MEMORANDUM ON THE OBJECTS OF THE BANKS AMENDMENT BILL, 2007

1. BACKGROUND TO THE BILL

1.1 On 26 June 2004 the International Basel Committee on Banking Supervision published an amended capital framework for banks entitled "International Convergence of Capital Measurement and Capital Standards: A Revised Framework", generally referred to and known as "Basel II". The primary objective of Basel II is to replace the 1988 Capital Accord to further strengthen the soundness and stability of the international banking system by the adoption of stronger risk management practices by the banking industry. Basel II has important implications for the capital frameworks of banks and the regulatory framework and supervisory processes applicable to banks.

1.2 Given the potential negative effects of not implementing Basel II on the South African banking industry, it is prudent to implement Basel II in its entirety and to amend the legal framework to facilitate its implementation.

1.3 An Accord Implementation Forum ("AIF") was established to manage and co-ordinate the implementation of Basel II. The Registrar of Banks chairs the Steering Committee of the AIF and its members include delegates from National Treasury, various departments of the South African Reserve Bank, the banks and the auditing profession. The Regulatory Framework Sub-Committee ("RFSC") of the Steering Committee was tasked to review the current legal framework relating to banks and to identify necessary amendments to give effect to Basel II.

1.4 The RFSC identified a number of amendments to the Banks Act that are necessary to give effect to Basel II and assisted the Office of the Registrar

of Banks in the drafting of the draft Banks Amendment Bill. The Bill is thus the result of an inclusive and consultative process between this Office, the banking industry and other role-players since 2004.

1.5 The proposed implementation date for Basel II is 1 January 2008. To achieve this date it is important to promulgate the amendments well in advance as the amendments will require the banks and the Office of the Registrar of Banks to effect crucial information technology system changes to be able to implement the amendments.

1.6 The draft Bill primarily contains amendments to the Banks Act necessitated by the revised Framework on International Convergence of Capital Measurement and Capital Standards published by the International Basel Committee on 26 June 2004. Additional amendments that have become necessary since the Banks Act was last amended in 2003 due to industry developments or to clarify certain provisions, are also proposed.

1.7 In summary the Basel II amendments aim to create a sufficiently robust regulatory environment that will enable the Registrar to properly discharge his/her respective roles and responsibilities in respect of banks, controlling companies and banking groups on a solo, cross-border or consolidated basis. The Banks Act pertaining to the supervision of banks and in particular as it relates to the following aspects are strengthened -

1.7.1 regulation of all relevant banks and banking groups on a consolidated basis;
1.7.2 stating the respective roles and responsibilities of consolidating and host supervisors;
1.7.3 providing for cooperation and sharing of information between supervisors;

1.7.4 clarifying the responsibilities of banks, banking groups, boards of directors of banks and banking groups;

1.7.5 increasing the reporting requirements of and providing comprehensive disclosure requirements for banks and banking groups;

1.7.6 facilitating the various options available to banks and banking groups in calculating minimum capital requirements in respect of credit risk exposure, market risk exposure and operational risk exposure; and

1.7.7 elaborating the supervisory review process in order to, amongst other things, assess the capital adequacy and control environment of banks and banking groups.

1.8 The other proposed amendments are largely of a technical nature and include the following:

1.8.1 **extending the regulatory authority** of the Registrar to divisions and controlling companies of banks in certain respects where his or her regulatory authority is currently limited to banks;

1.8.2 clarifying and strengthening the **powers of the Registrar** to ensure compliance with the Act. The Registrar is authorised to issue circulars, guidance notes and directives, request information from relevant institutions, impose administrative penalties, etc. The power of the Registrar to object to the appointment of directors and executive officers is also clarified;

1.8.3 imposing an **obligation on the Registrar** to keep a register of registered controlling companies, branches, eligible institutions, representative offices of foreign institutions or the subsidiaries and branches of banks; and

1.8.4 effecting a number of **technical and editorial amendments** such as –

- correcting references to Acts repealed since the last amendment to the Act (for instance, replacing the reference to the Insurance Act, No 27 of 1943 with a reference to the Long-term Insurance Act, No 52 of 1998);
- clarifying that a reference to a "bank" includes a reference to a "branch"; and
- clarifying the meaning of the term "assets and liabilities" when such is transferred.

