INTERNATIONAL MONETARY FUND

IMF Country Report No. 14/340

SOUTH AFRICA

FINANCIAL SYSTEM STABILITY ASSESSMENT

December 2014

The Financial System Stability Assessment for South Africa, prepared by a staff team of the IMF for the Executive Board's consideration on December 3, 2014. This report is based on the work of an IMF Financial Sector Assessment Program (FSAP) mission to South Africa during April, May, and June 2014. The FSSA was completed on 11/11/14

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

SOUTH AFRICA

FINANCIAL SYSTEM STABILITY ASSESSMENT

November 11, 2014

Approved By
Christopher Towe and Anne-Marie Gulde

Prepared By
Monetary and Capital Markets Department

This report is based on the work of the Financial Sector Assessment Program (FSAP) mission that visited South Africa in April, May, and June 2014. The FSAP findings were discussed with the authorities during the Article IV consultation mission in September 2014.

- The FSAP team was led by Cheng Hoon Lim and included Elsie Addo Awadzi, Ke Chen, Richard Lalonde (all LEG), Yibin Mu (AFR), Timo Broszeit, Marc Dobler, Eija Holttinen, Jaime Jaramillo-Vallejo (Deputy), Li Lin, Mala Nag, Narayan Suryakumar, Haruto Takimura, Froukelien Wendt, Xiaoyong Wu, and Mamoru Yanase (all MCM), and Su Hoong Chang, Tanis MacLaren, and Elizabeth Roberts (all external experts).

- The mission met with Minister Nene, Director General Fuzile, Governor Marcus, Governor Designate Kganyago, Deputy Governor Mminele, Deputy Governor Groepe, Executive Officer Tshidi, Chief Executive Officer Motshegare, their senior staff, as well as senior management of the financial industry, including banks, insurance companies, money market and other fund managers, trade associations, and law firms.

- FSAPs assess the stability of the financial system as a whole and not that of individual institutions. They are intended to help countries identify key sources of systemic risk in the financial sector and implement policies to enhance its resilience to shocks and contagion. Certain categories of risk affecting financial institutions, such as operational or legal risk, or risk related to fraud, are not covered in FSAPs.

- South Africa is a G-20 country and is expected to undertake an FSAP every five years.

- This report was prepared by Cheng Hoon Lim with contributions from the FSAP team.

CONTENTS

TABLES

APPENDICES

ANNEX

GLOSSARY

ALM	Asset-liability management
AML	Anti Money Laundering
ART	Alternative risk-transfers
ASB	Accounting Standards Board
ASISA	Association for Savings and Investment South Africa
AUM	Assets under Management
BA or Banks Act	Banks Act 1990 (Act No. 94 of 1990, as amended)
BCBS	Basel Committee on of Banking Supervision
BCP	Basel Core Principles
BSD	Bank Supervision Department of the SARB
BU	Bottom-up
CA	Companies Act
CAR(s)	Capital Adequacy Requirement(s)
CCAR	Comprehensive Capital Analysis and Review
CCP	Central Clearing Counterparty
CET1	Common Equity Tier 1
CFR	Council of Financial Regulators
CFT	Combating the Financing of Terrorism
CIS	Collective Investment Schemes
CISCA	Collective Investment Schemes Control Act (No. 45 of 2002)
CLF	Committed Liquidity Facility
CoB	Conduct of Business
CP	Core Principle
CRA	Credit Rating Agency
CRSA	Credit Rating Services Act (No. 24 of 2012)
CSD	Central Securities Depository
DIS	Deposit Insurance Scheme
DMA	Directorate of Market Abuse
DP	Deposit Preference
DTI	Department of Trade and Industry
EC	Enforcement Committee of the FSB
ELA	Emergency Liquidity Assistance
EM	Emerging Market
ERM	Enterprise Risk Management
ETFs	Exchange Traded Funds
FAIS Act	Financial Advisory and Intermediary Services (Act No. 37 of 2002)
FICA	Financial Intelligence Centre Act (Act No. 38 of 2001)
FIU	Financial Intelligence Unit
FMA	Financial Markets Act (No. 19 of 2012)
FSAP	Financial Sector Assessment Program
FSB	Financial Services Board

FSB Act	Financial Services Board (Act No. 97 of 1990)
FSCF	Financial Sector Contingency Forum
FSOC	Financial Stability Oversight Committee
FSP	Financial Services Provider
GFC	Global Financial Crisis
HQLA	High Quality Liquid Assets
IAASB	International Auditing and Assurance Standards Board
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standard Board
ICAAP	Internal capital adequacy assessment process
ICPs	Insurance Core Principles
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IRB	Internal ratings-based approach (credit risk)
IRBA	Independent Regulatory Board for Auditors
ISA	International Standards on Auditing
JIBAR	Johannesburg Interbank Average Rate
JSE	Johannesburg Stock Exchange
KA	Financial Stability Board's Key Attributes of Effective Resolution
King III	King Report on Governance for South Africa, 2009
LCR	Liquidity Coverage Ratio
LGDs	Loss-given Defaults
LTV	Loan-to-value
MCA	Market Conduct Authority
MCR	Minimum Capital Requirements
ML	Money Laundering
MMFs	Money Market Funds
MoF	Minister of Finance
MoU	Memorandum of Understanding
NAV	Net Asset Value
NBFIs	Nonbank Financial Institutions
NCA	National Credit Act
NCR	National Credit Regulator
NPA	National Prosecuting Authority
NPL	Non-performing Loans
NRA	National Risk Assessment
NSFR	Net Stable Funding Ratio
NT	National Treasury
ORSA	Own Risk and Solvency Assessment
OTC	Over-the-counter
PA	Prudential Authority
PDs	Probabilities of Default
RBA	Risk-based Approach
ROE	Return on Equity

RWA	Risk Weighted Assets
SA	South Africa
SAFCOM	Safex Clearing Company (Pty) Ltd
SAICA	South African Institute of Chartered Accountants
SAM	Solvency Assessment and Management
SAMOS	South African Multiple Option Settlement
SAPS	South Africa Police Services
SARB	South African Reserve Bank
SIFIs	Systemically Important Financial Institutions
SRO	Self-Regulatory Organization
ST	Stress Test
Strate	Strate Party Ltd
TCF	Treating Customers Fairly
TD	Top-down
TRP	Takeover Regulation Panel

EXECUTIVE SUMMARY AND OVERALL ASSESSMENT

South Africa's financial sector operates in a challenging economic environment. Despite remarkable progress since the end of apartheid in 1994, South Africa still has one of the world's highest unemployment and income inequality rates. Slow economic growth since 2008 has further aggravated unemployment, real disposable income is stagnant, and households are heavily indebted. As a result, banks are increasingly exposed to credit risk, while households and firms are vulnerable to a rise in interest rates. The large fiscal and current account deficits, a weak growth outlook, the reliance of banks on money market funds (MMFs) for short-term wholesale funding, and banks' active trading in the over-the-counter (OTC) derivatives market make South Africa susceptible to contagion and sudden stops of capital flows. This susceptibility and potential for spillovers have been exacerbated by the significant concentration and interconnections in the financial system, and the substantial expansion of South African banks into sub-Saharan Africa.

These vulnerabilities became apparent in August 2014. African Bank, a boutique lender catering mainly to low-income households, was placed under curatorship after record losses from unsecured lending. Although its small size would have suggested no systemic implications, its problems are a reminder that asset quality can quickly deteriorate in a weak economy and even small institutions can entail systemic risk due to high interconnectedness.

Relatively high capital buffers as well as sound regulation and supervision have helped mitigate the risks. Banks and insurers are well capitalized and profitable. The South African Reserve Bank (SARB) is a proactive supervisor, with a high level of compliance with international standards on effective banking supervision. The SARB's decisive action in placing African Bank under curatorship limited contagion. Its proposed bail-in of senior unsecured creditors to share in the burden of resolution is also welcome and a step in the right direction of reducing the "too big to fail premium" for the large banks. Overall, financial sector risks and vulnerabilities are elevated but manageable.

Stress tests (ST) confirm the capital resiliency of banks and insurance companies to severe shocks but illustrate a vulnerability to liquidity shortfalls. Some banks have difficulty meeting Basel's requirement to hold enough high quality liquid assets (HQLA) to survive a stress scenario lasting 30 days without assistance from the SARB. They face even bigger challenges meeting a more stringent requirement to hold a minimum amount of stable funding over a one year horizon. Although these requirements will be gradually phased in, African Bank's experience highlights the importance of ensuring the large banks maintain adequate liquidity.

Given significant downside risks to the economy, strong regulation and supervision are essential to ensure financial sector resilience. The outlook for lackluster growth amid an uncertain global environment requires intensifying scrutiny on asset quality. Remaining gaps in the supervisory and regulatory framework should also be closed. The FSAP recommends the following actions:

- Reduce systemic liquidity risk by introducing deposit insurance and variable net asset value (NAV) for MMFs.

- Break down existing silos and enhance group-wide supervision to manage credit, concentration, interconnected, and cross-border risks; conduct system-wide STs on a regular basis.

- Enhance the regulation of collective investment schemes (CIS) to address, in particular, gaps in disclosure and valuation.

- Enshrine in legislation the objectives, operational independence and enforcement powers of supervisors, and the basis for government intervention.

- Step up the surveillance of OTC derivatives markets to reduce counterparty and global liquidity risks, and consider establishing a local central clearing counterparty (CCP).

In addition, the crisis management and resolution framework should be upgraded. Early intervention powers of the SARB and other prudential regulators should be enhanced, and the intervention of African Bank underscores the need to introduce a resolution regime for banks and systemic nonbank financial institutions (NBFIs) that are in line with the Financial Stability Board's Key Attributes of Effective Resolution (KA). A deposit insurance scheme (DIS) founded on depositor preference (DP), with a carefully calibrated ex ante fund and a back-up credit line from the National Treasury (NT), would also be an important plank in the crisis management framework.

The Twin Peaks reform to the regulatory architecture provides an opportunity to strengthen areas needing improvement. As the African Bank case highlighted, it is essential to have a clear demarcation of supervisory responsibilities and accountability in the new framework, supported by effective coordination mechanisms. The macroprudential toolkit being readied seems adequate for systemic oversight, but the SARB should have the resources and authority to collect granular data and perform regular stress testing, especially of systemically important financial institutions.

Finally, the authorities should promote a more competitive financial system to make it more efficient. Fostering more competitive behavior would result in a greater supply of financial services at lower intermediation costs, particularly for small and medium enterprises (SMEs) and low-income households. The FSAP recommends reducing the amount of capital required for entry to encourage the establishment of smaller banks; adopting a transparent exit framework; closing regulatory and supervisory gaps on both prudential and conduct grounds that favor incumbents; and improving access to information on financial services that help users compare different products on their terms, price, risks and benefits. While a careful balance is needed between financial stability and the objective of a less concentrated financial system, there is room to accommodate more competition in the current environment of strong prudential regulation and supervision.

Table 1. Key FSAP Recommendations	
Priority Recommendations (Timeframe 1–2 years)	**Paragraphs**
Twin Peaks Reform	
Define clear and comprehensive institutional, governance and accountability arrangements for prudential and market conduct regulation, including NCR and other relevant institutions.	¶26
Publish a roadmap for regulatory reform, with adequate resource allocation, monitoring and evaluation, to carefully implement the move to Twin Peaks and minimize transition risks.	¶26
Microprudential	
Strengthen group-wide supervision, focusing on credit and interconnectedness risks; monitor intra-group transactions and aggregate exposures, and conduct joint on-site visits.	¶30, 32, 35
Clarify objectives and strengthen the operational independence of all financial sector supervisors in the relevant legislation in line with international standards.	¶30, 32, 36
Enhance regulatory requirements of CIS, particularly for disclosure, valuation and accounting, introduce variable net asset valuation for MMFs, and strengthen the supervision of CIS managers.	¶34, 35
Fully implement Solvency Assessment and Management and Treating Customers Fairly initiatives; give high priority in legislation to protecting policyholder rights and entitlements.	¶31
Macroprudential	
Continue building a top-down ST framework for the banking sector and give SARB more resources for data collection and analysis.	¶39
Financial Safety Nets	
Introduce a resolution regime compliant with the Key Attributes for, and make the SARB the resolution authority of, all banks and SIFIs.	¶46
Adopt depositor preference and introduce an ex ante funded DIS, with a back-up credit line from the NT.	¶48
Remove constraints to early intervention powers and improve legal protection for resolution officials.	¶46
OTC Derivatives Market Reforms and Oversight	
Improve data collection of OTC derivatives and enhance surveillance of the OTC derivatives market.	¶40
Consider establishing a local CCP, with credit lines from the SARB and securities collateral placed at a central securities depository to reduce dependency on local banks.	¶41
Competition	
Adopt international best practices on provision and disclosure of market information to retail customers and to potential entrants into the payments and clearance systems.	¶51
Adopt a transparent entry and exit framework, and lower entry hurdles to the financial system.	¶51

FINANCIAL SYSTEM PROFILE

1. South Africa's financial sector is large and sophisticated. Financial sector assets amount to 298 percent of GDP, a ratio exceeding that of most emerging market (EM) economies (Appendix Table 1). NBFIs, which have grown rapidly in recent years, hold about two thirds of financial assets, also unusually large for an EM economy:

- Pension funds assets of 110 percent of GDP are almost equal to banking assets of 112 percent;
- Long-term insurers (mostly life) hold most of the insurance assets of 64 percent of GDP, with only a small share for short-term insurers (nonlife); and
- Unit trusts or CISs, the fastest growing segment in the financial sector, hold assets of 42 percent of GDP.

2. Most banking assets are domestic, although banks have net foreign assets and an expanding presence in Africa. The system is dominated by four large banks (ABSA, FirstRand, Nedbank and Standard), a mid-sized investment bank (Investec), and two smaller banks (African Bank and Capitec) specializing in unsecured lending to low income households. Close to 95 percent of banking assets are domestic. The four largest banks have 46 foreign subsidiaries, of which 39 are in Africa (Appendix Table 2). The size of these subsidiaries is significant in some host countries (e.g., Lesotho, Namibia and Swaziland), but the combined African exposure accounts for only 2 percent of banking assets.

