



SOUTH AFRICA

FINANCIAL SECTOR ASSESSMENT PROGRAM

DETAILED ASSESSMENT OF COMPLIANCE ON THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

March 2015

This Detailed Assessment of Compliance on the Basel Core Principles for Effective Banking Supervision on South Africa was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in February 2015.

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February 2015

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION DETAILED ASSESSMENT OF COMPLIANCE

Prepared By
**Monetary and Capital
Markets Department**

This Detailed Assessment Report was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) mission in South Africa during May 2014, led by Cheng Hoon Lim, IMF and overseen by the Monetary and Capital Markets Department, IMF. Further information on the FSAP program can be found at

<http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

AASB	Auditing and Assurance Standards Board
AC	Additional criteria
ALM	Asset liability management
AMA	Advanced measurement approach (operational risk)
AML	Anti-money laundering
BA or Banks Act	Banks Act 1990 (Act No. 94 of 1990, as amended)
BCBS	Basel Committee on Banking Supervision
BCP	Basel Core Principles
BIS	Bank for International Settlements
BSD	Bank Supervision Department of the SAR
CDD	Customer due diligence
CEO	Chief executive officer
CET1	Common equity tier 1
CFT	Counter-terrorist financing
CLF	Committed liquidity facility
CP	Core Principle
EC	Essential criteria
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
FATF	Financial Action Task Force
FIC	Financial Intelligence Centre
FICA	Financial Intelligence Centre Act (Act No. 38 of 2001)
FIU	Financial Intelligence Unit
FMS	Financial management system
FSAP	Financial Sector Assessment Program
FSB	Financial Services Board
FSCF	Financial Sector Contingency Forum
FSOC	Financial Stability Oversight Committee
FSR	Financial Stability Review
FX	Foreign exchange
IAASB	International Auditing and Assurance Board
GFC	Global financial crisis
IAS	International Accounting Standard
IASB	International Accounting Standard Board
ICAAP	Internal capital adequacy assessment process
IFRS	International Financial Reporting Standards
IMA	Internal models approach (market risk)
IMF	International Monetary Fund
IRB	Internal ratings-based approach (credit risk)
IRBA	Independent Regulatory Board for Auditors
IRRBB	Interest rate risk in the banking book
ISA	International Standards on Auditing

JSE	Johannesburg Stock Exchange
KYC	Know your customer
LCR	Liquidity coverage ratio
LGD	Loss given default (IRB credit risk approaches)
ManCo	Management committee (of the BSD)
MIR	Management information report
MIS	Management information system
MOU	Memorandum of understanding
NCA	National Credit Act
NCR	National Credit Register
NPL	Non-performing loan
NSFR	Net stable funding ratio
OFA or Oracle	Oracle Financial Analyser (software used for data analysis)
OR	Operational risk
ORS	Operational Risk Subcommittee (of the FSCF)
OTC	Over-the-counter
PD	Probability of default (IRB credit risk approaches)
PEP	Politically exposed persons
PIIGS	Portugal, Ireland, Italy, Greece and Spain
POCA	Prevention of Organised Crime Act (Act No. 121 of 1998)
PRA	Prudential Regulatory Authority (in the United Kingdom)
QIS	Quantitative Impact Study (conducted by the BCBS)
Registrar	Registrar of Banks
Regulation(s)	Regulations relating to banks
RoE	Return on equity
RSF	Required amount of stable funding
SAICA	South African Institute of Chartered Accountants
SAMOS	South African Multiple Option Settlement
SARB	South African Reserve Bank
SARBA	South African Reserve Bank Act
SENS	Stock Exchange News Service (operated by the Johannesburg Securities Exchange)
SREP	Supervisory Review and Evaluation Process/Programme
STA	The standardized approach
Strate	South Africa's Central Securities Depository
SVaR	Stress value at risk
VaR	Value at risk
ZAR	South African Rand

INTRODUCTION

1. **South Africa has a high level of compliance with the Basel Core Principles for Effective Banking Supervision (BCPs).** The current supervisory regime is based on strong relationships with bank Boards and senior management, as well as with banks' internal and external auditors, supported by intensive qualitative and quantitative analysis. The Registrar of Banks (the head of banking supervision) and his staff in the Bank Supervision Department (BSD) of the South African Reserve Bank (SARB) hold banks to a very high standard of corporate governance and risk management.
2. **The South African banking system is highly concentrated with more than 90 percent of banking assets being controlled by the five largest banks.** The same laws, regulations and supervisory processes apply to all banking institutions, irrespective of their size. However, under a risk-based system, a much larger percentage of supervisory focus and resources centers quite naturally on the largest institutions.
3. **The SARB, as a member of the Basel Committee on Banking Supervision (BCBS), is committed to the adoption of international standards and sound practices promulgated by the BCBS, as well as other relevant international standard-setting bodies.** The SARB has implemented, or is in the process of implementing, all of the BCBS standards, most notably those related to capital adequacy and liquidity. The SARB is to be commended for its ongoing commitment to adhering to the highest standards for supervision and regulation, and also for encouraging and supporting its supervisory counterparts in neighboring countries in implementing key standards, as appropriate, which should also help to ensure the adequate oversight of South African banks' cross-border operations as they expand.
4. **Since the previous assessment conducted in 2010, the BSD has made several significant improvements to its supervisory framework.** Most notably, the department has increased supervisory staff by almost 50 percent, and it now includes a corps of risk specialists to complement the analysis teams, and additional on-site inspectors, thereby enabling the BSD to have more direct interaction with the banks and place less reliance on external auditors. In addition, several shortcomings in bank regulations have been addressed since 2010. Cooperation with relevant domestic and foreign supervisors has also been strengthened.
5. **There are a few areas in relation to the legal and regulatory frameworks as well as powers that still warrant improvement.** These include, among others, legal provisions related to objectives of the supervisory institution and appointment and dismissal of its head, the power to suspend or limit a bank's registration expeditiously, and supervisory techniques to address risks stemming from the non-banking activities of a financial group. While the BSD has been able, for the most part, to work around these weaknesses, amendments to the appropriate laws and regulations should be made as soon as possible. In addition, supervisory techniques to monitor the risk of an entire financial group should be further improved. The SARB anticipates that the laws and

regulations will be further strengthened in the next round of amendments expected to take place as part of the restructuring of the financial regulatory system in South Africa.

6. As the country's financial sector oversight is going through a substantial transition, efforts should be made to maximize the benefit of the new twin peaks structure. In 2011, the National Treasury announced its intention to adopt the twin peaks model of financial regulation. The new Prudential Authority will be a department within the SARB and the current BSD staff will become part of the new Authority, merging with prudential supervisors of insurers and several other categories of financial institutions currently within the Financial Services Board (FSB). This move has the potential to contribute to safeguarding the stability of the banking system, given the unique situation of the banking sector in South Africa, which is also substantially involved in insurance and other financial activities as groups. But the new prudential supervisor needs to establish an appropriate framework and improve tools to supervise these diversified entities without undermining the current high quality oversight of banks.

BACKGROUND INFORMATION AND METHODOLOGY

7. This assessment of the current state of the implementation of the Basel Core Principles for Effective Banking Supervision (BCPs) in South Africa has been completed as a part of a Financial Sector Assessment Program (FSAP) update undertaken by the International Monetary Fund (IMF) during 2014.¹ It reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment. It is not intended to represent an analysis of the state of the banking sector or crisis management framework, which have been addressed in the broader FSAP exercise.

8. An assessment of the effectiveness of banking supervision requires a review of the legal framework, and detailed examination of the policies and practices of the institution(s) responsible for banking regulation and supervision. In line with the BCP methodology, the assessment focused on banking supervision and regulation in South Africa and did not cover the specificities of regulation and supervision of other financial intermediaries, which are covered by other assessments conducted in this FSAP.

9. The South African authorities agreed to be assessed according to the Revised Core Principles Methodology issued by the BCBS (Basel Committee of Banking Supervision) in September 2012. This assessment was thus performed according to a significantly revised content and methodology as compared with the previous BCP assessment carried out in 2010 which was conducted under the former BCP methodology. It is important to note that this assessment cannot and should not be compared to the previous undertaking, as the revised BCPs have a heightened focus on risk management and its practice by supervised institutions and its assessment by the supervisory authority, raising the bar to measure the effectiveness of a supervisory framework (see box for more information on the Revised BCPs).

¹ The assessment team was comprised of Elizabeth Roberts (external expert) and Mamoru Yanase (IMF).

10. The South African authorities also chose to be assessed against both the Essential and Additional Criteria but rated against only the Essential Criteria. In order to assess compliance, the BCP Methodology uses a set of essential and additional assessment criteria for each principle. Only the essential criteria (EC) were used to gauge full compliance with a CP. The additional criteria (AC) are recommended best practices against which the South African authorities have agreed to be assessed but not rated. A four-part grading system is used: compliant; largely compliant; materially noncompliant; and noncompliant. This is explained below in the detailed assessment section. The assessment of compliance with each CP is made on a qualitative basis to allow a judgment on whether the criteria are fulfilled in practice. Effective application of relevant laws and regulations is essential to provide indication that the criteria are met.

Box 1. The 2012 Revised Core Principles

The revised BCPs reflect market and regulatory developments since the last revision, taking account of the lessons learnt from the financial crisis in 2008/2009. These have also been informed by the experiences gained from FSAP assessments as well as recommendations issued by the G-20 and Financial Stability Board, and take into account the importance now attached to: (i) greater supervisory intensity and allocation of adequate resources to deal effectively with systemically important banks; (ii) application of a system-wide, macro perspective to the microprudential supervision of banks to assist in identifying, analyzing and taking pre-emptive action to address systemic risk; (iii) the increasing focus on effective crisis preparation and management, recovery and resolution measures for reducing both the probability and impact of a bank failure; and (iv) fostering robust market discipline through sound supervisory practices in the areas of corporate governance, disclosure and transparency.

The revised BCPs strengthen the requirements for supervisors, the approaches to supervision and supervisors' expectations of banks. The supervisors are now required to assess the risk profile of the banks not only in terms of the risks they run and the efficacy of their risk management, but also the risks they pose to the banking and the financial systems. In addition, supervisors need to consider how the macroeconomic environment, business trends, and the build-up and concentration of risk inside and outside the banking sector may affect the risk to which individual banks are exposed. While the BCP set out the powers that supervisors should have to address safety and soundness concerns, there is a heightened focus on the actual use of the powers, in a forward-looking approach through early intervention.

The number of principles has increased from 25 to 29. The number of essential criteria has expanded from 196 to 231. This includes the amalgamation of previous criteria (which means the contents are the same), and the introduction of 35 new essential criteria. In addition, for countries that may choose to be assessed against the additional criteria, there are 16 additional criteria.

While raising the bar for banking supervision, the Core Principles must be capable of application to a wide range of jurisdictions. The new methodology reinforces the concept of proportionality, both in terms of the expectations on supervisors and in terms of the standards that supervisors impose on banks. The proportionate approach allows assessments of banking supervision that are commensurate with the risk profile and systemic importance of a wide range of banks and banking systems.

11. The assessors reviewed the framework of laws, rules, and other materials provided and held extensive meetings with officials of the South African Reserve Bank (SARB) Banking Supervision Department, and additional meetings with the National Treasury, auditing firms, and banking sector participants. The authorities provided a self-assessment of the CPs, as well as responses to additional questionnaires, and provided access to supervisory documents and files, staff and systems.

12. The assessors appreciated the cooperation received from the authorities. The team extends its thanks to staff of the authorities who provided cooperation, including provision of documentation and access, at a time when staff was burdened by many initiatives related to global regulatory changes and reforms in the financial sector oversight structure in South Africa.

13. The standards were evaluated in the context of the South Africa's financial system's structure and complexity. The CPs must be capable of application to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, according to the methodology, a proportionate approach is adopted, both in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the CPs must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, risk profile and cross-border operation of the banks being supervised. The assessment considers the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

14. An assessment of compliance with the BCPs is not, and is not intended to be, an exact science. Reaching conclusions required judgments by the assessment team. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the South African authorities with an internationally consistent measure of the quality of its banking supervision in relation to the BCPs, which are internationally acknowledged as minimum standards.

15. To determine the compliance with each principle, the assessment has made use of five categories: compliant; largely compliant, materially noncompliant, noncompliant, and non-applicable. An assessment of "compliant" is given when all ECs are met without any significant deficiencies, including instances where the principle has been achieved by other means. A "largely compliant" assessment is given when there are only minor shortcomings, which do not raise serious concerns about the authority's ability to achieve the objective of the principle and there is clear intent to achieve full compliance with the principle within a prescribed period of time (for instance, the regulatory framework is agreed but has not yet been fully implemented). A principle is considered to be "materially noncompliant" in case of severe shortcomings, despite the existence of formal rules and procedures and there is evidence that supervision has clearly not been effective, the practical implementation is weak or that the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance. A principle is assessed "noncompliant" if it is not substantially implemented, several ECs are not complied with, or supervision is manifestly

ineffective. Finally, a category of “non-applicable” is reserved for those cases that the criteria would not relate to the country’s circumstances.

INSTITUTIONAL AND MARKET STRUCTURE— OVERVIEW

A. Institutional Framework for Regulation and Supervision

16. The responsibility for the regulation and supervision of banks lies with the SARB. As provided by the Banks Act of 1990 (BA), its authority is exercised through the Registrar of Banks and the Office for Banks, also known as the BSD, which falls under the Registrar’s direction. Some important powers formally rest with the Minister of Finance, such as issuing regulations and formally making important supervisory actions. As an internal department of the SARB, the organizational governance of the BSD, including the Registrar, follows the rules applicable to the central bank. The Banks Act provides a comprehensive legal framework for banking regulation and supervision in the country. The SARB and the BSD also have the responsibility for the regulation and supervision of mutual banks as provided by the Mutual Banks Act of 1993. The National Credit Regulator (NCR), which reports to the Minister of Trade & Industry, has a certain regulatory power over lending activity for consumer protection. The Financial Intelligence Center (FIC) acts as the country’s Financial Intelligence Unit (FIU).

17. The regulatory framework for banks follows international standards, and the implementation of Basel III has started since 2013. The BSD attaches strong importance to adopting international standards established by the BCBS and other international bodies such as the Financial Stability Board and the International Accounting Standard Board (IASB). Its regulatory and supervisory framework on banks is continuously updated to incorporate the latest international standards. They were also one of the first jurisdictions implementing Basel II and 2.5. A shorter phase-in period for Basel III capital than that of internationally agreed is set. Also, one percent additional capital is required for all banks. The authorities also intend to introduce the Liquidity coverage ratio (LCR) and the Net stable funding ratio (NSFR) according to the internationally-agreed timeframe.

18. The FSB has broad regulatory authority over other types of financial activities. It regulates and supervises insurance companies, although some of their lending activities are also under the purview of the NCR. For securities companies, while the FSB is responsible for supervising fund managers and exchanges, the supervisory responsibility for market intermediaries is divided between the FSB and the Johannesburg Stock Exchange (JSE). The FSB does not have any role in issuer supervision, which is undertaken by the JSE for listed companies and by the Department of Trade and Industry (DTI) for unlisted companies. The FSB also regulates the JSE (including SAFCOM, its clearance and settlement subsidiary), Strate Limited, and pension funds.

19. The regulatory and supervisory framework for the financial sector is expected to go through a substantial transformation through the adoption of the Twin Peaks structure. Under

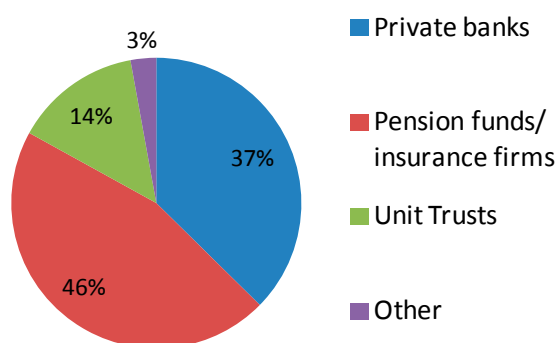
the plan, the prudential regulation and supervision of financial conglomerates, banks, insurance companies, securities exchanges and central counterparties as well as money market funds would be assigned to a single statutory entity located in the SARB, which will be called the Prudential Authority. The market conduct regulation and supervision of financial conglomerates, banks, insurance companies, securities exchanges and central counterparties as well as money market funds would be assigned to a separate dedicated statutory entity to be situated in the FSB, which will be called the Market Conduct Authority. The National Treasury has published the relevant bill for public consultation early this year, which is expected to be revised further. Amendments to acts regulating financial industries, such as the Banks Act, are expected to take place following the completion of the reorganization.

B. Overview of the Banking Sector

20. The financial sector in South Africa is large and sophisticated. Total financial sector assets of about 298 percent of GDP exceed those of most other emerging market. Commercial

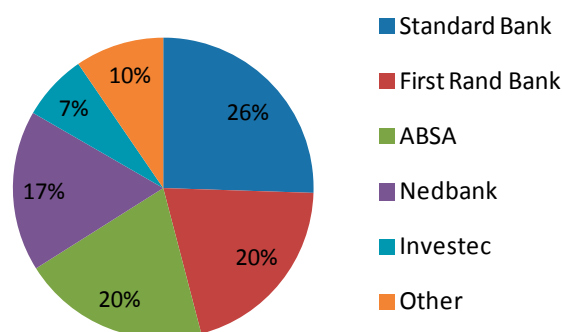
banks make up the single largest segment of the financial system with assets of slightly more than 112 percent of GDP. But their share in total financial assets has been declining in recent years with the rapid growth of the nonbank financial sector, and currently only comprises less than 40 percent of the total. Close to 95 percent of banking assets is domestic; some of the largest banks shrank their operations in advanced economies and non-African emerging market economies, but South African banks' exposure to other African countries has expanded rapidly in recent years.

Figure 1. Financial Assets in South Africa



Source: SARB.

21. The banking sector is comprised of only 31 banks and foreign bank branches, and highly concentrated where large banks dominate. Five large banks—ABSA Bank, FirstRand Bank, Nedbank, Standard Bank of South Africa, and Investec Bank—dominates the sector, which together account for more than 90 percent of total banking assets. Four of the five large banks are providing full-scale banking services nationwide, while Investec's operation is focused on corporate and private banking businesses. The rest of the sector consists of 7 locally owned banks, 5 subsidiaries of foreign banks, and 14 branches of foreign banks (end-2013). Except for two relatively large local banks focusing on retail banking, other banks, both locally controlled and foreign controlled, have limited operations, and not systemically important even regionally.

Figure 2. Shares of Banking Assets

Source: SARB.

22. The banking industry has strong cross-border and cross-sectoral linkages.

Three of the five large banks have strong ownership links with the U.K. Barclays, a U.K. global systemically important bank, has a fully-owned bank controlling company registered in South Africa, Barclays Africa Group, which owns a majority stake of ABSA Bank. Nedbank is indirectly owned by Old Mutual in the U.K, which also owns a major insurance subsidiary in South Africa. Investec is dual-listed on the JSE and

London Stock Exchange and has a parallel structure where the U.K. holding company oversees the group's non-African operations. In addition to Nedbank, all other major banks are also affiliated with insurance companies. For example, Standard Bank Group, the controlling company of Standard Bank, has the majority of shares in the Liberty Group, one of the largest insurers in the country. These bank-affiliated insurance companies underwrite a substantial proportion of private pension fund assets, and some banks also own asset management companies that offer unit trusts. These big banks have started to expand to other Sub-Saharan African countries, with Standard Bank and Barclays Africa Group spearheading the move. Four of the top five banks have 39 subsidiaries in 17 sub-Saharan countries. Their sizes of operation in these countries are still very small compared to the entire group, however.

23. Banks remained sound and profitable during the crisis, with good asset quality and high capital ratios. While non-performing loans (NPLs) jumped from 2 percent of total loans at the onset of the crisis to 6 percent in late 2009, the average NPL ratio declined steadily since then to 3.6 percent in 2013. The regulatory tier one ratio of 13.4 percent in 2013 also compares favorably with banks in other countries. Return on equity (ROE) of the four largest banks is staying close to 20 percent. South African banks have also accumulated a sizable net foreign asset position and there is no evidence of large-scale unreported borrowing from abroad. The SARB also applies a 1 percent systemic risk surcharge to the large banks in addition to minimum capital requirements.

24. Banks are dependent on wholesale deposits with high loan-to-deposit ratios. The average funding maturity seems to have shortened in recent years with short-term deposits (6 months in maturity) rising to 63.3 percent of total deposits from 60.3 percent in 2008. In addition, the liquid asset to short-term liabilities ratio is around 16 percent. While deposits make up the largest source of bank funding (87.5 percent), a large part (60 percent) of it is wholesale funding from non-bank financial institutions and corporations with maturities of six months or less, reflecting the structural situation in South Africa where households are investing in non-deposit products such as pensions, insurance products and unit trust, which are in turn deposited in banks by providers of those products. The average loan-to-deposit ratio is 127 percent.

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION

A. Macroeconomic Environment

25. The financial sector operates in a challenging economic environment. A combination of slow growth, high unemployment, low savings and relatively high household debt is sustaining large current account and fiscal deficits. The South African economy contracted by 0.6 percent of GDP in 2014Q1 and is projected to grow only by 1.4 percent this year, down from 2 percent in 2013, and a pre-crisis high of 5.6 percent in 2006. The unemployment rate, already persistently high, has risen steadily to 25 percent while inflation remained at 6 percent. Fiscal deficits averaging 4 ½ percent of GDP for the past five years has led to a sharp increase in government debt from 27 percent of GDP to 46 percent in 2014. Reflecting this macroeconomic environment, an international rating agency recently downgraded the sovereign foreign and local currency ratings. Exchange controls on capital transactions by residents are in place, which keeps rand in the system, although it has been gradually relaxed.

26. Household debt rose rapidly in the years prior to the global financial crisis (GFC) to 82.4 percent of disposable income in 2008, although declined somewhat since then. A credit boom in the years prior to the GFC and, from 2009 when interest rates dropped to record lows, fueled a sharp increase in household debt. Mortgage lending peaked at 30 percent annual growth rate in 2006, declining to single digits in 2012, before picking up again in the first quarter of 2014. Although the household-debt-to-disposal-income ratio has declined steadily from its peak, to 75.2 percent in 2013, it remains well above the historical average before the GFC. At end 2013, total bank lending to households is 56 percent of bank total loans and advances. Floating-rate mortgages account for a large proportion of household debt. Bank lending to the corporate sector is 31 percent of banking sector assets, and total corporate debt accounted for 62 percent of GDP in 2013, up from 57.6 percent in 2010. The increase reflected mostly external borrowing by public sector corporations, which doubled their external debt between 2010 and 2012.

B. Frameworks for Financial Stability Oversight, Crisis Management, and Systemic Protection

27. The SARB performs the function of promoting financial stability. This mandate was added by the Minister of Finance in 2010. The SARB has subsequently established the Financial Stability Committee to discuss issues related to financial stability. The Financial Stability Department of the SARB was recently separated from the BSD. To fulfill its macroprudential mandate, the SARB conducts a number of tasks including: assessing risks to system wide stability; sharing risk assessment with other agencies / the public; contributing to the development of macroprudential instruments and policies; and developing and implementing any discretionary policy actions to mitigate risks. The SARB publishes Financial Stability Review twice a year.

28. The framework is expected to be reorganized substantially as a part of the move to the Twin Peaks structure. The Financial Stability Oversight Committee (FSOC), chaired by the SARB Governor and includes the Prudential Authority and the Market Conduct Authority as a member and a representative from the National Treasury as an observer, will be created and become responsible for monitoring and assessing systemic risks to financial stability, and making recommendations or taking actions to reduce or eliminate these risks. The FSOC is also expected to play a central role in crisis management and resolution.

29. The current bank resolution regime in South Africa comprises powers assigned to a curator, who is appointed by the Minister based on the recommendation of the Registrar when a bank is close to insolvency. The curator has broad powers to take control of the bank and its assets, some of which require prior approval of the Minister, but they lack critical features necessary to deal with a systemic case, and minimize risks to public funds. The existing legal framework does not require mandatory recovery plans to be prepared by banks, but the BSD has announced the introduction of recovery and resolution planning in a phased-in approach through a number of Guidance Notes. As a member of the Financial Stability Board, the South African authorities are committed to reforming the resolution regime to make it compliant with the Key Attributes of Effective Resolution by end 2015.

30. Formal systemic protection is limited in South Africa, but the authorities have intervened in bank failure cases on an ad-hoc basis. The country does not have a depositor protection scheme or a framework for systemic liquidity provision, but, in the past, capital and liquidity injections were made mostly by the SARB in the interest of stemming deposit contagion and preserving financial stability. The authorities have been considering introducing a deposit insurance scheme for some time but no decision has been made yet. The SARB set up a committed liquidity facility (CLF) to support banks to meet the Basel III LCR requirement from 2015, but it does not prevent the central bank from providing emergency liquidity assistance on different terms than the CLF. While there is no formal legal framework for crisis management, the Financial Sector Contingency Forum, which is chaired by a Deputy Governor of the SARB and whose members include representatives from the National Treasury, SARB and FSB was established to coordinate efforts on contingency planning for financial crisis, among others.

C. Infrastructures for the Financial Sector

31. South Africa has a well-developed system of laws. The Companies Act was recently updated to incorporate the latest thinking. It includes provisions on bankruptcy/insolvency and related matters. The King Report III, which sets the corporate governance best practice, is applicable to all companies listed on the main board of the JSE. The contract law is also well developed and covers a wide range of matters including, among others, debt, mediation between parties, insurance, and share sales. Consumer protection is addressed in the Consumer Protection Act, which applies to the sale of goods and services, and supplemented by the National Credit Act (NCA) which covers credit agreements. Business laws can be enforced through the courts system or parties can make use of arbitration and mediation for the resolution of disputes. The independence and impartiality of

the judiciary have not been questioned, but the efficiency of the courts can be sometimes hampered and efforts for improvement are ongoing.

32. Accounting and auditing in South Africa are based on international standard and a well developed system exists to ensure their consistency and quality.²

- South Africa has implemented International Financial Reporting Standards (IFRS) and International Standards on Auditing since 2005. The JSE has required listed companies to use IFRS since January 1, 2005. The Companies Act, however, does not require all companies to have their financial statements audited. The Companies Act Regulations permit the use of either IFRS, the IFRS for SMEs, or South African GAAP in specific instances. The Financial Reporting Standards Council (FRSC), a governmental body formed in 2011, has responsibility as the advisor to the Minister of Trade and Industry on financial reporting standards.
- The Independent Regulatory Board for Auditors (IRBA) is responsible for overseeing registered auditors and audits performed by them. The South African Institute of Chartered Accountants (SAICA) is the national professional organization of Chartered Accountants, with more than 36,000 members. It participates in a number of international accounting bodies, including the trustees of the International Financial Reporting Standards Foundation (IFRS Foundation) and the International Accounting Standards Board (IASB). The Auditing and Assurance Standards Board (AASB), consists of SAICA and other business bodies, is responsible for ensuring consistency between South African auditing pronouncements and those of the International Auditing and Assurance Standards Board (IAASB). The Consultative Advisory Group advises the IAASB on technical issues, and its members include representatives from the SARB, FSB, JSE, Strate, and Institute of Internal Auditors.

33. South Africa also has a developed financial infrastructure, including a stock exchange, a Central Securities Depository, a national payment system, and credit bureaus:

- The JSE is the primary exchange in South Africa and the largest in Africa. It offers primary and secondary markets for a range of financial products, including equities, bonds and derivatives. SAFCOM, a wholly owned subsidiary of the JSE, is a licensed clearinghouse for derivatives listed on the JSE.
- Strate is the central securities depository (CSD). It provides electronic settlement for securities—including equity, bond and derivative products, such as warrants, Exchange Traded Funds (ETFs), retail notes and tracker funds for the JSE, and money market securities for the South African market, as well as equities for the Namibian Stock Exchange. It also acts as a clearinghouse for some debt trading.

² In the World Economic Forum's Global Competitiveness Report of 2013/14, South Africa was ranked as the number one nation in the world for Auditing and Reporting Standards. South Africa also received number one rankings for Efficacy of Corporate boards, Protection of minority shareholder's interests, Regulation of securities exchanges and Legal rights index achievements.

- The South African Multiple Option Settlement (SAMOS) system, owned and operated by the SARB, is the core of the South African national payment system. SAMOS is a real-time gross settlement system, which settles, among others, the rand settlement of all the financial market transactions, interbank transactions and the settlement of foreign exchange transactions with other international banks.
- South Africa has four major credit bureaus with consumer and business credit information. The NCA provides that the Minister of Trade & Industry must publish regulations on how consumer credit information held by credit bureau must be reviewed, verified, corrected and removed. The NCR provides oversight over these credit bureaus. Data contributors to the credit bureaus include banks, credit driven retailers, credit card companies, micro lenders, telecommunication and insurance companies, courts, debt counsellors, debt collectors.

DETAILED ASSESSMENT

Table 1. Supervisory Powers, Responsibilities, and Functions

Principle 1	Responsibilities, objectives and powers. An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. ³ A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns. ⁴
EC1	The responsibilities and objectives of each of the authorities involved in banking supervision ⁵ are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	The Banks Act of 1990 (BA) Section 3 provides “for the registration as banks of public companies desiring to conduct the business of a bank and for the other purposes of this Act there shall, as part of the Reserve Bank, be an office in Pretoria called the Office for Banks, and at the head of such office shall be a person to be styled the Registrar of Banks,” thus giving the power of registration and related matters to the South African Reserve Bank (SARB) Bank Supervision Department (BSD), and the Registrar, its head. The powers of the Registrar, including the registration of banks as well as conducting a supervisory review process—consists of, among others, on- and off-site supervision—are listed in the BA. No other authorities are provided responsibilities over prudential supervision of banks. The BA

³In this document, “banking group” includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example non-bank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

⁴The activities of authorising banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

⁵Such authority is called “the supervisor” throughout this paper, except where the longer form “the banking supervisor” has been necessary for clarification.

	and other legislation, however, do not provide the objectives of the BSD or the Registrar. Instead, the BSD's annual report, which is required by law as explained in CP2, describes its mission as "to promote the soundness of banking system and to contribute to financial stability." The BSD explains this is its interpretation of the BA and it has evolved over time.
EC 2	The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.
Description and findings re EC2	As explained above, although no objectives are given in related legislation, the BSD views its primary mission as "to promote the soundness of the banking system and contribute to financial stability," as described in its annual report. It regards its other responsibilities, such as the control of banking-related activities by unregulated persons, as secondary.
EC3	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile ⁶ and systemic importance. ⁷
Description and findings re EC3	<p>BA Chapter VI provides a general framework of quantitative prudential requirements—minimum capital, minimum liquid assets and large exposure requirements. BA Section 74 gives the Registrar power to take actions against banks and controlling companies who failed to comply with these quantitative requirements, including imposing administrative fines. BA Chapter V also sets out organizational requirements such as on corporate governance.</p> <p>The Finance Minister can issue regulations "as to any matter which is required or permitted to be prescribed by regulation under this act." Under the provision of this section, "Regulations relating to Banks" (Regulations) as well as other relevant regulations have been issued, which contain necessary details for implementing the BA, including reporting requirements (BA returns) as well as qualitative requirements on such issues as corporate governance and internal control. The Regulations are generally drafted by the BSD with necessary consultation with the National Treasury. The BSD states that it does not have any problem with issuing necessary regulations or amending them.</p> <p>The Registrar can also issue a circular "with guidelines regarding the application and interpretation of the provisions of this act" and a guidance note, which provides information and expectations regarding the BSD's regulation and supervision. These do not have the power of law by themselves, but are accepted by banks as indicating the</p>

⁶ In this document, "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

⁷ In this document, "systemic importance" is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

	<p>expectation of the BSD and thus followed.</p> <p>In addition, recently added BA Section 6(6) provides the Registrar power to issue a directive to a bank or a controlling company regarding the application of the BA, which may include the issuing of a non-financial sanction, requiring a bank to cease from engaging in acts or to perform corrective actions, or the request of additional reporting. Contrary to circulars and guidance notes, these are directly enforceable. Directives are sometimes issued to all banks to provide a requirement or guidance that apply to the whole industry.</p> <p>Regulation 38 (4) gives the power to the Registrar to increase prudential requirements for a bank, including to maintain additional capital, deduct amounts from the eligible capital, strengthen the risk management and other bank policies, to reflect its actual risk profile or inadequacy in risk management, internal control, remuneration or other policies.</p>
EC4	<p>Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.</p>
Description and findings re EC4	<p>The BA, which was promulgated in 1990, has been subsequently updated 8 times, to make it compliant with Basel II and III and to ratify issues detected during the previous BCP assessment, among others. Regulations, circulars and guidance notes are also revised and published frequently.</p> <p>In the case of changes to the Act, involvement of a Standing Committee for the Revision of the Banks Act is required (BA Section 92). The Standing Committee is chaired by a SARB Deputy Governor, and has members representing the Banking Association of South Africa, National Treasury, the BSD and other representatives of the SARB. Current employees and Board members of regulated entities, including banks, have not been appointed as members of the Standing Committee in the recent past. A first draft, prepared by the BSD, is presented to the Standing Committee. Approval of the Standing Committee is followed by release for public comment. After addressing substantive comments, a final version is again presented to the Standing Committee. Its final approval leads to approval by the Minister of Finance who furthermore obtains the Cabinet's permission for submitting the Bill to a parliamentary process. Once the Bill has been debated and approved by the Parliament and assented to by the President it will be promulgated as an amendment to the Act. The authorities explain the involvement of the Standing Committee is to provide technical expertise to the process. The members of the Standing Committee are appointed for the term of 3 to 4 years when a need arises. At the time of the assessment, no member is appointed.</p> <p>Changes to regulations follow the same route through the Standing Committee and public comment, culminating with the Minister of Finance signing and publishing the amended regulations. No parliamentary process is required for changes to regulations. The</p>

	<p>regulations are amended or issued frequently.</p> <p>For circulars and guidance notes, no consultation is required, as they only contain interpretations of existing laws and regulations, and are often issued in response to the industry's request for guidance. For directives, consultation with relevant banks is necessary.</p>
EC5	<p>The supervisor has the power to:</p> <ul style="list-style-type: none"> (a) have full access to banks' and banking groups' Boards, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations; (b) review the overall activities of a banking group, both domestic and cross-border; and (c) Supervise the activities of foreign banks incorporated in its jurisdiction.
Description and findings re EC5	<p>On access to banks, BA Section 6(3) provides the Registrar the power to have discussions with the CEO, executive officers or staff members of a bank, controlling company of a bank, subsidiary or trust of that bank to achieve effective supervision. Section 7(1) also provides the power to direct a bank to supply any information required for the performance of the Registrar's functions and duties prescribed in the BA.</p> <p>On the review of the overall activities of a banking group, in BA Section 1 (1), "banking groups" are defined in such a manner to include natural and judicial persons associated with and connected to a bank, irrespective of whether any of these persons is domiciled in the same country as any of the others. The abovementioned BA Section 6(3) provides that access to a bank and its related entities is to achieve effective supervision by the Registrar including on a consolidated basis of the group of which that bank is a member. Thus, reporting requirements prescribed in the Regulations covers consolidated activities of banks, including their cross-border activities. (Regulations 36, 37) (For details, see CP 12).</p> <p>On supervision of activities of foreign banks, foreign bank subsidiaries are treated as domestically incorporated banks and therefore subject to the same regulation and supervision that applies to all domestically incorporated banks in South Africa. For foreign banks operating as branches, BA section 18A provides that reference to banks in the laws covers foreign bank branches in the country unless expressly stated otherwise, making these branches subject to the same regulation and supervision as domestically-incorporated banks.</p>
EC6	<p>When, in a supervisor's judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to:</p>

	<ul style="list-style-type: none"> (a) take (and/or require a bank to take) timely corrective action; (b) impose a range of sanctions; (c) revoke the bank's license; and (d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.
Description and findings re EC6	<p>See CP 11 for detailed discussion.</p> <p>As explained above, BA Section 6 (6) provides the Registrar power to issue a directive concerning a particular bank, after consultation with the relevant bank. The section was recently added to the BA to provide flexible powers to the Registrar. Directives can be used to require banks to, within the specified time period, (i) cease or refrain from engaging in any act, omission or course of conduct or perform such acts necessary to remedy the situation, (ii) perform such acts necessary to comply with the directive or to effect the change required to give effect to the directive, or (iii) provide such information and documents relating to the matter as specified in the directive. Similarly, as described in EC3, the Regulation provides the supervisor power to require banks to correct their policies and processes.</p> <p>In addition, BA Section 74 gives the Registrar a specific power to apply measures for a case where a bank fails to comply with quantitative prudential requirements, such as minimum capital or minimum liquid assets. In this case, no consultation with the relevant banks is necessary.</p> <p>BA Section 91A provides the Registrar the power to impose a monetary penalty not exceeding 10 million ZAR for every day during which contravention or non-compliance with the Act continues.</p> <p>Regarding the banks' registration (license), BA Section 26 provides the Registrar power to restrict activities of a bank for such reasons as: the bank or its officers has been convicted of any offence in terms of the BA; the bank does not carry on satisfactorily the business of a bank; it has failed to comply with a requirement of the BA; or, it continues to employ an undesirable practice. However, a 30-day notice period is required. Alternatively, the supervisor can apply to a competent court for an order cancelling or suspending the registration of a bank for reasons such as above.</p> <p>On resolution, BA Section 69 provides that, when it has become evident to the BSD or a bank has informed the BSD that it is or will be unable to repay depositors when required, the Registrar may recommend to the Minister that it be placed under curatorship. The curator is appointed by the Minister with the management of the bank vested in the curator.</p>

EC7	The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.
Description and findings re EC7	The BA and the Regulations are applicable to both banks and controlling companies of banks, which have material control over banks. BA Section 4 (4) provides that the supervisory review process to be implemented and maintained by the Registrar covers “a bank or controlling company and its respective branches, subsidiaries, joint ventures or related entities, within or outside the Republic.” Those powers provided in BA Section 6 (3) and Section 7 described in EC5 apply not only to banks but also to controlling companies and subsidiaries of banks and controlling companies, with a view to achieving effective supervision of the group on a consolidated basis. For details, see CP 12.
Assessment of Principle 1	Largely Compliant
Comments	<p>The BA and associated rules provide a broadly appropriate framework for regulating and supervising banks. It also provides clear responsibilities of and adequate powers to the Registrar of Banks and the Banking Supervisory Department. However, the lack of legally defined objectives of the supervisor as well as regulation and supervision of banks is a shortcoming of the current BA and related legislation to be fully compliant with this CP. The assessors note and welcome, however, the authorities plan to address this issue in the expected twin peaks reform. (For discussion on the power to suspend or remove a bank registration, see CP 11.)</p> <p>In addition, to further improve the effectiveness and efficiency of the regulatory process, the assessors also recommend the authorities to review the following issues:</p> <ul style="list-style-type: none"> • The extent of delegation of powers in the Banks Act, with a view to transfer the power to set granular requirements from tier 2 rules (regulations), which need to be issued by the Minister, to tier 3 rules (circulars, directives), which can be issued by the Registrar. For example, templates and forms for reporting, as well as technical details of regulations, which comprise a substantial part of the current regulations, would be better as tier 3 rules. This would give more flexibility in fine-tuning the regulatory framework. • The composition of the Standing Committee for the Revision of the Banks Act, with a view to require its members to be not currently involved in not only any regulated entities but also bodies that represent interests of those regulated entities, to insulate the process from direct industry interests. Instead, as experts on financial business, the Committee could include retired officials from the industry or academics.
Principle 2	Independence, accountability, resourcing and legal protection for supervisors. The supervisor possesses operational independence, transparent processes, sound governance,

	budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.
EC1	The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.
Description and findings re EC1	<p>As mentioned in CP1, BA Section 3 provides that the Office for Banks (BSD) be established as a part of the SARB, with a head titled as the Registrar of Banks, who is designated by the SARB, subject to the approval of the Minister, from its officers or employees. Section 4 also provides that the Registrar “shall perform, under the control of the said Bank (SARB) and in accordance with the directions issued by the Bank from time to time, the functions assigned to the Registrar by or under this act.” However, there is no legally stipulated operational independence of the Registrar and the BSD <i>per se</i>. Also, there are a number of supervisory actions that require the Minister’s decision.</p> <p>The authorities explain that these are for the check-and-balance purpose and that in practice the Registrar and BSD have full discretion to take any supervisory actions or decisions, and the recommendations by the Registrar and the BSD are usually followed by the Minister. But, the authorities also noted that in very limited cases the Minister may make a different decision in view of other legitimate policy objectives such as with regards to the competition policy while paying due regard to the prudential objectives. According to the authorities, there have been no cases in recent years where the Minister acted against the Registrar’s recommendation to reject applications by banks or bank registration applicants.</p> <p>Regarding the SARB, its independence is prescribed in the Constitution of the Republic of South Africa, which stipulates that “the South African Reserve Bank, in pursuit of its primary object, must perform its functions independently and without fear, favour, or prejudice, but there must be regular consultation between the Bank and the Cabinet member responsible for national financial matters.” This provision is interpreted to cover the BSD’s banking regulatory and supervisory activities.</p> <p>The budget and corporate governance structures of the BSD form a part of the SARB and thus are approved by the SARB Board, which is responsible for the corporate governance of the SARB. The SARB Board includes representatives from the government and industries, including the financial industry, but it does not have power over, nor is it involved in, the regulatory and supervisory work of the BSD.</p>
EC2	The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority

	is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.
Description and findings re EC2	<p>BA Section 4 (2) stipulates that “the Reserve Bank shall, subject to the approval of the Minister, designate an officer or employee in its service as Registrar of Banks, who shall perform, under the control of the said Bank and in accordance with the directions issued by the Bank from time to time, the functions assigned to the Registrar by or under this act.”</p> <p>The Registrar has traditionally been appointed from the senior staff in the BSD (although the current Registrar came from the private sector) and is not appointed for a specific term, similar to other senior officials in SARB except for the Governor and the Deputy Governors. Laws define neither a minimum term nor specific reasons for removal from the office for the Registrar. Removal of the Registrar would be thus subject to general legal provisions in South Africa governing employment relations, as well as the SARB employment contracts and policies. There are no provisions that require reasons for removal to be publicly disclosed. The authorities explain dismissal occurs following labor law procedures and when the person is found guilty of misconduct. In such a case, the reason for dismissal may be made public.</p> <p>In case of the Governor and the Deputy Governors, a five-year term is stipulated in the South African Reserve Bank Act (SARBA), although the reasons for dismissal are not specified in law.</p>
EC3	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives. ⁸
Description and findings re EC3	<p>BA Section 10 provides that the Registrar annually submits to the Minister a report, which will then be transferred to the Parliament. No Parliamentary discussion follows.</p> <p>The annual report describes the BSD’s vision and mission, provides the Registrar’s review of the year, and explains the developments of the banking sector in the country as well as activities of the BSD.</p>
EC4	The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.
Description and findings re EC4	The BSD is managed by a Registrar’s Committee, consisting of the Registrar and the Deputy