2. OBJECTS OF THE BILL

The Objects of the draft Bill are to –

2.1 facilitate the implementation of Basel II; and

2.2 align the Act to changing supervisory policy, market developments and practical considerations.

3. SUMMARY OF THE BILL

The following is a brief summary of the Bill:

Section 1: Definitions

"Allocated capital and reserve funds" - This definition is moved from section 70 to the definitions in section 1 of the Act.

"chief executive officer" - To reflect the differences in the legal nature of a bank and a branch of a foreign institution.

"consolidating supervisor" and "host supervisor" - To give effect to the latest international practice of referring to the home supervisor as the consolidating supervisor and to facilitate the following Basel II requirements –

- Basel II should be applied on a consolidated basis to all relevant banks and banking groups;

- Clarifying the respective roles and responsibilities of consolidating and host supervisors;
- the need for cooperation between consolidating and host supervisors;
- the sharing of information between consolidating and host supervisors.

"deposit" - To correct references to Acts repealed since the last amendment to the Act. The following references are corrected:

- Insurance Act, No 27 of 1943 replaced with Long-term Insurance Act, No 52 of 1998;
- Insurance Act, No 27 of 1943 replaced with Short-term Insurance Act, No 53 of 1998.

Subparagraph (vi) is replaced and a new subparagraph (ix) is inserted to give effect thereto.

"Division" - To clarify what constitutes a "division" to facilitate the effective enforcement of section 52 in as far as it relates to the establishment of divisions of a bank in conjunction with third parties that are not banks.

"eligible institution" and "external credit assessment" - Basel II is a risk sensitive framework in terms of which external credit assessments or ratings issued by external credit assessment institutions form an integral part of calculating a bank's minimum required capital and reserve funds. Based on the important role that external credit assessment institutions or eligible institutions will play in determining a bank's minimum required capital and reserve funds, and the requirements of Basel II, a definition relating to eligible institution and external credit assessment is included in the Act.

"Hybrid-debt instrument" - To facilitate the use of the term in the Act (section 79) and the Regulations.

"primary share capital" - As Basel II provides supervisors the discretion to take minority interests into account with the calculation of primary capital on a consolidated basis, a provision is added to the definition of "primary capital" enabling the percentage of minority interests that would qualify as primary capital to be prescribed by regulation.

“primary and secondary unimpaired reserve funds" - In terms of international best practice, supervisors, amongst other things, need to keep the following matters in mind when they conduct consolidated supervision in respect of a banking group –

- Robust definitions relating to the elements of qualifying capital and reserve funds are necessary. One example is that instruments that qualify as capital of an insurer may not qualify as capital of a bank;
- The suitability, quality and availability of capital is equally important since, for example, a subordinated loan in a banking subsidiary may be included in the consolidation of group capital but may strictly not be available as capital for the group but only for the banking subsidiary.

Currently the definitions of primary and secondary unimpaired reserve funds only include references to “a/ the bank”. It is proposed that the definitions also make reference to a controlling company.

Furthermore, recently adopted International Financial Reporting Standards (IFRS), amongst other things, prescribe the manner in which entities, including banks and banking groups, have to account for certain fair value adjustments. It is proposed that the definitions of primary and/or secondary unimpaired reserve funds include wording such as “… such percentage of a reserve arising from compliance with financial reporting standards.” The percentage would then be prescribed in the Regulations.

The definitions exclude a fund required to be maintained in terms of any other law from qualifying as primary or secondary reserves. It is, however, possible that in the dynamic environment of banking and accounting, it might happen that certain statutory funds may qualify as primary or secondary reserves. In order to accommodate this possibility it is proposed that the definitions contain an enabler to prescribe such funds by means of regulation.

“qualifying capital and reserve funds” - This definition is moved from section 70 to the definitions in section 1 of the Act.

“Securitisation scheme” - To facilitate the use of the term in the Act and the Regulations.

“tertiary capital” – To align the definition of the term with Basel II requirements.

