Chapter 1: Registrar of Banks' review

1.1 Introduction

The mandate of the Bank Supervision Department (BSD) within the South African Reserve Bank (SARB) is to promote the safety and soundness of the banking system. This is done through the effective application of international regulatory and supervisory standards. BSD's approach to supervision is based on mutual trust, open communication and an intensive, risk-based assessment of culture, governance and prudential standards applied in banks. This contributes to a stable and growing economy.

The year under review is significant for BSD for two reasons. First, BSD issued two new commercial banking licences and one cooperative banking licence. Second, BSD worked tirelessly to prepare for the launch of the Prudential Authority (PA) on 1 April 2018.

As part of a global move towards greater oversight of the financial sector, BSD was responsible for gradually implementing the Basel III framework in South Africa. The Basel III framework includes a combination of macroprudential and microprudential policies that are designed to make the financial sector more resilient to shocks. Macroprudential and microprudential policies are really two sides of the same coin in that they use largely the same tools (capital, liquidity, etc.) but focus on different areas. Macroprudential policy is concerned with the stability of the entire financial system, while microprudential policy focuses on individual institutions.

During the year under review, good progress was made in placing the 'new' African Bank on a sustainable footing and under the curatorship of Residual Debt Services (RDS) (which houses the bad loans removed from the bank at the time of curatorship). The new bank has made good progress with the execution and delivery of its strategy, which includes diversifying its product offering to become a retail bank, widening its customer base and broadening its distribution channels. RDS has continued to recover amounts due in respect of the residual book.

BSD is a designated supervisory body responsible for supervising and enforcing compliance with the Financial Intelligence Centre Act 38 of 2001 (FIC Act). As a supervisory body and a significant partner in the Financial Intelligence Centre's (FIC) drive to ensure increased levels of compliance, 2017 was a milestone year for BSD in the world of anti-money laundering and combating the financing of terrorism (AML/CFT) with the promulgation and implementation of the FIC Amendment Act. This amendment introduced a fundamental change towards a risk-based rather than a prescriptive rules-based approach to AML/CFT. Administrative sanctions were imposed on several banks due to weaknesses in their control and compliance systems.

During the review period, the growth rate in banking sector assets remained in an upward trajectory. Banks remained adequately capitalised, with capital adequacy ratios (CARs) well above the minimum statutory requirements. While the liquidity coverage ratio's (LCR) minimum requirement increased to 80% with effect from 1 January 2017, banks were able to comply, mainly due to an increase in high-quality liquid assets.

There have been significant developments on the regulatory front, with a milestone being reached in the process of ushering in a new financial system regulatory architecture, the so-called Twin Peaks model. The Twin Peaks reform process is a journey that was long in the making. While, in general, South Africa has a modern and prudent financial sector that has the interests of all customers and citizens at heart, there are too many cases of abuse and exploitation in the sector, and the risks that the sector poses to the economy is still immense. Effective regulation will help make the financial sector more responsive to the needs of all South Africans.

On 21 August 2017, the Financial Sector Regulation Act 9 of 2017 (FSR Act) was signed into law. The passing of the FSR Act is the culmination of collaboration on financial sector reform by the SARB, National Treasury and Financial Services Board (FSB) over the past decade, and marks an important milestone on the journey towards a safer and fairer financial system that is able to serve all citizens.

The FSR Act gives effect to three important changes to the regulation of South Africa's financial sector. First, it gives the SARB an explicit mandate to maintain and enhance financial stability. Second, it creates a prudential regulator, which will be known as the Prudential Authority, or PA, located within the SARB. The PA will be responsible for regulating banks, insurers, cooperative financial institutions, financial conglomerates and certain market infrastructures. Third, the FSR Act establishes what is called a market conduct regulator, which will be known as the Financial Sector Conduct Authority (FSCA), which will be located outside of the SARB.

In addition to these three significant changes to the regulatory landscape, there are several important principles that underpin the new FSR Act. Key among those is the need to: strengthen the positive impact that the financial sector has on society and the economy; minimise the social and fiscal impact of bank and other failures; promote financial inclusion and transformation; and support competition, innovation and diversity in the sector. To prepare for the establishment of the PA within the SARB, 63 staff members from National Treasury and the FSB joined BSD in October 2017.

This is the final report that will be issued under the BSD banner. As we usher in a new landscape, we thank all team members for their commitment in this process. We look forward to the new regulatory chapter that awaits the financial sector. In addition to the legislated principles guiding the PA's approach to supervision, there is an overriding objective of harmonising and integrating the approach to prudential supervision across sectors. This journey will continue to be documented through the PA Annual Report.

1.2 Bank Supervision Department's strategic focus areas

Strategic focus areas (SFAs) direct the activities of BSD to focus resources where the need is most pertinent. BSD reviews its SFAs within the framework of the strategic objectives developed by the SARB. In doing so, it takes into additional consideration the stability and performance of banks within the context of a constantly changing external environment, changes emanating from international regulatory developments, and emerging trends in the South African banking sector.

Substantial progress was made in achieving the objectives of the SFAs, which included:

- ensuring the safety and soundness of the banking system through compliance with prudential standards and supervisory requirements;
- ensuring appropriate entry into and exit from the banking system through the issuance and retraction of licences as well as approvals to expand or contract operations;
- representing South African interests and concerns at regional and international committees on banking-related regulatory and operational matters; and
- focusing on the establishment of the PA under the Twin Peaks framework[1] through regulatory and organisational development.

BSD's strategy up to March 2018 will be overtaken by the PA's strategy from 1 April 2018. Initially, activities will focus primarily on ensuring the ongoing promotion of the safety and soundness of the banking sector in the context of the implementation and overall transition of the PA with its associated organisational and procedural adjustments.

1. The Twin Peaks approach recognises the different skills required for prudential and market conduct regulation. Prudential regulation is designed to maintain the safety and soundness of financial institutions, while market conduct regulation governs the treatment of the customer of a regulated institution.

1.3 High-level overview of key banking sector trends

1.3.1 Introduction

The number of entities that has been registered with, and report data to, BSD since 2007 is presented in Table 1.1. Detailed commentary regarding the entities registered or licensed with BSD as at 31 December 2017 is presented in appendices 1–4 and 6.

Table 1.1 Banking entities registered in South Africa

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Registered banks and local branches											
Banks*	19	19	18	17	17	17	17	17	17	17	19
Of which: banks under curatorship	0	0	0	0	0	0	0	1	1	0	0
Local branches of foreign banks	14	14	13	13	12	14	14	14	15	15	15
	33	33	31	30	29	31	31	31	32	32	34
Other											
Controlling companies	16	16	16	16	16	16	16	16	16	16	18
Banks in final liquidation	2	2	2	2	2	2	2	2	2	2	2
Mutual banks	2	2	2	2	2	3	3	3	3	3	3
Cooperative banks	0	0	0	0	2	2	2	2	2	2	3
Representative offices	46	43	42	41	43	41	43	40	40	36	31

* 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 94 1990

The aggregate statistics in this report relate exclusively to the sum of figures for banks and the local branches of foreign banks, but exclude figures for mutual banks, cooperative banks, representative offices, controlling companies and banks under curatorship or in final liquidation.

