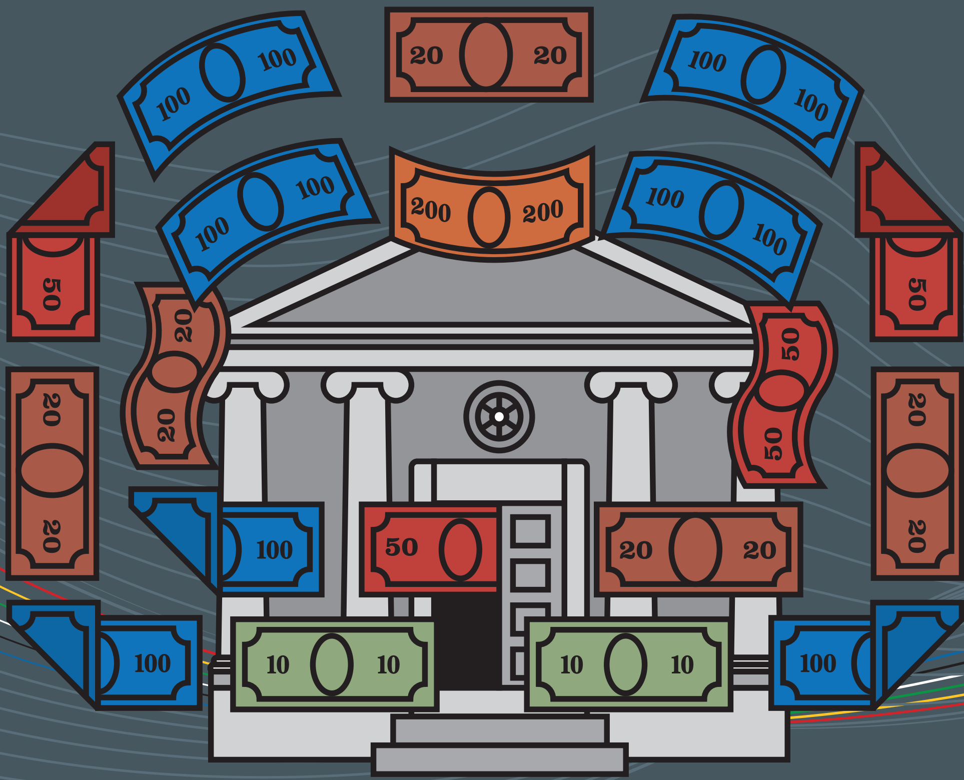

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BANKING REGULATION & SUPERVISION

Johann Scholtz, Dawid de Villiers and Lerato Lamola

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Introduction

South Africa boasts an advanced and well-regulated banking sector which aims generally to promote credibility, stability and economic growth. The principal legal instrument which seeks to achieve these aims, is the Banks Act, No. 94 of 1990 (Banks Act), and the regulations promulgated thereunder.

The South African Reserve Bank (SARB), the central bank of the country, plays an important role in banking regulation and supervision. The primary objective of the SARB is to protect the value of the South African currency in the interests of balance and sustainable economic growth. As part of this objective, the SARB is tasked generally to take such steps as may be necessary to establish, conduct, monitor, regulate and supervise payment, clearing or settlement systems.

In this context, the National Payment Systems Act, No. 78 of 1998 (the NPS Act), is relevant. The NPS Act contains provisions which are aimed at protecting the integrity of the settlement system established and operated by the SARB. The National Payment System refers generally to the infrastructure that enables individuals and organisations to transact with one another.

Importantly, the SARB is also tasked with regulating and maintaining minimum reserve balances that South African banks must hold on account with the SARB. The registration of banks; the regulation of payments, clearing or settlement systems; and the keeping of determined minimum reserve balances by South African banks, are effectively delegated by the governor of the SARB to the Office of Banks. This statutory office is part of the SARB and the Registrar of Banks (the Registrar), who is its principal official and charged with the administration of the Banks Act, among other things.

The Banks Act

The main objective of the Banks Act is to create the legal framework for the regulation and supervision of the business of accepting deposits from the South African public. To this end, the Banks Act governs the establishment of banks; the security of the investments of depositors; and the protection of the integrity of banks in the interest of the South African financial system.

The Banks Act adopts a functional approach in that it addresses the functions of accepting and employing deposits, and not the individual institutions accepting such deposits.