⁸ Please refer to Principle 1, Essential Criterion 1.

findings re EC4	<p>Registrars—sometimes called “Deputies meeting,” and a management committee (ManCo), chaired by the Registrar and consisting of Deputy Registrars and Assistant General Managers (AGMs). The delegation of powers is done in accordance with a document issued by the Legal Services Department of the SARB with the approval of the Governor’s Executive Committee. With regard to the BSD, while laws and regulations give powers explicitly to the Registrar, these can be delegated to other senior-level officers according to the significance of the issue. The BSD is also subject to the risk management and internal audit functions of the SARB.</p> <p>As mentioned in EC1, the overall responsibility for corporate governance of the SARB, including the BSD, lies with the SARB Board, which includes persons with skills and knowledge of different industries, including the financial industry. But the SARB Board’s role is limited to governance of the central bank and its approval is only needed for such issues as the SARB’s budget, annual reports, and general remuneration policies; it is not involved in regulatory and supervisory decision-making or personnel decisions. Directors and employees of banks and controlling companies are prohibited to become a member of the SARB Board. (South African Reserve Bank Act (SARBA) Section 4 (4)). Retired officials of the financial sector are also not appointed.</p>
EC5	<p>The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.</p>
Description and findings re EC5	<p>All staff of the SARB is subject to a Code of Conduct and a set of staff policies that aims to ensure professionalism and integrity. The Code of Conduct and the associated policies provide, for example, restrictions on the SARB employees taking positions outside the central bank or receiving gifts from supervised entities. In addition, the BSD has its own Code of Conduct to strengthen the aim. Regarding the information obtained through work, its confidentiality is set out in SARBA Section 33 (See CP3).</p> <p>Banks and external auditors confirmed to the assessors that they regard the BSD highly. They also see the BSD staff being highly professional and with integrity and technical expertise, even though a number of them joined the supervisor in recent years. The industry also expressed some concern that a number of experienced senior staff of the BSD are expected to leave in the near future.</p>
EC6	<p>The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes:</p> <p>(a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups</p>

	<p>supervised;</p> <p>(b) salary scales that allow it to attract and retain qualified staff;</p> <p>(c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks;</p> <p>(d) a budget and program for the regular training of staff;</p> <p>(e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups; and</p> <p>(f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g., supervisory colleges).</p>
Description and findings re EC6	<p>As a department of the SARB, the BSD's budget forms a part of the central bank's budget. The BSD explains that it has always been allocated the resources it requests from the Governors Executive Committee of the SARB, which decides on the budget. Oversight of the budget process is provided by the SARB Board. The SARB's budget is self-financed through revenues from its central banking operations. The BSD's budget is not supported by levy on supervised entities, although registration fees are charged on banks and controlling companies which go into the SARB's budget.</p> <p>The BSD staff number grew from approximately 100 in 2011 to 150 in 2014 (excluding the Financial Stability Unit) mainly due to an increase in the Risk Analysis teams and the Anti-Money Laundering Team. Among these, 54 are in charge of supervision, 34 are risk specialists, 9 in policy/regulation/legal, 7 in IT, and 17 for on-site reviews and AML. The Financial Stability Unit, with approximately 25 staff members, separated from the BSD in April 2014 to become an independent department in the SARB.</p> <p>Direct supervision responsibilities are allocated to those in charge of supervision, called frontline analysts in the BSD, who manage relations with banks and continuously monitor and communicate with them. Even for smaller banks, including foreign bank branches, no more than two banks are allocated to one frontline analyst. For a large bank, its frontline analysis team could consist of close to 10 staff members, including managers and senior managers. In addition, the risk specialists, who are specialized in each risk category, will be allocated to work on individual banks as needed. These risk specialists also conduct validations and reviews of banks' internal risk models, which include on-site reviews. The on-site and AML teams focus on "deep dive" on-site reviews on AML and other issues, mostly credit risk to date.</p> <p>Regarding the salary scale for its staff, the SARB's Human Resources Department conducts</p>

	<p>regular remuneration surveys to benchmark remuneration within the market. The SARB has a policy to benchmark its staff's salary 60 percent of the salary level of comparable private sector employees, excluding other benefits. The BSD explains that it has not experienced any difficulty in attracting and retaining staff of high caliber, for reasons such as its jobs providing unique intellectual challenges and that the central bank is regarded highly as an employer in the country. It also explains that it has been able to attract talent from the banking industry in recent years, including risk specialists, although a few pockets of relatively difficult areas to recruit people remain, most notably people with advanced quantitative skills. The turnover rate for the BSD has been relatively low, with 4.47 percent in 2013. In most cases, supervisors leaving the BSD are employed by the banking industry. Cooling-off periods are required for senior staff members, e.g., the Registrar and Deputy Registrars. Two well-defined expert career-paths for staff members—bank analyst and risk analyst—are defined and brought into force from April 2014. For example, a new frontline analyst is usually assigned to offshore analysis of a large bank to gain experiences before becoming responsible for standalone banks.</p> <p>The budget for the BSD has also increased significantly, more than doubling from 2009/10 FY to 2013/14 FY. This includes a significant increase in international travel as a number of staff members are involved in various subcommittees of the Basel Committee on Banking Supervision (BCBS), of which South Africa is now a member. The BSD explains it does not have any difficulty in securing adequate budget for training, IT and travel. As an example, it cited that the department has moved from a paper-based system in 2012 with adequate budgetary support.</p> <p>On training, the BSD emphasizes the importance of On-the-Job Training and in-house, peer-to-peer training. It also stresses the importance of participating actively in international works, particularly subgroups of the BCBS, to enhance its understanding of the latest issues in banking supervision, even though it involves substantial travel costs and staff time.</p>
EC7	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.
Description and findings re EC7	The annual budget cycle of the SARB requires senior management of the BSD to consider gaps in existing resources and skills which form the basis of its budget request. Also, the BSD is required to submit a document on its strategy to the Governor, which includes a description of necessary resourcing to implement the strategy. The BSD conducts more medium-term resource assessments from time to time. For example, in 2011, the BSD's assessment concluded the need to increase risk specialists and resources for AML/On-site work over time. Currently, as a part of the transition to the Twin Peaks framework, the BSD is engaging in a longer-term resourcing assessment.

EC8	In determining supervisory programmes and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings re EC8	As described in detail in CP8 and 9, an annual supervisory plan is established for each bank taking into account its risk profile and systemic relevance. The specialist resources are allocated based on specific supervisory need for a particular bank over the course of a year, which is incorporated in the supervisory plan. The supervisory plan is continuously revised, which may change the allocation of resources during the year. These are discussed constantly between the frontline analyst teams and risk teams, as well as among the BSD's senior management.
EC9	Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.
Description and findings re EC9	<p>BA Section 88 stipulates that no liability shall be attached for the SARB as well as its Board members, the Registrar, officers and employees, either in their official or personal capacities for any loss sustained by or damage caused to any person as a result of their performance with good faith of any function or duty under the BA. The SARB also has a framework, as a part of its employment contract, to cover cost of litigations against its staff members that arose from their work-related conduct.</p> <p>In recent years, there have been no cases where the Court ruled against the BSD or its staff on lawsuits regarding their performance of their duties.</p>
Assessment of Principle 2	Largely Compliant
Comments	<p>The BSD has an appropriate level of resources with highly qualified staff and substantial specialist skills recently added, even though some of them need to accumulate experiences further. The legal protection of the supervisor is also adequate. Its operational independence is fully respected in practice, but there are a few areas where the framework needs to be enhanced to enshrine the operational independence of the supervisor in related legislation and make it fully compliant with the CP. Particularly, regarding the appointment and removal processes of the Registrar, the legal framework should be revised to include (A) a fixed term of the appointment, (B) specific reasons for the removal, and (C) the requirement to publish the reasons for removal, as required in EC2.</p> <p>In terms of the involvement of the Minister in a few supervisory actions, although the assessors understand the supervisor's decisions are respected in practice, there is a need to ensure that the Minister's power is exercised under the principle of constrained discretion. Also, improvements in regulatory frameworks such as those on competition policies that</p>

	<p>overlap with the banking legislation have possibly reduced the need for the Minister's discretion. The authorities should therefore review the legislation to limit the cases that require the Minister's involvement to those that are absolutely necessary and clarify in the laws objectives for intervention. This should also include the clarification of the idea of "prudential veto" where the Minister should not be allowed to override the recommendation by the supervisor to reject applications on registration and other actions made on prudential grounds.</p> <p>Regarding the supervisory resources, while the assessors saw the current level as broadly adequate given the limited number of supervised entities, the authorities should review the adequacy of resources reflecting expected changes in the responsibility of the supervisor under the new twin peaks structure, taking into account the need for further improvements in its supervisory approach as recommended in CP 8, 9 and 12.</p>
Principle 3	Cooperation and collaboration. Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information. ⁹
EC1	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	MOUs for cooperation have been established between the BSD and the Financial Services Board (FSB) as well as STRATE, which includes arrangements for exchange of information and mutual assistance. With the FSB, quarterly meetings are held to discuss issues related to large banks and insurance firms, most of them are interrelated. Agenda of these meetings include such issues as supervisory plans and supervisory findings. Meetings with the National Treasury and the National Credit Regulator (NCR) also take place as needed. There are also frequent informal contacts between these institutions at the technical level. Close cooperation and frequent contacts exist between the BSD and the Financial Stability Department of the SARB, which is responsible for the stability of the financial system in South Africa. As described in CP2, the latter was a part of the BSD until April 2014, which contributes to the close relationship between the two departments.
EC2	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work

⁹ Principle 3 is developed further in the Principles dealing with "Consolidated supervision" (12), "Home-host relationships" (13) and "Abuse of financial services" (29).

	in practice, where necessary.
Description and findings re EC2	<p>BA Section 4(3) provides that the Registrar may enter into written cooperation arrangements with a host or consolidating supervisor or any other person or institution as the Registrar may deem fit. A number of MOUs have been entered into between the SARB and other regulatory authorities in jurisdictions where South African banks operate or from which banking institutions operating in South Africa originate—25 MOUs are already put in place at end-2013 and a number of others are under negotiation. These memoranda provide for the sharing/exchanging of information and coordination of supervision where applicable. These MOUs provide the framework for information exchange including the confidentiality requirements, meetings between the supervisors, on-site visits to banks' foreign operations, and crisis management. The assessors reviewed an example of MOU. For the practice of home-host relations, see CP13.</p> <p>Since 2009, the BSD's policy has been to allow only the acquisition or establishment of local (inward) and cross-border banking operations in instances where an MOU with the cross-border banking supervisor concerned has been concluded. The BSD explains that this decision is underpinned by global initiatives to ensure that cross-border activities do not contribute to enhanced risk, as was evidenced by the global financial crisis.</p> <p>For the member countries of the Southern African Development Community (SADC), heads of state or government have signed a Protocol on Finance and Investment (PFI), which, among other things, includes a section setting out the framework for cooperation and coordination in banking regulatory and supervisory matters, similar to those included in MOUs. SADC member countries are: Angola; Botswana; the Democratic Republic of Congo; Lesotho; Malawi; Mauritius; Mozambique; Namibia; Seychelles; South Africa; Swaziland; Tanzania; Zambia; and Zimbabwe. A few South African banks are particularly active in the region, which in the BSD's view enhances the importance of regional cooperation.</p>
EC3	The supervisor may provide confidential information to another domestic authority or foreign supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.
Description and findings re EC3	SARBA Section 33 provides that all information gathered by the SARB is confidential and may not be shared with third parties, except for the Minister and Director General of National Treasury. BA Section 89 then provides for specific instances when the Registrar may share information to persons who are given function by laws in South Africa (e.g., tax authorities) or to foreign supervisors, provided the recipient authorities are willing and able to keep the information confidential. As described above, clauses on sharing of confidential information are included in MOUs with foreign supervisors.
EC4	The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The

	<p>supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.</p>
Description and findings re EC4	<p>As mentioned in the previous EC, SARBA Section 33 provides that the SARB employees should not disclose information gained through participation in SARB activities, except (1) to the Finance Minister and Director General of National Treasury, (2) for the purpose of performing the employee's duties, or (3) being required before a court of law or under any law. However, there is no provision to limit the SARB, the Finance Ministry, or the National Treasury to use confidential information only for supervisory purposes.</p> <p>In case of information received from a foreign supervisor, MOUs contain provisions that stipulate information provided under the MOU shall be used only for lawful supervisory purposes and remain confidential. They also require that the supervisors do not disclose or act on information given by counterparts without the prior written consent and prompt notification if required to release such information. The BSD explains that there has not been any case where the BSD had to release confidential information given by foreign supervisors.</p>
EC5	<p>Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.</p>
Description and findings re EC5	<p>The Registrar and the BSD are the resolution authority for banks. Thus, it is expected ongoing supervision will support recovery and resolution planning and actions. See CP 9 for details.</p>
Assessment of Principle 3	<p>Compliant</p>
Comments	<p>Legal provisions as well as operational frameworks for cooperation and collaboration with domestic and foreign authorities are in place.</p> <p>Regarding the confidentiality of information, although the assessors view the current legal framework and its practical application provides a reasonable assurance of protecting the confidentiality of supervisory information, the reliance on SARBA Section 33 as well as the manner BA Section 89 is stipulated leave room for the information to be used for non-supervisory purposes. It is therefore recommended the authorities review the relevant</p>

	provisions of the BA to ensure the confidential information shall only be used for supervisory purposes, unless specifically required by court orders or provisions in other laws as provided in EC3 and 4.
Principle 4	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word “bank” in names is controlled.
EC1	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	BA Section 11 stipulates that “no person shall conduct the business of a bank unless such person is a public company and is registered as a bank in terms of this act.” “The business of a bank” is then defined in Section 1(1) as accepting deposits from the general public as a regular feature of its business, soliciting or advertising for deposits, or utilizing the collected money for loans or investments. A broad definition of “deposit” is also given in the same subsection.
EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings re EC2	As noted above “the business of a bank” is defined in BA Section 1(1). It covers such activities as accepting deposits from the general public, soliciting or advertising for deposits, and lending or investing those funds accepted as deposits. Also, the Registrar may cover certain activities as the business of banks by notice in the Gazette after consultation with the Governor. The BA does not provide restrictions on banks engaging in non-banking businesses except for investing in insurance firms. But the BSD has adopted a policy that non-banking business shall be conducted by a controlling company as its subsidiary and not directly by a bank, which is enforced by being included as a condition for registration, among others.
EC3	The use of the word “bank” and any derivations such as “banking” in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	BA Section 22 (5) prohibits the use of a name or a description which includes the word “bank,” or any derivative thereof, or the words “deposit-taking institution” or “building society,” or any derivative thereof, unless the business is an authorized bank, a foreign bank branch, or a registered controlling company, and authorized by the Registrar.

EC4	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks. ¹⁰
Description and findings re EC4	As described in EC1, BA section 11 (1) prohibits conduct of the business of a bank, which includes the taking of deposits from the public, unless it is done by a public company and registered as a bank under the BA. The exemption of application of the BA is provided in Section 2, which includes public institutions governed by separate acts and guaranteed by Government, such as the Land Bank, the Development Bank of Southern Africa, and the Public Investment Cooperation Limited, as well as mutual banks, which are covered by the Mutual Bank Act and under the supervisory authority of the Registrar. Other entities and activities can be exempted from “the business of banks” by being designated by the Minister by notice in the Gazette. Except for mutual banks, these entities in practice do not collect retail deposits from the public.
EC5	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	A list of all registered banks (including foreign bank branches and representative offices) is published in the annual report issued by the Registrar. The list is also available on SARB’s website and updated whenever changes to the list occur.
Assessment of Principle 4	Compliant
Comments	The Banks Act provides clear definitions of activities that are only permitted to be conducted by registered banks, including taking deposits from the public.
Principle 5	Licensing criteria. The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management) ¹¹ of the bank and its wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition-(including capital base). Where the proposed owner or parent

¹⁰ The Committee recognizes the presence in some countries of non-banking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

¹¹ This document refers to a governance structure composed of a board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms “board” and “senior management” are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

	organization is a foreign bank, the prior consent of its home supervisor is obtained.
EC1	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings re EC1	<p>The licensing of banks in South Africa is a two-step process where the Registrar has the power of granting application for both steps. For the first step, BA Section 12 (1) provides that any person who wishes to conduct the business of a bank may apply to the Registrar for authorization to establish a bank. Section 13 then provides that the Registrar may grant or refuse the relevant application or grant the application subject to conditions. After the authorization is granted, the applicant may apply to the Registrar for the registration of the institution as a bank (Section 16). The Registrar then either grants or refuses the application of the registration (Section 17). The Registrar can attach conditions to the registration (Section 18).</p> <p>Regarding revocation of authorization, the Registrar can revoke it if the application was based on false or misleading information or a bank cannot be formed within 12 months (Section 14).</p> <p>For revocation of registration:</p> <ul style="list-style-type: none"> • If the bank has not started any business as a bank in the first six months after the registration, the Registrar can cancel or suspend the registration with the consent of the Governor and after consultation with the Minister. • If the bank has gained the authorization or registration based on untrue or misleading information, the bank's foreign parent bank's license is revoked by the home authority, or the bank failed to comply with conditions prescribed by the Registrar, the Registrar can cancel or suspend the registration after consultation with the Minister. • If the bank ceased to conduct the business of a bank or is no longer in operation, the Registrar can cancel the registration after consultation with the Minister. (Section 23) <p>Furthermore, the Registrar can apply to a court for an order of cancelling or suspending the registration if there exist grounds justifying such cancellation or suspension in the opinion of the Registrar other than those described above. (Section 25). For details, see CP 11.</p> <p>In practice, only a handful of foreign bank branches have been registered in recent years; no domestically incorporated bank has been registered for more than 10 years.</p>

EC2	Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or-supervisor determines that the license was based on false information, the license can be revoked.
Description and findings re EC2	<p>BA Section 13 (2) provides a number of qualitative criteria for granting authorization, including that:</p> <ul style="list-style-type: none"> • The establishment of the bank will be in the public interest; • The bank will be successfully established; • The bank’s business will be conducted in a prudent manner; • Proposed directors and executive officers are fit and proper persons; • The proposed executive officers have sufficient managerial experiences; and, • The proposed composition of the board of directors will be appropriate. <p>In case of granting the application for registration, in addition to the above criteria for authorization, BA Section 17 provides further criteria including that the bank does not propose to adopt undesirable methods of conducting businesses and the memorandum of incorporation is consistent with requirements under the BA and not undesirable. The Regulations (52, 53) provide details for the application process.</p> <p>In case of foreign bank branches, additional criteria are provided in the Regulation on “Conditions for the conducting of the business of a bank by a foreign institution by means of a branch in the Republic,” such as that the parent institution’s total assets must be at least USD 1 billion and the parent bank needs to have a long-term investment grade credit rating by an internationally recognized rating agency.</p> <p>As described in EC1, the BA provides the Registrar the power to revoke the authorization or the registration when it is based on false or misleading information.</p>
EC3	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings re EC3	As described above, the BA provides criteria for authorization and registration that are consistent with those applied for ongoing supervision.
EC4	The licensing authority determines that the proposed legal, managerial, operational and

	ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. ¹² The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Description and findings re EC4	<p>As noted in EC2, the BA provides the broad criteria that only banks that will be in the public interest and conduct their businesses in a prudent manner should be authorized and registered. In addition, the criteria include specific requirements on the bank's management.</p> <p>During the application process, detailed information on various aspects of the proposed bank's structure needs to be submitted. This would include details on such matters as the framework for corporate governance, risk management and internal controls, and for banks belonging to a corporate group, a schematic representation reflecting all interests held in and by the applicant including the nature of those entities' businesses. (Form BA 002)</p> <p>In case of foreign bank branches, the parent bank is required to provide its organizational structure and internal risk management, governance and internal control policies and processes. A comfort letter is also needed to be submitted by the parent bank, which requires the parent bank to confirm the adherence of the home country to the BCPs, international minimum standards in respect of consolidated supervision of banking groups and cross-border operations, and international recommendations relating to the supervision of cross-border banking. These are evaluated by the BSD in assessing whether the application meets the criteria stipulated in the BA.</p> <p>The assessors reviewed files related to a recent application for registration by a foreign bank branch and confirmed that these and other assessments required by the BA and the Regulations were conducted by analysts in the BSD.</p>
EC5	The licensing authority identifies and determines the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.
Description and findings re EC5	The Regulations require the applicant to provide information regarding shareholders of a bank (From BA002) This information, based on Form BA125, includes current and proposed shareholders that own more than 1 percent of the total shares, and, when applicable, written confirmation by a public accountant that designated share capital received is held in a trust account. Regarding the treatment of the ultimate beneficial owners (UBO), see

¹² Therefore, shell banks shall not be licensed. (Reference document: BCBS paper on shell banks, January 2003).

	<p>CP6.</p> <p>In case of a foreign bank branch, the required comfort letter from its parent bank includes the requirement that the parent bank undertakes to safeguard the financial soundness and stability of the branch, including the maintenance of the endowment of the branch's capital.</p>
EC6	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC6	BA Section 70 prescribes the minimum share capital and unimpaired reserve funds that all banks are required to hold, which is currently ZAR 250 million.
EC7	<p>The licensing authority, at authorization, evaluates the bank's proposed Board members and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank.¹³ The licensing authority determines whether the bank's Board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.</p>
Description and findings re EC7	<p>As described in EC2, the criteria for the authorization prescribed in BA Section 13 (2) includes those applicable to the proposed Board members and senior management, such as:</p> <ul style="list-style-type: none"> • proposed directors and executive officers are fit and proper persons; • the proposed executive officers have sufficient managerial experience relevant to the proposed operation of the bank; and • the proposed composition of the Board of directors will be appropriate for the nature and scale of the bank's business. <p>Prospective directors and executive officers need to submit statements provided in Form BA 020 in the Regulations, which includes certification related to past criminal, regulatory, and financial records. In case of a new bank, these statements need to be confirmed by an external auditor.</p> <p>In addition, Regulation 40 provides guidelines relating to conduct of Board members, including the need to having the competence and knowledge of banks' businesses commensurate with their nature and scale. For details, see CP 15.</p>

¹³ Please refer to Principle 14, Essential Criterion 8.

EC8	The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank. ¹⁴
Description and findings re EC8	As noted in EC2, the authorization criteria includes that the business of the proposed bank will be conducted in a prudent manner. In order for the BSD to confirm this, Form BA 002 in the Regulations requires an applicant for authorization and registration of a bank to submit an “outline of the proposed strategic and operating or business plans in short, medium and long term,” which should include “detailed information on the relevant system related to corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, and the oversight of proposed outsourced functions” and “the scope and degree of sophistication of the proposed activities.” The information is analyzed by BSD analysts and in most cases the analysts require the bank to adjust its proposed business plan and operational systems.
EC9	The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.
Description and findings re EC9	<p>The criteria in the BA provide that the applicant will be able to establish itself successfully as a bank and that the applicant will have the financial means to comply with the requirements of the BA. In order for the BSD to assess these, Form BA 002 requires the applicant to submit financial statements—the balance sheet, the income statement, and others—for 3 years after the start of the operation. A frontline analyst is assigned to the approval process and conducts the assessment in tandem with a dedicated analyst for the registration process.</p> <p>As noted in EC5, financial information on the principal shareholders of the bank is not required and not assessed, although a report by a public accountant to confirm that funds received from anticipated shareholders are held in a trust account needs to be provided. In case of a foreign bank subsidiary/branch, this is in practice conducted through assessment of the parent bank’s adherence to requirements in the home country, the requirement in the Regulations to have the parent banking group to have an investment grade rating, and the no objection letter from the home supervisor. (See below).</p>
EC10	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the

¹⁴ Please refer to Principle 29.

	<p>home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.</p>
Description and findings re EC10	<p>In case of subsidiaries of foreign banks, BA Section 13(2)(i) lists a number of criteria for granting application for authorization, which includes that the proposed establishment of a subsidiary has been authorized by the home supervisor, that the home supervisor accepts and complies with the proposals, guidelines and pronouncements of the BCBS, and that it accepts its responsibilities as a consolidated supervisor.</p> <p>Similarly, in case of branches, the foreign bank applying for authorization needs to provide information with regard to the nature and extent of supervision exercised by the home supervisor. In addition, as noted above, the Regulation on “Conditions for the conducting of the business of a bank by a foreign institution by means of a branch in the Republic” provides similar criteria on the home supervisor supervision as for subsidiaries, including whether the home supervisor has authorized the establishment of the branch.</p> <p>In practice, a letter is sent to a home supervisor requiring a no-objection letter. Unless the letter from the home supervisor is received, the authorization of application will not be granted. Moreover, an MOU with the home supervisor is usually required. The BSD explained that there was a case where a registration of a foreign bank branch had to wait the conclusion of an MOU between the BSD and the applicant’s home supervisor.</p>
EC11	<p>The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.</p>
Description and findings re EC11	<p>Newly established banks are subject to monthly reporting requirements as with all banks, through which the BSD monitors the progress in their businesses and operations, as well as their compliance with requirements and conditions they are subject to.</p>
Assessment of Principle 5	<p>Compliant.</p>
Comments	<p>Provisions in the laws and regulations related to licensing and the process followed by the BSD provide a comprehensive framework to assess the adequacy of new registrations for banks, including foreign bank branches. The BSD adequately assesses applications in practice.</p>

Principle 6	Transfer of significant ownership. The supervisor ¹⁵ has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
EC1	Laws or regulations contain clear definitions of “significant ownership” and “controlling interest.”
Description and findings re EC1	<p>BA Section 37 (1) prohibits shareholding by a person/entity or a group of persons/entities (“associates”) beyond 15 percent of either the total nominal value or by voting rights of the issued shares, unless an approval is granted. Section 37 (7) provides a broad definition of “associate” that covers, for example: a close relative; any person who has an arrangement relating to the shareholding; a subsidiary, parent or sister company; a director of a company, and; a trust controlled or administered.</p> <p>Furthermore, BA Section 42 prohibits exercising control over a bank except cases where the (A) shareholding is approved, or (B) it is done by a domestic or a foreign bank or a registered controlling company, although prior approvals or registrations under the BA are necessary for the latter case.</p> <p>BA Section 42 (2) provides a definition of exercising control over a bank as including holding more than 50 percent of the nominal value or voting rights of total issued shares, or entitled or has the power to appoint the majority of the directors of the bank. Section 43 provides the need for registration as a controlling company in respect of a bank to exercise control over a bank.</p>
EC2	There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.
Description and findings re EC2	<p>BA Section 37 (1) and (2) prescribes multiple shareholding thresholds that require an application for the acquisition of shares in a bank or controlling company:</p> <ul style="list-style-type: none"> • 15 percent; • 24 percent (which gives power to negate a super-majority which is required, for example, to enter the special resolution process provided in the Companies Act); • 49 percent; and,

¹⁵ While the term “supervisor” is used throughout Principle 6, the Committee recognizes that in a few countries these issues might be addressed by a separate licensing authority.

	<ul style="list-style-type: none"> • 74 percent (which forms a super-majority). <p>In cases where holding exceeds 15 percent or 24 percent, the permission is granted by the Registrar; in cases where the holding exceeds 49 percent or 74 percent, the permission is granted by the Minister through the Registrar. For latter cases, the Registrar provides recommendations to the Minister. Generally, the Minister follows the recommendations of the Registrar. However, the assessors were explained that there was a case where the Minister objected to an acquisition of one of the largest bank by another for a competition ground.</p> <p>Changes in ownership do not happen frequently in South Africa given the limited number of locally controlled banks, except cases where a banking group reorganizes its structure. During the past four years, four applications have been approved, while none has been declined. The BSD explains this is partly due to the practice that prospective shareholders and banks consult with the BSD in advance to assess whether the application will be successful.</p> <p>In terms of beneficial ownership, BA Section 38 prohibits banks or controlling companies to allot or issue shares to, or register any of its shares in the name of, any person other than the intended beneficial shareholder without the written approval of the Registrar. This approval has never been granted, however. The BSD explains that given the small number of banks in South Africa, it is easy to monitor changes related to ownership structures.</p>
EC3	<p>The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.</p>
Description and findings re EC3	<p>As described above, BA Section 37 (4) stipulates that the approval of changes in significant ownership of a bank or a controlling company will only be given if the Registrar or Minister is satisfied that the proposed acquisition will not be contrary to (a) the public interest, and (b) the interests of the bank, its depositors, or the controlling company. It is understood that the minister would not grant approvals unless recommended to do so by the Registrar and, in fact, it has never happened. Also, to date, the Minister has not made any decision different from the Registrar's recommendation. BA section 37 (5) stipulates that the Registrar or Minister may apply to court to compel a shareholder to reduce its shareholding to not more than 15 percent of the total if it is deemed to be to the detriment of the bank/controlling company. The BSD explains that this has not happened in recent years.</p>
EC4	<p>The supervisor obtains from banks, through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence,</p>

	including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.
Description and findings re EC4	BA Section 39 requires shareholders of a bank or a controlling company to furnish information as required by the bank or the controlling company. Regulation 21 and Form BA 125 require banks to submit to the BSD annually the list of shareholders that have more than 1 percent of total shares including information such as their addresses, and the number and value of the shares. This also applies to a group of persons that has more than 1 percent of the total shares. For those shareholders that have less than 1 percent of total shares, less detailed information is required. As a part of on-going supervision, frontline analysts monitor changes in the ownership of banks through these reports and other available information.
EC5	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.
Description and findings re EC5	BA Section 37 (5) gives power to the Registrar or Minister to apply to court to compel a shareholder to reduce its shareholding. (See EC3)
EC6	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings re EC6	The BSD requires banks to inform it of any material changes related to significant shareholders, which is included as a condition for approval of shareholdings of more than 15 percent.
Assessment of principle 6	Compliant
Comments	The power given to the supervisor by laws and regulations as well as the current supervisory practices provide adequate control and oversight regarding significant ownership of a bank and a controlling company. As described in CP2, however, the authorities should clarify the principle of "prudential veto" in regard to approval of changes in significant ownership.
Principle 7	Major acquisitions. The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

EC1	<p>Laws or regulations clearly define:</p> <p>(a) what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval; and</p> <p>(b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank's capital.</p>
Description and findings re EC1	<p>BA Section 52 prohibits banks to carry out the following broad range of major acquisitions or investments without the prior approval of the Registrar:</p> <ul style="list-style-type: none"> • Establish or acquire a subsidiary both inside and outside South Africa; • Invest in a joint venture that results in the bank being exposed to an amount representing more than five percent of its capital and reserves; • Open or acquire a branch office outside South Africa; • Acquire an interest in undertaking outside South Africa, unless only notification to the Registrar is required (as explained below); • Create or acquire a trust, or establish or acquire any financial or other business undertaking under its direct or indirect control outside South Africa; • Establish or acquire a representative office outside South Africa; and • Create or acquire a division for any person so that that person can conduct his/her business through the division. <p>Controlling companies are also prohibited to carry out the above mentioned operations, except opening branches, representative offices, and creating or acquiring a division. These restrictions apply to subsidiaries of banks and controlling companies.</p> <p>Section 52 supersedes Section 76 (2), which gives the power to the Minister to approve banks to exceeding investment limits.</p> <p>Directive 13/2013 limits the case where a prior approval is needed in case of investment in a foreign entity to only the acquisition of interest of more than 5 percent of that entity or when the amount is equal to or more than 1 percent of the acquiring bank's eligible capital and reserves. In other cases, only a notification is required, except in cases where the investment has significant impact on the investing bank or the controlling company or the information flow necessary for effective supervision may be hindered.</p>
EC2	Laws or regulations provide criteria by which to judge individual proposals

Description and findings re EC2	<p>Regulation 56 provides a list of documents that an applicant must submit for a prior approval under BA Section 52, which includes, for example, the expected impact of the acquisition on management of the bank and the bank's assessment whether the transaction will materially influence the financial and risk position of the bank. A broader set of materials are required for an off-shore interest, for example, impact of the acquisition or establishment on the bank's profitability, capital adequacy and overall risk profile, as well as contagion potential, a worst case scenario and an opinion on the ability of the company to submit the required returns to the BSD.</p> <p>The BSD explains that, based on the guidance explained above, it applies a stringent set of requirements when providing approval under Section 53, including what kind of businesses a bank can conduct or operate through joint ventures or subsidiaries, which is informed to banks.</p>
EC3	<p>Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future.¹⁶ The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.</p>
Description and findings re EC3	<p>As described above, the BSD checks such aspects as impact on the bank's management as well as financial and risk positions; for an off-shore interest, the BSD assesses such aspects as the nature of supervisory functions performed by the host country, its country risk, and the ability to submit required returns. If these are not assessed as appropriate, an approval will not be granted. See also CP12 and 13.</p> <p>The assessors confirmed through review of relevant files that these as well as other assessments described below are conducted by the BSD.</p>
EC4	<p>The supervisor determines that the bank has, from the outset, adequate financial, managerial and organizational resources to handle the acquisition/investment.</p>
Description and findings re EC4	<p>See EC3. The BSD checks the bank's resources to handle the acquisition/investment based on materials submitted by the bank.</p>

¹⁶ In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

EC5	The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities.
Description and findings re EC5	<p>BA Section 76 requires banks to limit investments in real estate and shares of companies to a prescribed amount, including those through subsidiaries. Regarding controlling companies, BA Section 50 requires a controlling company to limit investments in:</p> <ul style="list-style-type: none"> • Undertakings other than banks, entities engaging in activities similar to banks outside south Africa, controlling companies, and entities or companies for holding or development property for conducting the business of a bank; and • Fixed property not for the purpose of conducting the business of a bank, to a prescribed amount. <p>Directive 9/2013 Section 50 provides the ceiling of 100 percent of the regulatory capital minus the amount of market risk for the aggregate amount of these investments.</p> <p>For other types of investments and activities, as noted in EC2, the BSD recognizes the risk arising from non-banking activities and considers the impact on the management as well as the bank's risk position in approving investments in or acquiring non-banking businesses. See also CP12.</p>
Assessment of Principle 7	Compliant
Comments	The regulatory framework subjects major acquisitions and investments by banks and controlling companies to prior approval by the Registrar. The BSD also has well established supervisory practices to limit and monitor risks arising from such activities.
Principle 8	Supervisory approach. An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.
EC1	<p>The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks:</p> <p>(a) Which banks or banking groups are exposed to, including risks posed by entities in the wider group; and</p> <p>(b) Which banks or banking groups present to the safety and soundness of the banking</p>

system.

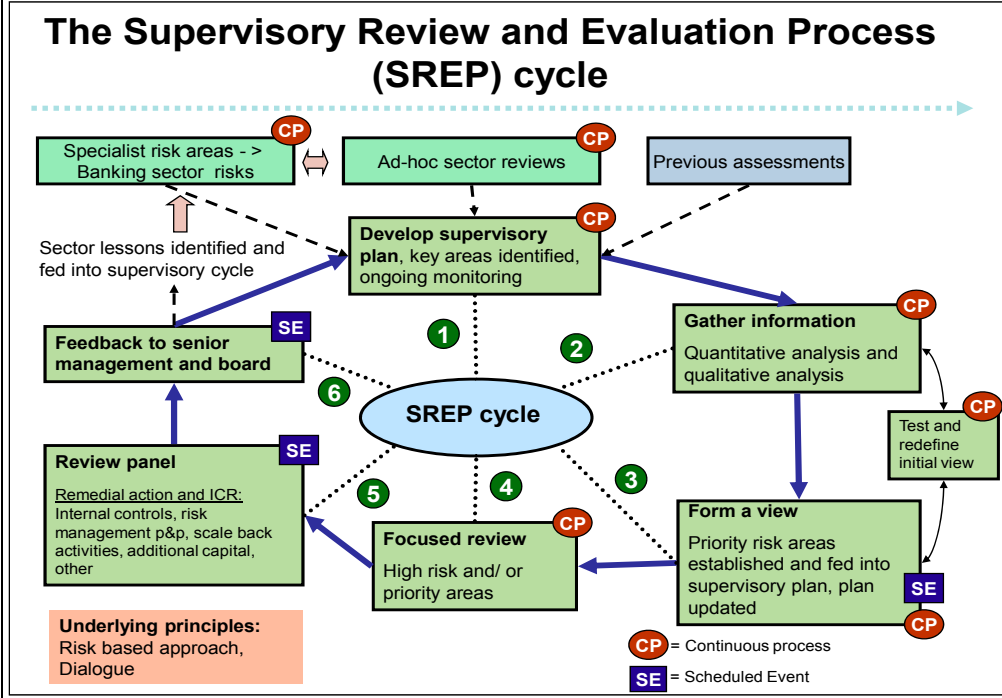
The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.

Description and findings re EC1

BA Section 4(4) stipulates that the Registrar shall implement and maintain a supervisory review process. The two main pillars of the BSD’s on-going supervisory work are the SREP cycle and the risk rating system.

SREP cycle

The BSD’s methodology for ongoing supervision of banks and banking groups is the Supervisory Review and Evaluation Process (SREP) cycle, which is described in the BSD’s internal SREP manual. The SREP cycle, as shown in the above schematic chart, is divided into various stages (stages 1 to 6) as explained below. These stages are conceptual in nature, thus a number of them are continuous processes and not necessarily sequential.



The SREP Cycle applies on a consolidated basis to both a bank and a banking group under a controlling company. (See CP 12 for details).

Stage 1 "Develop supervisory plan:"

The process begins with the formulation of a supervisory plan for a bank (banking group) by the frontline analyst team. An annual supervisory plan for each bank, including the

branch of a foreign bank, which covers a whole calendar year, is formulated during October to December. The main product of the annual supervisory plan is a schedule of various meetings and other supervisory activities (including on-site reviews) to be held during a calendar year. The supervisory plan takes into account the systemic relevance of and key risk areas identified related to the particular bank. In the determination of the systemic relevance and identification of the key risk areas, reliance is placed on risk ratings as well as previous years' assessments. The annual supervisory plan is communicated to the bank prior to the start of a calendar year. This process is a continuous and ongoing process—the supervisory plan is continuously updated as and when new information becomes available and a change of the supervisory plan becomes warranted.

Stage 2 "Gather information:"

Throughout the SREP cycle, information is gathered by analysts and risk specialists. Examples of such sources of information are the following:

- Various returns required by the BA, including quantitative data such as the bank's financial statements, various risk matrix and ICAAP reports, as well as quantitative data such as reports on internal governance and risk management. Graphs are generated from the quantitative information submitted by the bank to the BSD, including peer group analysis.
- Reports by internal and external auditors.
- Various meetings with the bank and banking group. These include regular meetings that are held at least annually—Board meetings with the full Board, CEO meetings, trilateral meetings (with the bank's Board audit committee, the bank's internal audit function, and the bank's external auditors), prudential meetings with risk managers and heads of business units (sometimes with heads of foreign operation units), and discussions on the graphs generated from the information submitted by the bank to BSD and including peer group analysis ("graph discussions"), as well as various ad-hoc meetings.
- Other information sources including regular bilateral meetings with the bank's external auditors as well as financial media, vendor-supplied market data (such as McGregor BFA Net, Moneyweb, JSE SENS, etc.), ratings' reports, and investment analyst reports.

Stage 2 is also a continuous ongoing process where frontline bank analysts are expected to keep gathering information from these sources year-round.

Stage 3 "Form a view:"

Stage 3 entails the process whereby the information gathered by analysts and risk specialists in stage 2 is assembled, and then analyzed and synthesized in order to form a

view of the bank with the focus on materiality and risk. It is envisaged that these processes will enable a bank and the analyst to compare findings and challenge one another's conclusions and recommendations in a constructive manner. This is again a continuous process, but the main outputs of the stage is the Management Information Report (MIR) for each bank/banking group which is updated monthly and contains various information regarding a bank as well as a composite risk rating and a number of component risk ratings. This MIR is discussed and reviewed quarterly by the ManCo. Semi-annually, the information is fed into a more detailed Risk Review for each bank/banking group. Also, a "pre-panel" review panel meeting could be called for at this stage by the frontline analyst team to seek guidance on priorities, clarification of issues and further work to be done from senior managers and the risk specialist and other teams. (See stage 5).

Stage 4 "Focused review:"

Depending on the outcome of stage 3, the analyst and the risk specialists will identify areas of the bank/banking group that may require a detailed or specialist review. This review may be carried out by the frontline analysts, risk specialists, on-site review teams, internal auditors, external auditors, or possibly by other experts. The resulting information gathered is incorporated into the SREP cycle, and necessary consequential adjustments are made, including to supervisory plans. In some cases, these reviews are conducted after supervisory plans are modified.

Stage 5 "Review panel:"

Stage 5 consists of the panel review process, which entails a review by the review panel of the procedural and substantive correctness of the SREP, as well as of the conclusions reached and recommendations made. For example, the risk reviews are subject to the review panel. The review panel consists of senior members of the BSD, including the Registrar and Deputy Registrars.

The conclusions reached and recommendations generated during the "forming-of-a-view" stage (stage 3) and the focused review stage (stage 4) by the analyst (in conjunction with the relevant risk specialists, if applicable) forms the basis for the panel review. The review panel's recommendations may include remedial actions to be taken and adjustments to the individual capital requirement (ICR)—the ICR is not the only tool in a supervisor's arsenal, however, and other recommendations, such as strengthening of internal controls or risk management policies and procedures, may in certain circumstances be seen as more appropriate.

Stage 6 "feed back to senior management and Board:"

Stage 6 consists of the process in terms of which the conclusions and recommendations reached in stage 5 are fed back to the bank's/banking group's Board, risk committee, audit committee and senior management. Usually, these are communicated during regular

meetings with these persons. A feedback letter is provided after a meeting that summarizes the main points of the meeting and includes remedial actions the bank should take, if any. Industry lessons identified are also fed back into the macro-surveillance cycle and report, and may warrant ad hoc sector reviews to be conducted.