1.3.2 Total asset structure of the South African banking sector

The balance sheet structure of the South African banking sector is presented in Figure 1.1. South Africa's banking sector is dominated by five large banks, which collectively held 90.5% of the total banking sector assets as at 31 December 2017 (31 December 2016: 90.7%). Local branches of foreign banks held 5.9% of banking sector assets as at the end of December 2017 (December 2016: 5.8%), while other registered banks collectively represented 3.7% (December 2016: 3.5%).

Figure 1.1 Total asset structure of the South African banking sector

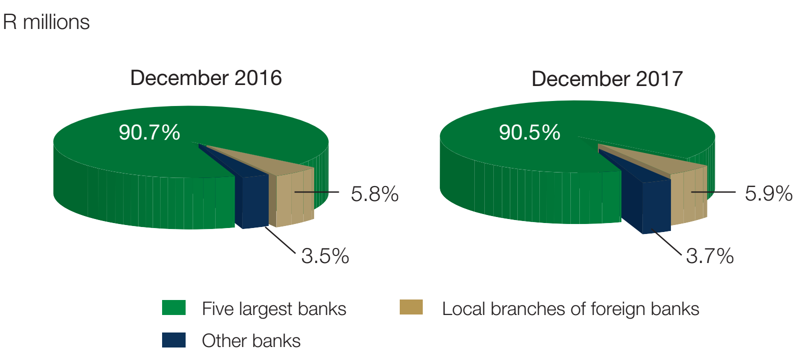


Table 1.2 Selected indicators for the South African banking sector

	Dec 2016	Mar 2017	Jun 2017	Sep 2017	Dec 2017
Balance sheet					
Total assets (R billions)	4 877	4 941	4 947	5 119	5 157
Total assets: year-on-year growth (per cent)	0.96	1.65	2.08	5.49	5.75
Gross loans and advances (R billions)	3 708	3 783	3 774	3 870	3 802
Gross loans and advances: year-on-year growth (per cent)	2.98	1.68	2.07	4.85	2.54
Total equity (R billions)	401	408	433	441	455
Profitability					
Cost to income (smoothed) (per cent)	55.07	55.24	55.59	55.72	56.65
Return on equity (smoothed) (per cent)	17.69	17.30	16.62	16.59	15.96
Return on assets (smoothed) (per cent)	1.32	1.34	1.31	1.34	1.31
Capital adequacy					
Common equity tier 1 capital adequacy ratio (per cent)	12.43	12.61	13.02	13.27	12.88
Tier 1 capital adequacy ratio (per cent)	12.86	13.04	13.47	13.83	13.43
Total capital adequacy ratio (per cent)	15.93	16.06	16.49	16.83	16.22
Leverage ratio (per cent)	6.20	6.29	6.71	6.70	6.62
Liquidity					
Liquidity coverage ratio (per cent)	107.83	111.29	119.76	114.11	119.02
Credit risk					
Impaired advances (R billions)	106	108	109	107	108
Impaired advances as a percentage of gross loans and advances (per cent)	2.86	2.84	2.90	2.77	2.84
Specific credit impairments as a percentage of impaired advances (per cent)	43.88	44.20	44.13	43.65	42.57
Portfolio credit impairments as a percentage of gross loans and advances	0.70	0.73	0.74	0.74	0.74

Note:

This table presents an overview of the financial and risk information, compiled by means of the aggregation of data submitted during 2016 and 2017 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 bank-solo information. Smoothed refers to calculations based on a 12-month moving average. Information is subject to change without notice. Banking sector data is available at http://www.resbank.co.za (refer to Prudential Authority link).

Total banking sector assets amounted to R5 157 billion at the end of 2017 compared to R4 877 billion at the end of 2016. The annual growth rate in banking sector assets accelerated to 5.7% at the end of 2017 (December 2016: 1.0%). The growth in banking sector assets in 2017 was apparent through increases in loans and advances, investment and trading securities, short-term negotiable securities, and derivatives.

The overall growth in gross loans and advances remained slow in 2017, on the back of a subdued macroeconomic environment. As at the end of December 2017, gross loans and advances recorded an annual growth of 2.5% compared to 3.0% at the end of 2016. The growth rate receded towards the end of 2017, as evidenced by a decline in the growth of term loans, foreign currency loans and specialised lending. Slow growth in respect of home loan advances was evident throughout 2017, as this category grew, on average, by 3.0% year on year.

Banking sector assets were mainly funded by deposits, current accounts and other creditors, which constituted 86.4% of banking sector liabilities at the end of December 2017 (December 2016: 87.6%). Derivatives and other trading liabilities as well as term debt instruments represented

7.4% and 4.0% respectively of total liabilities at the end of December 2017 (December 2016: 6.2% and 4.1% respectively). As at the end of December 2017, deposits comprised mainly fixed and notice deposits (28.5%), current accounts (20.9%) and call deposits (19.0%). Wholesale funding remained the largest source of funding to the banking sector and represented 44.1% of total funding as at December 2017 (December 2016: 41.0%). Retail deposits represented 26.3% of banking sector funding at the end of December 2017 (December 2016: 26.6%).

The banking sector remained profitable in 2017, despite a slow growth in operating profit. The 12-month moving average operating profit growth rate decreased throughout 2017, reaching 2.4% year on year in December 2017 (December 2016: 20.7%), mainly due to a decline in the growth of net interest income and an increase in operating expenses. The 12-month moving average return-on-equity (ROE) ratio deteriorated in 2017, ending the year at 16.0% (December 2016: 17.6%), while the return-on-assets (ROA) ratio remained relatively stable at 1.3%. The 12-month moving average cost-to-income ratio deteriorated to 56.6% at the end of 2017 (December 2016: 55.1%).

Banks (on a bank-solo basis) remained adequately capitalised in the year under review, with their CARs well above the minimum statutory requirements. The common equity tier 1 (CET 1), tier 1 and total CAR increased to 12.9%, 13.4% and 16.2% respectively at the end of December 2017 (December 2016: 12.4%, 12.9% and 15.9% respectively). The increase in CARs in 2017 was mainly driven by an increase in capital supply due to earnings and equity increases (mainly CET 1 capital). The leverage ratio remained above the minimum requirement of 4.0% in 2017, increasing slightly to 6.6% at the end of the year (December 2016: 6.2%).

The LCR remained elevated and above the minimum requirement of 80.0% in 2017. The LCR increased to 119.0% at the end of December 2017 (December 2016: 109.5%), as banks continued to accumulate stocks of high-quality liquid assets.

As at the end of 2017, impaired advances amounted to R108.0 billion compared to R106.0 billion at the end of 2016. The annual growth rate of impaired advances increased towards the end of 2017, reaching 1.9% in December 2017 (December 2016: -5.7%). The ratio of impaired advances to gross loans and advances, a key indicator of credit quality in the banking sector, remained relatively stable in 2017 and was 2.9% at the end of December 2017 (December 2016: 2.8%).

Specific credit impairments amounted to R46.0 billion at the end of 2017 compared to R46.5 billion at the end of 2016. The ratio of specific credit impairments to impaired advances (known as the coverage ratio) decreased towards the end of 2017, reaching 42.6% in December 2017 (December 2016: 43.9%), owing to a slight decrease in specific credit impairments coupled with an increase in impaired advances.

