SOUTH AFRICAN RESERVE BANK
Prudential Authority

PROMOTING AND ENHANCING **THE SAFETY, SOUNDNESS AND INTEGRITY** OF REGULATED FINANCIAL INSTITUTIONS

PRUDENTIAL AUTHORITY ANNUAL REPORT

2019/20

CONTENTS

1 EXECUTIVE SUMMARY

FOREWORD BY THE CHAIRPERSON OF THE PRUDENTIAL COMMITTEE

DURING 2019/20, THE PRUDENTIAL AUTHORITY (PA) CONTINUED TO GROW FROM STRENGTH TO STRENGTH WITHIN THE SOUTH AFRICAN RESERVE BANK. THE PRUDENTIAL COMMITTEE (PRUCO) IS PLEASED TO PUBLISH THE SECOND ANNUAL REPORT OF THE PA, OUTLINING THE ROLE THAT THE PA HAS PERFORMED IN ACCORDANCE WITH THE FINANCIAL SECTOR REGULATION ACT 9 OF 2017 (FSR ACT).

The PA continues to promote and enhance the safety and soundness of regulated financial institutions. This mandate is carried out in accordance with the FSR Act and informed by international standards and guidelines. Notwithstanding a very difficult macro-economic environment, South Africa's financial institutions and financial system remain safe and sound.

In its second year of existence, the PA focused on strengthening its capacity, implementing domestic legislation, as well as developing prudential and supervisory frameworks that are appropriate for each sector and proportionate to the risk posed by each regulated entity. Work is underway on a new regulatory framework for financial conglomerates, with consultation on prudential and regulatory instruments at an advanced stage.

In accordance with the FSR Act, the PA also took steps in making standards regarding significant owners of financial institutions to ensure that only persons or entities deemed to be fit and proper can own significant stakes in banks, insurers and market infrastructures. These regulations come into effect towards the end of 2020.

In terms of the Insurance Act 18 of 2017 (Insurance Act), the process of converting insurance licences to comply with the new legislation must be completed by the end of June 2020. A substantive amount of work has gone into this process and the PA is on track to meet this deadline.

The spread of the coronavirus disease 2019 (COVID-19) across the world has had a major impact on economies and financial systems. South Africa, like many other countries, responded to the crisis by putting in place various fiscal, monetary and regulatory support measures. A number of prudential policy interventions were issued by the PA covering banks and insurers. The relief measures for banks included a reduction in the minimum liquidity and capital requirements. The guidance notes covered accounting issues and the payment of dividends and bonuses by banks.

As envisaged in the FSR Act, the PruCo continued to perform its oversight role over the PA. The PruCo is satisfied with the PA's progress in executing its strategy.

E L (Lesetja) Kganyago
Governor of the South African Reserve Bank and Chairperson of the Prudential Committee

OVERVIEW BY THE CHIEF EXECUTIVE OFFICER OF THE PRUDENTIAL AUTHORITY

THE PA'S SECOND YEAR OF OPERATION WAS SUCCESSFUL. THE TWO MAIN AREAS OF PROGRESS WERE IN DEVELOPING THE PA'S CAPACITY AND IMPLEMENTING THE LEGISLATIVE FRAMEWORK THAT GOVERNS THE PA. NOTWITHSTANDING A DIFFICULT ECONOMIC ENVIRONMENT AND RAPID TECHNOLOGICAL CHANGES, THE PA HAS MADE GOOD PROGRESS IN PROMOTING AND ENHANCING THE SAFETY AND SOUNDNESS OF THE INSTITUTIONS IT REGULATES.

In addition to promoting and enhancing the safety and soundness of regulated institutions, which is the primary mandate of the PA, the law also obliges the PA to advance financial inclusion, competition and transformation. On all three fronts, the financial sector has made good progress, though the weak economic environment mutes some of the effects of the steps taken by policymakers and regulators to build a more inclusive economy and financial sector.

Strengthening and embedding the work of the PA involves enhancing our human capacity and skill set, investing in technology that enables better supervision and data analysis, and developing a culture consistent with that of the South African Reserve Bank (SARB) – one that values ethical behaviour, integrity, open communication and professionalism. The PA has made solid progress in enhancing its human capacity and developing a new culture. Efforts to introduce a single supervisory information technology (IT) system have, however, been slower than anticipated.

A critical success factor for the PA is our collaboration with other financial sector regulators, and in particular the Financial Sector Conduct Authority (FSCA). In addition to several memorandums of understanding signed in 2018 with other regulators, the past year was characterised by deep engagement on data sharing, regulatory cooperation and IT architectures. While deepening its relationship with the FSCA, the PA has also had regular engagements with the Financial Intelligence Centre (FIC), the National Credit Regulator and the South African Revenue Service. These engagements are aimed at minimising the duplication and overlap of regulation for regulated financial institutions and enhancing the effectiveness of our financial sector laws.

Key highlights of the PA's work in 2019/20 include having:

- built stronger and deeper relations with other financial sector regulators;
- developed a regulatory framework on governance in the sector;
- issued directives on significant owners;
- made good progress in converting insurance licenses to new order licenses consistent with new laws;
- drafted prudential standards for financial conglomerates;
- developed a framework for the prudential supervision of market infrastructures;
- continued to participate in numerous international standard-setting forums; and
- intensely participated in both the International Monetary Fund (IMF)/World Bank's Financial Sector Assessment Programme (FSAP) and the Financial Action Task Force's Mutual Evaluation exercise.

During the last two weeks of the financial year, economic activity slowed sharply due to the impact of COVID-19 and the lockdowns intended to stem its spread. During this turbulent period, the PA acted speedily to monitor the impact of the virus and the lockdown on all regulated institutions, provide regulatory relief to banks and insurers, and offer guidance on how to manage the crisis from regulatory and accounting perspectives.

The leadership and staff of the PA have established a reputation as regulators that act with integrity, professionalism and diligence. I would like to thank all the PA staff for their hard work and the good-natured manner in which they interact with each other and with outside stakeholders. I would also like to thank the entities regulated by the PA. These engagements are robust but professional. I welcome the maturity with which we can discuss difficult issues and, ultimately, your commitment to delivering a safer financial system for the people of South Africa.

K (Kuben) Naidoo
Deputy Governor and CEO of the
Prudential Authority

2 GOVERNANCE STRUCTURE

PRUDENTIAL COMMITTEE

THE FSR ACT PRESCRIBES THE GOVERNANCE STRUCTURE (INCLUDING THE PRUCO), RESOURCES, FINANCIAL MANAGEMENT AND REPORTING OBLIGATIONS OF THE PA.

Governor and Chairperson
E L (Lesetja) Kganyago

Deputy Governor and
CEO of the Prudential Authority
K (Kuben) Naidoo

Deputy Governor
N (Nomfundo) Tshazibana

Deputy Governor
R (Rashad) Cassim

PruCo met nine times during the reporting year. All records were maintained accordingly by the PruCo Secretariat.

Chairperson

Governor of the SARB

Members

Deputy Governors, with one of the Deputy Governors being the CEO of the Prudential Authority

Standing invitees

The four Prudential Authority Heads of Department

Responsibilities

- Provides oversight on the management and administration of the PA to ensure that it is efficient and effective.
- Oversees the implementation of key matters assigned to the PA by various laws pertaining to the financial sector.
- Authorises the CEO of the PA to sign memorandums of understanding with other international regulators.
- Develops prudential and joint standards as well as other regulatory instruments in terms of various laws pertaining to the financial sector.
- Approves the *Prudential Authority Annual Report* for tabling at the National Assembly.

OPERATIONAL STRUCTURE

Deputy Governor and CEO: Prudential Authority
K (Kuben) Naidoo

The Prudential Authority Management Committee (PA Manco) is responsible for the general operations and management of the PA regarding policy as well as regulatory and supervisory matters. In addition, the PA Manco provides advisory, technical and administrative support to the PruCo. The PA Manco, chaired by the CEO of the PA, meets on a monthly basis, with all its activities being coordinated by its Secretariat.

Head: Financial Conglomerate Supervision Department
D (Denzel) Bostander

Financial Conglomerate Supervision Department

This department is responsible for the consolidated prudential supervision of institutions designated as financial conglomerates, as well as for the supervision of anti-money laundering and countering the financing of terrorism (AML/CFT).

Head: Risk Support Department
F (Faizel) Jeena

Risk Support Department

This department is responsible for providing regulatory and supervisory support on credit, operational, market, liquidity and insurance risk, as well as for quantitative and actuarial analysis and financial institution statistics.

Head: Banking, Insurance, CFIs* and FMI** Supervision Department
S (Suzette) Vogelsang

Banking, Insurance, Co-operative Financial Institutions* and Financial Market Infrastructure Supervision Department**

This department is responsible for the prudential supervision of the medium- to smaller-sized banks, insurance companies and co-operative financial institutions (CFIs), as well as securities and derivative market infrastructures, on both a solo and a consolidated basis, where applicable.

Head: Policy, Statistics and Industry Support Department
U (Unathi) Kamlana

Policy, Statistics and Industry Support Department

This department oversees policy formulation and the development and implementation of regulatory and supervisory frameworks. It provides operational support, industry analysis and technical support on capital and accounting requirements, as well as support on legal administration and enforcement responsibilities.

As part of its day-to-day activities, the PA set up the following technical governance structures which serve as internal advisory structures to the CEO of the PA: Policy Panel, Licensing Panel, Restructures and Expansions Panel, PA Regulatory Action Committee, Risk and Capital Review Panel, Conversions Panel and Designation Panel.

3 PROGRESS AGAINST THE PA REGULATORY STRATEGY 2018–2021 AND RELATED FRAMEWORKS

The *Regulatory Strategy 2018–2021*, published on 1 October 2018, sets out the PA's approach to regulation and supervision and its key priorities for the period 2018–2021:

1 **Strengthen the regulation and supervision of banking institutions** with updating regulatory requirements related to mutual banks; assessing the co-operative banks framework and develop prudential standards for CFIs.

The Banks Act 94 of 1990 (Banks Act)

The PA continues to strive to ensure that the legal framework for the regulation and supervision of banks remains relevant and current. The legal framework pertaining to banking regulation should reflect both local and international market developments, and should comply with international regulatory and supervisory standards and best practice. The PA continually reviews banking legislation, including the Banks Act, banking regulations and related legislation.

Regulations relating to Banks (Regulations)

As part of the internationally agreed regulatory reforms to promote the safety and soundness of the international financial system, the Basel Committee on Banking Supervision has issued various new and revised frameworks and requirements. These include the so-called Basel III post-crisis regulatory reform package for implementation by member jurisdictions. In order to ensure adequate engagement with all interested key persons and that the potential impact, costs and benefits of the proposed regulations are duly considered and measured, the PA issued a statement of expected impact together with the proposed amendments to the Regulations, along with an invitation for all interested persons to submit comments.

During the past year, the PA:

- held extensive discussions with key stakeholders on the implementation of relevant internationally agreed regulatory reforms in South Africa;
- issued Guidance Note 6 of 2019 in November 2019, which sets out the proposed implementation dates for the Basel III post-crisis reforms; and
- released for public consultation:
  - a standardised approach for measuring counterparty credit risk exposures;
  - capital requirements for banks' equity investments in funds;
  - a capital standard for bank exposures to central counterparties;
  - a supervisory framework for measuring and controlling large exposures;
  - the total loss-absorbing capacity holdings standard;
  - revisions to the securitisation framework; and
  - capital treatment for simple, transparent and comparable short-term securitisations.

On 16 August 2019, the National Treasury published proposed amendments to the Regulations, inviting the public to submit their comments by no later than 6 September 2019. These proposed amendments primarily related to:

a. incorporating all the substantive requirements relating to the revised Basel III net stable funding ratio framework, some components of which are currently contained in the Regulations while others are contained in directives;

b. deleting all the detailed disclosure requirements currently specified in the Regulations, and consolidating all the disclosure requirements issued by the Basel Committee on Banking Supervision as part of the first and second phases of the revision to the Pillar 3 disclosure requirements into a single directive; and

c. incorporating further relevant revised requirements relating to corporate governance.

The comments were reviewed and amendments were tabled at the PruCo, and approved on 25 November 2019. These amendments were submitted to the National Treasury and the Minister of Finance for consideration and approval.