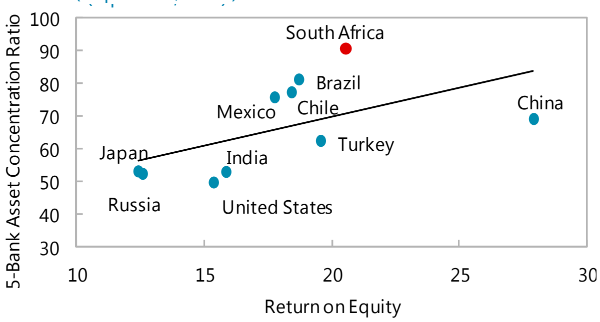
3. Most bank liabilities are domestic, short-term, and wholesale. Domestic deposits are the largest source of funding (87 percent), with 60 percent of the deposits coming from NBFIs and corporations with maturities of six months or less. The loan to deposit ratio is above 120 percent (Figure 1). Banks' foreign currency liabilities are relatively small at 6.5 percent of total liabilities.

4. The financial sector has a high degree of concentration and interconnectedness. The top five banks hold 90.5 percent of banking assets, the top five insurers account for 74 percent of the long-term insurance market, and the seven largest fund managers control 60 percent of unit trust assets (Appendix Table 3). All major banks are affiliated with insurance companies through holding companies or direct ownership. Bank-affiliated insurers underwrite a substantial proportion of private pension assets, and some banks also own fund managers that offer unit trusts. There are substantial levels of related party transactions within financial groups (Figure 1). This concentrated structure gives major financial institutions significant pricing power and enables them to achieve returns on equity and assets higher than in more competitive economies.

Figure 1. Features of the Financial System

Bank Profitability and Concentration

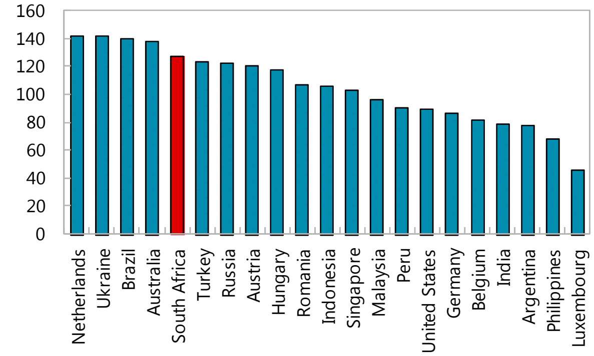
(In percent, 2013)



Note: ROE is the unweighted average of the top 4 banks in each country.

Loan-to-Deposit Ratios

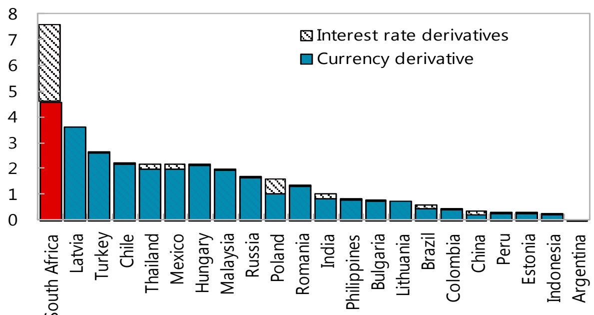
(In percent, 2013)



Note: 2013 indicates 2013 or latest available.

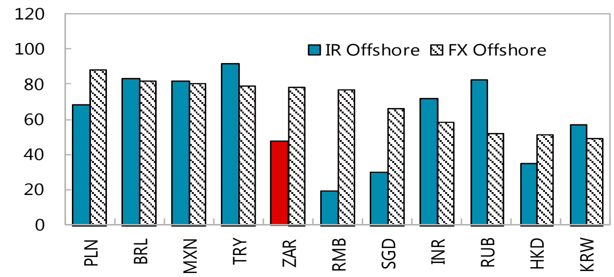
Onshore OTC Derivatives Average Daily Turnover

(In percent of GDP, 2013)



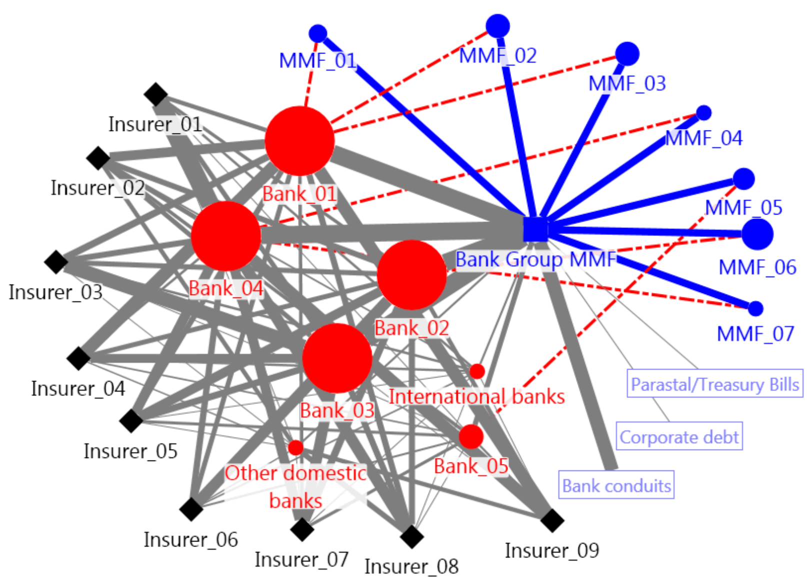
Offshore Derivatives Turnover

(In percent of total FX or IR derivatives turnover, 2013)



Sources: Bankscope, BIS, BIS Triennial Central Bank Survey 2013, IMF, International Financial Statistics, and IMF Staff calculations.

Interconnection between Banks and Non Bank Financial Institutions



Sources: FSB's supervisory data on major life and non-life insurers, ASISA (Association for Savings and Investment South Africa), and IMF staff calculations.

Note: Broader band indicates a strong connection between a bank and NBFI. Other domestic banks are 11 locally incorporated banks, and international banks include 14 registered local branches of foreign banks. The "Bank Group MMF" manages 73 percent of MMF industry asset. Bank conduits are securitization vehicles set up by banks that issue asset-backed commercial paper.

5. The capital market is large, supported by NBFIs and foreign investor participation. The market capitalization of the bond and equity markets, at 57 percent and 288 percent of GDP, respectively, is comparable to that of advanced economies. The liquidity and depth provided by NBFIs make these markets attractive to foreign investors, whose holdings of government bonds and equities, both at 34 percent of the total, are among the highest in EM economies. A large OTC derivatives market with a notional value of US$3 trillion allows investors considerable scope to hedge positions with interest rate and foreign exchange derivatives. Furthermore, the rand is traded as a proxy currency for EM risk and has a well-developed presence in London.[1]

RECENT DEVELOPMENTS

6. Although South Africa's financial sector escaped relatively unscathed from the global financial crisis (GFC), macroeconomic and credit risks still appear elevated (Appendix Figure 1):

- **Structural factors including persistent strikes, electricity shortages, and soft external demand have constrained growth and kept unemployment high.** The economy is projected to grow only 1.4 percent in 2014. The unemployment rate, already persistently high, rose to 25.5 percent in 2014Q2 (Figure 3). Government debt has risen from 27 percent of GDP in 2008 to 46 percent of GDP in 2014. The combination of slow growth, low savings, and high public expenditure is sustaining large current account deficits of over 5 percent of GDP.

- **Household debt rose to a historical high in 2008**. Rapid growth in private sector credit between 2003 and 2006 boosted household debt to 83 percent of income in 2008 (Figure 4). While the pace of credit growth has slowed sharply in the last few years, household debt at 75 percent of income in 2013 remained high by historical standards. House price inflation has moderated from 20–30 percent between 2003 and 2006 to 5–10 percent in 2013.

- **Public sector firms have substantially increased their borrowing mainly to fund large infrastructure projects**. This has raised total corporate debt to about 47 percent of GDP, although private sector firms have kept their leverage low and their balance sheets remain robust**.**

- **Cheap financing post-GFC and the government's financial inclusion efforts led to a sharp increase in retail unsecured lending**. Retail unsecured lending grew 47 percent between 2010 and 2012, reaching 11.7 percent of total bank loans at the end of 2013. As the economy sputtered, the proportion of retail unsecured lending to *low-income households* that was impaired rose to 18.7 percent in 2013 from 14.2 percent in 2011, causing unsecured lending to contract in real terms in the first half of 2014.[2]

---

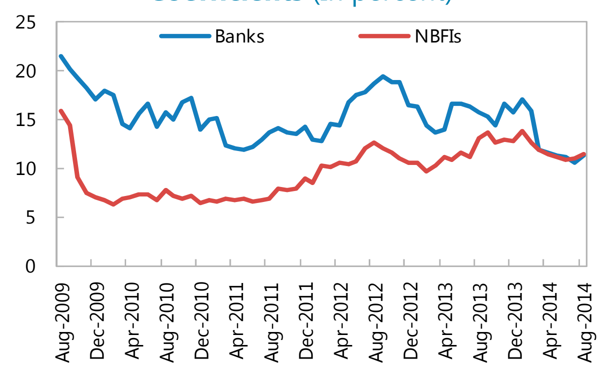
[1] Given its economic importance, the rand is used as legal tender in some neighboring countries, including the Common Monetary Area (Lesotho, Namibia, and Swaziland) and Zimbabwe.

[2] Based on SARB data, retail unsecured lending includes credit cards, overdrafts, personal loans and financing provided to SMEs in the retail sector in both on- and off-balance sheet exposures. See SARB "Financial Stability Review" for details.

7. These vulnerabilities became apparent in 2014. In June, Standard and Poor's downgraded South Africa's sovereign foreign currency debt to one notch above speculative grade, citing "lackluster GDP growth, high current account deficits, rising general government debt, and the potential volatility and cost of external financing potentially straining South African domestic banks' asset quality and profitability." In August, African Bank was placed in curatorship after announcing a record loss (Box 1). The SARB announced its decision to bail in senior unsecured creditors by writing down their claims by 10 percent, triggering a downgrade of the four large banks by Moody's.

8. Contagion from the failure of African Bank was limited. The SARB acted decisively in resolving African Bank and in soothing market jitters when some MMFs with exposure to African Bank "broke the buck."[3] Capitec, the other boutique lender, saw only a slight decline in its share price as it was perceived to have a more conservative credit risk policy. Market participants also quickly realized that the Moody's downgrade was not related to the soundness of the large banks but to a reduction in the "too big to fail premium" that had been implicit in the banks' credit ratings.[4] The vulnerability of financial institutions to contagion risk has remained low throughout the African Bank episode (Figure 2).[5]

Figure 2. SA Financial System Spillover Coefficients (In percent)



Sources: Moody's KMV, IMF, Financial Stability Measurement, and IMF Staff calculations.

9. On balance, the performance of the financial system as a whole remains relatively strong. While the average return on equity (ROE) of all banks declined from 21 percent in 2011 to 15 percent in early 2014, the ROE of the four largest banks has remained above 20 percent.[6] The total nonperforming loan ratio has remained below 3 percent in 2014. The banking sector is also well-capitalized, with the tier one capital ratio rising to 13 percent in early 2014 from 12 percent in 2011, providing a buffer against shocks.[7]

[3] While African Bank's debt accounted for only 1.3 percent of the assets held by the 43 MMFs, at least 10 of these funds "broke the buck," i.e., the losses caused the unit price to fall.

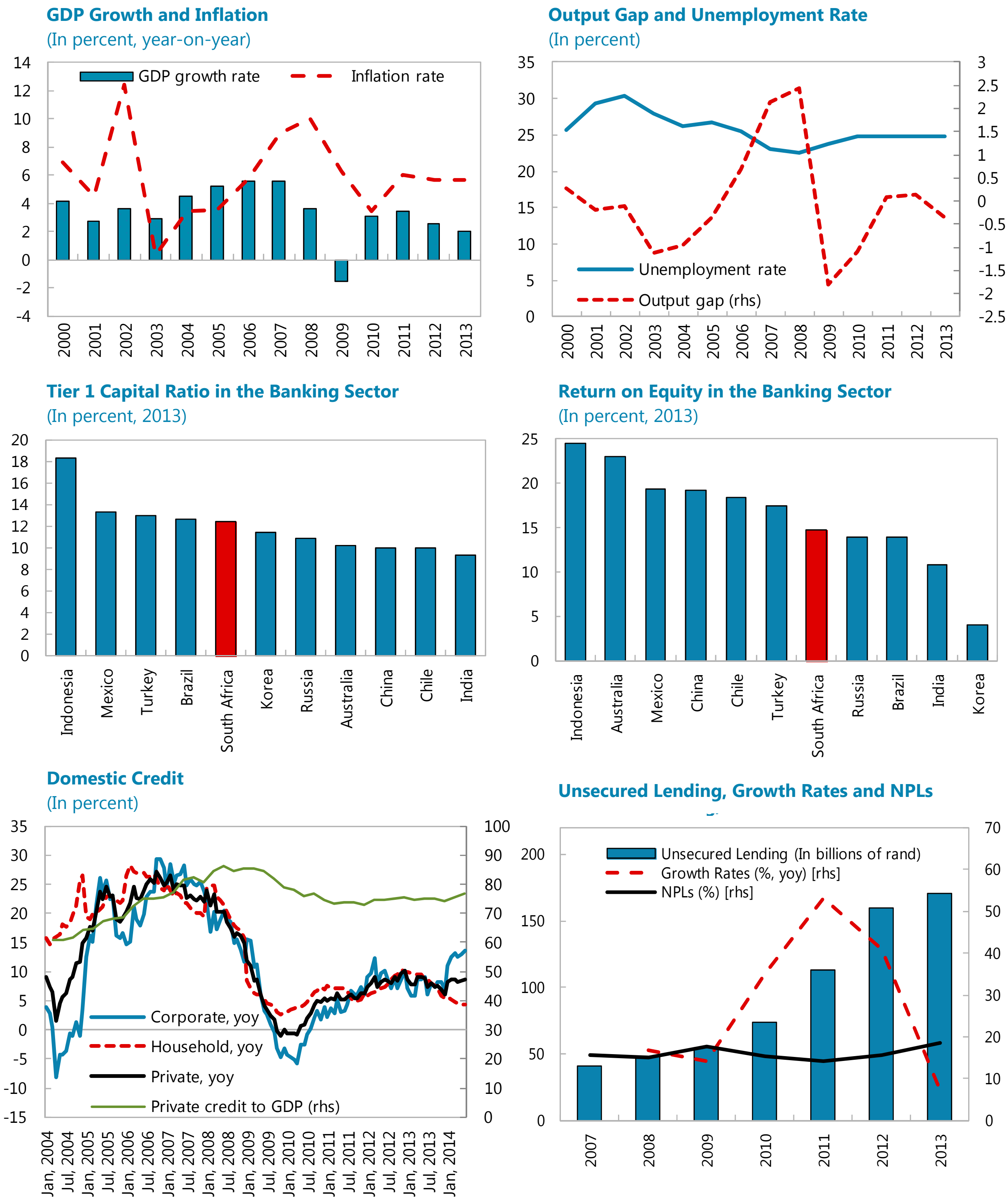
[4] Standard and Poor's ratings do not incorporate an implicit subsidy of government support.

