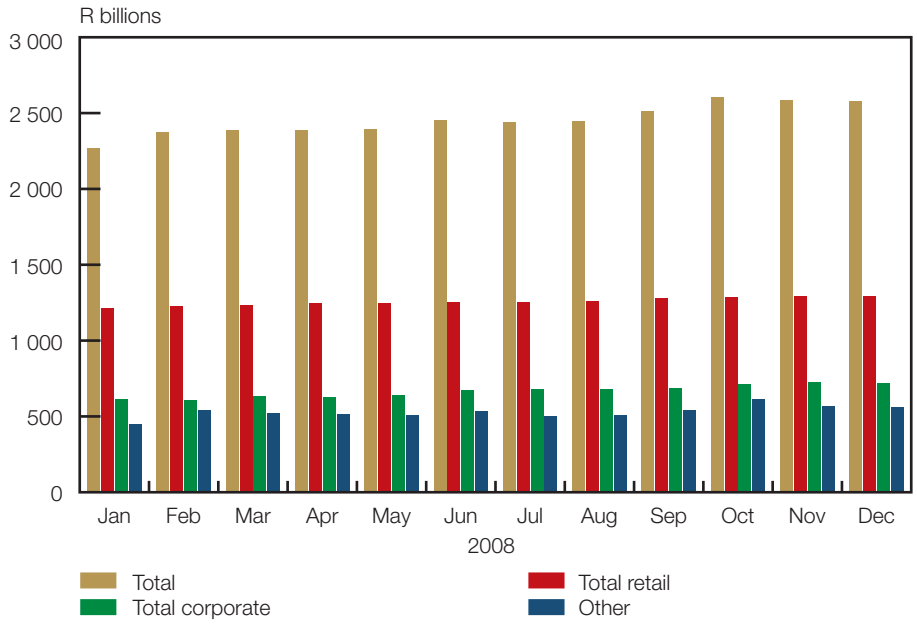
8.6 Exposure at default

EAD has increased by 13,5 per cent

Figure 40 presents the credit exposure (i.e., EAD) per asset class. EAD has increased by 13,5 per cent since January 2008, amounting to R2 576,8 billion at the end of December 2008 (January 2008: R2 270,3 billion). At the end of December 2008, 50,2 per cent of the EAD was classified as retail exposures, followed by the corporate classification (28,0 per cent) and other[11] (21,8 per cent), totalling R1 293,3 billion, R721,8 billion and R561,7 billion respectively.

Exposures classified as 'default',[12] per asset class, are presented in Figure 41. Also included are the default ratios per asset class (i.e., the defaults as a percentage of EAD).

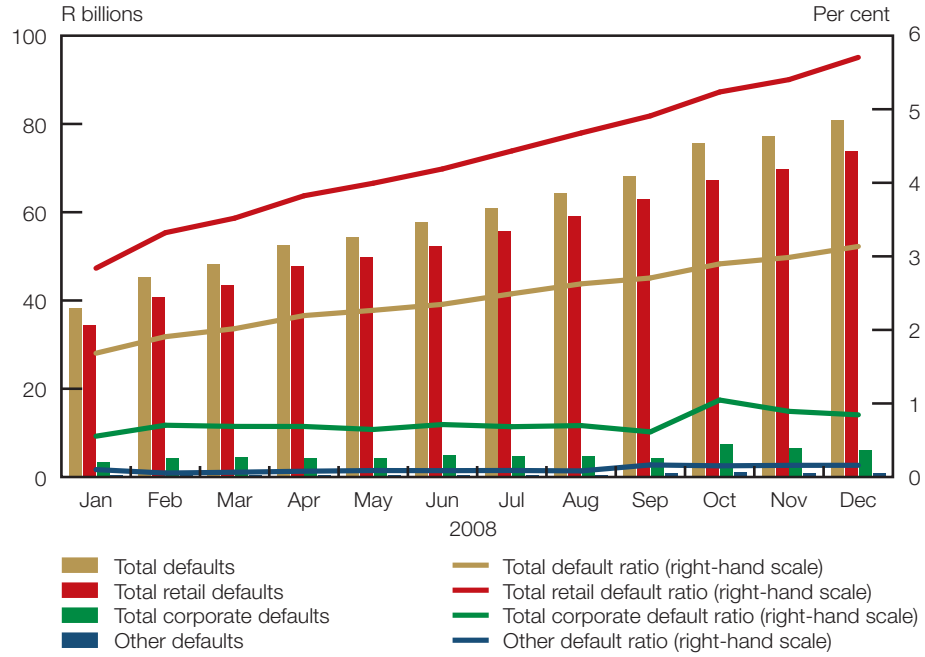
Figure 40 Total exposure at default



total default ratio increased

As presented in Figure 41, total defaults increased from R38,2 billion at the end of January 2008 to R80,8 billion at the end of December 2008, representing an increase of 111,3 per cent over the period. The retail defaults, corporate defaults and other defaults all increased significantly with growth rates over the period amounting to 114,7 per cent, 78,8 per cent and 99,1 per cent respectively. The total default ratio increased from 1,7 per cent of EAD at the end of January 2008 to 3,1 per cent at the end of December 2008. Most noticeably, the retail default ratio increased from 2,8 per cent at the end of January 2008 to 5,7 per cent at the end of December 2008.

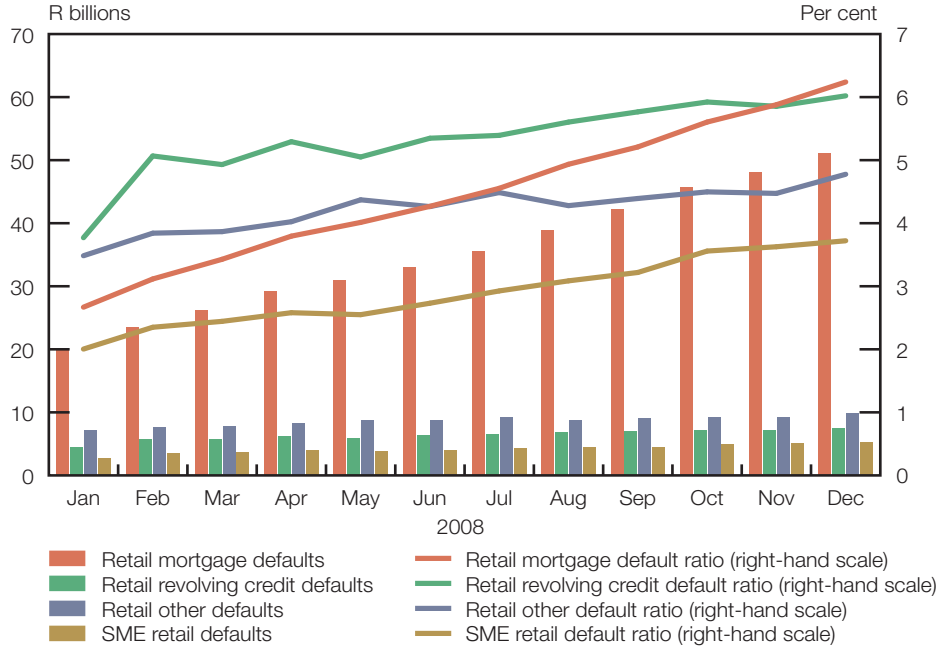
Figure 41 Total default exposure and default ratio per asset class



residential mortgage defaults increased

Figure 42 provides a breakdown of the respective retail defaults and retail default ratios, which deteriorated during the period under review. The increasing interest rate cycle, high levels of household indebtedness, and other unfavourable local and international economic conditions contributed to the deteriorating trend. In particular, residential mortgage defaults increased by 157,6 per cent between January 2008 and December 2008.

Figure 42 Composition of default retail exposures and respective retail default ratios



8.7 Credit concentration risk: Sectoral and geographic distribution of credit exposures

credit exposures according to the sectors or industries

Table 3 provides a breakdown of credit exposures according to the sectors or industries specified and Table 4 presents the geographic distribution of credit exposure. Private households, and financial intermediation and insurance were the largest if measured as a percentage of total credit exposure at 36,5 per cent and 25,4 per cent respectively at the end of December 2008. The distribution remained stable during 2008.

Table 3 Sectoral distribution of credit exposures (as a percentage of total credit exposure)

Concentration	Mar 2008	Jun 2008	Sep 2008	Dec 2008
Private households	34,75	36,65	36,63	36,47
Financial intermediation and insurance	23,86	25,49	24,79	25,39
Other	11,93	9,86	9,69	7,23
Business services	5,60	4,74	4,60	5,65
Real estate	2,77	2,97	3,14	4,83
Manufacturing	4,94	4,30	4,40	4,43
Community, social and personal services	3,63	3,24	3,27	4,14
Wholesale and retail trade	4,14	4,24	4,61	3,60
Mining	3,00	2,90	2,98	2,70
Transport and communication	2,64	2,42	2,43	2,36
Construction	0,87	1,27	1,31	1,28
Agriculture	1,27	1,39	1,37	1,20
Electricity	0,59	0,53	0,78	0,71
Total	**100,00**	**100,00**	**100,00**	**100,00**

Of the total credit exposure, 89,1 per cent is concentrated in South Africa, followed by 8,3 per cent exposure to European countries, at the end of December 2008.

Table 4 Geographic distribution of credit exposures (as a percentage of total credit exposure)

Concentration	Mar 2008	Jun 2008	Sep 2008	Dec 2008
South Africa	89,59	88,73	91,75	89,07
Europe	8,19	8,81	5,98	8,34
North America	1,40	1,65	1,40	1,61
Other African countries	0,55	0,50	0,47	0,51
Other	0,05	0,12	0,25	0,21
Asia	0,22	0,18	0,14	0,16
South America	0,00	0,01	0,00	0,11

9. Market risk

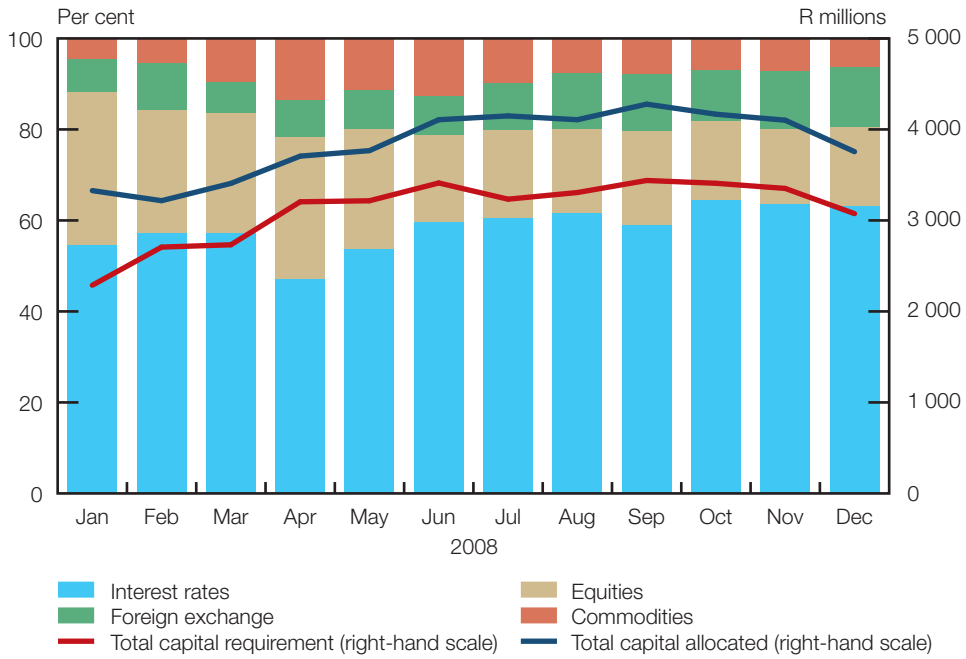
This section provides an overview of the composition of the regulatory capital requirement in respect of market risk, activities and developments in the derivative contract markets and the banking sector's foreign-currency open positions.