1.4 Authorisation to establish a bank, and the registration and cancellation of the registration of banks

1.4.1 Applications for authorisation to establish a bank in terms of section 12 of the Banks Act 94 of 1990

As indicated in the 2016 *Bank Supervision Annual Report*, the Registrar of Banks (Registrar) granted Postbank Limited's application for authorisation to establish a bank, submitted in terms of section 12 of the Banks Act 94 of 1990 (Banks Act). Postbank Limited also submitted its application for registration as a bank in accordance with the provisions of section 16 of the Banks Act, which application is under consideration by the PA.

1.4.2 Applications for registration as a bank in terms of section 16 of the Banks Act 94 of 1990

During 2017, the Registrar approved two institutions' applications for registration as a bank, submitted in terms of section 16 of the Banks Act. The following institutions were registered as banks in terms of section 17 of the Banks Act in the year under review:

- Commonwealth Bank of South Africa Limited trading as TymeDigital by CommonwealthBank SA; and
- Discovery Bank Limited.

1.4.3 Applications for authorisation to establish a mutual bank in terms of section 10 of the Mutual Banks Act 124 of 1993

During 2017, the Registrar approved one institution's application for authorisation to establish a mutual bank, submitted in terms of section 10 of the Mutual Banks Act 124 of 1993 (Mutual Banks Act), namely Neo Labs (Pty) Limited in respect of Bank Zero Mutual Bank. This institution may, at any time during the 12 months from the date of the granting of the authorisation, apply to the Registrar for registration as a mutual bank, provided that the aforementioned authorisation has not been revoked in terms of section 12 of the Mutual Banks Act and that certain specified conditions have been met.

1.4.4 Applications for authorisation to establish a cooperative bank in terms of section 6 of the Cooperative Banks Act 40 of 2007

The Registrar also approved an institution's application for authorisation to establish a cooperative bank, submitted in terms of section 6 of the Cooperative Banks Act 40 of 2007, namely Ziphakamise Savings and Credit Cooperative Bank.

1.5 Group structures: the approval of local and foreign expansions by South African banking groups

The number of applications approved by BSD in terms of section 52 of the Banks Act since 2007 is reflected in Table 1.3.

Table 1.3 South African banking sector: number of approvals for local and foreign expansions granted in terms of section 52 of the Banks Act 94 of 1990

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Local	12	15	10	16	19	12	19	13	40	15	11
Foreign*	25	19	26	22	27	14	21	25	19	13	16
Total	37	34	36	38	46	26	40	38	59	28	27

* Excludes transactions undertaken by Investec Plc

1.6 Enforcement

1.6.1 Introduction

During 2017, BSD continued to exercise its enforcement powers in terms of the Banks Act with regard to illegal deposit taking and to discharge its supervisory responsibilities in terms of the FIC Act. With regard to the latter, BSD conducted supervisory inspections of banks' control measures for AML/CFT. The SARB consequently imposed administrative sanctions on selected banks, which included financial penalties and the requirement that certain remedial actions be taken. Administrative sanctions were imposed, not because banks had been found to have facilitated transactions involving money laundering and/or the financing of terrorism, but because of weaknesses in their control measures.

1.6.2 Administrative sanctions imposed for AML/CFT non-compliance

In terms of the FIC Act, the SARB, through BSD, is mandated to supervise and enforce banks' compliance with the FIC Act. The FIC Act also stipulates that a supervisory body may impose an administrative sanction on an accountable institution for its failure to comply with the provisions of the FIC Act.

In line with its supervisory mandate, BSD conducted inspections at a number of banks with the aim of assessing whether appropriate measures and controls were in place to ensure compliance with the relevant provisions of the FIC Act.

Based on available facts and the findings of these inspections, BSD imposed administrative sanctions in terms of the FIC Act with a combined value of R77.5 million. In addition, the banks were directed to take remedial action to address the identified deficiencies. Table 1.4 provides a breakdown of the administrative sanctions imposed in the year under review.

Table 1.4 Penalities imposed on banks in 2017

Bank	Non-compliance	Administrative sanction
China Construction Bank Corporation – Johannesburg Branch	Not identifying and verifying customers' details (better known as Know Your Customer, or KYC, requirements) Not keeping records of customer identification and verification information Failing to report certain cash transactions above R24 999.99 to the FIC Failing to implement adequate processes and working methods in relation to the sanctions screening of customers to ensure that the bank complies with its reporting duties Inadequate controls and working methods pertaining to the reporting of suspicious and unusual transactions.	A financial penalty of R75 million (R20 million suspended for three years) A directive to take remedial action
VBS Mutual Bank	Not identifying and verifying customers' details (better known as Know Your Customer, or KYC, requirements) Failing to report certain cash transactions above R24 999.99 to the FIC Failing to implement adequate processes and working methods in relation to the sanctions screening of customers to ensure that the bank complies with its reporting duties Inadequate controls and working methods pertaining to the reporting of suspicious and unusual transactions	A financial penalty of R2.5 million (R2 million suspended for one year) A directive to take remedial action

It should be noted that the decision to impose administrative sanctions was not based on any evidence that China Construction Bank Corporation – Johannesburg Branch or VBS Mutual Bank had facilitated transactions relating to money laundering and/or the financing of terrorism.

1.6.3 Illegal deposit taking

The Banks Act empowers the Registrar to control certain activities of persons who conduct the business of a bank without being registered as a bank. The 'business of a bank' is comprehensively defined in the Banks Act, and can be broadly summarised as the acceptance of, soliciting of, or advertising for, deposits from the general public as a regular feature of the business.

The legal nature of money is such that when one person hands over an amount of money to another person to invest on that person's behalf, the money (physical notes and coin) generally becomes the property of the person receiving the money and hence part of his/her estate. In the case where such a person loses the money, steals the money or becomes insolvent or dies, the person that handed over the money merely has a (unsecured) claim against the other person or his/her estate. This of course places the person who handed over the money in a very precarious position. Therefore, in order to promote the safety and integrity of the banking system and to protect the general public, deposit-taking activities and the entities authorised to conduct such activities (i.e. banks) should be regulated and supervised to such a high degree, in accordance with international standard-setting bodies, that unregistered persons are prohibited from conducting deposit-taking activities.

In its previous *Bank Supervision Annual Report*, BSD mentioned the nationwide public awareness campaign it had embarked on in an effort to warn would-be participants against the risks of 'investing' with unregistered persons in what is usually marketed as get-rich-quick investments with no risk and high returns. The general public should be aware that operators do not start schemes to make investors rich but rather schemes are started, in contravention of the Banks Act, to lure investors to invest as much money as possible to benefit the operator.