[5] The vulnerability of a financial institution to spillover risks is measured by the conditional probability of its default given the default of another financial institution.

[6] The decline in the average ROE of all banks seems to have reflected, to a large extent, the poor performance of African Bank.

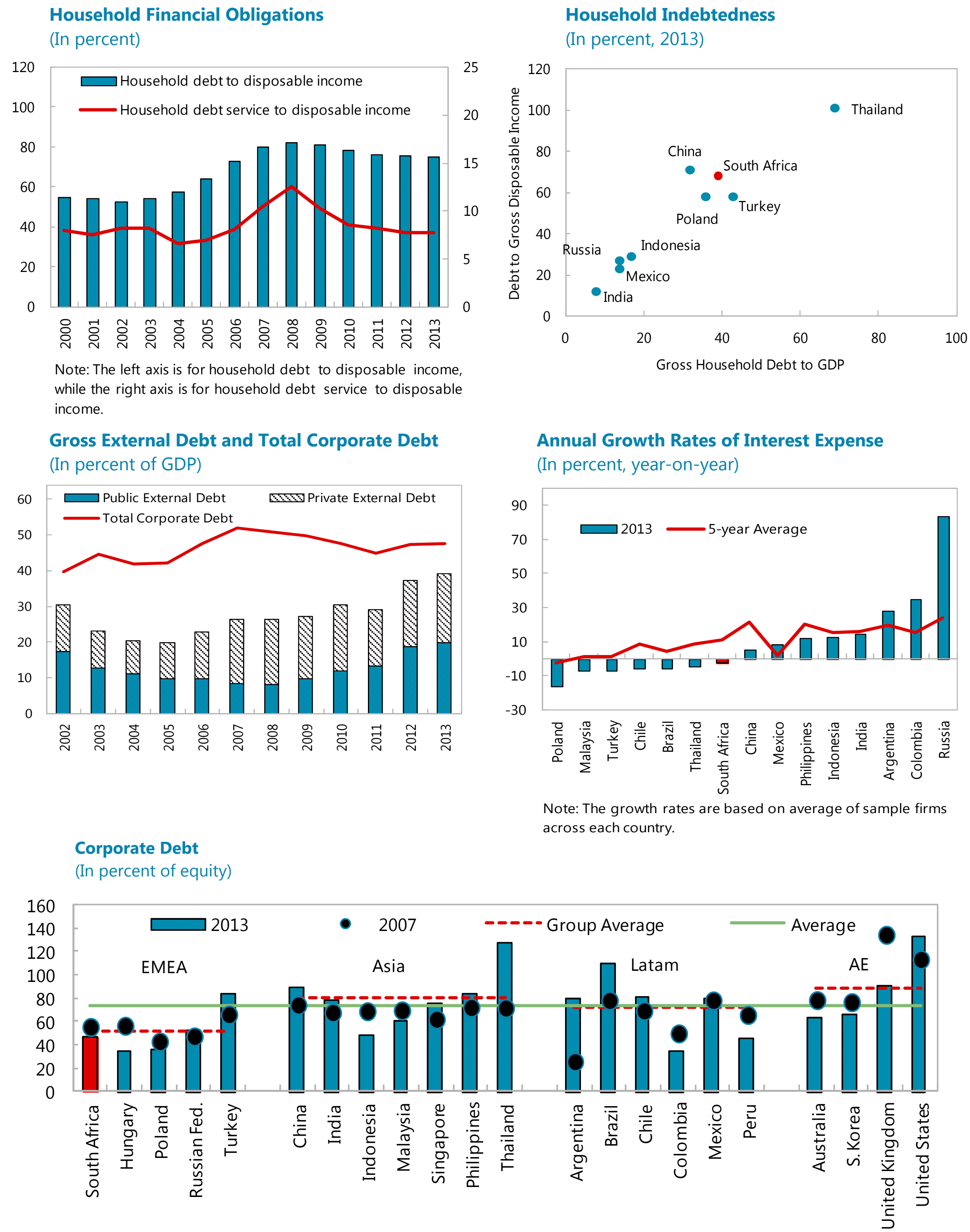
[7] The BCP found SARB's supervision over banks' provisioning policy to be generally sound. The provisioning framework is consistent with the International Financial Reporting System (IFRS).

Figure 3. Recent Economic and Financial Developments



Sources: Financial Soundness Indicators, Haver, IMF, World Economic Outlook database, South African NCR, SARB, and IMF Staff calculations.

Figure 4. The Debt Profile



Sources: Bankscope, BIS, BIS Triennial Central Bank Survey 2013, CVU , IMF, International Financial Statistics, and IMF Staff calculations.

RISKS AND VULNERABILITIES

A. Credit Risks

10. Slow growth and rising interest rates could make debt service more difficult, especially for highly indebted households. Household loans account for 44 percent of bank lending, and a large proportion of them are floating-rate mortgages. Most mortgages are held by high income households, which should have a higher debt service capacity, but a sharp rise in interest rates could still hamper their ability to service their debt. In addition, 48 percent of new mortgages, and 35 percent of mortgages outstanding, have loan-to-value (LTV) ratios above 80 percent, leaving banks with a relatively small collateral buffer. The stock of unsecured loans is not large in comparison to mortgages, but the proportion that is impaired is high. Lending to the corporate sector accounts for 32 percent of bank loans. Public sector corporations, which are more indebted, are vulnerable to interest rate and exchange rate shocks, although they are required to hedge their currency and interest rate risks.

B. Systemic Liquidity

11. The economy's dependence on external financing makes it vulnerable to a re-pricing of global risk and a sudden stop of capital inflows. Banks themselves do not rely heavily on external funding, but capital inflows, necessitated by the large current account and fiscal deficits, affect the pricing in the domestic funding market. As swings in investor demand for South African assets could push banks' funding costs higher, the dependence of the large banks on short-term wholesale funding and their active trading in the OTC derivatives market make them susceptible to external shocks and global re-pricing of risk.[8] While the flexible exchange rate and limited capital controls have helped buffer the economy from volatile capital flows, South Africa's external position remains weaker than implied by desired policies and fundamentals, and reserve coverage remains below most EMs.[9]

C. Concentration and Interconnectedness

12. Substantial interconnections within the financial system could amplify risks. NBFIs hold substantial assets in the four largest banks, partly through MMFs, which invest more than half their assets in the largest banks through deposits and other short-term instruments. Such holdings expose NBFIs to counterparty risks and banks to liquidity risks. A bank failure could have a significant impact on the asset quality of the affiliated NBFIs, while a sudden large withdrawal from NBFIs could cause liquidity stress for banks.

[8] Along with other emerging market economies, financial markets in South Africa were hit in mid-2013 and early 2014 when the U.S. announced its intention to withdraw monetary stimulus from the economy as recovery takes hold.

[9] The capital controls limit overseas investment of financial and nonfinancial institutions to 25–35 percent of their assets.

D. Cross-Border Expansion

13. Banks' rapid expansion into the rest of Africa could introduce new risks. Bank supervision and compliance with AML/CFT rules are typically weak in other African countries, where less developed infrastructure adds to the cost of doing business. The banks' information technology platforms may not be adequate for increased volumes, or for the proper application of group policies to these operations. In addition, acquiring, or entering into partnerships with banks in Africa with poor credit quality or weak risk practices could result in capital losses to the group.

14. The significant presence of South African banks in neighboring countries means they could have spillovers to, and spillbacks from, Sub-Saharan Africa. The spillover is likely to be particularly significant in countries that use the rand, where the share of assets of South African banks' subsidiaries in the local banking system ranges from 65 percent (29 percent of GDP) in Swaziland to 97 percent (47 percent of GDP) in Lesotho. South African banks also have a sizable presence in Botswana, Seychelles, Uganda and Zambia. Rising trade linkages could amplify the commodity price impact and expose South Africa to potential negative spillbacks from mispricing of risks and a slowdown in these economies.

STRESS TESTING RESILIENCY

A. Banking Stress Tests[10]

15. The banking sector was subjected to a wide range of STs. A bottom-up (BU) analysis was conducted by six individual banks, representing 94 percent of banking assets, and a top-down (TD) analysis was performed by the FSAP team covering four banks with 86 percent of banking assets.[11] The tests considered baseline, adverse, and severely adverse scenarios, and were informed by the IMF's Global Risk Assessment Matrix (Table 2). Since the stress tests were conducted, the baseline macroeconomic scenario has become considerably worse.

16. This analysis suggests that household debt is a source of vulnerability. Although the banks' own sensitivity analyses suggest a limited impact of interest rate hikes, the scenario-based TD tests show a significant increase in PDs, especially for retail unsecured loans. In these latter tests, the credit losses on retail credit account for 2.5 percentage points of the total 4.25 percentage point decline in the Common Equity Tier 1 (CET1) ratio.

---

[10] For details see Technical Note "Stress Testing the Financial System."

[11] The BU STs cover both domestic and foreign operations while the TD ST covers only domestic operations. The TD ST covers four banks because supervisory data on probability of defaults (PDs) and loss given defaults (LGDs) were not available for two smaller banks.

Table 2: Key Macro Variables [1]

(In percent)

Variables	Historical	Baseline					Adverse					Severely adverse				
	2013	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
Policy interest rate (REPO)	5.0	5.8	6.6	7.0	7.0	7.0	5.9	7.4	7.6	7.4	7.5	6.1	8.2	8.5	7.5	7.3
Effective lending rate	8.8	9.7	10.5	10.9	10.9	10.9	10.0	11.9	12.5	12.5	12.9	10.2	13.0	14.0	13.4	13.7
GDP growth	1.9	2.4	2.7	3.2	3.5	3.2	2.0	-1.8	-0.6	1.6	2.7	1.9	-3.9	-3.9	-1.0	2.1
Inflation	5.7	5.9	5.6	5.4	5.4	5.3	6.0	7.3	5.6	4.7	5.1	6.0	8.4	6.2	4.2	4.5
Official unemployment rate	24.7	24.6	24.5	24.2	23.8	23.4	24.6	24.9	25.5	25.6	25.3	24.6	25.2	26.3	26.8	26.7
NEER change	-13.9	-11.4	-1.8	-3.4	-3.8	-3.5	-17.9	-12.5	1.9	-0.9	-4.3	-20.0	-19.0	2.8	0.6	-4.4
Household debt to income ratio	76.9	76.8	74.6	72.5	70.1	68.2	77.0	76.7	77.2	77.1	76.2	77.2	77.8	80.3	82.7	83.0
Property price growth	10.0	7.2	4.5	4.6	5.8	5.5	7.3	5.0	1.3	0.6	0.0	7.2	5.3	-0.3	-2.9	-3.7
Stock market index change	19.0	9.0	0.8	2.3	1.9	2.0	6.2	-19.0	-14.6	-1.9	2.5	4.6	-25.3	-25.3	-14.7	-6.0

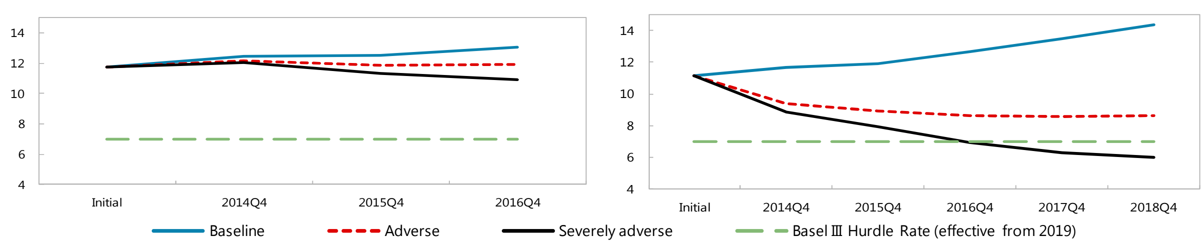
Source: SARB and IMF staff projections. The baseline projections are aligned with the IMF's economic projections for South Africa as of April 2014.

1/ The TD ST uses a more stringent assumption on property price than that simulated by the model. The TD ST assumes a 24 percent LGD for mortgage loans, which means that property prices decline by 40 percent for a mortgage loan with an initial LTV of 80 percent.

17. **However, the tests also suggest that high bank capital buffers mean that they could withstand large losses even in the severely adverse scenario.**[12] The BU tests suggest that by year three, banks' average capital ratios fall only modestly, from 11.75 percent to just under 11 percent (Figure 5). The TD tests show a larger impact, with a drop in the capital ratio of 4.25 percentage points, and the capital ratio of three out of four banks drops below the regulatory minimum (Figure 6). However, the shortfalls appear modest, especialy in light of the stringent assumptions underlying the TD tests.[13]

Figure 5. Scenario-Based STs Results—Aggregate Capital Ratio

Bottom-up, banking group system-wide CET1 ratio (In percent) — **Top-down, local banking system CET1 ratio** (In percent)



Sources: SARB supervisory data, bank reported results, and IMF Staff calculations.
Note: The starting point capital ratio is different because the BU STs apply to both local operations and foreign subsidiaries, while the TD ST applies to the local banks only.