Sections 1 and 70: Delete references to CAR Regulations

The provisions of the Regulations relating to Banks' Financial Instrument Trading (CAR Regulations) have been incorporated into the proposed amended Regulations. It is therefore proposed that the reference to the CAR Regulations be deleted in sections 1 and 70 of the Act.

Section 4(3): Written arrangements relating to respective roles and responsibilities and cooperation between consolidating and host supervisors

Basel II, amongst other things, clearly states that-

- in order to reduce the compliance burden and avoid regulatory arbitrage, the methods and approval processes used by a bank at the group level may be accepted by the consolidating supervisor at the local level, provided that they adequately meet the host supervisor's requirements;
- whenever possible, supervisors should avoid performing redundant and uncoordinated approval and validation work in order to reduce the implementation burden on banks, and conserve supervisory resources.

Furthermore in terms of the requirements of the Basel Concordat, before granting consent to the creation of a cross-border establishment, the host supervisor and the bank's or banking group's consolidating supervisor should each review the allocation of supervisory responsibilities recommended in Basel II in order to determine whether its application to the proposed establishment is appropriate.

Sharing of information and cooperation between supervisors are prerequisites for the effective supervision of a banking group on a consolidated basis. Sharing of information does not only relate to sharing of information between bank supervisors but also with securities or insurance supervisors.

Furthermore Core Principle 24 states that: *A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.*

It is proposed that the aspects pertaining to cooperation agreements be explicitly stated in the Act.

Section 4(4): Supervisory review process

Pillar 2 of Basel II deals comprehensively with the supervisory review process.

Based on the requirements of pillar 2 of Basel II, it is proposed that section 4 of the Act be amended to impose a duty on the Registrar to implement and maintain a supervisory review process.

Section 4(5): Mapping of external ratings

In terms of the requirements of Basel II, supervisors have to assign eligible external credit assessment institutions' ("eligible institution") assessments to the risk weights available under the standardised risk weighting framework, that is, deciding which assessment categories correspond to which risk weights.

The mapping process has to be objective and it should result in a risk weight assignment consistent with the level of credit risk reflected in the Basel II Accord and should cover the full spectrum of risk weights. Annexure 2 of Basel II contains comprehensive information to assist supervisors with the process of assigning credit assessments to the relevant risk weights.

Based on the requirements of Basel II relating to the mapping of external ratings, it is proposed that section 4 of the Act be amended to provide for such mapping process.

Section 4(6): National discretion

Since Basel II recognises that-

- the regulation and supervision of banks or banking groups is not an exact science; and
- discretionary elements within the supervisory review process are inevitable,

the new framework contains various items of national discretion.

Furthermore Basel II requires-

- supervisors to carry out their obligations in a transparent and accountable manner;
- supervisors to make publicly available items of national discretion.

Based on the requirements of Basel II relating to items of national discretion, it is proposed that section 4 of the Act be amended to provide for the exercise of such discretion, in consultation with the banks.

Section 4(7): Disclosure of information

Basel II, amongst other things-

- requires supervisors to make publicly available the criteria to be used in the review of banks' internal capital assessments;
- states that when supervisors choose to set target or trigger ratios or to set categories of capital in excess of the regulatory minimum, factors that may be considered in doing so should be publicly available;
- requires the supervisory process for recognising eligible institutions to be made public in order to avoid unnecessary barriers to entry;
- requires supervisors to make publicly available items of national discretion.

Based on the requirements of Basel II relating to disclosure of certain information, it is proposed that section 4 of the Act be amended to provide for such disclosure of information.

Section 6(4): Circulars, guidance notes and directives

Currently section 6(4) of the Act states that "The Registrar may from time to time by means of a circular furnish banks with guidelines regarding the application and interpretation of the provisions of this Act or provide banks with any other information".

Based on the fact that Basel II clearly makes provision for-

- eligible external credit assessment institutions;
- external auditors of banks or banking groups,

to fulfill certain duties, it is proposed that the ambit of section 6(4) be broadened to also include a controlling company, an eligible institution (rating agency) and an auditor of a bank or controlling company;

It is furthermore proposed that the provisions of section 6(4) clearly distinguish between circulars, guidance notes and directives:

- Circulars may be issued by the Registrar to furnish banks with guidelines regarding the application and interpretation of the provisions of the Act. Guidelines issued under a Circular are not obligatory.
- Guidance notes may be issued by the Registrar in respect of market practices that banks may or may not consider in the conduct of their business and which are not mandatory for banks to implement but merely provide banks with further information.
- Directives may be issued by the Registrar, after consultation with the affected parties, to prescribe certain processes or procedures to be followed by banks with regard to certain processes or procedures necessary in the administration of the Act. The legal nature of directives is that it would be obligatory for banks to comply with its prescriptions.

