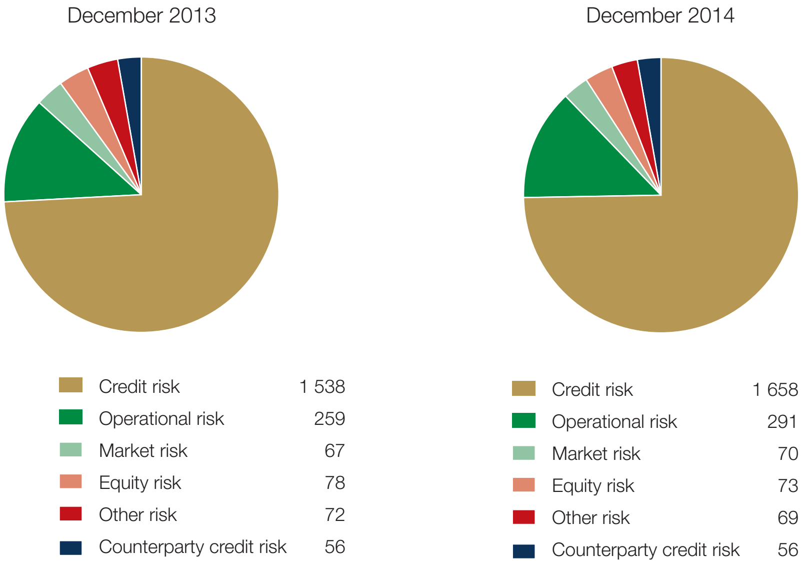
Chapter 2: Overview of supervisory activities

2.1 Introduction

This chapter provides an overview of the operations of the Department during the period under review at an industry level according to focused aspects of bank supervision that are common across banks. Figure 2.1 gives an indication of the aggregated risk profile of the banking sector as at 31 December 2013 and 31 December 2014. Figure 2.1 is limited to those risks that are quantifiable in terms of the Regulations and for which the sector is required to hold regulatory capital. However, the banking sector is also exposed to other risks that are not quantified in terms of Basel III (such as interest rate risk in the banking book). Credit, operational and market risk constituted the most significant risks that the banking sector was exposed to as at 31 December 2013 and 31 December 2014.

Figure 2.1 Composition of risk-weighted exposure

(R billions)



2.2 Credit risk

2.2.1 Introduction

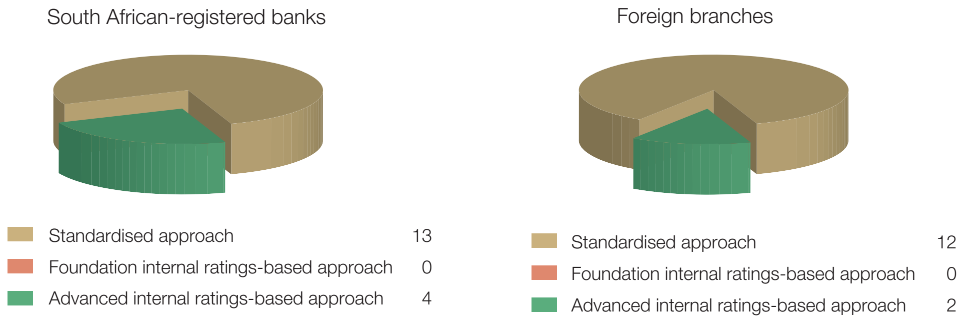
During 2014 credit risk remained a key focus area of the Department, considering the challenging economic environment and the continued high level of household indebtedness. The Department continued to monitor the impact of market conditions on South African banks' credit risk profiles and portfolios through a number of initiatives.

Under the regulatory framework employed in South Africa, banks can choose from the following three methodologies to calculate their minimum required regulatory capital relating to credit risk:

1. the standardised approach, including the simplified standardised approach;
2. the foundation internal ratings-based (FIRB) approach; and
3. the advanced internal ratings-based (AIRB) approach.

The number of banks registered in South Africa using each of the aforementioned approaches is depicted in Figure 2.2.

