Chapter 1: Registrar of Banks' review

1.1 Introduction

Supported by accommodative monetary policy, the global economic recovery strengthened modestly during 2014. Globally, however, monetary policy faces the challenge of balancing economic benefits and financial stability risks. While economic benefits are becoming more evident in certain countries, market and liquidity risks have increased and could impact adversely on financial stability. Global economic growth is therefore not yet sufficiently robust to quell lingering fears about the sustainability of the global economic recovery. Accordingly, the soundness of the global banking system is an essential precondition for the achievement of sustainable economic growth.

A robust regulatory and supervisory framework for banks creates not only an environment that promotes the safety and soundness of individual banks and the banking system as a whole, but also an environment conducive to sustainable investment. Since the recent global financial crisis, banks have introduced stabilising measures and adapted largely to new regulatory realities by maintaining higher levels of capital and introducing balance-sheet optimisation. Banks are currently also introducing more fundamental changes to their business models, including the restructuring of their businesses, the repricing of products and the reallocation of capital across activities.

In its annual reports of the past few years, the Bank Supervision Department (the Department) of the South African Reserve Bank (the Bank) focused on, among other things, the aftermath of the global financial crisis and the comprehensive regulatory reforms announced to address the causes thereof. In accordance with the agreed post-financial crisis reform agenda of international standard-setting bodies such as the Group of Twenty (G-20), the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (Basel Committee), the process of strengthening the South African regulatory and supervisory framework to promote and enhance financial stability, and the safety and soundness of banks and banking groups continued during 2014.

The year under review also saw two significant international reviews of the Department's policies and procedures in terms of international benchmarking exercises, namely the assessment by the International Monetary Fund (IMF) of the Basel Committee's Core Principles for Effective Banking Supervision (Core Principles) and the initiation of the Basel Committee's Regulatory Consistency Assessment Programme (RCAP). Both these reviews were performed by teams of experienced international banking supervisory peers. These reviews provide valuable insight into the Department's policies and processes, confirm areas of strength and identify areas that require further development or refinement.

Another significant event during 2014 was African Bank Limited (African Bank) being placed under curatorship on 10 August 2014 despite the Department intensifying its active engagement with the management and Board of Directors (Board) of African Bank since the end of 2012. In this regard, the Department expressed concerns particularly around African Bank's impairment and provisioning policy, its rapid credit growth and the need to reconsider its business model. Throughout 2013 and 2014, the Department continued to encourage African Bank to address the concerns raised, and in September 2014 the Bank instituted a formal independent investigation of the circumstances that gave rise to African Bank being placed under curatorship. A written report was submitted to the Registrar of Banks in the first quarter of 2015. On the whole, however, South Africa's banking sector remains healthy and robust.[1]

1. South African Reserve Bank media release titled 'South African Reserve Bank investigation into African Bank', issued on 2 September 2014 and address by the Governor at a press conference on 10 August 2014, available at http://www.resbank.co.za/.

The remainder of this chapter considers the Department's strategic focus areas, provides an overview of key international regulatory developments in the year under review, elaborates further on the two aforementioned international reviews and considers the 2014 thematic (or flavour-of-the-year) topics.

1.2 Bank Supervision Department's strategic focus areas

The strategic focus areas (SFAs) guide the activities of the Department to focus resources where the need is most pronounced. Each year the Department reviews its SFAs, taking into consideration the changing external environment, changes emanating from international regulatory developments, and emerging and actual trends in the South African banking sector. Good progress was made towards achieving the objectives relating to the SFAs, which included, among others, influencing international regulatory standards in the interest of both South Africa specifically and the African continent in general, participating in the design and implementation of the Twin Peaks regulatory framework, assessing risks arising from the continued expansion of South African banking groups into the African continent, embedding the principles of a forward-looking approach into the supervisory framework, and building and strengthening the Department's human resources capacity. The Department's strategy in 2015/16 will be guided by the establishment of the Bank as the Prudential Authority and any related provisions in the enacting legislation relating to the Twin Peaks model of financial regulation.

1.3 Key international developments, recommendations and focus areas

1.3.1 Introduction

As a member of the Basel Committee, and in order to ensure a level playing field between South African banks and other internationally active banks, the Department regards the full, timely and consistent implementation of internationally agreed frameworks, requirements and standards as critical.

During 2014 the Basel Committee issued various documents and further requirements[2] that will, over the next few years, materially impact on the regulation and supervision of banks and banking groups on matters such as:

- a leverage ratio framework and disclosure requirements, issued on 12 January 2014;
- guidance for supervisors on market-based indicators of liquidity, issued on 12 January 2014;
- disclosures related to the liquidity coverage ratio (LCR), issued on 12 January 2014;
- restricted version of committed liquidity facilities (CLFs), issued on 12 January 2014;
- risk management guidelines related to anti-money laundering and terrorist financing, issued on 15 January 2014;
- fundamental elements of banks' capital planning process, issued on 23 January 2014;
- the standardised approach for measuring counterparty credit risk exposures, issued on 31 March 2014;
- external audits of banks, issued on 31 March 2014;
- exposures to central counterparties, issued on 10 April 2014;
- measuring and controlling large exposures, issued on 15 April 2014;
- frequently asked questions on the Basel III framework's LCR, issued on 16 April 2014;
- principles for effective supervisory colleges, issued on 26 June 2014;
- principles for the sound management of operational risk, issued on 6 October 2014;

2. The key matters communicated by the Basel Committee in respect of these documents and requirements are summarised in Appendix 10.

- frequently asked questions on the Basel III leverage ratio framework, issued on 7 October 2014;
- the net stable funding ratio (NSFR), issued on 31 October 2014; and
- revisions to the securitisation framework, issued on 11 December 2014.

1.3.2 Ongoing development of regulatory reforms

As a member of the Basel Committee, South Africa, through the Bank and the Department in particular, contributes to the initiatives, strategies and the development of new or amended requirements and standards to comprehensively address the fundamental weaknesses revealed by the global financial crisis. The Department is also actively involved in developing regulatory reforms that promote the safety and soundness of the banking system, and that continue to support long-term economic growth.

1.4 High-level overview of key banking-sector trends

1.4.1 Banking entities registered in South Africa

The number of entities that have been registered or licensed with the Department since 2005 is presented in Table 1.1. As at the end of December 2014, the number of banking institutions reporting data to the Department remained unchanged at 31 (excluding three mutual banks, but including one institution conducting banking business in terms of an exemption from the provisions of the Banks Act 94 of 1990 (Banks Act), namely Ithala Limited). The number of international banks with authorised representative offices in South Africa declined from 43 in December 2013 to 40 in December 2014. As at the end of December 2014, one bank namely African Bank was under curatorship. Detailed commentary regarding the entities registered or licensed with the Department at the end of 2014 can be obtained from appendices 2, 3, 4, 5 and 7.