9.1 Regulatory capital requirement in respect of market risk

composition of total market risk regulatory capital requirement

Banks can choose between TSA and the IMA to measure and report their market risk regulatory capital requirements. Figure 43 presents an aggregate of both approaches, focusing on the total capital allocated and the total regulatory capital requirement in terms of market risk. The composition of the total market risk regulatory capital requirement is also provided.

Figure 43 Composition of regulatory capital requirement in respect of market risk



market risk regulatory capital requirement increased

The total market risk regulatory capital requirement increased from R2,3 billion at the end of January 2008 to R3,4 billion at the end of June 2008, whereafter it declined to R3,1 billion at the end of December 2008. Total allocated capital for market risk followed a similar trend, increasing from R3,3 billion at the end of January 2008 to R4,3 billion at the end of September 2008, in response to increased volatility in most financial markets, whereafter it eased off to R3,8 billion at the end of December 2008 following efforts by banks to reduce their risk exposures. The utilisation of allocated capital varied between 69 per cent and 87 per cent during the period under review.

interest rate instruments remained the largest contributor to total requirement

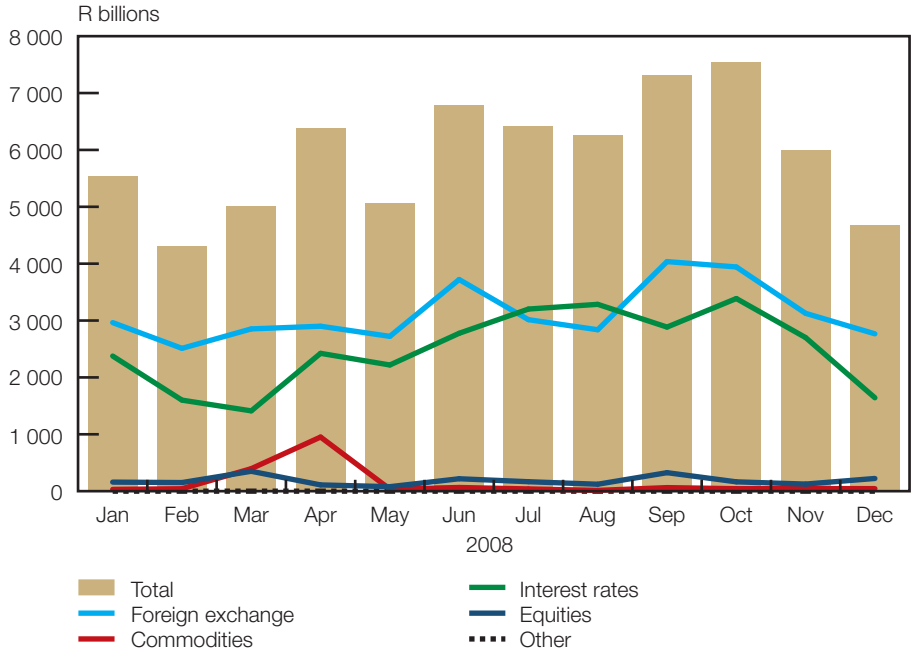
The composition of the total market risk regulatory capital requirement fluctuated a little during the period January 2008 to December 2008. The capital requirement in respect of interest rate instruments remained the largest contributor over the period, representing more than 50 per cent of the total capital requirement for most of the period. The capital requirement in respect of equity positions declined from 33,7 per cent at the end of January 2008 to 17,3 per cent at the end of December 2008 due to the rapidly declining equity markets, banks' closing positions and a general decrease in market activities towards the end of the year. Foreign-exchange instruments, in contrast, raised the market risk regulatory capital requirement, contributing 7,1 per cent at the end of January 2008 and increasing to 13,3 per cent at the end of December 2008. Commodities contributed the least to the total capital requirement at the end of December 2008, namely 6,2 per cent (January 2008: 4,7 per cent).

9.2 Derivative instruments

turnover in derivatives remained strong

The composition of monthly turnover in derivative contracts is shown in Figure 44. The turnover is calculated by aggregating the gross notional long and short positions. Throughout 2008 turnover in derivatives remained strong, reaching a high point at the end of October 2008 due to increased price volatility in all financial and commodity markets. The total turnover increased from R5 530 billion for the reporting month of January 2008 to R7 536 for October 2008, and reduced to R4 677 billion for December 2008.

Figure 44 Composition of monthly turnover in derivative contracts (gross notional value)



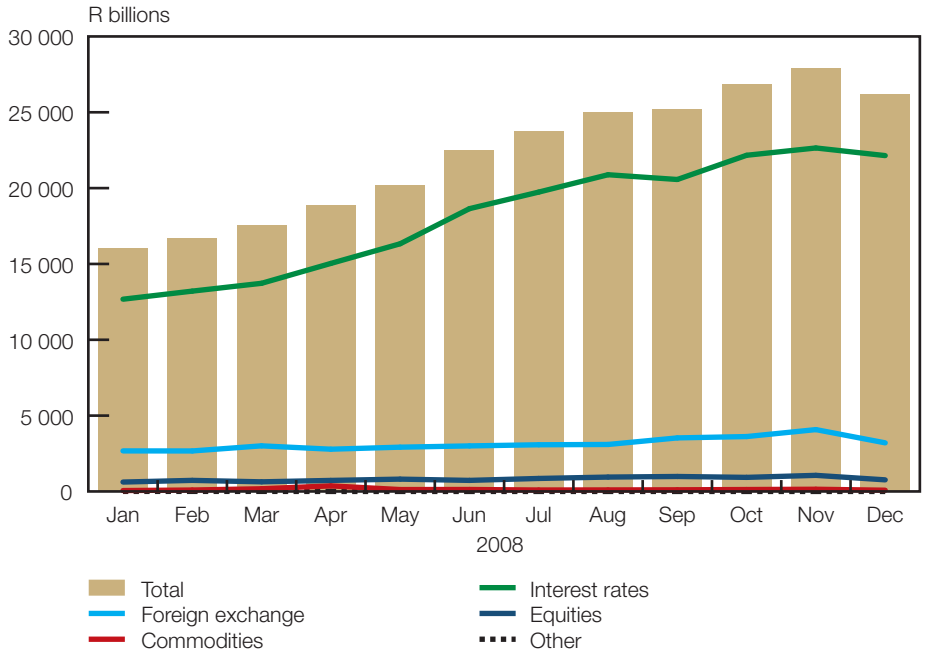
During October 2008, the value of the South African rand depreciated and fluctuated significantly as a result of negative sentiment towards emerging markets and general deleveraging on the part of global markets.

Derivative turnover activities throughout 2008 were mainly in respect of foreign-exchange and interest rate derivative contracts, which amounted to R2 767 billion (January 2008: R2 964 billion) and R1 642 billion (January 2008: R2 376 billion) respectively for the reporting month of December 2008.

increased hedging against expected interest rate changes

Figure 45 depicts the gross notional value of total unexpired derivate contracts and its composition. The total gross notional value of unexpired contracts increased from R16 029 billion at the end of January 2008 to R27 930 billion at the end of November 2008, followed by a marginal decline at the end of December 2008 to R26 194 billion. Unexpired interest rate derivative contracts represented approximately 80 per cent of the total unexpired derivative contracts throughout 2008, which were indicative of increased hedging against expected domestic interest rate changes.

Figure 45 Composition of unexpired derivative contracts at month-end (gross notional value)



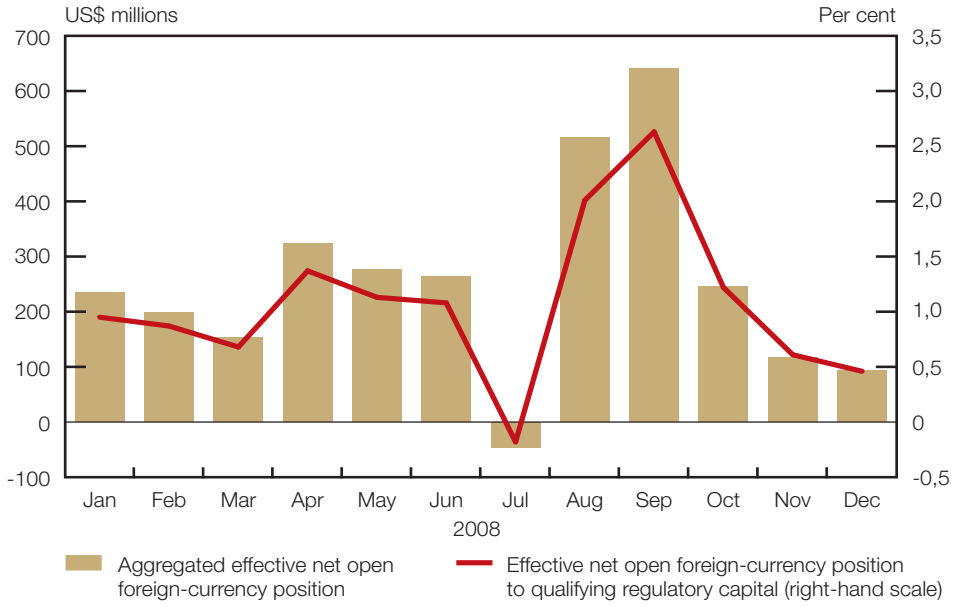
9.3 Currency risk

effective net open foreign-currency position fluctuated substantially during 2008

The aggregated effective net open foreign-currency position (Figure 46) is calculated by the addition of foreign-currency assets, foreign-currency liabilities, commitments to purchase foreign currency and commitments to sell foreign currency. The aggregated effective net open foreign-currency position as a percentage of qualifying regulatory capital fluctuated substantially during 2008 as a result of the significant variation in the actual aggregated effective net open foreign-currency position. Nevertheless, the ratio peaked at 2,6 per cent at the end of September 2008, whereafter it declined to 0,5 per cent at the end of December 2008 (January 2008: 1,0 per cent), remaining well within the 10 per cent regulatory limit.