Rating system

The BSD's risk based supervision strategy is two-dimensional. According to the BSD's view, in the one dimension, risk based supervision could be viewed as a methodology in order to decide where to focus supervision in terms of the banking system. In the other dimension risk-based supervision lies within the supervision of the particular bank/banking group and therefore focuses on the high-risk areas within a particular bank/banking group along with the controls in place to mitigate those risks.

Based on this approach, the BSD has a dual rating system, where one rating is based on the systemic relevance of the bank ("sector impact rating"), and the other rating is based on the risks the bank is facing ("risk rating"). The ratings are included in the MIRs and updated monthly. They are given initially by the frontline analyst, discussed by his/her managers, and signed off by one of two Assistant General Managers. The consistency of ratings is checked through this process. The summary information on ratings of individual banks is provided to ManCo monthly.

The sector impact rating is given as a number between 1 and 5, where the rating of 5 indicates a bank that is the most systemically relevant. Given the concentrated nature of the banking system where the five largest banks hold more than 90 percent of total banking assets, and the rest of the system comprises 25 banks including 14 branches of foreign banks, for the sector impact ratings, all the large banks are rated as 5 whereas other banks are rated between 1 and 3, based mostly on their size of operations. These ratings are stable over time as the relative size of banks do not change substantially, but the BSD explains that when a bank is in trouble and the risk of contagion to other banks is seen to be increasing, the BSD would raise the bank's systemic relevance rating and that it has happened to one of the smaller banks.

The risk rating for a bank/banking group includes one overall composite rating and component ratings. The component ratings are given each of the followings specific financial and non-financial risk categories:

- Balance sheet;
- Off-balance sheet;
- Capital adequacy;
- Profitability;

- Liquidity risk;
- Interest rate risk;
- Market risk;
- Credit risk;
- Currency risk;
- Operational risk;
- Money laundering and terrorist financing risk; and
- Corporate governance.

The component ratings are given with scales of 1 to 5, where each scale denotes: 1 "strong;" 2 "satisfactory;" 3 "fair (watch category);" 4 "marginal (some risk of failure);" and 5 "unsatisfactory (high degree of failure evident)." Component ratings are given by frontline analyst teams based on their supervisory judgments reflecting their assessments of quantitative and qualitative information gained through banks' supervisory returns and interaction with banks.

The composite rating is a weighted average of component ratings where a fixed weight is provided for each component. Generally, a composite rating of higher than 3 is seen as warranting some form of supervisory attention and a bank with a rating of 4 and higher is regarded as a problem bank. In practice, the assessors observed that most of the component ratings are clustered around 3, with only a few outliers given ratings of 4 or higher.

The frequency and intensity of the supervision of individual banks

The frequency and intensity of the supervision of banks and banking groups are determined by the relevant entity's risk assessment including the risk rating and the system impact rating referred to as the MIR and the Risk Review and would feed into stage 1 of the SREP. For example, the number of meetings would be changed according to changes in these ratings. Also, as noted in CP 2, the number of analysts allocated to a bank/banking group is also affected by these ratings.

In practice, given the relatively stable nature of the banking industry in South Africa where the difference in size between five big banks and other banks is substantial, intensity and frequency devoted to these two groups of banks also differ. For example, the assessors reviewed agendas and minutes of supervisory meetings with banks and affirmed those with large banks have more depth and broader coverage in proportion to the activities and risks of such banks. The assessors also noted that on-site reviews are more frequently conducted

	with these big banks, although it also found that the supervisory intensity was increased even for relatively small banks when they are exposed to substantial risks in the supervisor's view.
EC2	The supervisor has processes to understand the risk profile of banks and banking groups and employs a well defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.
Description and findings re EC2	<p>For the detailed process of the SREP methodology and the rating system used in South Africa, see EC1. The forward-looking view on a bank's strategy, performance and risk profile is captured and reflected in supervisory works as a part of the SREP cycle. Specifically, the following measures are used during each stage of the SREP cycle to make the oversight on and interaction with banks/banking groups forward-looking:</p> <p><i>Stage 2</i></p> <ul style="list-style-type: none"> • During the CEO meeting, the BSD receives information on the bank's business plans and strategies, new business activities/ventures and financial forecasts. Similar information is obtained at prudential meetings held with business heads of the entity. • During the graph discussion, the BSD discusses key issues relating to, and putting forward its opinion on, selected risk areas based on information received from the bank. This would also include bank representatives providing their views and perspectives on the risk profile, risk management and risk appetite of the bank. • During prudential meetings held with the bank's Head of Compliance and with Internal Audit, plans and focus areas for the year ahead are discussed based on forward-looking risk profile of a bank. • Stress testing is also used to evaluate the potential effects on an institution's financial condition of a specific event and/or movement in a set of financial variables. The BSD has a stress testing framework in place that provides an overview of the principles underlying the stress testing framework and delineates responsibilities of supervisors, banks and banking groups. <p><i>Stage 3</i></p> <ul style="list-style-type: none"> • Banks/banking groups are required to have in place a robust ICAAP, which contains financial and capital projections. The BSD conducts ICAAP on-site reviews on a risk-based approach. This would then feed into Stage 5 "Review Panel" where the BSD ensures that the Pillar 2b add-on is commensurate with the risk profile of the bank. • The BSD's rating system requires frontline analysts to understand and form a view on levels of the various categories of risks for the bank based on all the available

	<p>information.</p> <p><i>Stage 6</i></p> <ul style="list-style-type: none"> The BSD has implemented a more “forward looking” approach in respect of the meeting with the bank’s Board of directors which includes requiring presentations by the Board chair on the bank’s short and long-term strategy and discussing the bank’s projections for the next 12 months and the BSD’s views on these.
EC3	The supervisor assesses banks’ and banking groups’ compliance with prudential regulations and other legal requirements.
Description and findings re EC3	<p>The BSD utilizes a number of tools to assess compliance of banks and banking groups with prudential and other requirements under the BA, which are incorporated in the SREP cycle. These include:</p> <ul style="list-style-type: none"> An internal compliance check list, which covers prudential and other requirements, is prepared monthly by a frontline analyst. Monthly reports on capital adequacy (Form BA 700) and liquidity (Form BA 300) are also submitted to the BSD by banks. Regulation 4 requires the CEO, Chief Accounting Officer, Executive Officer responsible for reporting requirements under Financial Intelligence Centre Act (FICA) and officials responsible for each relevant risk to sign-off on the Form BA 099 indicating compliance with relevant regulatory and prudential requirements. Meetings with internal audit and compliance functions are held to determine any issues of non-compliance or concerns identified by the relevant functions as well as by the BSD (BA Section 60 A and Regulation 49 for the compliance section and Regulation 48 for the internal audit section). Regulation 46(3)(b) requires the bank’s external auditor to annually report to the Registrar on any significant weaknesses in the system of internal controls relating to compliance with the BA and the Regulations.
EC4	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	The BSD’s research division prepares a banking sector overview (BSO) presentation for the whole department on a monthly basis. During this forum, others members of BSD on an ad-hoc basis provide presentations on specific risk areas and other developments in the banking industry. In addition, a booklet providing a brief overview of the South African Banking Sector is distributed on a monthly basis. A full review of the banking sector data is presented on a quarterly basis, which contributes to the quarterly MIR reviews by the

ManCo. During other months, presentations are made on completed staff projects, international committee meetings attended and, presentations and discussions by the BSD to the SARB's Monetary Policy Committee and Financial Stability Committee.

The Financial Stability Department (FSD) of the SARB assesses the macro-economic risks in the context of preparing six monthly Financial Stability Reviews (FSRs), which are published. It also conducts common scenario stress testing of the banking sector. The latest one was conducted in 2012 covering 8 banks including the 5 largest, although the scope was limited to their South African banking operations. The SARB's research department also shares the quarterly bulletin which covers key information relating to the global and South African economic environment.

These works lead to identification of cross-system supervisory topics for a particular year, which is called "flavor of the year" topics. Each year, staff members of the BSD are asked to provide possible topics based on sector-wide risk assessments as well as international regulatory developments. After each of these topics is presented and discussed, a few topics were chosen as the "flavor of the year" topics by votes. These are incorporated into supervisory plans for the year and included as issues for focused discussions with banks—including their Boards—and external auditors as well as enhanced assessment by the frontline analysts and risk specialists. Banks are notified of these topics at the beginning of a year. The recent topics include such issues as unsecured lending, banks' African strategies, recovery plans, IT projects, and conduct of business.

The risk sections (for example, credit risk, market risk and operational risk) of the BSD are responsible for reviewing risks for individual institutions as well as across the sector. The risk sections also identify and produce reports on high risk focus areas—for example, the division produces a report on retail unsecured lending on a monthly basis which is distributed to the frontline analysis teams.

In terms of cross-sectoral developments, , , quarterly "high-level" bilateral meetings are held between the BSD the Financial Services Board (FSB), which is responsible for insurance supervision, based on the MOU between the two entities. In these meetings, information on developments of supervisory activities on banking and insurance groups is shared and views on individual groups are exchanged. Also, issues that need greater consistency of approaches are identified. The assessors saw the minutes of these meetings and confirmed these discussions are taking place. In addition, BSD has a working-level relationship with the FSB to enhance the supervision of banking groups which include insurance operations. Furthermore, the BSD holds meetings with, for example, the Banking Association of South Africa, National Treasury, Johannesburg Stock Exchange, National Credit Regulator and Financial Intelligence Centre on an ad-hoc basis.

South Africa is now in the process of implementing a "twin-peaks model" of financial regulation. Under the "twin peaks" approach, a prudential regulator housed in the SARB whose objectives are to maintain and enhance the safety and soundness of regulated

	<p>financial institutions and which is responsible for the prudential regulation and supervision of banks and insurers will be established. The authorities explain that this would entail the merging of insurance supervisors from the FSB with the BSD to form the prudential regulator and contribute to improving cross-sectoral supervision.</p>
EC5	<p>The supervisor, in conjunction with other relevant authorities, identifies, monitors and assesses the build-up of risks, trends and concentrations within and across the banking system as a whole. This includes, among other things, banks' problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.</p>
Description and findings re EC5	<p>The SARB, as a central bank, monitors and assesses trends, developments and risks for the domestic economy, which includes banks. The BSD provides presentations in the SARB's two senior committees—the Monetary Policy Committee and the Financial Stability Committee. The presentations to the MPC addresses credit extension in the banking sector and the one for the FSC discusses systemic issues in the banking sector. These presentations drive investigations into trends in the sector, both in preparation for the presentations and as a result of questions raised during the presentations.</p> <p>As described in EC4, BSD's Research and Information Division analyses data submitted by banks from a sector perspective. This information is reported monthly to senior management in the BSD. On a quarterly basis this analysis is presented and discussed with the whole department. In addition, the risk sections also focus on specific risk areas and produces reports on specific focus areas, such as unsecured retail lending, which is distributed to frontline supervision teams.</p> <p>When the BSD sees that an emerging trend in the industry may have certain risks for banks and the banking system general, it is often included horizontally in relevant banks' supervisory plans as "flavor of the year" topics. These topics are discussed in various meetings with banks and off-site analysis is conducted to support these meetings (See EC4).</p> <p>As an example, the BSD has recently identified unsecured lending, which has been growing significantly particularly in some banks, as an important risk factor to the sector and stepped up its supervisory effort. During 2012, specific surveys were conducted on the issue. It was also covered, as a "flavor of the year" topic, in discussions with the bank's Board, with a particular focus on the growth of the lending. A monthly report has been published which is distributed to the frontline analysis teams. Meetings with the FSB were also held on lending taking place at large insurers.</p> <p>To supplement its internal analysis, the BSD also reviews external analysts' reports on the</p>

	sector and individual banks. The BSD also monitors media coverage of individual banks and the banking sector. There are also biannual presentations by global auditing firms to the BSD on their published financial analysis of the sector and surveys of banking CEOs.
EC6	Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank's resolvability where appropriate, having regard to the bank's risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.
Description and findings re EC6	<p>The BA provides the Registrar a range of tools to address issues in banks on a going concern basis, including, among others:</p> <ul style="list-style-type: none"> • Issuing directives to banks individually or collectively (BA Section 6(6)(a)); • Raising an individual bank's capital requirement or requiring the bank to strengthen its risk management and internal controls (Regulation 38(4)); • Declaring that a bank's CEO or other officer is no longer fit and proper (BA Section 60(6)(a)); • Imposing fines (BA section 91A); • Seeking court decisions on offences committed by a bank or its officer; or • Taking the initiative for a cancellation or suspension of a bank's registration. <p>Under the MOU between the BSD and the FSB, the BSD would inform the FSB of material information (including remedial supervisory action) in respect of a bank that is part of a group that includes entities that are supervised by the FSB.</p> <p>Recently, all banks, excluding branches of foreign banks, were requested to develop recovery plans (Guidance Note 3/2012, 4/2012 and 10/2012). During 2013 the recovery plans of the systemically significant banks were reviewed by the BSD and further guidance was given in bilateral meetings to ensure that all banks' recovery plans were fairly consistent and covered all the required elements. During 2014 the BSD with the newly separated FSD plans to conduct a further review of the recovery plans of the systemically significant banks. In these recovery plans, banks are expected to identify barriers to smooth recovery and address them.</p> <p>The SARB has been identified as the resolution authority under the BA, but work is currently underway to draft a Resolution Bill, which provides additional resolution powers to the planned Prudential Authority in order to resolve a financial entity prior to failure.</p>

	Work on the resolution plans will commence once the bill is enacted.
EC7	The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.
Description and findings re EC7	<p>The BSD explains the following factors will be considered on a case-by-case basis when a bank is in distress:</p> <ul style="list-style-type: none"> • The systemic significance of the bank experiencing distress; • Whether the bank is still viable, i.e., is this a temporary problem; and • Whether the bank is experiencing a capital or liquidity problem. <p>Depending on the nature of the stress experienced by a bank, emergency liquidity assistance can be given by the SARB against pledged collateral or against a government guarantee. The National Treasury can play a role in providing public funds as part of a resolution package for a systemically significant bank.</p> <p>Other SARB resolution powers that could be utilized include:</p> <ul style="list-style-type: none"> • Acquire shares in a limited company (SARBA Section 10d)—which requires the Minister’s approval for a bank (SARBA Section 13b). The authorities view this as a potential way to inject capital into an insolvent institution, including a bank. • The SARB/BSR can facilitate a private-sector solution through participation in negotiations. The performing part of the loan book/other assets of a bank can be sold to other bank(s). This is normally done at a discount, or with some guarantee of asset quality, which is provided by the government. These are practices applied in past cases. However, the BSD is concerned there may be cases where other banks may have limited appetite to take on large additional microloan/unsecured lending books, in particular if there is doubt about the asset quality or if the unsecured lending market becomes saturated. <p>Also, as noted above, the BA provides the power of appointing a curator (section 69) and forcing liquidation/winding up of a bank (section 68) as the mechanisms for the handling a failed bank.</p> <p>As stated in EC6, however, the present laws do not provide the SARB a broad power to handle banks in stress, leading to the lack of clear framework or process for dealing with such a bank. Work is currently underway to draft a Resolution Bill to provide more extensive resolution powers. The draft Financial Sector Regulation Bill expects that the Minister of Finance will decide on the systemic significance of a financial entity and will be involved in the resolution process when public funds are involved in the resolution of a</p>

	systemically significant financial entity.
EC8	Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.
Description and findings re EC8	<p>BA Sections 81 to 84 set out the powers and duties of the Registrar with regard to bank-like activities being conducted. These provisions give the power to Registrar to apply for court for an order to prohibit the activities. They allow the Registrar/Supervisor to report the matter to the South African Police Services or the National Prosecuting Authority. Each year, the BSD reviews a number of cases in cooperation with the law enforcement authorities.</p> <p>The restructuring of a bank that involves establishing a subsidiary or investing in a joint venture requires a prior approval by the Registrar, where the bank needs to provide detailed information regarding structures and activities of the new undertaking. The BSD explains it will not approve the application if it results in avoidance of the regulatory perimeter.</p>
Assessment of Principle 8	Largely Compliant
Comments	<p>The SREP cycle and the risk rating system provide an adequate general framework of supervisory approach for the BSD. These processes focusing on individual banks and banking groups are complemented by sector-wide approaches such as the “flavor of the year” topics as well as enhanced thematic on-site reviews.</p> <p>However, the approaches related to resolution of banks required in EC 6 and 7 are still in the process of development, which lead to the rating above. Although those on the recovery plans as well as contingency planning have started, work on resolution plans for systemic banks has yet to begin. The assessors understand the required power will not be given until the expected legislation on bank resolution becomes effective and urge the authorities to enact the bill expeditiously.</p> <p>Another important issue related to this principle is planned transition to the twin peaks supervisory structure. The transition should involve not only providing the prudential supervisor responsibility over various financial sector entities, but also improved oversight over systemic risk and wider financial groups. The new prudential supervisor should therefore review the supervisory approach once the organizational changes are completed in order to enable it to have capacity to monitor the prudential risk of the entire financial system as well as that of financial conglomerates. This may require a more formalized framework to detect and assess system-wide and cross-sectoral risks and its integration to</p>

	<p>supervision of individual financial groups and regulated financial institutions. New tools to address those risks may also need to be added to its arsenal, such as common scenario stress testing across different financial sectors and a risk rating framework that takes into account the entire risk of financial groups. Close cooperation with the planned Financial Stability Oversight Committee and its secretariat will be essential in these endeavors.</p>
Principle 9	<p>Supervisory techniques and tools. The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.</p>
EC1	<p>The supervisor employs an appropriate mix of on-site¹⁷ and off-site¹⁸ supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between on-site and off-site supervision may be determined by the particular conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness and integration of its on-site and off-site functions, and amends its approach, as needed.</p>
Description and findings re EC1	<p>BA Section 4(4) stipulates that the Registrar shall implement and maintain a supervisory review process, which may include any one or any combination of: an on-site examination, inspection or review; an off-site review; a discussion with banks' management; a discussion with banks' Board members; a review of work done by external auditors, and; a review of reports submitted by banks.</p> <p>Off-site work</p> <p>Off-site reviews by the BSD include, among other things, ongoing analysis of statutory data submitted by individual banks/banking groups, internal and external auditors' reports, and minutes of the Boards. Also, analysis of various other sources of information are conducted such as published financial statements, media coverage, financial analyst's reports and industry reviews, etc. These are primarily conducted by frontline analysts in the BSD responsible for each bank/banking group. For example, the analysts go through each report submitted by banks and ask banks for clarifications regarding any substantial changes. Specialized risk units also conduct reviews of works assigned to external auditors on risk-specific assessment, such as the long-form reports on credit risk and operational risk models.</p>

¹⁷ On-site work is used as a tool to provide independent verification that adequate policies, procedures and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank's follow-up on supervisory concerns, etc.

¹⁸ Off-site work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further off-site and on-site work, etc.

The result of these reviews feeds into, primarily, MIR, which is produced monthly for each bank and includes risk ratings. These reviews may also result in the identification of areas within a bank that require detailed monitoring or specialized on-site review, as well as modification of supervisory plans. Where relevant, issues identified in a particular bank that may also be relevant at an industry level are elevated to the relevant specialized risk units for information purposes.

Supervisory meetings

The BSD attaches particular importance to periodic meetings with banks'/banking groups' Boards, Board subcommittees, CEOs and managers at various levels including CROs and those in compliance and internal audit functions, as well as external auditors. These are held at least annually for large banks. (For details of each meeting, see CP8). Given the BSD's emphasis on corporate governance and internal control, these meetings are used not only to communicate and follow-up supervisory concerns but also to evaluate risk profiles and quality of management and control of banks/banking groups. These are regarded as one of the major sources of information that feeds into the non-financial risk part of the bank ratings.

On-site work

The BSD employs focused on-site reviews to complement the above-mentioned supervisory meetings and off-site reviews. These on-site reviews are usually carried out either by specialist risk teams or the on-site review team, with participation from the frontline analyst teams as necessary.

The on-site reviews led by specialist risk teams are usually conducted to assess internal models for advanced approaches in Basel II/III, but also used for other purposes. Horizontal reviews are performed periodically based on inter alia, specific topics and emerging risks that could impact the industry as a whole. These reviews are often a combination of on-site and off-site work, and the total length is from a few days to a few weeks. Thematic inspections are often performed on an industry-wide level (i.e., all banks) or a peer group level (i.e., the 5 large banks). Topics are determined based on various factors such as prevailing market conditions, emerging risks, international and/or domestic regulatory developments, etc. Recent and planned thematic reviews include: a) counterparty credit risk; b) asset and liability management; c) equity risk in the banking book; and d) investment risk. This on-site work includes focused review of bank files, for example loan files in case of on-site reviews related to credit risk management.

Traditionally, the BSD has relied on banks' statutory external auditors to conduct on-site verification of accuracy of their supervisory reporting and compliance of their practices to regulatory requirements as well the banks' own policies and processes. Through formal bilateral meetings as well as informal communications, the BSD maintains close contact with the statutory auditors of banks. Through these meetings, the BSD may require the

audit program to be changed based on its supervisory concerns. The assessors' review of meeting agendas and minutes with statutory auditors and discussion with audit firms confirmed that the BSD is proactively involved in setting audit scopes for banks and informed of the audit results in detail. Audit firms also explained that the BSD challenges their work frequently. These interactions with audit firms feed into regulatory actions. For example, the BSD is now finalizing the policy to clarify treatment of restructured loans. (See CP 18.) Furthermore, the practice in South Africa supported by the BSD to have multiple statutory audit firms for a large bank is contributing to standardizing audit practices among major audit firms. The BSD has also used auditing firms that are not statutory auditors of a bank to conduct specific on-site assessments under BA Section 7 as described below (EC11).

Since the last BCP assessment in 2010, the BSD has enhanced its on-site reviews by conducting more deep-dive reviews utilizing its on-site review team. The team conducts on-site reviews for major topics that require extensive assessment of banks' actual practices. For example, the team has recently worked on the unsecured loan portfolio. The work involved an extensive review of sample loan files to assess, among other things, the adequacy of treatment regarding impaired loans and restructured loans. For these reviews, a core team consists of around 6 staff members with additional staff participation from specialist risk divisions and frontline analysis teams, and the length of the review can be more than one month. In the assessors' view, this added capacity now enables the BSD to adequately cover important risk areas for banks by itself, which is also contributing to its ability to monitor and assess the adequacy of external auditors' work. The increased intensity on on-site work is recognized by banks and audit firms and generally welcomed. The on-site review of AML/CFT is also conducted following a similar format. For large banks, the whole inspection process could take up to 2 months with around 10 staff members.

The final report will typically be sent to banks within a period of 6 to 8 weeks subsequent to the completion of the review. There is no mandated frequency for on-site inspections.

Planning of supervisory work

As described in CP8 EC1, the planning of supervisory work is carried out through formulation of an annual supervisory plan for each bank/banking group during the SREP cycle. The plan is based on, among other things, the risk assessment and profile of a particular bank, and takes a form of a schedule of supervisory actions during the year, such as meetings with bank officials and on-site reviews for particular areas. The BSD communicates the plan to the bank before the beginning of a year. The BSD views the main purpose of the supervisory plan as ensuring a disciplined and comprehensive planning process that forms the foundation for supervisory actions, interactions with the bank, and interventions.

The SREP cycle is continuous in nature and hence it is subject to ongoing reviews and

	<p>revisions if and where necessary to ensure effective supervision of a particular bank. As new information becomes available during the cycle, the supervisory plan is continuously updated. During the quarterly review of the MIR, review and sign-off of supervisory programs at a departmental level takes place, and appropriateness of the mix of supervisory tools are also revisited.</p> <p>In addition, the BSD has an annual strategic planning process where strategic risks are identified that should be taken into account in ongoing supervisory activities. It also provides an opportunity to review the current processes and tools for supervision. For example, the BSD is currently preparing a policy on the forward-looking supervisory approach.</p>
EC2	<p>The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.</p>
Description and findings re EC2	<p>As described in EC1, during Stage 1 of the SREP cycle, a supervisory plan for a particular bank is compiled annually. While the frontline analysis teams are primarily responsible for the supervision of a bank/banking group, discussions between frontline analysis teams and the various specialist risk teams, with involvement of the BSD's senior management as necessary, takes place during the preparation process. Through these discussions, on-site reviews required in respect of each bank during the supervisory cycle and a discussion of the allocation of responsibilities pertaining to each review, among others, are determined.</p> <p>The supervisory plan is further expanded at an operational level to include high-level details of key off-site activities, such as monthly and quarterly reviews of statutory data, timing of risk reviews and management information, etc.; and is supported by more granular operational schedules setting timelines and target dates for, among other things, internal group discussions, risk reviews, management information reports, and queries flowing from off-site analysis of statutory data submitted by banks.</p> <p>The objectives, principles and processes pertaining to ad-hoc on-site meetings (e.g., model reviews or thematic on-site reviews) with banks are also discussed and determined between frontline analysis and specialist risk teams. In certain instances standard questionnaires have been formalized and form part of the SREP Manual, such as a questionnaire on equity risk in the banking book and a questionnaire on counterparty credit risk. Customized and/or ad-hoc questionnaires are also compiled to suit particular on-site interventions if and when required.</p> <p>The BSD explains that it views off-site and on-site activities are often a combined effort involving both frontline analysis and specialist risk teams based on the type of intervention, although the frontline analysis team remains ultimately responsible for the supervision of</p>

	<p>individual banks. In order to ensure effective coordination and information sharing through ongoing interaction and communication between frontline analysis and the relevant specialist risk teams, the Principles of Engagement guidelines has been prepared, which provides high-level principles and guidelines pertaining to, among other things, ongoing interaction, key responsibilities and the flow of information. Sharing of relevant information between frontline analysis and risk support functions are also facilitated by formal interactions such as the departmental Correspondence Meetings, Management Forum Meetings, Risk Specialist Analysis Committee meetings and Divisional Meetings.</p> <p>The assessors' discussion with frontline analysts and specialist risk teams as well as review of a number of internal documents related to on-going supervisions confirmed that the BSD has a coherent supervisory process and coordination among various teams in the BSD is taking place.</p>
EC3	<p>The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank's related entities, and publicly available information. The supervisor determines that information provided by banks is reliable¹⁹ and obtains, as necessary, additional information on the banks and their related entities.</p>
Description and findings re EC3	<p>In the SREP cycle, different types of information are used to form a view not only on the risk profile of a particular bank but also in terms of the operating environment relevant to banking institutions. (See CP 8 as well s CP 9 EC1 for details). These sources include, among other things:</p> <ul style="list-style-type: none"> • Ongoing off-site analysis of statutory data submitted by banks, on a bank-solo and consolidated basis, and pertaining to banking operations in foreign jurisdictions. • Analysis of annual financial statements of banks as well as related public disclosures. • Review of various reports submitted by banks, such as internal audit reports, compliance reports, management information reports, etc. • Analysis of external audit reports. • Review on financial analyst's reports pertaining to particular banks or the industry as a whole. • Monitoring of media coverage pertaining to a particular bank or the industry and operating environment in general.

¹⁹ Please refer to Principle 10.

	<ul style="list-style-type: none"> • Meetings with the chief executive officer, various other executive officers and operational managers of a bank (as per the supervisory program, but it could also be on an ad-hoc basis). • Meetings with the Board, Board audit committee and other Board sub-committees of a bank and a controlling company, which takes place annually and on an ad-hoc basis. • Annual meeting with the chairperson of Board in case of a large bank. • Thematic reviews focused on selected risk areas or topics. • On-site reviews, such as model approval reviews and deep-dive reviews focusing on particular risk areas or topics. • Compliance reviews, such as Financial Intelligence Centre Act reviews performed by the BSD Review Teams. • Review of minutes of the Board and Board sub-committees on an ad-hoc basis. <p>Any discrepancies or inconsistencies in reporting identified in ongoing analysis is followed up with the particular bank and monitored to ensure that corrective action is taken. For example, queries on statutory BA submissions are sent to banks by frontline analysts on a regular basis. Although this is to understand any substantial movement in bank's submitted data, it could lead to issuance of directives from the BSD for banks to correct reporting on the statutory BA returns and to resubmit statutory data. The BSD also has the authority to call for any additional information that is required to perform its supervisory duties. The BSD explained it does not have a significant concern with the accuracy of reporting data, although it takes some time for banks to be able to provide quality data as reporting requirements have been expanded substantially in recent years reflecting regulatory changes.</p>
EC4	<p>The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as:</p> <ul style="list-style-type: none"> (a) Analysis of financial statements and accounts; (b) Business model analysis; (c) Horizontal peer reviews; (d) Review of the outcome of stress tests undertaken by the bank; and (e) Analysis of corporate governance, including risk management and internal control systems.

	<p>The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.</p>
<p>Description and findings re EC4</p>	<p>See CP 8 above. During the SREP cycle, a wide range of tools are used to assess and monitor the safety and soundness of banks. Examples of tools used include, but are not limited to, the following:</p> <ul style="list-style-type: none"> • Statutory BA returns required by the Regulations as defined in Regulation 7 • MIRs with risk ratings and graphs as well as risk reviews • Trigger reports that signals outliers on key prudential benchmarks and key statistics • Annual financial statements • External and internal audit reports • Compliance reports • Peer group and industry analysis • Thematic reviews and on-sites (could be bank specific or industry-wide) • Compliance reviews (for example to assess compliance with FICA or other regulatory requirements) • Prudential meetings with bank staff and meetings with the Board, Board sub-committees and chairperson of the Board • Ad-hoc meetings covering specific matters related to individual banks as and when required • Participation in QIS exercises • Thematic questionnaires • Management information requested from banks • Media reports • Economic reviews by the Research Department and Financial Stability Reviews by the Financial Stability Department of the SARB

	<ul style="list-style-type: none"> • Common scenario stress testing by the BSD (last conducted in 2012) • Financial sector-wide crisis simulation performed in March 2014, facilitated by one of the large auditing firms in South Africa. <p>Information/knowledge gained throughout the various stages of the supervisory cycle feeds into MIR and used to update and/or refine the supervisory plan as well as to determine further action required in respect of each individual bank on an ongoing basis. The BSD senior management reviews the overall supervisory program on a monthly basis and the revised program is signed off.</p> <p>Feedback is provided to banks through various means, including meetings with the Board, audit committee, chairperson of the Board, senior management, etc. During such meetings issues identified will be shared and the bank will be requested to furnish the BSD with action/remedial plans as well as provide regular feedback/updates on progress made in addressing identified issues. The key issues raised at such meetings are usually formally recorded in feedback letters provided to the relevant bank subsequent to meetings held.</p>
EC5	<p>The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings re EC5	<p>See CP8 EC4 and 5 for the BSD's efforts and tools to address emerging risks. In addition to the supervisory interactions with individual banks and the work on the whole sector, the BSD holds meetings with various parties including: quarterly meetings with the Financial Services Board to discuss matters relating to conglomerate groups comprising banks and non-bank financial institutions; periodic interaction with National Treasury and the Minister of Finance; ad-hoc meetings with the Financial Intelligence Centre, National Credit Regulator; attendance to the BCBS meetings and its subgroups; participation in international surveys, such as QIS exercises, and; representation in numerous domestic and regional committees, task groups and working groups.</p> <p>Issues and/or emerging risks identified owing to the above-mentioned interactions are assessed and follow-up actions are determined based on the particular circumstances. Follow-up action varies and could include:</p> <ul style="list-style-type: none"> • Active monitoring; • Feedback to banks through presentations or letters, or, more formally, directives,

	<p>circulars or guidance notes;</p> <ul style="list-style-type: none"> • Industry questionnaires; • On-site reviews; • Request to external or internal auditors to conduct audit on particular topics; • Amendments to regulatory requirements, e.g., a pillar 2b add-on to banks' minimum capital requirement; and • Stress testing exercises. <p>As noted in CP 8, the BSD uses "flavor of the year" topics for possible system-wide risk sources which are discussed during meetings with the bank Boards or CEOs.</p> <p>Regarding the stress testing exercises, the most recent common-scenario stress testing was conducted in 2012 with a severe but plausible economic downturn scenario which covers banks' South African operations. The BSD plans to repeat a similar exercise in the context of FSAP and continue thereafter.</p>
EC6	<p>The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.</p>
Description and findings re EC6	<p>BA Section 4(4) defines the supervisory review process to be implemented and maintained by the Registrar to include a discussion with the head of internal audit of a bank. The Regulations also include a number of references to the internal audit function, most notably Regulation 48 which provides requirements for internal audit (See CP 26).</p> <p>In the supervisory framework, a prudential meeting with the head of internal audit of individual banks/controlling company is held on an annual basis, or more regularly if necessary. The BSD will also discuss bank's internal audit function, including the appropriateness and reliability thereof, with the external auditors of the bank annually during the bilateral meeting. The BSD views that this gives a perspective on the external auditors' assessment of the internal audit function as well as the level of reliance placed by the external auditors on the work performed by the bank's internal auditors. This, together with information gathered during the prudential meetings with the internal auditor, provides the BSD with a perspective on the functioning of the internal audit function and the level of reliance that can be placed on the work performed by the function.</p> <p>The BSD requests copies of internal audit reports periodically, particularly for audits performed in key areas. In addition, the BSD requires internal audit reports which are submitted to the Board or the Board audit committee to be provided.</p>

	<p>A discussion of internal audit findings and steps taken by banks to resolve such finding is generally a standard agenda item in respect of most prudential meetings and on-site reviews performed by the BSD.</p>
EC7	<p>The supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive Board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. Where necessary, the supervisor challenges the bank's Board and senior management on the assumptions made in setting strategies and business models.</p>
Description and findings re EC7	<p>As mentioned in CP8 and 9, various interactions with Board members and senior and middle management take place during the SREP cycle, which form a major component of the supervisory plans. In addition to the scheduled interactions with banks, periodic ad-hoc meetings with banks' Boards, Board sub committees, executive/senior management, middle management, control functions, staff in operational areas, etc. may take place. Interaction is not limited by the supervisory program but is flexible and can be adjusted depending on circumstances to ensure effective and efficient supervision of banks.</p> <p>The BSD maintains multiple communication lines with banks. The BSD liaises with banks through a single point of entry namely the frontline analysis teams. The BSD explains there are typically strong professional relationships built between the BSD teams and the heads of compliance as well as internal audit functions of banks to facilitate the flow of relevant information between the BSD and banks. The assessors observed these frontline analysis teams having a good understanding of banks they are in charge of. Review of files and discussions with banks also confirmed that frequent and intensive discussions take place between various levels of banks and the BSD's frontline analysis teams. Banks also confirmed that the BSD often challenges the banks' Board and senior management on various issues.</p> <p>Matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls are typically discussed during prudential meetings held annually with the Board, Board audit committee, CEO, internal auditor, compliance head, external auditors, heads of selected business units, etc. of a bank/controlling company, depending on the supervisory program and prevailing circumstances pertaining to a particular bank or banking group. For example, a BSD frontline analyst team meets biannually with the CEO and the CFO of a large bank to discuss half-year and year-end financial results prior to information being made public. These discussions often cover items such as planned strategies and key areas of concern. Annual prudential meetings with, inter alia, the CEO, head of compliance and head of internal audit generally includes a discussion on emerging risks and concerns and changes in business strategies and plans. Supervisory challenge during these interactions is</p>

	<p>common practice and is often formalized in correspondence with banks subsequent to interventions.</p>
EC8	<p>The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses in a timely manner by means of written reports or through discussions or meetings with the bank's management. The supervisor meets with the bank's senior management and the Board to discuss the results of supervisory examinations and the external audits, as appropriate. The supervisor also meets separately with the bank's independent Board members, as necessary.</p>
Description and findings re EC8	<p>As described above, step 6 of the SREP cycle is feedback to the Board and senior management of a bank. Conclusions and recommendations reached through the SREP cycle are communicated to the bank's Board, risk committee, audit committee and senior management through meetings, particularly through biannual result presentations.</p> <p>Annual scheduled meetings with the Board, the chairperson of the Board, the audit committee and the CEO of a bank also provide platforms for discussion of any issues that may be relevant or necessary to ensure effective supervision of banks, including any supervisory findings. BSD may also choose to meet with the Board as a whole or separately with the chairperson of the Board to discuss particular issues of concern. The main points of these meetings, including supervisory findings and concerns raised by the BSD are documented in feedback letters and provided to the bank. Meetings with chairpersons of the Boards, who are independent Board members, are held without attendance of senior management.</p> <p>Also, key and/or material findings or issues, whether identified through off-site or on-site activities of the BSD, will be documented and shared promptly with the particular bank and/or industry. A typical example would be issues identified during an on-site review, which are shared with the bank by means of a letter or a report. The bank would have the option to respond to issues raised, which could be subject to further meetings being held with a bank or further correspondence with the bank. If violations of regulations or laws are identified during on-site reviews, they are formally communicated to banks in a close-out meeting following the on-site review. Banks are then normally afforded the opportunity to respond to the issues raised by BSD. The bank's response will be considered in preparing the final report that will be sent to the bank.</p> <p>Similarly, queries may be sent to a bank for follow-up subsequent to off-site analysis of statutory returns or a report submitted by the bank.</p>
EC9	<p>The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank's Board if action points are not addressed in an adequate or timely manner.</p>

Description and findings re EC9	See EC 8. The issues that need to be followed up are considered during the supervisory planning process and included in the topics for various meetings between the supervisor and the bank. Major issues are followed-up with the Board or the chairperson of the Board. Also, supervisory concerns may be communicated to internal or external auditors for follow-up. The assessors saw evidence that these issues are raised and followed up by a bank's Board or internal/external auditors.
EC10	The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.
Description and findings re EC10	<p>The BA provides a number of requirements for prior notification or approval from the BSD, including cases such as:</p> <ul style="list-style-type: none"> • The establishment or acquisition of subsidiaries within or outside South Africa, the acquisition of any interest in a foreign jurisdiction, investments in joint ventures, and the establishment of foreign branch offices or representative offices (Section 52); • Mergers involving a bank or banking group as well as the transfer of more than 10 percent of the assets and/or liabilities of a bank (Section 54); • Restructuring within banking groups (Section 55); • Alterations to the memorandum of incorporation of a bank or controlling company (Section 56); and • Investment made and loans and advances granted in excess of 25 percent of a bank's qualifying capital and reserves. <p>Regulation 47 also requires banks to report offences to the BSD that come to the attention of banks, such as breaches in fiduciary duties, market abuse and any other material irregularities.</p>
EC11	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties.
Description and findings re EC11	BA Section 6 stipulates that third parties may be appointed, with specific terms of reference, to conduct an inspection on behalf of the Registrar. Similarly, BA Section 7 allows the Registrar to direct a bank or any other appropriately skilled person to perform a review and to submit a report in respect of any matter that is reasonably necessary to enable the BSD to perform its supervisory functions and duties. Such a request will be subject to specified terms or reference. As described in EC1, in cases where an extensive review of

	<p>certain issues are deemed to be necessary, the BSD requires banks to be reviewed by independent audit firms under BA Section 7. In these cases, clear and detailed terms of reference are provided.</p>
EC12	<p>The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.</p>
Description and findings re EC12	<p>The BSD uses three main software packages to manage information submitted by banks, namely:</p> <ul style="list-style-type: none"> • Financial Management System/database (FMS) – used for purposes of receiving statutory data from banks, automated validation of data, and storage of data received. • Oracle Financial Analyser (OFA) system – which pulls data from the FMS and then allows manipulation of data to create graphs, trigger reports, summary reports, management information, etc. This is also the system that can be accessed by BSD analysts to view data and the various reports and graphs for purposes of analysis, on a bank solo, bank consolidated, peer group, and on an industry level. • EGIS Papertrail, which is the departmental document management system. All documents received from and sent to banks are captured electronically on the system and is available to all staff in the BSD. This system is also used as a tracking system and serves as an audit trail in respect of all correspondence, whether received or sent in physical or electronic format between the BSD and any outside/third parties. <p>Various key statistical and trigger reports as well as graphs are produced and saved in OFA to aid frontline analysts and specialist risk units in identifying and monitoring key risk areas and areas requiring follow-up actions. Various reports, such as MIRs and risk specific heat maps are also produced periodically within frontline analysis and specialist risk units to assist analysts and management to identify, analyze and monitor key risk areas.</p>
AC1	<p>The supervisor has a framework for periodic independent review, for example by an internal audit function or third party assessor, of the adequacy and effectiveness of the range of its available supervisory tools and their use, and makes changes as appropriate.</p>
Description and findings re AC1	<p>The BSD as a department is subject to periodic review/audit by the SARB's Internal Audit Division. The audit findings are shared with management and the Governor's Executive Committee, and used to guide ongoing improvements and refinements of the various supervisory tools and processes applied by BSD.</p>
Assessment of Principle 9	<p>Compliant</p>

Comments	<p>The BSD has improved its supervisory techniques and tools significantly. In particular, it has moved from a model relying substantially on external auditors for on-site work to one where the BSD's own staff conducts a number of on-site reviews to complement the work of external auditors, including deep-dive reviews that verify banks' actual practices through such means as extensive review of loan files. It has also added a number of risk specialists who conduct on-site reviews on particular risk areas including model validations, but also other topics related to particular risk areas. These improvements, in addition to detailed and intensive off-site analysis and frequent interactions with various levels of banks/banking groups, including their Boards, equip the BSD with wide-ranging high quality techniques and tools that are appropriate for providing oversight of risk profiles and operations of banks and banking groups in South Africa.</p> <p>The assessors encourage the BSD to further continue its effort to enhance its ability to conduct deep-dive on-site reviews and improve tools and technique to assess and monitor spill over risks to the banks from non banking activities in their financial groups.</p>
Principle 10	<p>Supervisory reporting. The supervisor collects, reviews and analyses prudential reports and statistical returns²⁰ from banks on both a solo and a consolidated basis, and independently verifies these reports through either on-site examinations or use of external experts.</p>
EC1	<p>The supervisor has the power²¹ to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.</p>
Description and findings re EC1	<p>BA Section 6 provides powers of inspection as stipulated in the Inspection of Financial Institutions Act, which includes access to any person related to the inspected institution or any document of the institution. Section 7 also provides powers to the Registrar to request banks, controlling companies or a subsidiary of a bank or controlling company to furnish information. Section 75 then requires banks and controlling companies to submit their returns in conformity with financial reporting standards.</p> <p>Based on these provisions in the BA, the Regulations then require banks to periodically report to the BSD a broad range of detailed information, which includes their balance sheets (BA 100), off-balance sheet activities (BA 110), income statement (BA120), capital adequacy and leverage (BA 700), liquidity risk (BA 300), credit risk—including large</p>

²⁰ In the context of this Principle, "prudential reports and statistical returns" are distinct from and in addition to required accounting reports. The former are addressed by this Principle, and the latter are addressed in Principle 27.