Section 7: Furnishing of information by banks

The Public Accountants' and Auditors' Act, 1991 (Act No. 80 of 1991) has been repealed by the Auditing Professions Act, 2005 (Act No. 26 of 2005). It is proposed that the reference be corrected in this provision.

Section 9: Review of decisions by the Registrar

The Public Accountants' and Auditors' Act, 1991 (Act No. 80 of 1991) has been repealed by the Auditing Professions Act, 2005 (Act No. 26 of 2005). It is proposed that the reference be corrected in this provision.

Section 12: Application for authorization to establish bank

The Public Accountants' and Auditors' Act, 1991 (Act No. 80 of 1991) has been repealed by the Auditing Professions Act, 2005 (Act No. 26 of 2005). It is proposed that the reference be corrected in this provision.

Section 18A: Branches of foreign institutions

Although the legal nature of the structure of a branch differs from that of a bank, most of the prescriptions of the Act apply equally to banks and branches, with a few exceptions.

Other legislation, such as anti-money laundering legislation, only refers to banks. It is, however clear that branches are also required to comply with the prescriptions.

In order to provide legal certainty to this issue, however, it is necessary to explicitly provide that a reference to "bank" in the Act or other legislation includes a reference to a "branch", unless expressly stated otherwise.

Section 30: Publication of information relating to banks, branches, controlling companies, eligible institutions and representative offices of foreign institutions and the keeping of records by the Registrar

Section 30 of the Act requires that the Registrar keeps a register of all registered banks, but does not require the Registrar to also keep a register of registered controlling companies, branches, eligible institutions, representative offices of foreign institutions or the subsidiaries and branches of banks.

In the light of the prescriptions of Basel II on consolidated supervision it is proposed that branches of foreign institutions, controlling companies and eligible institutions be included in the section.

Section 37: Permission for acquisition of shares in bank or controlling company

Section 37(1) places restrictions on the acquisition of the "…total nominal value of all the issued shares of the bank or controlling company…"

Since the Act was promulgated it has become common practice, at least amongst the major banks, to issue non-redeemable, non-cumulative preference shares comprising up to 20% of their primary capital and possibly more if non-qualifying shares are included. These preference shares usually do not have voting rights similar to those of ordinary shareholders.

In future, various forms of hybrid instruments (shares with some debt characteristics) will be issued, further increasing the total nominal value of all the issued shares of a bank or controlling company. It is therefore now quite possible for a single shareholder to own less than 15%, 24%, 49%, or 74% of the nominal value of all the issued shares of the bank or controlling company whilst breaching the thresholds in respect of the voting rights attached to those shares of the bank or bank controlling company.

The practice whereby certain share agreements provide for the transfer of voting rights from one shareholder to another shareholder is also a factor that has necessitated the proposed amendment.

It is recommended that this section be amended to also make the thresholds applicable to the voting rights in respect of the issued shares of a bank or controlling company that is exercisable by a person.

Section 43: Registration of controlling companies

Section 43(1) of the Act provides that a public company that *desires* to exercise control over a bank, *may* apply for registration as a controlling company.

It is proposed to amend the section to read that a public company that intends to exercise control over a bank *shall* apply for registration as a controlling company.

Section 50: Investments by controlling companies

Section 50 of the Act provides that a controlling company investing money in undertakings other than banks or in fixed property not being used for the purpose of conducting the business of a bank shall manage its transactions in such investments in such a way that the amount of such investments does not at any time exceed 40 per cent of the sum of its share capital and reserve funds.

It is proposed that the section be amended to properly reflect the accounting standards in this regard. It is proposed that the section be amended to provide that the amount of the said investments does not exceed a percentage as prescribed of the share capital and reserve funds of the controlling company

calculated on a consolidated basis as prescribed. (The manner of the calculation will then be provided for in the Regulations).