Figure 2.2 Credit risk reporting methods applied by banks as at 31 December 2014



2.2.2 Directive on restructured credit exposures

As reported in the 2013 *Annual Report*,[24] the Department embarked on a process to obtain a clearer understanding of how banks identified and controlled restructured credit exposures and how banks reported these on the statutory returns. Based on the data gathered and the discussions held with banks during the past two years, the Department issued Directive 9/2014[25] in December 2014, dealing with the identification of distressed restructures, the treatment of restructures for purposes of the definition of default and the rehabilitation of exposures through restructuring. The directive also clarifies the reporting requirement for restructured credit exposures. The aim of the directive is mainly to improve data comparability and promote the correct application of the definition of default for purposes of regulatory capital calculation. It also introduces a more conservative approach to the rehabilitation of loans by requiring six consecutive monthly instalments before a restructured exposure can be considered as 'performing'. The directive became effective on the date of issue; however, some banks indicated that even though they were compliant with certain elements, it would take some time to complete the system development which would be required in order to meet the full requirements. Timelines for full compliance were provided to the Department and follow-up reviews will be conducted during the latter part of 2015 to determine banks' level of compliance.

24. Section 2.2.6.

25. Available at http://www.resbank.co.za/Publications/Pages/Bank-Act-directives.aspx.

2.2.3 Commercial property thematic on-site reviews

The Department identified that banks experienced difficulty in terms of implementing rating systems and performing the prescribed annual re-rating of their commercial property portfolio during model-specific discussions with banks applying the IRB approach. The main reasons identified for the difficulty experienced were the significant number of inputs required and the additional costs banks may experience due to the need for more frequent property valuations. In addition, the complexity of the methodologies used for the calculation of probability of default and loss given default parameters in terms of these portfolios, and the long-form review process not specifically being tailored to assess simulation methodologies further highlighted the need for increased focus in this regard.

During 2014 the Department conducted a commercial property finance thematic review which covered, inter alia, (a) the review of banks' credit risk management processes pertaining to their respective commercial property finance portfolios to ensure that appropriate regulatory capital is maintained in respect of these portfolios, and (b) the investigation of holistic business practices to gain a better understanding of banks' commercial property finance portfolios.

The review was conducted at the five largest banks and each bank was required to complete a questionnaire which provided the Department with quantitative information and a list of relevant documentation. Various meetings were also held with relevant representatives of each bank, consisting of sessions of model development and validation, monitoring and capital, use and business impact, and pricing and impairments.

The Department is in the process of finalising the review and concluding industry trends. Feedback from an industry-wide perspective was provided to participating banks during the first half of 2015.

2.2.4 Model changes

The quantitative characteristics and qualitative thresholds for a material model change where prior written approval is required from the Department were introduced during May 2013 through the issuance of Directive 6/2013.[26] Potential areas of refinement were identified during the Department's formal approval process and through discussions with banks. This resulted in the amendment of quantitative and qualitative requirements and the directive was replaced by Directive 2/2014 issued in July 2014.

26. Available at http://www.resbank.co.za/Publications/Pages/Bank-Act-directives.aspx.

During 2014 the Department received 81 notifications of non-material changes and 37 submissions of material changes to the IRB banks' rating systems. The Department continued to follow a robust review and approval process as highlighted in the 2013 *Annual Report*.[27]

27. Section 2.2.5.

2.2.5 Regulatory developments

The TFSA's focus during 2013 was to identify the weaknesses in the existing standardised approach for credit risk and to propose alternative ways forward. As mentioned in chapter 1,[28] the TFSA issued a consultative paper for public comment in December 2014.[29] The revised standardised approach will bring with it significant changes and, given that most banks registered in South Africa use the standardised approach to report credit risk for the purpose of calculating the minimum regulatory capital requirements (refer to Figure 2.2), the Department closely followed developments and monitored the potential impact on the South African banking sector.

28. Section 1.8.15.

29. Available at http://www.bis.org/bcbs/publ/d307.htm.

2.2.6 On-site reviews

The Department's review team conducted on-site reviews focusing on two different products types, namely unsecured personal loans and residential mortgages. During 2014 the focus was on obtaining an understanding of banks' risk management processes relating to personal loans within the unsecured loans portfolio. The reviews were conducted at selected South African banks and assessed the following:

- the adequacy and effectiveness of the banks' collections and recovery policies, procedures and processes;
- consideration of whether the banks' processes used for determining the level of specific impairments is reasonable given the historical loss experience;
- the reasonableness of loan classifications and the valuation of collateral, and how such practices relate to the banks' approved policies;
- the accuracy of the reporting of defaulted exposures in the banks' collections and recovery process;
- the adequacy of the banks' management information in facilitating effective monitoring and risk management of the portfolio; and
- the adequacy and robustness of governance provided by banks' boards and senior management, including the processes in respect of loans in the collections, and legal and recovery processes.