well within the 10 per cent regulatory limit

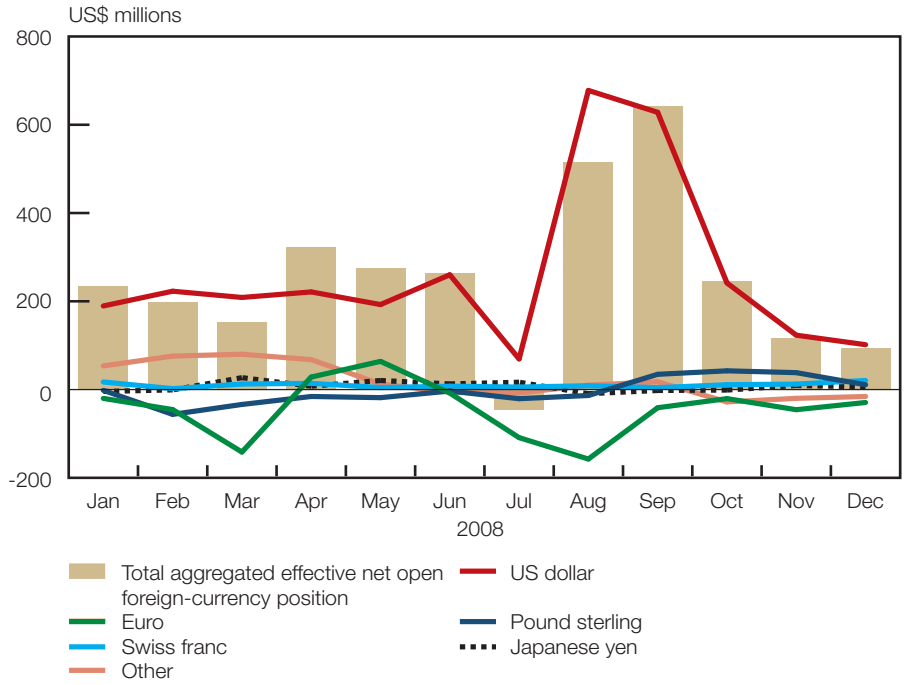
Figure 46 Aggregated effective net open foreign-currency position (as a percentage of qualifying regulatory capital)



US dollar dominated main constituent to fluctuations

Figure 47 indicates the contributions of each currency to the aggregated effective net open foreign-currency position. The US dollar dominated the positions during 2008 and remained the main constituent to the fluctuations experienced.

Figure 47 Aggregated effective net open foreign-currency position per currency

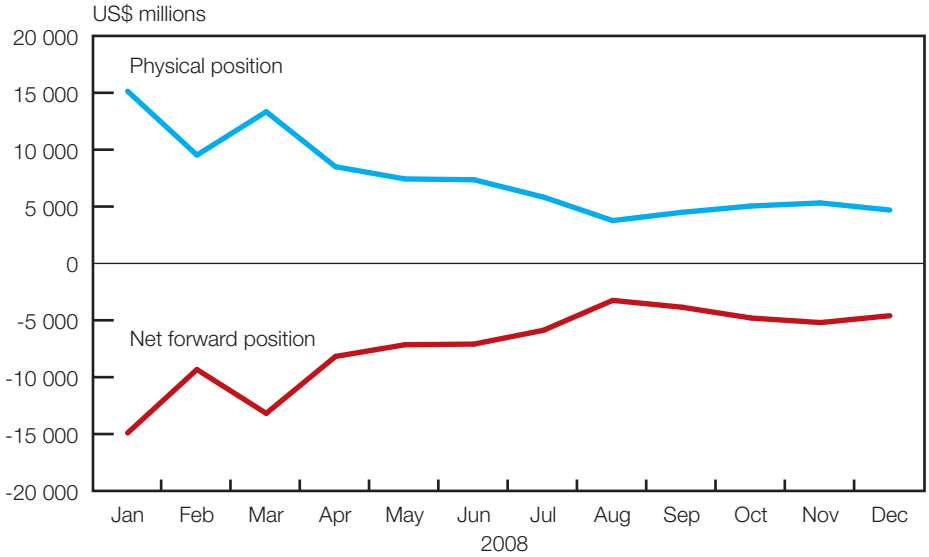


The banking sector's position in foreign-currency instruments can be illustrated by comparing the physical position (difference between current foreign assets and current foreign liabilities) with the net forward position (difference between commitments to sell foreign currency and commitments to purchase foreign currency).

overall net open position in line with regulatory limits

Figure 48 indicates that the physical position decreased from US$15,1 billion at the end of January 2008 to US$4,7 billion at the end of December 2008 and, similarly, the net forward short position decreased from US$14,9 billion at the end of January 2008 to US$4,6 billion at the end of December 2008. The physical position and the net forward short position are mirror images of each other, with the gap between the two narrowing substantially during the latter half of 2008. The mirror image results from banks reducing their net open position by acquiring forward positions to neutralise spot currency holdings and vice versa, in order to maintain a low overall net open position that is in line with regulatory limits.

Figure 48 Position in foreign-currency instruments



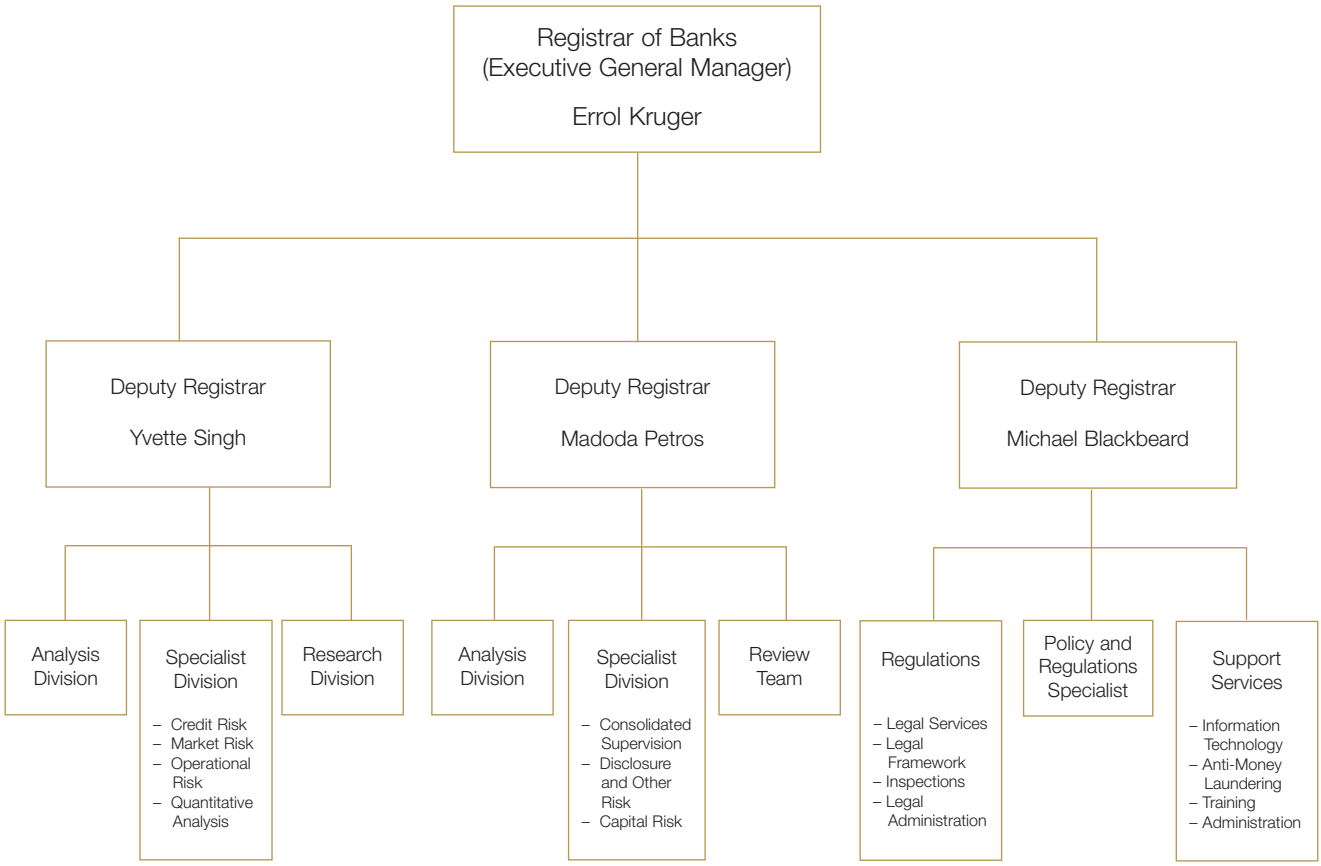
Notes

1 Gross domestic product at market prices.
2 Refer to background note by the World Bank, 'Banking and the leverage ratio' (March 2009) (www.worldbank.org).
3 'Credit losses' refers to the net value of credit impairments provision raised, credit impairments provision released, recoveries and suspended interest charge (and when relevant, also includes write-offs not applied directly against the balance sheet, that is, provision not previously raised).
4 'Tier 1' refers to primary capital and primary unimpaired reserve funds.
5 'Tier 2' refers to secondary capital and secondary unimpaired reserve funds.
6 'Adjusted liabilities' refers to total liabilities reduced by (1) funding received from head office or from other branches within the same group; and (2) amounts owing by banks, branches and mutual banks in South Africa.
7 For further reading and clarification, the original Basel II documentation is available on the website of the BIS: http://www.bis.org/publ/bcbsca.htm. The South African Reserve Bank's website (www.resbank.co.za) also contains useful information in this regard.
8 Refer to 'Overview of the new Capital Accord', April 2003, issued by the Basel Committee on Banking Supervision.
9 Refer to 'An explanatory note on the Basel II IRB risk weight functions', July 2005, issued by the Basel Committee on Banking Supervision.
10 'IRB banks' refers to information reported by banks in terms of the IRB approach for reporting credit risk data.
11 'Other' consists of public sector entities, local government, sovereign, banks and securities firms.
12 For a definition of 'default', refer to Chapter VII of the Regulations relating to Banks.