On 3 May 2019, the PA issued a proposed directive related to amendments to the Regulations, dealing with the following:

a. a standardised approach for measuring counterparty credit risk exposures;

b. a capital standard for bank exposures to central counterparties; and

c. capital requirements for banks' equity investments in funds.

The proposed directive allowed for public comment by 13 June 2019. The PA responded to the comments and updated the proposed amendments to both the Regulations and the directive, which were submitted to the PruCo on 28 January 2020. On 3 February 2020, the PA issued the updated proposed directive and amendments to the Regulations, with an implementation date of 1 October 2020. A further round of public consultation took place, inviting comment by 15 March 2020.

On 5 December 2019, the PA issued a proposed directive related to another set of amendments to the Regulations, primarily dealing with revised frameworks issued by the Basel Committee on Banking Supervision for member jurisdictions, with an implementation date of 1 January 2021. These amendments include:

a. a supervisory framework for measuring and controlling large exposures;

b. the total loss-absorbing capacity holdings standard; and

c. revisions to the securitisation framework.

The proposed directive invited comment by 15 February 2020. The PA has been reviewing the comments received and prepared its response.

Co-operative financial institutions, co-operative banks and mutual banks

The PA continues to ensure that the legal framework for the regulation and supervision of banks, banking groups and other deposit-taking institutions remains relevant and current. The ongoing reviews focus on developing an appropriate and proportional regulatory framework for CFIs, co-operative banks and mutual banks. The regulatory frameworks are cognisant of the PA's role in financial inclusion and transforming the financial sector.

To this end, the PA has developed the following regulatory frameworks for CFIs and co-operative banks:

a. Guidance Note 2 of 2019, which was published on 16 September 2019, guides prospective CFIs in developing business plans and drafting savings and loans policies. This documentation is a key requirement for registration as a CFI under the Co-operative Banks Act 40 of 2007 (Co-operative Banks Act).

b. Guidance Note 1 of 2020, which was published on 3 March 2020, assists prospective CFIs and co-operative banks in applying for registration with the PA. The note provides a model constitution upon which such entities can design their respective constitution as required by the Co-operatives Act 14 of 2005 and the Co-operative Banks Act.

In November 2019, the PA started to review the Supervisors' Rules issued under the Co-operative Banks Act in 2010. A suite of prudential standards is being developed to update the Supervisors' Rules and Regulations issued under the Co-operative Banks Act that will address the regulation of CFIs and co-operative banks.

On 3 February 2020, the PA made a determination on the form, manner and period within which information and reports must be submitted. This allows for the electronic submission of returns and the creation of a unique identity number for each co-operative bank.

THE PA AND THE NATIONAL TREASURY PLAN TO REVIEW THE DEPOSIT-TAKING LANDSCAPE TO ASSESS WHETHER CURRENT LEGISLATION ALLOWS FOR A PROGRESSIVE TIERED APPROACH TO DEPOSIT-TAKING IN SOUTH AFRICA.

This assessment will include a review of the Mutual Banks Act 124 of 1993 to determine whether it is fit for purpose, given the existing structure of mutual banks and the impact of technology and innovation in the provision of banking services. The PA plans to update the mutual banks framework to ensure it is appropriately based on market developments and the level of risk of mutual banks' activities.

2 **Implement prudential regulation and supervision of financial conglomerates,** including working to obtain a holistic view of group-wide activities, intragroup transactions and large exposures.

The PA is developing the regulatory framework for the regulation and supervision of financial conglomerates and has finalised its designation criteria.

In March 2020, the PA published the following draft prudential standards for a second round of informal consultation:

a. Prudential Standard FC01 – Capital requirements for financial conglomerates – Technical

b. Prudential Standard FC01 – Capital requirements for financial conglomerates – Principle-based

c. Prudential Standard FC02 – Intragroup transactions and exposures for financial conglomerates

d. Prudential Standard FC03 – Auditor requirements for financial conglomerates

e. Prudential Standard FC04 – Governance and risk management for financial conglomerates

f. Prudential Standard FC05 – Risk concentrations for financial conglomerates

3 **Prudentially regulate market infrastructures,** including strengthening their resilience and ensuring that international principles related to market infrastructures are adhered to, where appropriate.

The PA continues to develop regulatory and supervisory arrangements for market infrastructures which are informed by the provisions of the Financial Markets Act 19 of 2012 as well as the powers and responsibilities of the PA as set out in the FSR Act.

During December 2019, the PA and the FSCA jointly released the following frameworks for public comment:

a. Draft Joint Standard – Requirements relating to central counterparty licence applications

b. Draft Determination – Requirements relating to external central counterparty or external trade repository licence applications

c. Draft equivalence framework

The public consultation period ended on 21 February 2020 and comments are being reviewed with the aim of finalising and implementing these frameworks in 2020.

Margin requirements for non-centrally cleared over-the-counter derivative transactions

The PA and FSCA have developed the draft joint standard on margin requirements for non-centrally cleared over-the-counter derivative transactions. This joint standard was submitted to Parliament on 25 November 2019, served its 30-day statutory period and was subsequently approved by the PruCo and the Transitional Management Committee of the PA and FSCA respectively. Once the joint standard has been published and made (by June 2020), the PA and FSCA intend to consult the industry on the effective date for implementation of the margin requirements.

The PA and FSCA are also developing:

- minimum requirements on the recovery plans of market infrastructures;
- further guidance on the governance requirements for market infrastructures; and
- further guidance on the cyber-resilience applicable to market infrastructures.

The PA and FSCA intend to release these draft frameworks for consultation in July 2020.

Discussion paper on reforms to financial markets

In February 2020, the National Treasury issued a discussion paper for public comment titled 'Building competitive financial markets for innovation and growth: A work programme for structural reforms to South Africa's financial markets'. The paper proposes reforms to the regulatory and legislative framework for domestic financial markets and supporting competitive financial markets that are enabling and responsive. The PA continues to engage within the SARB, the FSCA and the National Treasury on these proposals, as the reforms to the financial markets will have an impact on the objective of the PA regarding the safety and soundness of market infrastructures and assisting in maintaining financial stability.

4 **Prudentially regulate and supervise insurers** by embedding the insurance Solvency Assessment and Management principles and issuing further regulatory instruments as per the Insurance Act.

The insurance standard setting out the fees payable for applications made in terms of the Insurance Act came into effect on 1 January 2020. The PA is finalising the draft prudential standards to prescribe the regulatory information that must be audited. An industry task team was established to determine the regulatory information that must be audited, as well as the level of assurance required for each item of information. The PA will release the draft prudential standards in April 2020 for a six-week consultation period.

5 **Establish a framework for significant owners,** including the development of regulatory standards for significant ownership.

The PA and FSCA have developed a joint standard setting out the requirements on the fitness and propriety of significant owners of financial institutions. It also outlines what constitutes an increase or decrease in the ability of a person, alone or together with a related or inter-related person, to control or materially influence the business or strategy of a financial institution. The Joint Standard on fitness, propriety and other related matters related to Significant Owners was submitted to Parliament on 27 November 2019 and served its 30-day statutory period at Parliament. Once the joint standard is approved by PruCo and the Transitional Management Committee, it will be published and made a standard. The joint standard will come into effect on 1 December 2020.

6 **Conclude memorandums of understanding** with other financial sector regulators, namely the FSCA, the National Credit Regulator, the FIC and the SARB.

The PA has been carrying out its functions through collaboration and coordination with the relevant regulators as set out in the memorandums of understanding.

THE PA ALSO FOCUSED ON OTHER PRIORITIES, IN LINE WITH ITS MANDATE TO PLAY A SUPPORTING ROLE. THESE PRIORITIES INCLUDE:

a. Transformation of the broader financial sector

Transformation of the financial sector is one of the objectives of the FSR Act. The Act defines 'transformation of the financial sector' as envisaged by the Financial Sector Code for Broad-Based Black Economic Empowerment issued in terms of section 9(1) of the Broad-Based Black Economic Empowerment Act 53 of 2003. The Insurance Act, as the first financial sector law enacted since the FSR Act, goes further by placing certain requirements on the PA relating to transformation of the insurance sector. The PA is considering transformation in light of the objectives of the FSR Act and its responsibilities towards transformation in the Insurance Act. The PA's approach to transformation for the other regulated financial sectors is also being considered and will be addressed on a medium- to long-term horizon.

b. Sustainable competition in the provision of financial products and services

The PA aims to balance its primary objective of ensuring the safety and soundness of PA-regulated financial institutions with supporting competition. The PA and other regulators are developing a policy position paper on its approach to supporting competition.

c. Financial inclusion and developments in financial technology (fintech)

THE PA'S APPROACH TO SUPPORTING FINANCIAL INCLUSION IS INFORMED BY THE NATIONAL TREASURY'S STRATEGY FOR FINANCIAL INCLUSION. A PA POSITION PAPER IN THIS REGARD IS BEING DEVELOPED.

The PA is a member of the Intergovernmental Fintech Working Group, which is a forum for regulators to gain deeper insights on the role of fintech innovation in driving financial inclusion. This working group should enable the regulation of responsible innovation to improve financial stability and the efficient functioning of financial markets. In addition, the PA plays a key role in the Innovation Hub set up by the SARB Fintech Unit, which enables regulators and market innovators to better understand innovative solutions and regulations for South Africa. A Regulatory Guidance Unit, set up in the Innovation Hub, provides a streamlined entry point for navigating the regulatory environment; an opportunity for the PA to use data and insights to inform policy development; and informal, non-binding direction to entities requesting assistance related to financial services regulations.

d. Medical schemes, pension funds, collective investment schemes and friendly societies

The PA's regulatory landscape will be widened to include the prudential supervision of other types of financial institutions outlined in the FSR Act, such as pension funds, collective investment schemes, friendly societies and medical schemes. These are currently regulated by the FSCA and the Council of Medical Schemes respectively. The PA, together with the National Treasury, the FSCA and the Council of Medical Schemes has established various task teams to determine how these types of financial institutions will be regulated from 1 April 2021 onwards. These teams will also assess the feasibility of the 2021 time frame, on the basis of which the Minister of Finance will make a decision.

e. Sustainable finance, including climate change

In line with the increased prominence of sustainable finance and climate change issues on the agendas of international regulatory organisations, the PA actively participated in related discussions through its membership in the Sustainable Insurance Forum and the Basel Committee on Banking Supervision.

In July 2019, the SARB formally joined the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). The NGFS aims to help strengthen the global financial sector's response to meeting the Paris Agreement goals, including by enhancing the role of financial systems in managing risks and mobilising capital for green and low-carbon investments. The SARB is also an active member on key work streams to address climate-related supervisory practices, develop analytical climate risk frameworks and develop green taxonomies.

In 2019, the PA surveyed the domestic banking and insurance sector on its implementation of the recommendations of the Task Force on Climate-related Financial Disclosures. The Financial Stability Board established this industry-led initiative to develop voluntary, consistent climate-related financial disclosures that help investors, lenders and insurance underwriters understand material risks.

The conclusions drawn from the survey indicate:

- an acute awareness among financial institutions (banks and insurers) that climate change will have a significant impact on their business, although awareness is higher in the insurance sector; and
- a need for more climate-related reporting is required to enhance industry's understanding of climate risk to better inform business planning and strategy conversations.

The PA intends to publish a document outlining proposals to insurers and banks to consider climate risks as part of their Pillar 2 assessments. The PA will enhance its supervisory processes and activities in assessing climate risks within its overall risk assessment process for financial institutions. Furthermore, the PA recognises the importance of introducing specific climate reporting as a component of regulatory reporting requirements.

THE WORLD BANK AND IMF FSAP

Earlier this year, the PA participated in South Africa's 2020 FSAP Article IV review with teams from the World Bank and IMF. FSAP reviews, conducted in a number of countries globally, assess the stability and developmental needs of financial systems to help mitigate the severity and likelihood of crises within the financial sector.

The 2020 FSAP mission included an assessment of regulators' oversight of the financial sector in relation to:

- the identification of systemic risk and emerging regulatory and supervisory matters;
- risk and financial analysis;
- AML/CFT;
- fintech developments and cyber-resilience ; and
- climate risks and sustainable finance.