During the third quarter of 2014, a review of the residential mortgages portfolio of smaller banks was conducted. The main purpose of the review was to ascertain the reasonableness of the amount of credit impairments these bank helds to support their credit activities. The evaluation in this regard encompassed the following:

- the appropriateness of the bank's credit risk underwriting policies, procedures and practices relating to the mortgage book and the bank's adherence thereto;
- the adequacy of the process for the bank's determination of overdue exposures and impairments as guided by the relevant policies;
- the appropriateness of the policies and procedures relating to the restructuring of loans and the correct application thereof;
- the appropriateness of the bank's write-off practices, the rationale behind its write-off policy and an assessment of losses incurred where properties had been liquidated; and
- the determination of legal statuses and the values of the securities the bank held.

Generally, the banks reviewed during 2014 remained committed to remediating deficiencies identified during the reviews.

2.3 Market risk

2.3.1 Market risk reviews

The Department performed both compliance-based and risk-focused supervision of market risk during the period under review. Market risk reviews conducted in 2014 focused on banks using the internal models approach for regulatory purposes. Reviews of certain banks' treasury and securities operations also took place. The Department completed one review on equity risk in the banking book, with further reviews scheduled for 2015. In addition, the Department conducted CCR reviews on selected banks.

2.3.2 Key findings

Slow economic growth and a lack of infrastructural investment, coupled with increasingly divergent trends at work in major economies, characterised the trading environment in 2014. The economic recovery gained traction in the United States and the United Kingdom, but is struggling in the euro area and Japan, parts of emerging Europe (especially Russia) and Latin America, while a carefully managed slowdown is underway in China. Several major forces are driving the global outlook: soft commodity prices that are expected to persist, continued low interest rates (but increasingly divergent monetary policies across major economies), and weak world trade. In particular, the sharp decline in oil prices since mid-2014 will support global activity and help offset some of the headwinds to growth in oil-importing developing economies. However, it will dampen growth prospects for oil-exporting countries.

The South African sovereign rating downgrade by Moody's Investors Service in November 2014 from Baa1/P-2 to Baa2/P-2 (with the credit outlook changing from 'negative' to 'stable') was based on the slowdown in economic growth and the need to implement growth-inducing initiatives.

The Department, through its engagements with banks, gained insight into the effect of global macroeconomic events and conditions on the domestic banking sector. The Department encouraged banks to build on sound risk management principles and remain abreast of the challenges facing the environment. The lack of liquidity in certain asset classes, together with low volumes of trading activity globally, has prompted this Department to closely monitor banks' risk management practices.

2.3.3 Counterparty credit risk thematic reviews

In terms of Core Principle 17, supervisors must be satisfied that banks have a CCR management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes appropriate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate this risk on a timely basis.

Therefore, in order for the Department to discharge its duties relating to Core Principle 17, it conducted a CCR thematic review by sending a questionnaire to certain banks in the South African banking industry. Following this, on-site meetings were held at the respective banks to discuss key issues emanating from the documents and any topics on which the Department may require clarity.

This thematic review encompassed all areas required to be covered under Core Principle 17, as well as certain additional aspects related to the Basel III international framework for risk measurement, standards and monitoring. A questionnaire was used to establish the fundamental drivers, controls and governance of CCR management and to assess banks' incorporation of the Basel III rules into their business practices and risk management procedures. Among other findings, the reviews noted that there was a general improvement in the industry's understanding and risk management practices relating to CCR.

The Department places great emphasis on the importance of CCR management, especially following the recent global financial crisis. Banks are therefore continually encouraged to actively manage CCR through ensuring that proper processes exist to promptly identify, measure, monitor and mitigate it.

Finally, increased focus will be placed on CCR management to ensure that South Africa's approach in this regard remains aligned to global standards.

2.3.4 Equity risk in the banking book

During 2014 the Department continued with the thematic reviews that addressed equity risk in the banking book. These exposures are generally held for long-term investment purposes and are included in the banking book for regulatory purposes, thus receiving a capital treatment that is independent of the market risk charge. For supervisory purposes, equity risk is regulated together with market risk, and the reviews are aimed at gaining in-depth insight into areas where this risk arises and the management of the risk over the life cycle of these investments. Of the banks that were assessed during the period under review, it was evident that while there had been notable progress made with regard to the management of this risk, there still remained areas requiring further improvement. It is also becoming apparent that this risk type has been diminishing over recent years as banks reduce this type of investment activity. Further assessments will continue during 2015 in this area for selected banks.