It is also proposed to apply the similar provisions to loans and advances by controlling companies.

Section 52: Subsidiaries, branch offices, other interests and representative offices of banks and controlling companies

The enforcement and administration of section 52 of the Act have become problematic due to certain interpretation issues and somewhat unclear wording of the section.

It is proposed that section 52 of the Act be amended to provide for a prior approval process if banks or controlling companies wish to establish or acquire subsidiaries within or outside South Africa. It is also proposed that the section also provides for the direct and indirect establishment or acquisition of subsidiaries.

It is furthermore proposed to regulate the establishment of divisions, involving non-bank third parties, by banks for reasons set out in paragraph 1 above.

Section 54: Compromises, amalgamations, arrangements and affected transactions

As a result of the wording of section 54 of the Act, and the various legal interpretations assigned to the term “assets **and** liabilities” the enforcement of its provisions has become somewhat problematic for the Bank Supervision Department.

Some of the concerns raised in the interpretation of section 54 of the Act include the following:

- Technically a bank cannot sell a pool car, fixed property or any other asset without the Minister's approval.
- The section refers to the transfer of assets **and** liabilities. Questions have been raised as to applicability of this section if and when banks transfer only assets in the normal course of business.

As a result of the issues set out above, it is proposed that section 54 of the Act be amended to address the difficulties in this regard.

Section 59: Returns regarding shareholders

Currently section 59 of the Act prescribes different reporting thresholds for domestic and foreign shareholders. For example, the name and certain particulars of a foreign shareholder is not required when the total nominal value of the shares registered in the name of the shareholder is less than the lower of R100 000 or one per cent of the total nominal value of all the issued shares. Although R100 000 may have been a substantial amount for investment in shares when the Act was written in 1990, it is unlikely to still be the case and it may be considered to prescribe similar reporting thresholds for domestic and foreign shareholders, namely a one per cent reporting threshold.

Furthermore the one per cent threshold currently relates to "… less than one per cent **of the total** nominal value of **all the issued shares** of …" This means, for example, that the details of a person that holds 3 per cent of the ordinary shares, that is, shares with permanent voting rights, but less than one per cent of **the total nominal value of all the issued shares**, are not required to be reported.

It is proposed that the detailed provisions be contained in the Regulations and that section 59 be amended to enable such prescriptions by Regulations.

Section 60: Directors of bank or controlling company

Section 60 of the Act was substantially amended in 2003 to provide the Registrar with powers to object to the appointment of directors and executive officers.

Since the promulgation of the amendments to section 60 of the Act and the establishment of a policy and procedure by the Bank Supervision Department in this regard, it has transpired that the provisions contain certain deficiencies.

The identified deficiencies in relation to section 60 of the Act include the following:

- Section 60(5) of the Act provides for two different procedures for the appointment by a bank of non-executive directors and executive-directors and

executive officers, respectively. The section also provides for two different processes for the Registrar to object to the appointment of non-executive directors and executive-directors and executive officers, respectively. This distinction has proved to be impractical and has resulted in legal uncertainty in this regard. It is proposed that the processes and procedures pertaining to the appointment of and the subsequent objection to the appointment of both non-executive directors and executive directors and officers be the same.

- Section 60(6) of the Act provides for a procedure of objection only in relation to executive directors and officers. It is necessary for the wording to be amended in order to reflect the legal position. The omission of non-executive directors is clearly a drafting oversight and needs to be corrected.

Section 63: Functions of auditor in relation to registrar

The Public Accountants' and Auditors' Act, 1991 (Act No. 80 of 1991) has been repealed by the Auditing Professions Act, 2005 (Act No. 26 of 2005). It is proposed that the reference be corrected in this provision.

Sections 64, 64A and 64B: Audit, risk and directors' affairs committee

Currently the provisions of sections 64, 64A and 64B of the Act only relate to banks.

Based on the fact that -

- the content of the said sections is equally relevant for a controlling company and banking groups; and
- Basel II clearly states that the scope of application of the framework will include, on a fully consolidated basis, any holding company that is the parent entity within a banking group to ensure that it captures the risk of the whole banking group,

it is necessary to require both a bank and its controlling company to establish and use the various committees.