A report of the findings will be published by the IMF and World Bank in the latter part of 2020.

PA STRATEGIC FOCUS AREA

VALUE PROPOSITION: PROMOTE AND ENHANCE THE SAFETY, SOUNDNESS AND INTEGRITY OF REGULATED FINANCIAL INSTITUTIONS

Since the establishment of the PA, work continues to focus on embedding its operational processes within the SARB for providing regulatory oversight to ensure the safety and soundness within the financial system. The PA has made significant progress in its supervision of market infrastructures by putting in place the required supervisory frameworks and processes.

The PA has strengthened its relationships with various internal and external stakeholders, including regulatory bodies. It has also developed various regulatory frameworks, prudential and joint standards, and other regulatory instruments, and it consults broadly with all its stakeholders on these matters.

THE PA'S 2019/20 STRATEGIC SCORECARD

Value proposition

Strategic measures	Target (annual)	2019/20 (annual)	2018/19 (annual)	
Percentage of financial institutions that meet or exceed the quantitative prudential standards for systemically important financial institutions (SIFIs)	**100%** or under adequate regulatory action	100%	100%	✓
Weighted percentage of financial institutions that meet or exceed the quantitative prudential standards for non-SIFIs[1]	**90%** or under adequate regulatory action	95%	90%	✓
Compliance with sound governance and risk management practices as required by different industry legislation for SIFIs (proportionate application of smaller banks and CFIs)	**100%** of institutions fully compliant or under specific regulatory action	100%	90%	✓
Weighted percentage of non-SIFIs that comply with sound governance and risk management practices required by different industry legislation[2]	**90%** of institutions fully compliant or under adequate regulatory action	75%	-	◒

1 Non-SIFIs: smaller banks or small- to medium-term insurers.
2 Reported for the first time.

Note: The measure that was partially met carries a very small scorecard weighting and therefore does not negatively affect the overall scorecard achievement.

✓ Target met ◒ Target partially met

Progress made during the year

To embed the PA while enhancing risk-based, outcomes-focused and forward-looking supervision.

- √ Strengthened integrated regulatory and supervisory approach
- √ Leveraged technologies to enhance supervision
- √ Enhanced relationships with external stakeholders through formal, structured workshops and engagements
- √ Published joint standards on trade repositories and margin requirements for non-centrally cleared derivatives
- √ Issued supervisory guidelines

PA target operating model

The PA has designed its target operating model (TOM) and identified three initiatives for implementation over a five-year period:

a. Foundation: Initiatives critical to enabling the PA to execute the TOM

b. Priority: Initiatives focusing on building priority capabilities for the PA

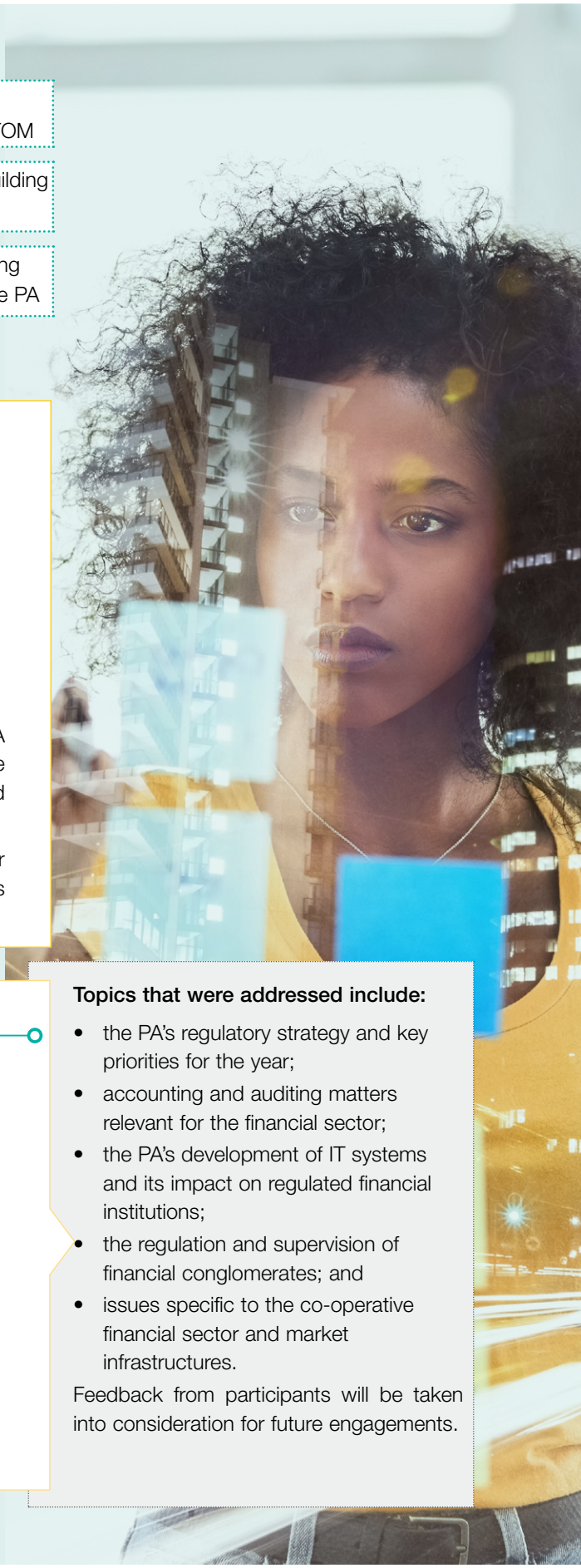
c. 2020 onwards: Initiatives delivering more advanced capabilities in the PA

The implementation of the TOM will be supported by:

- the delivery of an industry data taxonomy, allowing for both the PA and industry to have a shared understanding of the data terms used in the various returns the PA collects from supervised entities;
- the review and improvement of internal PA processes to enhance supervisory practices and efficiencies; and
- the implementation of IT solutions to enhance and transform regulatory processes.

A number of initiatives are under way between the PA and FSCA to improve processes between the two regulators, including the integration of technology to support the Twin Peaks model and to improve data collection from supervised entities.

The PA will continue to engage with industry and other stakeholders to provide updates on the progress of initiatives and its impact on supervised entities.



PA industry engagements

A key element of the PA's strategy is to continually engage with industry and the public on issues that arise in the supervision of the financial sector. In addition to routine meetings with individual entities, the PA engages with the associations representing various participants in the sector, including the Banking Association South Africa, the South African Insurance Association and the Association for Savings and Investment South Africa.

In October 2019, the leadership of the PA held regulatory workshops with the various sectors to provide updates on regulatory and supervisory matters impacting the financial sector.

Topics that were addressed include:

- the PA's regulatory strategy and key priorities for the year;
- accounting and auditing matters relevant for the financial sector;
- the PA's development of IT systems and its impact on regulated financial institutions;
- the regulation and supervision of financial conglomerates; and
- issues specific to the co-operative financial sector and market infrastructures.

Feedback from participants will be taken into consideration for future engagements.

4 KEY HIGHLIGHTS IN 2019/20

MARKET DEVELOPMENTS AND THE PA'S CRISIS MANAGEMENT ON THE IMPACT OF COVID-19 WITHIN THE REGULATED FINANCIAL SECTOR

While 2020 began with some optimism that South Africa's economy would recover, the negative impact of COVID-19 on economic prospects has been severe. Global supply chains have been disrupted, commodity prices have fallen and financial markets have experienced unprecedented price movements. While significant uncertainty remains on how the global pandemic will affect countries, many economic analysts are already predicting that the COVID-19 recession could be the worst since the Great Depression in the 1930s. Governments and central banks around the world have taken unprecedented action to respond to the health crisis, including through the closure of major economic sectors, alongside economic measures to moderate the economic effects.

In March 2020, South Africa exited the World Government Bond Index after losing its investment grade rating. This resulted in a significant increase in bond yields over and above what other emerging markets have experienced due to COVID-19. In addition, Moody's Investors Service downgraded the long-term local and foreign currency deposit ratings of the five large South African banks from a Baa3 to Ba1 investment grade.

At the time of publishing this report, the depth and duration of the economic downturn from the COVID-19 crisis remains uncertain. This pandemic, accompanied by a slowdown in economic activity, is expected to weaken banks' risk profiles or risk-weighted assets and reduce bank profitability, which would negatively affect the ability of banks to meet their minimum capital requirements.

Financial market volatility, together with the reaction of other financial institutions, has also placed pressure on market liquidity and the supply of term funding.

South Africa's response has included a reduction in interest rates, an injection of liquidity into financial markets and significant regulatory relief for banks. More recently, several fiscal and tax measures were announced, supporting households and firms. Despite significant turbulence in financial markets, these measures have helped stabilise markets, enabling banks to continue to operate by extending credit to support their customers. A government-guaranteed loan scheme for small businesses will complement the measures already taken by banks to support their customers during these trying times.

In addition to the deployment of the SARB monetary policy tools, the PA implemented measures to provide temporary capital and liquidity relief to banks during this time in a manner that complied with the internationally agreed framework.

The following policy interventions applicable to banks were approved by the PruCo during the stress period:

- **reducing the systemic risk add-on**, commonly referred to as the Pillar 2A add-on, from **1%** of total capital to **0%**
- **providing clear criteria on how banks can utilise their capital** conservation buffer (i.e. the loss-absorbing capital built up by banks for periods of economic stress);
- **reducing the minimum liquidity coverage ratio requirement** (i.e. the ratio of liquid assets that a bank has to maintain in relation to its anticipated outflows) from **100%** to **80%**; and
- **amending Directive 7 of 2015**, whereby loans that were restructured as a result of the impact of COVID-19 **will not attract a higher capital charge** relating to the resultant credit exposures.

The PA issued Guidance Note 3 of 2020 setting out the expectations of the PA when banks apply the requirements of International Financial Reporting Standard (IFRS) 9 to restructured credit exposures during the COVID-19 crisis. This guidance was important as it informed the banking sector on how it would account for and calculate the expected credit losses over its business cycle during this time. The PA also issued Guidance Note 4 of 2020 with recommendations for executive officers and material risk takers on the distribution of dividends on ordinary shares and the payment of cash bonuses.

INDUSTRY SECTOR OVERVIEW FOR PA-REGULATED SECTORS

Entities supervised by the PA as at* 31 December 2019, 28 February 2020 and 31 March 2020

Entities per sector	No. of entities	Balance-sheet size R millions		
		Dec 2019	Feb 2020	Mar 2020
Banking sector	**36**			**6 579 034**
Registered banks	19			6 117 919
Local branches of foreign banks	17			461 115
Mutual bank sector	**4**			**3 405**
Co-operative sector	**27**		**423**	
Co-operative banks	4		210	
Co-operative financial institutions	23		213	
Life insurance sector	**76**	**3 136 346**		
Primary insurers	70	3 121 239		
Cell captive entities	5	15 107		
Micro-insurers	1	000		
Non-life insurance sector	**83**	**199 929**		
Primary insurers	66	154 320		
Cell captive entities	9	42 803		
Captive insurers	8	2 806		
Reinsurers	**9**	**52 178**		
Life reinsurers	2	7 526		
Non-life reinsurers	2	6 902		
Composite reinsurers	5	37 750		
Other	**2**	**n/a**		
Market infrastructures	**9[1]**	**40 333**		

* There is a timing difference in the availability of data for banks, insurers and CFIs due to the varying respective submission intervals.

1 Note: Although there are 8 entities, Strate is counted twice as the entity is licensed both as a central securities depository and an associated clearing house.