Table 1.1 South African banking sector: number of entities registered or licensed

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Banks*................................	19	19	19	19	18	17	17	17	17	17
Mutual banks.......................	2	2	2	2	2	2	2	3	3	3
Branches of international banks in the Republic of South Africa.........................	15	14	14	14	13	13	12	14	14	14
Representative offices..........	47	43	46	43	42	41	43	41	43	40
Controlling companies.........	15	15	15	15	15	15	15	15	15	15
Banks under curatorship	0	0	0	0	0	0	0	0	0	1
Banks in receivership...........	0	0	0	0	0	0	0	0	0	0
Banks in final liquidation	2	2	2	2	2	2	2	2	2	2

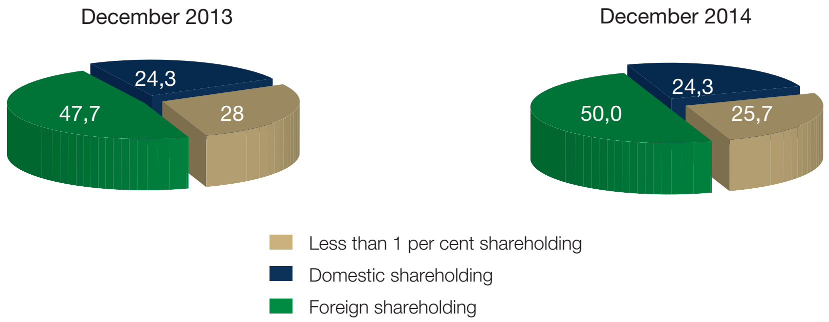
* Includes active banks and banks exempted by the Registrar of Banks (with effect from 1 July 1996) in terms of the Supervision of Financial Institutions Rationalisation Act 32 of 1996 and section 1(cc) of the Banks Act, 1990

1.4.2 Shareholding structure

The shareholding structure of South African banks is depicted in Figure 1.1. Foreign shareholders held 50,0 per cent of the nominal value of the total South African banking sector's shares in issue at the end of December 2014. The foreign shareholding of 63,5 per cent in Absa Bank Limited contributed significantly to the high percentage of banking-sector shares held by foreign shareholders. Domestic shareholders accounted for 24,3 per cent and shareholders with less than 1 per cent shareholding comprised 25,8 per cent of the nominal value of banking-sector shares in issue at the end of December 2014.

3. The data used to construct Figure 1.1 as at the end of December 2014 exclude African Bank Investments Limited.

Figure 1.1 Shareholding structure of the South African banking sector (nominal value of shares) (per cent)[3]



1.4.3 Approval of local and foreign expansions by South African banking groups

Table 1.2 South African banking sector: number of approvals for local and international expansions granted in terms of section 52 of the Banks Act, 1990

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Local	29	16	12	15	10	16	19	12	19	13
Foreign*	17	8	25	19	26	22	27	14	21	25
Total	46	24	37	34	36	38	46	26	40	38

* Excludes transactions undertaken by Investec plc

4. Refer to Appendix 8 for more information.

Table 1.2 presents the number of applications the Department has approved in terms of section 52 of the Banks Act since 2005. The majority of the applications received in 2014 were submitted by the five largest banking groups.[4]

1.4.4 Key banking-sector trends

5. All percentage movements are year on year, unless stated otherwise.

Total banking-sector assets increased by 8,8 per cent[5] to R4 179 billion at the end of December 2014 (December 2013: R3 842 billion) mainly due to a 9 per cent increase in gross loans and advances, and a 22,3 per cent increase in investment and trading securities (refer to Table 1.3). All categories of gross loans and advances grew, with the exception of loans granted and deposits placed under resale agreements. The largest measured growth in rand was in term loans (R108 billion), commercial mortgages (almost R33 billion), lease and instalment debtors (R22 billion) and overdrafts (R19 billion). Investment and trading securities increased largely due to increases of R25 billion in both government and government-guaranteed securities, and other dated securities. The gap in the banking sector's growth of assets compared to the growth in gross loans and advances widened to almost 300 basis points in June 2014 before reducing to 23 basis points in December 2014. Although the category gross loans and advances was the main driver of growth in the banking sector's balance sheet, growth in assets other than loans and advances was offset by contractions in pledged assets in the first quarter of 2014, and in derivative financial assets and other assets in the second quarter.

Table 1.3 Selected indicators for the South African banking sector

	Dec 2013	Mar 2014	Jun 2014	Sep 2014	Dec 2014
Balance sheet					
Total assets (R billions)	3 842	3 961	4 025	4 127	4 179
Total assets: year-on-year growth (per cent)	5,18	7,03	6,28	9,55	8,77
Gross loans and advances (R billions)	2 967	3 084	3 159	3 207	3 234
Gross loans and advances: year-on-year growth (per cent)	7,76	8,94	9,18	10,04	9,00
Total equity (R billions)	306	304	311	313	318
Profitability					
Cost-to-income (smoothed) (per cent)	53,65	54,11	54,74	54,32	54,39
Return on equity (smoothed) (per cent)	14,73	13,83	13,76	14,13	14,47
Return on assets (smoothed) (per cent)	1,11	1,03	1,02	1,05	1,06
Capital adequacy					
Common equity tier 1 capital-adequacy ratio (per cent)	11,77	11,51	11,37	11,12	11,38
Tier 1 capital-adequacy ratio (per cent)	12,42	12,08	11,92	11,66	11,92
Capital adequacy ratio (per cent)	15,58	14,84	14,79	14,34	14,74
Credit risk					
Impaired advances (R billions)	108	108	109	107	106
Impaired advances as a percentage of total advances (per cent)	3,64	3,51	3,44	3,35	3,27
Specific credit impairments as a percentage of impaired advances (per cent)	45,84	46,3	46,15	48,95	48,99
Specific credit impairments as a percentage of gross loans and advances (per cent)	1,67	1,63	1,59	1,64	1,6

Note:

This table presents an overview of the financial and risk information, compiled by means of the aggregation of data submitted during 2013 and 2014 from individual South African-registered banks (including domestic branches of international banks but excluding offshore branches and subsidaries of South African banks, mutual banks and cooperative banks). Information represents aggregated banks-solo information. Smoothed refers to calculations based on a 12-month moving average. Information is subject to change without notice. Banking-sector data are available at http://www.resbank.co.za/RegulationAndSupervision/BankSupervision/Banking%20sector%20data/Pages/default.aspx.

Gross loans and advances constituted 75,54 per cent (December 2013: 75,43 per cent) of the sector's assets as at 31 December 2014. Other significant asset classes included investment and trading securities, short-term negotiable securities, and derivative financial instruments constituting 7,43 per cent, 5,61 per cent and 4,96 per cent respectively of total assets as at 31 December 2014. Derivative financial instruments, as a percentage of total assets, declined compared to December 2013, whereas investment and trading securities, as a percentage of total assets, increased during the period under review. Home loans, term loans, and lease and instalment debtors comprised the most significant portion of gross loans and advances, although both home loans and lease and instalment debtors declined as a percentage of total gross loans and advances during the period under review. Assets were largely funded by deposits, current accounts and other creditors (88,13 per cent of total liabilities as at 31 December 2014), derivative financial instruments (6,22 per cent of total liabilities) and term debt (3,61 per cent of total liabilities). Fixed and notice deposits constituted 28,73 per cent of total deposits as at 31 December 2014, with current accounts and call deposits comprising the next largest portion at 20,01 per cent and 17,88 per cent respectively at the end of

6. After taking into account the losses reported by African Bank.

December 2014. Most deposits were made by corporates (42,92 per cent as at 31 December 2014), with retail customers' deposits at 24,57 per cent and banks' deposits at 12,44 per cent constituting other significant sources of deposits for the sector as at 31 December 2014. The sector continued to grow equity, with increases in both share capital (R5,6 billion) and retained earnings (R7,4 billion).[6]

The sector's smoothed return-on-equity (ROE) ratio declined slightly from 14,73 per cent in December 2013 to 14,47 per cent in December 2014. However, during the year under review the ROE and return-on-assets (ROA) ratios declined to a low of 13,04 per cent and 0,97 per cent respectively before recovering in December 2014. The decline was due to a decline in 12-month cumulative profit, largely due to a R4 billion impairment of goodwill reported by African Bank in August 2013, as well as R4,3 billion of credit losses reported by African Bank in July 2014. The smoothed cost-to-income ratio (also known as the efficiency ratio) increased marginally from 53,65 per cent in December 2013 to 54,39 per cent in December 2014. The increase was mainly due the pace of growth in operating expenses (10,52 per cent) exceeding that of operating income (9,01 per cent). A R6,9 billion increase in staff expenses was the main contributor to increased operating expenses, with increases in computer processing, fees and insurance, and other expenses contributing more than R1 billion each to the sector's expenses growth.