2.4 Operational risk

2.4.1 Introduction

In light of the dynamic and increasingly complex environment within which banks operate, operational risk and information technology risk have been propelled to the forefront of risk managers' agendas during the past year.

2.4.2 Operational risk reviews

During the year under review the Department conducted focused operational risk reviews at selected banks. This was done to ascertain whether these banks had appropriate operational risk frameworks that included management and measurement elements, and to obtain a view of their operational risk profiles and the extent to which these were affected as a result of the rapidly changing economic conditions. The main findings of these reviews were as follows:

- Operational risk governance structures, human resources, and frameworks and policies: banks underwent substantial changes in their governance structures and human resources to optimise and streamline operations. While various frameworks and policies are already in place, banks continue to work on ensuring that these are sufficiently embedded into their business and enforced efficiently.

- Operational risk strategic objectives: operational risk strategic objectives are understandably varied between banks. Nevertheless, one of the common themes identified was the determination of banks to further embed operational risk culture and mature operational risk processes within their organisations.

- African footprint: with the ever-increasing footprint into Africa, especially from the larger South African banks, some of these banks indicated that internal forums had been established in their respective organisations to discuss, inter alia, increasing challenges relating to the high prevalence of violent crime and other security-related matters across African countries. These forums comprise both executives and business representatives from security and risk management departments.

- Advanced measurement approach (AMA): banks continue to enhance their AMA models, re-evaluate their AMA capital software and refine their operational risk scenarios in order to ensure that the operational risk inherently and residually within each organisation adequately reflects the dynamic and complex business environment in which they operate.

- Operational risk losses: there has been a significant increase in operational risk losses in 2014 in comparison to 2013 against a backdrop of extremely challenging economic conditions. These losses emanated primarily from internal fraud, external fraud, and execution delivery and process management.

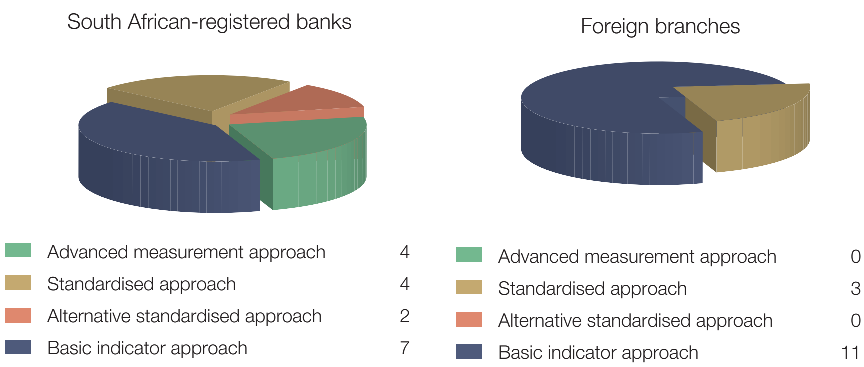
- Other common themes: despite continuous efforts by banks to prevent events, the following issues were prevalent across banks in the local industry, to varying degrees:
  - power outages;
  - offline systems; and
  - cross-border payment issues.

- Audit reports related to operational risk management: during on-site reviews, the Department held closed sessions with banks' internal auditors to ensure that a comprehensive review of operational risk was attained. In addition, during off-site analysis, internal and external audit reports were scrutinised to further support the Department's overall supervisory review and evaluation process.

2.4.3 Processing of applications

During the period under review there was no movement of banks in terms of approaches adopted, as depicted in Figure 2.3.

Figure 2.3 Operational risk reporting methods applied by banks as at 31 December 2014



2.4.4 Publications and notices

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

The following guidance notes were issued during the period under review:[30]

- Guidance Note 3/2014: the purpose of this guidance note was to reiterate the importance of adhering to risk management practices, specifically with regard to risk data aggregation and risk reporting.
- Guidance Note 5/2014: Guidance Note 3/2008 was replaced by Guidance Note 5/2014, which dealt with the outsourcing of functions within banks. The purpose of Guidance Note 5/2014 was to inform all banks of the potential risks arising from the use of service providers and to provide guidelines on assessing and managing risks pertaining to outsourcing relationships. These guidelines also highlighted the elements of an appropriate risk management programme for service providers.
- Guidance Note 6/2014: this guidance note detailed the application process for approval to adopt the standardised approach or alternative standardised approach for measuring banks' operational risk exposure. This guidance note was issued in order to formalise the requirements.
- Guidance Note 7/2014: this guidance note stipulated the application process to adopt the AMA for measuring banks' operational risk exposure. This guidance note was issued in order to formalise the requirements.