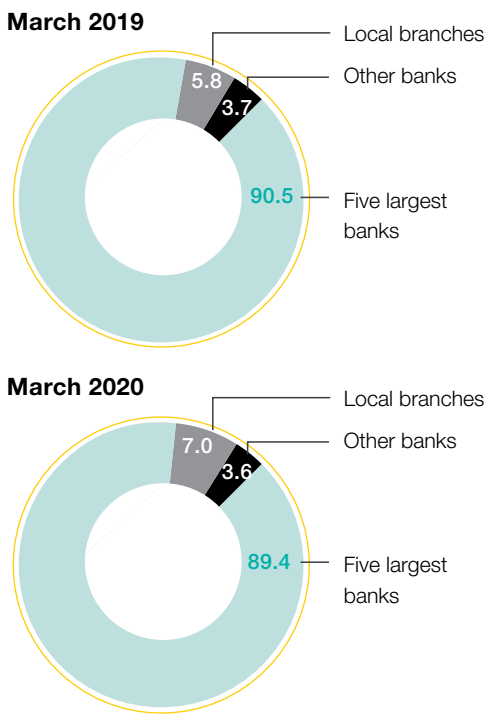
DEPOSIT-TAKING FINANCIAL INSTITUTIONS

South Africa's banking sector is dominated by the **five largest banks**, which collectively held **89.4%** of the total banking sector assets as at 31 March 2020 (March 2019: 90.5%).

Local branches of international banks accounted for **7.0%** of banking sector assets at the end of March 2020 (March 2019: 5.8%) while **other banks** represented **3.6%** at the end of March 2020 (March 2019: 3.7%).

Note: Banking sector data includes one institution conducting banking business in terms of an exemption from the provisions of the Banks Act, namely Ithala SOC Limited.

Total banking sector assets



CO-OPERATIVE BANKS AND CFIs

The co-operative financial sector consisted of 4 co-operative banks and 23 CFIs, as at the end of February 2020. In order for a CFI to apply for registration as a co-operative bank it must, at least, meet the minimum requirements (i.e. have at least 200 members and R1 million in deposits).

Based on total assets as at the end of February 2020, co-operative banks and CFIs both constitute 50% of the total financial co-operative deposit-taking sector.

February*	Number		Members		Deposits R millions		Assets R millions	
	2019	2020	2019	2020	2019	2020	2019	2020
Co-operative banks	4	4	4 321	4 280	145	174	177	210
CFIs	22	23	23 170	25 911	149	175	192	213
Total	**26**	**27**	**27 491**	**30 191**	**294**	**349**	**369**	**423**

* The financial year-end for all co-operative banks and CFIs is 29 February.

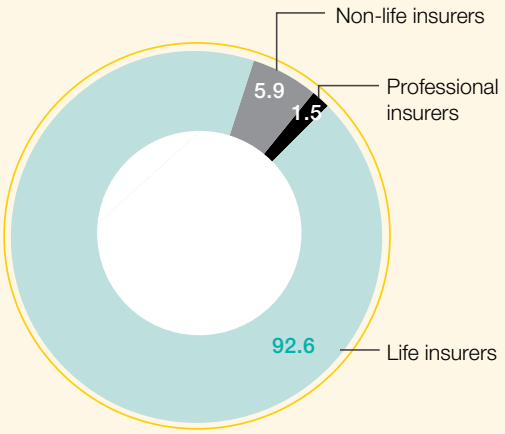
INSURANCE AND RE-INSURERS

The insurance sector information is based on the Insurance Act, as implemented on 1 July 2018. As a result, the information is not consistent with what had been reported under the previous Long- and Short-term Insurance Acts. The income and expenditure figures are based on aggregated data for the past four quarters ending December 2019, while the solvency and balance-sheet items are as at 31 December 2019.

South Africa's life insurance sector is dominated by the **five largest insurers**, which collectively held **71.0%** of the total assets, while the **non-life insurance sector** is dominated by **eight large insurers**, which held **55.2%** of gross premiums as at December 2019. All **nine professional reinsurers** are foreign-owned with less than **2%** of the total assets.

Total insurance sector assets (constant when compared to 2018)

December 2019



MARKET INFRASTRUCTURES

The PA is responsible for the prudential supervision of exchanges, clearing houses, central securities depositories (CSD), central counter-parties (CCPs) and trade repositories. There are currently nine registered market infrastructures made up of five securities, two CSDs and two clearing houses.

LICENSING

The PA is empowered by the FSR Act and various sector laws to issue licences, with the related licensing processes forming part of the PA's supervisory framework.

DURING THE FINANCIAL YEAR, THE PA RECEIVED 64 LICENCE APPLICATIONS, THE MAJORITY FROM THE INSURANCE AND CFI SECTORS.

The Insurance Act introduced a regulatory framework for micro-insurance which enables a tiered growth of insurers from small to large financial institutions. During the period under review, the PA licensed one new micro-insurer, converted one existing insurer to a micro-insurer and is currently considering a number of new licence applications for micro-insurers, insurers and controlling companies of insurance groups. The PA also licensed one new CFI. Other applications are at various stages of the PA's licensing process.

Unregistered persons conducting the business of a bank

The Banks Act empowers the PA to control certain activities of persons who conduct the business of a bank without the necessary registration. These investigations are executed by temporary inspectors appointed by the South African Reserve Bank Act 90 of 1989, as amended, and relevant provisions of the FSR Act. During the 2019/20 financial year, the PA continued to investigate six schemes that were carried over from previous years, and received two new cases for investigation. As at 31 March 2020, a total of five schemes were still open, following the finalisation of three schemes during the period under review.

Persons conducting unlicensed insurance business

The Insurance Act, read with the FSR Act, provides for the regulation of persons conducting unlicensed insurance business. The power and mandate to conduct investigations and impose the necessary sanctions in this regard has been delegated to the FSCA in terms of the memorandum of understanding concluded between the PA and FSCA.

Designation of insurance groups

Section 9 of the Insurance Act requires an insurer to notify the PA within 30 days of becoming part of a group of companies. Section 10 outlines who the PA may designate, and this includes the designation of the holding company or juristic person that must apply for a licence as a controlling company of that insurance group in terms of section 23 of the Act. The PA has designated 52 insurance groups in South Africa and is in the process of considering licensing applications submitted for the controlling company of these insurance groups in accordance with the requirements under section 23 of the Insurance Act.

For licensing-related figures, refer to **Additional information** at the end of the Annual Report for more detail.

page 45

ONGOING SUPERVISION

2019/20 FLAVOUR-OF-THE-YEAR TOPICS

FOREIGN BRANCHES OF BANKS

Topic per Guidance Note 2 of 2019: Effective capital and liquidity risk management practices

For liquidity management, the regulated financial institutions were requested to present to the PA on key elements such as:

- the functioning of the Asset and Liability Management Committee structure(s) with respect to liquidity risk management of the foreign branch;
- the liquidity management strategy as approved by executive management;
- the role of executive management in ensuring that policies and processes for risk-taking are developed;
- the ongoing measurement and monitoring of funding requirements;
- the impact of other risks such as credit, operational and market risks on the foreign branch's overall liquidity strategy;
- an analysis of funding requirements;
- the management of concentration risk in the foreign branch;
- an outline of the foreign branch's contingency funding plans;
- the liquidity risk management information systems; and
- the practices to ensure compliance with regulation 26 of the Regulations.

Regarding capital management, the PA assessed the:

- functioning of the Risk and Capital Management Committee or similar structure(s) in managing the foreign branch capital;
- capital management strategy approved by executive management, including a three-year capital plan;
- branch risk appetite statement and how this is used to monitor risk and capital;
- management of concentration risk in the foreign branch;
- foreign branch's contingency capital plans;
- conditions attached to capital drawdowns from head office;
- policies on repatriation or profit appropriation; and
- intra-group support measures, including letters of comfort or support.

Outcome

Foreign branches met their capital adequacy and liquidity (liquidity coverage ratio and net stable funding ratio) prudential requirements and were generally found to have prudent risk management processes. Senior management is responsible for functional risk management.

Concerns were, however, raised with a few foreign branches relating to:

- the maintenance of funds transfer pricing policies;
- the management of concentration risks; and
- matters on their financial reliance to head offices.

The PA is closely monitoring the foreign branches' action plans to address these concerns.

SMALLER LOCALLY REGISTERED BANKS

Topic per Guidance Note 3 of 2019: Life cycle of outsourcing

Smaller banks with total assets of less than R50 billion fall in this category. The presentations by the chairpersons of the boards of banks registered locally were structured as follows:

- determining which activity would be outsourced and how the decision linked to strategy;
- policies and processes in place for the selection of outsourcing partners;
- the contracting processes and standard elements found within the outsourcing contracts;
- transitional arrangements when moving into an outsourcing arrangement or changing from one service provider to another;
- the bank's management and review of outsourcing arrangements, including management, monitoring and risk management; and
- the processes when exiting outsourcing arrangements, including the contingency to ensure the continuous functioning of the business in the event of terminating the contract.

Outcome

The smaller banks were found to generally comply with Guidance Note 5 of 2014 on outsourcing of functions within banks.

Areas of improvement are:

- establishing a dedicated team to oversee the vendor management processes within the outsourcing management life cycle;
- improving governance, risk management and related controls when assessing outsourced partners;
- implementing formal processes to monitor budget allocation against outsourcing deliverables; and
- providing comprehensive reporting of management information to the Board of Directors and executive management on its outsourcing arrangements.

BANKS WITH TOTAL ASSETS IN EXCESS OF R50 BILLION

Topic per Guidance Note 4 of 2019: The creation and institutionalisation of a culture of ethics and awareness

The chairpersons of the Social and Ethics Committee were specifically requested to present on:

- how the organisations are governed to support an ethical culture; and
- the ethics governance framework, which provides for an ethics strategy, an overview of monitoring and reporting, how ethics is institutionalised, and specific codes or policies in place.

Outcome

Banks are promoting sound corporate culture and ethical conduct through:

√ setting the tone from the top;

√ aligning ethics and integrity to the strategy of the bank, its relationships with stakeholders and the way business is conducted;

√ establishing governance structures such as the Social and Ethics Committee to enable adequate oversight and consequence management processes;

√ establishing a code of conduct and ethics frameworks and policies;

√ aligning these frameworks and policies to the relevant legislation (the Banks Act and the Companies Act 71 of 2008) and the King IV Report on Corporate Governance for South Africa 2016;

√ having channels in place – such as whistleblowing hotlines – to encourage the reporting of unethical practices and behaviour.

MARKET INFRASTRUCTURES

Topic: Cybersecurity

- The boards of directors for market infrastructures were requested to provide a view of their cyber-defence and response capabilities.

Outcome

All market infrastructures were found to have:

- begun refining their cyber-resilience strategies;
- invested in cyber-defence initiatives; and
- improved processes and upgraded security systems.

Larger market infrastructures have combined information and cybersecurity teams and automated internal network traffic monitoring systems, while smaller market infrastructures, due to constraints in operational budgets, had limited their investment to penetration testing and were using manual systems. In instances where capability and capacity were deficient, market infrastructures have leveraged cybersecurity skills from strategic partners specialising in cybersecurity. Phishing attacks were the biggest cyber threats, with market infrastructures negotiating with insurers to provide bespoke insurance cover for cyber risk.

The market infrastructures were encouraged to participate in the local Critical Infrastructure Computer Security Incident Response Team and other national cybersecurity structures. They were also advised to continue building internal capacity and capabilities to manage their cyber risks. Issues that were identified relating to cyber-resilience and cybersecurity will be monitored by the PA through the ongoing supervisory programmes. The PA is also considering issuing an appropriate regulatory instrument to guide market infrastructures in cyber-resilience.

INSURANCE AND INSURANCE GROUPS

Topic: Governance frameworks

The Governance and Operational Standard for Insurers, together with the Governance and Operational Standards for Insurance Groups (collectively referred to as the Standards), issued in terms of the Insurance Act, highlight the PA's expectations for good governance and prescribe the minimum requirements.

The intention of this flavour-of-the-year topic was to:

- create awareness of international principles relating to governance;
- determine the commitment from insurers and insurance groups to comply with these principles; and
- consider amendments to regulatory instruments or further supervisory interventions.

Outcome

The PA found that the boards were properly constituted with an appropriate number of individuals and balance in terms of diversity, knowledge, skills and expertise, which were commensurate to the size, business and risk profiles of the respective insurers.

In general, the boards met the minimum requirements of the Standards in terms of independence, integrity, competence and capacity. Concerns over conflicts of interest were noted in some insurers, which impacted on the effectiveness of the boards' ability to properly discharge their duties. While it was noted that the board was involved in the formulation of strategy, there was room for improvement to ensure that the board takes ownership of the strategic direction of the entity.