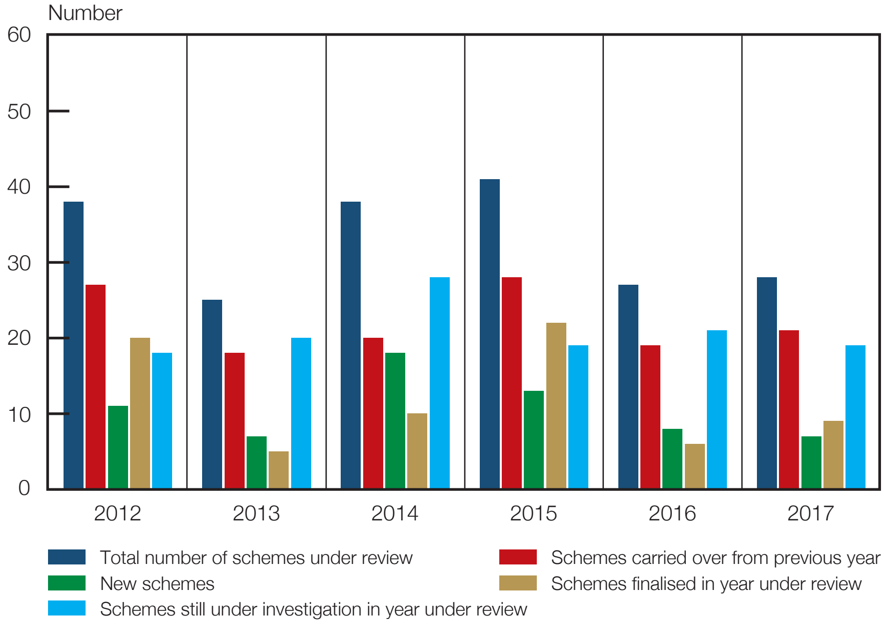
A five-year review of schemes investigated from January 2013 to December 2017 is depicted in Table 1.5 and Figure 1.2 below. During this period, BSD appointed temporary inspectors and, in some cases, repayment administrators in respect of 53 cases. A total of 52 schemes were finalised during the above-mentioned five years. In 2017 BSD investigated 28 schemes, comprising 21 schemes which were carried over from previous years and 7 new schemes. As at 31 December 2017, a total of 19 schemes were still being investigated, following the finalisation of 9 schemes during the year under review.

Table 1.5 Inspections relating to illegal deposit-taking schemes

Year	Total number of schemes under review*	Schemes carried over from previous years	New schemes in year under review	Schemes finalised in year under review	Schemes still under investigation in year under review
2013..................	25	18	7	5	20
2014..................	38	20	18	10	28
2015..................	41	28	13	22	19
2016..................	27	19	8	6	21
2017..................	28	21	7	9	19

* Includes schemes carried over from previous years

Figure 1.2 Inspections relating to illegal deposit-taking schemes



1.7 Regulatory developments affecting the domestic banking sector

1.7.1 Update on the implementation of a Twin Peaks model of financial regulation

The FSR Act, which enables the establishment of the PA within the SARB, was signed into law on 21 August 2017. The FSR Act sets out the mechanisms to achieve and promote financial stability, and to ensure: the safety and soundness of financial institutions; the fair treatment and protection of financial customers; the integrity and efficiency of the financial system; the prevention of financial crime; and financial inclusion, transformation of the financial sector and confidence in the financial system. It is expected that the PA will commence operations in early 2018.

The PA will incorporate the current FSB: Insurance Prudential Team, the current BSD of the SARB, and the Supervisory Team of the Cooperative Banks Development Agency. In order to prepare for the establishment of the PA, the FSB: Insurance Prudential Team and the Supervisory Team of the Cooperative Banks Development Agency were relocated to the SARB in October 2017.

The objectives of the PA, as set out in section 33 of the FSR Act, are to:

- promote and enhance the safety and soundness of financial institutions that provide financial products and securities services;
- promote and enhance the safety and soundness of market infrastructures;
- protect financial customers against the risk that those financial institutions may fail to meet their obligations; and
- assist in maintaining financial stability.

The PA will pursue a progressive realisation of its objectives, with an initial focus on banks (including mutual and cooperative banks as well as cooperative financial institutions), insurers, financial market infrastructures and designated financial conglomerates within which these institutions are located.

The functions of the PA are to:

- regulate and supervise financial institutions that provide financial products or security services and market infrastructures;
- assist the SARB, specifically in respect of financial stability, as well as work together with the National Credit Regulator and the FIC;
- cooperate with the Council for Medical Schemes on matters of mutual interest;
- support sustainable competition through cooperation and collaboration with the Competition Commission;
- support financial inclusion;
- regularly review the perimeter and scope of financial sector regulation, and take steps to mitigate risks identified to the achievement of its objective or the effective performance of its functions;
- conduct and publish research relevant to its objective; and
- cooperate with its counterparts in other jurisdictions and participate in international regulatory, supervisory, financial stability and standard-setting bodies.

The PA will be able to issue prudential standards, in addition to the sector-specific legislation and subordinate legislation. The PA will also be able to issue joint standards with the FSCA on matters where either authority has the power to make standards.

The FSR Act places an obligation on financial sector regulators to collaborate and cooperate in order to assist in maintaining financial stability as well as to ensure a better outcome for financial customers.

The approach of the PA will be pre-emptive, outcomes-focused and risk-based. In as far as practicable in the Republic of South Africa, the PA will take international regulatory and supervisory standards into account.

1.7.2 Mandatory audit firm rotation rule issued by the Independent Regulatory Board for Auditors

High levels of audit quality, enhanced by auditor independence, are important prerequisites to sound reporting and oversight, and hence crucial in assisting BSD in fulfilling its mission to promote the soundness of the domestic banking system in the interest of financial stability.

BSD therefore closely monitors developments pertaining to audit and accounting matters, as these are integral parts of its prudential supervisory approach. The Banks Act prescribes the various requirements of external auditors and audit committees of banks in order to ensure high-quality audits and independence.

The Basel Committee on Banking Supervision (BCBS) also issued various guidelines on the external audits of banks, the role of audit committees and expectations from supervisors.

In June 2017, the Independent Regulatory Board for Auditors (IRBA) issued its rule pertaining to mandatory audit firm rotation (MAFR) for auditors of all public interest entities. The main objective of its rule is to enhance auditor independence and protect public interest.

The SARB engaged actively throughout the consultation process with the IRBA and public hearings in Parliament through the Standing Committee on Finance, during which specific matters were raised that have an impact on the banking system, specifically in light of the high regulatory environment under which banks operate and the requirements imposed by BSD in terms of auditors and audit committees. An example is the requirement for large banking groups to have joint auditors and the requirement of BSD to approve the appointment of auditors after conducting a fit-and-proper assessment, together with the various requirements placed on, and oversight of, the audit committees of the banks.

Although the SARB in principle fully supports initiatives to strengthen auditor independence, BSD has raised some specific aspects that could negatively impact on the banking system and matters that require further research.

The SARB continued to engage with the IRBA after the release of its rule and will continue to engage with the oversight body to mutually refine the MAFR rule to ensure no negative or unintended consequences materialise on the banking sector as a result thereof.

1.7.3 Update on International Financial Reporting Standard 9

International Financial Reporting Standard 9 (IFRS 9) became effective for financial years commencing on or after 1 January 2018. It replaces International Accounting Standard 39 (IAS 39) and has a significant impact on the way in which provisions for credit losses will be calculated. While IAS 39 was based on an incurred loss approach (a loss event would need to happen before a provision could be raised), IFRS 9 requires an expected credit loss approach to provisioning, which includes taking into account forward-looking macroeconomic information when determining the extent of provisions for credit losses (also referred to as credit impairments).

With very little time left to meet their target dates, most banks moved from the planning phase to the implementation and testing phases of the IFRS 9 project during 2017. The South African Institute of Chartered Accountants (SAICA) IFRS 9 Implementation Working Group, which consists of representatives from banks, audit firms, the IRBA and the SARB, continued to meet on a regular basis in 2017 to discuss the application of the standard, including the modelling and disclosure requirements. Discussion papers on a number of IFRS 9 topics were prepared by the group and these will serve as a point of reference for the banking sector going forward.