---

[12] While banks' provision coverage ratio is lower than that of some other EMs, the difference in definitions and accounting frameworks makes such a comparison not particularly meaningful.

[13] The larger impact in the TD ST reflects more stringent assumptions of higher PDs and LGDs, larger credit exposures and risk weighted assets (RWAs), and lower net income and retained earnings than in the BU STs. The BU STs take better account of the granular data available to the banks and allow for actions (e.g., lower dividend payments) that can be taken to respond to a declining capital buffer.

Figure 6. Scenario-Based STs result—Distribution of Capital Ratios

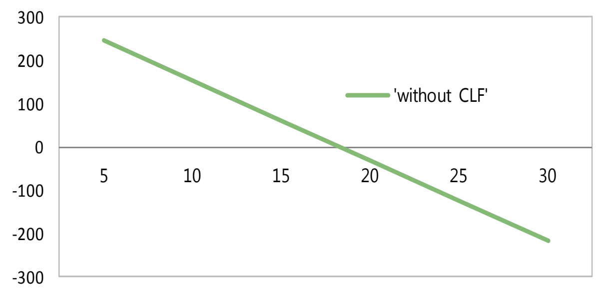
Source: IMF Staff calculations.

18. Banks also appear to be resilient to market risk in both the trading and the banking book. In a sensitivity analysis similar to the 2013 U.S. Comprehensive Capital Analysis and Review (CCAR) exercise, a multi-factor shock calibrated on the size of market movements during the GFC is shown to have a limited impact on banks' trading book. In the banking book, a downward parallel shift of rates by 200 bps would reduce the CET1 ratio by only 32 bps. The impact of a compressed spread between the prime-rate and the Johannesburg Interbank Average Rate (JIBAR), which could cause imperfect hedging and reduce net interest income, appears to be negligible.

19. Liquidity STs show that banks need larger liquidity capacity to meet regulatory requirements. The STs were conducted using Basel's liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) as the regulatory metric. The liquidity risk from withdrawals of unsecured funding by related parties is assessed in the LCR with a 100 percent runoff rate.

- The LCR of five of the six banks tested is below 100 percent, and for some banks it is below the 60 percent minimum that will become effective in 2015. In aggregate, banks experience a liquidity shortfall in less than 20 days (Figure 7), reflecting their dependence on short-term wholesale funding and the limited availability of HQLA. All banks are able to meet the LCR with support from the SARB in the form of a Committed Liquidity Facility (CLF), an alternative framework approved by Basel.[14]

Figure 7. Liquidity Stress Test: Simulated 30 Day Cumulative Cash Flow
(In billions of rand)



Sources: Bank reported results and IMF staff calculations.

- The NSFR of all but one bank is below 100 percent. The structurally small retail deposit base and limited availability of long-term funding in the capital markets make it difficult for banks to meet the NSFR before it becomes effective in 2018. Banks may need to reduce their long-term assets to meet the NSFR, or offer higher interest rates to attract funding with maturities beyond one year.

B. Insurance Stress Test

20. The insurance ST is based on the Financial Services Board (FSB)'s semiannual ST exercise that is part of its regular prudential supervision. The ST covers five life insurers and four non-life insurers with 70 and 50 percent, respectively, of market share. The overall stress level is higher than in the scenarios used for the banking STs.[15] In particular, the scenario assumes an equity shock of 50 percent and an increase in interest rate by a factor of 1.5, with all shocks occurring simultaneously at the beginning of the ST horizon. Companies report on a solo basis and calculations of capital adequacy requirements (CAR) are based on the current prudential solvency regime.

21. The ST indicates a high sensitivity of life insurers to market risks and the default of their largest banking counterparty. The median CAR coverage ratio declines from 317 percent at end-2013 to 125 percent after the shock, but recovers to 300 percent by end-2018, driven mainly by operating profits (Figure 8). The main drivers in the deterioration of the life insurers' solvency are

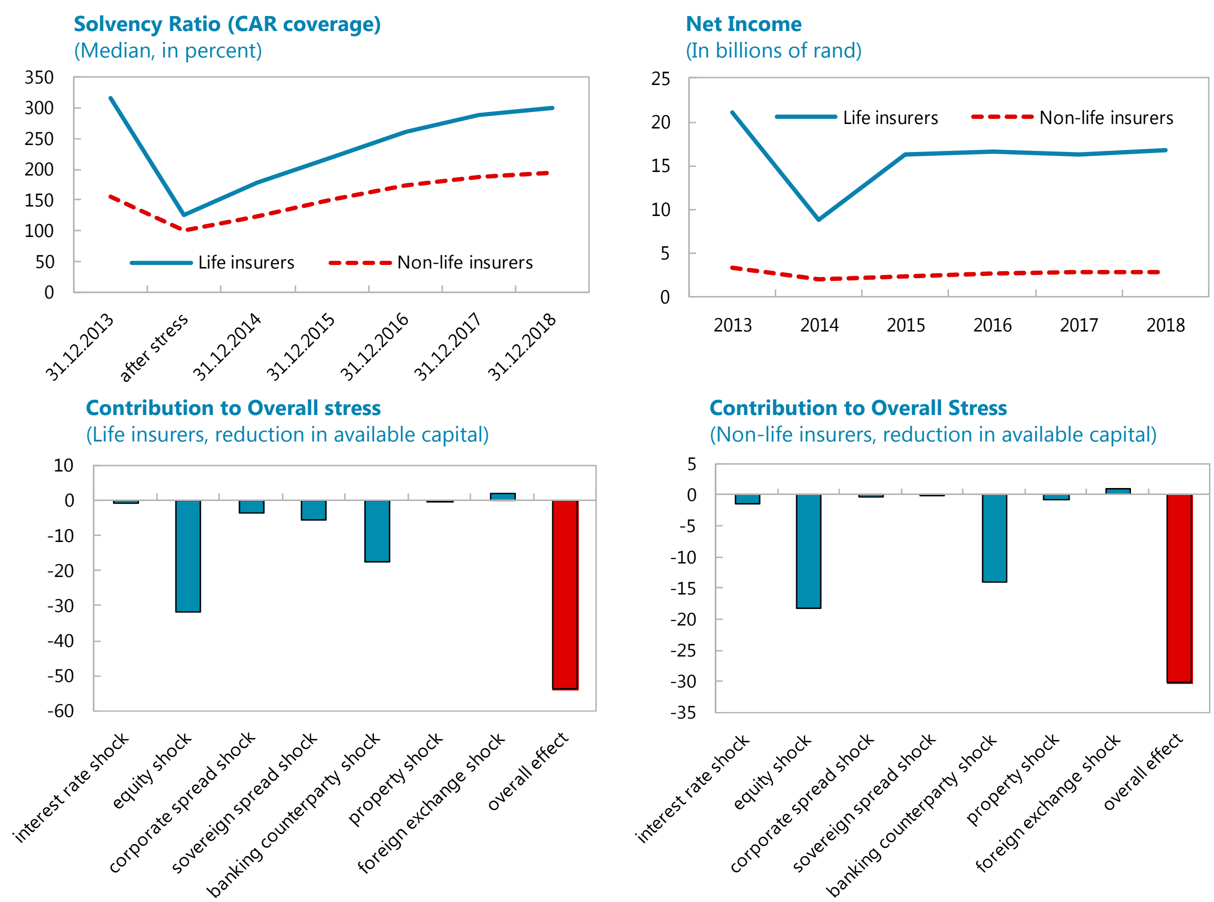
[14] The CLF will be available to all banks that apply at the discretion of the SARB, capped at a maximum of 40 percent of a bank's anticipated HQLA requirement. The SARB will charge a scaled commitment fee between 10 and 45 basis points based on each bank's usage of the facility. The interest rate will be the repo rate plus 100 basis points and draw downs will have a maturity of 31 days. Large-scale use of the CLF could have monetary policy implications that the SARB will need to address.

[15] Given time constraints, the FSAP team used the framework of the FSB's semiannual ST, which was already under way and had a more severe stress level (see Appendix Table 8 for details).

equity shocks and the default of the largest banking counterparty, which reduces average available capital by 28 and 23 percent, respectively.[16] Shocks can be mitigated by passing on investment losses to policyholders.

22. More conservative asset allocation makes non-life insurers less sensitive to market risks. The median CAR coverage ratio of non-life insurers drops more moderately than life insurers from 175 percent at the end of 2013 to 138 percent after the shock, but recovers to pre-stress levels in 2015. As with life insurers, the decline in the CAR coverage ratio is driven by the equity shock and bank default. Additional sensitivity analyses of catastrophe risks indicate a limited effect as large insurers have wide-ranging reinsurance coverage with foreign reinsurers. A major earthquake in the Johannesburg region is considered the main catastrophe risk—while the probability of such an event is low, the potential claims could be very high.

Figure 8. Insurance Stress Test Results



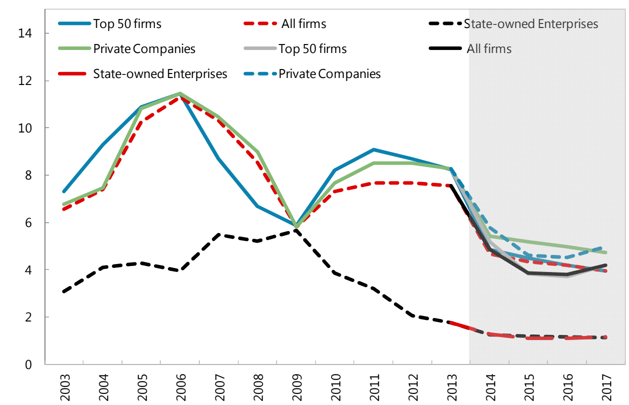
Sources: Company data and IMF staff calculations.

[16] However, the result of the bank default does not consider possible second-round effects or operational disruptions.

C. Corporate Stress Test

23. A sensitivity analysis was conducted to assess the solvency and liquidity risk for the corporate sector.[17] The analysis involves a shock to borrowing costs and earnings, a combination of an interest rate hike commensurate with the forward rate curve and an earnings decline similar to that during the GFC. The exercise indicates that debt at risk—debt of firms with earnings less than two times the interest coverage—rises from 38 percent to 55 percent of total corporate debt (Figure 9). Private firms fare reasonably well, but the interest coverage ratio of public sector corporations falls below 2, reflecting their weaker starting position that includes lower profitability, reliance on wholesale debt financing and foreign-loans (44 percent of total liabilities).[18] Although public sector corporations are required to hedge foreign currency, interest rates, and commodity price exposures, further deterioration in the sovereign credit rating could increase their cost of funding and hedging.

Figure 9. Interest Coverage Ratios



Sources: S&P Capital IQ and IMF Staff estimates.

STRUCTURAL REFORM TO ENHANCE RESILIENCY

24. The authorities have made good progress in addressing gaps identified in the 2008 FSAP and 2010 Standards Assessment (Appendix II). Basel III implementation is on track. A domestic systemically important bank capital requirement, conservation buffer, and countercyclical capital buffer will be phased in from 2016 when the current 1 percent systemic risk charge is phased out. The leverage ratio will be kept at 4 percent. Banks are currently required to hold 5 percent of total liabilities in liquid assets and 2.5 percent in cash and the LCR will be introduced in 2015.

25. A major overhaul of the regulatory and supervisory framework is underway. The current multi-layered supervisory structure is complex. The SARB is responsible for banking regulation and supervision, and the FSB is responsible for insurance regulation and supervision. The FSB also supervises fund managers and exchanges, and shares the responsibility for market intermediaries with the Johannesburg Stock Exchange (JSE). The JSE supervises listed companies while the

---

[17] This analysis is based on the April 2014 Global Financial Stability Report, but distinguishes between private and public companies and takes the forward rate curve as opposed to assuming a parallel 25 percent decrease in revenue and increase in interest expense. The interest rate increase is 250 bps between 2014 and 2017 and the earnings decline is 33 percent in 2014–15, similar to the decline seen during the GFC.

[18] A more conservative threshold of 2 is chosen to take account of liquidity risks, in addition to solvency risk, during periods of stress.

Department of Trade and Industry (DTI) supervises unlisted companies. The National Credit Regulator (NCR), which has a consumer credit regulation mandate, oversees lending up to R 1 million and reports to the DTI. This structure makes regulation and supervision fragmented along silos. To improve policy coordination, the authorities plan to adopt a Twin Peaks regulatory architecture with a Prudential Authority (PA) and a Market Conduct Authority (MCA) similar to the UK and Australian models.[19] The Twin Peaks reform provides an opportunity to address priority areas to enhance financial sector resiliency.

A. The Twin Peaks Model

26. The design and implementation of the Twin Peaks model should build on the strength of current supervision. The institutional and governance arrangements should promote operational autonomy while keeping supervisors accountable. Microprudential supervisory responsibilities should be allocated according to the relative strengths and capacity of each supervisory agency commensurate with risks of financial institutions. The scope of conduct regulation should be comprehensive and consolidated to avoid duplication of efforts and multiple regulatory layers, while cooperation and coordination among different supervisors is needed to minimize overlaps, gaps, and inconsistencies in supervision. In particular:

- The legal and operational relationship between the PA and the SARB as well as the operational independence of the PA's CEO should be made clear in the draft legislation.[20]
- Microprudential supervision of financial conglomerates should be addressed specifically in the law.[21]
- The NCR and other financial sector conduct supervisors and financial customer protection agencies should be absorbed into the MCA.
- The legislation should provide explicitly for the agencies expected to be members of the proposed Council of Financial Regulators (CFR).[22]

---

[19] The authorities are revising the draft Financial Sector Regulation Bill that is expected to clarify responsibilities, coordinating mechanisms, and address regulatory gaps.

[20] The distinction between whether the PA is a subsidiary of the SARB or its administrative department could have implications for whether the PA can in its own name enter into agreements and MoUs, acquire and hold assets, and sue or be sued. Also, the Management Oversight Committee of the PA, chaired by the Governor and made up of the CEO (a Deputy Governor) and other Deputy Governors, will act as a quasi-board, although its duties under the draft legislation appear to overlap with those of the CEO. The operational independence of the CEO needs to be clarified in the draft legislation to avoid the Committee potentially influencing the supervisor.