Appendices

Appendix 1

Organisational structure of the Bank Supervision Department



Total staff complement, vacancies and employment equity numbers

	31 December 2007	31 December 2008
Total job register (permanent positions)	108	108
Total employed	93	94
Total vacancies	15	14
Employment equity: Race (target group – per cent)		
General management	50	44
Other staff	51	51
Employment equity: Gender (target group – per cent)		
General management	40	33
Other	53	55

Appendix 2

Registered banks, mutual banks and local branches of foreign banks as at 31 December 2008

Registered banks

	Institution	Address	Total assets at 31 December		Annual growth (Per cent)
			2007 (R million)	2008 (R million)	
1	Absa Bank Limited	P O Box 7735, Johannesburg, 2000	579 199	700 168	20,89
2	African Bank Limited	Private Bag X170, Halfway House, 1685	11 762	17 370	47,68
3	Albaraka Bank Limited	P O Box 4395, Durban, 4000	1 685	1 869	10,96
4	Bidvest Bank Limited	P O Box 185, Johannesburg, 2000	767	1 509	96,63
5	Capitec Bank Limited	P O Box 12451, Die Boord, Stellenbosch, 7613	2 730	4 554	66,82
6	FirstRand Bank Limited	P O Box 786273, Sandton, 2146	492 760	607 766	23,34
7	Grindrod Bank Limited	P O Box 1, Durban, 4000	1 734	1 884	8,67
8	Habib Overseas Bank Limited	P O Box 62369, Marshalltown, 2107	538	647	20,21
9	HBZ Bank Limited	P O Box 1536, Wandsbeck, 3631	1 321	1 853	40,30
10	Imperial Bank Limited	P O Box 6093, Rivonia, 2128	37 534	47 245	25,87
11	Investec Bank Limited	P O Box 785700, Sandton, 2146	146 394	170 528	16,49
12	Mercantile Bank Limited	P O Box 782699, Sandton, 2146	4 753	5 935	24,89
13	Nedbank Limited	P O Box 1144, Johannesburg, 2000	436 698	506 359	15,95
14	Sasfin Bank Limited	P O Box 95104, Grant Park, 2051	1 482	1 407	-5,02
15	Teba Bank Limited	Private Bag X101, Sunninghill, 2157	2 579	3 116	20,82
16	The South African Bank of Athens Limited	P O Box 7781, Johannesburg, 2000	1 149	1 358	18,21
17	The Standard Bank of South Africa Limited	P O Box 7725, Johannesburg, 2000	659 145	861 396	30,68

Appendix 2

Registered banks, mutual banks and local branches of foreign banks as at 31 December 2008 (continued)

Bank (with effect from 1 July 1996) in terms of the Supervision of Financial Institutions Rationalisation Act, 1996 (Act No. 32 of 1996)

	Institution	Address	Total assets at 31 December		Annual growth (Per cent)
			2007 (R million)	2008 (R million)	
1	Meeg Bank Limited	P O Box 429, East London, 5200	1 057	1 220	15,43

Registered mutual banks

	Institution	Address	Total assets at 31 December		Annual growth (Per cent)
			2007 (R million)	2008 (R million)	
1	GBS Mutual Bank	P O Box 114, Grahamstown, 6140	651	718	10,19
2	VBS Mutual Bank	P O Box 3618, Makhado, 0920	234	235	0,06

Registered local branches of foreign banks

	Institution	Address	Total assets at 31 December		Annual growth (Per cent)
			2007 (R million)	2008 (R million)	
1	ABN AMRO Bank NV	P O Box 78769, Sandton, 2146	21 951	19 099	-12,99
2	Bank of Baroda	Premises No.14, 2nd floor, Sandton City Twin Towers (East Wing), Sandton, 2196	285	324	13,69
3	Bank of China Limited Johannesburg Branch (trading as Bank of China Johannesburg Branch)	P O Box 782616, Sandton, 2146	927	2 281	146,04
4	Bank of Taiwan South Africa Branch	P O Box 1999, Parklands, 2121	365	673	84,46
5	Calyon (trading as Calyon Corporate and Investment Bank)	P O Box 527, Melrose Arch, 2076	19 814	18 449	-6,88
6	China Construction Bank Corporation – Johannesburg Branch	Private Bag X10007, Sandton, 2146	2 644	4 418	67,10
7	Citibank NA	P O Box 1800, Saxonwold, 2132	34 141	71 376	109,06
8	Commerzbank Aktiengesellschaft	P O Box 860, Parklands, 2121	10 145	8 064	-20,51

Appendix 2

Registered banks, mutual banks and local branches of foreign banks as at 31 December 2008 (continued)

Registered local branches of foreign banks (continued)

9	Deutsche Bank AG	Private Bag X9933, Sandton, 2146	16 069	20 127	25,25
10	JPMorgan Chase Bank, NA (Johannesburg Branch)	Private Bag X9936, Sandton, 2146	24 778	49 075	98,06
11	Société Générale	P O Box 6872, Johannesburg, 2000	7 212	8 907	23,51
12	Standard Chartered Bank (Johannesburg Branch)	P O Box 782080, Sandton, 2146	7 611	11 680	53,46
13	State Bank of India	P O Box 2538, Saxonwold, 2132	1 470	1 710	16,39
14	The Hongkong and Shanghai Banking Corporation Limited (HSBC)	Private Bag X785434, Sandton, 2146	14 371	15 329	6,66

Banks in final liquidation

Institution		Liquidator	Date of order
1	Islamic Bank Limited	Mr A D Wilkens of Deloitte & Touche	13 January 1998
2	Regal Treasury Private Bank Limited	Mr T A P du Plessis of D&N Trust and Mr J Pema of Sekela Antrust (Pty) Limited	10 February 2004

Appendix 3

Name changes and cancellation of registration of banks and branches of foreign banks during the period 1 January 2008 to 31 December 2008

Name changes

Previous name		New name	Date of change
1	None		

Appendix 4

Registered controlling companies as at 31 December 2008

	Institution	Address
1	Absa Group Limited	P O Box 7735, Johannesburg, 2000
2	African Bank Investments Limited	Private Bag X170, Halfway House, 1685
3	Bidvest Bank Holdings Limited	P O Box 185, Johannesburg, 2000
4	Capitec Bank Holdings Limited	P O Box 12451, Die Boord, Stellenbosch, 7613
5	FirstRand Bank Holdings Limited	P O Box 786273, Sandton, 2146
6	Grindrod Financial Holdings Limited	P O Box 1, Durban, 4000
7	Investec Limited	P O Box 785700, Sandton, 2146
8	Mercantile Bank Holdings Limited	P O Box 782699, Sandton, 2146
9	Nedbank Group Limited	P O Box 1144, Johannesburg, 2000
10	Sasfin Holdings Limited	P O Box 95104, Grant Park, 2051
11	Standard Bank Group Limited	P O Box 7725, Johannesburg, 2000
12	Teba Bank Controlling Company Limited	Private Bag X101, Sunninghill, 2157

The following institutions are deemed to be controlling companies in terms of section 42 of the Banks Act, 1990:

1	Albaraka Banking Group (in respect of Albaraka Bank Limited)	P O Box 1882, Manama, Kingdom of Bahrain
2	National Bank of Greece (in respect of The South African Bank of Athens Limited)	86 Eolou Street, Athens TT 121, Greece
3	Pitcairn's Finance (in respect of Habib Bank Limited)	121, Avenue de la Faiencerie, L-1511 Luxemburg, RCS Luxemburg, B nr 33-106

Appendix 5

Foreign banks with approved local representative offices

	Institution	Address
1	Banco BPI, SA	P O Box 303, Bruma, 2026
2	Banco Espirito Santo e Comercial de Lisboa	P O Box 749, Bruma, 2026
3	Banco Privado Português, SA	P O Box 78407, Sandton, 2146
4	Banco Santander Totta SA	P O Box 309, Bruma, 2026
5	Bank Leumi Le-Israel BM	Private Bag X41, Saxonwold, 2132
6	Bank of Cyprus Group	P O Box 652176, Benmore, 2010
7	Bank of India	P O Box 653589, Benmore, 2010
8	BNP Paribas Johannesburg	P O Box 52897, Saxonwold, 2132
9	Barclays Bank plc	P O Box 1542, Saxonwold, 2132
10	Barclays Private Clients International Limited	P O Box 1542, Saxonwold, 2132
11	Bayerische Hypo- und Vereinsbank AG	P O Box 1483, Parklands, 2121
12	Credit Suisse	Private Bag X9911, Sandton, 2146
13	Credit Suisse Securities (Europe) Limited	Private Bag X9911, Sandton, 2146
14	Dresdner Bank AG	P O Box 413355, Craighall, 2024
15	Dresdner Kleinwort Limited	P O Box 413355, Craighall, 2024
16	Export-Import Bank of India	Suite 17, Aldrovande Palace, 6 Jubilee Grove, Umhlanga Rocks, Durban, 4320
17	Fairbairn Private Bank (Isle of Man) Limited	P O Box 787549, Sandton, 2146
18	Fairbairn Private Bank (Jersey) Limited	P O Box 787549, Sandton, 2146
19	First Bank of Nigeria	P O Box 784796, Sandton, 2146
20	Fortis Bank (Nederland) NV	P O Box 652065, Benmore, 2010
21	Hellenic Bank Public Company Limited	P O Box 783392, Sandton, 2146
22	HSBC Bank International Limited	Private Bag X785434, Sandton, 2146
23	Icici Bank Limited	P O Box 78261, Sandton, 2146
24	ING Bank (Switzerland) Limited	P O Box 650660, Benmore, 2010
25	JSCB IMEX Bank	P O Box 31262, Tokai, 7966
26	KFW Ipex-Bank GMBH	P O Box 2402, Saxonwold, 2132
27	Lloyds TSB Offshore Limited	Private Bank X25, Northlands, 2116
28	Millenium BCP	P O Box 273, Bruma, 2026
29	Natexis Southern Africa Representative Office	Postnet Suite 352, Private Bag X1, Melrose Arch, 2057
30	National Bank of Egypt	P O Box 55402, Northlands, 2116
31	Société Générale Representative Office for Southern Africa	P O Box 2805, Saxonwold, 2132
32	Sumitomo Mitsui Banking Corporation	Building Four, 1st floor, Commerce Square, 39 Rivonia Road, Sandhurst, Sandton, 2196
33	The Bank of New York, Johannesburg Representative Office	Postnet Suite 100, Private Bag X43, Sunninghill, 2157
34	The Bank of Tokyo-Mitsubishi, UFJ Limited	P O Box 78519, Sandton, 2146

Appendix 5

Foreign banks with approved local representative offices (continued)

	Institution	Address
35	The Mauritius Commercial Bank Limited	P O Box 3009, Parklands, 2121
36	The Representative Office for Southern and Eastern Africa of the Export-Import Bank of China	Postnet Suite 158, Private Bag X91-BE, Benmore, 2010
37	The Royal Bank of Scotland	3 Merchant Place, 1 Fredman Drive, Sandton, 2146
38	UBS AG	P O Box 652863, Benmore, 2010
39	Union Bank of Nigeria plc	P O Box 653125, Benmore, 2010
40	Vnesheconombank	P O Box 413742, Craighall, 2024
41	Wachovia Bank, NA	P O Box 3091, Saxonwold, 2132
42	WestLB AG	P O Box 786126, Sandton, 2146
43	Zenith Bank plc	P O Box 782652, Sandton, 2146

Appendix 6

Selected information on South African banks

Table

Table 1

Composition of total assets (R millions)