IFRS 9 is a complex accounting standard that leaves substantial room for interpretation. Different approaches, methodologies and assumptions may result in vastly different impairment numbers. For that reason, BSD's focus in 2017 was on understanding banks' IFRS 9 impairment methodologies at a technical level. In particular, BSD discussed with the seven largest banks their methodology for determining a significant increase in credit risk, the inclusion of forward-looking macroeconomic information in the impairment calculation, the definition of credit-impaired assets, the determination of 12-month and lifetime probability of default, and the write-off definitions. BSD also enquired on the governance processes adopted by banks, both during the implementation phase and once the standard becomes effective. Banks also updated BSD on the progress made on implementation, any challenges encountered as well as the expected impact on their financial position and capital adequacy.

In addition to the discussions mentioned above, BSD conducted a qualitative survey of all banks, including the branches of foreign banks. The aim of this survey was to obtain information about IFRS 9 impairment methodologies and policies adopted by the smaller banks. The BCBS's guidance on credit risk and accounting for expected credit losses served as the basis for the questionnaire.

In October/November 2017, BSD also performed an IFRS 9 quantitative impact study (QIS). As part of this QIS, banks were requested to provide the expected impact of IFRS 9 on their total impairments and CARs. The objective of the QIS was to obtain an understanding of the extent of the 'day one' impact on total impairments, impaired advances and CARs. Based on the results of the QIS, BSD was satisfied that the impact of IFRS 9 would not be so severe as to threaten the stability of individual institutions. While the survey and the QIS provided important information, BSD understood that, as banks were still finalising their IFRS 9 models at the time, the information was only preliminary and that changes in models and assumptions could result in actual numbers that differ from what was reported in terms of the QIS.

In March 2017 the BCBS issued its guidance on the regulatory treatment of accounting provisions regarding the interim approach and transitional arrangements. BSD subsequently issued Directive 5 of 2017 (Regulatory treatment of accounting provisions: interim approach and transitional arrangements, including disclosure and auditing aspects) which directs banks on how to treat accounting provisions under IFRS 9 for regulatory purposes. In terms of this directive, banks may elect to phase in the capital impact of IFRS 9 over a three-year period. Furthermore, the directive requires the opening retained earnings, after making adjustments for IFRS 9, to be audited in terms of International Auditing Standard (ISA) 805 within five months of adopting IFRS 9. As indicated in the directive, this audit report will be solely for the use of BSD for the purposes of duly discharging its supervisory responsibilities.

On 26 and 27 September 2017 the SARB, in conjunction with the Association of African Central Banks (AACB) hosted a workshop on IFRS 9 implementation for African regulators. The workshop was attended by 25 delegates representing 16 African jurisdictions and organisations, and was well received. It covered the most important aspects relating to IFRS 9 and provided a platform for regulators to exchange views and experiences.

The work on IFRS 9 is expected to continue in 2018 with BSD engaging with banks and auditors, both locally and internationally, and playing a part in ensuring the robust implementation of the standard by the South African banking sector.

1.8 Key international developments, recommendations and focus areas

South Africa is committed to the development of an effective and efficient global financial regulatory architecture. In this regard, the SARB is a member of, and actively participates in, relevant and strategic international forums, including the Group of Twenty (G20) and the Financial Stability Board. As such, influencing the global financial reform agenda has been an integral part of its work. Since the commencement of the global financial crisis in 2007, the international financial reform agenda has focused mainly on the development of adequate responses to the causes and effects of the crisis.

The new global financial reform agenda has significantly informed the focus of the BCBS, of which BSD is a member. BSD subscribes to the full, timely and consistent implementation of internationally agreed reforms. This is done in a way that acknowledges and takes into account domestic economic and financial system conditions.

The core elements of the G20's comprehensive programme of reforms comprise the following:

- building a more resilient global financial system;
- ending the 'too big to fail' conundrum;
- making derivative markets safer; and
- transforming shadow banking into a more resilient, market-based finance.

In this regard, the BCBS issued a number of documents in 2017,[2] which have a significant impact on the regulation and supervision of banks and banking groups. The relevant requirements will be incorporated into the regulatory framework over the next few years, in accordance with the internationally agreed timelines, with due consideration for domestic economic and financial system conditions, and the implementation by other member countries.

2. The key matters communicated by the BCBS in respect of these documents and requirements are summarised in Appendix 8.

The following list highlights the regulatory and supervisory matters addressed in some of these documents:

- Frequently asked questions on market risk capital requirements (issued on 26 January 2017).
- Basel III framework: the net stable funding ratio: frequently asked questions (issued on 24 February 2017).
- Pillar 3 disclosure requirements: consolidated and enhanced framework (issued on 29 March 2017).
- Regulatory treatment of accounting provisions: interim approach and transitional arrangements (issued on 29 March 2017).
- Prudential treatment of problem assets: definitions of non-performing exposures and forbearance (issued on 4 April 2017).
- Basel III framework: the liquidity coverage ratio: frequently asked questions (issued on 8 June 2017).
- Range of practices in implementing the countercyclical capital buffer policy (issued on 22 June 2017).

- Implications of FinTech developments for banks and bank supervisors: consultative document (issued on 31 August 2017).
- Basel III framework's definition of capital: frequently asked questions (issued on 19 September 2017).
- Implementation of the net stable funding ratio and treatment of derivative liabilities (issued on 6 October 2017).
- Identification and management of step-in risk (issued on 25 October 2017).
- Basel III framework: finalising post-crisis reforms (issued on 7 December 2017).

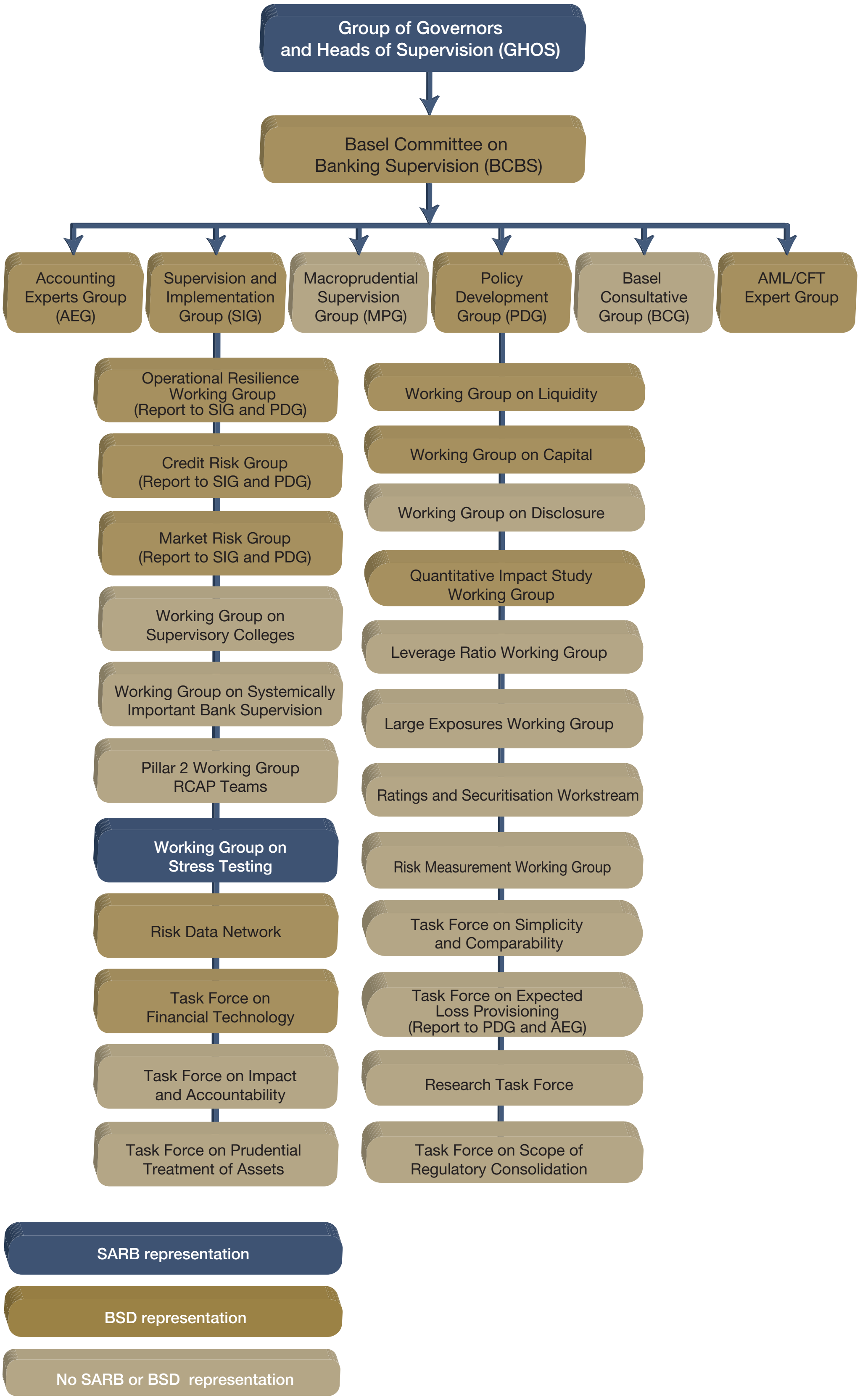
1.9 Participation in international regulatory and supervisory forums