Specific gaps that require closer monitoring include:

- key-person dependency on certain executive members without proper succession planning;
- lack of proper mechanisms to manage conflict of interest; and
- in certain instances, more participation from certain board members in formulating strategy.

MARKET INFRASTRUCTURES

The PA and the FSCA have varying degrees of oversight over market infrastructures to ensure prudential requirements are met. Through a coordinated effort, the PA and the FSCA have structured each licensed market infrastructure's supervision into risk-based and forward-looking supervisory planning, execution, reporting and follow-up phases.

The PA's supervisory activities comprised both on-site and off-site analysis. On-site analysis took the form of prudential meetings on matters relating to internal audit, and compliance, liquidity risk, counterparty credit risk, market risk, credit risk, capital risk, operational risk and IT risk. Off-site analysis included, but was not limited to, analysis of reporting returns submitted by licensed market infrastructures.

THE PA, IN COLLABORATION WITH THE FSCA AND THE FINANCIAL STABILITY DEPARTMENT OF THE SARB, CONDUCTED THE FIRST COMBINED REVIEW ON THE JSE CLEAR SELF-ASSESSMENT AGAINST THE PRINCIPLES FOR FINANCIAL MARKET INFRASTRUCTURES (PFMIs), WHICH WAS ISSUED IN APRIL 2012 BY THE COMMITTEE ON PAYMENT AND MARKET INFRA-STRUCTURES AND THE TECHNICAL COMMITTEE OF THE INTERNATIONAL ORGA-NISATION OF SECURITIES COMMISSIONS.

The main objective was to review the self-assessment conducted by JSE Clear relating to compliance with the PFMIs. A report was submitted to the Financial Stability Department of the SARB as per section 12(c) of the FSR Act which states that, for reporting purposes, "The Reserve Bank must regularly assess the observance of principles in the Republic developed by international standard setting bodies for market infrastructures, and report its findings to the financial sector regulators and the Minister, having regard to the circumstances and the context within the Republic". Market infrastructures are required to publish a self-assessment against these principles every two years.

CONVERSIONS OF INSURANCE LICENCES

Following the promulgation of the Insurance Act, the PA was required to convert all insurers' registration from licences issued in terms of either the Long-term Insurance Act 52 of 1998 and/or the Short-term Insurance Act 53 of 1998 to licences under the Insurance Act. According to the Insurance Act, the PA should convert all registered insurers by no later than 30 June 2020. During the financial year, insurers submitted workbooks that were reviewed in detail. By 31 March 2020, three insurers were converted, with the rest still under review.The conversions process is on track to be completed by 30 June 2020.

ENFORCEMENT

REGULATORY ACTIONS IMPOSED BY THE PA

The PA has at its disposal an adequate range of supervisory tools to use when a financial institution is not complying with the FSR Act or financial sector laws for which the PA is the responsible authority. During the year under review, the Prudential Authority Regulatory Action Committee met on five occasions to discuss and consider recommendations made to the CEO of the PA in relation to matters of non-compliance.

An administrative penalty of R1 million was imposed in terms of section 167(1) of the FSR Act on BrightRock Life Limited for underwriting fund policies for which it was not licensed (contravention of section 25(2) read with section 25(4) of the Insurance Act).[1] A penalty of R25 000 was also imposed in terms of section 68 of the Insurance Act regarding the late submission of regulatory returns.

1 Full details on the PA regulatory actions are available at http://www.resbank.co.za/PrudentialAuthority/FinancialSectorRegulation/Pages/Administrative-Penalties.aspx

Furthermore, the PA granted two exemptions to insurers in terms of section 13(b) of schedule 3 and section 66 of the Insurance Act respectively. The PA warned or cautioned 23 institutions not to repeat the conduct which led to the non-compliance.

A person aggrieved by a decision by the PA may apply to the Financial Services Tribunal in terms of section 230 of the FSR Act for reconsideration. One application was lodged with the Financial Services Tribunal, but was subsequently withdrawn during the financial year.

APPEALS

Bank of Baroda, Johannesburg Branch (Bank of Baroda) lodged an appeal in terms of section 45D of the Financial Intelligence Centre Act 39 of 2001, as amended (FIC Act). The Appeal Board substituted the R11 million financial penalty with a R400 000 financial penalty for Bank of Baroda's non-compliance with the reporting requirements in terms of the FIC Act. An appeal was lodged by the PA at the North Gauteng High Court to review the decision of the Appeal Board. The North Gauteng High Court upheld the decision of the Appeal Board to reduce the financial penalty from R11 million to R400 000.

RESOLUTION FRAMEWORK

In 2015, the National Treasury, the previous Financial Services Board and the SARB jointly published a discussion paper titled 'Strengthening South Africa's resolution framework for financial institutions', which informed the proposed resolution framework for banks and SIFIs as set out in the Financial Sector Laws Amendment Bill, 2018 (FSLAB). The FSLAB is expected to be tabled in Parliament in 2020. The PA and the Financial Stability Department continue to work closely together in preparation for the implementation of the FSLAB. The PA also participates in internal governance structures in the form of the Resolution Policy Working Group and the Resolution Policy Panel to ensure collaboration and coordination of the proposed framework.

ANTI-MONEY LAUNDERING AND COUNTERING THE FINANCING OF TERRORISM

During the financial period under review, the PA conducted a total of nine inspections with accountable institutions in the banking (six) and life insurance (three) sectors.

The PA also conducted a joint AML/CFT inspection with the Bank of Tanzania at Stanbic Bank Tanzania Limited in Dar es Salaam during November 2019, in accordance with the Financial Action Task Force standards on countering money laundering and the financing of terrorism. These standards require supervisors to conduct consolidated AML/CFT supervision of the overseas branches and subsidiaries of financial institutions headquartered in their countries.

FINANCIAL PENALTIES FOR NON-COMPLIANCE WITH THE FIC ACT, WERE IMPOSED ON SEVEN BANKS, AMOUNTING TO R23.9 MILLION.

See **Additional information** at the end of the Annual Report for detail. page 47

Media releases were published in respect of these administrative penalties and full details of the matters are available at https://www.resbank.co.za/Publications/Media/MediaReleases/Pages/MediaReleases-Home.aspx

SELECTED INDICATORS FOR THE SOUTH AFRICAN BANKING SECTOR

Financial indicators	Mar 2019	Mar 2020	Percentage change (%)
Balance sheet			
Total assets (R billions)	5 654	6 579	16.36
Gross loans and advances (R billions)	4 216	4 607	9.27
Total equity (R billions)	470	499	6.16
Profitability			
Cost-to-income ratio (smoothed) (%)	57.73	58.10	0.65
Return on equity (smoothed) (%)	15.69	13.50	-13.89
Return on assets (smoothed) (%)	1.28	1.06	-16.43
Life insurance sector			
Common equity tier 1 capital adequacy ratio (%)	12.61	12.08	-4.43
Tier 1 capital adequacy ratio (%)	13.33	12.89	-3.53
Total capital adequacy ratio (%)	16.28	15.85	-2.87
Leverage ratio (%)	6.44	6.12	-5.18
Liquidity			
Liquidity coverage ratio (%)	142.43	129.92	-8.82
Net stable funding ratio (%)	108.09	108.70	0.57
Credit risk			
Impaired advances (R billions)	159	186	16.90
Impaired advances as a percentage of gross loans and advances	3.77	4.03	6.98
Specific credit impairments as a percentage of impaired advances	45.96	43.37	-5.64
Portfolio credit impairments as a percentage of gross loans and advances	1.04	1.06	1.21

Total banking sector assets grew by **16.36%** year on year to **R6 579 billion** at the end of March 2020

(March 2019: R5 654 billion).

This was spurred by an increase in gross loans and advances, derivative financial instruments, and investment and trading securities (mainly government securities and other dated securities).

Gross loans and advances grew by **9.27%** year on year to **R4 607 billion** in March 2020, underpinned by an increase in term loans, loans granted under resale agreements and home loans.

Derivative financial instruments increased by **R388 billion** to **R584 billion** at the end of March 2020 compared to R196 billion a year ago.

The increase in derivative financial instruments in March 2020 was attributable to the depreciation of the South African rand against major trading currencies.

Equity amounted to **R499 billion** at the end of March 2020 (March 2019: R470 billion).

Retained earnings and share capital constituted **94.1%** of total equity at the end of March 2020 (March 2019: 95.2%).

THE BANKING SECTOR REMAINED PROFITABLE DURING THE PERIOD UNDER REVIEW, DESPITE A DECLINE IN THE PROFITABILITY RATIOS.

The **12-month moving average return-on-equity (ROE) ratio deteriorated** from 15.69% in March 2019 to 13.50% in March 2020 and the **return-on-assets (ROA) ratio deteriorated** to 1.06% (March 2019: 1.27%). The **12-month moving average cost-to-income ratio deteriorated** to 58.1% at the end of March 2020 compared to 57.7% a year ago.

Banks (on a bank-solo basis) **remained adequately capitalised**, with capital adequacy ratios (CARs) well above the minimum statutory requirements. **Common equity tier 1 (CET 1), tier 1 and total CARs** amounted to 12.1%, 12.9% and 15.8% respectively at the end of March 2020 (March 2019: 12.6%, 13.4% and 16.3% respectively).

The PA **increased** the **liquidity coverage ratio** (LCR) minimum requirement from 90% in 2018 to 100% in 2019 and remained at this level until the end of March 2020. The **LCR for the banking sector decreased** to 129.9% at the end of March 2020 (March 2019: 142.5%) due to increased net cash outflows in March 2020.

Impaired advances increased at an annual rate of 16.9% to R186 billion by March 2020 (March 2019: R159 billion) driven by retail and corporate exposures moving into the non-performing category. The **ratio of impaired advances to gross loans and advances deteriorated** to 4.0% at the end of March 2020 (March 2019: 3.8%). The **ratio of specific credit impairment to impaired advances (coverage ratio) decreased** to 43.4% in March 2020 (March 2019: 46.0%).

THE MUTUAL BANKING SECTOR

Selected indicators for the mutual bank sector

Financial indicators	Mar 2019	Mar 2020	Percentage change (%)
Balance sheet			
Total assets (R millions)	3 136	3 405	8.58
Gross loans and advances (R millions)	2 079	2 332	12.17
Profitability			
Return on equity (%)	5.40	-37.70	-798.15
Return on assets (%)	1.00	-7.40	-840.00
Operating expenses to total income (%)	72.80	111.74	53.49
Liquidity			
Average daily amount of liquid assets held to liquid assets requirement (%)	146.40	196.40	34.15
Credit risk			
Gross amount overdue (R millions)	81.00	265	229.13
Gross overdue to loans and advances (%)	3.90	11.38	192.81
Specific provisions to gross amount overdue (%)	81.10	37.40	-53.88
General provisions to loans and advances (%)	0.40	1.59	296.97
Capital adequacy			
Capital adequacy ratio (%)	23.10	23.66	2.43

The total mutual banking sector assets increased by **8.58%** year on year to **R3.405 million** as at the end of March 2020, mainly due to an increase in loans and advances.

As at the end of March 2020, the sector made a loss due to a high amount of provisions being booked through the income statement.

The **total CAR for the sector increased** slightly to **23.66%** (March 2019: 23.10%). **Overdue loans increased** significantly over the period and were standing on **R265 million** as at the end of March 2020. **Specific provisions as a percentage of the gross amount overdue** stood at **37.40%** (March 2019: 81.10%).

CO-OPERATIVE FINANCIAL SECTOR

CO-OPERATIVE BANKS

Selected indicators for co-operative banks

Financial indicators	Feb 2019	Feb 2020	Percentage change (%)
Balance sheet			
Total assets	177 493	210 358	18.52
Total net loans	134 998	156 240	15.74
Total liabilities	146 925	174 415	18.71
Total equity	30 816	36 191	17.44
Profitability			
Total income	23 140	25 301	9.34
Total expenses	16 106	18 837	16.96
Operating profit/income before taxation	6 904	6 838	-0.96
Cost-to-income ratio (%)	43.26	46.21	6.82
Capital adequacy			
Total capital adequacy ratio (%)	15.25	15.73	3.15
Asset quality and provisions			
Total delinquent loans	5 603	6 072	8.38
Portfolio delinquent (%)	3.99	3.75	-6.02
Total provisions	5 376	5 769	7.31
Provision as a percentage of total loans	3.83	3.69	-3.59

The overall **growth in the co-operative banking sector** is attributable to the **registration** of **a fourth co-operative bank** during 2018. **Net loans** for the period under review amounted to **R156 million**, a **15.74% increase** from February 2019 due to higher loan issuance across the portfolio.