²¹ Please refer to Principle 2.

	<p>exposures, risk concentrations, asset quality, loan loss provisioning and related party transactions (BA 200, 210, 220), interest rate risk (BA 330), and market risk (BA 320). Returns related to financial statements are usually required for a bank's South African operations and the bank as a legal entity including foreign branches as well as at the consolidated level from the bank and below and from its controlling company and below, but with less frequency. For other returns, they are usually required only for the bank's South African operations, but key information is required by form BA 600, Consolidated return. Also, individual branches and subsidiaries abroad are required to submit similar information quarterly by form BA 610.</p> <p>In addition, as described in CPs 8 and 9, the BSD requires a number of reports by banks on demand through its SREP cycle.</p>
EC2	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	<p>BA Section 75(3A) provides that the returns shall be prepared in conformity with financial reporting standards in terms of the Companies Act and shall be furnished to the Registrar in respect of such period, at such times and on such a form as may be prescribed. Regulation 3, Financial Reporting Standards, then provides that all the relevant prescribed returns shall be prepared in accordance with International Financial Reporting Standards. In terms of auditing, Regulation 46 requires a bank's external auditor to report to the Registrar the adequacy of returns on the year-end results.</p>
EC3	The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and are consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the supervisor determines that valuations are not sufficiently prudent, the supervisor requires the bank to make adjustments to its reporting for capital adequacy or regulatory reporting purposes.
Description and findings re EC3	<p>Regarding valuation of assets and liabilities, Regulation 3 (4) requires a bank to:</p> <ul style="list-style-type: none"> • Have a robust risk management system and Board approved policies, procedures and controls; • Comply with any relevant criteria or requirements contained in the relevant Financial Reporting Standard (IFRS);

	<ul style="list-style-type: none"> • Document its application of the fair value option or approach; and • Ensure relevant assets and liabilities are captured in risk measurement systems and resulting exposure amounts are included in internal reports comparing it to risk management limits. <p>It further requires regular verification of valuations by independent and qualified units and periodic reviews by the bank's internal audit function. Regulation 39(13) also provides detailed key elements of the required robust governance structures and control processes to ensure prudent valuation.</p> <p>The BSD discusses these issues in the annual bilateral meetings with external auditors or in the annual trilateral meetings that also include Board audit committees as necessary and internal audit functions. The BSD can require banks to make adjustments if needed.</p>
EC4	<p>The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.</p>
Description and findings re EC4	<p>Based on the provisions of the BA as described in EC1, Regulation 4 stipulates frequencies for different types of returns. For example, most of the financial statements as well as basic information regarding credit, liquidity and other risks are required monthly. Some of the more detailed credit risk related information as well as consolidated returns are required quarterly. Some information is required biannually. The frequencies stipulated in the Regulation do not differ among banks; ad-hoc information requests may be made depending on the risk profile and systemic importance of the bank, however. In the past, for example, frequent liquidity monitoring reports were requested of certain troubled banks.</p> <p>In on-going supervision, the SREP cycle includes a review of data submitted by banks, e.g., by utilizing time series analysis, automated key stats, trigger reports and automated graphical analysis. The BSD has also implemented validation rules that prevent banks from submitting incorrect data. Based on such a framework, monthly queries are performed by frontline analysts, following a review of statutory returns on, for example, large or unexpected movements in data. Queries are sent to the banks, and their responses are reviewed, and followed up if necessary.</p> <p>Other tools being used in analyzing data submitted by banks include:</p> <ul style="list-style-type: none"> • Graph discussions, which are held with banks in respect of the data submitted. Key graphs are presented to banks' Boards and senior management annually. • Monthly trigger reports, which are generated to assess the information and risks reported by banks. Triggers are assigned for various categories of statistical returns in

	<p>order to alert frontline analysts as well as the BSD management.</p> <ul style="list-style-type: none"> • MIRs include key statistical information. These are generated by frontline analysts to escalate to management issues or matters of concerns regarding a bank. • Semi-annual risk reviews, which are also performed by frontline analysts of each bank. <p>These provide an opportunity to conduct in-depth, focused reviews of the risks that banks face at a point in time. The results of these analyses are discussed internally in the BSD. They are also discussed in various meetings, including those with the banks' Boards and senior management. In addition, ad hoc consolidated supervision prudential meetings are held with banking groups to discuss, amongst other things, the data submitted on the group. The files reviewed by assessors show these analyses and discussions are taking place regularly with sufficient depth.</p>
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	See above ECs. The requirement of returns stipulated in the Regulations applies to all banks and controlling companies established in South Africa in the same manner in terms of the content and frequency.
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.
Description and findings re EC6	<p>As described in EC 1, BA Section 6 provides powers of inspection as stipulated in the Inspection of Financial Institutions Act, which includes access to any person related to the inspected institution or any document of the institution "for the purposes of the performance of his or her functions under this Act." Section 7 also provides powers to the Registrar to request banks, controlling companies or a subsidiary of a bank or controlling company to furnish information. Section 75 then requires banks and controlling companies to submit their returns in conformity with financial reporting standards. This requirement can cover internal management information as long as it is related to the BSD's responsibility.</p> <p>The assessors were informed that the BSD in the past requested, for example, a non-banking subsidiary of a controlling company to submit a number of BA returns on a quarterly basis.</p>

EC7	The supervisor has the power to access ²² all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required.
Description and findings re EC7	The Registrar has the power to access all bank records as well as a bank's Board, management and staff. (See EC1 and EC6)
EC8	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines the appropriate level of the bank's senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.
Description and findings re EC8	<p>BA Section 91(6) provides that if any person fails to submit to the Registrar or to furnish the Registrar with any return, statement, report or other document or information in accordance with a requirement of the BA within the period determined, the Registrar may impose a fine not exceeding ZAR1000 for every day during which such failure continues. BA Section 91 (6A) also provides the same power to impose a fine in case where information or returns provided are materially incorrect or inaccurate information.</p> <p>To date, no fines have been imposed on banks based on these provisions but a bank's ability to furnish appropriate returns has been one of the issues where BSD has been focusing. If a bank is seen as problematic in furnishing BA returns, the concern is conveyed to the bank's senior management or the Board and the bank is required to take corrective actions which are then followed up by the BSD in the supervisory cycle.</p> <p>In addition, according to Form BA099, the CEO, the Chief Accounting Officer and the FICA Officer have to sign and certify the form. For re-submissions of data, an updated form BA099 has to be completed and sent prior to re-submission of data, with appropriate sign-off by management responsible for each specific risk areas, and the 3 officers mentioned above also need to sign and certify the BA099.</p> <p>Discussions with banks and audit firms confirmed that the BSD is continuously making efforts to ensure correct reporting by banks.</p>
EC9	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a programme for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts. ²³
Description and findings re EC9	As described in EC3, BA Section 75 (3C) provides that, for those returns that most nearly

²² Please refer to Principle 1, Essential Criterion 5.

²³ May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

findings re EC9	<p>coincide with the end of the financial year of the bank, the bank's external auditor is required to report to the Registrar whether or not those returns present the condition of the bank fairly and are in conformity with financial reporting standards. The Registrar also has the power to require submission of such a report for other returns. Regulation 46 also provides that the bank's external auditor shall annually report on the bank's financial position and the results of its operations at the financial year-end as well as the completeness and accuracy of year-end materials. It also requires the external auditors to report on whether other returns reflect the information of the management accounts, using the same accounting policies as those applied in the management and statutory accounts, and following BA and the Regulations.</p> <p>In addition to the use of external auditors, as described in EC3, the BSD has implemented validation rules that prevent banks from submitting incorrect data and therefore ensuring the quality of reporting. Monthly queries are performed by the BSD analysts, following a review of statutory returns on, for example, large or unexpected movements. Queries are sent to the banks, and their responses are reviewed, and followed up if necessary.</p> <p>Based on Regulation 46(9), the BSD meets at least annually with the external auditors to discuss, amongst other things, the quality of reporting, financial condition of the bank, major risk areas and management. The BSD also holds annual trilateral discussions (with representatives from BSD, the Bank's Audit Committee and senior management and the external auditors) to discuss the findings and reports issued by the external auditors in terms of Regulation 46. The result of monitoring of submitted information by BSD staff feeds into these discussions.</p>
EC10	<p>The supervisor clearly defines and documents the roles and responsibilities of external experts,²⁴ including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.</p>
Description and findings re EC10	<p>BA Section 7(1)(b) provides the Registrar with the power to direct banks, controlling companies or subsidiaries to provide a report by a public accountant or any other person with appropriate skill on any matter about which the Registrar has directed or may direct the bank, controlling company or subsidiary to furnish information. In this case, the person needs to be designated or approved by the Registrar. The BSD provides a clear terms of reference for these works.</p>

²⁴ May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be satisfied with the results of the reviews conducted by such external experts.

	In practice, the BSD usually requires the bank to be assessed by an audit firm which is not its statutory auditor.
EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	In case of the assessment under BA Section 7, the audit firm is required to report all material information they find during the assessment to the BSD according to the TOR.
EC12	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Description and findings re EC12	The BSD reviews reporting forms at the annual policy meeting. The forms were last revised substantially at the time when Basel III was introduced.
Assessment re Principle 10	Compliant
Comments	The regulatory framework requires banks and controlling companies to periodically submit a broad range of information. Strong regulatory and supervisory processes exist to ensure accuracy and comparability of submitted returns. Well developed procedures for analyzing collected information and feeding into supervisory actions are in place.
Principle 11	Corrective and sanctioning powers of supervisors. The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
EC1	The supervisor raises supervisory concerns with the bank's management or, where appropriate, the bank's Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank's Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.
Description and findings re EC1	The SREP cycle provides in Step 6 that feedback to the Board and senior management of a bank is to take place. More generally, key/material findings or issues identified through off-site or on-site activities, such as meetings with banks' Boards and senior management as well as on-site reviews, will be documented and shared with the bank in the form of feedback letters. These are followed up in subsequent meetings with the bank and other

	<p>supervisory actions. See CPs 8 and 9, particularly CP 8 EC1 on the SREP cycle and CP9 EC8.</p> <p>The review of supervisory files, including MIRs and feedback letters, as well as discussion with banks by the assessors confirmed that in practice such process is applied forcibly by the BSD. The discussion on supervisory concerns, including follow-up on the banks' progress in addressing shortcomings communicated in the past, is one of the main topics in the supervisory meetings with the Boards or senior management of banks.</p>
EC2	<p>The supervisor has available²⁵ an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.</p>
Description and findings re EC2	<p>See CP1 EC3 and 5. The BA provides the Registrar a range of tools, including:</p> <ul style="list-style-type: none"> • Section 6(6)—issuing a directive to a bank or to banks collectively. The Registrar may also impose non-financial sanctions in this regard. • Section 60—opposing appointment of a Board member or a CEO. • Section 69—recommending to the Minister to appoint a curator if a bank will be unable to repay deposits and other obligations. • Section 74(2)—taking action against a bank or controlling company if there is a failure to comply with prudential requirements. • Section 91A—imposing fines regarding contravention of a provision of the BA. <p>Moreover, Sections 23 to 26 of the BA provide the power to the Registrar to suspend registration of a bank or controlling company or to restrict its activities, but a number of limitations apply. In the case of a bank that does not comply with conditions attached to the registration, the Registrar can, after consultation with the Minister, suspend or cancel the registration. Similarly, the Registrar can restrict a bank's activities for various broad reasons including cases where: the bank does not carry on satisfactorily the business of a bank; the bank has failed to comply with a requirement of the BA; or the bank continues to employ an undesirable practice. However, the Registrar must notify the bank at a minimum 30 days in advance to give an opportunity to the bank to refute the claim and during that time cancellation or suspension of registration or restriction of activities does not become effective. Alternatively, the Registrar can apply to the court for an order of cancellation or suspension of the registration. In this case, the 30-day notice period does not apply. The BSD explains that this court process can be processed expeditiously, possibly in a matter of</p>

²⁵ Please refer to Principle 1.

	<p>days, but it has not been tested.</p> <p>In addition, Regulation 38(4) affords the Registrar the power to increase prudential requirements commensurate with a bank's risk profile.</p>
EC3	<p>The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.</p>
Description and findings re EC3	<p>See EC2. In particular, BA Section 74(2) provides that the Registrar may take action against a bank or controlling company if there is a failure to comply with prudential requirements. Unlike directives stipulated in BA Section 6(6), no consultation with the relevant bank is required in this case.</p> <p>Regarding early interventions, as described in CPs 8 and 9, the SREP cycle emphasizes early identification of problems in banks. Once problems are identified in a bank, the bank is requested to submit action/remedial plans and provide regular feedback/updates on the progress made in addressing identified issues, which is followed by the BSD closely. These are often carried out without issuing directives stipulated in BA Section 6(6). The BSD explains such an approach can be applied to prevent a bank from breaching the regulatory minimum requirements.</p>
EC4	<p>The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.</p>
Description and findings re EC4	<p>See above, particularly EC2, as well as CP1.</p> <p>BA section 6 (6) gives the Registrar power to issue directives which include non-financial sanctions or require banks, controlling companies, or their auditors to cease or refrain from engaging in any act, perform certain acts, and providing information to the Registrar. This provision is interpreted as enabling the Registrar to, among others: require banks to restrict or suspend payments to shareholders or share repurchases; restricting asset transfers;</p>

	<p>restricting the powers of managers, Board members or controlling owners; or facilitating takeover by or merger with a healthier institution. While a consultation with the relevant bank is required, the agreement with the bank is not required.</p> <p>As explained in EC2, BA Section 26 provides the power to the Registrar to restrict the activities of a bank for a number of reasons including if the bank does not carry out satisfactorily the business of a bank or fails to comply with a requirement of the BA, subject to the 30 days advance notice. BA Section 25 also provides the Registrar to apply to a court for an order of cancelling or suspending the registration of a bank. The bank's registration lapses on the date that order comes into force.</p> <p>BA Section 60 (6) provides the power to the Registrar to object to the appointment or continued employment of a CEO, director or executive officer of a bank if the Registrar believes that these persons are not or no longer a fit and proper person or it is not in the public interest for these persons to hold or to continue to hold these positions. However, the Registrar does not have power to impose temporary management.</p> <p>In addition to the above, the BA and the Regulations give the supervisor power to impose more stringent prudential requirements (Regulation 38 (4)) and subject most new activities and acquisitions to prior approval (BA Section 52).</p> <p>In practice, most supervisory concerns are addressed without resorting to particular powers given by the laws described above. In some cases, directives under BA Section 6 (6) are issued. The request of review by independent audit firms under BA Section 7 is also seen by the BSD as a strong corrective action. Furthermore, administrative fines have been applied under BA section 91 A for AML/CFT related issues.</p>
EC5	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings re EC5	As described in EC4, the Registrar has the power to remove senior managers or Board members of a bank. In addition, BA Section 60(1B) provides that the Registrar may, according to the provisions in the Company Act, order restitution against a director, CEO or executive officer of a bank who was knowingly carrying on the business of the bank "recklessly." The BA, however, does not provide the supervisor the power to impose administrative fines on members of the Board, senior management or other employees of banks.
EC6	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related entities in matters that could impair the safety and soundness of the bank or the banking system.

Description and findings re EC6	As described in EC4, directives under BA Section 6 (6) can be used to implement wide-ranging corrective actions on banks and controlling companies. For example, this could be used to restrict a subsidiary bank's dividend payment to its controlling company, its exposure to the controlling company or to its related entities, or controlling company's exercise of its shareholder's right over the bank.
EC7	The supervisor cooperates and collaborates with relevant authorities in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC7	<p>BA Section 68 provides that:</p> <ul style="list-style-type: none"> • The Registrar has the right to apply to a court for the winding-up of a bank as well as the right to oppose any such application made by others. • No person other than the Registrar shall be appointed by the High Court as liquidator of a bank. • During the voluntary winding-up of a bank, the liquidator shall furnish the Registrar returns required for banks. <p>BA Section 69 provides that if the Registrar believes a bank will be unable to repay deposits or will probably be unable to meet any other obligations, the Minister may appoint a curator to the bank, in whom the management of the bank is vested, subject to the supervision of the Registrar. The section also enables the Minister to empower the curator to take such actions as: suspending or reducing the right of creditors of the bank to claim or receive interest; making payments to creditors; canceling any agreement between the bank and other parties to advance funds or extend facilities; convening a meeting of creditors; negotiating with creditors; and, to cancel guarantees issued by the bank. The curator is required to provide reports to the Registrar monthly whether there is a reasonable probability exists that the bank will become a successful concern. The curatorship lapses when the bank is regarded as having no reasonable probability recover. The curator may be dismissed by the Minister at any time or upon application by the Registrar to that effect.</p>
AC1	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.
Description and findings re AC1	There is no provision in laws and regulations that set dates for taking corrective actions or other measures to guard against undue delay of actions, although the authorities explain the common law principles require such actions to be taken within an appropriate timeframe.

AC2	When taking formal corrective action in relation to a bank, the supervisor informs the supervisor of non-bank related financial entities of its actions and, where appropriate, coordinates its actions with them.
Description and findings re AC2	During the regular bilateral meeting with the FSB, information on corrective actions taken is provided and coordination is made between the two supervisors. Also, the BSD explains that it will inform the FSB promptly of a formal corrective action if the action is expected to affect entities supervised by the FSB substantially.
Assessment re Principle 11	Materially non-compliant
Comments	<p>While there have been a few significant improvements since the last assessment, the major problem of the need for 30 days prior notice in suspending registration or restricting activities based on BA Sections 23, 24 and 26 has not been changed. The newly introduced power of directives under BA Section 6(6) as well as the application of a motion by the court could address the issue partially. But the former still requires consultation with the relevant bank and the bank may challenge on the ground that a similar due process to that of Section 24 should be required for sanctions with similar effect. The latter is yet untested and relies on a court's judgment, which may take a different position than that of the supervisor.</p> <p>Given supervisors would consider taking such drastic measures only in cases where the risk is imminent and large, impact to the public could be significant, and when the relevant bank is not cooperating with the supervisor, any possible delays in or uncertainty regarding the outcome of the process needs to be avoided. The assessors understand the strong framework for licensing and corporate governance as well as relatively stable structure of the banking industry enables the supervisor to address these issues in a cooperative manner using less formal and stringent measures in most of the cases. However, the supervisor needs to be prepared for cases where these cooperative and more informal measures may not work—the framework for corrective and enforcement actions need to cover such situations. The assessors are thus still of the view that strengthening laws to provide the Registrar with the power to suspend or limit a bank's activities without delay is essential to improve compliance with the CP.</p> <p>The lack of ability for the supervisor to fine individuals related to banks, such as Board members and senior management, is another important gap in the current regulatory framework in relation to EC5, which also contributed to the above grading.</p>
Principle 12	Consolidated supervision. An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring

	and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide. ²⁶
EC1	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	<p>BA Section 4(4) provides that the Registrar shall implement and maintain a supervisory review process, which includes on-site and off-site works on a bank or controlling company and its respective branches, subsidiaries, joint ventures or related entities. Section 52 prohibits establishment of subsidiaries, branch offices, other interests and representative offices of banks and controlling companies without prior approval of the Registrar. (See CP7). Similarly, Section 55 provides that no reconstruction (restructuring) of companies within a group shall be effected without the prior written approval of the Registrar.</p> <p>Regulation 36 on consolidated return states the primary objectives of the consolidated supervision as “to duly capture all material risks to which the banking group may be exposed, including its exposures to credit risk, market risk and operational risk” as well as “to preserve the integrity of the banking group’s capital and reserve funds, amongst other things, by eliminating any double or multiple gearing of capital and reserve funds.” It also states that consolidated supervision extends to all the companies, institutions or entities.</p> <p>A broad scope of consolidated supervision is defined in Regulation 36, including:</p> <ul style="list-style-type: none"> • All banks in the relevant banking group; • All related regulated or unregulated financial entities or financial activities conducted by such banks or any relevant subsidiary, joint venture or associate; • The controlling companies of such banks; • All related regulated or unregulated financial entities or financial activities conducted by such controlling company or any relevant subsidiary, joint venture or associate; and • Any other entity that may be specified the financial distress or potential insolvency of which entity is deemed by the Registrar potentially to constitute a material or significant risk to the relevant banking group. (Although this designation has not been made to date).

²⁶ Please refer to footnote 19 under Principle 1.

	<p>A bank or a controlling company is required to submit Form BA 600 quarterly that includes group capital adequacy, intragroup exposures, group large exposures, group currency risk, and group liquidity. These capture the group as the controlling company and below.</p> <p>The BSD has a dedicated consolidated supervision analyst for every large banking group as a part of its frontline analysis team. All banking groups have to submit biannually a detailed organizational charts reflecting all interests under the bank or controlling company. During various meetings with the bank, it is usual practices to discuss issues at the consolidated level.</p> <p>Given large banks in South Africa are parts of financial conglomerates that engage in other financial activities through subsidiaries, the BSD is well aware of risks coming from non-banking activities conducted by entities in the groups. The BSD therefore pays particular attention to the situation of entities in the banking groups, monitors their conditions and impact on banks, and discusses these issues regularly with banks' and controlling companies' Board members and senior management. The review of supervisory files and the discussion with banks and external auditors confirmed these are monitored by the BSD and discussed with banks.</p> <p>Furthermore, for all applications in terms of BA Section 52, the BSD's internal Section 52 Committee will consider the impact that the proposed investment could have on the banking group, in which occasion all banking group structures are reviewed and assessed.</p> <p>However, tools for monitoring risks stemming from non banking activities of a larger financial group is not yet highly developed. ICAAP stress testing requirements are not yet applied on the impact from insurance activities of a banking group, or the reputational spill-over from a parent group. The SARB's common scenario stress testing is also only applied to banking operations in South Africa.</p>
EC2	<p>The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, exposures to related parties, lending limits and group structure.</p>
Description and findings re EC2	<p>BA Section 70a provides that controlling companies are subject to the minimum capital requirement. The large exposure limit is also applied to controlling companies (Section 73). Regulation 36 then provides details of consolidated supervision, which in Subsection (2) prescribes that all the directives, instructions or requirements specified in the Regulations that relate to a bank on a solo basis shall <i>mutatis mutandis</i> apply to that bank or its controlling company on a consolidated basis. Thus, prudential requirements stipulated in the BA and Regulations, such as capital adequacy, liquidity, large exposures and exposures to related parties are applied on a consolidated basis.</p> <p>Regarding reporting requirements, Form BA 600 on consolidated supervision covers such</p>

	<p>areas as: consolidated balance sheet (Form BA 100); consolidated off-balance-sheet activities (Form BA 110); consolidated income statement (Form BA 120); group capital adequacy; intragroup exposures; group large exposures; group currency risk; and group Liquidity risk. In addition, Regulation 37 (Foreign operations of South African Bank, Form BA 610) which applies to individual foreign subsidiaries and branches covers the following areas: balance sheet; off-balance sheet; income statement; capital adequacy; credit risk; liquidity risk; market risk; interest-rate risk in the banking book; equity risk in the banking book; and operational risk.</p> <p>As described in EC 1, for the analysis of such information, the BSD has a dedicated consolidated supervision analyst for every large banking group. During prudential and other meetings held with banks, consolidated groups are discussed. Also, all banking group structures are reviewed and assessed, and reflected in their risk ratings in the monthly MIR and the biannual risk review, which are discussed internally.</p>
EC3	<p>The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.</p>
Description and findings re EC3	<p>BA Section 52 provides that establishing a subsidiary, a joint venture, or a branch requires prior approval by the Registrar as described in CP 7. For the Section 52 application, the applicant is required to provide a broad range of information including the proposed managerial structure, nature of supervisory functions performed by the host country, and an opinion on the ability to submit the returns required by the BA. For all applications of establishing foreign operations, the Section 52 Committee, which consists of BSD staff members from different teams, considers amongst other things the experience and qualifications of the management of the entities. For the acquisition or establishment of cross-border banking operations, the BSD requires the establishment of a MOU with the cross-border banking supervisor concerned, which includes the assurance that necessary information will not be hindered in the host country.</p> <p>On the oversight of a bank's foreign operations by management, BA Section 60B provides requirements on corporate governance. Regulation 36 (17) provides details of the requirement of corporate governance, which applies to the oversight by a bank's head office on its operations abroad.</p> <p>The quarterly return, Form BA 610, is required for each foreign subsidiary and branch of</p>

	<p>South African banking groups. The form requires detailed financial and risk information on individual subsidiaries/branches including, for example, financial statements as well as regulatory risk weighted exposures on credit, market, operational and other risks. These are reviewed by the off-shore analyst, who belongs to frontline analyst teams of large banks. The related Regulation 27 stipulates requirements related to governance, risk management and internal governance that applies both at the consolidated level and at the level of each foreign operation. In addition, during the CEO meetings with banks and control companies in South Africa, issues relating to the bank's foreign operations, including branches, joint ventures and subsidiaries, are addressed, including their oversight over these operations. The BSD also meets with CEOs of local operations of large banking groups from time to time. Also, according to Regulation 46, the external auditors are required to issue a report on each foreign banking operation, which reports are reviewed and discussed at the trilateral meeting.</p> <p>Banks confirmed that the BSD exercises close monitoring of their control over foreign operations including appointments of local Board members and senior management. They also confirmed that these are regularly discussed at the periodic meetings between the BSD and the banks' Boards and CEOs.</p>
EC4	<p>The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.</p>
Description and findings re EC4	<p>The BSD holds regular as well as ad-hoc meetings with foreign supervisors to discuss supervisory issues concerning cross-border establishments. Ad-hoc meetings will take place whenever either side reasonably requests on the basis that it has a material supervisory concern, based on MOUs with those foreign authorities. The BSD would also on an ad-hoc basis pay visits to host supervisors of South African banks. These meetings are planned between all parties involved, in advance, with agreed upon agendas, and from the BSD side, based on its supervisory plans. (See CP13 for details).</p> <p>The Registrar has the power to require additional reporting on a bank or a controlling company on its foreign operations. (BA Section 7).</p>
EC5	<p>The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group, and takes appropriate supervisory action.</p>
Description and findings re EC5	<p>As described above, the BSD's supervisory process covers controlling companies and the consolidated returns cover the consolidated groups, including controlling companies and their subsidiaries. As noted in EC1, the BSD monitors subsidiaries of controlling companies</p>

	<p>that may have a material impact on the safety and soundness of banks. For example, the supervisor continues to monitor the soundness of a large insurance company which is a subsidiary of a bank controlling company to ensure appropriate actions are taken by the controlling company which is a major shareholder of the insurance group to manage the risk arising from the subsidiary.</p>
EC6	<p>The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that:</p> <ul style="list-style-type: none"> (a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed; (b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or (c) the exercise of effective supervision on a consolidated basis is hindered
Description and findings re EC6	<p>BA Section 50 limits a controlling company's investment in as well as loans and advances to (A) undertakings of non-bank activities, and (B) fixed property not intended or used mainly for the business of the bank, to no more than its share capital and reserve funds minus regulatory capital required for the market risk. Section 26 also provides the power to the Registrar to restrict activities of a bank. BA Section 76 restricts the amount a bank can invest in real estate or shares of any company, or provide loans and advances to its subsidiary whose main object is acquiring, holding or developing real estate. Similar restrictions exist for investments in, loans and advances to, and guarantees for its associates. (BA Section 77)</p> <p>During the process for approvals under BA Section 52 to acquire or establish subsidiaries, joint ventures, branch offices, divisions, other interests and representative offices of banks or controlling companies, the Section 52 Committee will consider the impact that the proposed investment could have on the banking group, and has the right to reject application. The Committee attaches a set of conditions that accompanies the approval letter, which needs to be adhered to or the approval can be withdrawn. The BSD in its capacity as home supervisor also uses moral suasion to impose limits on South African banks' foreign banking operations.</p> <p>Regarding supervision by foreign supervisors, the BSD requires the establishment of a MOU with the host supervisor of its banks' foreign operations. As described in EC2, during the approval process under BA Section 52, the applicant is required to submit information concerning the supervision by the host country and the capacity of the subsidiary/branch to submit required returns. These are taken into account in determining the application. The BSD also looks at the quality of supervision of foreign supervisors using various</p>

	<p>information sources and reviews the legal framework of the country to see whether it would hinder provision of information needed for effective supervision on a consolidated basis. These assessments are reviewed and confirmed by the Section 52 Committee. The assessors reviewed the Section 52 Committee minutes and confirmed these assessments are conducted and discussed.</p>
EC7	<p>In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group.²⁷</p>
Description and findings re EC7	<p>The primary focus of the supervision of banks in South Africa is that of the supervision on a stand-alone (solo) basis. The consolidated supervision acts as a compliment to the solo supervision in the BSD's view. For example, Regulation 36(3) stipulates that "consolidated supervision... (v) serves as a compliment to, instead of a substitute for, the solo supervision of a bank." All locally registered banks are required to comply with all the prudential and reporting requirements on a solo basis. As described above, reporting requirements are established on a banking group's structure.</p> <p>Currently, there is no bank in South Africa that belongs to the same banking group as another bank.</p>
AC1	<p>For countries which allow corporate ownership of banks, the supervisor has the power to establish and enforce fit and proper standards for owners and senior management of parent companies.</p>
Description and findings re AC1	<p>As described in CP8, BA Section 38 provides requirements of prior approval by the Registrar for an increase in shareholding in a bank or a controlling company that exceeds a certain level. In addition, BA Section 42 restricts entities that can control a bank to another bank, a foreign bank, ora controlling company, which needs to be registered. The definition of control is broad, including not only holding of more than 50 percent of shares in the total nominal value or voting rights, but also having the power to determine the appointment of the majority of Board members.</p> <p>To be granted registration as a controlling company by the Registrar, BA Section 44 (2) provides that "every director or executive officer of the applicant is, as far as can reasonably be ascertained, a fit and proper person to hold the office of such director or executive officer, and that every such executive officer has sufficient knowledge and experience to manage the affairs of the applicant in its capacity of a controlling company" and that "no interest with any person has in the applicant is inconsistent with a provision of this act."</p> <p>In on-going supervision, meetings with a bank and a controlling company are frequently</p>

²⁷ Please refer to Principle 16, Additional Criterion 2.

	held in which the consolidated group and its shareholding, corporate governance structures, and management of risk and activities, among others, are discussed. For reporting, form BA 020 is submitted in respect of all senior management appointments in terms of the controlling company and the bank.
Assessment of Principle 12	Compliant
Comments	<p>The supervisory and reporting framework provides an adequate framework for monitoring and assessing risks to banks in South Africa from non-banking and foreign banking operations in banking groups to be compliant with this CP.</p> <p>However, given the prevalence of conglomerate-type financial groups in South Africa, the authorities should make further effort to monitor and manage risks arising from non-banking activities or parent entities of a financial group (some of which are not bank controlling companies) to which a South African bank belongs. In this regard, as described in CP 8 and 9, the authorities should strengthen its technique, such as group-wide stress testing, to monitor and assess those risks. The authorities should further improve the recovery and resolution planning of large banking groups particularly once the necessary power is given to the supervisor by the expected new legislation. Such planning should also consider scenarios where shocks originate from non banking entities or parent groups.</p>
Principle 13	Home-host relationships. Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
Essential criteria	
EC1	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.
Description and findings re EC1	A few large South African banks have started to expand further into other African countries. Also, traditionally, some of the large South African banks have close relations with the UK's financial industry—two of them belonging to large financial groups based in the UK and one of them being listed there. In this context, the BSD has in recent years started organizing supervisory colleges for its large banking groups with the host country supervisors in Africa. The BSD is also attending supervisory colleges of foreign banks as a

	<p>host supervisor. In addition, various ad hoc meetings have been held with supervisors from other jurisdictions, particularly the Prudential Regulation Authority (PRA) in the UK.</p> <p>In 2007 the BSD organized a meeting for host supervisors of the African operations of one of the biggest banking groups. The purpose of this meeting was to inform the host supervisors of the impact of Basel II on the banking group. In May 2013, the BSD hosted a supervisory college for the same banking group, which has operations in a number of African countries. It has material market shares in most of the jurisdictions where it has a presence, although the size of banking assets in these countries is still small compared to that of the whole group. All the African countries where the group has presence were invited to the supervisory college and 15 countries attended. During the meeting, representatives from the group made presentations on its strategy, strategic focus, risk management, corporate governance and plans for its African operations. They also informed attendees about their oversight and controls throughout the entire group to combat money laundering. In turn, the BSD presenters shared their supervisory assessment of the group with the other regulators, while the attending African delegates presented information on their risk analyses of the relevant entity operating in their jurisdiction. Attending delegates also provided an update on Basel II and Basel III implementation, and their requirements and controls with regard to anti-money laundering and terrorist financing in their respective jurisdictions. The BSD informed the assessors that the attendees agreed that communication between supervisors was of immense importance to ensure an effective understanding and supervision of the banking group. It was also agreed that home and host regulators would make use of formal and informal communication lines to ensure the frequent and timely sharing of information between supervisors. The next college meeting for the group is scheduled in 2015. This non-annual frequency is due to the fact that the host supervisors do not think that an annual frequency is needed at this stage.</p> <p>The BSD explains that it received overwhelming positive feedback from the attending delegates subsequent to the college and is of the view that such colleges are the way forward to ensure effective consolidated supervision of cross-border banking operations. The supervisory college for another large bank with host supervisors in Africa is also planned this year.</p>
EC2	<p>Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices of the banking group²⁸ and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential</p>

²⁸ See Illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.

	information.
Description and findings re EC2	<p>In addition to college meetings as described in EC1, the BSD visits the host supervisors as well as the foreign banking operations of South African banks based on the significance of their operations, although it has not become a regular practice. During the meetings with host country supervisors, aspects of common interest are discussed and information is shared. Informal and formal arrangements exist to facilitate information sharing, including the MOU which is required for the acquisition or establishment of and cross-border banking operations. (See CP3). In particular, given many banking groups have substantial operations in the UK, the BSD has a various arrangements with the UK's PRA to ensure smooth communication and sharing of information. Meetings between the two supervisors are held frequently. For example, for a bank which is dual-listed both in the UK and South Africa, annual meetings are held between the two authorities.</p> <p>Banks also confirmed that frequent communications and sharing of information are taking place between the BSD and supervisors of jurisdictions where their substantial operations exist.</p>
EC3	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings re EC3	As noted above, an agreement exists between the BSD and the PRA for annual meetings to discuss a banking group that has a dual listed company structure over South Africa and the UK. The typical format of the meetings includes presentations by the BSD and the PRA on their assessments of the risk profile of the group. A trilateral discussion involving representatives of the banking group is also held. The results of these meetings feed into the BSD's ongoing supervision.
EC4	The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.
Description and findings re EC4	As described above, a MOU is required for the approval of establishing cross-border banking. The MOU provides a framework for communication including for such cases as a bank is in trouble. The BSD staff also visits host supervisors to discuss matters related to foreign operations of South African banks, although it is still relatively limited except in the UK, and joint supervisory activities are yet to happen with African host supervisors.
EC5	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-

	border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.
Description and findings re EC5	<p>The BSD participates in the crisis management groups and supervisory colleges of G-SIFIs in which South African entities play significant roles.</p> <p>The draft Resolution Bill is currently being worked on and should be available by the end of 2014, to be promulgated in 2015. The authorities explain cross-border cooperation and coordination on crisis preparation for South African banking groups with the countries where their significant subsidiaries/branches are located will be developed after the new prudential authority is given appropriate mandates through the approval and implementation of the required legislation.</p>
EC6	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	See EC5. The BSD has required all banks to prepare recovery plans that cover the entire group, although the coverage of non-banking activities and beyond the controlling company is still sporadic. The BSD plans to address the issue of resolution plans for large banks once they are given the necessary mandates by the planned new legislation.
EC7	The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC7	In South Africa, a bank subsidiary of a foreign banking group is regarded as a domestic bank and therefore treated the same as a locally owned bank. Regarding a branch of a foreign banking group, BA Section 18A requires such a branch to be registered and that provisions in the BA or other legislation that apply to a bank also apply to the foreign bank branch. Based on these provisions, all foreign branches under South African jurisdiction are required to comply with the same prudential requirements as domestic banks, and they need to submit BA returns as are required for domestic banks. As described in CP2, a dedicated frontline supervision analyst is assigned to each foreign bank branch. The SREP cycle described in CPs 8 and 9, including the off-site monitoring and the on-site review also applies to foreign bank branches.
EC8	The home supervisor is given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and

	compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC8	Foreign supervisors are permitted to conduct on-site visits to branches and subsidiaries based in South Africa in order to enable them to assess the entities' soundness and compliance with KYC requirements, provided that such visits are arranged in conjunction with the BSD. The conditions are described in MOUs, including the need for a prior notice and "no objection" from the host supervisors.
EC9	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings re EC9	The BSD does not permit the creation of shell banks and booking offices. Representative offices are not allowed to do any banking business.
EC10	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.
Description and findings re EC10	A standardized MOU provides that both home and host supervisors notify each other of remedial actions on banks to address material supervisory concerns prior to or immediately after such actions are taken. As prescribed in these MOUs, the BSD will consult with the foreign supervisor who provided the information before taking consequential action based on the information. The BSD will also provide assurance that all possible steps are taken to preserve the confidentiality of information received, including that information obtained will not be passed to third parties without the provider of the information approval.
Assessment of Principle 13	Largely Compliant
Comments	<p>The current arrangements and frameworks for cooperation with foreign supervisors are broadly adequate, although cooperation with supervisors in other African countries needs further enhancement as the South African banking groups are expected to continue to expand their operations in these countries. While the biennial frequency of the college meetings with host supervisors for the largest banks is understandable at this stage—particularly considering the resource constraints the host supervisors are facing, the authorities should consider increasing the frequency in the future. One option would be to have conference call meetings in between physical meetings. To further improve the effectiveness of cooperation and ensure adequate oversight is carried out on African operations of South African banking groups, the assessors encourage the authorities to continue their efforts to support the capacity building of these supervisors.</p> <p>The authorities also need to finalize their policies and processes on the conduct of on-site</p>

	<p>reviews/inspections of South African banks' cross-border operations in other African countries and enhance practices, with due consideration to the risk those operations pose to the parent banks. These should in time evolve to incorporate joint supervisory activities with the host supervisors.</p> <p>The supervisor should also enhance its effort in cross-border recovery and resolution planning, lack of which is reflected in the rating of this CP. Given a few of the big banks have strong ties with the UK, the recovery and resolution plans need to be developed with close collaboration with the UK authorities. Furthermore, as a few South African banking groups' foreign operations in other African groups have become systemically important for some host jurisdictions, in developing recovery and resolution plans of these groups, due regards need to be paid to the impact on these jurisdictions' financial system. This will also require close cooperation with supervisory authorities in these jurisdictions.</p>
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Table 2. Prudential Regulations and Requirements

Principle 14	Corporate governance. The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks' Boards and senior management, ²⁹ and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
EC1	Laws, regulations or the supervisor establish the responsibilities of a bank's Board and senior management with respect to corporate governance to ensure there is effective control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance.
Description and findings re EC1	<p>The BA clearly sets out extensive requirements related to corporate governance, including:</p> <ul style="list-style-type: none"> • Section 60 - Directors and officers of a bank/controlling company • Section 60A - Compliance function • Section 60B - Corporate governance • Section 64 - Audit committee • Section 64A - Risk and capital management committee • Section 64B - Directors' affairs committee

²⁹ Please refer to footnote 27 under Principle 5.

	<ul style="list-style-type: none"> • Section 64C - Remuneration committee <p>In addition, Regulation 39 (Process of corporate governance) states that:</p> <ul style="list-style-type: none"> • The Board of directors of a bank is ultimately responsible for ensuring that an adequate and effective process of corporate governance, which is consistent with the nature, complexity and risk inherent in the bank's on-balance sheet and off-balance sheet activities and that responds to changes in the bank's environment and conditions, is established and maintained, provided that the Board of directors may appoint supporting committees to assist it with its responsibilities. <p>Other specific regulations related to corporate governance include:</p> <ul style="list-style-type: none"> • Regulation 40 - Guidelines relating to conduct of directors • Regulation 41 - Composition of the Board of directors of a bank or controlling company • Regulation 42 - Statement relating to attributes of serving or prospective directors or executive officers • Regulation 43 – Public disclosure • Regulation 46 – Audit reports • Regulation 48 – Internal audit <p>In practice, the BSD continuously engages with the Boards of directors and the senior management of banks regarding various supervisory requirements related to corporate governance. This interaction includes, at a minimum, an annual meeting with a bank's Board of directors (bilateral meeting), with its CEO, and with the Board's Audit Committee and external auditors (trilateral meeting). In addition, an analysis of the corporate governance practices at individual banks is part of the SREP.</p>
EC2	<p>The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.</p>
Description and findings re EC2	<p>Regulation 39(18) requires that the Board of directors of a bank or a committee appointed by the Board for such purpose:</p> <ul style="list-style-type: none"> • Shall at least once a year assess and document whether the processes relating to corporate governance, internal controls, risk management, capital management and capital adequacy implemented by the bank successfully achieve the objectives

	<p>specified by the Board.</p> <ul style="list-style-type: none"> • Shall at the request of the Registrar of Banks provide the Registrar with a copy of the report compiled by the Board of directors or committee in respect of the adequacy of the processes relating to corporate governance, risk management, capital management and capital adequacy. <p>Following from the above, Regulation 39(19) requires that the external auditors of a bank shall annually review the process followed by the Board of directors in assessing the corporate governance arrangements, including the management of risk and capital, and the assessment of capital adequacy, and report to the Registrar whether any matters have come to their attention to suggest that they do not concur with the findings reported by the Board of directors, provided that when the auditors do not concur with the findings of the Board of directors, they shall provide reasons therefore.</p> <p>The assessment is conducted by the bank in conjunction with its financial year-end audit. The external auditors are required to provide their assessment of the Regulation 39 report to the Registrar within 120 days of the bank's financial year end and the report is also an agenda item for the annual trilateral discussions between the BSD, the bank's audit committee and senior management and its external auditors. If any issues are identified, the BSD will keep the issue open until the matter is resolved to the satisfaction of the BSD.</p> <p>Regulation 39(18) and (19) also apply to any controlling company.</p>
EC3	<p>The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members</p>
Description and findings re EC3	<p>BA Section 64B requires the Board of directors of a bank or controlling company to appoint a directors' affairs committee. The functions of this committee include, among other things, assisting the Board of directors in establishing and maintaining a Board directorship continuity program entailing:</p> <ul style="list-style-type: none"> • A review of performance of and planning for successors to the executive directors; • Measures to ensure continuity of non-executive directors; • A regular review of the composition of skills, experience and other qualities required for the effectiveness of the Board; and • An annual self-assessment of the Board as a whole and of the contribution of each

	<p>individual director.</p> <p>The BA prohibits more than 49 percent of the directors from being employees of the bank or controlling company or their subsidiaries. This requirement ensures that there are an appropriate number of non-executive members on the Boards of all banks and controlling companies.</p> <p>The Act also requires the establishment of:</p> <ul style="list-style-type: none"> • An audit committee; • A risk and capital management committee; and • A remuneration committee. <p>Regulation 41 deals with the composition of the Board of Directors of a bank or controlling company and includes prohibition of the chairperson of the Board of a bank or controlling company from being an employee of the organization or from serving on the Board's audit committee.</p> <p>The BSD provided the assessors with a recent example of a bank that they determined did not have a sufficient number of independent directors. The bank subsequently rectified the situation to the BSD's satisfaction.</p>
EC4	Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty." ³⁰
Description and findings re EC 4	<p>Regulation 39(6)(a) requires that a Board of directors shall possess sufficiently detailed knowledge of all the major business lines of the bank to ensure that the policies, processes, procedures, controls and risk monitoring systems are appropriate and effective. In addition, Board members shall have sufficient expertise to understand the various instruments, markets and activities in which the bank conducts business, including capital market activities such as securitization and the related off-balance sheet activities, and the associated risks.</p> <p>Regulation 40 provides guidelines relating to the conduct of directors and includes the provision that all directors and executive officers of a bank or controlling company shall perform their functions with diligence and care and with such a degree of competence as</p>

³⁰ The OECD (OECD glossary of corporate governance-related terms in "Experiences from the Regional Corporate Governance Roundtables," 2003, www.oecd.org/dataoecd/19/26/23742340.pdf). defines "duty of care" as "The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a 'prudent man' would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgment rule." The OECD defines "duty of loyalty" as "The duty of the board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders."