2.4.5 Operational risk long-form reviews

31. Available at http://www.resbank.co.za/RegulationAndSupervision/BankSupervision/TheBaselCapitalAccord(Basel%20II)/Pages/Advance-measurement-approach-.aspx.

The long-form review process for operational risk was finalised late in 2013 after the template was completed and published on the Bank's website.[31] The long-form review is a process whereby external auditors perform agreed-upon attestation procedures and report findings to the Department. This forms part of the risk management and audit processes of banks with approval to use the AMA to calculate the minimum amount of required capital and reserve funds.

2.4.6 Information technology risk

Cybercrime continued to receive increased focus during the year under review both locally and globally as a result of an increasing number of security breaches which highlighted the potential risks in this regard. In line with the practices of some international regulators, South African banks were encouraged to collaborate and cooperate with each other on cybercrime to consolidate efforts and minimise this threat. Cyber security risk management is also being discussed internationally in order to try and develop guidance on this.

Advances in technology, combined with the desire for a bigger market share, specifically of the unbanked population, and regulatory requirements are driving change in banks, and the amount and complexity of IT projects continued unabated during the year under review.

2.4.7 Information technology risk reviews

During 2014 various focused IT risk on-site meetings were conducted. In general, themes such as IT project management, business continuity management, disaster recovery planning, information security, cybercrime and outsourcing, which themes had been identified during the 2013 regulatory activities, were covered in more detail. The key findings from these reviews were as follows:

- the amount and complexity of rolling projects continued to require heightened focus;
- several changes to IT human resources structures and teams were observed, although this appeared to have stabilised;

- the quality of business continuity and disaster recovery capability was deficient in some instances and required improvement;
- numerous control breakdowns were evident as noted as part of unresolved and repeat audit findings; and
- combined assurance relating to IT risk still seemed to be at an early stage of development.

2.5 Asset and liability management risk

2.5.1 Regulatory developments

The Department spent a significant amount of time operationalising the CLF and finalising the negotiations bilaterally with participating banks.[32] The Department also issued a number of directives setting out requirements for compliance with the LCR, including national discretion as allowed for in the LCR framework and how compliance with the LCR would be measured. As part of its responsibilities as a member of the TFIR,[33] the Department engaged with the banking sector through BASA during the year to monitor and discuss international regulatory developments and the impact thereof on South Africa.

32. Also refer to section 1.9.

33. Also refer to section 1.8.14.

2.5.2 Focused reviews

According to the Core Principles, a supervisor is required to determine that banks have in place certain minimum standards. During 2014 the Department sent out a questionnaire covering banks' policies, procedures and internal controls relating to liquidity risk and interest rate risk in the banking book. Following an off-site review of the responses received, the Department conducted on-site meetings to discuss the responses and to probe any relevant additional information.

The Department conducted several of these reviews covering both major banks and small individual banks during the year to evaluate their current practices.

2.5.3 Participation in liquidity risk simulations

The Department continued to participate in ad hoc liquidity risk simulation exercises at banks, which were facilitated by an independent external party, in order to assess the adequacy and effectiveness of banks' liquidity risk management frameworks. Representatives of the Department fulfilled an observatory role during these exercises. These simulation exercises continued to be of great value both to the Department and participating banks by highlighting areas of improvement and by demonstrating the need for robust liquidity risk management.

2.6 Capital management

2.6.1 Overview of internal capital adequacy assessment process reviews and key findings

During 2014 the Department continued with focused ICAAP reviews, in particular on improvements of credit risk economic capital models, capital management, stress testing, the validation of economic capital and stress-testing models, and a continued focus on the use test.

On-site reviews during 2014 highlighted the following aspects:

- Banks' capital planning was robust and underwent regular challenges by management, while forecasted capital ratios indicated that South African banks remained well capitalised.
- Large and complex banks used economic capital models to more accurately measure risks and to relate the risks to capital requirements. The results of these models were used

in decision-making; therefore, management should continue to ensure economic capital models are validated and are still appropriately calibrated in the aftermath of the recent global financial crisis.