It is, however, also necessary that the Registrar be afforded the power to exempt a bank from establishing such committees in cases where the Registrar is

satisfied that the relevant committee of the controlling company adequately performs the tasks also in respect of the bank.

As a result of the prescriptions of Basel II introducing a risk sensitive approach to the management of a bank, requiring banks to relate risk to capital and requiring banks to maintain a sound capital management process, it is proposed that the name of the Risk Committee be changed to the “Risk and capital management committee”, and to add the provisions setting out the required functions of the said committee.

The Corporate Laws Amendment Bill, 2006 also contains certain provisions relating to Audit Committees. It is proposed that this Act be amended to reflect the provisions of the said Bill.

Section 70: Minimum share capital and unimpaired reserve funds

Currently section 70 of the Act provides that, in the calculation of the aggregate amount of capital that a bank is required to maintain, the sum of the bank’s secondary capital and secondary unimpaired reserve funds shall be taken into account to an amount not exceeding the sum of the bank’s allocated and qualifying primary share capital and allocated and qualifying primary unimpaired reserve funds, that is, the split may be 50:50.

In order for the legislative framework to remain in line with international regulatory and supervisory requirements and developments, it is proposed to amend section 70 as set out in the Bill.

Section 70A: Minimum capital and reserve funds in respect of a controlling company

The current requirements of section 70A of the Act provide that a controlling company has to maintain capital and reserve funds equal to the sum of the required capital amounts of the individually regulated entities, as determined by their respective regulators, *plus* a capital proxy amount in respect of unregulated entities.

Neither the Act nor the Regulations, however, require a banking group at any stage to calculate *consolidated or aggregated risk positions or exposures* before calculating a capital requirement for the banking group based on the consolidated or aggregated amount of risk exposure, not even in respect of a locally incorporated bank and its foreign branches.

The abovementioned position is, however, not sufficiently comprehensive since Basel II, amongst other things, clearly states that-

- the framework will be *applied on a consolidated basis* to internationally active banks;
- the consolidating country supervisor is responsible for the oversight of the implementation of the framework for a banking group on a consolidated basis;
- the scope of application of the framework will include, on a fully consolidated basis, any holding company that is the parent entity within a banking group to ensure that it captures the risk of the whole banking group;
- the framework will also apply to all internationally active banks at every tier within a banking group, also on a fully consolidated basis. A three-year transitional period for applying full sub-consolidation will be provided for those countries where this is not currently a requirement.

The aforementioned requirements mean that-

- individual entities within a banking group have to be adequately capitalised on a stand-alone basis; and
- based on the overall activities and aggregated amount of risk exposures incurred by entities included in the banking group, the banking group has to be adequately capitalised.

Based on the aforementioned requirements and the requirements specified in paragraph 3 above relating to robust definitions in respect of the elements of qualifying capital and reserve funds, it is proposed that section 70A of the Act be amended as proposed in the Bill.

Section 73: Large exposures

Currently section 73 of the Act deals comprehensively with various matters relating to the exposure of a bank, controlling company, branch or branch of a bank to a single person, including-

- requirements for the board of directors to approve exposures in excess of certain amounts;
- requirements to maintain additional capital and reserve funds in respect of certain exposures to a private-sector non-bank person;
- reporting requirements to the Registrar; and
- comprehensive definitions relating to a "person" and a "private sector non-bank person".

However, Basel II clearly states that-

- "… supervisors should assess the extent of a bank's credit risk concentrations, how they are managed, and the extent to which the bank considers them in its internal assessment of capital adequacy under Pillar 2. Such assessments should include reviews of the results of a bank's stress tests. Supervisors should take appropriate actions where the risks arising from a bank's credit risk concentrations are not adequately addressed by the bank…";
- concentration risk does not only relate to counterparty exposure but also exposure to an industry, sector or a geographical area.

Finally, due to the size of certain corporate conglomerates in relation to banks, the uniqueness of certain corporate structures and the extent of corporate concentration in South Africa, it may be considered to also include an enabling provision in section 73 of the Act that will allow the Registrar, with the approval of the Minister of Finance, to exempt certain concentrations or exposures from the requirements of the Act or the Regulations that would otherwise be in force, which exemption will be for such time and subject to such conditions as may be prescribed by the Minister or specified in writing by the Registrar.