7. Refer to Directive 5/2013 available at http://www.resbank.co.za/Publications/Pages/Bank-Act-directives.aspx.

The banking sector's capital-adequacy ratio declined from 15,58 per cent in December 2013 to 14,74 per cent in December 2014. This decline was largely due to an increase in credit and operational risk-weighted exposures, as well as the phasing out of non-Basel III compliant capital instruments with effect from 1 January 2014. Accordingly, the total minimum capital required increased to 10 per cent with effect from 1 January 2014 as a result of the adopted phasing in of the Basel III capital requirements.[7]

8. Impaired advances are those advances in respect of which a bank has raised a specific impairment and include any advance or restructured credit exposure subject to amended terms, conditions or concessions that are not formalised in writing.

9. IRB portfolios account for 82,39 per cent of total gross credit exposure.

Impaired advances[8] reported by the sector declined by 2,08 per cent from R108 billion to R106 billion. Most of this decline in impaired advances was due to declines reported by African Bank in June 2014 as well as declines reported on credit portfolios using the internal ratings-based (IRB) approach for calculating and measuring credit risk. The ratio of impaired advances to gross loans and advances, a key ratio for assessing credit risk in the sector, declined from 3,64 per cent in December 2013 to 3,27 per cent in December 2014. This decline was due to both the above-mentioned 2,08 per cent decline in impaired advances and the 9 per cent increase in gross loans and advances in December 2014. The sector has been increasing both portfolio and specific impairments, with these two categories respectively increasing by 29,45 per cent and 4,65 per cent from R19,4 billion and R49,5 billion in December 2013 to R25,1 billion and R51,8 billion in December 2014. Default exposures reported for portfolios using the IRB approach for credit risk[9] declined by 4,95 per cent to the end of December 2014, largely due to a 13,19 per cent decline in residential mortgage default exposures. However, selected asset classes reflected increasing default exposures in December 2014, with the small and medium enterprise (SME) corporate, qualifying retail revolving credit, and vehicle and asset finance categories increasing by 38,12 per cent, 10,76 per cent and 13,78 per cent respectively. The Department continues to monitor and engage with the banking sector regarding potential risks arising in the sector.

1.5 Thematic topics for 2014

1.5.1 Introduction

10. Available at http://www.resbank.co.za/Publications/Pages/BanksActGuidance.aspx.

The Department identifies certain thematic (or flavour-of-the-year) topics to be discussed with banks' boards annually as part of its ongoing supervisory interventions. Guidance Note 2/2014[10] identified the following two topics for 2014:

1. information technology project governance; and
2. market conduct.

Banks' boards were requested to make presentations and engage with the Department on each topic. A review of the Department's interactions related to these topics is detailed in sections 1.5.2 and 1.5.3.

1.5.2 Information technology project governance

During 2013 the Department's information technology (IT) risk team conducted several on-site reviews, which revealed that some banks had numerous often-complex projects. In line with international trends, it was also observed that banks experienced difficulties with regard to the governance of IT projects. A self-assessment questionnaire to establish the adequacy of IT risk oversight in the South African banking sector was also distributed for completion. Despite several reassuring aspects of banks' IT project governance being highlighted by the questionnaire, the results indicated that banks were lacking agility (i.e. the ability to change business processes at an acceptable cost and speed, with a primary focus on projects).

Based on these findings, IT project governance was included as a thematic topic for 2014. The focus areas which the boards presented on included the following:

- processes through which boards ensured that IT project governance was robust;
- the degree to which significant IT projects affected the strategic direction of the bank;
- the value derived from investment in significant IT projects;
- independent assurance provided to boards on IT project governance; and
- the degree to which project reporting criteria were clearly defined and aligned with banks' unique requirements.

Principles prescribed in governance element 5 of King III[11] were subsequently incorporated and added to the required focus areas, namely that boards are responsible for IT governance, that IT should be aligned with the performance and sustainability objectives of banks, and that boards should monitor and evaluate significant IT investment and expenditure.

11. Institute of Directors of South Africa, *King Code of Governance for South Africa, 2009.*

Despite some deficiencies being identified across the industry, these either were or are in the process of being addressed. Generally, the view of the Department is that banks in South Africa demonstrate adequate project governance and are capable of managing their projects effectively. South African banks face similar project issues to those encountered globally and in other industries. The Department will continue to verify and follow up on the identified issues until they have been completely addressed.

1.5.3 Market conduct

Banks' boards were required to engage with the Department on the mechanisms through which the banks they govern eliminate inappropriate market conduct practices, in particular those that potentially expose banks to reputational risk.

Banks' representations addressed governance structures relating to market conduct and policies implemented to ensure acceptable behaviour and culture. The Department also expected banks' boards to indicate how they obtained comfort that all conduct-related governance structures and policies were effectively deployed across the organisation and the monitoring tools used to assess this.

From the discussions with banks' boards it was evident that market conduct and the potential reputational risk associated therewith were focus areas for banks' boards and senior management. Various frameworks and policies were accordingly developed and implemented by banks together with an increased focus on their culture.

An area of improvement identified by the Department was that boards should continue to ensure that they obtained comfort that all the policies and processes designed to ensure adequate market conduct were working effectively and as intended.

1.6 Update on the implementation of a Twin Peaks model of financial regulation in South Africa

12. Section 1.6.

13. See the policy document titled *A safer financial sector to serve South Africa better* (commonly referred to as the Red Book) released by National Treasury in February 2011.

As explained in the Department's 2013 *Annual Report*,[12] South Africa is in the process of implementing a Twin Peaks model of financial regulation. According to the policy document[13] released by National Treasury in 2011, the Bank, as the Prudential Authority, will be responsible for the prudential oversight of banks, insurers, financial conglomerates and financial market infrastructures, and will also become the Resolution Authority. The Financial Services Board will become the Financial Sector Conduct Authority (FSCA) and will be responsible for supervising the market conduct of all financial services institutions, including banks. The fundamental objectives of the implementation of the Twin Peaks model of financial regulation are to create a more resilient and stable financial system, and to strengthen consumer protection and market conduct practices in the financial sector.

Since the 2013 *Annual Report*, a number of working groups have been formed and are finalising their mandates of implementation, funding and resource requirements. In particular, the Prudential Authority Implementation Working Group (PAIWG) was established to facilitate a smooth transition to the Twin Peaks model of financial regulation with a focus on aligning the legal frameworks, creating a supervisory framework for the new regime and formalising coordination arrangements between the Bank's financial stability mandate, the Prudential Authority and the FSCA. The PAIWG is a joint effort between the Financial Services Board's Insurance Department and the Department.

The Prudential Authority will be established under the Financial Sector Regulation Bill, 2014 (FSR Bill) with the objective of promoting and enhancing the safety and soundness of financial institutions that provide financial products, market infrastructures or payment systems to protect financial customers and to assist in maintaining financial stability. The FSR Bill also gives effect to the powers of the Bank's financial stability mandate and establishes the Financial Stability Oversight Committee by giving it powers and outlining its functions.

The Twin Peaks model of financial regulation will follow a phased-in approach pending the promulgation of the FSR Bill, which will give effect to the establishment of the regulators. A second draft of the FSR Bill was released for public comment by National Treasury in December 2014. The closing date for comments was 2 March 2015.