- In certain instances banks applied the standardised approach to calculate capital requirements for credit risk, especially relating to exposures in foreign jurisdictions where the standardised approach was found not to be a true reflection of the underlying risk. The Department imposed additional capital requirements in such instances.
- The identification, measurement, monitoring and mitigation of credit concentration risk, model risk and business risk required improvements at certain banks.
- It was found to be beneficial for banks to be capable of performing ad hoc stress testing to investigate the impact of any possible changes in the economic environment within a short turnaround time.

2.6.2 Regulatory and economic capital data collection exercise

The Department continued to collect and monitor forecasted regulatory and economic capital data from selected banking institutions in order to supplement the ICAAP reviews.

The data collected included forward-looking projected regulatory capital planning data. The aforementioned data continued to enhance the Department's assessment of capital planning at banks, the importance of which was emphasised in the, Basel Committee publication titled *A sound capital planning process: fundamental elements*[34] released in January 2014, as well as in light of the work done by the Capital Planning Workstream of the Basel Committee.

34. Available at http://www.bis.org/publ/bcbs277.htm

2.6.3 Assessment of capital and liquidity instruments

The Department conducted an exercise where banks were required to complete a self-assessment template with reference to the minimum conditions for the issuance of instruments or shares of which the proceeds may qualify as either common equity tier 1 capital, additional tier 1 capital or tier 2 capital.

The above exercise was found to be beneficial in terms of assessing both individual banks and the wider banking industry with regard to financial instruments in issue. It was later deemed appropriate to expand the exercise to also include subordinated term debt issued for liquidity purposes.

The data were received in 2014 and comprised all instruments issued for liquidity and capital purposes by the banking sector as at the end of December 2013. The main highlights are mentioned on the next page.

The purpose of the survey was mainly to:

- assess the type of funding the banking sector was utilising;
- assess the concentration of maturity or early call dates for individual banks and the sector;
- determine the ability of banks to roll capital and liquidity instruments; and
- determine the proportion of instruments issued by the banking sector.

The main findings from the survey were as follows:

- Domestic systemically important banks (D-SIBs), on a consolidated basis, had total subordinated term debt and tier 2 qualifying capital instruments in issue of more than R184 billion as at the end of December 2013, which amounted to only 6 per cent of D-SIBs' total liabilities.

- Sixty per cent of the above-mentioned subordinated debt instruments was issued for liquidity and 40 per cent was issued for regulatory capital purposes.
- A high level of concentration in terms of maturity and early call dates within the banking sector was expected over the next five years (i.e. 2015 to 2019). However, it was deemed to be manageable in terms of the capital and liquidity management processes of the banks.

2.6.4 Domestic systemically important banks

During 2014 the Department again applied its D-SIB methodology to assess which banks were deemed D-SIBs together with their allocated loss-absorbency requirements. Banks were informed of their D-SIB status and loss-absorbency capital requirements to be phased in over a three-year period from 1 January 2016 to 31 December 2018.

The Department subsequently continued to monitor and assess banks and bank-controlling companies based on the latest available data, as the D-SIB status is assessed regularly and communicated to the affected banks at least annually.

Although the D-SIB loss-absorbency capital requirement will only be phased in from 1 January 2016, the Department deemed it necessary to continuously keep D-SIBs informed of any changes to the size of the imposed D-SIB capital buffer requirement. This communication allows banks and bank-controlling companies sufficient time to adequately plan and manage the aforementioned capital buffer requirements.

2.7 Pillar 3: disclosure

2.7.1 Overview of key activities

During 2014 the Department's Pillar 3 reviews focused on the assessment of quarterly, semi-annual and annual Pillar 3 reports for compliance with regulatory requirements for public disclosure. To this end, Directive 4/2014 titled 'Matters related to the Basel III leverage ratio framework and disclosure requirements' and Directive 11/2014 titled 'Liquidity coverage ratio: scope of application and related disclosure requirements'[35] were issued by the Department as additional disclosure requirements.

35. Available at http://www.resbank.co.za/Publications/Pages/Bank-Act-directives.aspx.

2.7.2 Developments

In January 2015 the Basel Committee issued a document titled *Standards: revised Pillar 3 disclosure requirements*.[36] A key goal of the revised Pillar 3 disclosures was to improve comparability and consistency across banks. The revised disclosure requirements introduce greater use of templates, with prescriptive fixed-form templates being proposed for quantitative information that is considered essential for the analysis of a bank's regulatory capital requirements, and templates with a more flexible format being proposed for information that is considered meaningful to the market but not central to the analysis of a bank's regulatory capital adequacy.