The sector **remained adequately capitalised** with a **CAR** of **15.73%** as at February 2020 > which is well in **excess of the 6% minimum requirement.**

Although profit before taxation declined slightly during the year under review, the co-operative banking sector remained profitable with income before taxation standing on R6.8 million as at the end of February 2020. The cost-to-income ratio deteriorated to 46.21% during the period under review (February 2019: 43.26%)

Delinquent loans accounted for 3.75% of the co-operative banking sector's gross loans as at the end of February 2020, a decline of 6% when compared to February 2019. The sector continued to provide sufficiently for potential losses in accordance with regulatory requirements during the review period.

CO-OPERATIVE FINANCIAL INSTITUTIONS

The analysis below relates to the 23 registered CFIs for periods ended February 2019 and February 2020.

Selected indicators for CFIs

Financial indicators	Feb 2019	Feb 2020	Percentage change (%)
Balance sheet			
Total assets	192 119	213 376	11.06
Total net loans	112 023	111 254	-0.69
Total liabilities	153 431	178 294	16.20
Total equity	38 688	35 082	-9.32
Profitability			
Total income	27 804	27 630	-0.63
Total expenses	23 892	26 856	12.41
Operating profit/income before taxation	3 912	775	-80.19
Cost-to-income ratio (%)	77.92	95.05	21.98
Capital adequacy			
Total capital adequacy ratio (%)	13.41	9.14	-31.84
Asset quality and provisions			
Total delinquent loans	3 293	7 301	121.71
Portfolio delinquent (%)	2.89	6.45	123.18
Total provisions	1 816	1 948	7.27
Provision as a percentage of total loans	1.62	1.75	8.01

Total assets in respect of CFIs continued to **grow** in 2020, ending the financial year-end of February 2020 at an annualised growth rate of **11%**.

Net loans amounted to R111 million for the period under review, and **decreased by 1%** from the R112 million reported in February 2019. **Sector assets** remained concentrated, with the **three largest CFIs** contributing **85%** in February 2020 to the overall sector net loans.

The sector remained adequately capitalised, with a **CAR** of **9.14%** as at the end of February 2020, down from 13.41% in February 2019 (minimum CAR requirement is 6%). Although the sector remained profitable, profitability declined during the period under review due to increased operating expenses. **Income before taxation** was at **R775 000** in February 2020, down from R3.9 million in February 2019. The **cost-to-income ratio deteriorated** to 95% in February 2020 from 77.92% in February 2019.

Delinquent loans accounted for 6.45% of the CFI sector's gross loans as at the end of February 2020.

SELECTED INDICATORS FOR THE SOUTH AFRICAN LIFE INSURANCE INDUSTRY AS AT THE END OF DECEMBER 2019

LIFE INSURERS

The **net premium income** (after deducting premiums for reinsurance) for primary life insurers (those that do not conduct business solely as reinsurers), cell captives and reinsurers was standing at **R529 473 million** for the 12 months ending December 2019. **Benefit payments** for the same period totalled **R481 106 million.**

Insurance companies typically generate a significant portion of their income from investment revenues (both realised and unrealised).

THE 2019 CALENDAR YEAR SAW AN EXCEPTIONAL EQUITY PERFORMANCE, RESULTING IN HIGHER INVESTMENT INCOME.

	Primary	Cell captives	Reinsurers	Total
	R millions			
Income				
Net premiums	513 818	13 305	2 349	**529 473**
Investment income	274 704	1 082	417	**276 204**
Other income	11 066	14	139	**11 219**
Total	**799 588**	**14 402**	**2 905**	**816 895**
Expenditure				
Benefits	477 629	1 100	2 377	**481 106**
Commission paid/received	20 610	1 339	169	**22 118**
General expenses	52 596	1 372	421	**54 388**
Other acquisition costs	5 263	-	-	**5 263**
Other expenses	5 302	5	24	**5 330**
Excess of income over expenditure	**238 187**	**10 587**	**-84**	**248 689**

The assets in respect of the primary life insurers, cell captives and reinsurance industry stood at R3 144 billion as at the end of December 2019.

The majority of these assets were invested in investment funds and equities.

	Total assets (R millions)		Liabilities (R millions)		MCR[1]		SCR[2]	
	2018	2019	2018	2019	2018	2019	2018	2019
Primary	2 993 436	3 121 239	2 630 845	2 750 139	4.3	4.2	1.9	2.0
Cell captives	10 768	15 107	3 602	6 643	4.1	4.2	1.1	1.1
Reinsurers	7 256	7 525	3 900	3 990	5.3	5.7	1.5	1.6
Total	**3 011 459**	**3 143 872**	**2 638 348**	**2 760 772**	**4.3**	**4.2**	**1.5**	**1.6**

1 MCR: minimum capital requirement cover ratio (median)
2 SCR: solvency capital requirement cover ratio (median)

NON-LIFE INSURERS

Gross premiums of primary insurers (those that do not conduct business solely as reinsurers), cell captives, captives and reinsurers in the non-life insurance industry were standing at R159 549 million for the 12 months ending December 2019.

Underwriting results (where underwriting profit is expressed as a percentage of net earned premiums) stood at 9.9% for the primary insurers, cell captives, captives and reinsurers in the non-life insurance industry as at the end of December 2019. Underwriting results were stable.

DURING 2019, THE INSURANCE INDUSTRY EXPERIENCED SEVERE WEATHER-RELATED CLAIMS, PARTICULARLY DURING THE FOURTH QUARTER.

Operating profit, which includes investment income, stood at R20 704 million as at the end of December 2019.

THE NON-LIFE INSURANCE INDUSTRY ALSO BENEFITED FROM HIGHER-THAN-NORMAL INVESTMENT INCOME, RESULTING IN HIGHER OPERATING INCOME.

Total assets amounted to
R207 million
(2018: R197 million)

Liabilities amounted to
R117 million
(2018: R115 million)

Selected indicators for the South African non-life insurance industry as at the end of December 2019:

	Primary	Cell captives	Captives	Reinsurers	Total
			R millions		
Income					
Gross premiums	125 207	22 747	1 921	9 675	**159 549**
Net earned premiums	81 292	12 742	1 379	2120	**97 533**
Investment income	8 090	2 200	175	558	**11 023**
Other income	788	70	30	-	**888**
Total	**90 170**	**15 013**	**1 584**	**2 677**	**109 444**
Expenditure					
Claims incurred	48 549	6 301	437	1 897	**57 184**
Commission paid/received	4 748	94	-43	1 264	**6 063**
General expenses	23 478	2 120	164	315	**26 076**
Other expenses	1 169	42	182	-3	**1 390**
Excess of income over expenditure	**12 226**	**6 455**	**843**	**-795**	**18 730**
Underwriting profit	7 558	1 150	774	199	**9 681**
Operating profit	15 648	3 350	949	757	**20 704**

	Total assets (R millions)		Liabilities (R millions)		MCR[1]		SCR[2]	
	2018	2019	2018	2019	2018	2019	2018	2019
Primary	149 882	154 320	85 097	84 921	3.9	4.0	1.8	1.7
Cell captives	37 584	42 803	23 155	26 477	2.5	2.5	2.1	1.6
Captives	2 517	2 806	845	723	3.9	4.0	1.8	1.7
Reinsurers	7 279	6 902	5 731	5 256	4.5	4.7	1.6	1.8
Total	**197 262**	**206 831**	**114 828**	**117 377**	**3.8**	**4.0**	**1.8**	**1.7**

1 MCR: minimum capital requirement cover ratio (median)
2 SCR: solvency capital requirement cover ratio (median)

COMPOSITE REINSURERS

Five reinsurers are currently classified as composite reinsurers (writing both life and non-life business).

Gross premiums relating to the 12 months ending December 2019 stood at **R11 140 million** and **R13 414 million** for life and the non-life businesses respectively.

Summary of the results of the composite business as at the end of December 2019

	Life	Non-life
	R millions	
Income		
Gross premiums	11 140	13 414
Net premiums/net earned premiums	10 542	3 167
Investment income	1 131	318
Other income	16	4
Total	**11 689**	**3 490**
Expenditure		
Claims incurred	8 512	1 336
Commission paid/received	674	399
General expenses	607	74
Other expenses	421	111
Excess of income over expenditure	**1 476**	**1 570**
Underwriting profit		1 607
Operating profit		1 925

Summary of the results of the composite business as at the end of December 2019

	Life and non-life		
	2018 R millions	2019 R millions	Percentage change (%)
Assets	33 835	37 750	11.57
Liabilities	23 549	25 577	8.61
SCR (% median)	1.5	1.5	-
MCR (% median)	4.0	4.6	15.00

In addition to the **170 insurance entities** registered and being supervised, the PA also supervised Lloyds and the Road Accident Fund.

MARKET INFRASTRUCTURES

Total assets amounted to

R40 billion

as at the end of December 2019

(2018: R42 billion)

4.8%

reduction from the previous year.

CREDIT RISK

The macroeconomic challenges facing the South African economy continue to have a direct impact on lending patterns to various sectors. While appetite for credit risk still exists, credit granting criteria have tightened.

BANKS HAVE SEEN INCREASED DEMAND FROM CLIENTS FOR UNSECURED AND REVOLVING CREDIT PRODUCTS.

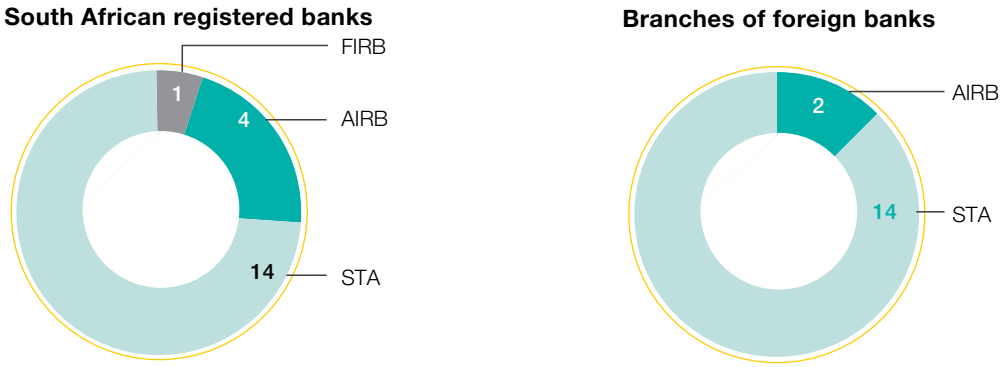
BANKS HAVE ALSO PURSUED A VARIETY OF LENDING STRATEGIES ACROSS AFRICA, WITH MACROECONOMIC CONDITIONS, REGULATORY ENVIRONMENTS, POLITICAL RISKS AND NOW COVID-19 PLAYING KEY ROLES IN LENDING UNDERTAKEN.

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

a. the standardised approach (STA), including the simplified STA;
b. the foundation internal ratings-based (FIRB) approach;[1] and
c. the advanced internal ratings-based (AIRB) approach.

[1] Subject to regulatory approval.

Reporting methods applied by banks as at 31 March 2020



AIRB approach application

As reported in the PA's 2018/19 Annual Report, the PA granted approval to a bank to calculate its minimum capital requirements in respect of credit risk for its retail portfolios, while using the AIRB approach for its wholesale portfolios as of April 2019. During October 2019, the bank requested approval from the PA to migrate its wholesale portfolios to the AIRB approach.

Model-related reviews

During 2019, the PA received 21 notifications of non-material changes and 19 submissions of material changes to the ratings systems used by banks applying the FIRB approach. The PA continued to follow a robust review and approval process.