1.7 Participation in international surveys

During the year under review the Department participated in numerous international surveys, which included the following:

1.7.1 Financial Stability Board's questionnaire on measures to be applied to non-cooperative jurisdictions

14. For more information on this initiative, refer to the FSB's website at http://www.financialstabilityboard.org/what-we-do/implementation-monitoring/initiative-on-cooperation-and-information-exchange/.

In March 2010, the FSB commenced an initiative to encourage countries to adhere to regulatory and supervisory standards on cooperation and information exchange.[14] The FSB developed various measures to promote adherence to prudential standards and cooperation with jurisdictions. As part of this initiative, an Expert Group of the FSB's Standing Committee on Standards Implementation (SCSI) conducted a survey on legal or other issues regarding members' ability to implement the various measures for addressing non-cooperative jurisdictions. South Africa, as a member jurisdiction of the FSB, participated in the survey and is committed to contributing towards similar FSB initiatives in the future.

1.7.2 The Southern African Development Community Protocol on Finance and Investment follow-up survey

One of the protocols entered into by South African Development Community (SADC) member states is the Protocol on Finance and Investment (PFI), which is designed to give effect to member states' commitments under the SADC Treaty. The Department participated in a survey that was a follow-up exercise on the survey that was discussed in previous annual reports.[15] This ongoing survey forms part of the SADC Secretariat's measurement matrix to track member states' progress in implementing the PFI. The survey addresses a wide range of topics relating to legal and operational frameworks for investment and finance in South Africa. In relation to bank supervision, the template specifically addresses compliance with the Core Principles,[16] enforcement of anti-money laundering provisions and regional cooperation and coordination in banking regulation and supervision.

15. Refer to Bank Supervision Department 2012 (section 1.7.2) and 2013 (section 1.8.1) *Annual Reports*.

16. See the Basel Committee on Banking Supervision's Core Principles for Effective Banking Supervision published during September 2012, available at http://www.bis.org/publ/bcbs230.htm.

1.7.3 Commonwealth Secretariat's study on Prioritising the Implementation of International Financial Regulation

In May and June 2014, the Commonwealth Secretariat conducted a study titled 'Prioritising the Implementation of International Financial Regulation', the results of which are to be used to develop a methodology for evaluating the effect of potential systemic risks that a member state could pose to other states. The study gathered information on various aspects of the domestic financial system, including details on deposit-taking institutions. Information collected included details such as the number and aggregate asset size of deposit-taking institutions, and the extent of interconnectedness between large domestic deposit-taking institutions and non-residents.

1.7.4 Community of African Banking Supervisors' survey of member country needs

The Department participated in the Association of African Central Bank's (AACB) Community of African Banking Supervisors' (CABS) survey to identify member countries' needs relating to banking supervision and regulation. The questionnaire was designed to identify existing gaps and shortcomings in banking supervision, and to explore areas that required urgent action at a regional and continental level. The survey focused on various aspects of supervision and regulation in each member country, including its compliance with the Core Principles, the legal and regulatory framework for banking supervision, the ongoing supervision and reporting systems used by the supervisory agency, information sharing between regulators, human resources and capacity building in the regulatory authority, and current supervisory initiatives undertaken by the regulatory authority.

1.7.5 International Monetary Fund's questionnaire on the regulation of banks' international operations

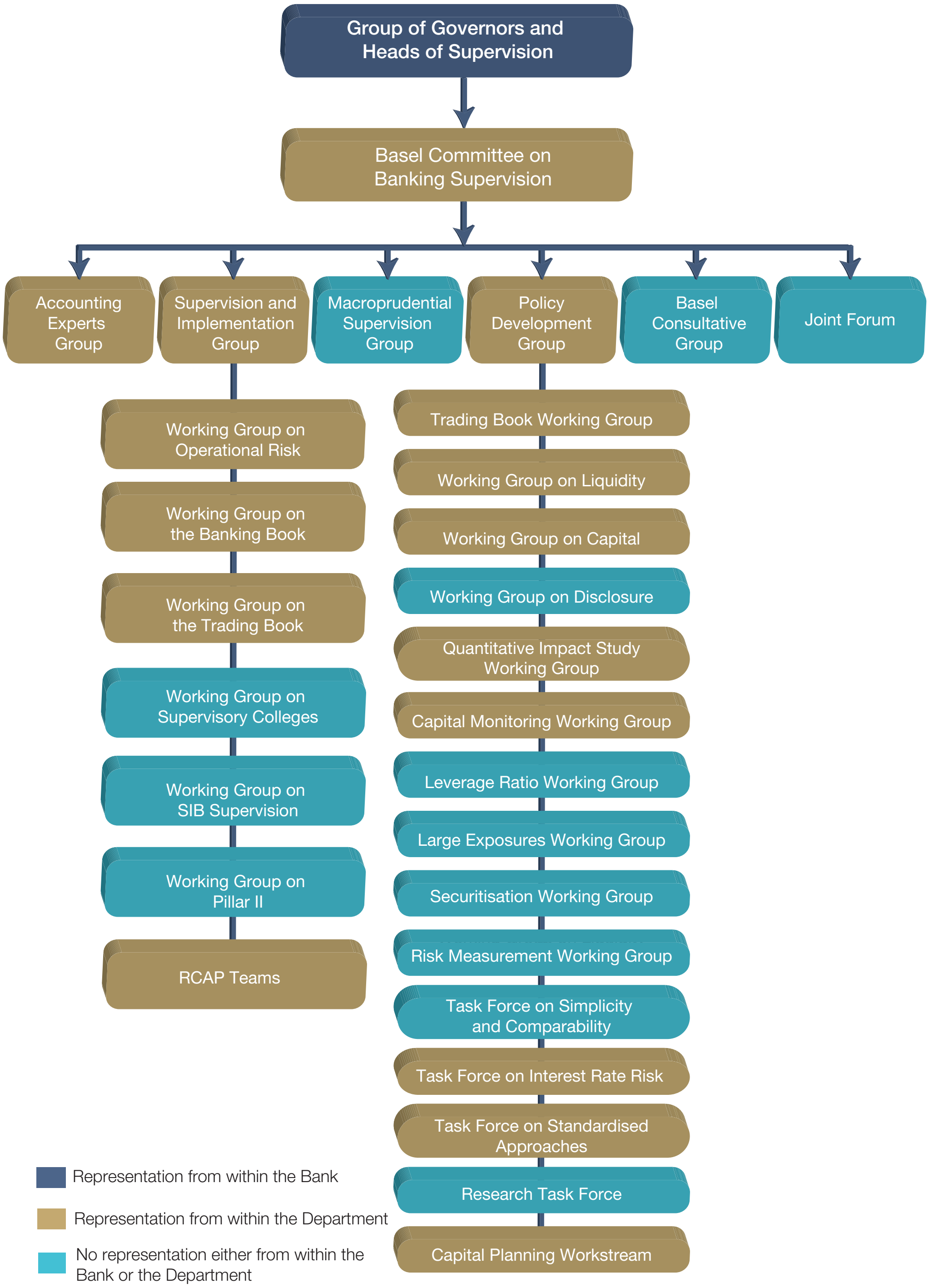
The IMF conducted a survey on the regulation of banks' international operations, with specific reference to regulations currently in place and changes that have taken place since 2006. The questionnaire explored regulation from the perspective of both banking groups domiciled in South Africa and the effect of banking groups domiciled outside of South Africa with operations in the country.