BSD participated in a number of international regulatory and supervisory forums during the period under review. Participation in forums that form part of the BCBS structures is described in section 1.9.1. Participation in other international forums is set out in section 1.9.2.

1.9.1 Basel Committee on Banking Supervision

BSD represents South Africa on the BCBS 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 with which BSD expects South African banks to comply. Participation in forums that form part of the BCBS structures is described in figure 1.3 on the next page.

Figure 1.3 Structure of the Basel Committee on Banking Supervision, 2017



Source: Bank for International Settlements

1.9.1.1 Accounting Experts Group

The Accounting Experts Group (AEG) is a subcommittee of the BCBS that takes an active role in the development of international accounting and auditing standards by standard-setting bodies such as the International Accounting Standards Board (IASB), the Federal Accounting Standards Board (FASB) and the International Auditing and Assurance Standards Board (IAASB). The aim of the AEG is to ensure that these standards and practices 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 AEG held four meetings in 2017 during which it discussed many topical accounting and auditing issues. The agenda during the year continued to be dominated by the implementation of IFRS 9 and the impact thereof on banks' regulatory capital. The AEG's work stream on expected credit losses conducted a survey among AEG member jurisdictions with a view to understanding differences in interpretation and implementation. The AEG is also very interested in high-quality audits of accounting provisions and is therefore actively monitoring the work of the IAASB with regard to the revisions to ISA 540 on accounting estimates. Another area of interest for the AEG is the proposed change to the governance structure of the IAASB as discussed in the consultative paper[3] issued by the IAASB's Monitoring Group.

3. Available at https://www.iosco.org/about/?subsection=monitoring_group

1.9.1.2 Supervision and Implementation Group

The Supervision and Implementation Group (SIG) is the peer review committee of the BCBS. Its mandate is to help foster financial stability by supporting the strong national and international regulation and supervision of banks. It has two primary objectives, namely to:

- foster the timely, consistent and effective implementation of BCBS standards and guidelines; and
- advance the improvement in practices in banking supervision, particularly across BCBS member countries.

1.9.1.3 Working Group on Operational Risk/Operational Resilience Group

The Working Group on Operational Risk (WGOR) was a working group under the SIG and the Policy Development Group (PDG). Its focus included operational risk policy and implementation issues. It was disbanded in late 2016.

WGOR was replaced in late 2017 with the formation of the Operational Resilience Group (ORG). The initial scope of the ORG will relate to cyber-risk but the group will subsequently build on this work to consider further operational resilience. The ORG will additionally be responsible for issues related to the revised standardised approach for operational risk.

1.9.1.4 Market Risk Group

During 2016, the BCBS agreed to merge the Trading Book Group (TBG) and the Standards Implementation Group on the Trading Book into a single working group – the Market Risk Group (MRG). The new group will address both policy and implementation-related aspects of the market risk framework. This will include the revised market risk standard, counterparty credit risk standard and the credit valuation adjustment standard. The MRG will report to both the PDG and SIG, depending on the issue. Participation in the MRG is open to representatives of the BCBS, of which South Africa is a member.

The global financial crisis exposed significant flaws and issues in the 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 was released in July 2009, the BCBS agreed that a fundamental review of the framework was required, in particular 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, more general market risk) 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).

4. Available at www.bis.org/bcbs/publ/d352.htm

During 2016, the BCBS published the final standard on the fundamental review[4] which attracted intense debate on certain topics within the framework by the banking fraternity. The MRG undertook to address the unclear aspects emanating from the framework, which included the finalisation of the profit and loss attribution test, the development of a simplified standardised approach to market risk, and interpretative guidance on the finalised market risk standards in the form of responses to frequently asked questions (FAQs). Additionally, the MRG provided assistance for the quantitative impact studies that were conducted throughout the year. The revised implementation date for the FRTB is 1 January 2022.

1.9.1.5 Regulatory Consistency Assessment Programme teams

The BCBS established a comprehensive Regulatory Consistency Assessment Programme (RCAP) in 2012 to monitor and assess its members' adoption and implementation of its standards under the Basel III framework. The full, timely and consistent adoption and implementation of the Basel standards is critical to improve the resilience of the global banking system, promote confidence in prudential ratios, and to encourage a predictable and transparent regulatory environment for internationally active banks.

BCBS members are assessed on their capital standards as well as on their liquidity standards. In the period under review, the BCBS assessed the European Union's implementation of the LCR. Specialists from BSD were selected by the BCBS to lead and support the work of the European Union's assessment team. The assessment team was led by BSD, and comprised a technical expert from Australia and from Indonesia.

1.9.1.6 Risk Data Network

The Risk Data Network (RDN) is a work stream under the SIG that was established in 2016. The main objective of the RDN is to develop and maintain a framework, and to monitor banks and supervisors' compliance with the Principles for Effective Risk Data Aggregation and Risk Reporting (Principles).

The RDN has been monitoring the implementation of the Principles since its publication in January 2013. During the period 2013–15, three reports were published. In 2016 work continued, but with a stronger focus on supervisory evaluations and adopting an evidence-based approach to monitoring. In July 2016, supervisors were asked to complete a questionnaire to assess their banks' progress on compliance with the Principles. The supervisory assessments formed the basis of a report that was published in March 2017.

During the period under review, the approach and focus of an implementation and monitoring exercise for 2017 was developed and a decision was taken that it would be similar to the one carried out in 2016 (i.e. conducted via a questionnaire and with a focus on supervisory evaluations).