	<p>can reasonably be expected.</p> <p>Regulation 42 and form BA 020 (“fit and proper” questionnaire) relate to the statement and declaration by serving (at the request of the Registrar) or prospective directors or executive officers of a bank or controlling company regarding their attributes and qualifications. BA 020 is a detailed and comprehensive report (containing 40 questions) with the final one asking directors or prospective directors if they understand their responsibilities and duties as a director of the institution.</p> <p>In practice, the BSD interacts with Board members and receives minutes of Board meetings, which helps them to determine the effectiveness of individual Board members and the Board as a whole.</p>
EC5	<p>The supervisor determines that the bank’s Board approves and oversees implementation of the bank’s strategic direction, risk appetite³¹ and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment.</p>
Description and findings re EC5	<p>BA Section 60B(2) states that the process of corporate governance shall be established with the objective to achieve the bank’s strategic and business objectives efficiently, effectively, ethically and equitably, within acceptable risk parameters.</p> <p>As part of the supervisory review cycle of the SREP, the BSD establishes that the Board approves and oversees implementation of the bank’s strategic direction. The BSD has meetings with the chairpersons of Boards of directors as well as the full Boards of directors of all banks. The discussions held with individual bank Boards are both qualitative and quantitative in order to understand the Board’s strategic initiatives. Furthermore the meetings are aimed at establishing the bank’s overall corporate culture and values and the level of the effectiveness of the bank’s control environment.</p> <p>The BSD annually issues a guidance note regarding meetings to be held with the Board of directors detailing some of the key system-wide issues that will be discussed with individual banks in addition to more bank-specific issues.</p> <p>As per the supervisory process established by the BSD, banks are required to provide an assessment report stating whether the bank has met successfully its objectives as specified by the Board in terms of corporate governance, internal controls, risk management, capital management and capital adequacy as set out in Regulation 39(18)(a).</p> <p>The BSD also receives a regulatory report wherein a bank’s Board confirms that the bank</p>

³¹ “Risk appetite” reflects the level of aggregate risk that the bank’s Board is willing to assume and manage in the pursuit of the bank’s business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purposes of this document, the terms “risk appetite” and “risk tolerance” are treated synonymously.

	<p>has a strong internal control environment per Regulation 40(4).</p> <p>Through interactions with the Board of directors, review of Board minutes and the regulatory reports received in terms of the requirements of Regulations 39 and 40, the BSD regularly assesses Board oversight at individual banks and controlling companies.</p>
EC6	<p>The supervisor determines that the bank's Board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's execution of Board strategies, including monitoring senior management's performance against standards established for them.</p>
Description and findings re EC6	<p>Regulation 36(8)(b)(v) requires banks to provide each quarter the respective management structures of the significant entities included in the consolidated return and the respective main responsibilities of such senior management. This allows BSD staff to understand key reporting lines within the bank.</p> <p>As with prospective Board members, Form BA020 ("fit and proper" questionnaire) needs to be filed by persons to be appointed as executive officers of a bank or controlling company. Such forms need to include a declaration by the Board chair that the chair has carefully studied the information contained in the questionnaire and, following discussions with the individual, as well as all other members of the Board, has concluded that the individual is fit and proper to take the position within the bank or controlling company.</p> <p>Through various meetings with the Board of directors and Board committees of a bank, BSD staff is able to judge whether the Board is aware of the quality of the bank's management and whether there are any weak performers. The BSD also monitors how a Board follows up with any problems at the senior management level.</p> <p>As part of their meeting process with bank Boards, the BSD also ensures that banks have strong succession planning for executive management positions.</p>
EC7	<p>The supervisor determines that the bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.</p>
Description and findings re EC7	<p>The BSD subscribes to the <i>Financial Stability Board Principles for Sound Compensation Practices</i> and their <i>Implementation Standards</i>. In 2010 the banks in South Africa undertook a self-assessment on the above and in 2011 it was included in the "flavor of the year" discussions with banks' Boards of directors where any shortcomings were discussed with the Boards and actions taken to rectify shortcomings. Any further actions are followed up through the normal supervisory process. Developments pertaining to the Principles and</p>

	Standards, as well as new requirements such as those imposed by the EU CRD IV are followed closely and if necessary will be implemented in South Africa.
EC8	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (e.g., special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	<p>Regulation 39(6)(a)(i) requires that the Board of directors and senior management of a bank possess sufficiently detailed knowledge of all the major business lines of the bank to ensure that the policies, processes, procedures, controls and risk monitoring systems are appropriate and effective.</p> <p>Regulation 36(8)(b) requires that, in addition to BA 600 (Consolidated return), a bank or controlling company must furnish the Registrar with qualitative information relating to:</p> <ul style="list-style-type: none"> • The group structure based on business line structure and legal structure. • The respective main business activities conducted by the material entities included in the consolidated return. • The business model or strategy adopted by the relevant bank or controlling company and whether or not the financial activities conducted within the banking group cut across legal entities or are conducted autonomously within individual financial entities. • The strategy adopted by the relevant bank or controlling company in respect of intragroup transactions and transactions with related persons or entities. <p>The BSD holds annual meetings with the Boards of the banks where issues that affect the bank and banking group, including regulatory issues, are discussed. This interaction enables the BSD to determine the level of knowledge of the directors regarding the structure and activities of the bank.</p>
EC9	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings re EC9	In terms of the provisions of BA section 60(6), the Registrar may object to the appointment or continued employment of a chief executive officer, director or executive officer of a bank if the Registrar reasonably believes that the chief executive officer, director or executive officer concerned is not, or is no longer a fit and proper person to hold that appointment, or if it is not in the public interest that such chief executive officer, director or executive

	<p>officer holds or continues to hold such appointment.</p> <p>When the Registrar wishes to terminate the appointment or the continued employment of a chief executive officer, director or executive officer of a bank, the Registrar has to notify in writing (a) the chief executive officer, director or executive officer concerned; (b) the chairperson of the Board of directors of that bank (except if the chairperson of the Board is the person whose appointment the Registrar wishes to terminate, in which case each director of the bank concerned shall be notified); (c) the chief executive officer of that bank (except if the chief executive officer is the person whose appointment the Registrar wishes to terminate, in which case the deputy chief executive officer shall be notified) of his or her intention, and of the grounds for the proposed termination.</p>
AC1	Laws, regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material and bona fide information that may negatively affect the fitness and propriety of a bank's Board member or a member of the senior management.
Description and findings re AC1	<p>Regulation 47 requires a bank to report an offence in writing to the Registrar within 30 days after the bank becomes aware of the reportable offence. Such reportable offences include:</p> <ul style="list-style-type: none"> • a breach of the fiduciary duty of a member of the Board of directors, an employee in charge of a risk-management function or an executive officer; • any act of a member of the Board of directors, an employee in charge of a risk management function or an executive officer that results in or will probably result in the reputation of the bank being adversely affected; • any act of a member of the Board of directors, an employee in charge of a risk management function or an executive officer that results in or will probably result in the bank contravening the code of conduct or ethical code of any institution of which the bank is a member or with which the bank is associated; • any reportable irregularity as envisaged in section 45 of the Auditing Profession Act, 2005 (Act 26 of 2005), as amended, which irregularity was brought to the attention of the Board of directors and/or senior management of the relevant bank.
Assessment of Principle 14	Compliant
Comments	Through regulations and practice, the SARB places strong emphasis on sound and effective corporate governance at all banks in South Africa. BSD staff is able to assess the quality of corporate governance at individual banks through regular meetings, as well as review of audit reports and Board and Board committee minutes.

Principle 15	Risk management process. The supervisor determines that banks ³² have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate ³³ all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank. ³⁴
EC1	The supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Boards and that the Boards set a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the Board ensures that: <ul style="list-style-type: none"> (a) A sound risk management culture is established throughout the bank; (b) Policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite; (c) Uncertainties attached to risk measurement are recognized; (d) Appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and (e) Senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.
Description and findings re EC1	Regulation 39 (Process of corporate governance) states that the Board of directors of a bank is ultimately responsible for an adequate and effective process of corporate governance, including effective risk management. The regulation cites 27 specific types of risk that could be included in the risk management process. In particular, Regulation 39(5)(a-b) states that, at a minimum, the risk management processes, practices, procedures

³² For the purposes of assessing risk management by banks in the context of Principles 15 to 25, a bank's risk management framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is a member of a group of companies, the risk management framework should in addition cover the risk exposure across and within the "banking group" (see footnote 19 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

³³ To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 25) as reflected by the underlying reference documents.

³⁴ It should be noted that while, in this and other Principles, the supervisor is required to determine that banks' risk management policies and processes are being adhered to, the responsibility for ensuring adherence remains with a bank's Board and senior management.

	<p>and policies:</p> <ul style="list-style-type: none"> • Shall be adequate for the size and nature of the activities of the bank...and shall periodically be adjusted in light of the changing risk profile or financial strength of the bank, financial innovation or external market developments; • Shall be duly aligned with, and, where appropriate, provide specific guidance for the successful implementation of and the continued adherence to, the business strategy, goals and objectives, and the risk appetite or tolerance for risk, of the bank; • Shall duly specify relevant limits and allocated capital relating to the bank's various risk exposures. <p>In practice, the BSD utilizes the SREP to assess a bank's compliance with Regulation 39, including a check on whether risk management policies are Board approved. In addition, prudential meetings are held to discuss various risk areas and to establish the adequacy of the overall risk management process that includes senior management's monitoring and control of all material risks in line with the Board-approved policies and processes. Risk management is also discussed at meetings with banks' Boards of directors, risk committees, audit committees and external auditors.</p> <p>The BSD also utilizes bi-annual graph discussions with banks. During these meetings, all risk areas are discussed with senior management to ensure correct reporting and understanding with regard to the regulations. During these meetings, financial data as reported to the BSD are discussed with banks and are benchmarked against the bank's strategies. The BSD also uses these meetings to highlight concerns or irregularities detected. The analysis division prepares a closing summary for each risk area that contains a conclusion highlighting the positive and negative features based on that risk area. The presentation may also contain an overall summary of the main features highlighted in the risk area conclusions, if required.</p>
EC2	<p>The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate:</p> <ol style="list-style-type: none"> (a) To provide a comprehensive "bank-wide" view of risk across all material risk types; (b) For the risk profile and systemic importance of the bank; and (c) To assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank's risk management process.
Description and	Regulation 39(1) to (6) establishes such requirements for the risk management process.

findings re EC2	<p>As mentioned in EC1, the BSD utilizes a variety of techniques to determine the adequacy of the risk management policies and procedures at individual banks. For instance, prudential meetings are held to discuss various risk areas and to establish the adequacy of the overall risk management processes that includes senior management’s monitoring and control of all material risks in line with the Board-approved policies and processes. Risk management is also discussed at meetings with banks’ Boards of directors, risk committees, audit committees and external auditors.</p> <p>As part of the ICAAP reviews, the BSD investigates the process followed by banks to identify all material risk exposures, as well as the mapping to risk appetite frameworks.</p>
EC3	<p>The supervisor determines that risk management strategies, policies, processes and limits are:</p> <ul style="list-style-type: none"> (a) Properly documented; (b) Regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and (c) Communicated within the bank <p>The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank’s Board where necessary.</p>
Description and findings re EC3	<p>Prudential meetings are held with banks to discuss various risk areas and to establish the adequacy of the overall risk management processes, which includes an assessment of whether exceptions to policies, processes and limits receive prompt attention and, where appropriate, senior management and/or Board authorization are obtained. In addition, the BSD may request internal audit/external audit to review specific areas for compliance with a bank’s policies, including limits.</p> <p>During their on-site work, BSD staff review a bank’s risk management policies and procedures, as well as any relevant internal documentation such as “risk appetite tables.”</p>
EC4	<p>The supervisor determines that the bank’s Board and senior management obtain sufficient information on, and understand, the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also determines that the Board and senior management regularly review and understand the implications and limitations (including the risk measurement uncertainties) of the risk management information that they receive.</p>
Description and findings re EC4	<p>BA Section 64 requires that a risk and capital management committee of the Board of directors be established.</p>

	<p>Through the assessment of the bank's ICAAP, the BSD determines whether the Board and senior management understand the risks being taken and how these risks influence capital adequacy. The annual Board discussions support this process. In addition, during the IRB application approval process, the BSD focuses on senior management understanding of risks.</p> <p>Prudential meetings are held to discuss various risk areas and to establish the adequacy of the overall risk management process, which includes an assessment of whether the policies and processes are appropriate in light of the banks risk profile and business plan.</p> <p>At the above meetings, an assessment is also made of the reporting of risk information to the Board and senior management. Such assessment includes the adequacy of information provided and Board and senior management understanding of the information.</p>
EC5	<p>The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.</p>
Description and findings re EC5	<p>Through the assessment of a bank's ICAAP (including strategies), the BSD assesses the overall capital adequacy and processes in relation to the banks risk profile. Such an assessment takes into account the bank's size and complexity.</p> <p>On-site meetings are held with banks in order to determine overall liquidity adequacy and processes in relation to risk appetite and risk profiles.</p> <p>Regulation 38 (Capital adequacy) provides power to the Registrar to strengthen risk management processes if found inadequate.</p>
EC6	<p>Where banks use models to measure components of risk, the supervisor determines that:</p> <ul style="list-style-type: none"> (a) Banks comply with supervisory standards on their use; (b) The banks' Boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and (c) Banks perform regular and independent validation and testing of the models <p>The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.</p>
Description and findings re EC6	<p>Prudential meetings are held to discuss those risk areas where banks use models to measure the components of risk. During these meetings it is established whether</p>

	<p>independent validation and testing of these models and systems are performed.</p> <p>With regard to credit risk, for IRB banks, the bank's estimates and models used for that purpose are subject to specific additional review as specified by the BSD on an annual basis. Furthermore, the external auditor will produce the 'long form report' in that regard. The BSD also requires banks to submit their "annual validation report" on selected asset classes.</p> <p>With regard to operational risk, regular meetings are held with all banks on the AMA for operational risk.</p>
EC7	<p>The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing and reporting on the size, composition and quality of exposures on a bank-wide basis across all risk types, products and counterparties. The supervisor also determines that these reports reflect the bank's risk profile and capital and liquidity needs, and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use.</p>
Description and findings re EC7	<p>Regulation 23 (Minimum requirements) requires a bank to have, among other things, sufficiently robust information systems. Information systems is a topic that BSD staff discuss with banks during numerous meetings (with the Board of directors, chief executive officer, audit committee, compliance, internal audit) and is usually also a focus area for banks wanting to implement new products and advanced model approaches. During meetings with external auditors, a bank's management information systems, as well as systems in general, are discussed. The BSD also receives Board and risk committee packs, which are reviewed on an ad hoc basis to determine that the Board and senior management are receiving appropriate and accurate information. Certain banks, through the BSD operational risk team, receive specific information system reviews or on-site reviews.</p> <p>In early 2014, the BSD issued Guidance Note 3. The note, which is based on the Basel Committee's <i>Principles for Effective Risk Data Aggregation and Risk Reporting</i> (issued in January 2013), reiterates the importance of adhering to sound risk management practices, specifically with regard to risk data aggregation and risk reporting. The note includes a detailed questionnaire that banks had to submit to the Registrar so that the BSD could determine the status of banks' implementation of the eleven principles.</p>
EC8	<p>The supervisor determines that banks have adequate policies and processes to ensure that the banks' Boards and senior management understand the risks inherent in new products,³⁵ material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor</p>

³⁵ New products include those developed by the bank or by a third party and purchased or distributed by the bank.

	determines that the Boards and senior management are able to monitor and manage these risks on an ongoing basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board.
Description and findings re EC8	<p>Regulation 39 (Process of corporate governance) has several provisions related to the required risk management procedures for the review and assessment of any potential new products or activities.</p> <p>Furthermore, during operational risk on-site reviews BSD staff will assess the new product approvals process and policies that banks have in place to assess the risk of new products.</p>
EC9	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority and access to the banks' Boards to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings re EC9	<p>BA Section 64A(2) states that the risk and capital management committee of the Board shall assist it to: establish an independent risk management function and establish and implement a process of internal controls and reviews to ensure the integrity of the overall risk and capital management process. In addition, Regulation 39 contains several provisions related to the independence of risk control units.</p> <p>The BSD reviews the various risk management functions of a bank as part of the SREP. During discussions with internal audit, specific evaluation of the risk management function is covered to ensure that it is regularly reviewed. In addition, prudential meetings are held with banks' risk management and control functions (including internal audit) to establish whether appropriate segregation of duties are in place and to confirm whether these functions report directly to senior management and the Board.</p> <p>During operational risk on-site reviews, BSD staff holds meetings with a bank's internal audit department in order to assess the work done by them on operational risk and related matters and to determine what the findings or outcomes of their work have been.</p>
EC10	The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the f and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.
Description and	As mentioned in EC9, BA Section 64A(2) states that the risk and capital management committee of the Board shall assist it to: establish an independent risk management

findings re EC10	<p>function and establish and implement a process of internal controls and reviews to ensure the integrity of the overall risk and capital management process. Assessment of this requirement is assessed as part of the SREP.</p> <p>Larger and more complex banks are assessed for compliance with all standards, including the requirement to have independent and adequately resourced risk and audit functions. During discussions with internal audit, specific evaluation of the risk management function is covered to ensure that it is regularly reviewed.</p>
EC11	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC11	<p>The Regulations relating to banks have detailed requirements related to specific risk categories, as follows:</p> <p>Regulations 23-25 - Credit risk</p> <p>Regulation 26 - Liquidity risk</p> <p>Regulation 28 - Market risk</p> <p>Regulation 30 - Interest-rate risk</p> <p>Regulation 31 - Equity risk in the banking book</p> <p>Regulation 33 - Operational risk</p> <p>These various regulations are described in further detail in subsequent CPs.</p>
EC12	The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.
Description and findings re EC12	Regulation 36(8) requires banks and controlling companies to submit in writing to the Registrar qualitative information relating to the strategy adopted in respect of contingency planning, including the extent to which contingency planning is centralized or managed on a business or legal entity basis.

	<p>In practice, the BSD utilizes several specific tools to ensure that banks have appropriate contingency planning processes. The SREP drives most of these.</p> <p>Market risk: Stress testing, system validation and operational risk responsibilities such as business continuity planning, disaster recovery and other continuity policies are checked during IMA applications/renewals and IMA assessments and thematic reviews.</p> <p>Liquidity: ALM reviews are conducted both off-site and on-site. The availability of contingency plans is assessed during the ALM review. Certain banks during the past two years were subject to a liquidity simulation exercise where the bank, BSD and external auditors were involved in testing the bank's liquidity contingency plans and processes under a simulated stress situation.</p> <p>The review of the bank's ICAAP covers all material risks that a bank faces, which includes reputational, strategic, technological and any other risk not specifically covered in the BCPs.</p> <p>During 2012 and 2013, specific focus was placed on the development of the banks' recovery plans. Detailed discussions were held with banks and this was also a 'flavor of the year' topic for discussion at meetings between BSD management and bank Boards.</p>
EC13	<p>The supervisor requires banks to have forward-looking stress testing programmes, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank's stress testing programme and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing programme:</p> <ul style="list-style-type: none"> (a) Promotes risk identification and control, on a bank-wide basis (b) Adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks; (c) Benefits from the active involvement of the Board and senior management; and (d) Is appropriately documented and regularly maintained and updated. <p>The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing programme or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process</p>
Description and findings re EC13	Regulation 39(5) requires banks to have risk management processes, practices, procedures and policies that are sufficiently robust to ensure that the bank regularly conducts appropriate stress-testing or scenario analysis and also to ensure that the bank maintains

	<p>sufficient liquidity and capital adequacy buffers to remain solvent during prolonged periods of financial market stress and illiquidity. Additional sections of Regulation 39 set out other requirements related to the various aspects of stress testing and Regulation 23 focuses on stress testing of credit risk while Regulation 28 focuses on stress testing of market risk (see CPs 17 and 22 below).</p> <p>The review of a bank's ICAAP usually includes discussions related to stress testing and scenario testing, assumptions made, stress-testing results and how they link to the capital buffer as well as management actions.</p> <p>With regard to market risk, the utility of stress testing as a management tool is verified during IMA assessment, market risk thematic reviews, stress testing thematic reviews and to a certain extent in ICAAP assessments.</p>
EC14	The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.
Description and findings re EC14	The review of a bank's ICAAP covers discussions based on performance measurement and EVA, pricing and return on risk adjusted capital.
AC1	The supervisor requires banks to have appropriate policies and processes for assessing other material risks not directly addressed in the subsequent Principles, such as reputational and strategic risks.
Description and findings re AC1	<p>Regulation 39 sets out a total of 27 risk types that banks need to be aware of and manage, including reputational and strategic risk.</p> <p>The BSD utilizes the SREP to assess the management of various additional risk categories by banks. The review of a bank's ICAAP covers all material risks that a bank faces, which includes reputational, strategic, technological and any other risk not specifically covered in the BCPs.</p>
Assessment of Principle 15	Compliant
Comments	<p>The SARB's SREP cycle places emphasis on verifying that banks have robust risk management policies and procedures.</p> <p>A recent significant increase in supervisory staff has allowed the BSD to form specialized teams to review the major risk categories. While the skills of some of the newer members of these teams are in the process of being strengthened, primarily through on-the-job experience, the teams have enhanced the BSD's understanding of the risks faced by South African banks, most especially at the largest institutions.</p>

Principle 16	Capital adequacy. ³⁶ The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
EC 1	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings re EC1	<p>BA Section 70 deals with minimum capital requirements for banks and banking groups. The provisions of the Act are implemented through Regulation 38 (Capital adequacy and leverage).</p> <p>The BSD has fully implemented Basel II, 2.5 and is in the process of fully implementing Basel III. Capital is calculated on a consolidated and solo basis for all South African banks, as well as foreign branches, to consistently observe prescribed capital requirements and capital buffers.</p> <p>Capital is calculated and measured in the following tiers: CET 1, Tier 1 and Total Capital. BA Section 1 defines “additional tier 1 capital,” “additional tier 1 unimpaired reserve funds,” “common equity tier 1 capital,” “common equity tier 1 unimpaired reserve funds,” “tier 2 capital” and “tier 2 unimpaired reserve funds.”</p> <p>BA Sections 70 and 70A prescribe minimum capital requirements based on risk-weighted assets for banks and groups respectively.</p> <p>Regulation 38(8) prescribes capital requirements (base minimum, systemic capital requirements, domestically systemic important banks, conservation buffer, countercyclical buffer, idiosyncratic risk requirement and the Board buffer). Regulation 38(9)(a)(i) prescribes the minimum capital set per tier of capital.</p> <p>Directive 5/2013 – prescribes the components of capital with emphasis on those that are permanently available to absorb losses.</p>

³⁶ The Core Principles do not require a jurisdiction to comply with the capital adequacy regimes of Basel I, Basel II and/or Basel III. The Committee does not consider implementation of the Basel-based framework a prerequisite for compliance with the Core Principles, and compliance with one of the regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.

	<p>For the plan for the phase-in of Basel III, see below.</p> <p><i>Shading indicates transition periods - all dates are as of 1 January</i></p> <table border="1"> <thead> <tr> <th></th> <th>Basel III</th> <th>2013</th> <th>2014</th> <th>2015</th> <th>2016</th> <th>2017</th> <th>2018</th> <th>2019</th> <th>2020</th> <th>2021</th> <th>2022</th> </tr> </thead> <tbody> <tr> <td colspan="12">Common Equity Tier 1 requirements (CET1)</td> </tr> <tr> <td>Minimum CET1 Ratio (per Basel III)</td> <td>4,5%</td> <td>3,5%</td> <td>4,0%</td> <td>4,5%</td> <td>4,5%</td> <td>4,5%</td> <td>4,5%</td> <td>4,5%</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Pillar 2A for CET1</td> <td></td> <td>1,0%</td> <td>1,5%</td> <td>2,0%</td> <td>1,75%</td> <td>1,50%</td> <td>1,0%</td> <td>0,50%</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Minimum CET1 plus Pillar 2A</td> <td></td> <td>4,5%</td> <td>5,5%</td> <td>6,5%</td> <td>6,25%</td> <td>6,0%</td> <td>5,5%</td> <td>5,0%</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Phasing in of D-SIB requirements at CET1 level ¹</td> <td></td> <td></td> <td></td> <td></td> <td>25%</td> <td>50%</td> <td>75%</td> <td>100%</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Capital Conservation buffer ²</td> <td>2,5%</td> <td></td> <td></td> <td></td> <td>0,625%</td> <td>1,25%</td> <td>1,875%</td> <td>2,5%</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Countercyclical buffer (maximum per cent, if imposed) ²</td> <td>2,5%</td> <td></td> <td></td> <td></td> <td>0,625%</td> <td>1,25%</td> <td>1,875%</td> <td>2,5%</td> <td></td> <td></td> <td></td> </tr> <tr> <td colspan="12">Tier 1 requirements (T1)</td> </tr> <tr> <td>Minimum Tier 1 Ratio (per Basel III)</td> <td>6,0%</td> <td>4,5%</td> <td>5,5%</td> <td>6,0%</td> <td>6,0%</td> <td>6,0%</td> <td>6,0%</td> <td>6,0%</td> <td></td> <td></td> <td></td> </tr> <tr> <td>Pillar 2A for T1</td> <td></td> <td>1,5%</td> <td>1,5%</td> <td>2,0%</td> <td>1,5%</td> <td>1,25%</td> <td>1,0%</td> 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III	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Common Equity Tier 1 requirements (CET1)												Minimum CET1 Ratio (per Basel III)	4,5%	3,5%	4,0%	4,5%	4,5%	4,5%	4,5%	4,5%				Pillar 2A for CET1		1,0%	1,5%	2,0%	1,75%	1,50%	1,0%	0,50%				Minimum CET1 plus Pillar 2A		4,5%	5,5%	6,5%	6,25%	6,0%	5,5%	5,0%				Phasing in of D-SIB requirements at CET1 level ¹					25%	50%	75%	100%				Capital Conservation buffer ²	2,5%				0,625%	1,25%	1,875%	2,5%				Countercyclical buffer (maximum per cent, if imposed) ²	2,5%				0,625%	1,25%	1,875%	2,5%				Tier 1 requirements (T1)												Minimum Tier 1 Ratio (per Basel III)	6,0%	4,5%	5,5%	6,0%	6,0%	6,0%	6,0%	6,0%				Pillar 2A for T1		1,5%	1,5%	2,0%	1,5%	1,25%	1,0%	0,75%				Minimum T1 plus Pillar 2A		6,0%	7,0%	8,0%	7,5%	7,25%	7,0%	6,75%				Phasing in of D-SIB requirements at Tier 1 level ¹					25%	50%	75%	100%				Total capital requirements												Minimum Total Capital Ratio (per Basel III)	8,0%	8,0%	8,0%	8,0%	8,0%	8,0%	8,0%	8,0%				Pillar 2A for 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EC2	At least for internationally active banks, ³⁷ the definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.																																																																																																																																																																																																																																				
Description and findings re EC2	Regulations 38(9)(a)(i), 38(9)(a)(ii) and 38(9)(a)(iii) prescribe the phase-in of the South African base minimum requirements that are more onerous than Basel.																																																																																																																																																																																																																																				
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EC3	The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g., securitization transactions) ³⁸ entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.																																																																																																																																																																																																																																				
Description and findings re EC3	Regulation 38(4) empowers the Registrar to prescribe additional capital requirements in respect of any risk type or risk exposure.																																																																																																																																																																																																																																				
	Regulation 38(8)(e)(iii) prescribes a bank-specific additional capital requirement for idiosyncratic risk.																																																																																																																																																																																																																																				

³⁷ The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.

³⁸ Reference documents: Enhancements to the Basel II framework, July 2009 and: International convergence of capital measurement and capital standards: a revised framework, comprehensive version, June 2006.

	Per the Basel standards, both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.
EC4	The prescribed capital requirements reflect the risk profile and systemic importance of banks ³⁹ in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.
Description and findings re EC4	<p>BA Section 4(7)(ii) prescribes that the Registrar may disclose factors relating to the setting of capital adequacy ratios in excess of the minimum. These factors assist the Registrar in establishing bank-specific capital requirements for individual banks.</p> <p>Regulation 38(4) empowers the Registrar to impose additional capital if the aggregated risk exposure of a bank does not reflect its risk profile (and the Registrar applies this Pillar 2 surcharge in practice).</p> <p>Regulation 38(8)(e)(ii) prescribes an additional minimum capital requirement for systemic risk.</p> <p>Regulation 38(8)(e)(vi) prescribes an additional capital requirement for the largest banks (systemically important).</p> <p>Regulation 38(8)(e)(vii) prescribes a Board buffer that is based on stress testing and macro-economic conditions.</p> <p>Regulation 38(8)(g) prescribes a countercyclical capital buffer in the event of excessive credit growth or the buildup of system-wide risks.</p> <p>Regulation 38(17)(a) prescribes a leverage ratio to prevent the build-up of excessive on- and off-balance sheet leverage.</p> <p>Regulation 38(17)(b)(iv) prescribes a minimum leverage ratio of 4 percent.</p>
EC5	<p>The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use:</p> <p>(a) Such assessments adhere to rigorous qualifying standards;</p>

³⁹ In assessing the adequacy of a bank's capital levels in light of its risk profile, the supervisor critically focuses, among other things, on (a) the potential loss absorbency of the instruments included in the bank's capital base, (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures and (d) the quality of its risk management and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

	<p>(b) Any cessation of such use, or any material modification of the bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor;</p> <p>(c) The supervisor has the capacity to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken;</p> <p>(d) The supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so; and</p> <p>(e) If a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.</p>
Description and findings re EC5	<p>The Regulations relating to banks set out numerous requirements for banks utilizing the more advanced measurement approaches. These include (but are not limited to):</p> <ul style="list-style-type: none"> • Regulation 23(3)(b) prescribes that prior approval is required from the Registrar to apply the IRB approach for credit risk and Regulation 23(10)(a) requires continuous compliance with the qualifying conditions. • Regulation 23(10)(b)(v11) requires banks applying internal models for equity risk in the banking book to obtain prior written approval of the Registrar and also sets out quantitative and qualitative requirements. • Regulation 28(4)(b) and (c) requires banks applying internal models to measure market risk to obtain prior written approval from the Registrar, subject to certain conditions. <p>The Registrar has the authority to impose additional conditions on a bank and approval for use of an internal model can be revoked if conditions cease to be met. In practice, there is an example of a bank's approval having been revoked.</p> <p>As part of the SREP, BSD staff regularly reviews banks' internal assessment processes and internal models approaches. The BSD acknowledged that they face an ongoing challenge finding qualified staff for models validation as there is a shortage of individuals in South Africa with highly technical quantitative skills. The SARB has addressed this issue, in part, through in-house training initiatives.</p>

EC6	<p>The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing).⁴⁰ The supervisor has the power to require banks:</p> <ul style="list-style-type: none"> (a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and (b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.
Description and findings re EC6	<p>Regulation 23(11)(b)(ix) sets out a stress testing requirement for banks that have adopted the IRB approach for credit risk.</p> <p>Regulation 39(6) requires the Board and senior management to have in place an MIS system that can generate forward looking scenario analysis that captures stressed conditions and requires senior management to conduct stress tests on a periodic basis. The BSD also issued a guidance note in 2008 on stress testing requirements.</p> <p>Regulation 39(8)(h) requires the incorporation of stress testing in the ICAAP and further requires stress testing to be compared against the impact of capital.</p> <p>Regulation 39(16)(a)(v)(B) requires senior management to ensure the ICAAP incorporates stress testing and measures to ensure the bank builds and maintains capital buffers that would ensure the bank could withstand severe market downturns. It also requires that the ICAAP examines future capital resources under adverse conditions and analyses capital instruments during stress.</p> <p>Regulation 39(16)(b)(v) requires that the ICAAP incorporate stress testing the result of which shall be considered in evaluating the adequacy of capital buffers.</p> <p>Regulation 39(5)(d) states that risk management processes shall regularly conduct stress testing or scenario analysis and should ensure the bank maintains adequate liquidity and capital during prolonged periods of market stress.</p> <p>In practice, BSD staff discusses stress testing and management actions to limit the impact of stresses on banks during on-site ICAAP meetings. In addition, projected capital adequacy ratios are calculated to show the impact of stresses on banks before and after management actions on a forward-looking basis (for the upcoming three years).</p>

⁴⁰ "Stress testing" comprises a range of activities from simple sensitivity analysis to more complex scenario analyses and reverses stress testing.

AC1	For non-internationally active banks, capital requirements, including the definition of capital, the risk coverage, the method of calculation, the scope of application and the capital required, are broadly consistent with the principles of the applicable Basel standards relevant to internationally active banks.
Description and findings re AC1	The BSD applies the Basel capital requirements to all banks in South Africa, irrespective of whether they are internationally active.
AC2	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks. ⁴¹
Description and findings re AC2	It is up to a bank to determine how it distributes capital within different entities of the banking group; however, certain regulations apply. These include Regulation 36(8)(b)(ix) which requires banks to submit in writing to the Registrar qualitative information relating to the bank's strategy to monitor capital in relation to risks incurred by entities and the allocation of capital amongst various entities within the banking group.
Assessment of Principle 16	Compliant
Comments	The SARB has adopted or is in the process of adopting the various components of Basel II, 2.5 and III according to or in advance of the schedule established by the Basel Committee. Capital is calculated on a consolidated and solo basis for all banks and the BSD has the authority to impose additional capital requirements on individual banks, as deemed necessary. The BSD has applied the three Basel ratios (common equity tier 1, tier 1 and total capital) as well as systemic capital requirements, large bank capital add-ons and a "Board buffer" that ensures that banks do not fall below the minimum requirements. BSD staff regularly assesses banks' capital management and planning, most intensely at the largest (IRB) banks.
Principle 17	Credit risk. ⁴² The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk ⁴³ (including counterparty credit risk) ⁴⁴ on a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.

⁴¹ Please refer to Principle 12, Essential Criterion 7.

⁴² Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁴³ Credit risk may result from the following: on-balance sheet and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivative transactions, securities financing transactions and trading activities.

⁴⁴ Counterparty credit risk includes credit risk exposures arising from OTC derivative and other financial instruments.

EC1	Laws, regulations or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.
Description and findings re EC1	<p>Numerous regulations exist that support the elements of EC1. Primary among these are the following:</p> <ul style="list-style-type: none"> • Regulation 39(4)-(6) states that a bank shall have in place a comprehensive risk management process, practices and procedures and Board approved policies for credit risk and counterparty credit risk • Regulation 23(11)(b)(iii)(A) provides that, for IRB banks, there should be a duly documented credit policy with should be applied consistently over time for internal risk management purposes • Regulation 39(7)(a)(ii)(D) requires that an IRB bank shall bring to the attention of senior management and the Board of directors matters such as credit concentration or any violations of specific risk or appetite limits • Regulation 39(5)(b) requires that the risk management policies, processes and procedures should be aligned with business strategy goals and objectives and risk appetite or tolerance of risk of the bank <p>As part of its overall supervisory process, the BSD ensures that there are appropriate governance structures within all banks that address all risks, including credit risk, and their particular composition, for example: risk appetite, risk profile, systemic importance and capital strength of the bank. The ICAAP meeting that is held annually with the banks entails calculating, understanding, monitoring and managing of economic capital as it relates to credit and other risks. Stress testing is also done as part of this process using macroeconomic simulations and variables to assess the effect that credit and other risks can have on the bank and more importantly the bank's capital adequacy ratio and ability to absorb, mitigate and manage such events should they occur.</p>
EC2	The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming, ⁴⁵ identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that

⁴⁵ "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.

	<p>senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.</p>
Description and findings re EC2	<p>Regulation 39(18) requires a bank's Board of directors to assess at least once a year whether processes relating to corporate governance, internal controls, risk management (including credit risk management) implemented by the bank successfully achieve the objectives specified by the Board. This assessment must be documented and reviewed by the external auditors, who in turn would report to the Registrar if they did not concur with the assessment conducted by a bank's Board. The Registrar also has the authority to request a copy of the assessment directly from a bank although this is done on a very infrequent basis.</p> <p>In practice, the bank's BSD relationship team will discuss credit risk management strategies and significant policies and processes during prudential meetings focused on credit risk. Reliance will also be placed on work performed by the internal and external auditors and specific findings identified by them will be followed up during these meetings.</p> <p>Peer group comparisons, trend analysis, etc. specific to credit risk are compiled based on monthly quantitative information (BA200 reporting series). This is discussed periodically with senior management and at least annually during a meeting with the bank's Board. These meetings confirm that the bank's quantitative information reflects the bank's adopted strategies, policies, etc. Furthermore, BSD staff will engage specifically with the bank on significant deviations from peers, BSD's expectations and economic trends. For IRB banks, separate on-site visits focusing specifically on the retail and wholesale portfolios are conducted.</p> <p>During 2013, banks were required to complete a questionnaire for counterparty credit risk that, among other things, described the governance of counterparty credit risk, the process and frequency for review and future planned changes to policy. Counterparty credit risk on-site meetings were also held with certain banks based on the size of their counterparty credit risk book.</p>
EC3	<p>The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including:</p> <ul style="list-style-type: none"> (a) A well documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments; (b) Well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures;

	<p>(c) Effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system;</p> <p>(d) Effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank's Board and senior management on an ongoing basis;</p> <p>(e) Prudent and appropriate credit limits, consistent with the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff;</p> <p>(f) Exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board where necessary; and</p> <p>(g) Effective controls (including in respect of the quality, reliability and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.</p>
Description and findings re EC3	<p>Refer to the responses to EC 1 and EC 2 above. Also relevant to this EC are the following:</p> <ul style="list-style-type: none"> • Regulation 23 requires banks to have a duly documented credit policy. • Regulation 39 requires that the Board of directors of a bank shall ensure that the bank establishes and maintains an independent credit risk control unit that shall be headed by a person who reports directly to the chief executive officer and the bank's Board of directors or to an independent chief risk officer if one has been appointed by the bank. <p>The BSD places some reliance on the external auditors, with specific reference to Regulation 46 (Audit reports), to confirm the quality of the bank's credit environment. Section 4 requires the external auditor of a bank to report to the Registrar within 120 days of the bank's financial year-end any significant weaknesses in the system of internal controls that came to the auditor's attention while performing the necessary auditing procedures as regards the policies, practices and procedures of the bank relating to, among other things, the granting of loans; the making of investments; and the ongoing management of the loan and investment portfolios.</p> <p>The external auditor will review the quantitative information submitted to the BSD via the BA 200 series and will comment on the underlying processes, systems, etc. supporting the generation of the series. The external auditor's report in terms of Regulation 46 is reviewed, assessed and discussed with the auditors, as well as the bank's audit committee as part of</p>

	<p>the SREP.</p> <p>For IRB banks, the bank's estimates and models used for that purpose will be subject to specific additional review as specified by the BSD on an annual basis. The external auditor will produce the 'long form report' in that regard and the report will be reviewed by the BSD as part of the SREP.</p> <p>In addition, the BSD has had discussions with banks to ensure a "single client view" across the bank. Where banks' systems are unable to do so, the BSD has discussed with banks the need to upgrade their systems.</p>
EC4	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged foreign exchange risk.
Description and findings re EC4	<p>Regulation 39(5)(d) requires that risk management processes, practices, procedures and policies at a bank shall be robust enough to determine and monitor the total indebtedness of entities to which the bank extends credit. Banks typically utilize credit bureaus to help in this endeavor.</p> <p>BSD staff includes this issue on the agendas for prudential meetings with banks and discusses policies and procedures with senior management.</p>
EC5	The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm's length basis.
Description and findings re EC5	<p>BA Section 60 requires directors and officers of a bank to avoid any conflicts of interest and that the process of corporate governance shall ensure that mechanisms and procedures are established and maintained to minimize or avoid potential conflicts of interest between the business interests of the bank.</p> <p>There is also a requirement in Regulation 36 that, from a consolidated supervision perspective, intercompany/intergroup loans should be conducted on an arm's-length basis and that for intragroup advances not conducted at arm's length, banks shall provide the Registrar in writing with information regarding these transactions.</p> <p>Regulation 39 sets out the requirement that the Board of Directors and senior management shall ensure adequate segregation of duties to promote sound governance and effective risk management in the bank, and avoid conflict of interests.</p> <p>There are also extensive regulations related to transactions with related parties. These include the regulations cited in CP 20 – Transactions with Related Parties.</p>

EC6	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re EC6	<p>There are several regulations related to the banks' oversight and management of major credit risk exposures. These include the regulations cited in CP 19 – Concentration Risk and Large Exposure Limits. By law, a bank may not make investments or grant loans or other credit to any person in an aggregate amount exceeding 10 percent of its capital and reserves without the permission of its board of directors or a committee appointed for such purpose.</p> <p>In practice, BSD staff has discussions with the management of banks to determine how loan approvals are being governed, including Board approval of larger credit risk exposures. The topic is also included in discussions with the banks' internal auditors, especially with regard to wholesale business where larger exposures exist. In addition, BSD staff review the approval policies and processes, including the limits applied to the approval process.</p>
EC7	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings re EC7	<p>The BA provides powers of inspection to the Registrar and stipulates that the Registrar may direct a bank to provide any information in order for the Registrar to fulfill his duties. Various regulations also support the Registrar's ability to access information.</p> <p>In practice, the BSD can request any information from banks not captured in the regulatory returns and any internal reports. For credit risk prudential meetings held with individual banks, a copy of the latest reports submitted to the Credit Risk Committee can be requested and any concerns discussed at the meeting.</p> <p>The BSD also has full access to all staff and can ask to meet with specific individuals.</p>
EC8	The supervisor requires banks to include their credit risk exposures into their stress testing programmes for risk management purposes.
Description and findings re EC8	<p>Banks are required to incorporate credit risk exposures in their stress testing exercises and banking regulations establish numerous specific requirements for banks to stress test various aspects of their credit risk. These regulations include (but are not limited to):</p> <ul style="list-style-type: none"> • Regulation 23(11)(b)(ix) – stress testing requirements for IRB banks • Regulation 23(15)(c)(iv) – assessment through scenario analysis and stress testing of whether the level of capital held against CCP exposures are adequate

	<ul style="list-style-type: none"> • Regulation 36(14)(b)(ii)(C) - policies, processes, procedures and systems should enable senior management to conduct stress testing for credit concentration risk • Regulation 39(5)(d)(vii) – risk management policies, processes, procedures and systems shall ensure that banks conduct regular stress testing or scenario analysis • Regulation 39(6)(b)(vi) – senior management shall periodically conduct stress tests on the bank’s main risk exposures • Regulation 39(16)(a)(v)(B)(iii) – Senior management of the bank shall incorporate robust stress testing to complement and validate the bank’s measures and give the Board of directors and senior management a better understanding of the bank’s exposures • Regulation 39(16)(a)(v)(E) - senior management of the bank shall define the bank’s stress testing objectives and scenarios. • Regulation 39(16)(b)(v) – a sound capital assessment program should be in place to incorporate forward-looking stress testing • Regulation 39(16)(d)(ii)(vi) – periodic reviews of the risk management process includes review of appropriate stress testing <p>In addition, Guidance Note 9/2008 – High level guidance for stress testing – sets out additional guidance from the BSD regarding stress testing at individual banks.</p> <p>With regard to the supervisory process in place, the BSD conducts ICAAP assessments on an annual basis, and stress testing forms part of the issues covered in this process. Once the document submitted by the bank has been reviewed, an on-site meeting is held with the bank and the results of the ICAAP are discussed and any areas of concern regarding stress testing are raised.</p> <p>The BSD also requests banks to perform a common scenario stress test where the factors to be stressed are provided to the banks by the BSD.</p>
Assessment of Principle 17	Compliant
Comment	Regulation 39 clearly sets out the requirement for adequate policies and procedures related to credit risk management, approved by the Board of directors and effectively implemented by management. BSD staff, including the analyst(s), credit specialist team and on-site review team, takes an active role in assessing the quality of credit risk management at all banks, including as part of the SREP.