[21] Prudential oversight over financial market infrastructures (FMIs) should be strengthened and vested in the SARB directly, given their potential systemic nature, and not with the PA as is currently proposed under the draft FSB Bill.

[22] The draft twin-peaks legislation will introduce a number of formal coordinating mechanisms including the establishment of the CFR as a consultative and coordinating forum for matters of common interest, with subcommittees for enforcement, legislation, standard-setting, and analysis of financial sector outcomes.

- Membership of the Financial Stability Oversight Committee (FSOC) should be expanded to include the NCR while it is a separate entity. Given the proposal to vest responsibility for financial stability in the SARB, it would be more appropriate to make the FSOC an advisory body. The power to obtain necessary information from other agencies and financial institutions as a systemic regulator should be given to the SARB.

- Operational issues such as the integration of staff and information systems should be managed carefully to minimize transition risks. Memoranda of Understanding (MoU) among the SARB, PA, and MCA should set out the nature and extent of cooperation between them. A mechanism for a periodic sunset review of the framework should be included in the legislation.

B. Microprudential Framework[23]

27. The regulatory and supervisory frameworks for banking, insurance and securities are broadly sound with room for improvement in a number of areas.

Banking

28. There is a high level of compliance with the Basel Core Principles (BCP) for Effective Banking Supervision. The supervisory regime is based on strong relationships with bank Boards, senior management, and banks' internal and external auditors, supported by intensive qualitative and quantitative analyses. The Registrar and Bank Supervision Department (BSD) hold banks to a very high standard of corporate governance and risk management.

29. Since the previous standards assessment, the SARB has made several significant improvements to its supervisory framework. The BSD has increased supervisory staff to include a corps of risk specialists and additional on-site inspectors. This will help increase the BSD's direct interaction with banks and reduce its reliance on external auditors. Cooperation with relevant domestic and foreign supervisors has strengthened, and the BSD is supporting capacity-building in neighboring countries to help ensure adequate oversight of South African banks' cross-border operations and any potential spillover risks to these countries.

30. Nevertheless, there is room for improvement in a number of areas. The Registrar's powers to suspend a bank's activities without delay are still limited. Work on resolution plans for systemic banks has yet to begin, while cross-border recovery and resolution planning needs strengthening. More intensive group-wide supervision, including stress testing, is needed to monitor and manage risks from the non-banking or parent activities of a financial group. The objectives and operational independence of the supervisor should be enshrined in legislation, which should clarify the conditions for the Minister's intervention and limit his involvement to absolutely necessary situations. Amendments to laws and regulations in these areas should be made as soon as possible.

[23] Please refer to Annex I, the Report on Standards and Codes for further details.

Insurance

31. The authorities have been updating and formalizing the regulatory and supervisory regime to better reflect current international best practices. Key regulatory initiatives include a formal group supervision framework giving the FSB legal authority to supervise insurance groups with direct powers over a group holding company; a risk-based Solvency Assessment and Management (SAM) regime supported by explicit regulatory requirements on corporate governance and risk management; and a Treating Customers Fairly (TCF) approach to conduct of business (CoB) supervision, which seeks to ensure that fair treatment of customers is embedded within the culture of regulated entities. The proposed enhancements to the regulatory framework would significantly improve observance with the Insurance Core Principles.

32. The intensity and effectiveness of risk-based supervision can be further improved. There is scope for more intensive on-site visits that are proportionate to the risk profiles of insurers, reinsurers, and counterparties used by insurers; including joint visits with the SARB to financial conglomerates. Group supervision should cover all insurance groups with holistic off-site monitoring of intra-group transactions and aggregate group exposures. The FSB should strategize an appropriate risk-based supervisory cycle to cover the large number of financial services providers (FSPs), and adopt a more structured surveillance framework that considers cross-sectoral inter-linkages and system-wide market conduct issues. It is also important that conduct risks be included in the combined risk assessment summary documentation. In addition:

- The objectives for insurance supervision and legal authority for group-wide supervision should be formalized in legislation;
- Operational independence should be strengthened to minimize undue political or industry interference;
- The adequacy of supervisory resources should be reviewed, and skill sets augmented, in light of current and impending regulatory initiatives. Successful implementation of the Twin Peaks model hinges on the adequacy and quality of supervisory resources; and
- The FSB should continue its positive engagement with domestic and international counterparts to ensure effective supervisory cooperation.

Securities

33. The implementation of the International Organization of Securities Commissions (IOSCO) Principles is satisfactory in many areas. The legal framework is robust, providing the authorities with broad supervisory, investigative and enforcement powers. There are arrangements for on-site and off-site monitoring of regulated entities. The powers to cooperate with domestic and foreign counterparts are extensive. Accounting and auditing standards are high, as is the disclosure regime applied by listed companies. The market infrastructure is robust for the current, largely domestic, character of direct market participants.

34. The securities regulatory structure is complex. Responsibility is divided across several authorities with differing mandates and resources, reporting to different government ministries. The same structural challenge is evident within the FSB, where supervision is divided on a sectoral basis that may not reflect how some important market participants conduct business. While the proposed Twin Peaks structure may address some of this complexity, there is a potential for gaps and duplication to remain where responsibilities continue to be shared. It is important to ensure a common understanding among relevant regulators, particularly the FSB, SARB and JSE, of the scope, depth, and focus of their supervision.

35. It is important that the scope of regulation and intensity of supervision be more uniform across sectors. In particular, the CIS framework is notably less comprehensive and intrusive than in other areas. The disclosure regime for unlisted companies and CIS has substantive gaps, as do the CIS valuation and accounting standards, and needs strengthening. Given the risks involved with constant NAV MMFs, the FSB should consider requiring them to convert to variable NAV funds. In addition, capital and reporting requirements for FSPs should be strengthened. The FSB should use all of its available authority, including pursuing more criminal prosecutions, for enforcement.

36. Certain aspects of the FSB's governance structure raise concerns about its independence. The presence of industry members on certain Board Committees and the authority of the MoF to remove a Board or Executive Committee member for reasons other than misconduct or incompetence may be perceived as a threat to the FSB's independence. Nevertheless, there is no indication of any interference with its day-to-day operations. The government recognizes the need for greater regulatory independence, and reflects this in the governance models in the proposed Twin Peaks legislation. The independence of the IRBA should also be strengthened.

C. Macroprudential Framework

37. The SARB plays a key role in the evolving macroprudential framework. Currently, the SARB has an implicit mandate for financial stability provided in a government letter in February 2010. The letter, however, did not include specific powers, accountability and coordination mechanisms, which are addressed in the proposed Twin Peaks legislation. It is essential for the new framework to have an effective mechanism for coordination within and between regulatory agencies.

38. The macroprudential policy toolkit being readied by the SARB seems adequate. The toolkit consists of capital, liquidity, asset-related instruments, such as the countercyclical buffer, reserve requirements, and LTV ratios, respectively. These instruments can be applied as an add-on to minimum prudential regulatory requirements. The SARB conducts systemic risk analysis in its regular Financial Stability Review, which provides the analytical foundation for using the toolkit.

39. The SARB should be given more resources to carry out its function as a systemic regulator. To facilitate the use of macroprudential instruments, which are generally more targeted than monetary policy tools, the SARB should have the authority to collect more granular data. In addition, the SARB should have the capability to monitor systemic risk by performing regular system-wide stress tests, with special attention to systemically important financial institutions. Given the importance of NBFIs in the financial system and the role of financial markets, the SARB also needs increased expertise in these areas, complemented by strengthened cooperation with the MCA. Adequate resources are imperative for the SARB to effectively perform these additional responsibilities.

D. Derivatives Markets Reform[24]

40. OTC derivatives market reforms are implemented through the Financial Markets Act (FMA) and new regulations for banks, which reflect the Basel III capital requirements. In implementing these reforms, consideration should be given to the following:

- *Enhancing the surveillance of OTC derivatives activities*. More comprehensive information on OTC derivatives transactions and positions of NBFIs and corporate users, in addition to banks, would improve the authorities' ability to identify and evaluate potential risks.

- *Increasing capital and margining requirements*. Margining practices are uneven and could subject participants to losses following a failure of one or more counterparties.

- *Avoiding unintended consequences of tighter regulation*. Tighter regulations may increase cost and reduce hedging, exposing NBFIs and corporates to exchange rate and interest rate volatility.

41. The authorities should consider the benefits of establishing a local CCP for OTC derivatives. Otherwise, banks would be required to use global CCPs, which might limit the ability of smaller players to provide clearing services to their clients. Moreover, a local CCP would enable local supervisory oversight and the ability to clear and exchange collateral without conflict with South Africa's capital controls. These advantages would outweigh the fact that netting opportunities will be reduced and the local CCP will have less capacity to manage a default because of a lower number of surviving clearing members. If this approach were to be adopted, regulation would be needed to ensure a level playing field between the local and global CCPs, especially with regard to the timing of, and exemptions to, regulations (e.g., implementing initial margin requirements). Moreover, the local CCP (as well as the existing CCP for exchange-traded derivatives) should have strong risk management, reduce its dependency on local banks by pursuing credit lines at the SARB, and place collateral at a recognized central securities depository (CSD).

E. Crisis Management and Bank Resolution

42. The resolution regime should focus on deposit-taking institutions and systemic NBFIs. The draft Financial Services Regulation Bill assigns resolution powers to the SARB, but the scope of the proposed resolution regime needs clarification. For instance, it should focus on deposit-taking institutions and NBFIs deemed systemic. Non-deposit taking institutions whose failure would not be systemic should be resolved by their lead regulator. This decision will need to take into account the wider financial and economic circumstances at that point in time.

[24] See Technical Note "Reforms in the OTC Derivatives Market" for further discussion on CCPs.

43. Existing cooperation and coordination mechanisms are effective but can be improved. The proposed FSOC and CFR will strengthen regulatory cooperation and coordination for crisis management. The role of the existing Financial Sector Contingency Forum (FSCF), however, should be reviewed to minimize duplication with the mandates of the FSOC and CFR. MoUs with foreign authorities for cross-border banks pertaining only to supervision[25] should be expanded to cover resolution and crisis management, including mechanisms for information exchange, decision-making powers and burden-sharing.

44. The SARB's arrangements for liquidity assistance may be further enhanced by:

- Introducing a solvency test, preferably in the SARB Act, such that Emergency Liquidity Assistance (ELA) is provided to potentially insolvent financial firms only with an indemnity from the government;
- Replacing remaining collateral prohibitions in the SARB Act with a generic requirement to follow prudent collateral policies;
- Assessing potential liquidity needs of systemic NBFIs, such as CCPs, to determine whether ELA might be needed to preserve systemic functions, with access at the SARB's discretion and eligibility explicitly defined and made public; and
- Periodically adjusting the fee structure of the CLF to ensure banks have adequate incentive to restructure their balance sheets, and revising collateral and haircut policies on some securities classes to reduce potential risks to the SARB.

45. The framework for early intervention of problem banks requires strengthening. There are limitations to the SARB's authority to suspend licenses, restrict activities, or remove directors or officers, of banks. Furthermore, the SARB is required in many instances to provide 30 day ex ante notices before taking action against banks or their officers. Reforms are needed to align the legal framework more closely with good practices and promote early corrective action in troubled banks. A clear statutory basis for Recovery and Resolution Plans (RRPs) is needed as well as comprehensive guidelines for recovery plans. Explicit powers given to the future PA to require changes in group structures and operations would enhance resolvability.

46. The resolution regime should be updated to meet international best practice. Under the current regime, a curator is appointed by the MoF at or close to insolvency, whose powers include taking control of a bank and its assets, seeking temporary relief from creditors, and taking decisions usually subject to a special shareholder resolution. While these powers have been used for small bank failures, they fall short of the KA, lacking key features to address systemic cases and minimize taxpayer risk. The resolution regime should be enhanced with all powers in the KAs, including

[25] With the exception of Barclays' crisis management group.

transfer bridge bank and bail-in powers, and triggers for early deployment when the firm is, or likely to be, no longer viable.

47. Judicial or administrative review of resolution actions should not hamper the effectiveness of resolution powers. A number of provisions in the Banks Act create legal uncertainty or constrain resolution authorities. For example, a Review Board and the courts can reverse SARB decisions. These should be removed, as judicial review should not hinder the exercise of resolution powers, or suspend or reverse regulatory actions. Where the authorities are found to have acted in bad faith or gross negligence, relief to claimants should be limited to monetary compensation. The immunity from personal liability provided to SARB officials under the Banks Act should be extended to non-SARB employees appointed to undertake or assist in resolution. Relevant officials should also be indemnified for the cost of defending legal actions.

48. An ex ante-funded DIS, complemented by DP, is desirable.[26] An ex ante fund, with a backup credit line preferably from the NT, can be built up to a prudent target level sufficient for the payout of a number of small and medium sized banks. The fund can be used to support resolution, subject to a strict least cost test. The fund can also be complemented by introducing DP, which would increase recoveries for the fund in the event of a payout and facilitate resolution. While the absence of DP does not preclude a transfer of retail deposits, compensation and litigation risks would be higher in situations where retail deposits are treated preferentially in a resolution but rank pari passu with other senior creditors.[27]

F. Promoting Competition in the Financial System

49. The authorities should promote more competitive behavior by financial institutions as a long term objective. As noted by the Competition Commission's 2008 Banking Enquiry, a more competitive behavior entails improving information for market participants and easing entry into the financial system. There is room for improvement on both fronts, although a balance is needed between maintaining financial stability and fostering a more efficient system through competition.[28]

50. The existing legal framework limits entry, particularly in the banking sector. For instance, the minimum capital requirements (MCR) for banks are between 4 and 100 times higher than in other EMs (Figure 9). Access to clearance and payments is also biased against new entrants, contrary to CPSS-IOSCO principle 18. In addition, exits are limited. To promote more competitive behavior in the financial sector, entry hurdles could be lowered without sacrificing a stringent fit and proper test for new entrants. Promoting more competition among financial institutions would result

[26] DP gives depositors a preferential claim on the assets of a failed bank.

[27] However, DP does not provide access to deposit balances as fast as a DIS (e.g., within 7 days), which typically is needed to preserve depositor confidence, and is not a substitute for deposit insurance.