1.8 Participation in international regulatory and supervisory forums

1.8.1 Basel Committee on Banking Supervision

The Department represents South Africa on the Basel Committee and on several of its subcommittees. Representation is aimed at influencing the formulation of global regulatory standards, so that the distinct financial and social environment that South African institutions are exposed to is recognised in the rules to which the Department expects South African banks to adhere.

Figure 1.2 Structure of the Basel Committee on Banking Supervision (2014)



The main committee achieves its executive responsibilities through several subcommittees, as illustrated in Figure 1.2, which also identifies South Africa's participation. Subcommittees under the Policy Development Group are responsible for producing new regulatory standards and maintaining rules previously approved by the Basel Committee for inclusion in the Basel framework. Under the Supervision and Implementation Group, the subcommittees review the impact of changing regulations, the effectiveness and consistency of implementation of the Basel framework among jurisdictions and banks, implementation within regulatory risk areas, and the convergence between banking and other standard-setting regimes.

Work has been completed by some of the groups which will disband eventually, while the Basel Committee is also in the process of establishing new committees to address emerging topics.

Participation in the groups is generally by invitation, although the Department requests inclusion in committees when the subject matter has gained sufficient importance in the South African banking context.

The objectives of these groups are explained hereunder for groups on which the Department represented South Africa during the year under review. Focal issues being dealt with by these subcommittees are reported on where the Basel Committee has permitted public dissemination.

1.8.2 Accounting Experts Group

The Accounting Experts Group (AEG) subcommittee of the Basel Committee, which is chaired by the Registrar, takes an active role in the development of international accounting and auditing standards by standard-setting bodies such as the International Accounting Standards Board to ensure that these standards promote sound risk management at banks, support market discipline through transparency, and reinforce the safety and soundness of the banking system. The AEG also develops prudential reporting guidance where necessary.

The audit subgroup of the AEG focuses on all auditing issues affecting banks and banking supervision. International auditing standard-setting developments come under its attention, as well as any other documents emanating from the International Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants.

During 2014 the AEG closely monitored developments around the creation of accounting standards for forward-looking expected credit losses by both the International Accounting Standards Board (IASB) and the Federal Accounting Standards Board.

1.8.3 Supervision and Implementation Group

The Supervision and Implementation Group (SIG) is the peer review committee of the Basel Committee. Its mandate is to help foster financial stability by supporting strong national and international supervision and regulation of banks. It has two primary objectives, namely (a) to foster the timely, consistent and effective implementation of the Basel Committee's standards and guidelines, and (b) to advance improvements in practices in banking supervision, particularly across Basel Committee member countries.

The results of the level 2 RCAP studies that are commissioned by the Basel Committee are discussed at the SIG's meetings prior to publication. Assessments on Australia, the European Union, the United States and Canada were completed and published during 2014, with the evaluation of South Africa beginning in early 2015. Other focus areas during 2014 by the SIG included business model analysis, corporate governance and the supervisory review process, among others.

The Basel Committee work programme identified four themes for 2015, namely (a) policy development; (b) ensuring an adequate balance between simplicity and risk sensitivity across the regulatory framework; (c) monitoring and assessing the implementation the of the Basel framework; and (d) improving the effectiveness of supervision. Meetings of the SIG in 2015 will also continue to review reports on country RCAPs and build on the focus areas of 2014.

1.8.4 Working Group on Operational Risk

The Basel Committee established the Working Group on Operational Risk (WGOR) as a permanent working group to address operational risk policy and implementation issues. It reports to both the Policy Development Group (PDG) and the SIG.

The primary focus of WGOR relates to the development of policy and the practical challenges accompanying the successful development, implementation and maintenance of an operational risk framework that addresses the requirements and expectations of the Basel Committee's allowed approaches for the calculation of regulatory capital.

The focus for 2014 included the following:

- finalising and publishing a consultative document in relation to the revisions to the simpler approaches and hosting an industry meeting to obtain comments, feedback and input;
- conducting a review of the principles for the sound management of operational risk and publishing the key findings and observations; and
- advanced measurement approach (AMA) benchmarking and streamlining of practices.

South Africa is further an active member on both the Principles for the Sound Management of the Operational Risk and Advanced Measurement Approach Benchmarking sub-workstreams.

1.8.5 Working Group on the Banking Book

The SIG Banking Book (SIG-BB) subgroup is a workstream of the SIG and was initially established to evaluate differences in risk-weighted assets (RWAs) across banks using the IRB approach for credit risk, assess their compliance with RWA calculations according to the Basel framework's standards and develop recommendations to encourage the convergence of practices. In addressing these tasks, the initial work performed by the SIG-BB culminated in a public report titled *Regulatory Consistency Assessment Programme: analysis of risk-weighted assets for credit risk in the banking book*.[17]

17. Available at http://www.bis.org/publ/bcbs256.htm.

The initial work performed covered only banks' wholesale portfolios (i.e. corporate, bank and sovereign exposures). Thus, at its September 2013 meeting, the Basel Committee requested the SIG-BB to prepare a programme for further analytical work. The programme consisted of additional analysis of core portfolios not yet subject to in-depth studies and work on formulating guidance on specific issues to improve regulatory and supervisory practices influencing the consistency of RWA calculations.

During the course of 2014 and the first quarter of 2015, the SIG-BB performed a benchmarking exercise on the retail and SME portfolios of selected banks, further analysed the impact of the exposure at default (EAD) parameter on RWA variation, and produced guidance on specific issues to improve regulatory and supervisory practices influencing the consistency of RWA calculations. Selected South African banks were included in the data request with respect to the EAD parameter. The work of the SIG-BB will be completed by June 2015, following which a public report will be issued.

1.8.6 Working Group on the Trading Book

The SIG Trading Book (SIG-TB) subgroup is a workstream of the SIG established in 2012 to analyse reasons for differences in RWA in the trading book across different jurisdictions. This analysis forms part of the wider RCAP initiated by the Basel Committee in 2012. The aim of the RCAP is to ensure consistent implementation of the Basel III framework, help strengthen the resilience of the global banking system, maintain market confidence in regulatory ratios and provide a level playing field for banks operating globally.

During the period under review the SIG-TB extended its initial focus area conducted in prior years to cover the analysis of RWA for counterparty credit risk (CCR). The CCR hypothetical portfolio exercise (HPE) covers the last block of the internal model method (IMM) for trading book positions. Specifically, the CCR HPE covers the internal model approaches for CCR exposures for over-the-counter (OTC) derivative positions. The exercise included qualitative questionnaires covering IMM and credit valuation adjustment (CVA) modelling approaches, and a quantitative HPE covering risk measures for IMM effective expected positive exposure (EEPE), stressed EEPE, CVA and stressed CVA. In addition, the SIG-TB collects information on the status of regulatory model approval for IMM and CVA models.

1.8.7 Regulatory Consistency Assessment Programme teams

Among the global regulatory reforms, the complete, consistent and timely implementation of global regulatory standards took priority during the year under review. The Basel Committee adopted a comprehensive programme to assess its members' implementation of the latest standards published under its direction, which make up the Basel III framework. The RCAP is administered at the Bank for International Settlements (BIS) under the Basel Committee with the support of specialist contributors who are drawn from the membership group.

Assessments are conducted at various levels, including risk-specific themes, such as risk-based capital and jurisdictional assessments. All of the Basel Committee's member countries are scrutinised under the jurisdictional programme, which consists of two separate phases covering risk-based capital standards and liquidity standards respectively.

During the course of the assessment, a specialist team reviews information submitted by the jurisdiction's banking authority, raises questions clarifying statements made, and requests supportive data to ascertain the materiality of deviations before conducting further review work on the premises of the banking authority. Banks are often questioned as part of the jurisdictional assessment. Following the finalisation of the assessment team's report, a review team independently examines the findings before a review panel concludes the assessment and the results are published.