Principle 18	Problem assets, provisions and reserves. ⁴⁶ The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves. ⁴⁷
EC1	Laws, regulations or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	<p>Regulation 39(3) identifies credit risk “and in particular risks arising from impaired or problem assets and the bank’s related impairments, provisions and reserves” as one of the types of risk that may arise from a bank’s on and off-balance sheet activities. Regulation 39(4) subsequently requires a bank, as a minimum, to have in place comprehensive risk management processes, practices, procedures related to problem assets, provisions and reserves.</p> <p>Regulation 39 also requires the risk management processes and practices to be adequate for the size and nature of the activities of the bank and for the bank to ensure that both the Board and senior management receive appropriate and timely communication on all related risks, including problem assets.</p> <p>Regulation 39(5)(d)(xiii) states that a bank’s risk management processes, practices, procedures and policies shall be sufficiently robust to ensure that the bank’s Board of directors and senior management receive timely and appropriate information regarding the condition of the bank’s respective asset portfolios, including matters related to the relevant classification of credit exposure, the level of impairment or provisioning, and major problem assets.</p> <p>Various aspects of Regulation 23 (Credit risk: monthly return), Section 22 (Credit impairment) set out the regulatory requirements for dealing with and reporting problem assets. The Section states, as a minimum, every bank:</p> <ul style="list-style-type: none"> • Shall have in place a sufficiently robust system for the calculation of credit impairment in accordance with the relevant requirements specified in Financial Reporting Standards issued from time to time; • Shall have in place sufficiently robust processes and Board-approved policies, and dedicated resources to ensure –

⁴⁶ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁴⁷ Reserves for the purposes of this Principle are “below the line” non-distributable appropriations of profit required by a supervisor in addition to provisions (“above the line” charges to profit).

	<ul style="list-style-type: none"> ○ the early identification of assets of deteriorating credit quality; ○ ongoing oversight of problem assets or credit exposure; ● That the bank periodically reviews and assesses (1) all relevant problem assets at an individual level, or a portfolio level in the case of credit exposures with homogeneous characteristics, (2) the adequacy of the bank’s asset classification, provisioning and write-offs, and (3) the value, adequacy and enforceability of all relevant risk mitigation instruments or contracts, including guarantees, credit derivative instruments or other forms of collateral or credit protection; ● That all relevant off-balance sheet exposures are duly considered; ● That the bank’s credit impairments and write-offs reflect realistic repayment and recovery expectations; ● Ongoing collection of past due loans; ● That the bank’s Board of directors receives timely and appropriate information on the condition of the bank’s relevant credit portfolios, including the classification of credit exposures, the level of provisioning and major problem assets.
EC2	<p>The supervisor determines the adequacy of a bank’s policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor’s opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank’s policies and processes</p>
Description and findings re EC2	<p>Regulation 46 (Audit reports) Section 4 requires the external auditor of a bank to report to the Registrar within 120 days of the bank’s financial year-end any significant weaknesses in the system of internal controls that came to the auditor’s attention while performing the necessary auditing procedures as regards the policies, practices and procedures of the bank relating to, among other things, the relevant credit impairments or loan loss provisions and reserves.</p> <p>The external auditor is required under Regulation 46(9) to hold preliminary discussions with the BSD prior to the annual audit. Interpretive matters arising from audits performed by external auditors are also sent to BSD to obtain clarity on the interpretation of such items.</p> <p>In most cases, the BSD relies on work by the external auditors to determine the adequacy of a bank’s policies and processes for grading and classifying assets and establishing appropriate and robust provisioning levels. If any significant weaknesses are identified by the external auditors, BSD staff will follow this up during the normal course of supervisory interaction with the bank.</p>

	With regard to other supervisory activities, the approval process for PD and LGD models includes an evaluation of whether the models apply the definition of default correctly.
EC3	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures. ⁴⁸
Description and findings re EC3	<p>Regulation 23 (Credit risk: monthly return), Section 22 (Credit impairment) requires banks to include all relevant off-balance sheet exposures in their consideration and reporting of credit impairment.</p> <p>In this regard, the BSD relies on the work of external auditors to determine that a bank gives due consideration to off-balance sheet exposures when determining classifications and provisioning.</p>
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.
Description and findings re EC4	<p>As mentioned under EC2, Regulation 23(22) requires banks to have in place sufficiently robust processes and Board approved policies, and sufficient dedicated resources to ensure that the bank's credit impairments and write-offs reflect realistic repayment and recovery expectations.</p> <p>In practice, provisions must be determined in terms of IAS 39 (Financial Instruments: Recognition and Measurement), which requires the bank to consider at each reporting period whether there is objective evidence of impairment. Such evidence includes national or local economic conditions that correlate with defaults on the assets in the group.</p> <p>With regard to supervisory oversight, it has been the policy of the BSD to place reliance on the external auditors' assessment of a bank's provisioning levels as part of their statutory audit. Any significant issues raised by the external auditors are addressed by the BSD during follow-up meetings with bank management. In respect of the work performed by external auditors, the BSD held extensive discussions with the South African Institute of Chartered Accountants (SAICA) to ensure the appropriateness of the Regulation 46 reports in view of the applicable audit standards and BSD requirements. In September 2013 a revised audit matrix was approved by BSD management that specifies the level of assurance to be given by external auditors.</p> <p>In addition, recognizing the added risk since the start of the global financial crisis, in 2012</p>

⁴⁸ It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.

	<p>the BSD initiated a project to review the adequacy of impairments raised by selected banks, mostly IRB banks (the largest banks in South Africa) and banks engaged in unsecured lending. The BSD's on-site review team has been primarily responsible for these reviews, with the assistance, where appropriate, of the credit risk and quantitative analysis teams. These reviews continue in 2014.</p>
EC5	<p>The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g., 30, 60, 90 days). The supervisor tests banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing or reclassification of loans).</p>
Description and findings re EC5	<p>See EC 1 above for relevant regulations pertaining to the early identification of deteriorating assets. In addition, Regulation 67 (Definitions) stipulates that an exposure that is overdue more than 90 days shall be classified as in default. Circular 2 of 2014 (Interpretation of definition of default as outlined in regulation 67 of the Regulations relating to Banks) also provides information in this regard.</p> <p>Classification in terms of Regulation 24 (Credit risk – Directives and interpretations for completion of the quarterly return concerning credit risk) sets out the following classification categories for banks on the Standardised Approach to credit risk:</p> <ul style="list-style-type: none"> • Overdue between 60 and 90 days – Special mention • Overdue between 91 and 180 days – Substandard (unless sufficient security is held by the bank) • Overdue between 181 and 365 days – Doubtful (unless sufficient security is held by the bank) • Overdue for more than one year – Loss <p>For IRB banks, the classification of loans is based on a combination of both objective (days in arrears) and subjective criteria. All loans overdue more than 90 days are classified as in default with the classification category based on the number of days in arrears. In addition, when a bank is of the opinion that an obligor is unlikely to pay its credit obligations in full, without recourse by the bank to actions such as the realization of security, the exposure shall be classified as in default.</p> <p>The SREP gives due consideration to banks' policies and procedures for the early identification of deteriorating assets, as well as for management and collection of problem</p>

	<p>assets. Credit risk prudential meetings between the BSD and bank management normally include a discussion on credit risk management processes, including the ongoing oversight of problem assets.</p> <p>During 2013, the BSD's on-site team conducted a detailed "deep dive" review of the provision, write-off and collection policy (including the application of the policy) of a bank in the unsecured lending sector. The project continues in 2014 with other unsecured lenders.</p> <p>In addition, BSD staff conducted research with regard to how banks treat rescheduled/restructured transactions after the terms and conditions have been changed. It was noted that banks treat such transactions differently. Consequently, the BSD is in the process of finalizing a directive that will address the inconsistencies. This directive includes a provision that loans, once restructured, must be reported at a minimum as Special Mention so as to prohibit banks from using restructuring as a means of concealing the extent of problem loans.</p>
EC6	<p>The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.</p>
Description and findings re EC6	<p>Form BA200 (Credit risk: monthly return) contains details of the classification of credits and assets and provisioning and is submitted to the Registrar on a monthly basis. In addition, Form BA210 (Credit risk: quarterly return) provides additional details on credit risk, including restructured credit exposures and specific impairments related to large exposures, industry sectors and for watch list clients on a quarterly basis.</p> <p>Banks are required to have a duly documented credit policy that specifies the bank's process relating to the assignment of ratings to credit exposures (i.e., grading).</p> <p>The proposed directive on restructured credit exposures requires banks to keep evidence in support of whether or not a restructure is considered necessary because of financial distress of the obligor, in which case the exposure must be assessed for impairment.</p> <p>In practice, information is submitted to the BSD via Oracle Financial Analyser (OFA) and validation rules are in place to ensure that all returns are received from banks by the prescribed dates.</p>
EC7	<p>The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g., if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to</p>

	adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.
Description and findings re EC7	<p>Regulation 23(22)(b) states:</p> <ul style="list-style-type: none"> • When the Registrar is of the opinion that the policies and procedures applied by a bank during its assessment of asset quality, risk mitigation and related credit impairment are inadequate, the Registrar may require the relevant bank to raise a specified credit impairment amount against potential credit losses, for example, by requiring in writing the said bank to transfer a specified amount from retained earnings or distributable reserves to a non-distributable reserve. <p>Through the ICAAP, the supervisor can increase the minimum capital requirement (either through increasing the minimum ratio or increasing the risk weighted exposure amount). Regulation 38(4) affords the Registrar the power to increase prudential capital requirements commensurate with a bank's risk profile. One of the factors that would be taken into consideration when considering an increase is the BSD's view of the accuracy of asset classification and credit impairments.</p> <p>The assessors were made aware of a few recent instances where the BSD had discussions with banks regarding the adequacy of their provisioning and the banks acted to address supervisory concern as a result. One such bank received formal notification of the BSD's concerns and resolved the situation in a timely manner, obviating the need for the Registrar to amend the bank's capital or provisions.</p>
EC8	The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.
Description and findings re EC8	<p>For banks on the simplified standardized, standardized and foundation IRB approaches to credit risk, Regulation 23 requires banks to apply certain standards to credit risk mitigants, including the requirement that a reduction in the risk exposure of a bank shall be allowed only if such collateral or guarantee can be realized by the bank under normal market conditions (e.g., the value at which the collateral can be realized in the market does not materially differ from its book value...). In addition, a bank shall mark its collateral to market and revalue its collateral at regular intervals but not less frequently than once every six months. Regulation 23 also contains general and specific requirements for credit derivatives. For Foundation IRB banks, there are also unique requirements for commercial real estate and other physical collateral valuation.</p> <p>For the major banks on the advanced IRB approach, Regulation 23 requires LGD ratios and EAD amounts to be based on economic and market conditions that are relevant and current, and shall be reviewed on a regular basis but not less frequently than once a year or</p>

	when material new information is obtained.
EC9	<p>Laws, regulations or the supervisor establish criteria for assets to be:</p> <p>(a) identified as a problem asset (e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and</p> <p>(b) reclassified as performing (e.g., a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).</p>
Description and findings re EC9	<p>With regard to the identification of problem assets, see the details of Regulations 67 and 24 described under EC 5.</p> <p>The proposed directive on restructured credit exposures requires restructured credit exposures to be classified as in default until a minimum of three full consecutive payments under the revised terms and conditions have been received before the exposure can be reclassified as performing. It is expected that the new directive will be issued no later than September 2014.</p> <p>In terms of Regulation 23(11)(b)(iii)(I), banks are required to have a duly documented credit policy that shall comprehensively deal with overdue amounts, exposures that are in default and re-aging of facilities. Banks therefore need to document their policy on when to reclassify defaulted loans to performing.</p>
EC10	<p>The supervisor determines that the bank's Board obtains timely and appropriate information on the condition of the bank's asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.</p>
Description and findings re EC10	<p>See the references to Regulations 23(22) and 39(5) described above.</p> <p>BSD staff reviews management information (i.e., Board packs), mainly for significant portfolios, on an ad hoc basis. In addition, the BSD reviews the minutes of Board and risk committee meetings to establish the issues being discussed.</p> <p>At credit risk prudential meetings between BSD staff and bank Boards, one of the agenda items is usually a discussion on corporate governance relating to credit risk, including the type and extent of reporting of credit risk information to the Board.</p>

EC11	The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.
Description and findings re EC11	<p>Regulations do not specifically require banks to set a threshold for the purpose of identifying significant exposures and to regularly review the level of such threshold; however, in terms of Regulation 23(22)(a)(i), banks are required to determine any credit impairment in accordance with the relevant requirements specified in Financial Reporting Standards from time to time. Banks must therefore comply with IAS 39 for determining the provisioning for financial instruments such as loans and advances. In terms of paragraph 58 of IAS 39 an entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant.</p> <p>Furthermore, the proposed directive on restructured credit exposures will require that the assessment of distressed restructured classifications should be done on a case-by-case basis. In terms of this directive, once a restructure has been classified as distressed, it must be tested for impairment under IAS 39. In addition, on a quarterly basis, disclosure of large exposures is required per person ("person" is defined in regulation 67) in terms of Regulation 24(2)(e). The disclosure includes any specific impairment raised against a large exposure. Large exposures are determined in terms of BA Section 73 and Regulation 24(6) and (7).</p> <p>The definition of default requires the assessment for wholesale exposures to be made per obligor. For the retail portfolio, the evaluation is performed at a facility level where no single exposure shall be seen as significant.</p>
EC12	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.
Description and findings re EC12	Credit concentration risk is monitored by geography as well as sector (or industry). The BSD receives geographic credit information in three ways, namely, the form BA210 classifies credit by (1) continent, (2) according to the IMF Financial Soundness Indicator template, and (3) the BSD receives the PIIGS country survey (the form BA202 which is submitted by the five largest banking institutions). The banks also submit credit exposures by industry sector classification (on Form BA210). This information is monitored and published in the Financial Stability Review and the Bank Supervision Annual Report. Before publication, there is a review of trends and the draft reports are submitted to senior SARB management. Furthermore, presentations are made every second month to the Financial Stability

	<p>Committee, which includes presentations on Financial Stability Indicators (both by sector classification and geographic classification).</p> <p>A banking sector overview is presented to the BSD on a monthly basis. The credit risk portion of this presentation is prepared by the Credit Risk division in the BSD and covers the banking sector as a whole. The presentation looks at trends in total credit exposure, default exposure, impaired advances, specific and portfolio credit impairments and impairment ratios. Where increasing trends are noted, this is discussed and, where necessary, action will be initiated.</p> <p>For example, an area that has received a lot of attention in the past two years as a result of the monitoring of trends and concentrations in risk has been the unsecured lending sector. Significant growth was identified in this area and there was a concern about the risk that might be caused to the industry. Due to this, unsecured lending received a lot of scrutiny by the BSD in order to understand the risk management practices surrounding these types of assets. The BSD conducted on- and off-site reviews of banks unsecured retail lending portfolios (as well as conducting a joint review of two large insurers with the Financial Services Board), included this as a “flavor of the year” topic for discussion with bank Boards, and continues to prepare and submit reports of build-ups of risk in this category to the frontline analysis teams. Increased focus was also placed on the adequacy of provisions relating to unsecured loans, including on-site assessments of provisions for unsecured lending.</p> <p>Risk mitigation concentrations are currently not actively monitored; however, in South Africa, cash, government bonds and certain high quality shares would be the most typical forms of collateral. Guarantees are also used for credit risk mitigation purposes. For counterparty credit risk, a questionnaire was issued to banks which had to indicate the type of collateral used for OTC derivatives. From the responses received it is evident that there is a high concentration in cash collateral for such exposures.</p>
Assessment of Principle 18	Compliant
Comments	<p>Through the use of reports submitted on a regular basis, the review of external auditor reports and selected on-site examinations, the BSD monitors problem assets at individual banks. Supervisory staff evaluates the adequacy of banks’ provisioning for problem assets on both an individual bank and peer group basis.</p> <p>The assessors encourage the BSD to finalize as soon as possible the draft Directive on restructured credit exposures which will help to prevent banks from using restructuring to improve their classified loan levels. The compliant rating issued for Principle 18 is based, in part, on the expectation that this directive will be issued in the very near term.</p>

Principle 19	Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties. ⁴⁹
EC1	Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. ⁵⁰ Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and findings re EC1	Regulation 36(14)(b) requires banks to have in place robust Board approved policies, processes, procedures and systems to allow management to identify and monitor their concentration risk levels. Form BA 210, which is submitted to the BSD on a quarterly basis, requires banks to report their large exposures and the distribution of credit exposures per sector. These exposures include both on- and off-balance sheet exposures.
EC2	The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure ⁵¹ to single counterparties or groups of connected counterparties.
Description and findings re EC2	Regulation 39(6)(a)(iii) requires the Board and senior management of a bank to ensure that there are management information systems in place that, amongst other things, allow for the proactive management of risk and provide regular information regarding the bank's aggregate risk profile. Regulation 39(4) requires banks to have management processes, practices, procedures and Board approved policies to manage risks listed in Regulation 39(3) which includes concentration risk. The BSD reviews banks' information systems during on-site reviews. If deemed necessary, the BSD can communicate any concerns it may have with regard to a bank's information

⁴⁹ Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management or any combination thereof.

⁵⁰ This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

⁵¹ The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure (i.e., it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should not be used in measuring credit exposure for this purpose as the relevant risk weights were devised as a measure of credit risk on a basket basis and their use for measuring credit concentrations could significantly underestimate potential losses (see *"Measuring and controlling large credit exposures"*, January 1991).

	systems to the relevant management within the bank.
EC3	The supervisor determines that a bank's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes require all material concentrations to be regularly reviewed and reported to the bank's Board.
Description and findings re EC3	<p>Regulation 24(7)(a) and (b) establish prescribed percentages related to specified concentration risk. A bank or controlling company may not make investments or any form of credit to any person/entity that is greater than 10% of its capital and reserves without the approval of the Board and notification to the Registrar. In addition, a bank or controlling company may not make an investment or grant any form of credit that exceeds 25% of the bank's capital and reserves without the prior written approval of the Registrar. In practice such requests to the Registrar are exceptionally rare.</p> <p>Regulation 39(3) requires banks to manage risks on an ongoing basis; these risks may arise from the banks' on- and off-balance sheet exposures and include concentration risk.</p> <p>Regulation 39(4) requires banks to have in place comprehensive Board approved risk management processes, practices and procedures to identify, measure, monitor, control, price, mitigate and report on risks, which include concentration risk.</p> <p>BA Directive 5/2008 - 'Composition of Board-Appointed Committee to Approve Large Exposures' - requires a bank's Board to actively monitor and make decisions on large credit exposures.</p> <p>In practice, the BSD monitors Board and management oversight of concentration risk through the SREP. This includes a review of bank policies and Board approved procedures and the review of Board and Board committee meeting minutes. Concentrations are also discussed at credit risk meetings and graph discussions. Finally, concentration risk is addressed through the ICAAP reviews.</p>
EC4	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Description and findings re EC4	Form BA 210, which banks submit to the BSD on a quarterly basis, includes information related to sectoral, geographical and currency exposures of the bank. These quarterly returns are reviewed by BSD analysts.
EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor

	may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC5	Regulations relating to banks do not use the exact term “connected counterparties” but instead refer to “connected persons,” which is defined in Regulation 67 (Definitions) as “two or more persons, whether natural or juristic, that, unless proved to the contrary, constitute a single risk due to the fact that one of them has direct or indirect control over the other or others” or “two or more persons... between whom there is no relationship or control, but they are to be regarded as constituting a single risk due to the fact that they are so interconnected that should one of them experience financial difficulties, the other or all of them would be likely to encounter repayment difficulties.”
EC6	Laws, regulations or the supervisor set prudent and appropriate ⁵² requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. “Exposures” for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings re EC6	See response to EC3. In addition, Regulation 36(14)(d) provides a broad definition of “large exposure” to include on- and off-balance sheet exposures and various transactions, including those giving rise to counterparty exposure. Banks are required to report such transactions on both a consolidated and solo basis and management monitoring of the limits is reviewed as part of the SREP.
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programmes for risk management purposes.
Description and findings re EC7	Regulation 36(14)(b)(ii)(C) requires banks to conduct appropriate stress testing and scenario analysis in respect of concentration risk. The BSD reviews these stress tests through its annual ICAAP reviews.
AC1	In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following: (a) Ten percent or more of a bank’s capital is defined as a large exposure; and

⁵² Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

	<p>(b) Twenty-five percent of a bank's capital is the limit for an individual large exposure to a private sector non-bank counterparty or a group of connected counterparties.</p> <p>Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.</p>
Description and findings re AC1	See response to EC3. In addition, BA Section 73(4) states that the Registrar may exempt certain exposures by means of a circular.
Assessment of Principle 19	Compliant
Comments	Regulations require the Board and senior management to establish and maintain adequate policies and procedures related to concentration risk and large exposures. The BSD utilizes reports received from banks on a quarterly basis to monitor large exposures and risk concentrations. In addition, the BSD monitors Board and management oversight of concentration risk through the SREP and ICAAP reviews.
Principle 20	Transactions with related parties. In order to prevent abuses arising in transactions with related parties ⁵³ and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties ⁵⁴ on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.
EC1	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of "related parties." This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC1	<p>Regulation 36(6)(c) states that a "related person" in respect of a bank or controlling company includes:</p> <ul style="list-style-type: none"> • Any associate of the relevant bank or controlling company; • A significant shareholder of the relevant bank or controlling company;

⁵³ Related parties can include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

⁵⁴ Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as, dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

	<ul style="list-style-type: none"> • A Board member of the relevant bank or controlling company, or a close family member of the Board member; • A member of senior management of the relevant bank or controlling company, or a close family member of the member of senior management; • A key member of staff of the relevant bank or controlling company, or a close family member of the key member of staff; • A company controlled by any shareholder of the relevant bank or controlling company; • Any majority owned or controlled entity; • Any significant minority owned or controlled entity; and • Any other person or entity specified in writing by the Registrar.
EC2	Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties. ⁵⁵
Description and findings re EC2	<p>Regulation 24(9) - Matters specifically related to connected lending or lending to a related person – requires banks and controlling companies to have in place robust processes, procedures, systems and Board approved policies to ensure that transactions with related parties are conducted on an arm’s-length basis.</p> <p>In addition, Regulation 39(6)(a) requires the Board and senior management of a bank to ensure that the monitoring and reporting of individual and aggregate exposures to related persons are subject to an independent individual credit review process.</p>
EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank’s Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.
Description and findings re EC3	Regulation 24(9)(a)(iv) requires that any transaction with a related person and the write-off of any related party exposure exceeding one percent of the bank or controlling company’s qualifying common equity tier 1 capital and reserve funds, or otherwise posing special risks, is subject to the prior written approval of the Board of directors of the bank or controlling

⁵⁵ An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g., staff receiving credit at favorable rates).

	<p>company.</p> <p>In addition, Regulation 24(9)(a)(ii) states that no person benefitting from a particular loan or exposure is responsible for the preparation of the loan assessment or credit decision, or the subsequent management of the exposure or any relevant matter related to that exposure.</p>
EC4	The supervisor determines that banks have policies and processes to prevent persons benefitting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings re EC4	<p>As mentioned in EC 3, Regulation 24(9) requires that every bank and every controlling company must have in place Board approved policies and procedures to ensure that “no person benefitting from a particular loan or exposure is responsible for the preparation of the loan assessment or credit decision, or the subsequent management of the exposure or any relevant matter related to that exposure.”</p> <p>BSD staff makes the determination that a bank is following this requirement primarily through its discussions with internal audit.</p>
EC5	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.
Description and findings re EC5	<p>Regulation 24(9)(b) states that when the Registrar is of the opinion that a bank or controlling company’s policies, processes, procedures and systems related to connected lending or lending to a related person are inadequate, the Registrar may require the relevant bank or controlling company:</p> <ul style="list-style-type: none"> • to deduct from its capital and reserve funds such amount relating to the said transactions or exposures as may be specified in writing by the Registrar; and/or • to obtain adequate collateral in respect of the relevant exposure. <p>While there is no regulatory provision enabling the Registrar to set limits for transactions with related parties other than intra-group companies, BA Section 73 prescribes limits in terms of when Board approval is required and for which transactions written approval of the Registrar is required.</p> <p>Regulation 36(16) deals with matters specifically related to intragroup transactions or exposures and specifies that the Registrar may set limits in respect of intra-group transactions or exposures.</p>

EC6	The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
Description and findings re EC6	<p>Banks are required to provide selected information on a quarterly basis (see response to EC7 below). The bank needs to respond to the following questions in terms of each specific exposure reported:</p> <ul style="list-style-type: none"> • Are loans and advances to related persons/intra-group entities conducted on an arm's length basis? (Yes = 1; no = 2) • When no, a separate schedule of all exposure to related persons/ intra-group entities not at arm's length shall on request be submitted in writing. • Does the Board of directors of the relevant bank or controlling company effectively monitor extensions of credit to related persons/intra-group entities? (Yes=1; no=2) • Are appropriate steps taken to control or mitigate the risks relating to related persons/intra-group exposures? (Yes = 1; no = 2. <p>Any areas identified as a concern during the ongoing analysis of the relevant prescribed returns will be included as a topic of discussion in prudential meetings held with banks.</p> <p>Also see the response to EC2.</p>
EC7	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings re EC7	<p>Regulation 24(2)(g) and Form BA 210 require quarterly reporting of selected information in respect of connected lending or lending to a related person.</p> <p>Regulation 36(2)(b) and Form BA 600 require quarterly reporting of the nature and extent of intragroup exposures and any relevant exposures to a connected or related person.</p> <p>In practice, the information provided by banks on Forms BA 210 and BA 600 are reviewed by BSD staff as part of the SREP and other ongoing supervisory analysis of individual banks.</p>
Assessment of Principle 20	Compliant

Comments	<p>Regulations set out a comprehensive definition of “related person” and require banks and controlling companies to conduct transactions with related parties on an arm’s-length basis. In addition, Regulation 39 requires the Board and senior management of a bank to ensure that the monitoring and reporting of individual and aggregate exposures to related persons are subject to an independent individual credit review process.</p> <p>The BSD receives and reviews information on transactions with related parties on a quarterly basis. Any matters of concern would be included as a topic of discussion in prudential meetings held with individual banks.</p> <p>The assessors recommend that the SARB amend its regulations so that the Registrar has the ability to set limits on exposures to any related parties. At this point, it only has the ability to set limits on intragroup transactions and exposures.</p>
Principle 21	Country and transfer risks. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk ⁵⁶ and transfer risk ⁵⁷ in their international lending and investment activities on a timely basis.
EC1	The supervisor determines that a bank’s policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	<p>Regulation 39(3) identifies country risk and transfer risk as two of the types of risk that may arise from a bank’s on- and off- balance sheet activities. Regulation 39(4) subsequently requires a bank, as a minimum, to have in place comprehensive risk management processes, practices and procedures, and Board approved policies to identify, measure, monitor, control, and appropriately price, mitigate and communicate or report country and transfer risk amongst other risk types.</p> <p>Regulation 39 also requires the risk management processes and practices to be adequate</p>

⁵⁶ Country risk is the risk of exposure to loss caused by events in a foreign country. The concept is broader than sovereign risk as all forms of lending or investment activity whether to/with individuals, corporates, banks or governments are covered.

⁵⁷ Transfer risk is the risk that a borrower will not be able to convert local currency into foreign exchange and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower’s country. (Reference document: *IMF paper on External Debt Statistics – Guide for compilers and users*, 2003).

	<p>for the size and nature of the activities of the bank and for the bank to ensure that both the Board and senior management receive appropriate and timely communication on all related risks, including country and transfer risk. The Regulation outlines further requirements in regards to the identification, monitoring and reporting of country and transfer risk, as well as the monitoring of developments in country and transfer risk and the application of appropriate countermeasures.</p> <p>Annual on-site reviews are conducted by the BSD to assess banks policies, and the risk management processes against these requirements. For instance, annual prudential meetings held with banks include a discussion on issues such as the operating environment in those jurisdictions where the bank has exposure. In addition, banks are also required to submit quarterly statutory returns outlining, inter alia, their total exposures and the credit quality of such exposures to the various geographical regions (Form BA 210, lines 118-174)</p>
EC2	The supervisor determines that banks' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	Regulation 39(4) requires all risk management policies, strategies and processes to be approved by the Board. BSD staff reviews the policies and processes related to country and transfer risks for all banks engaged in activities resulting in such risks. This is done primarily as part of the SREP.
EC3	The supervisor determines that banks have information systems, risk management systems and internal control systems that accurately aggregate, monitor and report country exposures on a timely basis; and ensure adherence to established country exposure limits.
Description and findings re EC3	<p>Regulation 39(5)(h)(ii) requires risk management processes and procedures to ensure that country exposures are accurately monitored and reported in the bank's information systems, risk management systems and internal control systems. In addition, Regulation 39(5)(h)(iii) requires banks to continuously adhere to established country exposure limits.</p> <p>The BSD makes this determination as part of its SREP, including through meetings and on-site reviews.</p>
EC4	<p>There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include:</p> <p>(a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum</p>

	<p>provisioning levels where appropriate.</p> <p>(b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate.</p> <p>(c) The bank itself (or some other body such as the national bankers association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.</p>
Description and findings re EC4	<p>Regulation 39(5)(h)(v) requires banks to raise appropriate provisions for loss against country and transfer risk. While the BSD has not, to date, set any country specific percentage limits, it requires banks to have such limits approved internally as part of the risk appetite setting process. In addition, banks must also have policies and processes in place to monitor adherence to these approved limits. Furthermore, the quarterly BA 210 statutory returns submitted by banks provide a breakdown of provisions for various geographical regions (see BA 210 lines 118-193). This information is utilized by BSD staff to assess and evaluate the appropriateness of banks' provisions for the geographical regions to which they have exposures.</p> <p>On an annual basis the external auditors of the bank are also required to report to the BSD any significant weaknesses in the system of internal controls that may have come to their attention during their audit in regards to the bank's overall credit granting activities.</p>
EC5	The supervisor requires banks to include appropriate scenarios into their stress testing programmes to reflect country and transfer risk analysis for risk management purposes.
Description and findings re EC5	Regulation 39 requires banks' risk management processes, practices, procedures and policies to be sufficiently robust to ensure that regular stress testing or scenario analysis is conducted in regards to inter alia country and transfer risk.
EC6	The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g., in crisis situations).
Description and findings re EC6	On a quarterly basis the BSD receives, in the form of statutory returns, data on banks exposures to foreign countries, broken down into various geographical regions (see BA 210 lines 118-193). In addition, the BSD can also collect additional information as and when needed, for instance during crisis situations. For instance, at the height of the crisis period, the BSD collected information on banks' exposures to some of the Euro countries (PIIGS

	specifically) on a monthly basis.
Assessment of Principle 21	Compliant
Comments	Since the last BCP assessment, Regulation 39 has been amended to specifically include country and transfer risks. In addition, the BA 210 quarterly report was amended in 2011 and now requires more granular information on bank's country and transfer risks. While the level of country and transfer risk for most banks remains relatively small, the BSD monitors such exposures on an ongoing basis through the SREP and includes this risk category as part of its discussions with bank Boards, management and auditors, as appropriate.
Principle 22	Market risk. The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
EC1	Laws, regulations or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.
Description and findings re EC1	<p>Regulation 39(3) identifies market risk as one of the types of risk that may arise from a bank's on and off-balance sheet activities. Regulation 39(4) subsequently requires a bank, as a minimum, to have in place comprehensive risk-management processes, practices and procedures, and Board approved policies to identify, measure, monitor, control, and appropriately price, mitigate and communicate or market risk amongst other risk types.</p> <p>Regulation 39 also requires the risk management processes and practices to be adequate for the size and nature of the activities of the bank and for the bank to ensure that both the Board and senior management receive appropriate and timely communication on all related risks, including market risk. The Regulation outlines further requirements in regards to the identification, monitoring and reporting of market risk, as well as the monitoring of developments in market risk.</p> <p>In addition, Regulation 28 (Market risk) indicates the methods for calculating bank-wide market risk while Regulation 39(13) states that a bank that trades in contracts or positions that are measured at FV shall implement robust governance structures and control procedures as part of its risk management framework for the prudent valuation of the said instruments, contracts or positions. Regulation 39(14)(b) sets out specific corporate</p>

	<p>governance principles for IMA Banks.</p> <p>Finally, the BSD has issued several Circulars, Guidance Notes and Directives related to market risk management.</p> <p>The SREP includes on-site analysis of individual bank's market risk policies and practices. This includes quarterly discussions held with the largest banks. Off-site analysis is performed on all banks.</p> <p>There is also a process in place for the completion of Questionnaires (IMA, Treasury) by banks, which are in turn assessed by BSD market risk analysts. This review process leads to the identification of response weaknesses, gaps or IMA problems, as well as any need for follow-up or supplementary information. This is then followed by an on-site review regarding the structure, roles, responsibilities, methods, systems, plans, problems and other factors related to market risk. Finally, BSD staff prepares a report summarizing the process and key findings.</p> <p>Regular reports include:</p> <ul style="list-style-type: none"> • Value-at-Risk (VaR) measures – Reported on daily and monthly basis (See BA 325 and BA 320 market risk returns); • Stressed VaR (SVaR) measures – Reported on daily and monthly basis (See BA 325 and BA 320 market risk returns); • Market risk measures (risk weighted exposure, VaR and SVaR) are reported for banking groups on a quarterly basis via the BA 600 and BA 610 returns. These returns are specifically tailored for consolidated supervision and foreign operations; <p>VaR limit utilizations across banks are monitored on a monthly basis. Where a bank does not have IMA approval for market risk reporting purposes, the standardized approach equivalent is reported. The standardized rules are prescribed in Regulation 28(7), which is in line with the standardized rules set forth in the Basel capital standards. Key performance measures are reviewed and discussed at quarterly onsite meeting with banks with internal model approach approval.</p> <p>The market risk specialist team of the BSD currently consists of five individuals, including a manager.</p>
EC2	<p>The supervisor determines that banks' strategies, policies and processes for the management of market risk have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.</p>

Description and findings re EC2	<p>The BSD makes the determinations set out in EC2 through a combination of on-site and off-site reviews (see response to EC1). In particular, quarterly discussions related to market risk are held with the largest banks. Supervisory staff determines that adequate policies and procedures for the day-to-day management of market risk are in place. Banks are required to submit the most recent Board-approved market risk policies as part of the IMA renewal process.</p> <p>Non-IMA banks can be classified into two categories:</p> <ol style="list-style-type: none"> 1. smaller banks and or branches that may trade some FX products. These banks do not have quarterly on-site reviews; however due to the trading business in some, Treasury reviews will be conducted at these banks and branches; and 2. the remaining standardized banks in South Africa have limited trading exposure in the market. Due to their limited systemic risk from a market risk perspective, their market risk queries and discussions (if any) may be included in the graph discussions. Even though these banks may be subject to less on-site review, similar stringent rules are in place from a regulatory perspective in terms of policies and risk being governed in the appropriate fashion. <p>In addition, as part of the review of banks' ICAAPs, supervisors determine that bank Boards oversee management in a way that ensures that the policies and procedures approved by the Board are implemented effectively and fully integrated into the banks' overall risk management process.</p>
EC3	<p>The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment including:</p> <ol style="list-style-type: none"> (a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's Board and senior management; (b) appropriate market risk limits consistent with the bank's risk appetite, risk profile and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff; (c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board, where necessary; (d) effective controls around the use of models to identify and measure market risk, and set limits; and (e) sound policies and processes for allocation of exposures to the trading book.
Description and	The Regulations prescribe that banks should have information systems that can be

findings re EC3	<p>effectively used for risk management purposes. Banks with IMA approval are required to provide a quarterly update on any system changes. This is a standard agenda item for quarterly IMA meetings. In addition, the IT risk/operational risk section of the BSD will communicate with the market risk team should anything pertaining to market risk systems arise as a result of their meetings/reviews.</p> <p>The Regulations prescribe that banks should have in place a limit structure that is commensurate with the bank's risk profile and can be adequately monitored. Banks with IMA approval are required on an annual basis to provide the BSD with their approved market risk limits as part of the IMA renewal questionnaire. A large portion of quarterly onsite meeting discussions is around business strategy and risk appetite. Limit structures and limit utilizations are discussed.</p> <p>Internal VaR and Stressed VaR limits are reported on a daily and monthly basis via the BA 325 (line items 24-35) and BA 320 (100-110) market risk regulatory reporting returns. Internal committee packs are sent to the BSD on a monthly basis. These typically contain discussions around limit reviews and any breaches that may have occurred during the period. Signed limit mandates are typically sent to BSD on an annual basis. Internal Audit will review whether limits have been adhered to.</p> <p>The Regulations also prescribe that banks should have in place policies and processes pertaining to exception tracking and relevant reporting escalation processes so as to ensure prompt response/action by senior management. Banks are requested on a regular basis (annually) to provide the BSD with their market risk policy and any supporting policies that would detail the necessary reporting lines. During onsite meetings, exception tracking and associated governance controls are discussed.</p> <p>The Regulations prescribe that banks should have effective controls around the use of models to identify and measure market risk and the subsequent setting of limits. Policies detailing the use of models for market risk measurement and limit setting are reviewed on an annual basis, unless changes have been made prior to the annual review.</p> <p>Banks are required to have minimum standards for policies and processes pertaining to the allocation of trading book exposures. In addition, banks are required to regularly review their policies and processes pertaining to trading book exposures. Banks are also required to send the BSD a trading/banking book split policy on an annual basis.</p>
EC4	<p>The supervisor determines that there are systems and controls to ensure that banks' marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function</p>

	<p>independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.</p>
Description and findings re EC4	<p>The BSD determines that there are systems and controls to ensure that banks' marked-to-market positions are revalued frequently. Banks are required to have adequate policies and processes in place that address systems and controls applicable to marked-to-market revaluations. These policies are sent to the BSD on a regular basis. The supervisor also determines that all transactions are captured on a timely basis and that the valuation processes use consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). Certain banks will provide independent market verification status reports on a quarterly basis to the BSD.</p> <p>To the extent that a bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. If a bank does make use of mark-to-model valuations, the bank is required to adhere to the rules specified in the regulations.</p> <p>The BSD requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions. Regulations specify that banks should have in place policies and processes related to valuation adjustments for positions that cannot be prudently valued.</p> <p>Recently banks were encouraged to review the EBA document released on prudent valuation adjustments and many local banks have done work in this regard.</p>
EC5	<p>The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.</p>
Description and findings re EC5	<p>Regulation 39 requires banks to hold capital based on the nature, complexity and risk inherent in the banks activities and specifies that banks need to have procedures for valuation adjustments specifically for (i) uncertainty due to liquidity in the markets and (ii) model risk for complex products.</p> <p>As part of the SREP, quarterly on-site discussions are held with systemically important banks. Off-site analysis is completed on the system. The supervisory questionnaire forwarded for completion by banks requires pricing and valuation methods used for all products including less liquid products. Additionally, banks are expected to adhere to the IFRS rules at a minimum.</p>

EC6	The supervisor requires banks to include market risk exposure into their stress testing programmes for risk management purposes.
Description and findings re EC6	Regulation 39 requires that, as a minimum, the risk management processes, practices, procedures and policies shall be sufficiently robust to ensure that the bank regularly conducts stress testing and scenario analysis. IMA banks are required to have in place a rigorous and comprehensive process of stress testing. Banks with IMA approval are required to send their stress testing results on a monthly basis to the BSD. Ad hoc stress testing exercises are also conducted.
Assessment of Principle 22	Compliant
Comments	The SARB has implemented a comprehensive approach to the supervision of market risk, especially at the largest banks that have been approved for the IMA. For most banks in South Africa, market risk remains at rather modest levels.
Principle 23	Interest rate risk in the banking book. The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk ⁵⁸ in the banking book on a timely basis. These systems take into account the bank's risk appetite, risk profile and market and macroeconomic conditions.
EC1	Laws, regulations or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments.
Description and findings re EC1	Regulation 39(3) identifies interest rate risk as one of the risks that may arise from a bank's on- and off-balance sheet activities. Regulation 39(4) subsequently requires a bank, as a minimum, to have in place comprehensive risk-management processes, practices and procedures, and Board approved policies to identify, measure, monitor, control, and appropriately price, mitigate and communicate or report interest rate risk amongst other risk types.