Every year, banks that have adopted the FIRB approach are required to submit a series of self-assessment templates in order to evaluate their level

of compliance with the minimum requirements prescribed in the Regulations. The 2019 self-assessment submissions were reviewed by the PA to identify any compliance gaps and exceptions. In addition, the PA receives model registers biannually with high-level information on credit risk models. During 2020, the PA will revise and consolidate these templates into one which will allow for more granular information on internal ratings-based (IRB) systems. As a complementary measure, the PA will introduce a practice of having at least one on-site meeting with the validation units annually.

Low default portfolio thematic review

In June 2019, the PA published a report that summarised findings from the 2018 low default portfolio thematic review. The report also served as a consultative document for policy proposals to complement the Basel III post-crisis reforms. The comments received from banks were summarised and included in a report issued for a second round of consultation.

Post-model implementation thematic reviews

As mentioned above, the PA commenced its post-model implementation thematic reviews in 2020. These reviews are used to gather information on the model risk management practices in the sector. The aim is also to assess the adequacy of these practices against the regulatory requirements and determine whether policy interventions are needed to close any gaps. The reviews cover four broad themes, namely model implementation, use, ongoing monitoring, and the role of the internal audit unit.

Implementation of a revised supervisory framework for measuring and controlling large exposures

In April 2014, the Basel Committee on Banking Supervision issued a paper titled 'Supervisory framework for monitoring and controlling large exposures' (the revised Large Exposure[2] Framework). The internationally agreed implementation date for the framework was set for 1 January 2019. As per Guidance Note 6 of 2019 issued by the PA, the proposed implementation date for the Large Exposure Framework in South Africa has been postponed from 1 April 2020 to 1 January 2021. Draft 1 of the proposed amendments to the Regulations incorporating the revised Large Exposure Framework was issued for comment in December 2019. The comments received will be taken into consideration in finalising the proposed amendments.

Implementation of the revised Securitisation Framework

The Basel Committee on Banking Supervision paper titled 'Revisions to the securitisation framework'[3] (the revised Securitisation Framework) was issued in December 2014 and revised in July 2016. The revised Securitisation Framework includes the alternative capital treatment for 'simple, transparent and comparable' (STC) securitisations. The Basel Committee on Banking Supervision, together with the International Organization of Securities Commissions, issued the criteria for identifying STC securitisations[4] in July 2015.

The internationally agreed implementation date for the revised Securitisation Framework was set for 1 January 2018. As per Guidance Note 6 of 2019 issued by the PA, the proposed implementation date in South Africa was postponed from 1 April 2020 to 1 January 2021.

Draft 1 of the proposed amendments to the Regulations incorporating the revised Securitisation Framework was issued for comment in December 2019. The PA will take comments received into consideration in finalising the proposed amendments.

2 https://www.bis.org/publ/bcbs283.pdf
3 https://www.bis.org/bcbs/publ/d374.pdf
4 www.bis.org/bcbs/publ/d332.htm

INSURANCE RISK

The PA compiles and publishes monthly yield curves and equity symmetric adjustments for the insurance industry.

Five applications for the use of an iterative approach in calculating the solvency capital requirement and risk margin were considered and two were approved. Four applications to use an alternative interest rate term structure were considered for approval but none were approved. One application for the use of a partial internal model was considered and approved.

THE PA EMBARKED ON AN EXERCISE TO BETTER UNDERSTAND THE PREPAREDNESS OF THE LARGER LIFE INSURERS FOR THE IMPLEMENTATION OF IFRS 17.

The PA also continued to work on providing industry guidance on the new insurance prudential standards. To this end, various engagements took place with industry bodies such as the Actuarial Society of South Africa (ASSA), the Association for Savings and Investment South Africa and the South African Insurance Association.

The PA presented key technical features and actuarial experience of the insurance industry for 2018, based on Solvency Assessment and Management reporting in terms of the Act, at sessional meetings of ASSA.

MARKET RISK

PRUDENTIAL REGULATIONS IN MARKET RISK, COUNTERPARTY CREDIT RISK AND EQUITY RISK IN THE BANKING BOOK

On 16 December 2019, the Basel Committee on Banking Supervision released its consolidated framework, which effected changes to the capital treatment of bank exposures to central counterparties (BE-CCPs) and the capital requirements for banks' equity investments in funds (CREIF). The PA has worked extensively on preparing to implement these regulations and assessing overall industry readiness in South Africa. The PA subsequently decided to revise the implementation date of BE-CCPs, CREIF and counterparty credit risk from 1 October 2019 to 1 October 2020 to accommodate comments and proposals from stakeholders. The capital impacts of the new regulations will vary materially across the banking industry and predominantly depend on an institution and its business strategy. With the ongoing effects of COVID-19, the feasibility of regulations going live in 2020 will be assessed. The PA continues to engage with industry on these matters.

FUNDAMENTAL REVIEW OF THE TRADING BOOK

The PA, together with the Banking Association South Africa and respective banks, has embarked on a supervisory programme to assess readiness and prepare for the implementation of the fundamental review of the trading book (revised market risk framework) in January 2023.

STANDARDISED APPROACH TO CREDIT VALUATION ADJUSTMENTS

In 2019, the Basel Committee on Banking Supervision released a consultative document with revisions to the credit valuation adjustment framework due to be published in 2020. The PA revised the implementation for South Africa to 1 January 2023.

GLOBAL INTERBANK OFFERED RATES TRANSITION

The PA conducted a survey of banks' and insurers' interbank offered rates (IBOR) transition programmes. The review assessed contractual agreements, systems, policies, and operational and governance processes. While a number of risks were highlighted during the assessment, banks and insurers were generally aware of the transition. The PA will continue to monitor the risks and engage industry further.

ASSESSMENT OF BANKS' VALUATION ADJUSTMENT PRACTICES

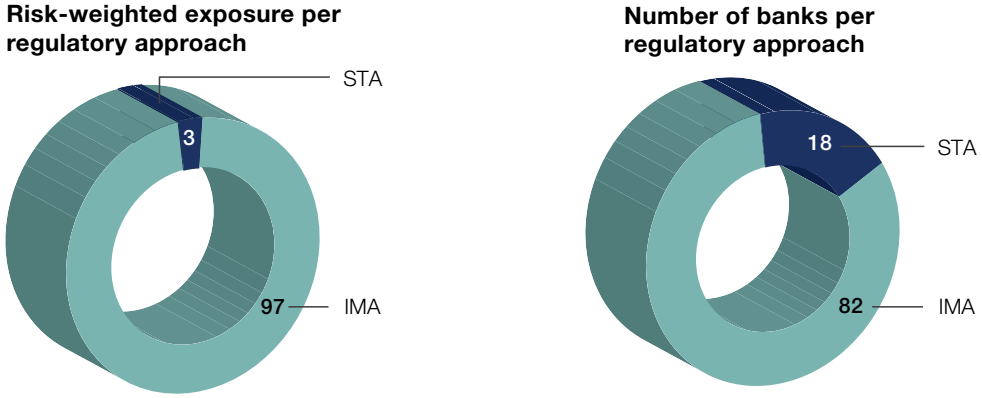
The findings of an industry-based assessment on valuation adjustment practices relative to the Basel III regulatory framework will be published in 2020.

SUPERVISORY REVIEWS

Banks

Market risk reviews focused on banks using the internal models-based approach (IMA). The equity risk in the banking book review was completed with institutions that were not inspected in the 2018 review cycle. Key challenges include market liquidity and volatility, making it difficult for banks to find direction, a trend that is likely to continue and will be exacerbated by the COVID-19 pandemic. Banks continued to highlight the regulatory burden and associated capital imposition.

Market risk methodologies applied by banks as at 31 December 2019



INSURANCE

The PA met with insurers to review their exposure to market risk, gain insights into the practical implementation of their risk management frameworks and the structures and tools utilised, identify areas for improvement, and assess their strategy in light of the relevant regulatory rules and the macroeconomic environment. The PA will collaborate with industry associations to enhance the regulation and supervision of insurers with the aim of improving industry participation and analysis.

MARKET INFRASTRUCTURES

The PA conducted reviews of certain market infrastructures that are exposed to counterparty credit risk. The review assessed how the risks emanating from such entities may affect the risk profile of the associated infrastructure and the broader financial market system. The review looked at the clearing businesses, systems utilised, risk management processes and regulatory issues with respect to counterparty credit risk.

OPERATIONAL RISK

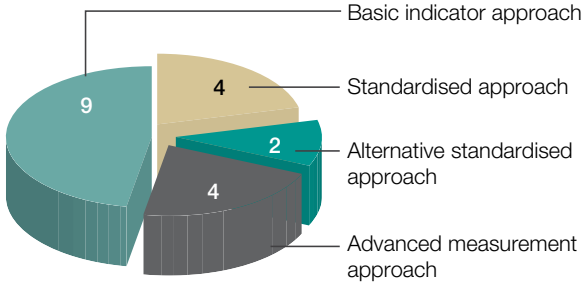
The banking industry continued to strengthen its capabilities through the tools employed to manage operational risk, which led to a slight reduction in the frequency and severity of losses. Fraud, execution delivery and process management remained the largest contributors to operational risk losses. The PA engaged with the insurance and market infrastructure industries to gain an understanding of the operational risk management landscape and to ensure that tools deployed are adequate and effective.

The regulatory framework in South Africa allows registered banks to select from the following four methodologies to calculate their minimum required regulatory capital relating to operational risk:

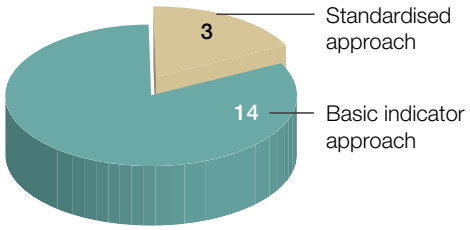
- the basic indicator approach;
- the standardised approach;
- the alternative standardised approach; and
- the advanced measurement approach.

The figures below show a breakdown in usage of these approaches by the 36 registered banks

South African registered banks



Branches of foreign banks



The banking industry is preparing for the new operational risk framework, the new standardised approach, which will replace all the current operational risk regulatory capital calculation methodologies. The planned implementation date for South Africa has been set for January 2023.

Insurance entities licensed under the Insurance Act are required to calculate the regulatory operational risk capital using the standardised formula or the advanced measurement approach. The 171 registered insurance entities have adopted the standardised formula.

All registered market infrastructures hold a minimum six months' operating expenses as regulatory operational risk capital, which is in line with minimum regulatory requirements.

Outcomes from operational risk reviews

Operational risk strategic objectives

Banks maintained sound governance structures by implementing decisions that were agile and aligned to their risk strategy and appetite. The PA cautioned banks against diluting operational risk management due to the integration of operational risk processes with other risk types. Operational risk management within the insurance industry and market infrastructures is still maturing and thus requires refinement to promote the alignment of operational risk objectives with the organisation's business objectives.

Internal loss data

Institutions provided a high-level overview of the internal loss data process covering data collection thresholds, reconciliations, boundary events, material incidents, verification and validation. Loss data management practices were less mature within insurance and market infrastructure entities than they were for banks.

African region footprint

The PA noted a general improvement in the management of operational risk by regulated operations outside South Africa.

Operational risk appetite

Market infrastructures have developed appetite metrics for the monitoring and management of IT risk exposures. Some entities experienced challenges with monitoring control weaknesses and designing appropriate key risk indicators.

Outsourcing

The PA continues to critically analyse applications, notifications and reporting for the outsourcing of material and critical third-party service providers. The PA observed that banks experienced challenges with the management of third-party service providers. The PA noted significant utilisation of outsourced and third-party services by insurers.

INFORMATION TECHNOLOGY RISK

The PA continued with its enhanced strategy to supervise insurers and market infrastructures while maintaining its sustained supervision of the banking industry. The reviews conducted highlighted that cybersecurity risks were prevalent across the industries.

The PA upheld its membership at the Operational Risk Subcommittee and the recently established Cybersecurity Resilience Subcommittee of the Financial Sector Contingency Forum, where various systemic aspects are discussed. Membership of international bodies such as the Operational Resilience Group and Information Technology Supervisors Group has assisted the PA to align its views of global IT supervisory practices and experiences to the local environment.

The SARB is also a member of the Central Banks, Regulators and Supervisory Entities (CERES) Forum, which is a programme of the Financial Services Information Sharing and Analysis Center relating to cyber threats.