[28] Progress has been made since the 2008 inquiry to reduce bank charges. See "Bank Charges Report 2014" by the Solidarity Research Institute, a think tank affiliated with the trade union in South Africa.

in a greater supply of financial services at lower intermediation costs, especially for SMEs and lower income households.

51. Increased information to all market participants and transparent entry and exit will foster competition. Greater availability of information will help address opaque pricing of loans and other products, and give market participants more and better informed choices. The authorities are moving on developing a transparent bank resolution (exit) system, but entry rules should also be reformed. The Twin Peaks reform provides a good opportunity to improve information disclosure and consumer education. Specifically:

- The Basel Committee's recommendations on point of sale information should be adopted as quickly as possible. In the case of FMIs, the CPSS- IOSCO principle 23 on the disclosure of rules, procedures and market data should be followed.
- Existing interest rates caps should be removed and financial institutions should be required to be transparent with their customers and provide them with sufficient information so that they can compare the different products on their terms, price, risks and benefits.
- Absent unification, the MCA should have a very close working relationship with the NCR and Competition Commission and operate within a framework of checks and balances.

G. Anti Money Laundering and Combating the Financing of Terrorism (AML/CFT)

52. Significant progress has been made in improving AML/CFT measures since the 2008 assessment. The AML/CFT supervisory framework has strengthened with the shift to a risk-based approach (RBA) to supervision in the banking sector and the planned expansion of the RBA to AML/CFT measures in the financial sector. This should be supported by amendments to the legal framework, a national risk assessment (NRA), clearly communicated supervisory expectations, more practical guidance to the institutions, and an appropriate level of supervisory resources. While the record of convictions for money laundering (ML) and confiscations may have improved, enhanced capacity is needed to pursue complex ML cases. Customer due diligence measures need to be strengthened by requiring financial institutions to identify and verify the identity of beneficial owners; the authorities should also have timely access to accurate information on beneficial ownership.

53. Conducting an AML/CFT NRA should be a priority. A reasonable understanding of ML risks is shared by the authorities and the private sector. There is a broad consensus that corruption, fraud and organized crime generate most criminal proceeds in South Africa, and that banks act as the gateway for sub-Saharan funds. The authorities are in the initial stages of preparing the first NRA, the findings of which should help the authorities and the private sector take appropriate risk mitigating action.

Box 1. The Intervention of African Bank

African Bank Limited (African Bank) was placed under curatorship by the SARB on August 10, 2014.

Following a period of enhanced supervisory monitoring, the authorities intervened after record losses triggered a loss of confidence by shareholders and creditors. African Bank was the sixth largest bank in South Africa, accounting for about 1.5 percent of banking system assets. It was primarily funded by domestic and externally issued wholesale debt, and at the time of curatorship its main shareholders were a state-owned investment fund (the Public Investment Corporation) and other institutional investors.

Following the recommendation from the SARB, the Minister of Finance appointed a curator and announced a private and public sector supported resolution and restructuring of African Bank. While key aspects remain to be finalized, the plan entails separating African Bank's performing assets from impaired assets as follows:

- A newly established "good bank" comprising retail deposits at face value (of less than 1 percent of total liabilities), senior debt and wholesale deposits written down to 90 percent of their face value, and new capital of approximately ZAR 10 billion, to be underwritten by a consortium of major private banks and the state-owned Public Investment Corporation. Approximately ZAR 26 billion of performing loans from African Bank will be transferred to this "good bank," which the authorities plan to list in due course.

- A run-down of remaining impaired assets and liabilities. Impaired assets, along with shareholders and subordinated investor claims, will remain in African Bank, under curatorship. The SARB also announced it will inject ZAR 7 billion (0.2 percent of GDP) to finance the resolution, taking security of impaired loans which were recorded with a book value of ZAR 17 billion, that will not transfer to the "good bank."

- The government has not provided any funds to bail out African Bank, but has provided a R7 billion backstop to the SARB in line with international practice. The authorities indicated that it is unlikely that the SARB will draw on this facility, and no costs to the taxpayer are expected.

The authorities must carefully manage the restructuring to minimize financial risks. Most importantly the on-going banking entity ("good bank") needs to be well capitalized and liquid to restore creditor confidence and market access. The NT has already indemnified the SARB up to R7 billion for the quasi-fiscal risk that it has assumed, but the SARB should conduct careful due diligence of the impaired assets it plans to use as collateral, and revise its valuations if necessary once thorough assessment has taken place. In addition, the SARB must insure that adequate arrangements are in place so that these loans are efficiently managed and serviced going forward. This will require appointing and properly incentivizing private sector expertise, and that decisions (including with respect to foreclosures) are taken on an arm's length, commercial basis.

Appendix I. Tables and Figures

Appendix Table 1. Financial Sector Structure and Selected Social Indicators

	Total Assets (In billions of ZAR)						**Total Assets** (In percent of GDP)					
	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Banks	3185.1	2980.9	3140.9	3431.4	3682.5	3873.3	141.2	123.9	118.1	117.6	116.7	112.8
Commercial Banks	3166.5	2962.6	3121.8	3405.1	3648.2	3835.4	140.3	123.1	117.4	116.7	115.6	111.7
Number of Institutions	33	31	30	29	31	29	...	...	...	...	...	...
Mutual Banks	1.0	1.0	1.0	1.1	1.7	2.4	0.0	0.0	0.0	0.0	0.1	0.1
Number of Institutions	2	2	2	2	3	3	...	...	...	...	...	...
Public Banks	17.7	17.3	18.0	25.3	32.5	35.2	0.8	0.7	0.7	0.9	1.0	1.0
Postbank	2.3	2.4	2.8	3.0	3.2	3.3	0.1	0.1	0.1	0.1	0.1	0.1
Land and Agricultural Development Bank	15.3	14.9	15.3	22.2	29.3	31.9	0.7	0.6	0.6	0.8	0.9	0.9
Co-operative Financial Institutions	...	...	...	...	...	0.2	...	...	...	...	...	0.0
Number of Institutions	...	...	...	...	...	18	...	...	...	...	...	...
Non-bank Financial Institutions	3591.0	3931.0	4466.9	4748.8	5570.8	6376.7	159.1	163.4	168.0	162.8	176.6	185.8
Insurance Companies and Pension Funds	2774.6	3032.2	3418.9	3589.9	4200.8	4675.1	123.0	126.0	128.6	123.0	133.1	136.2
Pension funds	2169.9	2437.5	2726.5	2859.9	3342.2	3773.6	96.2	101.3	102.5	98.0	105.9	109.9
Official funds	801.1	900.2	1066.2	1130.5	1388.3	1541.2	35.5	37.4	40.1	38.7	44.0	44.9
Private Self-administered Funds (PSAF)	773.4	893.0	958.7	986.1	1106.1	1195.1	34.3	37.1	36.1	33.8	35.1	34.8
o/w Funds Invested with Insurers	243.4	311.8	301.0	328.1	349.2	375.1	10.8	13.0	11.3	11.2	11.1	10.9
Underwritten private pension funds	595.4	644.2	701.6	743.3	847.8	1037.3	26.4	26.8	26.4	25.5	26.9	30.2
Insurance Companies (Gross)	1443.5	1550.7	1695.0	1801.5	2055.6	2313.9	64.0	64.4	63.7	61.7	65.1	67.4
Long-term Insurers (Gross)	1363.2	1462.3	1609.8	1706.8	1948.8	2196.9	60.4	60.8	60.5	58.5	61.8	64.0
Less Underwritten Pension Funds	595.4	644.2	701.6	743.3	847.8	1037.3	26.4	26.8	26.4	25.5	26.9	30.2
Less Insurance Policies of PSAF	243.4	311.8	301.0	328.1	349.2	375.1	10.8	13.0	11.3	11.2	11.1	10.9
Long-term Insurers (Net)	524.4	506.3	607.2	635.3	751.8	784.5	23.2	21.0	22.8	21.8	23.8	22.9
Short-term Insurers	80.3	88.4	85.2	94.8	106.8	117.0	3.6	3.7	3.2	3.2	3.4	3.4
Unit Trusts (Mutual Funds)	661.8	739.7	866.9	946.2	1138.3	1446.9	29.3	30.7	32.6	32.4	36.1	42.1
Money Market Funds	212.9	237.2	276.8	254.0	244.3	258.6	9.4	9.9	10.4	8.7	7.7	7.5
Other Financial Institutions	154.6	159.1	181.2	212.6	231.8	254.7	6.9	6.6	6.8	7.3	7.3	7.4
Finance Companies	118.1	122.0	139.7	167.7	183.6	204.6	5.2	5.1	5.3	5.7	5.8	6.0
Trust Companies	33.1	33.7	37.8	41.2	44.7	49.0	1.5	1.4	1.4	1.4	1.4	1.4
Participation Bond Schemes	3.4	3.5	3.6	3.8	3.5	1.2	0.1	0.1	0.1	0.1	0.1	0.0
Total Assets of Financial Institutions	6776.1	6912.0	7607.8	8180.2	9253.2	10250.0	300.3	287.2	286.1	280.4	293.3	298.6
Other												
Public Investment Corporation	754.8	875.4	1025.7	1115.1	1358.9	1565.5	33.4	36.4	38.6	38.2	43.1	45.6
Funds received from official pension funds	687.9	797.9	932.1	1006.0	1225.5	1412.4	30.5	33.2	35.0	34.5	38.8	41.1
Stock Market Capitalization /1	4514.5	5883.9	6119.7	6370.2	7701.5	9874.8	200.1	244.5	230.1	218.3	244.1	287.6
Bond Market Capitalization /2	874.4	1321.0	1531.9	1432.3	1800.2	1968.7	38.8	54.9	57.6	49.1	57.1	57.3
o/w Corporate Bond Market	399.3	560.6	596.5	520.7	642.7	669.3	17.7	23.3	22.4	17.8	20.4	19.5

Memo Item: Social Indicators

GDP		**Poverty**	
Nominal GDP (2013, billions of U.S. dollars)	351	Headcount ratio at $1.25 a day (2009, percent of population)	13.8
GDP per capita (2013, U.S. dollars)	6628	Undernourishment (2011, percent of population)	5
Population characteristics (2014Q1)		**Income Distribution (2009)**	
Total (millions)	52.982	Income share held by highest 10 percent of population	51.7
Urban population (percent of total)	64	Income share held by lowest 20 percent of population	2.7
Life expectancy at birth (years), 2012	55	Gini index	63.1

Sources: SARB Bulletin, Bloomberg, BIS, Haver, and World Bank.

1/ Stock Market Capitalization is calculated from World Federation of Exchanges.

2/ Bond Market Capitalization is calculated from BIS data.

Appendix Table 2. SA Bank Subsidiaries in Africa

(In percent of host country's banking assets, end 2013)

Bank Group	Standard Bank	ABSA Bank	FirstRand Bank	Nedbank	Total	In Percent of Host Country GDP
Rand area						
Lesotho	60.3		9.7	26.9	96.9	47.0
Namibia	25.3		29.3	12.2	66.8	41.0
Swaziland	29.6		18.2	16.9	64.8	29.0
Non-Rand area						
Angola	2.4				2.4	1.0
Botswana	12.8	14.0	19.2		45.9	30.0
Congo (DRC)	5.6				5.6	1.0
Ghana	8.0	8.2			16.2	6.0
Kenya	5.9	7.2			13.1	10.0
Malawi	22.3			2.2	24.5	11.0
Mauritius	7.3	11.4			18.7	52.0
Mozambique	15.4	5.7	2.8		24.0	15.0
Nigeria	2.8				2.8	2.0
Seychelles		41.5			41.5	34.0
Tanzania	4.1	9.4	0.3		13.8	6.0
Uganda	18.0	7.6			25.6	8.0
Zambia	13.2	11.7	3.0		28.0	11.0
Zimbabwe	7.7	4.6		2.9	15.2	7.0

Sources: Bankscope and IMF Staff calculations.

Appendix Table 3. Market Share of Largest Financial Conglomerates

(In percent)

Financial Conglomerate	Banking Assets	Assets in Life Insuran	Premiums in General Insurance	Assets Under Manage
Standard Bank	25.5	11.9	-	31.7
Barclays (ABSA)	20.2	0.7	2.8	21.3
Old Mutual (Nedbank)	17.2	22.4	8.6	11.3
FirstRand Bank	20.4	-	-	0.4
Investec	7.1	4.3	-	11.4
MMI Holdings	n/a	15.5	5.6	0.6
Sanlam Life	n/a	14.7	17.2	1.1
Total share	90.5	69.5	34.2	77.8

Sources: Annual Reports, ASISA, and IMF Staff calculations.