⁵⁸ Wherever "interest rate risk" is used in this Principle the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

	<p>Regulation 39 also requires the risk management processes and practices to be adequate for the size and nature of the activities of the bank and for the bank to ensure that both the Board and senior management receive appropriate and timely communication on all related risks, including interest rate risk.</p> <p>Banks file information on their IRRBB with the Registrar on a monthly basis on Report BA 330 – Interest Rate Risk: Banking Book. In practice, the BSD evaluates IRRBB primarily through the SREP. Assessment of policies and their implementation takes place during the ALM reviews, both off-site and on-site. As part of the SREP, the BSD sends out a questionnaire to the bank and then assesses its responses and, as needed, poses further questions. During Stage 4 of the SREP (Focused review), the BSD engages with senior management to verify the quality of the bank’s ALM. For systemically important banks, an on-site visit will occur irrespective of the initial analysis.</p> <p>IRRBB is also assessed as part of the ICAAP process.</p>
EC2	<p>The supervisor determines that a bank’s strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank’s Board. The supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.</p>
Description and findings re EC2	<p>Banks are required to submit a completed questionnaire related to IRRBB prior to an on-site review by the BSD (typically conducted on a two-year cycle for the larger banks and on an ad hoc basis for other banks). The on-site reviews typically focus on established limits and controls. In addition, off-site data is filed and monitored on a monthly basis.</p>
EC3	<p>The supervisor determines that banks’ policies and processes establish an appropriate and properly controlled interest rate risk environment including:</p> <ul style="list-style-type: none"> (a) comprehensive and appropriate interest rate risk measurement systems; (b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions); (c) appropriate limits, approved by the banks’ Boards and senior management, that reflect the banks’ risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff; (d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks’ senior management or Boards where necessary; and (e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks’ Boards and

	senior management.
Description and findings re EC3	See response to EC 1 above. In practice, the assessment of policies and implementation of these policies takes place during ALM (Asset and Liability Management) reviews (both off-site and on-site reviews). The first step is to send out a questionnaire, followed by assessment of the responses. For systemically relevant banks an on-site visit will occur irrespective of the quality of the response.
EC4	The supervisor requires banks to include appropriate scenarios into their stress testing programmes to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC4	In addition to the shock scenario that the BSD applies to banks (200bp parallel shift), banks are required to submit their own specific stress test scenarios to the BSD. During on-site visits, the results of such stress tests for interest rate risk would be discussed, as well as any actions the bank may be taking due to the results.
AC1	The supervisor obtains from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book.
Description and findings re AC1	Banks report the impact on their economic capital to the BSD on a periodic basis. The BSD is in the process of strengthening its program of review of and follow-up on this information.
AC2	The supervisor assesses whether the internal capital measurement systems of banks adequately capture interest rate risk in the banking book.
Description and findings re AC2	Interest rate risk in the banking book forms part of the ICAAP process. The bank's approach to management of interest rate risk in the banking book and the capital impact thereof is also discussed with the bank and, where required, certain recommendations are made and followed-up.
Assessment of Principle 23	Compliant
Comments	Banks in South Africa currently deal with minimal interest rate risk in the banking book due to the fact that a large percentage of lending is done on a floating rate basis. The BSD, as part of its SREP, reviews the policies and procedures in place at banks to manage such risk. The BSD also noted that they are giving IRRBB more focus in 2014 and providing additional training to members of the analysis teams.

	The assessors encourage the BSD to continue with its plans to further strengthen its review of banks' internal interest rate risk measurement systems.
Principle 24	Liquidity risk. The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
EC1	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than, those prescribed in the applicable Basel standards.
Description and findings re EC1	<p>Banks in South Africa are currently subject to two prudential liquidity requirements: a cash reserve requirement and a liquid assets requirement (both based on a percentage of adjusted external liabilities). In addition, as a member of the Basel Committee, the SARB has committed to implementing the LCR and NSFR requirements, with the LCR going into effect on 1 January 2015.</p> <p>Regulation 26 (Liquidity risk) requires both on- and off-balance sheet information on various aspects of liquidity risk to be filed with the Registrar (Form BA 300). This includes information on the LCR and NSFR ratios that the SARB is implementing according to the BCBS phase-in requirements. The regulation also provides guidance on the calculation of the LCR and NSFR.</p> <p>Directive 2/2013 (Matters relating to the LCR) was sent to all banks on in March 2013 advising banks of the BSD's intention to incorporate all the BCBS changes made to the calculation of the LCR in their document published in January 2013 (<i>Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools</i>). In addition, Guidance Note 6/2013 was sent to all banks in August 2013 detailing the provision of a committed liquidity facility (CLF) to banks by the SARB to meet LCR requirements subject to certain conditions, adopting one of Alternative Liquidity Approaches defined in the Basel text. However, banks are required to meet the 60% minimum LCR without use of CLF when the phased-in implementation of the LCR starts in 2015.</p> <p>Regulation 29 requires daily reporting of a bank's liquid asset position, as well as a daily</p>

	<p>LCR to be reported on Form BA 325.</p> <p>The BSD monitors liquidity risk through the SREP, which includes daily analysis of regulatory reports and funding levels.</p>
EC2	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	As a member of the Basel Committee, the SARB has committed to implementing the LCR and NSFR requirements. As with several other Committee member countries, certain aspects of the South African financial market make implementation of the LCR and NSFR difficult (e.g., a limited supply of government bonds, an illiquid and small corporate debt market and disintermediation of retail funding through money market funds into the banking sector). The BSD is closely monitoring bank data in order to follow the progress of banks in meeting the new requirements.
EC3	The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events, and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' Boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance
Description and findings re EC3	<p>Regulation 39(3) identifies liquidity risk as one of the types of risk that may arise from a bank's on and off-balance sheet activities. Regulation 39(4) subsequently requires a bank, as a minimum, to have in place comprehensive risk management processes, practices and procedures, and Board approved policies to identify, measure, monitor, control, and appropriately price, mitigate and communicate or report liquidity risk amongst other risk types.</p> <p>Regulation 39 also requires the risk management processes and practices to be adequate for the size and nature of the activities of the bank and for the bank to ensure that both the Board and senior management receive appropriate and timely communication on all related risks, including liquidity risk.</p> <p>The BSD, as part of its SREP, monitors adherence to the Regulation 39 requirements.</p>
EC4	<p>The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including:</p> <p>(a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks'</p>

	<p>Boards;</p> <p>(b) sound day-to-day, and where appropriate intraday, liquidity risk management practices;</p> <p>(c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide;</p> <p>(d) adequate oversight by the banks' Boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and</p> <p>(e) regular review by the banks' Boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.</p>
Description and findings re EC4	<p>Regulation 39(16) sets out the key features a bank's policies, processes and procedures relating to governance, effective risk management, adequate capital and internal controls shall contain.</p> <p>The BSD conducts both on-site and off-site ALM reviews as part of the SREP. In addition, with regard to the larger banks in South Africa, the BSD sends out a questionnaire on liquidity risk every two years. BSD staff reviews the responses to the questionnaire and additional questions might be posed. The BSD then conducts on-site work and meets with bank management where the bank's liquidity risk management is discussed in detail based in part on the results of the questionnaire. This enables the BSD to get a sense of the end-to-end management of liquidity risk at the bank. Following these meetings, the BSD sends a formal letter to the bank summarizing its findings and making recommendations, where necessary. In addition, through peer comparison, the BSD is able to formulate a view on industry best practice and identify leaders and laggards.</p>
EC5	<p>The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g., credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy, and include:</p> <p>(a) an analysis of funding requirements under alternative scenarios;</p> <p>(b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress;</p> <p>(c) diversification in the sources (including counterparties, instruments, currencies and</p>

	<p>markets) and tenor of funding, and regular review of concentration limits;</p> <p>(d) regular efforts to establish and maintain relationships with liability holders; and</p> <p>(e) regular assessment of the capacity to sell assets.</p>
Description and findings re EC5	<p>Regulation 39(5)(i) sets out the criteria for a liquidity risk function. It states that risk management processes, practices, procedures and policies shall in the case of liquidity risk be sufficiently robust to ensure that the bank:</p> <ul style="list-style-type: none"> • conducts comprehensive cash flow forecasting; • duly specifies, implements and maintains appropriate limits in respect of its funding sources, including all relevant products, counterparties and markets; • conducts robust liquidity scenario stress testing, including stress tests in respect of such bank specific or sector specific scenarios as may be specified in writing by the Registrar; • develops and maintains robust and multifaceted contingency funding plans; and • maintains a sufficient cushion of liquid assets to meet contingent liquidity needs.
EC6	<p>The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.</p>
Description and findings re EC6	<p>Regulation 26(13) requires banks to maintain a liquidity cushion, made up of unencumbered liquid assets, to protect the bank against liquidity stress events, including potential losses of unsecured and typically available secured funding sources. Regulation 36 also requires a bank to submit to the Registrar in writing qualitative information relating to its strategy in respect of contingency planning.</p> <p>In practice, the BSD reviews such contingency funding plans as part of its on-site and off-site ALM reviews. In particular, BSD staff determine how a bank arrived at the amount they need to "survive" in a crisis situation.</p>

EC7	The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programmes for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies and positions and to develop effective contingency funding plans.
Description and findings re EC7	<p>Regulations 26 and 39 set out a variety of requirements related to stress testing, including liquidity stress scenarios.</p> <p>In practice, the BSD receives the assumptions that banks apply for the idiosyncratic scenario and judge these relative to those of the bank's peers. For the BSD, the LCR requirements supersede the domestic banks' internal liquidity stress requirements, thereby providing additional assurance that liquidity is adequate. The four largest South African banks conduct liquidity simulation exercises facilitated by a third party and these exercises are observed by BSD staff. These simulations aid in "walking through" and understanding the banks' contingency funding plans.</p>
EC8	The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency, and evaluates the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities.
Description and findings re EC8	<p>Regulation 26 (Liquidity risk) sets out several requirements related to foreign currency business. Form BA 300 (monthly report) contains a table that has a foreign exchange contractual maturity ladder and analysis of this report is conducted monthly by the BSD.</p> <p>Regulation 26(12)(a)(vi) requires that, while the bank has to report its LCR in rand on a solo and consolidated basis, the bank has to continuously meet its liquidity needs in each relevant currency.</p> <p>In practice, the BSD monitors individual banks' potential vulnerability through the regular ALM reviews conducted both on-site and off-site as part of the SREP.</p>
AC1	The supervisor determines that banks' levels of encumbered balance-sheet assets are managed within acceptable limits to mitigate the risks posed by excessive levels of encumbrance in terms of the impact on the banks' cost of funding and the implications for

	the sustainability of their long-term liquidity position. The supervisor requires banks to commit to adequate disclosure and to set appropriate limits to mitigate identified risks.
Description and findings re AC1	<p>Regulation 26 addresses issues related to unencumbered assets. In particular, the following regulations apply:</p> <ul style="list-style-type: none"> • Regulation 26(12)(a) Specified minimum requirements of the LCR which requires unencumbered assets. • Regulation 26(12)(a)(iv) defines unencumbered assets referred to above. • Regulation 26(13) Available sources of stress funding and related matters • Regulation 26(14)(c) Matters related to the calculation of a bank's required amount of stable funding (RSF) – All require unencumbered assets. Table 4 • Regulation 26 (14) (c)(ii)(C) - off-balance-sheet exposures • Regulation 27 (6) Available unencumbered assets <p>The BSD determines compliance with the requirements through its off-site and on-site ALM reviews as part of the SREP.</p>
Assessment of Principle 24	Compliant
Comments	The BSD has already initiated adoption of the LCR by South African banks and intends to implement the NSFR on schedule as well. This is despite the fact that South Africa (like several other Basel Committee member countries) is disadvantaged by a limited supply of government bonds, an illiquid and small corporate debt market and disintermediation of retail funding through money market funds into the banking sector.
Principle 25	Operational risk. The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk ⁵⁹ on a timely basis.
EC1	Law, regulations or the supervisor require banks to have appropriate operational risk management strategies, policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the bank's risk profile, systemic importance, risk

⁵⁹ The Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

	<p>appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).</p>
Description and findings re EC1	<p>Regulation 39(3) identifies operational risk as one of the types of risk that may arise from a bank's on- and off-balance sheet activities. Regulation 39(4) subsequently requires a bank, as a minimum, to have in place comprehensive risk management processes, practices and procedures, and Board approved policies to identify, measure, monitor, control, and appropriately price, mitigate and communicate or report operational risk amongst other risk types.</p> <p>Regulation 39 also requires the risk management processes and practices to be adequate for the size and nature of the activities of the bank and for the bank to ensure that both the Board and senior management receive appropriate and timely communication on all related risks, including operational risk.</p> <p>In addition, in 2013, the BSD issued Guidance Note 2/2013 instructing banks to implement the principles contained in the Basel Committee's <i>Principles for the Sound Management of Operational Risk</i>. Principles 1 and 2 of the document cover the criteria contained in EC1 of this CP.</p>
EC2	<p>The supervisor requires banks' strategies, policies and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Boards. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.</p>
Description and findings re EC2	<p>Regulation 39(15) requires banks adopting an AMA for operational risk to have in place an independent operational risk management function responsible for the development of:</p> <ul style="list-style-type: none"> • Policies and procedures relating to operational risk management and control, including policies to address areas of non-compliance, which policies shall be approved by the bank's Board of directors • Strategies to identify, measure, monitor and control or mitigate the bank's exposure to operational risk <p>As mentioned in EC1, Guidance Note 2/2013 requires all banks to implement the Basel Committee's <i>Principles for the Sound Management of Operational Risk</i>. Principles 1-5 of the document cover the criteria contained in EC2 of this CP.</p>
EC3	<p>The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank's overall risk management process.</p>

Description and findings re EC3	As with other risk categories, the BSD's SREP is the primary tool for supervisory oversight of banks' management of operational risk. In addition, annual onsite reviews have been conducted by the BSD for the five largest banks to assess banks policies, and the risk management processes against these requirements. As of 2014, a two-year on-site review cycle has been implemented. For medium to small banks, on-site reviews are conducted if operational risk issues are detected by the analysts during their off-site analysis.
EC4	The supervisor reviews the quality and comprehensiveness of the bank's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
Description and findings re EC4	<p>Regulation 36(8)(b)(xi), relating to the quarterly consolidated return, requires banks to submit in writing to the Registrar qualitative information on the strategy adopted by the bank or controlling company in respect of contingency planning, including the extent to which contingency planning is centralized or managed on a business or legal entity basis.</p> <p>As mentioned in EC1, Guidance Note 2/2013 requires all banks to implement the Basel Committee's <i>Principles for the Sound Management of Operational Risk</i>. Principles 10 of the document covers the criteria contained in EC4 of this CP.</p> <p>As with other aspects of this CP, the SREP is utilized to review the quality and comprehensiveness of a bank's disaster recovery and business continuity plans.</p>
EC5	The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor and manage technology risks. The supervisor also determines that banks have appropriate and sound information technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive risk management.
Description and findings re EC5	<p>Regulation 39(3) identifies technological risk as one of the types of risk that may arise from a bank's on- and off-balance sheet activities. Regulation 67 (Definitions) defines operational risk to include inadequate or failed internal systems. In addition, IT risk is included in operational risk for the purposes of Forms BA 400 and 410.</p> <p>Guidance Note 2/2010 included information technology as part of the 'flavor of the year' topics for discussions held with the Boards of directors during 2010. Guidance Note 2/2014 includes "information technology (IT) project governance" as a topic during 2014.</p> <p>The Basel Committee paper referenced above, which all banks must adhere to, includes</p>

	<p>various aspects of information technology risks.</p> <p>The SREP includes the IT aspects of operational risk. The BSD has recently hired an additional IT expert (the IT risk team now stands at two, excluding the manager) to enhance the department's review of IT risk at individual banks and across the system as a whole.</p>
EC6	<p>The supervisor determines that banks have appropriate and effective information systems to:</p> <ul style="list-style-type: none"> (a) Monitor operational risk; (b) Compile and analyze operational risk data; and (c) Facilitate appropriate reporting mechanisms at the banks' Boards, senior management and business line levels that support proactive management of operational risk.
Description and findings re EC6	<p>Various regulations require banks to have appropriate information systems to monitor operational risk and keep the Board of directors, senior management and business units apprised of the operational risks of the bank. For example, Regulation 39(15) requires banks adopting an AMA for operational risk to have in place an independent operational risk management function responsible for the design and implementation of:</p> <ul style="list-style-type: none"> • A methodology for the measurement of the bank's exposure to operational risk • A risk reporting system relating to operational risk <p>The same regulation requires the operational risk management function to:</p> <ul style="list-style-type: none"> • Have in place an internal operational risk measurement system that is closely integrated into the day-to-day risk management processes and subject to regular validation and independent review • Have techniques to allocate capital to major business units and create incentives to improve operational risk management throughout the bank • Report on a regular basis its exposure to operational risk, including material losses, to the management of the bank's business units, senior management and the Board of directors <p>The desktop analysis stage of the SREP is one of the key methods for supervisory verification of the information systems related to operational risk at individual banks, which provides that banks:</p> <ul style="list-style-type: none"> • Shall have in place adequate measures to take appropriate action, including in cases of

	<p>non-compliance with internal policies, controls and procedures</p> <ul style="list-style-type: none"> • Shall duly document the bank's operational risk management systems • Shall have in place a process to ensure compliance with the bank's documented set of internal policies, controls and procedures concerning the operational risk management system • Shall have in place a robust operational risk management process, which is subject to regular review by the bank's internal and/or external auditors
EC7	The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.
Description and findings re EC7	Form BA 400 – Operational risk: six-monthly return - (for banks utilizing the BIA, Standardized or Advanced Measurement Approaches for calculating the capital requirement for operational risk) and Form BA 410 – Operational risk: six-monthly return – (for banks utilizing an AMA to submit selected information in respect of, among other things, the bank's loss event types, recorded losses and recovery of losses, which information is based on specified business lines and specified loss event types) are utilized to capture information on banks' operational risk, to determine that they are holding adequate capital against such risk and to obtain information on bank-specific internal loss data. Banks that utilize the Standardized Approaches, although not specifically required to do so as per the Regulation, have also been requested bilaterally to complete Form BA 410.
EC8	<p>The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management programme covers:</p> <ul style="list-style-type: none"> (a) Conducting appropriate due diligence for selecting potential service providers; (b) Structuring the outsourcing arrangement; (c) Managing and monitoring the risks associated with the outsourcing arrangement; (d) Ensuring an effective control environment; and (e) Establishing viable contingency planning. <p>Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</p>
Description and	Regulation 39(3) identifies outsourcing of material tasks or functions as one of the types of

findings re EC8	<p>risk that may arise from a bank's on and off-balance sheet activities. Regulation 39(4) subsequently requires a bank, as a minimum, to have in place comprehensive risk management processes, practices and procedures, and Board approved policies to identify, measure, monitor, control, and appropriately price, mitigate and communicate or report outsourcing risk amongst other risk types.</p> <p>Regulation 39 also requires the risk management processes and practices to be adequate for the size and nature of the activities of the bank and for the bank to ensure that both the Board and senior management receive appropriate and timely communication on all related risks, including outsourcing risk.</p> <p>Regulation 36(8) requires banks to provide the Registrar with qualitative information relating to the control structure adopted by the bank or controlling company relating to outsourcing.</p> <p>Regulation 48 (Internal audit) requires the internal audit function to be a permanent function of the bank; however, a bank may outsource some of its internal audit functions subject to the prior written approval of, and such conditions as may be specified in writing by, the Registrar. In these instances, the bank's Board of directors and senior management shall remain ultimately responsible for the adequacy and effectiveness of the bank's system of internal controls and internal audit.</p> <p>Guidance Note 3/2008 deals with outsourcing functions within banks. As mentioned in EC1, Guidance Note 2/2013 requires all banks to implement the Basel Committee's Principles for the Sound Management of Operational Risk, various sections of which relate to outsourcing.</p> <p>As part of the supervisory process, BSD staff reviews documents such as bank-specific outsourcing arrangement questionnaires, in order to satisfy themselves that due diligence procedures related to outsourcing have been followed.</p>
AC1	<p>The supervisor regularly identifies any common points of exposure to operational risk or potential vulnerability (e.g., outsourcing of key operations by many banks to a common service provider or disruption to outsourcing providers of payment and settlement activities).</p>
Description and findings re AC1	<p>Guidance Note 3/2014 states that effective risk data aggregation and reporting could assist with identifying common points of exposure to operation risk as well as potential vulnerabilities.</p> <p>As part of the SREP review, the BSD takes note during on-site visits of outsourcing to common service providers in the industry. A typical service provider that falls within this scope in South Africa is Telkom, which provides fixed-line data and voice to the whole</p>

	<p>industry.</p> <p>Staff from the BSD also attends the Operational Risk Subcommittee (ORS) of the Financial Sector Contingency Forum (FSCF). The primary objectives of the FSCF are to identify potential threats of a systemic nature that may adversely impact the stability of the South African financial sector, to develop and coordinate appropriate plans, mechanisms and structures to mitigate these threats, and to manage systemic crises. The ORS comprises stakeholders from the South African Reserve Bank, the Payments Association of South Africa, the Johannesburg Stock Exchange, the National Disaster Management Centre, STRATE, Financial Services Board, Banking Association of South Africa, BankServ Africa and the five largest banks in the country.</p>
Assessment of Principle 25	Compliant
Comments	The SARB has developed a robust program for assessing the quality of operational risk management at individual banks. This combines on-site and off-site analysis of the systems in place at banks. The BSD has enhanced the specialist team for operational risk, which includes IT experts.
Principle 26	Internal control and audit. The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent ⁶⁰ internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
EC1	<p>Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank's Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address:</p> <p>(a) Organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g., clear loan approval limits), decision-making policies and</p>

⁶⁰ In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

	<p>processes, separation of critical functions (e.g., business origination, payments, reconciliation, risk management, accounting, audit and compliance);</p> <p>(b) Accounting policies and processes: reconciliation of accounts, control lists, information for management;</p> <p>(c) Checks and balances (or “four eyes principle”): segregation of duties, cross-checking, dual control of assets, double signatures; and</p> <p>(d) Safeguarding assets and investments: including physical control and computer access.</p>
Description and findings re EC1	<p>The Banks Act contains several provisions related to internal controls and audit. These include:</p> <ul style="list-style-type: none"> • Section 60A – compliance function of banks; • Section 60B – corporate governance; and • Section 64 – audit committee of a bank or controlling company. <p>In addition, various regulations set out the key elements of the internal control, audit and compliance functions.</p> <ul style="list-style-type: none"> • Regulation 39 – process of corporate governance, inter alia setting out requirements pertaining to Board members and executive and senior management of banks, including the requirement to ensure the establishment, implementation and effective functioning of adequate internal control frameworks. • Regulation 40 – guidelines relating to the conduct of directors, including the requirement to report annually to the Registrar on the adequacy and effectiveness of a bank’s internal control framework. • Regulation 41 – composition of the Board of directors, including the prohibition of the chairman of a bank or controlling company being on the audit committee of the controlling company or any of its banks. • Regulation 46 – requirement for external auditors to annually assess banks’ internal control frameworks and to identify and report to the Registrar any weaknesses. • Regulation 48 – requirements pertaining to the internal audit function of banks. • Regulation 49 – requirements pertaining to the compliance function of banks. <p>The SREP cycle (notably Stages 2 to 4), includes a wide range of interactions with banks and the external auditors of banks in order to gather information relating to, and assess the</p>

	<p>adequacy and effectiveness of, banks' internal control frameworks. Any material weaknesses identified will be documented and communicated to the bank, either to executive/senior management or the Board of directors, and actions by the bank to address weaknesses will be tracked until resolved.</p> <p>In addition, periodic reviews are performed in respect of internal audit and compliance reports, as well as external audit reports to further facilitate BSD's assessment and monitoring of the internal control frameworks of banks.</p>
EC2	The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank's Board) to be an effective check and balance to the business origination units.
Description and findings re EC2	In addition to the tools and measures described in EC1, annual meetings with the chief executive officer, head of internal audit, head of the compliance function and the external auditors will include a discussion of human resources. This will include discussions on such matters as staff numbers, skills, experience, turnover, and segregation of duties. Agendas pertaining to prudential meetings with operational and other functional and administrative managers, as per the supervisory program, will typically also include a discussion on these topics.
EC3	The supervisor determines that banks have an adequately staffed, permanent and independent compliance function ⁶¹ that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function are suitably trained, have relevant experience and have sufficient authority within the bank to perform their role effectively. The supervisor determines that the bank's Board exercises oversight of the management of the compliance function.
Description and findings re EC3	<p>BA Section 60A and Regulation 49 (Compliance function) require all banks in South Africa to establish an independent compliance function. Further, Regulation 49 prescribes minimum requirements pertaining to the compliance function, including:</p> <ul style="list-style-type: none"> • The compliance function shall be headed by a senior executive officer of the bank with the authority to communicate directly and freely in respect of any relevant matter, including, for example, decisions made by the management of the bank that may be in conflict with legal or regulatory requirements with the members of chairman of the bank's Board of directors, with the members or chairman of the audit committee or

⁶¹ The term "compliance function" does not necessarily denote an organizational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

	<p>with the external auditor of the bank.</p> <ul style="list-style-type: none"> • The compliance function shall have adequate resources and stature in order to ensure that non-compliance with laws and regulations or supervisory requirements by the bank can be duly addressed. <p>In addition, Regulation 39 (Process of corporate governance) includes the requirement that Board members and executive and senior management of banks ensure that compliance risk is adequately monitored and managed.</p> <p>Staff of the BSD holds annual meetings with the head of the compliance function of banks in order to discuss and assess the appropriateness and effectiveness of the function. These discussions cover a wide range of topics relevant to the compliance function, including reporting lines into the governance structures of the bank. These meetings are based on an agenda prepared by the BSD. Any material weaknesses identified during these meetings are documented and communicated to the bank, either to executive/senior management or the Board of directors (if regarded as necessary owing to the materiality of the issue) and actions by the bank to address weaknesses will be tracked until resolved.</p> <p>In addition, periodic reviews are performed in respect of internal audit and compliance reports, as well as external audit reports to further facilitate the BSD's assessment and monitoring of the appropriateness and effectiveness of a bank's compliance function.</p>
EC4	<p>The supervisor determines that banks have an independent, permanent and effective internal audit function⁶² charged with:</p> <ol style="list-style-type: none"> (a) Assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank's business; and (b) Ensuring that policies and processes are complied with.
Description and findings re EC4	<p>Regulation 48 (Internal audit) states that "in order to evaluate and improve the effectiveness of a bank's risk management, control, capital management and governance processes and/or systems, a bank shall establish an independent and objective internal audit function..." The regulation sets out the requirements pertaining to the internal audit function of banks, including:</p> <ul style="list-style-type: none"> • The audit function shall form an integral part of the ongoing monitoring of the bank's system of internal controls, and the bank's internal capital assessment procedure;

⁶² The term "internal audit function" does not necessarily denote an organizational unit. Some countries allow small banks to implement a system of independent reviews, e.g., conducted by external experts, of key internal controls as an alternative.

- Based on the nature and extent of the bank's operation and risk exposure, shall be appropriately structured within the bank's governance structure;
- Based on the governance structure of the bank, shall report directly to the bank's chief executive officer, Board of directors or audit committee;
- Shall have sufficient resources and appropriately trained staff;
- Shall be functionally independent from the activities audited and the day-to-day internal control processes of the bank;
- Shall be able to conduct any assignment with objectivity and impartiality;
- Shall be headed by a senior executive officer of the bank with the authority to communicate directly and freely...with the members or chairman of the bank's Board of directors, with the members or chairman of the bank's audit committee, or with the external auditor of the bank, where appropriate;
- Shall be subject to independent review...by an independent person or committee such as external audit or the bank's audit committee;
- Shall adopt and comply with all relevant generally accepted internal audit standards;
- May from time to time meet with the bank's external auditor...and shall provide the bank's external auditor access to any relevant internal audit reports;
- Shall have in place a sufficiently robust process in order to follow up responses that relate to audit findings, whether or not recommendations have been implemented, and whether or not the department's concerns were appropriately addressed'
- Shall regularly report to and advise senior management and the Board of directors or audit committee on the performance of the internal control system and the achievement of the objectives of the internal audit department.

Annual meetings are held between the BSD and the head of internal audit of banks in order to discuss and assess the appropriateness and effectiveness of the function. These discussions cover a wide range of topics relevant to the internal audit function, including reporting lines into the governance structure of the bank. The meetings are based on an agenda prepared by the BSD. Any material weaknesses identified during these meetings are documented and communicated to the bank, either to executive/senior management or the Board of directors (if regarded as necessary owing to the materiality of the issue) and actions by the bank to address weaknesses will be tracked until resolved.

	<p>The BSD is furnished annually with the internal audit plan of a bank. In addition, periodic reviews are performed in respect of internal audit and compliance reports, as well as external audit reports to further facilitate BSD's assessment and monitoring of the appropriateness and effectiveness of a bank's internal audit function.</p> <p>The appropriateness, effectiveness and work performed by the internal audit function are also discussed at the annual meeting held with the audit committee of banks.</p> <p>Most supervisory dealings with bank management across the bank's operations typically include an agenda item dealing with internal audit interaction and findings.</p>
EC5	<p>The supervisor determines that the internal audit function:</p> <ul style="list-style-type: none"> (a) Has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; (b) Has appropriate independence with reporting lines to the bank's Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations; (c) Is kept informed in a timely manner of any material changes made to the bank's risk management strategy, policies or processes; (d) Has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; (e) Employs a methodology that identifies the material risks run by the bank; (f) Prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and (g) Has the authority to assess any outsourced functions.
Description and findings re EC5	<p>See description provided in EC4 above.</p> <p>The various requirements of EC5 typically form part of the items discussed during annual meetings with the heads of internal audit.</p>
Assessment of Principle 26	Compliant
Comments	The BSD closely monitors the adequacy of internal controls and compliance at individual banks. Through such off-site practices as the review of banks' internal reports and regular meetings with Board audit committees, internal auditors and compliance officers, the BSD

	is able to assess the quality of internal controls and audit at banks.
Principle 27	Financial reporting and external audit. The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
EC1	The supervisor ⁶³ holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.
Description and findings re EC1	<p>IFRS accounting standards are applied to all banks and controlling companies in South Africa without any deviations.</p> <p>BA Section 75 as well as Regulations 3(1), 4(1) and 44(1) of the Regulations relating to Banks, place the onus on the management of a bank to prepare financial statements in accordance with International Financial Reporting Standards (IFRS) and that management takes responsibility for these.</p> <p>Sections 24 (Forms and standards for company records) and 28 (Accounting records) of the Companies Act refer to the requirements for banks to maintain records. Sections 29 (1) and 29 (5) require that financial statements conform to the financial reporting standards. Section 30(1) further requires that the financial statements be prepared annually.</p> <p>BA Section 85 places the responsibility on the management of the bank to certify the returns or any other documents (which would therefore include financial statements) submitted to the Registrar as correct. This would therefore imply that they have been prepared as required.</p>
EC2	The supervisor holds the bank's Board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor's opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.
Description and	Regulation 46(6) requires that audit reports be rendered in accordance with the wording and practices of the Independent Regulatory Board for Auditors (which conforms to

⁶³ In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.

findings re EC2	<p>internationally accepted auditing practices and standards).</p> <p>Section 30(2) of the Companies Act requires that annual financial statements be audited and section 30(3) requires that they include an auditor's report.</p> <p>Section 90 of the Companies Act details the requirements for an auditor of a company (bank), including the independence requirement (Section 90(2)(b)) and registration with the Independent Regulatory Board for Auditors (Section 90(2)(a)).</p> <p>BA Section 65 places the duty on the bank to furnish the Registrar with copies of the financial statements. Regulation 46 (1) requires that annual returns submitted to the Registrar be audited.</p>
EC3	<p>The supervisor determines that banks use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.</p>
Description and findings re EC3	<p>Regulation 3(1) specifies that all returns shall be prepared in accordance with Financial Reporting Standards and regulation 3(2) states that the same accounting policy shall apply to both the annual financial statements and the regulatory returns, unless otherwise provided.</p> <p>Regulations 2 and 3(3) address the need for returns submitted to the Registrar to be reconcilable to the bank's management accounts and/or Board reports and annual financial statements.</p> <p>Regulation 3(4) addresses the requirement for banks adopting the fair value option to have robust risk management policies, procedures and controls in place, to comply with the requirements of the relevant Financial Reporting Standard, and be subject to independent verification and validation.</p> <p>In practice, BSD staff makes such determinations as part of their ongoing supervisory work, supported in part through their discussions with banks' external auditors.</p>
EC4	<p>Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality based approach in planning and performing the external audit.</p>
Description and findings re EC4	<p>Section 5 of the Companies Act gives prevalence to the Auditing Profession Act. In terms of Section 2(c) of the Auditing Profession Act, the Act is aimed at improving the development and maintenance of internationally comparable ethical standards and auditing standards for auditors. The Independent Regulatory Board for Auditors established under the</p>

	<p>Auditing Profession Act has adopted the International Standards on Auditing issued by the International Auditing and Assurance Standards Board as the applicable auditing standards to be applied by registered auditors (responsible for the audit of banks). The ISAs (ISA 300, 315 and 320) include requirements for audits to be conducted following a risk and materiality based approach in planning and performing an external audit.</p> <p>Regulation 46 deals with the additional scoping requirements for auditors in relation to the audits of banks.</p>
EC5	Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.
Description and findings re EC5	International Standards on Auditing (ISAs) determine that a risk and materiality based approach be followed when planning and conducting audits. Audits of banks include areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting. In addition, Regulation 46(4) requires that the auditor report to the Registrar specifically on the granting of loans, the making of investments, the ongoing management of the loan and investment portfolios and the relevant credit impairments, loan loss provisions and reserves.
EC6	The supervisor has the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.
Description and findings re EC6	<p>BA Section 61(3) gives the power to the Registrar to either refuse the application for the appointment of an auditor or withdraw any approval of an auditor due to reasons specified in the section. The form BA 006 is to be completed by banks for approval of appointment of an auditor.</p> <p>Section 62 provides that the Registrar may appoint an auditor if for any reason the bank fails to make such appointment.</p>
EC7	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings re EC7	Section 92 of the Companies Act requires that auditors (specifically, the senior partner) be rotated from time to time (typically every five years).

	BA Section 61(3) also states that the Registrar may refuse the re-appointment of an auditor who has already served the prescribed number of years consecutively.
EC8	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re EC8	<p>Regulation 46(9) provides for discussions to be held between the auditors and the Registrar to discuss matters pertaining to the audit of a bank. Bilateral meetings are held between the BSD and the auditors of each bank annually (refer to BA Section 4(4)(e)).</p> <p>In addition, the BSD participates in various banking industry groups where interaction with external audit firms takes place.</p>
EC9	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re EC9	<p>Regulation 46 (Audit reports) Sections (2)-(4) detail the scope of the auditors' reporting requirements to the Registrar, which includes the requirements relating matters of material significance, compliance with laws and regulations and significant deficiencies in internal controls.</p> <p>BA Section 63(1) details the functions of the auditor in relation to the Registrar and includes the requirement for the auditor to report on matters which may endanger the bank's ability to continue as a going concern, impair the protection of depositors' funds, be contrary to the principles of sound management (including risk management) or amounts to inadequate maintenance of internal controls.</p> <p>Section 63(3) further states that an auditor acting under the Act may not under any circumstances be deemed to be in contravention of the law or code of professional conduct to which the auditor may be subject.</p> <p>In addition, bilateral meetings are held between BSD staff and the external auditors prior to an audit to discuss, amongst other things, any areas of concern as well as scoping requirements for the year's audit. Trilateral meetings are also held after an audit between the BSD, external auditors and the audit committee of the bank to discuss key external and internal audit findings.</p>
AC1	The supervisor has the power to access external auditors' working papers, where necessary.