It is therefore proposed to change the heading of this section to "Concentration risk" and to add the provisions as set out in the Bill.

Section 74: Failure or inability to comply with prudential requirements

Currently section 74 of the Act only relates to the failure or inability of a bank to comply with prudential requirements.

However, due to the requirements of Basel II that, amongst other things, clearly state that-

- the framework will be *applied on a consolidated basis* to internationally active banks;
- the scope of application of the framework will include, on a fully consolidated basis, any holding company that is the parent entity within a banking group to ensure that it captures the risk of the whole banking group;
- the framework will also apply to all internationally active banks at every tier within a banking group, also on a fully consolidated basis. A three-year transitional period for applying full sub-consolidation will be provided for those countries where this is not currently a requirement,

it is proposed that provisions of section 74 of the Act be amended as set out in the Bill.

Sections 75 and 90: Returns and regulations

The Act and the Regulations contain various references to Statements of Generally Accepted Accounting Practice.

Recently South Africa adopted International Financial Reporting Standards (IFRS).

The latest proposed amendments to the Companies Act provides for a definition of “financial reporting standards” as well as the establishment of a “Financial Reporting Standards Council”.

It is therefore proposed that the terms “Generally Accepted Accounting Practice” be removed from the Act and replaced with a reference to the financial reporting standards issued by the Financial Reporting Standards Council as set out in section 440S of the Companies Act.

Section 76: Restriction on investments in immovable property and shares, and on loans and advances to certain subsidiaries

The principal Act was amended during 2003 resulting in certain deletions from subsection section 76(1) of the Act. These deletions were however misaligned with the provisions of the regulations in this regard.

It is therefore proposed to amend the section in order to properly reflect the provisions contained in the Regulations.

Section 79: Shares, debentures and NCDS

Currently section 79 of the Act only refers to a bank that needs to obtain approval or comply with certain conditions in respect of the issue of certain instruments.

However, based on the fact that Basel II requires consolidating supervisors to also regulate the capital adequacy of a banking group and a controlling company, it is proposed that the provisions of section 79 of the Act be amended to also apply to a controlling company.

Currently section 79(1)(c) of the Act only refers to negotiable certificates of deposit that may not be issued otherwise than in accordance with prescribed conditions. Following certain amendments to the Income Tax Act, banks recently commenced issuing instruments such as promissory notes instead of negotiable certificates of deposit.

Since instruments such as negotiable certificates of deposit and promissory notes are instruments of similar characteristics, it is proposed that the heading of section 79 and the content of section 79(1)(c) of the Act to include the wording "… negotiable certificates of deposit, promissory notes or instruments of similar characteristics …"

With the advent of so-called hybrid instruments, it is necessary to also include such instruments in this provision.

Sections 81-84: Control of certain activities of unregistered persons

One of the main problems in enforcing sections 81 to 84 of the Act is the fact that once inspectors have been appointed to investigate a person operating an illegal scheme, it invariably happens that such a person is liquidated or sequestrated. Such a liquidation or sequestration negates the work done by the inspectors, and the higher fees charged by the appointed liquidator/trustee of the insolvent estate are to the detriment of depositors in such a scheme.

For various reasons, BSD has been loathe to become involved in the liquidation process of unregistered persons. Their experience in the recent past, however, has made it imperative that the Registrar becomes involved to some degree.

It is proposed that provision is made that whilst a person operating an illegal scheme is under investigation or management in terms of the provisions of the Act, such a person may not be liquidated or sequestrated by any person, save with the leave of the court and only once the Registrar has been notified of such an application.

It is also proposed that a duly appointed fund manager should report to the Registrar on the solvency of the person operating the illegal scheme. When the person is found to be solvent, the manager may repay depositors as provided for in section 84 of the Act. When a person is found to be insolvent, the Registrar may apply for the liquidation of the person and will be able to recommend the liquidator to be appointed as well as agree to the liquidator's fee structure in this regard.