INFORMATION TECHNOLOGY RISK REVIEWS

IT risk on-site visits were conducted at banks, insurers and market infrastructures. Topics of discussion included strategic objectives, governance structures and human resources, information security and cybercrime, operational resilience, project management and emerging technologies.

Key outcomes from these reviews were as follows:

- Although the second line of defence still seemed insufficient, institutions were strengthening operating models to enforce adequate segregation of duties.
- Reporting lines for information security and cyber governance were perceived to be inappropriate and revealed shortcomings relating to independence, visibility, capacity and capability.
- Deficiencies in user access and identity management remained a concern.
- Project risk management was not aligned to the enterprise risk management framework.
- Outsourced and third-party management monitoring and reporting were of concern at a number of institutions.
- The majority of institutions continued to adopt evolving technologies based on their proof of concepts. Strategies and frameworks, in this regard, still need to be matured.

RISK DATA AGGREGATION AND RISK REPORTING

Although ongoing efforts by banks in deploying the risk data aggregation and risk reporting (RDARR) principles has yielded tangible progress, attaining compliance to data architecture and IT infrastructure remained a challenge.

Findings on industry challenges include the following:

- Structural changes and scale of business operations due to mergers and acquisitions have created complexities in integrating IT infrastructures.
- Banks are still struggling to adapt to an authoritative single source for risk data due to the fragmentation of their data platforms.
- There are inconsistencies in the deployment of data governance and the sustainability thereof.
- There is a lack of documentation for manual processes as well as data-specific matters definition, data quality and data lineage.
- There is a lack of a strategic and multi-year vision on how RDARR should be managed under 'business as usual'.
- Scarcity of skilled resources and capacity is more prevalent in smaller banks.
- There is a deficiency in risk-reporting practices and the effectiveness of these during stress periods.
- There is an inadequate understanding of the difference between normal and stressed periods.

DIRECTIVE 2 OF 2019: DIRECTIVE ON THE REPORTING OF MATERIAL IT AND/OR CYBER INCIDENTS

The purpose of this directive was to set out the PA's minimum reporting requirements for banks in relation to material incidents that are IT- and/or cyber-related. These incidents were previously not formally reported to the PA and the directive ensures uniformity, consistency and timeliness of such reporting.

5 PA FINANCIAL ACCOUNTS

In terms of section 55 of the FSR Act, the SARB is required to prepare financial accounts for the PA for each financial year in a manner that reflects the direct costs that accrue to the PA. As the PA is a department within the SARB, it follows the same financial reporting framework and basis of presentation as the SARB. The full disclosure of the PA financial accounts and related notes can be found in the SARB Annual Report 2019/20.

Levies will be charged once the new Financial Sector Levies Bill is promulgated to collect the necessary levies on the regulated financial institutions, as envisaged in the FSR Act. Levies will serve as the basis to recover the direct operating cost of running the PA and not as return for any direct service or goods that will be supplied.

Penalties are raised for non-compliance by persons within the regulated sector should they be found guilty of contravening a financial sector law or an enforceable undertaking accepted by the PA. The PA deducts from this total all costs incurred in making and enforcing the administrative penalty order. The remaining balance (if any) after applying this deduction is paid into the National Revenue Fund. The SARB has a responsibility in terms of the FIC Act to ensure that banks and life insurance companies comply with the Act. The SARB has authority in terms of section 45C of the FIC Act to impose administrative sanctions on these entities if and when they fail to comply with a provision of this Act or any order, determination or directive made in terms of this Act. The SARB issues notices with the said penalties to the relevant entities but does not account for the penalties in its financial statements as the penalties imposed are paid directly to the National Revenue Fund belonging to the National Treasury. Total penalties issued on behalf of the National Treasury amounted to R1 million for the financial year.

Personnel and operational costs consist of only the direct costs related to the administration of the PA. Although the PA uses the various support departments of the SARB and incurs costs from these services (such as legal services, IT, risk management, compliance, internal audit, human resources, international economic relations and policy, security, and facilities), these costs were borne by the SARB for the year ended 31 March 2020. Amounts funded by the SARB amounted to R332 million for this financial year.

6 ADDITIONAL INFORMATION

ACTIVITIES FROM 1 APRIL 2019 TO 31 MARCH 2020

LICENCE APPLICATIONS

	Received	Licensed	In progress	Cancelled	Declined
Banks/mutual banks/co-operative banks	2	-	2	-	-
Branches	-	-	-	-	-
Representative offices	1	-	1	-	-
Insurers	31	1	26	4	-
CFIs*	30	-	30	-	-

* In terms of Prudential Standard TCFI-01, all CFIs previously registered by the Co-operative Banks Development Agency must apply for registration to the PA in terms of the Co-operative Banks Act on or before 1 August 2019.

Note: For the CFI figures, 7 of the 30 applications in progress have been approved within the PA and are with the FSCA for its concurrence.

FINANCIAL INSTITUTIONS REGISTERED DURING 2019/20

Branches of foreign banks

- **Bank of Communications Co., Ltd., Johannesburg Branch – 17 October 2019**
- **Goldman Sachs International Bank, Johannesburg Branch – 13 August 2019**

Representative offices

- **Bank Vontobel AG – 18 September 2019**

DE-REGISTRATIONS OR WITHDRAWAL OF LICENCES

Controlling company – banks	Effective date
Mercantile Bank Holdings Limited	12 February 2020
Representative offices – banks	**Effective date**
Zenith Bank Plc	11 November 2019
Insurer	**Effective date**
Sabsure Limited	2 December 2019

FIT AND PROPER ASSESSMENTS FOR EXECUTIVE OFFICERS

Deposit-taking financial institutions			
Applications received	**Approved**	**Declined**	**In progress**
237	223	14	0

Insurers				
Applications received	**Approved**	**Declined**	**In progress**	**Cancelled**
522	148	2	322*	50

* The majority of these applications are being considered within the conversions process.

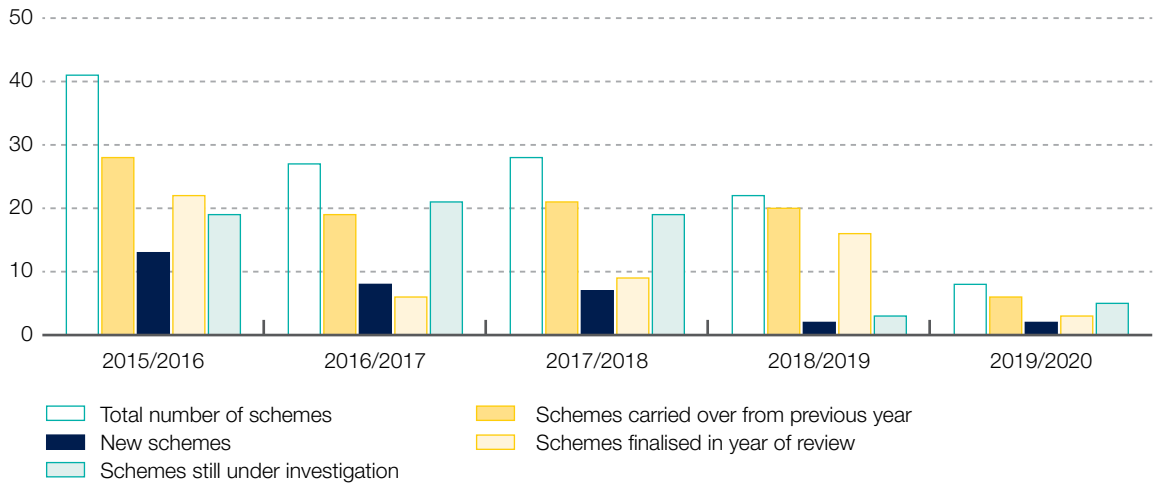
NAME CHANGES

Old name	New name	Effective date
Onderlinge Versekeringsgenootskap Avbob	Avbob Mutual Assurance	27 January 2020

TRANSFER OF BUSINESS

Transferor insurer	Transferee insurer	Effective date
Hollard Specialist Life Limited	Centriq Life Company Limited	28 June 2019
Hollard Specialist Insurance Limited	Centriq Insurance Company Limited	28 June 2019
Real People	Old Mutual Alternative Risk Transfer	Under consideration

INSPECTIONS OF ILLEGAL DEPOSIT-TAKING SCHEMES



FINANCIAL PENALTIES FOR NON-COMPLIANCE WITH THE FIC ACT

Name of institution	Non-compliance	Administrative sanction
Sasfin Bank Limited	Failure to provide adequate training to certain employees as required by section 43(a) of the FIC Act, read with the guidance provided by the FIC in Public Compliance Communication 18.	A financial penalty of R500 000 and a directive to take remedial action.
Bank of Baroda	Failure to comply with the cash threshold reporting requirement in terms of section 28 of the FIC Act.	A financial penalty of R400 000.
The Standard Bank of South Africa Limited	Failure to comply with suspicious and unusual transaction reporting requirements in terms of regulation 24(3) of the FIC Act, read with regulation 29(7) of the Money Laundering and Terrorist Financing Control Regulations.	A financial penalty of R30 million and a directive to take remedial action (R7.5 million of the R30 million is suspended for a period of three years).
GroBank Limited (formerly known as South African Bank of Athens Limited)	Failure to comply with cash threshold reporting requirements in terms of section 28 of the FIC Act; failure to comply with suspicious and unusual transaction reporting requirements in terms of section 29 of the FIC Act; and failure to comply with the training requirements in terms of section 43(a) of the FIC Act.	A financial penalty of R5 million and a caution not to repeat the conduct which led to non-compliance (the financial penalty is suspended for a period of three years).
Bank of China – Johannesburg Branch	Failure to comply with cash threshold reporting requirements in terms of section 28 of the FIC Act.	A financial penalty of R2 million and a directive to take remedial action (the financial penalty is suspended for a period of three years).
Ubank Limited	Failure to comply with the cash threshold reporting requirements in terms of section 28 of the FIC Act and deficiencies relating to section 43(a) and section 43(b) of the FIC Act respectively (training and monitoring of compliance).	A financial penalty of R500 000 and a directive to take remedial action. A reprimand and a caution not to repeat the conduct which led to non-compliance.
HBZ Bank Limited	Failure to comply with suspicious and unusual transaction reporting requirements in terms of regulation 24(3) of the FIC Act, read with regulation 29(7) of the Money Laundering and Terrorist Financing Control Regulations, and failure to comply with training requirements in terms of section 43(a) of the FIC Act.	A caution not to repeat the conduct which led to non-compliance.

ABBREVIATIONS

AIRB	advanced internal ratings-based [approach]
AML	anti-money laundering
Banks Act	Banks Act 94 of 1990
BCBS	Basel Committee on Banking Supervision
BE-CCP	bank exposure to central counterparties
CAR	capital adequacy ratio
CCP	central counterparty
CEO	Chief Executive Officer
CET	common equity tier
CFI	co-operative financial institution
CFT	countering the financing of terrorism
Co-operative Banks Act	Co-operative Banks Act 40 of 2007
COVID-19	coronavirus disease 2019
CREIF	capital requirements for banks' exposures to equity investments in funds
CSD	central securities depository
FIC Act	Financial Intelligence Centre Act 38 of 2001, as amended
fintech	financial technology
FIRB	foundation internal ratings-based [approach]
FSAP	Financial Sector Assessment Programme
FSCA	Financial Sector Conduct Authority
FSLAB	Financial Sector Laws Amendment Bill, 2018
FSR Act	Financial Sector Regulation Act 9 of 2017
IFRS	International Financial Reporting Standard
IMA	internal models-based approach
IMF	International Monetary Fund
Insurance Act	Insurance Act 18 of 2017
IT	information technology
LCR	liquidity coverage ratio
MCR	minimum capital requirement
NGSF	Network of Central Banks and Supervisors for Greening the Financial System
PA	Prudential Authority
PA Manco	Prudential Authority Management Committee
PFMIs	Principles for financial market infrastructures
PruCo	Prudential Committee
RDARR	risk data aggregation and risk reporting [principles]
Regulations	Regulations relating to Banks
SARB	South African Reserve Bank
SCR	solvency capital requirement
SIFI	systemically important financial institution
STA	standardised approach
STC	simple, transparent and comparable
TOM	target operating model