36. Available at https://www.bis.org/bcbs/publ/d309.htm.

Previous documents released by the Basel Committee on Pillar 3 disclosure that are superseded by the above-mentioned *Standards: revised Pillar 3 disclosure requirements* include *Basel II: International convergence of capital measurement and capital standards: a revised framework* and *Enhancements to the Basel II framework*.

The Department will continue to monitor compliance with Pillar 3 disclosure requirements, with greater focus on preparing for the implementation of the new *Standards: revised Pillar 3 disclosure requirements* document.

2.8 Consolidated supervision

2.8.1 Barclays Africa Group Limited: African Supervisory College

The importance of effective supervisory colleges between home- and host-country supervisors has in recent years gained prominence, with both the Basel Committee and the IMF emphasising the value of such colleges. In line with international best practice, the Department held an inaugural supervisory college for supervisors of Barclays Africa Group Limited's (BAGL) African banking operations from 24 to 26 November 2014. BAGL is involved in 10 countries in Africa, including South Africa, and a total of 12 supervisors from 9 countries attended the supervisory college for the African operations of BAGL.

The overarching objective of the college was to assist the Department as the home-country supervisor and the various attending host-country supervisors in developing a better understanding of the risk profile of BAGL and the consolidated activities of BAGL in Africa. A further objective was to improve and strengthen information sharing and regional cooperation between all the supervisors involved with BAGL. The knowledge gained from the various host-country supervisors of the banking conditions in the jurisdiction they are responsible for was of great value to the Department.

2.8.2 Supervisory meetings with the Financial Services Board

South African banking groups have significant investments in banking, insurance and securities. The Department supervises these entities on a conglomerate basis. These financial conglomerates and the financial conglomerates headed by insurance companies are discussed during the regular meetings between the Financial Services Board and the Department. Valuable information is shared between the supervisory agencies during these meetings and it is regarded as an integral part of the Department's supervisory process. These meetings continue to contribute to the Department's ability to effectively supervise financial conglomerates.

2.9 Anti-money laundering and countering the financing of terrorism

2.9.1 Thematic sanctions review

As part of the Department's supervisory mandate it conducted banking industry-wide thematic review of banks, sanctions-screening systems and controls. The scope of the thematic review evaluated whether banks' sanctions-screening systems were adequately configured to identify sanctioned individuals and entities with the aim of protecting the South African banking industry against being used for the financing of terrorist and related activities. The thematic review also aimed to test whether banks effectively complied with local CFT legislation.

The thematic review was conducted over a period of approximately 21 weeks with 31 banks participating in the exercise. Both client and transactional screening systems were assessed utilising data extracted from:

- United Nations Security Council Resolutions Sanctions Lists;
- Her Majesty's Treasury List issued by the United Kingdom; and
- United States Office of Foreign Assets Control Lists.

All participating banks cooperated fully and for those deficiencies identified the banks had demonstrated a high level of commitment to improve their sanctions-screening systems and controls within the agreed time frame.

2.9.2 AML/CFT supervisory benchmarking visit to De Nederlandsche Bank in Amsterdam

During September 2014 the Department undertook a three-day benchmarking visit to De Nederlandsche Bank NV (DNB) in Amsterdam, which also included a visit to the Dutch Financial Intelligence Unit (DFIU).

The purpose of the visit to DNB and the DFIU was to:

- benchmark the Department's AML/CFT supervisory framework against that of DNB;
- gain an understanding of DNB's approach to the cross-sectorial application of AML/CFT between insurance and banking industries (i.e. while keeping in mind South Africa's move to a Twin Peaks approach of financial supervision); and
- learn how information is shared between DNB, the DFIU and DNB's frontline prudential supervisors (including the type of information that is shared and the arrangements that are in place to share such information).

It is expected that the professional connections made during the visit will lead to further collaborative efforts between the Department and DNB, while the knowledge gained from the visit will assist the Department in further strengthening its AML/CFT on- and off-site supervisory processes.

2.9.3 Administrative sanctions imposed for AML/CFT non-compliance

In terms of the Financial Intelligence Centre Act 38 of 2001 (FIC Act), the Bank, through the Department, is mandated to supervise and enforce banks' compliance with the FIC Act to ensure that the necessary AML/CFT controls are in place. Following from inspections conducted to assess whether appropriate measures were in place to ensure compliance with the relevant provisions of the FIC Act, in 2014 the Department imposed administrative sanctions on the four major banks in South Africa to the value of R125 million.