2008	Cash and balances with central bank	Short-term negotiable securities	Loans and advances to customers	Investment and trading securities	Derivative financial instruments	Other assets	Total assets
January	55 351	92 549	2 076 991	118 280	228 497	91 495	2 663 162
February	57 345	101 472	2 147 428	109 250	257 215	85 260	2 757 970
March	60 244	95 199	2 181 815	108 985	295 407	85 686	2 827 336
April	59 135	101 139	2 165 820	111 712	262 444	90 544	2 790 794
May	56 660	103 142	2 212 037	117 026	286 693	85 004	2 860 562
June	58 740	102 995	2 249 718	130 972	314 633	97 597	2 954 656
July	60 145	107 409	2 238 573	137 166	268 339	86 301	2 897 934
August	60 259	115 336	2 229,426	140 328	235 292	78 662	2 859 304
September	64 218	112 031	2 287 747	135 288	244 678	91 768	2 935 730
October	63 156	122 146	2 317 727	139 279	507 322	90 584	3 240 214
November	62 320	131 882	2 300 563	154 045	492 131	84 287	3 225 228
December	66 929	124 031	2 276 155	167 206	455 474	79 803	3 169 597

Table 2

Composition of loans and advances to customers (R millions)

2008	Homeloans	Commercial mortgages	Credit cards	Lease and instalment debtors	Overdrafts	Term loans	Other	Less: Credit impairments	Loans and advances to customers
January	693 453	168 060	55 950	238 860	122 070	284 469	540 322	26 194	2 076 991
February	701 629	167 289	56 689	241 891	118 362	330 047	559 139	27 618	2 147 428
March	709 506	170 069	56 452	244 240	119 641	332 840	576 990	27 922	2 181 815
April	711 686	173 857	57 381	246 708	115 949	314 382	574 697	28 840	2 165 820
May	719 939	177 401	57 584	248 273	116 654	328 805	593 150	29 770	2 212 037
June	726 158	182 022	57 504	249 523	122 590	344 314	599 070	31 461	2 249 718
July	735 082	187 999	57 613	250 342	113 581	327 505	599 127	32 675	2 238 573
August	741 140	192 049	58 060	251 043	111 679	341 892	567 796	34 233	2 229 426
September	746 452	196 865	58 041	252 679	116 653	356 019	596 712	35 675	2 287 747
October	755 991	201 239	58 085	253 644	110 587	383 799	591 722	37 340	2 317 727
November	761 424	206 711	57 967	253 628	109 748	365 935	582 662	37 512	2 300 563
December	763 499	208 587	57 345	252 725	106 855	377 288	549 603	39 748	2 276 155

Table 3

Composition of total liabilities (R millions)

2008	Deposits, current accounts and other creditors	Derivative financial instruments and other trading liabilities	Term debt instruments	Other	Total liabilities
January	2 107 501	271 429	62 535	67 341	2 508 806
February	2 162 887	307 009	64 650	67 480	2 602 026
March	2 193 374	343 321	65 414	67 273	2 669 380
April	2 202 310	300 433	65 346	64 292	2 632 381
May	2 237 373	329 862	66 400	66 385	2 700 020
June	2 294 885	353 658	66 896	76 014	2 791 454
July	2 294 840	305 509	68 230	62 444	2 731 022
August	2 288 782	271 171	68 716	62 932	2 691 601
September	2 354 406	286 599	69 201	57 578	2 767 783
October	2 400 292	535 948	68 129	65 019	3 069 388
November	2 381 293	537 723	66 611	62 315	3 047 941
December	2 378 556	491 649	67 254	51 100	2 988 559

Table 4

Composition of selected liabilities (R millions)

	Deposits, current accounts and other creditors							
2008	Current accounts	Savings deposits	Call deposits	Fixed and notice deposits	Negotiable certificates of deposit	Other deposits and loan accounts	Deposits received under repurchase agreements	Total
January	403 392	92 143	466 876	532 943	336 958	183 063	92 125	2 107 501
February	394 030	95 665	480 425	543 838	332 739	226 123	90 066	2 162 887
March	412 327	90 528	497 515	552 052	331 356	215 292	94 301	2 193 374
April	394 048	93 797	496 298	542 206	338 500	243 525	93 936	2 202 310
May	385 498	96 126	498 758	570 946	342 263	235 987	107 795	2 237 373
June	422 604	99 007	504 109	547 412	337 707	268 002	116 045	2 294 885
July	389 808	102 220	507 844	577 172	355 545	243 745	118 505	2 294 840
August	396 443	103 011	496 508	580 708	364 813	230 653	116 645	2 288 782
September	400 249	104 951	520 366	583 818	367 728	235 633	141 660	2 354 406
October	402 097	109 511	554 337	607 770	371 137	236 168	119 272	2 400 292
November	394 616	112 578	537 879	612 018	392 175	223 207	108 820	2 381 293
December	414 813	113 226	525 465	593 339	387 492	235 251	108 970	2 378 556

	Derivative financial instruments and other trading liabilities			Term debt instruments		
2008	Derivative financial instruments	Other trading liabilities	Total	Qualifying as capital	Other	Total
January	236 348	35 081	271 429	47 175	15 360	62 535
February	267 106	39 903	307 009	49 073	15 577	64 650
March	306 772	36 548	343 321	48 691	16 722	65 414
April	271 194	29 239	300 433	50 588	14 759	65 346
May	294 579	35 284	329 862	51 605	14 795	66 400
June	322 745	30 913	353 658	52 333	14 564	66 896
July	270 214	35 295	305 509	52 890	15 340	68 230
August	238 479	32 691	271 171	53 284	15 432	68 716
September	250 511	36 088	286 599	53 620	15 581	69 201
October	510 233	25 715	535 948	52 024	16 105	68 129
November	493 832	43 891	537 723	49 886	16 724	66 611
December	452 499	39 149	491 649	49 476	17 778	67 254

Table 5

Sources of deposits (R millions)

2008	Sovereigns including central banks	Public-sector entities	Local authorities	Banks	Securities firms	Corporate customers	Retail customers	Other	Total
January	103 632	105 552	33 587	315 476	142 316	823 706	467 965	123 925	2 116 159
February	74 673	98 534	40 791	388 925	149 528	851 174	459 835	108 512	2 171 972
March	76 492	114 984	41 106	347 020	171 834	875 098	463 434	113 797	2 203 807
April	72 093	106 901	35 919	328 061	177 761	898 195	471 396	122 986	2 213 312
May	63 073	108 365	33 620	353 939	179 726	897 109	492 673	120 695	2 249 202
June	95 635	117 406	34 532	315 342	182 462	955 218	482 000	122 307	2 304 903
July	74 483	113 168	39 384	313 746	186 566	987 845	484 285	104 745	2 304 222
August	73 467	122 306	34 373	308 569	172 603	989 690	482 075	107 244	2 290 327
September	88 134	132 152	31 829	403 855	160 087	1 016 953	419 014	102 939	2 354 962
October	85 070	135 259	31 349	373 562	168 628	1 002 003	496 838	113 419	2 406 127
November	70 278	135 201	32 609	325 732	165 680	1 028 809	502 886	120 097	2 381 293
December	83 814	133 404	30 333	344 790	158 469	995 510	505 401	126 834	2 378 556

Table 6

Composition of total equity (R millions)

2008	Share capital	Retained earnings	Other reserves	Preference shareholders' equity	Total equity
January	73 183	66 451	14 269	453	154 357
February	74 210	68 180	13 101	453	155 944
March	79 050	63 505	13 461	1 944	157 956
April	79 145	64 608	12 717	1 944	158 413
May	79 221	67 192	12 186	1 944	160 543
June	79 225	69 814	12 219	1 944	163 202
July	80 235	71 756	12 977	1 944	166 912
August	81 690	72 900	11 169	1 944	167 702
September	83 456	72 306	10 181	2 004	167 947
October	84 352	73 482	10 988	2 004	170 825
November	87 207	76 288	11 787	2 004	177 287
December	87 617	79 482	11 936	2 004	181 038

Table 7

Composition of off-balance-sheet items (R millions)

2008	Guarantees on behalf of clients	Letters of credit	Committed undrawn facilities	Credit derivative instruments	Other	Total
January	103 223	20 655	182 713	11 764	22 473	340 828
February	102 518	21 181	186 340	12 106	22 706	344 852
March	104 915	21 829	196 950	12 096	23 354	359 143
April	106 697	22 070	199 072	12 578	22 738	363 155
May	103 795	22 886	201 239	12 537	27 253	367 709
June	110 633	24 889	193 761	10 532	27 151	366 967
July	105 005	25 309	186 453	12 542	27 585	356 894
August	111 463	25 801	185 309	14 206	25 736	362 515
September	115 955	28 003	194 665	14 623	21 236	374 481
October	116 029	31 204	194 152	15 510	18 494	375 390
November	112 360	27 007	192 357	15 507	18 479	365 711
December	108 121	24 761	194 844	18 281	20 263	366 270

Table 8

Composition of the income statement (R millions)

	Income		Expenses			
2008	Net interest income	Non-interest income	Credit losses	Operating expenses	Indirect taxation	Operating profit/(loss)
January	7 264	4 414	1 900	5 484	180	4 114
February	6 670	4 032	1 780	5 786	226	2 911
March	5 913	7 233	1 628	6 016	234	5 271
April	6 633	5 452	2 252	5 815	206	3 812
May	6 370	5 351	2 039	5 931	73	3 678
June	5 633	7 636	2 799	6 884	300	3 286
July	6 740	5 403	2 503	6 373	187	3 080
August	6 555	5 758	2 672	6 123	213	3 305
September	6 607	5 822	3 092	5 919	229	3 190
October	6 850	6 424	3 012	6 756	176	3 330
November	6 138	6 012	2 542	6 054	-23	3 577
December	6 342	7 867	3 500	5 998	109	4 603

Table 9

Composition of interest and similar income (R millions)

2008	Short-term negotiable securities	Homeloans	Commercial mortgages	Credit cards	Lease and instalment debtors	Overdrafts	Term loans	Other	Government and other dated securities	Less: Interest income on trading assets allocated to trading revenue	Interest and similar income
January	912	7 774	1 790	908	2 745	1 363	2 925	4 948	681	1 794	22 253
February	868	6 976	1 710	964	2 662	1 122	2 523	5 237	419	526	21 956
March	999	7 549	1 846	911	2 983	1 338	2 756	3 968	621	835	22 136
April	929	7 527	1 900	902	2 983	1 289	2 363	4 691	608	396	22 796
May	932	8 026	2 011	979	3 114	1 350	2 720	4 463	602	763	23 435
June	1 187	7 869	2 020	939	3 076	650	3 588	5 098	246	1 099	23 573
July	1 297	8 379	2 226	974	3 177	1 317	4 507	3 570	1 832	869	26 410
August	1 257	8 488	2 275	1 003	3 154	1 371	3 652	4 761	903	1 213	25 650
September	1 192	8 274	2 194	946	3 098	2 141	3 666	3 870	861	454	25 788
October	1 162	8 570	2 420	986	3 212	1 350	4 058	3 987	243	1 543	24 445
November	1 280	8 105	2 323	956	3 060	1 546	4 618	3 845	1 989	736	26 986
December	1 789	8 777	2 477	954	3 175	783	4 858	3 450	2 365	548	28 081