Appendix Table 4. Financial Soundness Indicators

(In percent)

	2008	2009	2010	2011	2012	2013	2014 Q2
Capital Adequacy							
Risk-weighted capital adequacy ratio	13.0	14.1	14.9	15.0	15.8	15.6	14.6
of which Tier 1 capital	10.2	11.0	11.8	12.2	12.6	14.1	13.5
Capital to asset ratio	5.7	6.7	7.0	7.2	7.8	7.9	7.7
Asset Quality							
Nonperforming loans (percent of outstanding loans)	3.9	5.9	5.8	4.7	4.1	3.6	3.4
Nonperforming loans net of provisions (percent of regulatory capital)	34.4	47.6	40.8	31.0	23.6	19.1	18.4
Earnings, Profitability, and Efficiency							
Return on assets	1.5	1.1	1.2	1.5	1.3	1.5	1.4
Return on equity	26.9	18.0	18.2	21.0	17.5	18.6	17.9
Interest income (percent of gross income)	43.6	39.5	43.9	49.1	49.6	48.1	53.5
Trading income (percent of gross income)	13.4	16.0	13.8	10.5	8.9	7.8	7.0
Non-interest expenses (percent of gross income)	44.5	48.8	63.4	54.2	53.1	56.3	57.9
Personnel expenses (percent of non-interest expenditure)	48.3	43.7	43.5	52.6	37.0	47.3	48.9
Liquidity							
Liquid assets (percent of total assets)	16.8	15.8	16.0	15.7	16.2	16.6	17.9
Liquid assets (percent of short-term liabilties)	33.2	32.8	32.0	32.6	33.0	33.0	34.7
Customer deposits (percent of total non-interbank loans)	43.4	46.3	48.0	51.4	52.2	53.1	53.3
Exposure to FX risk							
Effective net open FX position (percent of regulatory capital)	0.5	0.8	-0.3	0.8	0.5	0.3	0.9
Foreign-currency-denominated loans (percent of outstanding loans)	7.5	7.0	6.7	9.2	8.3	8.7	9.8
Foreign-currency-denominated liabilities (percent of total liabilities)	5.1	4.3	4.1	4.5	5.7	6.3	7.2
Sectoral Distribution of Loans and Advances							
Residents	90.4	91.6	91.2	90.0	90.5	89.2	88.6
Central Bank and Other Financial Corporations /1	14.4	12.4	11.3	12.2	12.7	11.2	12.7
General government	0.6	0.7	0.9	0.9	0.8	0.7	0.6
Nonfinancial corporations	32.7	33.6	32.4	31.3	31.0	31.1	31.8
Households	42.5	44.9	46.5	45.6	46.1	46.2	43.6
Nonresidents	9.6	9.9	9.5	10.0	9.5	10.8	11.4
Derivatives (percent of regulatory capital)							
Gross asset position in financial derivatives	251.5	133.9	124.3	112.5	88.8	70.4	61.8
Gross liability position in financial derivatives	249.9	126.5	121.5	112.5	87.8	75.4	65.1
Real Estate Market							
Residential real estate prices (annual percentage change)	-0.4	6.5	0.3	1.7	0.3	8.7	9.6
Residential real estate loans (percent of total loans)	33.0	34.9	35.3	32.8	30.3	28.5	27.1
Commercial real estate loans (percent of total loans)	9.0	9.7	9.8	9.5	9.1	8.8	8.8
Household Debt							
Household debt (percent of GDP)	49.1	47.9	45.0	44.3	45.7	45.1	45.2
Household debt (percent of disposable income)	82.4	81.5	78.6	75.4	76.3	74.3	74.5
Household debt service (percent of disposable income)	11.0	10.0	9.0	8.0	7.7	7.7	7.9

Source: South African Reserve Bank.

1/ Including interbank loans.

Appendix Table 5. Selected Economic Indicators

	2010	2011	2012	2013	2014	2015
					Projected	
National income and prices (annual percentage change unless otherwise indicated)						
Real GDP	3.1	3.6	2.5	1.9	1.4	2.3
Real GDP per capita	1.8	2.2	1.1	0.5	0.0	0.9
Real domestic demand	4.4	5.2	3.9	2.5	1.2	2.0
GDP deflator	7.7	5.9	4.5	5.8	5.9	5.6
CPI (annual average)	4.3	5.0	5.7	5.8	6.2	5.6
CPI (end of period)	3.5	6.1	5.7	5.4	6.2	5.6
CPIX (period average) /1	4.4					
Labor market (annual percentage change unless otherwise indicated)						
Unemployment rate (percent of labor force, annual average)	24.9	24.8	24.9	24.7	25.2	25.2
Average remuneration (formal nonagricultural, nominal)	13.5	7.2	7.5	7.5	7.0	7.5
Labor productivity (formal nonagricultural)	3.9	1.4	1.3	1.4	1.4	1.5
Unit labor costs (formal nonagricultural)	9.3	5.8	6.2	6.0	5.5	5.8
Savings and Investment (percent of GDP unless otherwise indicated)						
Gross national saving	17.1	16.8	14.2	13.5	13.6	13.9
Public (incl. public enterprises)	-0.5	0.8	0.5	0.5	-0.7	-0.7
Private	17.6	16.0	13.7	13.1	14.3	14.6
Investment (incl. inventories)	19.1	19.1	19.4	19.4	19.4	19.5
Public (incl. public enterprises)	7.0	7.0	7.1	7.2	7.5	7.5
Private	12.1	11.8	11.8	12.1	12.1	12.2
Fiscal position (percent of GDP unless otherwise indicated) 1/						
Revenue, including grants	27.5	27.9	28.3	28.8	29.1	29.2
Expenditure and net lending	32.4	31.9	32.6	33.2	33.9	34.0
Overall balance	-4.9	-4.0	-4.3	-4.4	-4.8	-4.9
Primary balance	-2.3	-1.3	-1.4	-1.3	-1.4	-1.3
Structural balance (percent of potential GDP)	-3.6	-3.8	-4.2	-4.3	-4.4	-4.5
Gross government debt /2	35.3	38.8	42.1	45.2	47.6	49.6
Government bond yield (10-year, percent) /3	8.3	8.5	7.3	7.3	8.3	...
Money and credit (annual percentage change unless otherwise indicated)						
Broad money	6.9	8.3	5.2	7.2	6.9	7.5
Credit to the private sector	3.3	5.7	9.3	6.7	7.7	8.0
Repo rate (percent) /3	5.5	5.5	5.0	5.0	5.8	...
Balance of payments (percent of GDP unless otherwise indicated)						
Current account balance (billions of U.S. dollars)	-7.2	-9.4	-20.0	-20.4	-19.6	-19.9
Percent of GDP	-2.0	-2.3	-5.2	-5.8	-5.8	-5.7
Merchandise exports growth (volume)	6.1	6.8	0.4	4.2	2.6	3.5
Merchandise imports growth (volume)	8.9	10.0	6.0	4.7	1.8	2.3
Terms of trade (percentage change)	-0.4	0.5	-2.2	-1.9	-1.8	-0.6
Overall balance	1.2	1.1	0.3	0.1	0.0	0.0
Gross reserves (billions of U.S. dollars)	43.8	48.9	50.7	49.6	49.6	49.6
Percent of short-term debt (residual maturity)	145.8	151.6	133.2	130.2	125.8	115.2
Total external debt	30.5	29.2	37.2	39.1	42.4	44.9
of which short-term (residual maturity)	8.2	8.0	10.0	10.9	11.6	12.3
Nominal effective exchange rate (percentage change, end-period) /4	11.3	-16.6	-5.4	-15.3	-5.9	...
Real effective exchange rate (percentage change, end-period) /4	12.2	-14.1	-2.2	-12.4	-1.9	...
Exchange rate (Rand/U.S. dollar, end-period) 3/	6.6	8.1	8.5	10.5	11.3	...

Sources: South African authorities, World Bank, IMF INS database, and Fund staff estimates and projections.

1/ General government unless otherwise indicated.

2/ Central government.

3/ For 2014, end-August data.

4/ For 2014, end-July data.

Appendix Table 6. Risk Assessment Matrix		
	Overall Level of Concern	
	Likelihood of Severe Realization of Threat in the Next 1–3 Years *(high, medium or low)*	Expected Impact on Financial Stability if Threat is Realized *(high, medium or low)*
1. Surge in market volatility and higher-than-expected increases in interest rates	**Staff assessment: High** • South Africa is vulnerable to the shocks as its financial market is large relative to GDP; the rand is widely used as a proxy for EM currency; sovereign yields in South Africa are highly responsive to those in the US; and foreign participation in the domestic bond market is high.	***Staff assessment: High*** • Higher rates would affect households' ability to service debt. While most mortgages are held by high income households, which should have a higher debt service capacity, a sharp rise in interest rates could still hamper their ability to service their debt. The deterioration in household debt quality would have a large impact on bank capital. • Market volatility could cause significant price changes and spillovers across domestic markets. ST results show that banks and insurance companies could sustain large market risk shocks. • A sharp fall in capital inflows would likely entail an abrupt reversal of the current account deficit and a concomitant fall in growth, with implications for financial institutions' asset quality. ST results show that capital ratios of banks remain adequate in the adverse scenarios with lower growth and capital outflows. • Banks themselves do not rely heavily on external funding, but capital inflows, necessitated by the large current account and fiscal deficits, affect the pricing in the domestic funding market. As swings in investor demand could push banks' funding costs higher, the dependence of the large banks on short-term wholesale funding and their active trading in the OTC derivatives market make them susceptible to external shocks and global re-pricing of risk. The flexible exchange rate and limited capital controls may help buffer the economy from volatile capital flows, South Africa's external position remains weaker than implied by desired policies and fundamentals, and reserve coverage remains below most EMs.
2. Protracted period of slower growth in advanced and emerging economies	***Staff assessment: High*** • External headwinds could trigger a severe recession in South Africa, compounded by lackluster growth in an environment of already persistently high unemployment.	***Staff assessment: Medium*** • Substantially lower output and higher unemployment would hamper debt repayment, particularly on unsecured credits. • ST indicates that the well capitalized banking system would be able to sustain large shocks with manageable recapitalization needs in the most severe scenario. • Weaker fundamentals and structural issues would weigh on the sovereign credit rating, potentially increasing funding costs and credit risks of the financial and non-financial sectors.

Appendix Table 6. Risk Assessment Matrix (Concluded)		
	Overall Level of Concern	
	Likelihood of Severe Realization of Threat in the Next 1–3 Years	**Expected Impact on Financial Stability if Threat is Realized**
	(high, medium or low)	***(high, medium or low)***
3. Liquidity shortfall in banking system	***Staff assessment: Medium*** • Banks are dependent on wholesale funding. • Banks' reliance on short-term deposits, which already exceed 60 percent of total deposits, appears to be increasing.	***Staff assessment: Medium/High*** • Five out of the six banks maintain LCR and NSFR lower than 100 percent. Some banks are yet to meet the minimum 60 percent target (effective 2015). • The SARB's CLF and banks' strong capitalization, which would reduce run risks in the system, should limit the impact.
4. Stress in certain financial institutions spilling over to others in the financial system	***Staff assessment: Medium*** • The financial sector has a high degree of interconnectedness. All major banks belong to financial conglomerates that own banks and NBFIs, or own shares in NBFIs, which provide funding to banks. • Risk could accumulate due to the lack of a robust group-wide supervisory approach to conglomerate supervision.	***Staff assessment: High*** • The large amount of funding provided by NBFIs to banks, and the highly concentrated and interconnected market structures of banks and NBFIs mean that an idiosyncratic shock in one sector could be easily translated into another, becoming systemic. • Funding withdrawals by a stressed NBFI are likely to cause a significant liquidity shortage in banks (linked to risk no.3) while the default of a large bank would cause substantial losses to NBFIs. • ST shows that failure by the five largest financial borrowers of banks has a large impact, causing the CET1 ratio to decline by 1.9 percentage points.
5. Losses due to cross-border expansions	***Staff assessment: Medium*** • Claims of South Africa banks on Sub-Saharan Africa have tripled over the last five years. • Incomplete cross-border supervision leaves gaps in risk management.	***Staff assessment: Medium/Low*** • The significant presence of South African banks in neighboring countries means they could have spillovers to, and spillbacks from, Sub-Saharan Africa, although the combined African exposure accounts for only 2 percent of banking assets. • Bank supervision and compliance with AML/CFT rules are typically weak in African countries, where less developed infrastructure adds to the cost of doing business. • BU STs cover banks' foreign exposures. Banks' overall capital adequacy position remains solid under large adverse shocks.

Appendix Table 7. Banking Sector Stress Testing Matrix			
Domain		**Assumptions**	
		Bottom-up by banks	**Top-down by FSAP Team**
Banking Sector: Solvency Risk			
1. Institutional Perimeter	Institutions included	• Six banks.	• Four banks.
	Market share	• 93.9 percent of the total assets in the banking system.	• 85.7 percent of the total assets in the banking system.

<table>
<tr><th colspan="3">Appendix Table 7. Banking Sector Stress Testing Matrix (Continued)</th></tr>
<tr><th colspan="2" rowspan="2">Domain</th><th colspan="2">Assumptions</th></tr>
<tr><th>Bottom-up by banks</th><th>Top-down by FSAP Team</th></tr>
<tr><th colspan="4">Banking Sector: Solvency Risk</th></tr>
<tr><td></td><td>Data and baseline date</td><td>• Bank proprietary data.
• Baseline date: end-Dec 2013.
• Bank solo; foreign and local operations.</td><td>• Supervisory data and public information.
• Baseline date: end-Dec 2013.
• Bank solo; local operations.</td></tr>
<tr><td rowspan="3">2. Channels of Risk Propagation</td><td>Methodology</td><td>• Banks' internal models.
• Guidelines issued by the FSAP team.</td><td>• Balance sheet approach.</td></tr>
<tr><td>Satellite models for macro-financial linkages</td><td>• Satellite models for credit risk measures, income and expense items, and balance sheet growth.</td><td>• FSAP team estimated models for credit risk measures.</td></tr>
<tr><td>ST horizon</td><td>• 3-year (2014-2016).</td><td>• 5- year (2014-2018).</td></tr>
<tr><td>3. Tail shocks</td><td colspan="3">Scenario analysis
• Macro scenarios include baseline, adverse, and severely adverse scenarios for both TD and BU STs to analyze impacts on the banking book and the trading book.
• Baseline scenario: modest GDP growth, persistent high unemployment level and the gradual upward normalization of interest rates. The baseline projections are aligned with the IMF's economic projections for South Africa as of April 2014. In August 2014, the projections for GDP growth rates in 2014 and 2015 were adjusted to 1.4 and 2.3 percent, respectively.
• Adverse scenario: mild decline in GDP growth because of a disorderly exit from unconventional monetary policy by the advanced economies, resulting in capital outflows, increased market volatility and higher-than-expected increases in interest rates. It assumes GDP growth declines to -1.8 percent in the first year, recovering afterwards and turning positive in 2017. The first year shock corresponds to the 2.5 percent left tail of the historical distribution.
• Severely adverse scenario: a "perfect storm," where GDP falls sharply due to the confluence of several negative factors including a recession in advanced economies; intensified domestic labor tensions amidst high unemployment; large capital outflow; and substantially higher domestic interest rates. In terms of the GDP path, the scenario would be equivalent to a cumulative eight standard deviation event from the baseline. It assumes three years of negative growth (-3.9, -3.9 and -1 percent from 2015 to 2017, respectively). The "-3.9" percent growth corresponds to the 0.25 percent left tail of the historical distribution. For the BU STs, an additional set of market shocks applies in 2015 in the severely adverse scenario following the US CCAR methodology. These shocks are calibrated to be consistent with those observed in 2008.
• Macro-financial variables include real GDP growth, repo rate, 10y government bond yield, inflation, unemployment, credit spread between the effective lending rate and prime rate, household debt to GDP ratio, government debt to GDP ratio, domestic credit extension growth, M3 money supply growth, property price growth, stock market index, nominal effective exchange rate, rand/USD effective exchange rate, real GDP growth for key trading partners and regions, oil prices, and commodity prices.
• A caveat is that the evolution of the macro variables in the five-year scenarios is pre-determined and no second round effects are considered.</td></tr>
</table>