Description and findings re AC1	In terms of BA Section 4(4) the Registrar may review the work done by an external auditor of a bank.
Assessment of Principle 27	Compliant
Comments	Banks in South Africa are required to publish their financial statements based on IFRS standards, and to have the statements audited. The supervisory process is based, in part, on a strong working relationship between the BSD and banks' external auditors.
Principle 28	Disclosure and transparency. The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.
EC1	Laws, regulations or the supervisor require periodic public disclosures ⁶⁴ of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC1	<p>Regulation 43 (Public disclosure) sets out the detailed requirements for public disclosure of information by banks and states that:</p> <ul style="list-style-type: none"> • a bank shall disclose in its annual financial statements and other disclosures to the public, reliable, relevant and timely qualitative and quantitative information that enables the users of that information, among other things, to make an accurate assessment of the bank's financial condition, including its capital adequacy position, and financial performance, business activities, risk profile and risk management practices... <p>Regulation 43(2) details the extent of disclosures to be made by banks to ensure that they reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.</p> <p>Subject to certain conditions as may be specified in writing by the Registrar, Regulation 43(3) states that when a bank is controlled by a controlling company, another bank, or an institution approved by the Registrar that conducts business similar to the business of a bank in a country other than South Africa, the requirements of Regulation 43 shall apply to such controlling company, bank or institution instead of the bank.</p> <p>Financial disclosures are made in line with the requirements of IFRS as part of the annual</p>

⁶⁴ For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

	<p>financial statements and are audited as part of the external audit of banks.</p> <p>The Registrar has also fully implemented the Pillar 3 disclosure requirements set out in Basel II. Regulation 43 (3) requires that all bank controlling companies submit the full set of Pillar 3 disclosures.</p>
EC2	<p>The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.</p>
Description and findings re EC2	<p>Regulation 43(2) requires that both qualitative and quantitative disclosures be made and sets out the detailed disclosure requirements. This includes disclosures on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, governance and remuneration. Disclosures related to aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration are included in the required IFRS disclosures as part of the annual financial statements. Banks' disclosures are periodically reviewed by the BSD's relationship teams/bank analysts as part of their ongoing work.</p> <p>In reviewing the annual reports of several banks, the assessors determined that the scope of disclosure for banks is quite extensive, including both qualitative and quantitative information.</p>
EC3	<p>Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.</p>
Description and findings re EC3	<p>Regulation 43(2) requires banks to disclose information relating to material entities in the group structure.</p>
EC4	<p>The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.</p>
Description and findings re EC4	<p>The Pillar 3 Disclosure function of the BSD (with the aid of the risk and analysis teams) is responsible for the review and enforcement of disclosure standards.</p> <p>Pillar 3 disclosures submitted by banks are reviewed according to resource availability. These disclosures are reviewed for completeness and reconciled on a sample basis to the supervisory returns. Neither the Pillar 3 requirements nor the Regulations relating to Banks require that Pillar 3 disclosures be audited; however, where material errors/discrepancies</p>

	<p>are noted as part of the BSD's review, these are communicated to the bank in question.</p> <p>Directive 8 of 2013 was issued to communicate banks' revised Pillar 3 disclosure requirements in line with the changes in the Basel III framework.</p>
EC5	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings re EC5	<p>The South African Reserve Bank (SARB) publishes information relating to the banking sector on a monthly basis.</p> <p>The data series includes such topics as balance sheet and off-balance sheet activities, capital adequacy, large exposures and such risk categories as credit, liquidity, market, interest rate risk in the banking book, counterparty and currency.</p>
AC1	The disclosure requirements imposed promote disclosure of information that will help in understanding a bank's risk exposures during a financial reporting period, for example on average exposures or turnover during the reporting period.
Description and findings re AC1	The SARB adheres to and has fully adopted the Pillar 3 disclosure requirements as prescribed by the Basel framework.
Assessment of Principle 28	Largely Compliant
Comments	<p>The banks in South Africa are required to disclose a wide range of information to the public on a regular basis.</p> <p>As is permitted under the Basel capital framework, Pillar 3 disclosures are not currently audited. Therefore it is important for these disclosures to be reviewed on a consistent basis by BSD staff. Currently, the reports are only reviewed on a sporadic basis. With recent staff increases, the BSD should endeavor to assign the responsibility for reviewing the Pillar 3 disclosures to either analysts or other individuals with the requisite skills. The alternative to a consistent internal review process would be to impose a requirement that the reports be reviewed by the banks' external auditors.</p>
Principle 29	Abuse of financial services. The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical

	and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities. ⁶⁵
EC1	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	<p>BA Sections 3, 4, 5, 6, 7, 8, 9, and 10 give powers to the Registrar to supervise banks. Furthermore, in the Regulations relating to Banks:</p> <ul style="list-style-type: none"> • Regulation 39 requires a bank to manage its risk, of which one of the risks includes "detection and prevention of criminal activities." • Regulation 47 dealing with reportable offences requires banks to report an offence in writing to the Registrar within 30 days after the bank became aware of any Money Laundering (ML)/Terrorist Financing (TF) activity in which the bank was involved and which was not identified in a timely manner and reported as required by law, including those requirements contained in the Financial Intelligence Center Act (FICA). • BA Regulation 50 requires a bank to have robust structures, policies and processes in place to guard against market abuse, financial fraud, market manipulation, financing of terrorism and money laundering. <p>FICA Schedule 2 lists the SARB and the Registrar as a supervisory body. Each supervisory body listed in Schedule 2 has the primary responsibility for supervising those accountable institutions regulated or supervised by it for compliance with the FICA and the Money Laundering and Terrorist Financing Control Regulations. FICA Section 45 sets out the supervisory responsibilities relating to accountable institutions. Every supervisory body is responsible for supervising and enforcing compliance with the FICA or any order, determination or directive made in terms of the FICA by all accountable institutions regulated or supervised by it. Then, FICA Section 45(1A) inserts this duty into the statutory mandate of each supervisory body and makes it a core function of that supervisory body.</p> <p>FICA Section 45B gives powers to the BSD to conduct routine inspections to confirm that banks are committed to ensuring that their business is conducted in conformity with high ethical standards, laws and regulations. Section 45B (b) gives powers to the BSD to conduct non-routine inspections. The Constitutional Court in 2014 ruled this power of non-routine inspections as unconstitutional on the ground of the right to privacy and the prohibition of</p>

⁶⁵ The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit (FIU), rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8 and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

	<p>warrantless searches. The assessors were informed that the Court ordered such inspections to be suspended 18 months after the ruling and the relevant authorities are preparing to amend the act before the deadline.</p> <p>The FIC, the Financial Intelligence Unit in South Africa, or BSD may in terms of Section 43A issue directives regarding the application of the FICA. For directives specifically applies for banks, the BSD is assumed to issue such directives.</p>
EC2	<p>The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.</p>
Description and findings re EC2	<p>FICA Section 42 requires banks, as accountable institutions to formulate and implement internal rules concerning key requirements contained in the FICA and related Regulations.</p> <p>The Money Laundering and Terrorist Financing Control Regulations, Chapter 5 in Regulations 25, 26 and 27 provide guidelines on policies, processes and working methods to be implemented in order to demonstrate appropriate money laundering and terrorist financing internal controls within an accountable institution. A specialized AML/CFT review team was established within the BSD in 2011. The BSD has created an internal Anti-Money Laundering and Combating the Financing of Terrorism Supervisory Manual (AML/CFT manual), within which it has set out the processes and procedures to be followed by the BSD in carrying out its supervisory duties as outlined in the FICA. In order to protect the integrity of the banking system from being compromised by money laundering and the financing of terrorism and proliferation, the AML/CFT manual contains detailed guidelines on how the department will undertake supervision and assessment of compliance of a bank's AML/CFT controls through both on-site and off-site responsibilities. In the BSD's view, this links to the mission of the BSD, which is "to promote the soundness of the banking system and to minimize systemic risk through the effective and efficient application of international regulatory and supervisory standards."</p> <p>As part of its off-site supervision, the BSD also receives monthly statistical AML returns from banks which provide updated information on:</p> <ul style="list-style-type: none"> • Whether the bank's policies and rules on anti-money laundering and terrorist financing control measures had been updated during the past month. • Number of suspicious transaction reports (STR's) during the past month, including the total of amounts involved and particular mention of the highest amount involved. • Statistics and breakdown of the number of employees that received AML/CFT specific

	<p>training during the past month.</p> <p>The BSD's onsite inspection on AML/CFT procedures includes amongst others procedures to assess the adequacy of banks' internal rules and working methods (policies and procedures) to prevent the bank being used for money laundering and the financing of terrorism. The onsite inspection is conducted based on risks a bank poses to the system. The supervisory plan is formulated by information provided by various sources including off-site analysis, meeting with bank management, internal and external auditors' reports, among others.</p> <p>Since the AML/CFT team was established in 2012, large banks as well as some foreign branches with strong cross-border operations were chosen as the priority for on-site activities. After all of these inspections are completed, the focus has shifted to smaller banks, although not all banks have been covered. The BSD explains they look at not only bank sizes but also their business such as customer bases and products they offer, in prioritizing banks. The inspections for large banks are conducted by around 10 staff members and take 6-8 weeks. For small banks, the team could consist of around 5 staff members and take as short as 3 weeks. Usually, these inspections result in 40-50 findings.</p> <p>As mentioned in EC1, the Regulations, particularly Regulation 50, set out general requirements for banks to have in place robust structures, policies and processes to manage ML/FT risks. Although the primary AML/CFT legislation (FICA) does not provide a firm legal basis for the BSD to assess adequacy of specific AML/CFT policies and procedures against the international best practices and take supervisory actions accordingly, the BSD, on the basis of its broader supervisory powers provided by the BA and its Regulations, expects banks to apply a risk-based approach by establishing ML/FT risk assessment frameworks and taking proportionate mitigating measures. Thus, in the BSD's view, the scope of its supervision has extended beyond the current FICA to require implementation of the non-enforceable FIC Guidance Notes (in particular Guidance Note 3) and the FATF standard such as enhanced CDD measures on high risk customers. However, this interpretation is not yet officially tested as the formal sanctions applied to banks so far are based on the FICA and not the BA.</p> <p>In order for the BSD to apply a risk-based approach in its supervision of ML/FT risk in banks, preliminary risk matrix and other supervisory tools are being developed to help identify higher risk institutions to which on-site inspections should be targeted. Since the transformation from a rules-based supervisory approach to a risk-based one is still at an early stage, the BSD's supervisory practices have not yet fully adapted to this transformation and the supervisory expectations have not been communicated sufficiently clearly to, nor fully internalized by the banks.</p>
EC3	<p>In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when</p>

	such activities/incidents are material to the safety, soundness or reputation of the bank. ⁶⁶
Description and findings re EC3	<p>Regulation 47, dealing with reportable offences, requires banks to report an offence in writing to the Registrar of Banks within 30 days after the bank became aware of any money laundering and financing of terrorism activity in which the bank was involved and which was not identified in a timely manner and reported as required by law, including those requirements contained in the FICA. Furthermore, reportable offenses also includes those incidents that results in or will result in the bank losing in excess of one percent of its qualifying capital and reserve funds. The assessors were informed that this has happened before where a bank found that their reporting process had not been properly followed.</p> <p>In addition, FICA Sections 27, 28, 28A , 29, 30 and 31 require banks to report information that may be related to crime to authorities for further investigation and prosecution where necessary.</p>
EC4	<p>If the supervisor becomes aware of any additional suspicious transactions, it informs the financial intelligence unit and, if applicable, other designated authority of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities.</p>
Description and findings re EC4	<p>FICA Section 36 stipulates that if the BSD knows or suspects that an accountable institution such as a bank, wittingly or unwittingly has received or is about to receive the proceeds of unlawful activities or has been used or may be used in the future for money laundering purposes, it must advise the FIC and any other supervisory body and furnish all information and records.</p> <p>The FIC shares financial intelligence information with law enforcement agencies such as South African Police Services, Directorate for Priority Crime Investigation, and the South African Revenue Services. The law enforcement authorities investigate and prosecute based on the financial intelligence produced by the FIC.</p> <p>The BSD's supervisory procedures ensure that banks have suspicious transaction detection systems and processes in place. There are specific inspection procedures that include a review by the BSD of suspicious and unusual transactions detected by automated systems or by staff and determining whether these transactions were analyzed by the bank and reported to the FIU. There were cases that as a result of onsite inspections the BSD identified unreported suspicious and unusual transactions as well as unreported large cash transactions. The BSD in these instances informed the FIC of the aforementioned non-reporting.</p>

⁶⁶ Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national centre, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

EC5	<p>The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall risk management and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management programme, on a group-wide basis, has as its essential elements:</p> <ul style="list-style-type: none"> (a) A customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks; (b) A customer identification, verification and due diligence programme on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant; (c) Policies and processes to monitor and recognize unusual or potentially suspicious transactions; (d) Enhanced due diligence on high-risk accounts (e.g., escalation to the bank's senior management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk); (e) Enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons); and (f) Clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five year retention period.
Description and findings re EC5	<p>(a) FICA Section 21 sets out the customer identification and verification requirements. The Money Laundering and Terrorist Financing Control Regulations, Chapter 5, Regulations 25 and 26 set out the requirement to have documented internal rules related to the establishment and verification of customer identities, as well as the record keeping rules together with guidelines on policies, processes and working methods to be implemented. The FIC issues guidance based on section 4(c) of the FIC Act to assist accountable institutions and the relevant supervisory bodies with the practical application of certain requirements of the FICA. FICA assigns relevant supervisors the duties to assess accountable institution' alignment with the guidance provided through the Guidance notes, through the supervisory body inspection powers and responsibilities contained in section 45. FICA Guidance note 3 sets out the client acceptance policy requirements under</p>

paragraph 5.

(b) Money Laundering and Terrorist Financing Control Regulations, Chapter 1, Regulations 3 to 16 provide for the specific customer identification and verification requirements for different categories of clients. Regulation 19 provides requirements regarding the ongoing maintenance of customer information. This is supplemented by FICA Guidance note 3 paragraph 14 provides further details, including conduct of due diligence reviews on existing relationships at appropriate times.

(c) Money Laundering and Terrorist Financing Control Regulations, Regulation 27 sets out the requirement of accountable institutions to have internal rules concerning the detection and reporting of suspicious and unusual transactions.

(d) FICA Guidance note 3 sets out under paragraphs 2, 3, 4 and 5 the due diligence processes to be followed in respect of higher risk customers. For example, paragraph 4 provides a detailed list that should be considered in identifying higher risk customers. Then, paragraph 5 requires a graduated customer acceptance policy for higher risk customers.

(e) FICA Guidance note 3 also sets out under paragraphs 25 to 27, the enhanced due diligence requirements in respect of Politically Exposed Persons, including the escalation to senior management for related decisions.

(g) FICA Sections 22, 23, 24, 25, and 26 stipulate the record-keeping requirements including records to be kept, retention period, admissibility of records and access to such records.

The BSD's onsite inspection procedures assess whether banks comply with CDD, record-keeping requirements in the various legislation and FIC Guidance notes as outlined above. In addition, the inspection procedures also assesses banks compliance to the "internal rules" requirements, essentially ensuring that banks have policies, procedures and working methods for CDD, enhanced CDD for higher risk customers. The onsite assessment goes further and assesses the adequacy of these policies, procedures and working methods, which includes an assessment of the banks' risk-based approach to customer acceptance and general CDD. In case of a bank controlling company, the BSD's assessment covers group-wide policies, although the FICA requirements only apply to banks.

The BSD also at on-site inspections assesses banks' enhanced due diligence procedures for the acceptance of higher risk customers such as politically exposed persons or higher risk transactions such as money services businesses and trade finance transactions.

As mentioned in EC2, in the BSD's view, although FICA Guidance notes themselves do not have power of law, the BSD can take supervisory measures based on these guidelines as these are regarded to set expectations for structures, policies, processes and procedures

	<p>that banks need to adhere as stipulated in BA Regulation 50 on such issues as identifying customers, maintaining ethical standards in all business transactions, providing adequate training and guidance to staff, maintaining internal records of transactions, and reporting suspicious customers and transactions, among others. In practice, the BSD's inspections often includes findings regarding compliance with FICA guidance notes, the banks' corrective actions on which are followed-up off-site.</p> <p>The BSD recently imposed administrative fines on 4 large banks for their failures to comply with the FICA, which was detected through its on-site activities. Failures in the CDD practices were one of the reasons for the fines.</p>
EC6	<p>The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include:</p> <ul style="list-style-type: none"> (a) Gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and (b) Not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
Description and findings re EC6	<p>FICA Guidance note 3 for Banks sets out under paragraph 28, citing this EC, the AML/CFT control measures that need to be put in place by a bank in respect of correspondent banking relationships which includes gathering sufficient information about the respondent bank.</p> <p>A number of principles set out by the Wolfsberg group have been used to determine the risk indicators to be considered in order for a bank to ascertain the AML/CFT risks associated to having a relationship with a particular respondent bank, and then to determine to commensurate level of due diligence to be undertaken in respect of such bank.</p> <p>The BSD's inspection procedures includes and assessments of the existence of and the adequacy of bank's internal rules, policies and procedures and working methods in dealing with correspondent banks. The BSD explains that the correspondent banking inspection procedures were developed from the standards in the FATF Recommendations as well as the FICA Guidance note listed above.</p>
EC7	<p>The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.</p>

Description and findings re EC7	<p>FICA Sections 27, 28, 28A, 29 and 32 set out the reporting obligations in respect of threshold reports, property associated with terrorists and related activities, suspicious and unusual activities as well as information requests from authorized persons.</p> <p>Regulation 21 of the Money Laundering and Terrorist Financing Control Regulations sets out the requirement for accountable institutions to obtain information that will assist in identifying proceeds of unlawful activities or money laundering activities. Regulation 27 sets out the requirement for accountable institutions to have internal rules concerning the detection and reporting of suspicious and unusual transactions.</p> <p>In practice, a large number of banks in South Africa utilize customer screening systems and automated suspicious and unusual transaction monitoring systems to detect banking system abuse and potential or suspected money laundering and terrorist financing activities. Manual processes of client monitoring is also utilized by all banks to detect and report banking system abuse and identify potential or suspected money laundering and terrorist financing activities.</p> <p>On-site inspection procedures have been developed and are incorporated within the AML/CFT manual which is used during supervisory interactions and inspection to determine the robustness of the preventative controls put in place within a bank to safeguard against money laundering, terrorist financing and associated financial crime based on Regulation 50, among others. As explained in EC1, the comprehensive on-site inspections focusing on AML/CFT has been conducted since the establishment of responsible teams in 2012, with inspections on all large banks has completed. As mentioned below, these inspections led to the recent application of administrative fines for large banks due to weakness in their frameworks, including their controls and systems over monitoring and reporting suspicious transactions.</p>
EC8	The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.
Description and findings re EC8	<p>The amendment to the FICA in 2010 empowered the BSD in terms of section 45C to impose administrative sanctions on banks non-compliant with the Act. The BSD exercised these powers very recently by fining most of the large banks in April 2014 based on the findings of on-site inspections.</p> <p>Furthermore, As requirements by FICA and relevant regulations are regarded as comprising requirements under the BA, the Registrar has can apply a number of measures under the BA, although no formal measures against banks on AML/CFT issues based on the BA have not been taken to date.</p>

EC9	<p>The supervisor determines that banks have:</p> <ul style="list-style-type: none"> (a) Requirements for internal audit and/or external experts⁶⁷ to independently evaluate the relevant risk management policies, processes and controls. The supervisor has access to their reports; (b) Established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential abuses of the banks' financial services (including suspicious transactions) are reported; (c) Adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship; and (d) Ongoing training programmes for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities.
Description and findings re EC9	<ul style="list-style-type: none"> (a) BA Regulation 48 requires banks to establish an independent and objective internal audit function to evaluate and improve the effectiveness of a bank's risk management, control and governance processes and/or systems, including those related to abuse of financial services. Copies of reports emanating from such internal and/or external audit exercises conducted are submitted to BSD. (See relevant CPs). (b) FICA Section 43(b) sets out the requirements for accountable institutions to appoint a compliance officer tasked with the responsibility of ensuring that the bank and its employees comply with the FICA and its internal rules. (c) BA Regulation 50 requires banks to have adequate structures, policies, processes and procedures to maintain high ethical standards in all business transactions. (d) FICA Section 43(a) sets out the requirement for the accountable institution to provide training to its employees in order to ensure that the bank complies with the provisions of the FICA and its internal rules. In addition, BA Regulation 50 requires banks to provide adequate training and guidance to their staff. <p>The BSD's onsite inspection procedures, as prescribed in the AML/CFT Supervisory Manual, assess banks' compliance with the regards to ongoing training of employees on AML/CFT, the appointment of an AML/CFT compliance officer. In addition, the BSD also review banks' internal audit reports on compliance with AML/CFT requirements as part of conducting AML/CFT onsite inspections. The BSD's inspection procedures also include an assessment</p>

⁶⁷ These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	<p>of whether internal audit has performed an independent review of AML/CFT, such as the suspicious transaction monitoring systems.</p> <p>As part of the quarterly AML/CFT “prudential” meetings with banks, discussions are also held with the banks on internal audit’s involvement in assessing compliance with AML/CFT requirements. Issues related to AML/CFT compliance are also discussed at prudential meetings with banks’ internal audit and compliance functions.</p>
EC10	The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks’ financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize adequate management information systems to provide the banks’ Boards, management and the dedicated officers with timely and appropriate information on such activities.
Description and findings re EC10	The BSD’s AML Teams established inspections procedures to determine whether banks have policies and processes for staff to report any problems related to the abuse of the banks’ financial services to either local management or the relevant dedicated officer or to both. It also looks at the adequacy of management information systems.
EC11	Laws provide that a member of a bank’s staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.
Description and findings re EC11	FICA Section 38 provides for the protection of persons making reports in terms of the FIC Act. The Protected Disclosures Act 26 of 2000 (PDA) protects persons who reports suspicious activities in good faith.
EC12	The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	<p>The FIC is the only institution permitted to share financial intelligence information with law enforcement agencies such as South African Police Services, Directorate for Priority Crime Investigation, and the South African Revenue Services. The law enforcement authorities investigate charge and prosecute based on the financial intelligence gathered by the FIC. The FIC further shares the state of compliance information with FATF, ESAAMLG, BIS, IMF, and Egmont Group where necessary.</p> <p>The BSD does not have the discretion to share details of suspected or actual criminal activities with external third parties, save for its duty to report and share information with the FIC and relevant supervisory bodies related to suspected facilitation of money laundering or proceeds of crime by a bank in terms of FICA Section 36.</p>

	<p>The BSD does however share issues of non-compliance with AML/CFT requirements of particular banking institutions with other domestic and international supervisory authorities with whom the BSD have a MOU in place.</p>
EC13	<p>Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.</p>
Description and findings re EC13	<p>The FIC has AML/CFT specialists who interact with accountable institutions in South Africa including banks. The FIC bears the sole responsibility for receipt and analysis of suspicious transactions reports.</p> <p>The BSD have AML/CFT specialists (10 staff members dedicated to AML/CFT solely) who are also inspectors in terms of FICA Section 45A. This BSD team is responsible to assess and enforce compliance with the FICA, and not to investigate and/ or address criminal activities.</p> <p>The FIC and BSD however jointly conduct AML/CFT prudential meetings and to discuss money laundering controls, terrorist financing controls, suspicious transaction reports and trends, predicate crimes, and cyber-crime trends.</p> <p>The BSD is afforded certain powers in terms of BA Sections 81 to 84 to control the activities of unregistered persons that have not been granted a license to operate the business of a bank by the Registrar. These activities are, however, confined to illegal deposit-taking only.</p> <p>The above-mentioned provisions provide, among other things, that the Registrar may do the following in respect of unregistered persons that are suspected of taking deposits from the general public in contravention of the BA:</p> <ul style="list-style-type: none"> • Apply to court for an order prohibiting anticipated or actual schemes involved in illegal deposit-taking. • Extract information from unregistered persons. • Inspect the affairs of an unregistered person. • Direct such a person to repay such money if the Registrar is satisfied that a person has illegally taken deposits from the general public. • Appoint a manager to manage and control the repayment of the money unlawfully obtained.
Assessment of	Largely Compliant

Principle 29	
Comments	<p>The BA and associated regulations as well as the revised FICA provide a generally adequate framework for supervising banks' policies and processes against abuse of financial services. On the implementation front, the BSD has significantly stepped up its effort for supervision of measures against abuse of financial services, including the AML/CFT measures: a dedicated unit for the AML/CFT issues was established and has been conducting on-site inspections with inspections on large banks completed; administrative fines are recently imposed on some large banks on the AML/CFT issues; and more attention is being paid to these issues in the whole SREP process.</p> <p>However, some weakness still remains. The Guidance Notes issued by the FIC which contain many essential requirements relevant to many ECs in this CP as well as the concept of risk-based approach do not have the legal enforceability under the FICA. Even though they are applied by the BSD in its supervision, their enforceability through the general supervisory power based on the BA has not yet been formally tested. In addition, on-site inspections of all banks are not yet completed.</p> <p>The assessors thus recommend:</p> <ul style="list-style-type: none"> • The authorities to proceed with the planned revision of the FICA to incorporate the risk-based approach to the AML/CFT issues and ensure the enforceability of a number of essential elements currently included in the FICA Guidance Notes. • The BSD to continue the current effort on the AML/CFT on-site inspections to cover all banks expeditiously and improve approaches and techniques based on the lessons learned.

Table 3. Summary Compliance with the Basel Core Principles

Core Principle	Grade	Comments
1. Responsibilities, objectives and powers	LC	<p>The BA and associated rules provide a broadly appropriate framework for regulating and supervising banks. It also provides clear responsibilities of and adequate powers to the Registrar of Banks and the Bank Supervision Department. However, the lack of legally defined objectives of the supervisor as well as regulation and supervision of banks is a shortcoming of the current BA and related legislation to be fully compliant with this CP. The assessors note and welcome, however, the authorities plan to address this issue in the expected twin peaks reform.</p> <p>In addition, to further improve the effectiveness and efficiency of the regulatory process, the assessors also recommend the authorities to review the following issues:</p>

Core Principle	Grade	Comments
		<ul style="list-style-type: none"> • The extent of delegation of powers in the Banks Act, with a view to transfer the power to set granular requirements from tier 2 rules (regulations), which need to be issued by the Minister, to tier 3 rules (circulars, directives), which can be issued by the Registrar. This would give more flexibility in fine-tuning the regulatory framework. • The composition of the Standing Committee for the Revision of the Banks Act, with a view to require its members to be not currently involved in not only any regulated entities but also bodies that represent interests of those regulated entities, to insulate the process from direct industry interests. Instead, as experts on financial business, the Committee could include retired officials from the industry or academics.
2. Independence, accountability, resourcing and legal protection for supervisors	LC	<p>The BSD has an appropriate level of resources with highly qualified staff and substantial specialist skills recently added, even though some of them need to accumulate experiences further. The legal protection of the supervisor is also adequate. Its operational independence is fully respected in practice, but there are a few areas where the framework needs to be enhanced to enshrine the operational independence of the supervisor in related legislation and make it fully compliant with the CP. Particularly, regarding the appointment and removal processes of the Registrar, the legal framework should be revised to include (A) a fixed term of the appointment, (B) specific reasons for the removal, and (C) the requirement to publish the reasons for removal, as required in EC2.</p> <p>In terms of the involvement of the Minister in a few supervisory actions, although the assessors understand the supervisor's decisions are respected in practice, there is a need to ensure that the Minister's power is exercised under the principle of constrained discretion. Also, improvements in regulatory frameworks such as those on competition policies that overlap with the banking legislation have possibly reduced the need for the Minister's discretion. The authorities should therefore review the legislation to limit the cases that require the Minister's involvement to those that are absolutely necessary and clarify in the laws objectives for intervention.</p> <p>Regarding the supervisory resources, while the assessors saw the current level as broadly adequate given the limited number of supervised entities, the authorities should review the adequacy of resources reflecting expected changes in the responsibility of the supervisor under the new twin peaks structure, taking into account the need for further</p>

Core Principle	Grade	Comments
		improvements in its supervisory approach as recommended in CP 8, 9 and 12.
3. Cooperation and collaboration	C	<p>Legal provisions as well as operational frameworks for cooperation and collaboration with domestic and foreign authorities are in place.</p> <p>Regarding the confidentiality of information, although the assessors view the current legal framework and its practical application provides a reasonable assurance of protecting the confidentiality of supervisory information, the reliance on SARBA Section 33 as well as the manner BA Section 89 is stipulated leave room for the information to be used for non-supervisory purposes. It is therefore recommended the authorities review the relevant provisions of the BA to ensure the confidential information shall only be used for supervisory purposes, unless specifically required by court orders or provisions in other laws as provided in EC3 and 4.</p>
4. Permissible activities	C	The Banks Act provides clear definitions of activities that are only permitted to be conducted by registered banks, including taking deposits from the public.
5. Licensing criteria	C	Provisions in the laws and regulations related to licensing and the process followed by the BSD provide a comprehensive framework to assess the adequacy of new registrations for banks, including foreign bank branches. The BSD adequately assesses applications in practice.
6. Transfer of significant ownership	C	The power given to the supervisor by laws and regulations as well as the current supervisory practices provide adequate control and oversight regarding significant ownership of a bank and a controlling company.
7. Major acquisitions	C	The regulatory framework subjects major acquisitions and investments by banks and controlling companies to prior approval by the Registrar. The BSD also has well established supervisory practices to limit and monitor risks arising from such activities.
8. Supervisory approach	LC	<p>The SREP cycle and the risk rating system provide an adequate general framework of supervisory approach for the BSD. These processes focusing on individual banks and banking groups are complemented by sector-wide approaches such as the “flavor of the year” topics as well as enhanced thematic on-site reviews.</p> <p>However, the approaches related to resolution of banks required in EC 6 and 7 are still in the process of development, which lead to the rating</p>

Core Principle	Grade	Comments
		<p>above. Although those on the recovery plans as well as contingency planning have started, work on resolution plans for systemic banks has yet to begin. The assessors understand the required power will not be given until the expected legislation on bank resolution becomes effective and urge the authorities to enact the bill expeditiously.</p> <p>Another important issue related to this principle is planned transition to the twin peaks supervisory structure. The transition should involve not only providing the prudential supervisor responsibility over various financial sector entities, but also improved oversight over systemic risk and wider financial groups. The new prudential supervisor should therefore review the supervisory approach once the organizational changes are completed in order to enable it to have capacity to monitor the prudential risk of the entire financial system as well as that of financial conglomerates. This may require a more formalized framework to detect and assess system-wide and cross-sectoral risks and its integration to supervision of individual financial groups and regulated financial institutions. New tools to address those risks may also need to be added to its arsenal, such as common scenario stress testing across different financial sectors and a risk rating framework that takes into account the entire risk of financial groups. Close cooperation with the planned Financial Stability Oversight Committee and its secretariat will be essential in these endeavors.</p>
9. Supervisory techniques and tools	C	<p>The BSD has improved its supervisory techniques and tools significantly. In particular, it has moved from a model relying substantially on external auditors for on-site work to one where the BSD's own staff conducts a number of on-site reviews to complement the work of external auditors, including deep-dive reviews that verify banks' actual practices through such means as extensive review of loan files. It has also added a number of risk specialists who conduct on-site reviews on particular risk areas including model validations, but also other topics related to particular risk areas. These improvements, in addition to detailed and intensive off-site analysis and frequent interactions with various levels of banks/banking groups, including their Boards, equip the BSD with wide-ranging high quality techniques and tools that are appropriate for providing oversight of risk profiles and operations of banks and banking groups in South Africa.</p> <p>The assessors encourage the BSD to further continue its effort to enhance its ability to conduct deep-dive on-site reviews and improve tools and technique to assess and monitor spill over risks to the banks from non</p>

Core Principle	Grade	Comments
		banking activities in their financial groups.
10. Supervisory reporting	C	The regulatory framework requires banks and controlling companies to periodically submit a broad range of information. Strong regulatory and supervisory processes exist to ensure accuracy and comparability of submitted returns. Well developed procedures for analyzing collected information and feeding into supervisory actions are in place.
11. Corrective and sanctioning powers of supervisors	MNC	<p>While there have been a few significant improvements since the last assessment, the major problem of the need for 30 days prior notice in suspending registration or restricting activities based on BA Sections 23, 24 and 26 has not been changed. The newly introduced power of directives under BA Section 6(6) as well as the application of a motion by the court could address the issue partially. But the former still requires consultation with the relevant bank and the bank may challenge on the ground that a similar due process to that of Section 24 should be required for sanctions with similar effect. The latter is yet untested and relies on a court's judgment, which may take a different position than that of the supervisor.</p> <p>Given supervisors would consider taking such drastic measures only in cases where the risk is imminent and large, impact to the public could be significant, and when the relevant bank is not cooperating with the supervisor, any possible delays in or uncertainty regarding the outcome of the process needs to be avoided. The assessors understand the strong framework for licensing and corporate governance as well as relatively stable structure of the banking industry enables the supervisor to address these issues in a cooperative manner using less formal and stringent measures in most of the cases. However, the supervisor needs to be prepared for cases where these cooperative and more informal measures may not work—the framework for corrective and enforcement actions need to cover such situations. The assessors are thus still of the view that strengthening laws to provide the Registrar with the power to suspend or limit a bank's activities without delay is essential to improve compliance with the CP.</p> <p>The lack of ability for the supervisor to fine individuals related to banks, such as Board members and senior management, is another important gap in the current regulatory framework in relation to EC5, which also contributed to the above grading.</p>

Core Principle	Grade	Comments
12. Consolidated supervision	C	<p>The supervisory and reporting framework provides an adequate framework for monitoring and assessing risks to banks in South Africa from non-banking and foreign banking operations in banking groups to be compliant with this CP.</p> <p>However, given the prevalence of conglomerate-type financial groups in South Africa, the authorities should make further effort to monitor and manage risks arising from non-banking activities or parent entities of a financial group (some of which are not bank controlling companies) to which a South African bank belongs. In this regard, as described in CP 8 and 9, the authorities should strengthen its technique, such as group-wide stress testing, to monitor and assess those risks. The authorities should further improve the recovery and resolution planning of large banking groups particularly once the necessary power is given to the supervisor by the expected new legislation. Such planning should also consider scenarios where shocks originate from non banking entities or parent groups.</p>
13. Home-host relationships	LC	<p>The current arrangements and frameworks for cooperation with foreign supervisors are broadly adequate, although cooperation with supervisors in other African countries needs further enhancement as the South African banking groups are expected to continue to expand their operations in these countries. To further improve the effectiveness of cooperation and ensure adequate oversight is carried out on African operations of South African banking groups, the assessors encourage the authorities to continue their efforts to support the capacity building of these supervisors.</p> <p>The authorities also need to finalize their policies and processes on the conduct of on-site reviews/inspections of South African banks' cross-border operations in other African countries and enhance practices, with due consideration to the risk those operations pose to the parent banks. These should in time evolve to incorporate joint supervisory activities with the host supervisors.</p> <p>The supervisor should also enhance its effort in cross-border recovery and resolution planning, lack of which is reflected in the rating of this CP. Given a few of the big banks have strong ties with the UK, the recovery and resolution plans need to be developed with close collaboration with the UK authorities. Furthermore, as a few South African banking groups' foreign operations in other African groups have become systemically important for some host jurisdictions, in developing recovery and</p>

Core Principle	Grade	Comments
		resolution plans of these groups, due regards need to be paid to the impact on these jurisdictions' financial system. This will also require close cooperation with supervisory authorities in these jurisdictions.
14. Corporate governance	C	Through regulations and practice, the SARB places strong emphasis on sound and effective corporate governance at all banks in South Africa. BSD staff is able to assess the quality of corporate governance at individual banks through regular meetings, as well as review of audit reports and Board and Board committee minutes.
15. Risk management process	C	<p>The SARB's SREP cycle places emphasis on verifying that banks have robust risk management policies and procedures.</p> <p>A recent significant increase in supervisory staff has allowed the BSD to form specialized teams to review the major risk categories. While the skills of some of the newer members of these teams are in the process of being strengthened, primarily through on-the-job experience, the teams have enhanced the BSD's understanding of the risks faced by South African banks, most especially at the largest institutions.</p>
16. Capital adequacy	C	The SARB has adopted or is in the process of adopting the various components of Basel II, 2.5 and III according to or in advance of the schedule established by the Basel Committee. Capital is calculated on a consolidated and solo basis for all banks and the BSD has the authority to impose additional capital requirements on individual banks, as deemed necessary. The BSD has applied the three Basel ratios (common equity tier 1, tier 1 and total capital) as well as systemic capital requirements, large bank capital add-ons and a "Board buffer" that ensures that banks do not fall below the minimum requirements. BSD staff regularly assesses banks' capital management and planning, most intensely at the largest (IRB) banks.
17. Credit risk	C	Regulation 39 clearly sets out the requirement for adequate policies and procedures related to credit risk management, approved by the Board of directors and effectively implemented by management. BSD staff, including the analyst(s), credit specialist team and on-site review team, takes an active role in assessing the quality of credit risk management at all banks, including as part of the SREP.
18. Problem assets, provisions, and	C	Through the use of reports submitted on a regular basis, the review of external auditor reports and selected on-site examinations, the BSD monitors problem assets at individual banks. Supervisory staff evaluates

Core Principle	Grade	Comments
reserves		<p>the adequacy of banks' provisioning for problem assets on both an individual bank and peer group basis.</p> <p>The assessors encourage the BSD to finalize as soon as possible the draft Directive on restructured credit exposures which will help to prevent banks from using restructuring to improve their classified loan levels. The compliant rating issued for Principle 18 is based, in part, on the expectation that this directive will be issued in the very near term.</p>
19. Concentration risk and large exposure limits	C	<p>Regulations require the Board and senior management to establish and maintain adequate policies and procedures related to concentration risk and large exposures. The BSD utilizes reports received from banks on a quarterly basis to monitor large exposures and risk concentrations. In addition, the BSD monitors Board and management oversight of concentration risk through the SREP and ICAAP reviews.</p>
20. Transactions with related parties	C	<p>Regulations set out a comprehensive definition of "related person" and require banks and controlling companies to conduct transactions with related parties on an arm's-length basis. In addition, Regulation 39 requires the Board and senior management of a bank to ensure that the monitoring and reporting of individual and aggregate exposures to related persons are subject to an independent individual credit review process.</p> <p>The BSD receives and reviews information on transactions with related parties on a quarterly basis. Any matters of concern would be included as a topic of discussion in prudential meetings held with individual banks.</p> <p>The assessors recommend that the SARB amend its regulations so that the Registrar has the ability to set limits on exposures to any related parties. At this point, it only has the ability to set limits on intragroup transactions and exposures.</p>
21. Country and transfer risks	C	<p>Since the last BCP assessment, Regulation 39 has been amended to specifically include country and transfer risks. In addition, the BA 210 quarterly report was amended in 2011 and now requires more granular information on bank's country and transfer risks. While the level of country and transfer risk for most banks remains relatively small, the BSD monitors such exposures on an ongoing basis through the SREP and includes this risk category as part of its discussions with bank Boards, management and auditors, as appropriate.</p>

Core Principle	Grade	Comments
22. Market risk	C	The SARB has implemented a comprehensive approach to the supervision of market risk, especially at the largest banks that have been approved for the IMA. For most banks in South Africa, market risk remains at rather modest levels.
23. Interest rate risk in the banking book	C	<p>Banks in South Africa currently deal with minimal interest rate risk in the banking book due to the fact that a large percentage of lending is done on a floating rate basis. The BSD, as part of its SREP, reviews the policies and procedures in place at banks to manage such risk. The BSD also noted that they are giving IRRBB more focus in 2014 and providing additional training to members of the analysis teams.</p> <p>The assessors encourage the BSD to continue with its plans to further strengthen its review of banks' internal interest rate risk measurement systems.</p>
24. Liquidity risk	C	The BSD has already initiated adoption of the LCR by South African banks and intends to implement the NSFR on schedule as well. This is despite the fact that South Africa (like several other Basel Committee member countries) is disadvantaged by a limited supply of government bonds, an illiquid and small corporate debt market and disintermediation of retail funding through money market funds into the banking sector.
25. Operational risk	C	The SARB has developed a robust program for assessing the quality of operational risk management at individual banks. This combines on-site and off-site analysis of the systems in place at banks. The BSD has enhanced the specialist team for operational risk, which includes IT experts.
26. Internal control and audit	C	The BSD closely monitors the adequacy of internal controls and compliance at individual banks. Through such off-site practices as the review of banks' internal reports and regular meetings with Board audit committees, internal auditors and compliance officers, the BSD is able to assess the quality of internal controls and audit at banks.
27. Financial reporting and external audit	C	Banks in South Africa are required to publish their financial statements based on IFRS standards, and to have the statements audited. The supervisory process is based, in part, on a strong working relationship between the BSD and banks' external auditors.
28. Disclosure and	LC	The banks in South Africa are required to disclose a wide range of

Core Principle	Grade	Comments
transparency		<p>information to the public on a regular basis.</p> <p>As is permitted under the Basel capital framework, Pillar 3 disclosures are not currently audited. Therefore it is important for these disclosures to be reviewed on a consistent basis by BSD staff. Currently, the reports are only reviewed on a sporadic basis. With recent staff increases, the BSD should endeavor to assign the responsibility for reviewing the Pillar 3 disclosures to either analysts or other individuals with the requisite skills. The alternative to a consistent internal review process would be to impose a requirement that the reports be reviewed by the banks' external auditors.</p>
29. Abuse of financial services	LC	<p>The BA and associated regulations as well as the revised FICA provide a generally adequate framework for supervising banks' policies and processes against abuse of financial services. On the implementation front, the BSD has significantly stepped up its effort for supervision of measures against abuse of financial services, including the AML/CFT measures: a dedicated unit for the AML/CFT issues was established and has been conducting on-site inspections with inspections on large banks completed; administrative fines are recently imposed on some large banks on the AML/CFT issues; and more attention is being paid to these issues in the whole SREP process.</p> <p>However, some weakness still remains. The Guidance Notes issued by the FIC which contain many essential requirements relevant to many ECs in this CP as well as the concept of risk-based approach do not have the legal enforceability under the FICA. Even though they are applied by the BSD in its supervision, their enforceability through the general supervisory power based on the BA has not yet been formally tested. In addition, on-site inspections of all banks are not yet completed.</p>

RECOMMENDED ACTIONS AND AUTHORITIES

COMMENTS

A. Recommended Actions

Table 4. Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks

Reference Principle	Recommended Action
Principle 1	<p>Define objectives of the supervisor in the legal framework.</p> <p>Review the extent of delegation of powers in the Banks Act, with a view to transfer the power to set granular requirements from tier 2 rules (regulations), which need to be issued by the Minister, to tier 3 rules (circulars, directives), which can be issued by the Registrar.</p> <p>Review the composition of the Standing Committee for the Revision of the Banks Act, with a view to require its members to be not currently involved in not only any regulated entities but also bodies that represent interests of those regulated entities, to insulate the process from direct industry interests. Instead, as experts on financial business, the Committee could include retired officials from the industry or academics.</p>
Principle 2	<p>Revise the legal framework for the head of the supervisor to include (A) a fixed term of the appointment, (B) specific reasons for the removal, and (C) the requirement to publish the reasons for removal, as required in EC2.</p> <p>Review the legislation to limit the cases that require the Minister's involvement to those that are absolutely necessary and clarify in the laws objectives for intervention.</p> <p>Review the adequacy of resources reflecting expected changes in the responsibility of the supervisor under the new twin peaks structure, taking into account the need for further improvements in its supervisory approach as recommended in CP 8, 9 and 12.</p>
Principle 3	<p>Review the relevant provisions of the BA to ensure the confidential information shall only be used for supervisory purposes, unless specifically required by court orders or provisions in other laws.</p>

Principle 8	<p>Enact legislation to provide the supervisor power related to resolution of banks expeditiously and develop resolution plans.</p> <p>The new prudential supervisor should review the supervisory approach once the organizational changes are completed in order to equip it with capacity to monitor the prudential risk of the entire financial system as well as that of financial conglomerates.</p>
Principle 9	<p>Continue the effort to enhance the supervisor's ability to conduct deep-dive on-site reviews.</p> <p>Improve tools and technique to assess and monitor spill over risks to the banks from non banking activities in their financial groups.</p>
Principle 11	<p>Strengthen laws to provide the supervisor with the power to suspend or limit a bank's activities without delay.</p> <p>Provide the power to fine individuals related to banks.</p>
Principle 12	<p>Strengthen the supervisory technique, such as group-wide stress testing, to monitor and assess risks arising from non-banking activities or parent entities of a financial group in which a South African bank belongs to.</p> <p>Improve the recovery and resolution planning of large banking groups particularly once the necessary power is given to the supervisor by the expected new legislation. Such planning should also consider scenarios where shocks originate from non banking entities or parent groups.</p>
Principle 13	<p>Continue efforts to support the capacity building of host supervisors of African operations of South African banking groups to further improve the effectiveness of cooperation and ensure adequate oversight of those operations.</p> <p>Finalize policies, processes and practices to conduct on-site reviews/inspections of South African banks' cross border operations in other African countries.</p> <p>Enhance its effort in cross-border recovery and resolution planning with close collaboration with the UK authorities as well as paying due regards to the impact on financial systems of jurisdictions where South African banks' operations are significant. This will also require close cooperation with supervisory authorities in these jurisdictions.</p>

Principle 18	Finalize as soon as possible the draft Directive on restructured credit exposures which will help to prevent banks from using restructuring to improve their classified loan levels.
Principle 20	Amend the Regulations so that the Registrar has the ability to set limits on exposures to any related parties.
Principle 23	Continue with the plans to further strengthen its review of banks' internal interest rate risk measurement systems.
Principle 28	Review Pillar 3 disclosures consistently either by the BSD's internal staff or by requiring external auditors to do it.
Principle 29	<p>Proceed with the planned revision of the FICA to incorporate the risk-based approach to the AML/CFT issues and ensure the enforceability of a number of essential elements currently included in the FICA Guidance Notes.</p> <p>Continue the current effort on the AML/CFT on-site inspections to cover all banks expeditiously and improve approaches and techniques based on the lessons learned.</p>

B. Authorities' Response to the Assessment

We would like to express our appreciation to the IMF assessment team for their professionalism, their guidance and their insights into supervision. We found the experience very valuable towards improving our understanding of the Basel Core Principles, and ultimately, improving the regulatory framework and supervisory processes. We also appreciated the constructive engagements with the assessment team. The recommendations will be used as input during the establishment of the new Prudential Authority (PA) to strengthen its compliance with the BCPs and assist the PA to promote and enhance the safety and soundness of financial institutions.