Specialists in the Department have been selected to lead or support the work of assessment teams in other jurisdictions and as members of review teams. Jurisdictions whose assessments the Department's staff have or will contribute to include Switzerland, Australia, India, the United States, Mexico, Saudi Arabia and Russia.

1.8.8 Policy Development Group

The PDG assesses changes to banking regulations that are proposed by its subgroups and other workstreams of the Basel Committee. It serves the Basel Committee by identifying issues, commissioning research, overseeing quantitative analysis and making recommendations on policy which the Basel Committee has the discretion to adopt. It also reviews emerging supervisory issues aimed at promoting a sound banking system and high supervisory standards. The PDG has several executive subgroups and workgroups reporting to it on a wide range of risk and capital issues. The Department is represented on the PDG and many of its subgroups where the subject matter is relevant to South Africa.

1.8.9 Trading Book Working Group

South Africa has been a member of the Trading Book Working Group (TBG) since 2007. The TBG deals with market risk in its various forms, including the trading book.

The financial crisis exposed significant flaws in the existing regulatory capital approach to market risk and trading activities. While some of the issues have been addressed in the revisions to the market risk capital framework that were released following a Basel Committee meeting in July

2009, the Basel Committee agreed that a fundamental review of the framework is required, in particular of whether or not the distinction between the banking and trading books should be maintained, how trading activities are defined, and how risks in the trading books (and possibly market risk more generally) are captured by regulatory capital. It is in this regard that the TBG embarked on what came to be known as the fundamental review of the trading book (FRTB).

The outcome of the FRTB is being communicated to the banking industry at various stages for comments in the form of consultative papers. Thus far, three consultative papers have been issued, with comments on the third consultative paper being received in February 2015.

1.8.10 Working Group on Liquidity

The Working Group on Liquidity (WGL) deals with the two main standards relating to liquidity and funding, namely the LCR and the NSFR.

The NSFR is defined as the amount of available stable funding[18] relative to the amount of required stable funding, and should never fall below 100 per cent. Its aim is to limit over-reliance on short-term wholesale funding, encourage better assessment of funding across all on- and off-balance-sheet items, and promote funding stability over a longer term. The NSFR is subject to a monitoring period before it will become a statutory requirement. Formal monitoring commenced on 1 January 2013, with the NSFR becoming a prudential requirement from 1 January 2018.

The Department has been actively involved in the design of the NSFR through its involvement in the WGL and other various Basel Committee committees where the ratio has received attention, and where decisions about its implementation have been made. The considerable effort expended in creating an agreed standard has culminated in the release of the finalised framework for the NSFR.[19]

18. Available stable funding is defined as the portion of capital and liabilities expected to be reliable over the time horizon considered by the NSFR, which extends to one year. The amount of such stable funding required by a specific institution is a function of the liquidity characteristics and residual maturities of the various assets held by that institution as well as those of its off-balance-sheet exposures.

19. Available at http://www.bis.org/publ/bcbs230.htm.

1.8.11 Working Group on Capital

The Working Group on Capital (WGC) was established early in 2013 and combines two groups that deal with issues related to capital: the Definition of Capital Subgroup and the Contingent Capital Working Group. These two groups merged into the WGC, which is responsible for handling all policy issues associated with the definition of capital under Basel III and capital-like instruments.

A key aspect being formulated by the WGC is the minimum eligibility criteria for total loss-absorbing capacity (TLAC) instruments in conjunction with the FSB. The objective of minimum TLAC requirements is to ensure that global systemically important banks (G-SIBs) have sufficient loss-absorbing and recapitalisation capacity necessary to ensure that during or immediately after the resolution of a bank, the critical functions can be continued without public funds or financial stability being put at risk. The impact of the TLAC requirements will be collated, assessed and analysed during 2015 by means of additional quantitative impact studies (QISs).

1.8.12 Capital Monitoring Working Group

The Department contributed to the work of the Capital Monitoring Group (CMG), which monitors the level and cyclicality of minimum required capital produced under the Basel 2.5 and Basel III frameworks. Since Basel III has now been implemented, the focus of the quantitative analyses produced by the PDG's working groups has shifted towards the monitoring of Basel III implementation and the QIS work related to its current policy initiatives. During 2014 the CMG merged with the QIS Working Group.[20] The combined group will in particular remain responsible for the design of the capital monitoring reporting templates and the analysis of bank-level parameters (e.g. capital requirements, eligible capital and capital ratios).

20. Also see section 1.8.13.

1.8.13 Quantitative Impact Study Working Group

The Basel Committee established the QIS Working Group to calibrate the Basel III rules and to assess their impact on participating banking groups in member countries. Although a number of Basel Committee member countries implemented the Basel III framework during 2013, the QIS exercise continues to take place semi-annually with end-June and end-December reporting dates.

As a result of the implementation of Basel III in member countries, the focus of the quantitative analyses produced by the PDG's working groups (i.e. the CMG and the QIS Working Group) shifted towards the monitoring of Basel III implementation and the QIS work related to current policy initiatives. As a result it was decided by the Basel Committee in July 2014 that the QIS working group should be merged with the CMG.

Apart from collecting data on Basel III implementation monitoring, the focus of the 2014 QIS exercises was on collecting data supportive of assessing active policy initiatives underway across the Basel structures. These included the impact of proposals made in the FRTB and changes to the operational risk measurement framework, interest rate risk in the banking book and credit spread risk in the banking book. Future exercises will include an impact assessment of the revised standardised approach to credit risk (including a revision of the capital floors), a hypothetical test portfolio study of the IMM and an assessment of the impact of the new TLAC requirements.

The Basel Committee published the documents titled *Basel III monitoring report* and *Analysis of the trading book hypothetical portfolio exercise*[21] during September 2014. These documents detail the results of the QIS exercise as at 31 December 2013. The reports incorporated the data of the participating South African banking groups. Furthermore, it is the intent of the Basel Committee to continue publishing the results of the Basel III monitoring exercise during 2015.

21. Available at http://www.bis.org/publ/bcbs288.htm.

Both the Department and the participating banks continued to find value in participating in these studies and will continue to actively engage in such surveys in 2015.

1.8.14 Task Force on Interest Rate Risk

Proceeding from the work carried out under the FRTB by the TBG, the Basel Committee, under the PDG, created a Task Force on Interest Rate Risk (TFIR) to examine options for capturing interest rate risk and credit spread risk in the banking book in the capital framework. During 2014 the TFIR investigated the development of a Pillar 1 and Pillar 2 option for these risk types, and is in the process of enhancing the work done by the Basel Committee in 2004. A consultation paper is expected to be circulated for comment in the first half of 2015.

1.8.15 Task Force on Standardised Approaches

Since its inception in 2006, various structural weaknesses in the standardised approach for credit risk have become increasingly apparent. The recent global financial crisis further exposed these structural weaknesses and accordingly necessitated a revision of the standardised approach for credit risk. Some of these weaknesses include an over-reliance on external credit ratings, a lack of risk sensitivity, particularly for off-balance-sheet exposures, and some inconsistencies of interpretation both between the standardised and advanced approaches, and across different jurisdictions.

In light of these weaknesses, the Basel Committee took a decision to establish the Task Force on Standardised Approaches (TFSA) with the primary mandate of proposing some revisions to the standardised approach. The key mandate of the TFSA is to:

1. ensure the standardised approaches for credit and operational risk continue to be suitable for assessing the capital adequacy of internationally active banks, as well as other banks that are not using the advanced approaches for credit and operational risk;
2. ensure that the calibration of capital requirements under the standardised approaches reflects, to a reasonable degree, the inherent riskiness of positions for all main categories of exposures;

3. seek to strengthen the link between the standardised approaches and measures of risk based on banks' internal models; and

4. seek to reduce or remove, where possible, the reliance on external ratings, including developing supplementary measures for risk classification and encouraging stronger supervisory practices to promote alternative measures for risk assessment.