Table 10

Composition of interest expense and similar charges (R millions)

2008	Current accounts	Savings deposits	Term and other deposits	Negotiable certificates of deposit	Other deposits and loans	Other liabilities	Term debt instruments	Less: Interest expense on trading liabilities allocated to trading revenue	Interest expense and similar charges
January	3 020	441	7 221	3 033	1 755	154	465	1 100	14 989
February	3 027	435	7 796	2 668	1 980	481	341	1 442	15 285
March	3 285	482	7 778	3 049	2 943	538	476	2 328	16 222
April	2 562	497	7 842	2 792	3 776	11	423	1 740	16 163
May	3 324	540	7 956	3 054	-370	425	608	-1 529	17 065
June	3 568	562	8 540	3 662	1 903	179	476	951	17 940
July	3 322	618	9 122	4 044	1 359	546	1 341	681	19 670
August	3 213	640	9 031	3 981	2 639	383	546	1 338	19 096
September	2 516	635	9 321	3 729	2 311	398	943	673	19 180
October	3 472	674	9 168	3 912	959	281	620	1 491	17 594
November	3 289	673	9 260	4 333	2 545	489	1 209	951	20 848
December	3 297	700	9 460	4 813	2 528	589	1 201	849	21 738

Table 11

Profitability ratios (unsmoothed) (per cent)

2008	Return on equity	Return on assets	Cost-to-income ratio	Net interest income to assets	Non-interest revenue to assets	Operating expenses to assets	Interest and similar income to interest-earning assets	Interest expense and similar charges to funding liabilities	Net interest income ratio*
January	24,12	1,39	46,96	3,27	1,99	2,47	12,30	8,13	4,16
February	18,04	1,02	54,06	2,90	1,75	2,52	11,70	8,08	3,62
March	33,50	1,85	45,77	2,51	3,07	2,55	11,64	8,45	3,19
April	19,20	1,08	48,12	2,85	2,34	2,50	12,06	8,40	3,65
May	20,95	1,16	50,60	2,67	2,24	2,49	12,13	8,73	3,40
June	19,21	1,05	51,88	2,29	3,10	2,80	12,01	8,92	3,09
July	17,03	0,97	52,48	2,79	2,24	2,64	13,50	9,83	3,67
August	16,46	0,95	49,73	2,75	2,42	2,57	13,11	9,56	3,55
September	19,27	1,09	47,62	2,70	2,38	2,42	12,88	9,37	3,51
October	17,90	0,93	50,90	2,54	2,38	2,50	12,01	8,42	3,59
November	19,65	1,07	49,82	2,28	2,24	2,25	13,30	10,07	3,22
December	28,71	1,62	42,21	2,40	2,98	2,27	14,02	10,55	3,47

* 'Interest and similar income to interest-earning assets' less 'interest expense and similar charges to funding liabilities'

Table 12

Composition of gross operating income (R millions)

2008	Net interest income	Net fee and commission income	Net trading income	Other	Gross operating income
January	7 264	3 325	806	283	11 678
February	6 670	3 447	544	41	10 703
March	5 913	3 961	1 116	2 156	13 146
April	6 633	3 677	1 359	415	12 086
May	6 370	3 835	2 243	-727	11 721
June	5 633	3 921	1 832	1 883	13 269
July	6 740	3 912	-285	1 776	12 143
August	6 555	3 759	1 198	800	12 312
September	6 607	3 851	1 317	654	12 429
October	6 850	4 210	1 796	418	13 274
November	6 138	3 960	1 225	827	12 150
December	6 342	4 915	831	2 121	14 209

Table 13

Composition of gross operating expenses (R millions)

2008	Staff	Computer processing	Marketing	Travel, occupation and equipment	Other	Operating expenses
January	3 018	586	200	928	752	5 484
February	3 367	582	265	947	625	5 786
March	3 339	596	299	960	823	6 016
April	3 302	598	281	952	683	5 815
May	2 984	641	304	1 062	939	5 931
June	3 513	576	321	1 079	1 395	6 884
July	3 405	630	285	1 057	996	6 373
August	3 491	609	318	949	756	6 123
September	3 345	597	267	983	727	5 919
October	3 391	718	351	1 067	1 229	6 756
November	3 357	715	256	977	749	6 054
December	3 154	817	314	1 130	583	5 998

Table 14

Composition of qualifying capital and reserve funds (R millions)

2008	Primary capital and reserve funds	Secondary capital and reserve funds	Tertiary capital and reserve funds	Total
January	129 567	41 849	593	172 009
February	131 958	42 024	585	174 567
March	138 011	41 076	600	179 688
April	139 531	43 262	600	183 393
May	141 126	43 790	600	185 516
June	147 738	45 280	600	193 619
July	149 793	46 043	600	196 436
August	149 535	46 342	600	196 477
September	150 100	46 100	300	196 499
October	151 294	44 562	300	196 156
November	152 939	42 222	300	195 461
December	159 216	43 056	300	202 573

Table 15

Composition of risk-weighted exposure (R millions)

2008	Credit risk	Operational risk	Market risk	Equity risk	Other risk	Total
January	1 135 536	155 751	33 967	65 428	66 673	1 457 355
February	1 133 947	156 069	33 062	72 952	57 813	1 453 843
March	1 141 399	157 675	34 943	76 624	49 854	1 460 495
April	1 146 234	156 214	38 060	78 215	52 802	1 471 525
May	1 164 507	156 265	38 614	78 361	50 741	1 488 488
June	1 157 137	180 679	40 372	92 732	54 668	1 525 589
July	1 171 632	180 619	42 547	91 240	55 005	1 541 043
August	1 170 639	180 061	42 113	92 460	50 433	1 535 705
September	1 172 457	181 963	43 119	90 752	52 641	1 540 933
October	1 173 378	181 993	42 723	101 012	54 474	1 553 580
November	1 176 782	182 067	42 048	83 571	55 234	1 539 702
December	1 185 481	186 478	38 518	89 464	56 154	1 556 094

Table 16

Contractual maturity of liabilities (composition) (R millions)

2008	Next day	2 to 7 days	8 days to 1 month	More than 1 month to 2 months	More than 2 months to 3 months	More than 3 months to 6 months	More than 6 months to 1 year	More than 1 year	Non-contractual
January	937 297	78 114	482 555	137 949	101 986	145 863	235 866	386 840	200 573
February	953 043	126 855	445 076	160 094	102 603	168 779	246 280	433 631	203 428
March	1 007 395	100 489	446 701	157 667	97 012	175 691	271 128	477 615	194 066
April	977 706	107 995	436 630	175 401	105 036	177 256	265 393	461 641	191 061
May	956 785	141 611	524 200	142 539	102 260	169 047	258 554	481 469	191 314
June	1 031 389	122 172	478 412	179 472	92 409	155 964	301 079	502 587	193 214
July	984 805	118 611	476 104	165 339	103 436	161 355	313 725	468 624	195 593
August	951 926	145 068	430 747	174 375	105 440	173 803	301 378	463 938	191 430
September	999 536	135 477	413 774	175 240	74 919	221 202	292 737	450 371	188 167
October	1 094 059	156 746	389 661	163 002	139 056	234 554	324 003	558 051	192 425
November	1 095 712	118 827	348 011	216 351	131 250	229 163	311 916	571 876	197 720
December	1 058 512	144 913	400 164	183 253	125 503	212 217	265 363	583 302	200 647

Table 17

“Business-as-usual” maturity of liabilities (composition) (R millions)

2008	Next day	2 to 7 days	8 days to 1 month	More than 1 month to 2 months	More than 2 months to 3 months	More than 3 months to 6 months	More than 6 months to 1 year	More than 1 year	Non-contractual
January	126 764	85 439	268 004	115 114	132 017	262 273	391 205	1 046 678	206 714
February	114 257	139 156	253 248	127 157	129 240	255 285	366 592	1 174 978	222 517
March	154 042	103 371	284 223	130 670	124 531	269 085	375 440	1 198 368	208 690
April	142 567	110 421	291 112	135 703	113 911	282 652	367 062	1 184 843	214 209
May	138 580	128 014	332 102	120 706	126 405	294 897	374 232	1 184 906	210 955
June	176 696	121 355	298 110	137 269	115 978	288 592	416 476	1 231 615	212 856
July	163 944	121 082	275 663	129 392	118 145	272 518	428 099	1 214 151	216 801
August	158 575	109 296	237 970	130 395	119 936	281 106	422 088	1 237 116	212 949
September	164 512	72 989	279 140	127 143	97 944	312 265	411 859	1 263 520	209 719
October	220 593	94 752	232 696	143 380	141 669	317 261	437 936	1 386 909	224 973
November	238 698	53 362	214 856	162 876	140 688	293 530	443 779	1 394 922	226 836
December	200 325	84 909	231 113	143 835	151 129	292 076	418 201	1 385 454	225 554

Table 18

Concentration of short-term funding (composition) (R millions)

2008	Deposit funding received from:			
	Associates	Ten largest depositors	Ten largest financial institutions	Ten largest government and parastatals
January	40 418	214 789	116 153	78 001
February	48 962	217 500	153 090	62 502
March	59 782	220 938	132 318	77 617
April	59 516	200 167	131 049	64 134
May	58 037	197 532	140 383	62 143
June	59 239	210 451	133 371	71 665
July	42 051	185 887	113 951	65 881
August	39 702	180 326	108 890	66 178
September	41 408	204 159	120 495	77 729
October	52 453	203 750	137 770	73 029
November	46 886	210 507	140 058	78 901
December	41 936	214 453	127 514	73 327

Table 19

Analysis of credit risk

2008	Impaired advances (R millions)	Gross loans and advances (R millions)	Specific credit impairments (R millions)	Impaired advances as a percentage of gross loans and advances (Per cent)	Specific credit impairments as a percentage of gross loans and advances (Per cent)	Specific credit impairments as a percentage of impaired advances (Per cent)
January	47 619	2 103 185	17 632	2,26	0,84	37,03
February	50 849	2 175 046	18 729	2,34	0,86	36,83
March	53 103	2 209 737	19 489	2,40	0,88	36,70
April	56 166	2 194 660	19 963	2,56	0,91	35,54
May	60 518	2 241 807	20 744	2,70	0,93	34,28
June	64 434	2 281 179	22 173	2,82	0,97	34,41
July	66 649	2 271 249	23 532	2,93	1,04	35,31
August	70 957	2 263 659	25 039	3,13	1,11	35,29
September	72 090	2 323 422	26 255	3,10	1,13	36,42
October	80 516	2 355 066	27 730	3,42	1,18	34,44
November	84 473	2 338 075	27 634	3,61	1,18	32,71
December	87 256	2 315 904	28 496	3,77	1,23	32,66