A "bank" is defined in the Banks Act as a public company registered as a bank in terms thereof and the "business of a bank" is defined to include, inter alia, the acceptance of deposits from the general public as a regular feature of the business in question and, more importantly, the soliciting of or advertising for deposits. A "deposit" is very widely defined in the Banks Act to cover the payment of any money by one party to another on a basis requiring the repayment of the whole or part thereof, with or without interest. The Banks Act establishes the supervisory authority of the Registrar by making registration a prerequisite for conducting the "business of a bank" in South Africa. Conducting the "business of a bank" in South Africa without being registered is an offence which attracts severe penalties.

The Banks Act sets out a number of prudential requirements which are aimed at the efficient management of banking-related risks. In this regard, the Registrar possesses extensive regulatory and supervisory powers.

The Banks Act provides that every registered bank is required to furnish returns prescribed by regulation to the Registrar in order to enable him or her to monitor compliance with the formal, prudential and other requirements imposed on banks by the Banks Act.

The Banks Act also regulates the conducting of the "business of a bank" by foreign banking institutions in South Africa. An institution which has been established in a country other than South Africa, and which lawfully conducts in that other country a business similar to the "business of a bank", may conduct the "business of a bank" by means of a branch or a representative office of the foreign institution in South Africa. This is only with the prior written authorisation of the Registrar and subject to whatever conditions, if any, the Registrar may determine.

Basel III and the South African Banking Industry

Following its implementation in many countries, including South Africa, the Basel II framework has been subject to continuous refinement, resulting in what is commonly referred to as Basel III.

Basel III is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision (primarily in response to the global economic crisis of 2008) to strengthen the regulation, supervision and risk management of the banking sector. These measures basically aim to:

- improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source;
- improve risk management and governance; and
- strengthen banks' transparency and disclosures.

As was evidenced from lessons learnt in the wake of the global economic crisis, the capital adequacy rules of Basel I and Basel II were not sufficient to address the risks posed by securitisations, derivatives and repurchase agreements, nor did they take into account the systemic risks associated with the build-up of leverage in the financial system. In addition to this, Basel I and Basel II were only focused on capital and no provision was made for internally agreed quantitative standards for liquidity.

The reforms target:

- bank-level, or micro prudential, regulation, which is designed to help raise the resilience of individual banking institutions to periods of stress; and
- macro prudential, system-wide risks that can build up across the banking sector as well as the procyclical amplification of these risks over time.

The Bank Supervision Department (Department) of the SARB commenced a formal process to amend the regulatory framework in accordance with the latest internationally agreed regulatory and supervisory best practices and standards.

The Department, as a member of the Basel Committee, will continue to be actively involved in future developments and reforms, thereby promoting the safety and soundness of the domestic banking system and supporting long-term economic growth.

The South African banking industry is currently implementing the Basel III framework using a phase-in approach. This process commenced on 1 January 2013 and is due to continue up to 2018, which is in accordance with the timelines specified by the Basel Committee. The approach has involved the adoption of the regulations relating to Banks issued under Section 90 of the Banks Act and published under Government Notice R.1029 in *Government Gazette* No. 35950, dated 12 December 2012 (the new regulations) which entered into force on 1 January 2013.

The objective of the new regulations is to provide for the establishment of basic principles relating to the maintenance of effective risk management by banks and controlling companies, with due allowance for the ancillary objective that the benefits derived by banks and controlling companies from compliance with the new regulations exceed the costs entailed by such compliance.

The new regulations repealed and replaced the old regulations. The capital framework established by the old regulations was therefore amended by the capital framework as set out in the new regulations. This is part of a broader amendment process of the current South African regulatory framework for banks in order to bring it in line with the Basel III framework.

Conclusion

The Banks Act and the regulations promulgated thereunder are the main sources of regulation and supervision of the South African banking sector. The SARB is responsible for the majority of the regulatory activities in the banking landscape, along with the Registrar of Banks, who is responsible for the administration of the Banks Act.

Due to the necessity of converting to a banking sector which is compliant with Basel III, the local regulators will over the course of the next few years implement a number of far-reaching amendments. The new regulations form the first step in adopting the Basel III framework over a period of years. This phased-in approach of implementation will be an ongoing process until its planned completion scheduled for 2018.