Pursuant to this mandate, the TFSA issued a consultative paper for public comment in December 2014.

1.8.16 Anti-money Laundering/Combating the Financing of Terrorism Expert Group

The Basel Committee's Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) Expert Group (AMLEG) develops guidance to banking institutions on how to implement the provisions of the Core Principles dealing specifically with the abuse of financial services and AML/CFT standards by producing technical and practical guidance applicable to national and international banks and banking groups. AMLEG also gives inputs to Financial Action Task Force (FATF) standards, guidance papers and public statements relating to AML/CFT matters. In 2014, the Department provided inputs to the Basel Committee's review of the 2003 *General guide to account opening and customer identification* to be published in 2015.

1.8.17 Eastern and Southern Africa Anti-Money Laundering Group

A number of meetings by the Eastern and Southern African Anti-Money Laundering Group (ESAAMLG) were held during the year. Matters considered in relation to the ESAAMLG region included the following:

- money laundering through money or value transfer and currency exchange service providers, poaching and illegal trade in wildlife and wildlife products, money laundering through the securities market industry, and financial inclusion and AML/CFT controls; and
- member countries' AML/CFT status reports and ESAAMLG membership applications from different countries.

The Department and the Financial Intelligence Centre (FIC) were given the opportunity to present to ESAAMLG members South Africa's AML/CFT progress towards addressing the findings of the 2009 FATF mutual evaluation conducted on South Africa.

1.8.18 Financial Action Task Force meetings

The FATF working groups and plenary meetings for 2014 focused on the following matters:

- FATF and G-20 held a joint meeting to bring together AML and CFT experts and corruption experts to discuss issues of common interest relating to transparency of beneficial ownership.
- The Department participated in drafting the risk-based approach and the transparency and beneficial ownership guidance issued by FATF.
- The Department also provided inputs to FATF publications on terrorist financing in West Africa, money laundering and terrorist financing through trade in diamonds, risk of terrorist abuse in non-profit organisations, and financial flows linked to the production and trafficking of Afghan opiates.
- The Department participated in the development of money-laundering risk definitions for virtual currencies.

1.8.19 Community of African Bank Supervisors of the Association of African Central Banks

The AACB, at its meeting of 26 February 2014 held in Dakar, Senegal, authorised the 2014 CABS interim programme and, in August 2014, adopted the three-year work plan by the Assembly of Governors. The interim 2014 work plan provides for the Bank to lead one of the two working groups to be established, namely that on cross-border banking supervision. The first working group on cross-border banking supervision will be hosted by the Bank in May 2015.

1.9 Participation in domestic regulatory and supervisory forums

During the year under review the Department continued to serve on, and participate in numerous domestic committees, task groups and working groups to consult with banking industry participants and bodies, external audit bodies, government departments and other financial regulatory authorities on relevant matters. These bodies include National Treasury's committees and initiatives, the Banking Association of South Africa (BASA), the South African Institute of Chartered Accountants (SAICA), the Committee for Audit Standards (CFAS), the Financial Services Board, the National Credit Regulator (NCR), the FIC and the Independent Regulatory Board for Auditors (IRBA).

The objective of these interactions is topical and ranges from ongoing consultation on detailed complexities in the regulatory environment, to operational and systemic concerns arising from economic developments or developments in the regulatory environment. These interactions enable the Department to stay abreast of developments across a wide spectrum and to monitor their potential impact on the domestic banking industry.

In a collaborative effort the Department, in conjunction with several other departments in the Bank and together with inputs obtained from the banks via BASA, developed a framework for the CLF. The CLF is available to all commercial banks to assist them in meeting the stricter requirements of the revised LCR that became effective on 1 January 2015. The CLF framework was based on the requirements from the Basel Committee and was designed to, as far as possible, fit into the existing processes of the Bank. The CLF essentially enables banks to unlock liquidity from otherwise illiquid, but nevertheless high-quality, assets. The CLF therefore enables local banks to meet the LCR despite the shortage of high-quality liquid assets in the South African economy, thereby minimising the potential negative impact it could have on business activity.

1.10 Regional cooperation and interaction

1.10.1 Financial Stability Institute: high-level meeting for African banking supervisors

The ninth Financial Stability Institute (FSI) high-level meeting for banking supervisors was held in Cape Town, South Africa, from 30 to 31 January 2014. As in previous years, the meeting was jointly hosted by the FSI and the Department. The theme for the 2014 meeting was 'Strengthening financial sector supervision and current regulatory priorities'.

1.10.2 Southern African Development Community Committee on Banking Supervision

At the annual meeting of the Committee of Central Bank Governors held on 19 March 2014 in Namibia, the Governors decided to hold the next meeting of the SADC Subcommittee on Banking Supervisors (SSBS) in Maputo, Mozambique from 26 to 28 May 2014. The meeting was hosted by the Bank of Mozambique. Heads of banking supervision were invited to participate in the SSBS meeting.

Issues that were discussed at this meeting included the draft SADC Model Bank Law, Basel III, the financial soundness indicators, AML policies and the development strategy for the SSBS.

1.10.3 Macroeconomic and Financial Management Institute of Eastern and Southern Africa

A regional workshop on Consolidated Supervision and Cross Border Investment was held by the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI) in Arusha, Tanzania from 28 July to 1 August 2014. South Africa was one of 13 African countries that attended the workshop.

1.10.4 IMF Institute for Capacity Development/ African Training Institute

The African Training Institute of the Institute for Capacity Development held a course on the core elements of banking supervision in Ebene, Mauritius during June and October 2014.

The course in June provided micro- and macroprudential supervision training to 36 representatives from 14 countries from sub-Saharan Africa. The same course was offered to an audience of Francophone and Anglophone Africans in October 2014. This course was attended by 25 participants of which 14 were from Francophone Africa and 11 from Anglophone Africa. The Department provided technical assistance for both these courses.

1.11 Curatorship of African Bank Limited

African Bank was placed under curatorship on 10 August 2014 by the Minister of Finance after consultation with the Registrar. Mr Tom Winterboer of PricewaterhouseCoopers was appointed by the Registrar as the curator of African Bank and assumed responsibility for the management of the bank. Information at the disposal of the Department at the time of imposing the curatorship indicated that African Bank was illiquid yet solvent, and consequently the decision was made to continue the operations of the bank under curatorship.

The sharp decline in the share price of African Bank's holding company, African Bank Investments Limited (ABIL), together with the liquidity stress experienced by African Bank for an extended period prior to curatorship, emanated from a number of factors, which all contributed to an erosion of confidence and trust in African Bank. These events resulted in African Bank being unable to attract new funding and roll existing funding.

In terms of section 69 of the Banks Act, the Registrar appointed Adv. J F Myburgh as Commissioner to investigate whether any business of African Bank had been conducted recklessly, negligently or with the intent to defraud depositors, other creditors or any other person for any other fraudulent purpose, or whether the business of African Bank involved questionable management practices or material non-disclosures with the intent to defraud depositors or other creditors. The Commissioner's report was released in March 2015. Following the events leading to African Bank's curatorship, the Department has considered its supervisory practices and procedures with a view to future changes and enhancements.