Table 20

Internal ratings-based banks: Composition of total credit exposure – Exposure at default (R millions)

	Retail			Corporate			Other			Total credit exposure		
2008	Total exposure	Default	Default ratio (Per cent)	Total exposure	Default	Default ratio (Per cent)	Total exposure	Default	Default ratio (Per cent)	Total exposure	Default	Default ratio (Per cent)
January	1 210 414	34 362	2,84	614 248	3 411	0,56	445 625	450	0,10	2 270 287	38 222	1,68
February	1 224 175	40 659	3,32	607 358	4 275	0,70	538 966	290	0,05	2 370 499	45 224	1,91
March	1 235 878	43 493	3,52	631 734	4 345	0,69	521 346	339	0,07	2 388 958	48 178	2,02
April	1 246 772	47 668	3,82	625 146	4 296	0,69	514 451	406	0,08	2 386 369	52 369	2,19
May	1 243 081	49 648	3,99	642 592	4 152	0,65	508 310	448	0,09	2 393 983	54 248	2,27
June	1 249 791	52 347	4,19	669 327	4 775	0,71	533 751	462	0,09	2 452 870	57 584	2,35
July	1 256 038	55 677	4,43	679 854	4 652	0,68	503 929	447	0,09	2 439 821	60 776	2,49
August	1 262 598	59 046	4,68	676 940	4 734	0,70	505 109	419	0,08	2 444 646	64 199	2,63
September	1 280 534	62 873	4,91	688 968	4 227	0,61	543 155	892	0,16	2 512 657	67 992	2,71
October	1 282 628	67 138	5,23	714 319	7 474	1,05	609 940	928	0,15	2 606 887	75 539	2,90
November	1 291 447	69 771	5,40	724 027	6 464	0,89	568 391	902	0,16	2 583 864	77 137	2,99
December	1 293 278	73 777	5,70	721 823	6 099	0,84	561 734	896	0,16	2 576 836	80 771	3,13

Table 21

Internal ratings-based banks: Composition of total retail credit exposure – Exposure at default (R millions)

	Retail mortgages			Revolving credit			Retail other			SME retail			Total retail credit exposure		
2008	Total exposure	Default	Default ratio (Per cent)	Total exposure	Default	Default ratio (Per cent)	Total exposure	Default	Default ratio (Per cent)	Total exposure	Default	Default ratio (Per cent)	Total exposure	Default	Default ratio (Per cent)
January	743 802	19 846	2,67	118 143	4 454	3,77	208 046	7 248	3,48	140 424	2 814	2,00	1 210 414	34 362	2,84
February	756 378	23 565	3,12	114 602	5 806	5,07	200 259	7 694	3,84	152 935	3 594	2,35	1 224 175	40 659	3,32
March	762 833	26 145	3,43	116 767	5 756	4,93	202 899	7 844	3,87	153 381	3 747	2,44	1 235 878	43 493	3,52
April	769 013	29 183	3,79	118 118	6 252	5,29	204 598	8 232	4,02	155 043	4 001	2,58	1 246 772	47 668	3,82
May	773 015	31 018	4,01	118 673	5 993	5,05	201 977	8 828	4,37	149 416	3 809	2,55	1 243 081	49 648	3,99
June	775 969	33 114	4,27	120 812	6 461	5,35	204 336	8 711	4,26	148 674	4 060	2,73	1 249 791	52 347	4,19
July	781 005	35 559	4,55	122 241	6 592	5,39	205 327	9 211	4,49	147 466	4 314	2,93	1 256 038	55 677	4,43
August	787 040	38 838	4,93	121 972	6 835	5,60	206 487	8 834	4,28	147 099	4 539	3,09	1 262 598	59 046	4,68
September	809 524	42 169	5,21	121 573	7 010	5,77	208 567	9 160	4,39	140 870	4 534	3,22	1 280 534	62 873	4,91
October	814 856	45 666	5,60	122 245	7 240	5,92	206 439	9 283	4,50	139 087	4 949	3,56	1 282 628	67 138	5,23
November	818 119	48 095	5,88	123 860	7 250	5,85	207 088	9 262	4,47	142 380	5 163	3,63	1 291 447	69 771	5,40
December	819 422	51 127	6,24	123 506	7 435	6,02	206 360	9 856	4,78	143 990	5 358	3,72	1 293 278	73 777	5,70

Table 22

Composition of market risk risk-weighted exposure (R millions)

2008	Interest rates	Equities	Foreign exchange	Commodities
January	1 246 244	771 672	162 229	107 647
February	1 547 143	735 334	278 940	145 449
March	1 564 111	716 825	189 832	261 457
April	1 509 282	997 331	262 823	435 270
May	1 724 438	850 927	274 454	366 176
June	2 031 525	654 419	292 249	433 409
July	1 960 244	625 163	330 257	317 721
August	2 037 582	606 737	407 734	254 383
September	2 031 096	708 894	429 346	269 651
October	2 195 290	590 955	383 032	238 898
November	2 132 215	549 187	428 990	241 095
December	1 942 020	531 905	409 237	191 385

Table 23

Turnover in derivative contracts (R millions)

2008	Interest rate contracts	Foreign-exchange contracts	Equity and indices	Commodities	Other	Total
January	2 375 777	2 963 525	159 099	31 229	0	5 529 630
February	1 600 462	2 511 147	151 402	42 747	0	4 305 758
March	1 411 726	2 852 877	349 336	395 856	0	5 009 795
April	2 423 336	2 900 230	110 058	951 477	0	6 385 101
May	2 218 492	2 721 892	78 983	36 248	6	5 055 620
June	2 775 913	3 721 087	218 234	64 586	6	6 779 825
July	3 202 101	3 015 297	166 201	39 276	6	6 422 882
August	3 285 111	2 838 070	121 895	13 628	6	6 258 711
September	2 884 977	4 036 304	325 170	62 505	0	7 308 957
October	3 386 828	3 942 360	163 910	43 246	0	7 536 344
November	2 700 391	3 126 682	124 755	46 036	0	5 997 864
December	1 641 915	2 766 574	223 253	44 772	0	4 676 514

Table 24

Effective net open foreign-currency position (US$ millions)

2008	Total foreign-currency assets	Total foreign-currency liabilities	Net spot position	Commitments to purchase foreign currency	Commitments to sell foreign currency	Mismatched forward commitments	Effective net open foreign-currency position
January	34 910	19 772	15 139	304 285	319 190	-14 905	234
February	27 834	18 310	9 524	269 512	278 837	-9 326	198
March	32 060	18 725	13 335	288 244	301 426	-13 182	153
April	28 075	19 575	8 501	280 836	289 013	-8 177	323
May	26 396	18 969	7 427	286 106	293 257	-7 152	276
June	26 239	18 885	7 354	288 497	295 587	-7 091	263
July	24 191	18 358	5 834	284 014	289 893	-5 879	-46
August	23 093	19 327	3 766	293 538	296 788	-3 249	516
September	23 232	18 741	4 491	301 184	305 033	-3 850	641
October	25 564	20 516	5 047	314 352	319 153	-4 802	245
November	26 414	21 096	5 318	326 282	331 483	-5 200	118
December	24 946	20 255	4 691	315 534	320 131	-4 597	94

Appendix 7

Directives sent to banking institutions during 2008

Banks Act Directive 1/2008	Use of divisional names
Banks Act Directive 2/2008	Procedure to be followed in respect of applications in terms of the provisions of sections 37, 52 and/or 54 of the Banks Act, 1990
Banks Act Directive 3/2008	Appointment of directors or executive officers and completion of form BA020
Banks Act Directive 4/2008	Disclosure of repurchase and resale agreements and similar transactions
Banks Act Directive 5/2008	Composition of board-appointed committee to approve large exposures
Banks Act Directive 6/2008	Auditor rotation
Banks Act Directive 7/2008	Mapping of the international scale rating symbols of Fitch Ratings and Moody's Investors Service to the prescribed risk weights available in terms of regulation 23 of the Regulations relating to Banks
Banks Act Directive 8/2008	Completion of specified items of form BA320 for commodities and foreign exchange including gold

Circulars sent to banking institutions during 2008

Banks Act Circular 1/2008	Status of previously issued circulars
Banks Act Circular 2/2008	Meetings to be held during the 2008 calendar year with the Board of Directors, Audit Committee and external auditors

Guidance notes sent to banking institutions during 2008

Banks Act Guidance Note 1/2008	Status of previously issued guidance notes
Banks Act Guidance Note 2/2008	Position statement on personal account trading
Banks Act Guidance Note 3/2008	Outsourcing of functions within banks
Banks Act Guidance Note 4/2008	Issue of a guidance note by the Financial Intelligence Centre in terms of section 4(c) of the Financial Intelligence Centre Act, 2001
Banks Act Guidance Note 5/2008	Electronic communication with the Office of the Registrar of Banks
Banks Act Guidance Note 6/2008	Cell-phone banking
Banks Act Guidance Note 7/2008	Development programme for directors of banks
Banks Act Guidance Note 8/2008	Financial Action Task Force calls for enhanced scrutiny of transactions with certain jurisdictions and United Nations sanctions in relation to proliferation of weapons of mass destruction
Banks Act Guidance Note 9/2008	Stress testing

Appendix 8

Exemptions and exclusions from the application of the Banks Act, 1990

Section 1(cc): Exemptions by the Registrar of Banks

Government Gazette		Topic	Expiry
Date	Number		
2006/12/01	29412	A group of persons between which a common bond exists	Indefinite
1994/12/14	16167	Commercial paper	Indefinite
2008/12/19	31716	"Ithala Limited" A wholly owned subsidiary of Ithala Development Finance Corporation Limited	2011/12/31
1994/12/14	16167	Mining houses	Indefinite
1994/12/14	16167	Trade in securities and financial instruments	Indefinite
2008/01/01	30628	Securitisation schemes	Indefinite

Section 1(dd): Exemptions by the Minister of Finance

Government Gazette		Topic	Subparagraph	Expiry
Date	Number			
1991/01/31	13003	Participation bond schemes	(dd)(ii)	Indefinite
1991/01/31	13003	Unit trust schemes	(dd)(ii)	Indefinite
2008/08/22	31342	Financial Service Co-operative	(dd)(i)	Indefinite

Section 1(gg): Exemptions by the Registrar of Banks

Government Gazette		Topic	Expiry
Date	Number		
1998/09/22	19283	Members of the Johannesburg Stock Exchange as persons authorised to accept money as mandatories and to deposit such money into banking accounts maintained by them	Indefinite

Section 2(vii): Exclusions by the Minister of Finance

Government Gazette		Topic	Expiry
Date	Number		
1992/01/24	13744	Post Office Savings Bank	Indefinite
1994/12/14	16167	Industrial Development Corporation of SA Limited	Indefinite

Section 78(1)(d)(iii): Exemptions by the Registrar of Banks

Government Gazette		Topic	Expiry
Date	Number		
1997/05/02	17949	Category of assets of a bank held in the name of a person other than the bank concerned	Indefinite