New Section 85A: Approval of eligible institutions

In terms of the requirements of paragraph 90 of Basel II, supervisors are responsible for determining whether or not an eligible institution meets the criteria listed in paragraph 91 of Basel II, and as such may be regarded as an approved eligible institution.

Furthermore-

- the assessments of eligible institutions may be recognised on a limited basis, that is, by type of claims or by jurisdiction;

- Basel II requires the supervisory process for recognising eligible institutions to be made public in order to avoid unnecessary barriers to entry.

Based on the aforementioned requirements of Basel II, it is proposed that section 85A of the Act be included as a new section in the Act.

New Section 85B: Verification of information

In terms of international best practice, all information submitted in respect of a bank or controlling company and its foreign branches, subsidiaries or joint ventures to a consolidating or host supervisor should be verified in one of three ways, namely:

- by the host supervisory authority;
- by external auditors appointed by either the host or consolidating supervisory authority; and
- by the consolidating supervisory authority.

It is therefore proposed that a new section 85B of the Act be inserted to make provision for the Registrar to request that certain information submitted in respect of a locally incorporated bank or controlling company and its foreign branches, subsidiaries or joint ventures be verified in such a manner and at such intervals as may be prescribed or specified in writing by the Registrar.

The proposed new section in the Act may also serve as an enabling section for the current regulation 45 reports submitted to the Registrar by the external auditors of banks.

Section 89: Furnishing of information by Registrar

Basel II requires that a duty be placed on supervisors to ensure that they satisfy themselves that the recipient of information that is furnished by the supervisor will be able and willing to deal with such information in a confidential manner.

It is proposed that section 89 of the Act be amended to reflect the above-mentioned prescription.

Section 91A: Financial penalties and sanctions or fines for non-compliance

Although the Act provides for the imposition of fines to banks in certain prescribed instances (sections 74 and 91 of the Act), it is clear that the provisions are inadequate with regard to the application of and the compliance to the Act in general.

It is proposed that the Registrar be afforded the power to impose substantial fines or sanctions on banks, including directors and executive officers of banks, for non-compliance to certain provisions of the Act or in respect of certain directives issued by the Registrar. In order for such power to be exercised judiciously and fairly, it is proposed that the decision to impose a fine or sanction be taken only after affording the bank concerned with an opportunity to make representations to the Registrar.

4. ORGANISATIONS AND INSTITUTIONS CONSULTED

4.1 The provisions of the Bill has been debated and recommended to the Minister of Finance by the Standing Committee for the Revision of the Banks Act, established in terms of section 92 of the Banks Act, 1990.

4.2 Consultation with various stakeholders was undertaken over a period of two years on the various proposals. The stakeholders include:

- The National Treasury & Registrar of Banks;
- The Financial Services Board;
- The Banking Association (representing banks in general);
- Individual banks;
- Auditing firms; and
- The Competition Commission.

4.3 In addition, the draft Bill was published on the internet websites of both the National Treasury and the South African Reserve Bank on 7 September 2006 for comment up to and including 7 November 2006. Comments were

primarily received from the Banking Association (representing banks in general), The Standard Bank of South Africa Limited, Investec Bank Limited and Ithala Limited. The Bill was revised where considered necessary in light of comments received.

5. FINANCIAL IMPLICATIONS TO THE GOVERNMENT

5.1 The Bill will not have significant financial implications for Government.

5.2 The Banking Sector will incur significant costs to implement Basel II. The Sector supports the implementation of Basel II as it will enhance their competitiveness in the international market, is aware of the costs associated with the implementation and is willing to incur the associated costs.

6. CONSTITUTIONAL IMPLICATIONS

None.

7. PARLIAMENTARY PROCEDURE

7.1 The State Law Advisers and the National Treasury are of the opinion that this Bill must be dealt with in accordance with the procedure prescribed by section 75 of the Constitution since it contains no provision to which the procedure set out in section 74 or 76 of the Constitution applies.

7.2 The State Law Advisers are of the opinion that it is not necessary to refer this Bill to the National House of Traditional Leaders in terms of section 18(1)*(a)* of the Traditional Leadership and Governance Framework Act, 2003 (Act No. 41 of 2003), since it does not contain provisions pertaining to customary law or customs of traditional communities.