It is reiterated that the said administrative sanctions imposed were not as a result of any of the banks facilitating transactions involving money laundering and/or the financing of terrorism. All financial penalties were credited to the criminal assets recovery account established by section 63 of the Prevention of Organised Crime Act 121 of 1999. Table 2.1 provides a breakdown of the administrative sanctions imposed.

Table 2.1 Penalties imposed on banks in 2014

	Financial penalty
Absa Bank Limited	R10 million
FirstRand Bank Limited	R30 million
Nedbank Limited	R25 million
The Standard Bank of South Africa Limited	R60 million
Total	**R125 million**

2.9.4 On-site inspections

The Department follows an AML/CFT risk-based approach to determine which banks to inspect during the year. Nine AML/CFT on-site inspections in terms of section 45B of the FIC Act were conducted in 2014. All local inspections undertaken in 2014 were on average conducted over a period of three weeks. In addition, the Department conducted its first cross-border inspection of a foreign subsidiary of a South African bank. Table 2.2 reflects the details of the inspections conducted and also provides a comparison of the inspections conducted from 2012 to 2014.

Table 2.2 On-site inspections

Nature of inspection		2012*	2013	2014
Routine	Large banks	2	3	0
	Small banks	6	2	8
	Cross border (Africa)			1
Non-routine	Large banks	0	1	0
	Small banks	0	1	0
Total		8	7	9

* AML/CFT inspections commenced in April 2012

The most pertinent findings arising from inspections conducted in 2014 include, inter alia, the following:

- Customer identification and verification, and record keeping: the results of customer identification and verification and record-keeping assessments showed that there was still room for improvement for banks to ensure that they obtained appropriate documentation from clients as prescribed in section 21 of the FIC Act.
- Cash threshold reporting: generally, the smaller banks implemented manual cash threshold reporting processes. Some instances were found where such processes did not comply with the requirements outlined in the Money Laundering and Terrorist Financing Control Regulations and guidance provided in Guidance Note 5 issued in terms of the FIC Act.[37]
- Training: AML/CFT training provided to employees was found to be generic and did not focus on all requirements specific to the FIC Act. In some instances, AML/CFT training programmes lacked targeted training on specialised business areas (i.e. in line with employees' responsibilities, activities and skills).

37. Available at https://www.fic.gov.za/SiteContent/ContentPage.aspx?id=15.

In addition to testing banks' compliance with the FIC Act, the Department also assessed their adopted AML/CFT risk-based approaches, including their treatment of politically exposed persons, wire transfers and correspondent banking relationship processes. The implementation of the said approaches and processes varied from bank to bank. The Department urged banks to ensure that they paid particular attention to these areas to ensure that their AML/CFT frameworks adhere to international best practice and standards. Progress made by banks in this regard will be duly monitored in 2015.

2.10 Recovery planning

The FSB issued a document titled *Key attributes of effective resolution regimes for financial institutions*[38] (key attributes) in 2011. In this document the FSB recommends that all systemically significant financial institutions have recovery and resolution plans in place.

38. Available at http://www.financialstabilityboard.org/wp-content/uploads/r_111104cc.pdf?page_moved=1.

The Department first requested banks to start developing recovery plans in 2012. In order to review the progress made by banks in the development of their draft recovery plans, workshops were held with each of the large South African banking groups during 2013. These recovery plans were benchmarked against the key attributes and feedback was given to the banks on the gaps identified by the Department. The banks were given until the end of 2013 to have a board-approved, integrated recovery plan. The Department, in conjunction with the Bank's Financial

Stability Department, continued the process of reviewing the board-approved recovery plans of these banking groups during 2014. The focus during 2014 was on the feasibility of the recovery options identified by the banks and the severity of the selected stress scenarios. Further refinement of the recovery plans will continue in 2015 and is considered to be an ongoing process. The Department also issued Directive 1/2015 on the minimum requirements for recovery plans[39] as further guidance against which banks can benchmark their recovery plans.

39. Available at http://www.resbank.co.za/Publications/Pages/Bank-Act-directives.aspx.

2.11 Cooperative banks

In view of the fact that all data and relevant information pertaining to cooperative banks are contained in the *Combined annual report of the supervisors of the Cooperative Banks Development Agency and the South African Reserve Bank*,[40] this data and information will not be repeated in this report.

40. Available at http://www.resbank.co.za/Publications/Reports/Pages/CombinedAnnualReport.aspx.