Appendix 9

Approval of acquisition or establishment of foreign banking interests in terms of section 52 of the Banks Act, 1990, from 1 January 2008 to 31 December 2008

Name of bank/ controlling company	Date of approval	Name of interest (and percentage interest held, if not 100 per cent)	Country
Absa Group Limited	2008/02/12	Concession Investments (Pty) Limited (15 per cent)	Botswana
Absa Group Limited**	2008/07/22	Absa Namibia Holdings Limited	Namibia
Absa Group Limited**	2008/07/22	Absa Bank Namibia Limited	Namibia
Absa Group Limited	2008/08/05	Visa Incorporated (0,76 per cent class C common stock shares)	United States of America
FirstRand Bank Limited	2008/02/25	FirstRand Bank India Limited (Branch)	India
FirstRand Bank Holdings Limited	2008/02/25	FirstRand Zambia Holdings Limited	Zambia
FirstRand Bank Holdings Limited	2008/02/25	First National Bank Zambia Limited	Zambia
FirstRand Bank Limited	2008/08/15	FirstRand Bank UK Branch	United Kingdom
FirstRand Bank Holdings Limited	2008/10/08	RMB Capital Partners II LP	Australia
FirstRand Bank Limited	2008/10/29	Visa Incorporated (0,2 per cent class C of ordinary shares)	United States of America
Investec Limited	2008/06/17	Visa Incorporated (less than 0,1 per cent class C of ordinary shares)	United States of America
Investec plc*	2008/02/05	Gresham Zebra Limited Partnership (25 per cent)	United Kingdom
Investec plc*	2008/02/05	Think Tank Holdings Limited (14,4 per cent)	China
Investec plc*	2008/02/05	IdaTech UK Limited	United Kingdom
Investec plc*	2008/02/05	Netti Atom Holdings (Pty) Limited (20,8 per cent)	Australia
Investec plc*	2008/02/05	Lausane International Investments Limited	British Virgin Islands
Investec plc*	2008/02/05	Doolin Commercial Property Fund	United Kingdom
Investec plc*	2008/02/05	Gale Pacific Limited (4 per cent)	Australia
Investec plc*	2008/03/11	Perseus Mining Limited (0,5 per cent)	Australia
Investec plc*	2008/01/14	E-Band Communication Corporation (8,2 per cent)	United States of America
Investec plc*	2008/07/28	Tersichore Wind SA (50 per cent)	United Kingdom
Investec plc*	2008/07/28	Aonia Wind SA (24,9 per cent)	United Kingdom
Investec plc*	2008/12/31	IdaTech plc	United Kingdom
Investec plc*	2008/06/18	Dolphine Coast Marina Estate Limited (40 per cent)	Mauritius
Investec plc*	2008/06/18	RUI (Mauritius) Limited (45 per cent)	Mauritius
Investec plc*	2008/08/13	Eperien Insurance Services (Pty) Limited (33 per cent)	Australia
Investec plc*	2008/06/05	Investec GP (Jersey) Limited	United Kingdom
Investec plc*	2008/07/22	Investec Finance (Jersey) plc	United Kingdom
Investec plc*	2008/08/13	Magma Metal Limited (1,3 per cent)	Australia
Investec plc*	2008/08/13	Strandbags (16 per cent)	Australia
Investec plc*	2008/06/25	Investec Africa Frontier Private Equity Fund GP Limited	United Kingdom
Investec plc*	2008/07/16	IPCO Investments (Pty) Limited	Australia
Investec plc*	2008/06/17	Investec Asset Management Australia Limited	Australia
Investec plc*	2008/07/28	Cooper's Gap (Pty) Limited	Australia
Investec plc*	2008/07/28	Collgar Wind Farm (Pty) Limited	Australia

Appendix 9

Approval of acquisition or establishment of foreign banking interests in terms of section 52 of the Banks Act, 1990, from 1 January 2008 to 31 December 2008 (continued)

Name of bank/ controlling company	Date of approval	Name of interest (and percentage interest held, if not 100 per cent)	Country
Investec plc*	2008/07/28	Oaklands Hill Wind Farm (Pty) Limited	Australia
Investec plc*	2008/11/21	Lokrida Wind SA (24,9 per cent)	Greece
Investec plc*	2008/08/19	South Africa Alpha Capital Management Limited	Bermuda
Investec plc*	2008/09/29	Bluewater Developments (WA) Pty Limited (50 per cent)	Australia
Investec plc*	2008/11/10	CODIR Company Direction Limited	United Kingdom
Investec plc*	2008/11/10	CONMAN Company Management Limited	United Kingdom
Nedbank Limited	2008/08/15	Fairbairn Private Bank: UK Branch	United Kingdom
Nedbank Limited	2008/09/29	Nedbank Canada	Canada
Nedbank Limited	2008/10/27	Nedbank Representative Office Kenya	Kenya
Nedbank Limited	2008/10/27	Nedbank Representative Office Angola	Angola
Nedbank Limited	2008/10/29	Sax Leasing No 7	Cayman Island
Nedbank Limited	2008/12/02	NedCapital Kenya Limited	Kenya
Nedbank Limited	2008/06/17	Namclear (Pty) Limited	Namibia
Standard Bank Group Limited	2008/03/25	Stanbic Nominees Uganda Limited	Uganda
Standard Bank Group Limited	2008/04/02	CFC Stanbic Holdings Limited (60 per cent)	Kenya
Standard Bank Group Limited	2008/04/02	CFC Stanbic Bank Limited	Kenya
Standard Bank Group Limited	2008/04/02	Heritage A II Insurance Company Limited (64 per cent)	Kenya
Standard Bank Group Limited	2008/04/02	Heritage A II Insurance Company Tanzania Limited (60 per cent)	Tanzania
Standard Bank Group Limited	2008/04/02	Azali Limited	Kenya
Standard Bank Group Limited	2008/04/02	Alliance Insurance Company Tanzania Limited (45 per cent)	Tanzania
Standard Bank Group Limited	2008/04/02	Strategis Tanzania (49 per cent)	Tanzania
Standard Bank Group Limited	2008/04/02	CFC Holdings Limited	Kenya
Standard Bank Group Limited	2008/04/02	CFC Life Assurance Limited	Kenya
Standard Bank Group Limited	2008/04/02	CFC Financial Services Limited	Kenya
Standard Bank Group Limited	2008/04/02	CFC Financial Services Nominees Limited	Kenya
Standard Bank Group Limited	2008/04/23	Standard Bank plc Sydney Branch	Australia

* Applications in respect of Investec plc to establish or acquire foreign interests or subsidiaries were noted in terms of the conditions of approval of the dually listed company structure.

** Absa Group Limited subsequently decided to establish a representative office as opposed to a bank. Consequently, the Bank Supervision Department withdrew its approval for Absa Group Limited to establish Absa Namibia Holdings (Pty) Limited and Absa Bank Namibia Limited.

Appendix 10

Memorandums of understanding concluded between the Bank Supervision Department of the South African Reserve Bank and foreign supervisors as at 31 December 2008

Name of foreign supervisor (listed alphabetically)	Country of foreign supervisor	Effective from
Australian Prudential Regulation Authority	Australia	4 July 2007
Bank of Mauritius	Mauritius	25 January 2005
Bank Supervision Department of the Bank of Namibia	Namibia	27 September 2004
Bundesanstalt für Finanzdienstleistungsaufsicht	Germany	13 August 2004
Central Bank of Nigeria	Nigeria	20 March 2008
Financial Services Authority	United Kingdom	21 July 2006
Financial Supervision Commission of the Isle of Man	Isle of Man	13 August 2001
Irish Financial Services Regulatory Authority	Ireland	21 July 2004
Monetary Authority of Hong Kong	Hong Kong	12 December 2006
Superintendencia de Entidades Financieras y Cambiarias	Argentina	18 July 2007

Abbreviations

AIGOR	Accord Implementation Group
AIRB	advanced internal ratings based
AMA	advanced measurement approach
AML	anti-money laundering
ASA	alternative standardised approach
BIA	basic indicator approach
BIS	Bank for International Settlements
CFT	combating of the financing of terrorism
EAD	exposure at default
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
EU	European Union
FATF	Financial Action Task Force (on Money Laundering)
FIC	Financial Intelligence Centre
FICA	Financial Intelligence Centre Act
FIU	Financial Intelligence Unit
FIRB	foundation internal ratings based
FSAP	Financial Sector Assessment Program
FSB	Financial Services Board
FSCF	Financial Sector Contingency Forum
FSF	Financial Stability Forum
FSI	Financial Stability Institute
FSRBS	Financial Action Task Force-style Regional Bodies
FSSA	Financial System Stability Assessment
G-20	Group of Twenty
H-index	Herfindahl–Hirschman Index
HSBC	Hongkong and Shanghai Banking Corporation Limited
IASs	International Accounting Standards
IASB	International Accounting Standards Board
ICAAP	internal capital-adequacy assessment process
ICBC	Industrial and Commercial Bank of China
ICBS	International Conference on Banking Supervisors
IFRSs	International Financial Reporting Standards
IMA	internal models-based approach
IMF	International Monetary Fund
IRB	internal ratings based
ISA	International Standards on Auditing
IT	information technology
JSE	JSE Limited
LDCE	loss data collection exercise
LGD	loss given default
MEQ	Mutual Evaluation Questionnaire
MER	Mutual Evaluation Report
MMS	Model Monitoring System
PD	probability of default
PIN	Public Information Notice
QIS	quantitative impact study
ROA	return on assets
ROE	return on equity
SA	the standardised approach (credit risk)
SADC	Southern African Development Community
SARB	South African Reserve Bank
SBG	Standard Bank Group Limited
SIDA	Swedish International Development Co-operation Agency

SPV	special-purpose vehicle
SREP	supervisory review and evaluation process
TDC	Training and Development Committee
TSA	the standardised approach (market risk and operational risk)
UK	United Kingdom
USA	United States of America
VaR	value at risk

Glossary

Basel I	*International Convergence of Capital Measurement and Capital Standards*
Basel II	*International Convergence of Capital Measurement and Capital Standards: A Revised Framework*
Basel Committee	Basel Committee on Banking Supervision
boards	boards of directors
Branch Regulations	Conditions for the conducting of the business of a bank by a foreign institution by means of a branch
Core Principles	Core Principles for Effective Banking Supervision
the consultant	delegation from the Basel Institute on Governance
the Department	Bank Supervision Department of the South African Reserve Bank
the Basel Committee	Basel Committee on Banking Supervision
the Bank	South African Reserve Bank
the Banks Act	the Banks Act, 1990 (Act No. 94 of 1990)
the Registrar	Registrar of Banks
the study team	International Monetary Fund/World Bank team
securitisation schemes	Designation of an activity not falling within the meaning of 'the business of a bank'
40+9 Recommendations	The Forty Recommendations of 2003 and the Nine Special Recommendations of 2001 of the Financial Action Task Force