1.12 International Monetary Fund's assessment of the Core Principles

The IMF conducted an assessment of the current state of implementation of the Core Principles as part of a Financial Sector Assessment Programme (FSAP). The detailed assessment report on South Africa's compliance with the Core Principles was published in March 2015 and a summary was included as part of South Africa's *Financial System Stability Assessment*.[22] Key findings from the assessment are as follows:

- South Africa has a high level of compliance with the Core Principles; and
- the Department has made significant improvements to its supervisory framework since the previous assessment conducted in 2010.

Some of the key recommendations cited for improvement include the following:

Core Principle	IMF recommendation
1 Responsibilities, objectives and powers of the supervisor	The legislation should be amended to address the lack of legally defined objectives of the supervisor as well as regulation and supervision of banks. The assessors explained that the Banks Act did not provide the objectives of the Department or the Registrar. The assessment also suggested a review of the extent of delegation of powers in the Banks Act with a view of transferring the power to set granular requirements to lower-tier legislation (i.e. to set out granular requirements in tier 3 legislation such as circulars and directives), which can be issued by the Registrar, rather than in tier 2 legislation (Regulations relating to Banks or the Regulations), which need to be issued by the Minister of Finance (the Minister). A further recommendation in this area was that the composition of the Standing Committee for the Revision of the Banks Act should be reviewed to avoid potential conflicts of interest by members representing industry.
2 Supervisory independence, accountability, resourcing and legal protection	The legal framework regarding the appointment and removal processes of the Registrar should be revised to include a fixed term of appointment, specific reasons for his/her removal, and the requirement to publish the reasons for removal. It also recommended a review of the legislative references to the Minister to limit the cases that require his/her involvement to only those absolutely necessary and clarify in the laws objectives for intervention. Another recommendation in this area was a review of the adequacy of the Department's resources in light of the expected changes in the responsibility of the supervisor under the new Twin Peaks structure and considering the need for further improvements to its supervisory approach.
8 Supervisory approach	Enact new legislation to provide the supervisor power related to the expeditious resolution of banks and develop resolution plans, and that the newly formed Prudential Authority "should review the supervisory approach to equip it with capacity to monitor the prudential risk of the entire financial system as well as that of financial conglomerates".
11 Corrective and sanctioning powers	The legislative framework should be strengthened "to provide the supervisor with the power to suspend or limit a bank's activities without delay" and that the supervisor should be provided with "the power to fine individuals related to banks".
13 Home-host relationships	The supervisory authority should "continue efforts to support the capacity building of host supervisors of African operations of South African banking groups to further improve the effectiveness of cooperation and ensure adequate oversight of those operations". The supervisory authority should also "finalise policies, processes and practices to conduct on-site reviews/inspections of South African banks' cross border operations in other African countries". Another recommendation relating to home-host relationships was for the supervisory authority to "enhance its effort in cross-border recovery and resolution planning with close collaboration with the UK authorities as well as paying due regards to the impact on financial systems of jurisdictions where South African banks' operations are significant. This will also require close cooperation with supervisory authorities in these jurisdictions".
28 Disclosure and transparency	Pillar 3 disclosures should be reviewed "consistently either by [the Department's] internal staff or by requiring external auditors to do it".
29 Abuse of financial services	The responsible authorities should "proceed with the planned revision of the Financial Intelligence Centre Act 38 of 2001 (FIC Act) to incorporate the risk-based approach to the AML/CFT issues and ensure the enforceability of a number of essential elements currently included in the FIC Act Guidance Notes". The report also recommended that the authorities "continue the current effort on the AML/CFT on-site inspections to cover all banks expeditiously and improve approaches and techniques based on the lessons learned".

22. Available at http://www.imf.org/external/pubs/ft/scr/2014/cr14340.pdf.

The Department experienced the assessment as very constructive and values the IMF's input to strengthen its functioning and supervisory processes. Going forward, the Department will consider recommendations made that fall within its control, particularly during the process of forming the Prudential Authority in terms of the Twin Peaks framework.

1.13 Basel Committee on Banking Supervision's Regulatory Consistency Assessment Programme

Full, timely and consistent implementation of the Basel standards (i.e. Basel II, Basel 2.5 and Basel III) within the internationally agreed timelines is fundamental to raising the resilience of the global banking system. Similarly, implementation of and adherence to such standards and timelines by the Department are crucial for maintaining confidence in the domestic financial system, and for providing a level playing field for internationally active banks operating in different jurisdictions.

As part of its post-crisis reform efforts, the Basel Committee established the RCAP to assess members' implementation of the Basel standards. The assessments are conducted by a team of regulatory specialists from other Basel Committee member countries. The objective of the RCAP is not to assess individual banks or system-wide preparedness to meet Basel standards, but rather to assess the consistency of domestic regulations with Basel standards and prescribed phase-in periods.

The Department endorses the Basel Committee's post-crisis reform efforts and the RCAP in particular. To this end, the Department has been following developments in member jurisdictions closely where the Basel standards are being implemented, including the reports on the outcome of the RCAP in those jurisdictions.

South Africa was also subjected to an RCAP assessment, which commenced during the latter part of 2014. The RCAP for South Africa focused on both risk-based capital and Basel III standards on liquidity. The first phase of the RCAP requires countries to conduct a self-assessment of their compliance with the Basel standards. The completed self-assessment questionnaire is then used by the RCAP team as the foundation for the detailed on-site review. The second phase comprises the RCAP team conducting an on-site review, whereafter an off-site review, approval and publication process is conducted prior to the RCAP team's findings being released.

A review panel scrutinises the assessment team's recommendations and the joint assessment is then discussed by a Peer Review Board that presents final conclusions at a meeting of the Basel Committee, which has the final responsibility for approving and enforcing the recommendations of the RCAP report. After obtaining the Basel Committee's formal approval, the report, including a specific response from the assessed jurisdiction, is published on the Basel Committee's website. The report on the outcome of South Africa's RCAP is expected to be finalised by June 2015.

The Department has embraced the RCAP and will use this opportunity to strengthen and enhance South Africa's regulatory framework with the ultimate aim of eliminating all areas of material inconsistencies.

1.14 Issues to receive particular attention during 2015

The Department intends to continually review, amend and update the regulatory and legislative framework in accordance with the latest internationally agreed regulatory and supervisory practices and standards. Other areas receiving attention include:

- ongoing monitoring of compliance with all new standards and/or requirements issued by the Basel Committee;
- the completion of the Basel Committee's RCAP assessment;
- the completion of the Myburgh Commission's investigation into African Bank Limited;
- ongoing implementation of the Prudential Authority in terms of the Twin Peaks model of financial regulation;
- continued monitoring of the banking sector's capital adequacy and compliance with the Regulations relating thereto;
- assessment of the compliance of new additional tier 1 and tier 2 capital issuances against the Basel III criteria as set out in the Regulations and against Guidance Note 7/2013;[23]
- continued focus on internal capital adequacy assessment processes (ICAAPs) and in particular economic capital modelling, stress testing and capital planning; and
- assessment of the implementation readiness of both banks and external auditors of banks relating to IASB's International Financial Reporting Standard 9 on accounting for expected credit losses.

23. Available at http://www.resbank.co.za/Publications/Pages/BanksActGuidance.aspx.

1.15 Expression of gratitude

I wish to express my appreciation to the Minister of Finance, Mr Nhlanhla Nene, for his input on requests in terms of statutory requirements. To the former Governor of the Bank, Ms Gill Marcus, current Governor Lesetja Kganyago and Deputy Governor Francois Groepe: thank you for your ongoing cooperation, guidance and support during 2014.

My sincere appreciation also goes to the staff members of the Department for their continued efforts and willingness to repeatedly go beyond the call of duty to meet the challenges and demands of an ever-changing supervisory and regulatory landscape.

René van Wyk
Registrar of Banks