Given that the implementation deadline for the Principles had lapsed, it was proposed that the 2017 questionnaire should adopt a more targeted approach to explore the incremental progress made in the implementation of the Principles by banks and the supervisory consequences conveyed or actually taken.

The questionnaires were received during the latter part of 2017 and work commenced to draft and publish the results in a public report, which is expected to be published in 2018.

1.9.1.7 Task Force on Financial Technology

The Task Force on Financial Technology (TFFT) reports directly to the SIG. The main purpose of the TFFT is to assess risks and supervisory challenges in relation to innovation and technological changes that affect banking. The task force's work during the period consisted of two main phases, namely to (i) outline the current financial technology (FinTech) landscape and supervisory approaches, and (ii) identify the implications of FinTech developments for banks and challenges for effective supervision. The TFFT wrapped up its fieldwork during 2017 and started drafting a publication on the work conducted, which is expected to be issued publicly in the first quarter of 2018.

1.9.1.8 Policy Development Group

The PDG assesses the proposed changes to banking regulations developed by its subgroups and other work streams of the BCBS. The group serves the BCBS by identifying issues, commissioning research, overseeing quantitative analysis, and making recommendations on policy to the BCBS. 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. BSD is represented on the PDG and on many of the subgroups where the subject matters are relevant to South Africa.

1.9.1.9 Working Group on Liquidity

The primary focus of the Working Group on Liquidity (WGL) is policy development. The WGL also deals with the practical challenges accompanying the successful development, implementation and maintenance of a liquidity risk framework that addresses the requirements and expectations of the BCBS's regulatory requirements relating to liquidity and funding.

The WGL has, over several years, developed appropriate standards for measuring and mitigating liquidity risks in banks. Currently, the WGL deals with the two main standards relating to liquidity and funding, namely the LCR and net stable funding ratio (NSFR).

With the finalisation of the LCR and NSFR standard, and the LCR that became a prudential requirement from 1 January 2015, the focus of the WGL has shifted towards refining the broad understanding of the rules and their implementation by dealing with FAQs on the two standards and dealing with post-implementation issues of the LCR.

Furthermore, as part of its continued mandate, the WGL will be used as a forum to exchange information across jurisdictions in order to improve liquidity risk management and supervisory practices. As part of this process, the WGL will also consider whether elements of the Principles for Sound Liquidity Risk Management, published by the BCBS in September 2008, should be updated and/or enhanced to reflect current best practices.

1.9.1.10 Working Group on Capital

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

The WGC continues to assess the relevance of the definition of capital and instruments. The Basel III definition of capital and FAQs were updated in September 2017.[5]

5. Available at https://www.bis.org/bcbs/publ/d417.htm

1.9.1.11 Quantitative Impact Study Working Group

The biannual international Basel III implementation monitoring by the BCBS continued in 2017, in the form of QISs.

In addition to the Basel III implementation monitoring, the focus of the 2017 QIS exercises was on collecting data for the assessment of policy initiatives underway. These included the impact of proposals on the fundamental review of the trading book, initiatives to enhance comparability between banks such as constraining internally modelled approaches relating to the internal ratings-based (IRB) approach, and removing the use of the modelled approach for operational risk. Furthermore, revisions were made to the standardised approach for credit risk, the counterparty credit risk framework, and the Basel III leverage ratio framework. Analyses were also done on the proposal to replace the Basel I-based floor with more risk-sensitive output-based floors.

The BCBS published the 'Basel III Monitoring Report'[6] in September 2017. This document details the result of the QIS exercise as at 31 December 2016. The report incorporates the data of the South African participating banking groups. Furthermore, it is the intent of the BCBS to continue publishing the results of the Basel III monitoring exercise.

6. Available at https://www.bis.org/bcbs/publ/d416.htm

BSD continued with the submission of specific data obtained from the Supervisory Reporting System to enhance the analysis and monitoring of capital- and credit-related data.

The QIS Working Group will, in particular, remain responsible for the design of the capital monitoring reporting templates that contain the fully implemented Basel framework and, more recently, the final post-crisis reforms. The analysis of bank-level parameters (e.g. capital requirements, eligible capital and capital ratios) will also be done.

1.9.1.12 Credit Risk Group

The Credit Risk Group's (CRG) mandate is to address both policy- and implementation-related aspects of the credit risk framework. This will include the revised standardised approach and the IRB approaches for credit risk. The CRG is in the process of devising ways in which to monitor the impact of all the changes in the credit risk framework.

The following areas will be considered in monitoring the overall impact of the credit risk reforms (i.e. determine the contribution of credit risk approaches to the overall capital impact):

- the reforms on the risk-weighted assets variability;
- the relative calibration of the standardised and IRB approaches;
- the sensitivity of the changes to the credit risk framework on capital; and
- the evolution of bank exposures and business models attributed to the revised credit risk framework.

The CRG partially approved a report that included proposed approaches to address the aforementioned areas. This report will be discussed at future meetings for final review and approval.

1.9.1.13 Anti-money Laundering and Combating the Financing of Terrorism Expert Group

The BCBS's AML/CFT Expert Group assists both financial institutions and regulators in implementing the AML/CFT elements of the Core Principles for Effective Banking Supervision (Core Principles) in accordance with the Financial Action Task Force (FATF) standards by producing technical and practical guidance that is applicable to national and international banks and banking groups. The group also contributes to the standards set by the FATF relating to AML/CFT matters.

The AML/CFT Expert Group holds meetings twice a year. BSD participated in both meetings held in 2017 and contributed on an ongoing basis to the group's projects and initiatives.

1.9.2 Participation in other international forums

1.9.2.1 Financial Action Task Force

The FATF is an intergovernmental body that was established in 1989 and has developed the international standard for combating money laundering and the financing of terrorism.

The FATF holds three plenary meetings per year during which key decisions are taken.

BSD was represented at all three FATF plenary meetings held in 2017, and also participated in working group discussions and policy development.

During 2017, BSD also participated in a FATF public sector consultation forum on correspondent banking and money value transfer services during which feedback was provided and discussions held on the de-risking of correspondent banking relationships.

1.9.2.2 Community of African Banking Supervisors of the Association of African Central Banks

The Community of African Banking Supervisors (CABS) is a committee of the Bureau of the AACB Governors. At the August 2017 meeting of the AACB Governors, the SARB was nominated as the Chair of the AACB and as a result became the chair of CABS, which consists of two working groups, namely the Working Group on Cross-border Banking Supervision, chaired by the SARB, and the Working Group on Crisis Management and Banking Resolutions, chaired by the Central Bank of Nigeria.

During 2017, the CABS Working Group on Cross-border Banking Supervision meeting was held in Pretoria, South Africa. In strengthening the information sharing among supervisors on the African continent, members developed an information-sharing template to be housed on the AACB website. The template and the platform will be refined on an ongoing basis to improve the quality of data available to banking supervisors. The objective is to create a platform where experiences are shared and ideas discussed among banking supervisors in order to promote the strengthening of effective supervision of cross-border banking operations in Africa.

The sharing of information and workshops conducted are crucial in harmonising the supervisory frameworks and for formulating sufficient methods to improve cross-border supervision on the African continent.

In terms of the CABS capacity-building initiatives, the Working Group on Cross-border Banking Supervision conducted a workshop on IFRS 9 in September 2017 and an AML workshop in December 2017. Both workshops were held at the SARB Head Office in Pretoria.

1.9.2.3 Information Technology Supervisors Group

BSD was granted full membership status of the Information Technology Supervisors Group (ITSG), an independent and cooperative international working group for prudential information technology (IT) supervisors which is not affiliated to the BCBS or its subcommittees.

The mandate of the group includes supervisory aspects and 'lessons learned' from on-site and off-site reviews as well as other supervisory engagements, with special attention given to the supervisory practices, tools and assessment frameworks used.

In addition to the provision of an ongoing communication platform, an annual conference is organised. The following key themes were discussed at the meeting held in 2017:

- IT supervisory evolutions and/or concerns per jurisdiction;
- cybersecurity (remained on the agenda from 2016 due to its prevalence and heightened importance);

- FinTech;
- system resilience and recovery; and
- the macro IT risk landscape.

1.10 Participation in international surveys

During the year under review, BSD participated in the following international surveys and questionnaires:

- Financial Stability Board: Questionnaire on the effects of derivative reforms
- Implementation of policy recommendations to address-shadow banking risks in securities lending and repos
- Compensation Monitoring Contact Group: Questionnaire on compensation
- Financial Institutions Group (FIG): FinTech – regulatory responses
- World Bank: Survey on the mobile money framework
- International Financial Consumer Protection Organisation (FinCoNet): Survey on practices and tools required to support risk-based supervision in a digital age
- FinCoNet: Survey on digitalisation of short-term high-cost lending – supervisory challenges to promote responsible lending
- Financial Stability Board: Consultation on international audit standard-setting arrangements
- Financial Stability Board: Responsibility mapping on corporate governance
- International Banking Federation: Survey on financial technology regulation
- Standing Committee on Supervisory and Regulatory Cooperation: Survey on cybersecurity
- Survey on the joint SIG–FSI project on supervisory approaches and the allocation of resources
- International Monetary Fund (IMF): Financial Access Survey (2017 test module)
- Institutional responsibilities for financial sector supervision and financial stability
- World Bank: Survey on bank regulation and supervision
- G20: Process survey
- BCBS: Updating the previous IMF survey on the regulation and supervision of banks' international operations

1.11 Participation in domestic regulatory and supervisory forums

In the year under review, BSD continued to serve on, and participate in, numerous domestic committees, forums, task groups and working groups to consult with financial industry participants and bodies, external audit bodies, government departments and other financial regulatory authorities on relevant matters.

These institutions and bodies include National Treasury, FSB, Banking Association South Africa (BASA), SAICA, NCR, FIC, and the IRBA and its Committee for Audit Standards.

BSD has interacted actively with these institutions and bodies and will continue to leverage off the networks developed to discuss matters that could impact on financial stability.

1.12 Regional cooperation and interaction

1.12.1 Eastern and Southern Africa Anti-Money Laundering Group

The Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) is a FATF-styled regional body that was established in 1999 and has a membership of 18 countries, including South Africa as one of the founding members.

In September 2016 the ESAAMLG Task Force of Senior Officials approved a proposal by the Working Group on Risk, Compliance and Financial Inclusion to conduct a survey on the termination of correspondent banking relationships. This stemmed from the global phenomenon, referred to as de-risking, that saw a marked increase in the termination of correspondent banking relationships, particularly in developing countries, including those in the ESAAMLG region. FATF has defined de-risking as a situation where financial institutions terminate or restrict business relationships with a particular country or class of customers for a variety of reasons, including but not limited to, AML/CFT.

BSD actively participated and provided technical assistance throughout this project, and temporarily seconded a resource to be part of the ESAAMLG team that collated and analysed the survey responses and provided inputs to the final report.

The survey covered ESAAMLG member countries' private and public sector. In South Africa, 13 banks completed the survey. The report from this survey has been published on the ESAAMLG website.[7]

7. Available at http://www.esaamlg.org

1.12.2 Collaborative on-site meetings

BSD is committed to achieving the principles of consolidated supervision as determined by the BCBS. Core Principle 12 of the Core Principles states that an essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis and adequately monitor and, if appropriate, apply prudential norms to all aspects of the business conducted by the group worldwide.

Furthermore, BSD is committed to maintaining its relationship with foreign regulators for mutual assistance, cooperation and exchange of information in fulfilment of the respective central banks' supervisory responsibilities.

Pursuant to Core Principle 12, BSD conducted nine collaborative on-site visits to the subsidiaries of locally registered banks with a banking interest in Botswana, Ghana, Lesotho, Namibia, Tanzania and the United Kingdom (including Wales and Isle of Man). The visits entailed meeting with the relevant banking supervisory authorities in each respective country for information-sharing purposes and also conducting a collaborative on-site meeting at the banking subsidiaries under their supervision, during which discussions were held with the respective executive management structures responsible for the banking entity in that country. The open and frank discussions during the meetings with the respective supervisory authorities as well as with the banking subsidiaries were informative and most useful in gaining a better understanding of the supervisory framework and processes applied in Botswana, Ghana, Lesotho, Namibia, Tanzania and the United Kingdom as well as the assessments of the respective banking subsidiaries in those countries.

1.12.3 Interaction with other regulatory authorities in the Southern African Development Community (SADC) region

BSD hosted members from the Central Bank of Angola's AML/CFT Supervision Department for a four-day technical assistance and knowledge-sharing visit. During this visit, BSD shared its AML/CFT supervisory methodologies and practices as well as its experiences in conducting domestic and cross-border joint inspections.

1.13 Issues to receive particular attention in 2018

BSD will continue to review, amend and update the regulatory and legislative framework in accordance with the latest relevant internationally agreed regulatory and supervisory standards and practices.

Other areas that will receive particular attention in 2018 include:

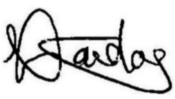
- the ongoing implementation of the PA in terms of the Twin Peaks model of financial regulation;
- the continued monitoring of the banking sector's capital adequacy and liquidity ratios as well as their compliance with relevant laws and regulations;
- the implementation of the Basel III regulatory reforms released by the BCBS;
- the continued monitoring of the implementation of both banks and the external auditors of banks relating to the IASB's IFRS 9 on accounting for expected credit losses;
- BSD's continued focus, in conjunction with the industry, in the search for a viable clearing solution for over-the-counter (OTC) derivatives;
- the further embedding of a risk-based approach framework and an AML/CFT self-assessment questionnaire, which will have to be completed by all banks and mutual banks on an annual basis;
- the implementation of solvency assessment and management (SAM) across the insurance sector and implementation readiness of IFRS 17;
- a sustained focus on IT, including digitalisation, FinTech and cybersecurity;
- the finalisation of requirements and guidelines relating to cloud computing and the offshoring of data; and
- collaboration with industry on the reporting of material IT incidents, including cybersecurity and reporting.

1.14 Expression of gratitude

I wish to acknowledge the new staff members that joined the PA family in 2017 and express my sincere appreciation to the entire team for their continued hard work and dedication. During much of 2017 there were concerted efforts in collaborating and preparing for the transitioning into the PA, and my gratitude goes out to all involved.

A special note of appreciation goes to National Treasury and the FSB for working tirelessly with the team from BSD to bring this process full circle. I look forward to our further engagements as we continue on this journey.

Finally, my gratitude goes to the executives and staff of the SARB for their guidance, input and support in making this a positive and exciting journey for all those involved.



Kuben Naidoo
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