<table>
<tr><th colspan="4">Appendix Table 7. Banking Sector Stress Testing Matrix (Continued)</th></tr>
<tr><th colspan="2" rowspan="2">Domain</th><th colspan="2">Assumptions</th></tr>
<tr><th>Bottom-up by banks</th><th>Top-down by FSAP Team</th></tr>
<tr><th colspan="4">Banking Sector: Solvency Risk</th></tr>
<tr><td></td><td colspan="3">Sensitivity analysis
• Sensitivity analyses are conducted in the BU STs.
• Credit risk on the banking book is analyzed using single-factor and multi-factor shocks including:
  ◦ Failures of five largest non-financial or financial borrowers.
  ◦ Interest rate shocks affecting floating-rate mortgages and unsecured credit.
• Market risk in the banking book is analyzed, assuming:
  ◦ Upward parallel moves in rates by 200, 300, and 500 bps, and downward move by 200 bps.
  ◦ A widening and narrowing of the Prime- JIBAR spread of 50 and 100 bps.
• The trading book and fair valued banking book, including equity, commodity, interest rate, exchange rate, and credit risk sensitive exposures, are tested using additional single-factor shocks, including:
  ◦ A widening and narrowing of interest rates of 300 and 500 bps.
  ◦ A widening of credit spreads of 300 and 500 bps for investment grade, 400 and 1000 bps for sub-investment grade, and 500 and 2000 bps for speculative grade.
  ◦ A depreciation or appreciation of rand against all currencies by 30 and 50 percent.
  ◦ A strengthening of commodity price by 15 and 30 percent as well as a weakening by 15 and 40 percent.
  ◦ Volatilities of the interest rates increase by 50 and 100 percent.
  ◦ Volatilities of equity prices increase by 50 and 100 percent.
  ◦ Volatilities of rand/U.S. dollar exchange rate increase by 20 and 50 percent.
  ◦ Volatilities of commodity prices increase by 50 and 100 percent.
  ◦ Adverse movements of curves to examine the impact of basis risk owing to approximate hedging strategies. The curves movements assumed are:
    ▪ Total basis moves of interest rates curve adversely by 20 and 40 bps.
    ▪ Total basis moves of equity price adversely by 20 and 40 percent.
    ▪ Total basis moves of exchange rates adversely by 10 and 20 percent.
    ▪ Total basis moves of commodity prices adversely by 15 percent.
    ▪ Total basis moves of credit spreads adversely by 200 and 400 bps.
    ▪ Largest basis position between two interest rates curves moves adversely by 50 and 100 bps.
    ▪ Largest basis strategy in equity positions moves adversely by 30 and 50 percent.
    ▪ Largest basis strategy in currency moves adversely by 15 and 30 percent.
    ▪ Largest basis strategy in commodities moves adversely by 30 percent.
    ▪ Largest basis strategy in credit risk sensitive instruments moves adversely by 300 and 500 bps.
  ◦ Largest counterparty exposure fails (assume a recovery rate of 55 percent).
  ◦ Largest three counterparty exposures fail (assume recovery rates of 55 percent).
  ◦ Top non-SA-government issuer fails (assume a recovery rate of 40 percent).
  ◦ Top three non-SA-government issuers fail (assume recovery rates of 40 percent).</td></tr>
<tr><td>4. Risks and Buffers</td><td>Risks/factors assessed
(How each element is derived, assumptions).</td><td>• Credit risk on the banking book and trading book.
• Market risk on the banking book and trading book due to adverse movements in interest rates,</td><td>• Credit risk on the banking book.</td></tr>
</table>

Appendix Table 7. Banking Sector Stress Testing Matrix (Continued)

<table>
<tr><th colspan="2" rowspan="2">Domain</th><th colspan="2">Assumptions</th></tr>
<tr><th>Bottom-up by banks</th><th>Top-down by FSAP Team</th></tr>
<tr><td colspan="4">Banking Sector: Solvency Risk</td></tr>
<tr><td></td><td></td><td>exchange rates, equity prices and sustained declines in commodity prices. To adequately assess trading losses, credit value adjustment and incremental default risk are considered.</td><td></td></tr>
<tr><td></td><td>Behavioral adjustments</td><td colspan="2">• The relative proportion of the balance sheet items and trading positions will remain the same under all macro-financial scenarios.
• The growth of the balance sheet will depend on banks' capital adequacy ratios and the nominal GDP growth rate, following a rule specified by the FSAP team.
• The dividend payout will depend on the banks' buffer over the minimum capital requirements, following a rule specified by the FSAP team.</td></tr>
<tr><td rowspan="2">5. Regulatory and Market-Based Standards and Parameters</td><td>Calibration of risk parameters</td><td>• Banks use internal models to estimate PDs, LGDs and RWAs.</td><td>• PDs are estimated using satellite models.
• Downturn LGDs are assumed.
• Regulatory RWAs are calculated using the Basel II formula; actual RWAs are assumed to grow at the same rate as the regulatory RWAs.</td></tr>
<tr><td>Regulatory/Accounting and Market-Based Standards</td><td colspan="2">• Capital metrics: Basel III and SA regulatory requirements.
• Common equity tier one capital.</td></tr>
<tr><td>6. Reporting Format for Results</td><td>Output presentation</td><td colspan="2">• System-wide capital ratio and capital shortfall.
• Number of banks[1] in the system that fall below certain ratios.</td></tr>
<tr><td colspan="4">Banking Sector: Liquidity Risk (Bottom-up only)</td></tr>
<tr><td rowspan="3">1. Institutional Perimeter</td><td>Institutions included</td><td colspan="2">• Six banks.</td></tr>
<tr><td>Market share</td><td colspan="2">• 93.9 percent of total banking assets in the system.</td></tr>
<tr><td>Data and baseline date</td><td colspan="2">• Bank proprietary data.
• Positions as of March 31, 2014.</td></tr>
<tr><td>2. Channels of Risk Propagation</td><td>Methodology</td><td colspan="2">• LCR.
• NSFR.</td></tr>
<tr><td>3. Risks and Buffers</td><td>Risks Buffers</td><td colspan="2">• Risks: funding liquidity risk and market liquidity risk.
• Buffers: SARB's provision of committed liquidity facility.</td></tr>
<tr><td>4. Tail shocks</td><td>Size of the shock</td><td colspan="2">• LCR: adjustment factors as specified in the Basel Committee on Banking Supervision (BCBS) (2013); which are consistent with stressed funding conditions.</td></tr>
<tr><td>5. Regulatory and Market-Based Standards and</td><td>Regulatory standards</td><td colspan="2">• LCR and NSFR.</td></tr>
</table>

Appendix Table 7. Banking Sector Stress Testing Matrix (Concluded)			
Domain		**Assumptions**	
		Bottom-up by banks	**Top-down by FSAP Team**
Banking Sector: Solvency Risk			
Parameters			
6. Reporting Format for Results	Output presentation	• The number of banks that fall within certain ratios.	
1/ We prefer not to disclose the distribution by size since it may reveal bank specific information given the small number of banks included in the ST.			

Appendix Table 8. Insurance Sector Stress Testing Matrix		
Domain		**Assumptions**
		Bottom-Up by Insurance Corporations
Insurance Sector: Solvency Risk		
1. Institutional Perimeter	Institutions included	• Life: Old Mutual, Sanlam, MMI, Liberty, Discovery. • Non-Life: Santam, Mutual&Federal, Hollard, Outsurance.
	Market share	• Life: 70 percent (assets). • Non-Life: 50 percent (premiums).
	Data and baseline date	• Companies' own data. • Reference date: 31/12/2013. • Solo-entity basis.
2. Channels of Risk Propagation	Methodology	• Companies' internal models. • Assumption of no new business during the projection horizon.
	Valuation	• Statutory values of assets and liabilities. • No discounting of non-life liabilities according to statutory rule.
	Stress test horizon	• Instantaneous shocks at reference date, followed by baseline projections for 5 years (2014-2018). • Instantaneous shocks in sensitivity analyses.
3. Tail shocks	Scenario analysis	• Adverse scenario: based on market risk ST semiannually performed by the FSB.
	Sensitivity analysis	• Sudden decline in interest rates. • Catastrophic event.
4.Risks and Buffers	Risks/factors assessed	• Interest rates, equity, property, FX, credit spreads, default of largest banking counterparty. • Summation of risks within scenarios, no diversification effects.
	Buffers	• Absorption effect of technical provisions (profit sharing).
	Behavioral adjustments	• Management actions limited to non-discretionary rules in place at the reference date.
5. Regulatory and Market-Based Standards and Parameters	Calibration of risk parameters	• Interest rates: +50 percent parallel shift. • Equity: -50 percent for ordinary shares (-30 percent for fixed-rate preference shares, -10 percent for variable-rate preference shares). • Real estate: -30 percent. • FX: 30 percent depreciation of ZAR. • Corporate spreads: +173bp for investment grade in advanced economies, +321bp for non-investment grade in advanced economies, +217bp for investment grade in emerging economies, +148bp for non-investment grade in emerging economies.

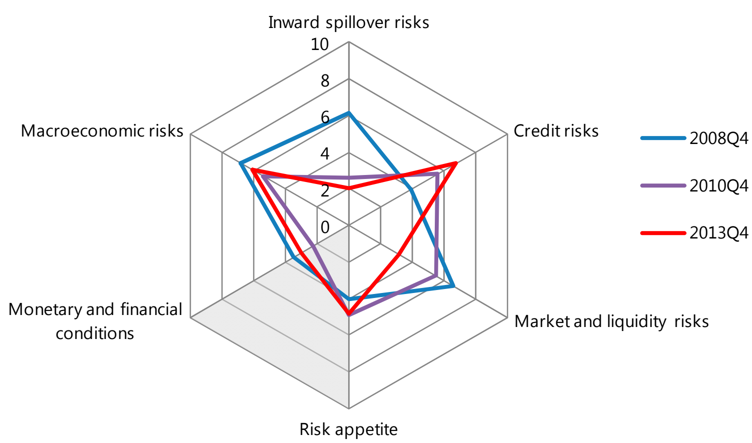
Appendix Table 8. Insurance Sector Stress Testing Matrix (Concluded)

Domain		Assumptions: Bottom-Up by Insurance Corporations
Insurance Sector: Solvency Risk		

		• Sovereign spreads: +262bp for ZAF.
		• Default of largest banking counterparty: 45 percent LGD on obligations, -100 percent for equity exposures.
		• Sensitivity analyses:
		  • Interest rates: -35 percent parallel shift.
		  • Catastrophe: 1-in100 years probable maximum loss.

	Regulatory/Accounting and Market-Based Standards	• Statutory solvency regime (CAR).
6. Reporting Format for Results	Output presentation	• Impact on solvency ratios (CAR coverage ratios). • Capital shortfall for companies falling below 100 percent CAR ratio. • Impact on net income. • Contribution of individual shocks. • Dispersion measures of solvency ratios and net income.

Appendix Figure 1. Country Financial Stability Map



Source: IMF staff calculations.
Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

Appendix II. 2008 Financial Sector Assessment Program

Key Findings and Recommendations

Recommendation	Agency in Charge	Time-frame	Progress (Full/Partial/ Ongoing/ Not Implemented)	Explanation
Financial Stability				
Integrate TD stress testing of individual banks in financial stability analysis.	SARB	ST	Full	The Fund provided technical assistance for TD solvency stress testing to SARB during May 2014, and these STs are now integral to financial stability analysis.
Remain vigilant on credit risk in banking, stemming from retail and concentrated corporate exposures, and on the funding risks, resulting from reliance on short-term domestic wholesale funding.	SARB	ST	Full	SARB has established a fully-fledged department to monitor financial stability, which will produce periodic reviews of financial conditions. SARB's supervisory process monitors emerging risks in banks and for the whole sector. Credit risk exposure is monitored by frontline supervision teams at individual banks, by credit risk analysts for the individual banks and for the sector, and by the research team for the whole sector.
Focus on market risks in the life insurance companies, and actively engage the long-term insurance companies in a dialogue about their exposures to these risks.	FSB	ST	Full	All insurers must submit stress testing results on both the market and the insurance risks on an annual basis. Market risk is also assessed as part of the risk assessment done on all insurers. Where market risk is rated as high, the insurer is engaged with as part of on-going supervision.
Strengthen the off-site stress testing capacity and employ this capacity to inform the regular supervisory discussions.	SARB, FSB	MT	Full	Banks stress testing is discussed with and the results are reviewed for each individual bank by SARB as part of the Internal Capital Adequacy Assessment Process (ICAAP). The banks stress testing is benchmarked against BIS's Principles for sound stress testing practices and supervision. All insurers must submit to FSB stress testing results on both the market and the insurance risks on an annual basis.

Key Findings and Recommendations (continued)

Recommendation	Agency in Charge	Time-frame	Progress (Full/Partial/ Ongoing/ Not Implemented)	Explanation
Systemic Liquidity, Crisis Management				
Enhance focus on liquidity and funding issues and discuss medium-term strategies to reduce banks' dependency on wholesale market funding. Analyze in a collaborative exercise between the SARB, the NT, and the FSB, for instance in the context of a Basel II Pillar 2 exercise and in drawing on the results of the planned study of the effects of an eventual lifting of remaining capital controls.	SARB, FSB, NT	ST	On-going	In 2010 the NT formed a Structural Funding and Liquidity Risk Task Team to review regulatory asymmetries (for example, tax incentives, money market regulations, etc) that may contribute to increasing reliance on short-term wholesale funding. The outcome was increased tax incentives for saving and a broadened investment mandate for pension funds. In addition, SARB developed tools to bolster banks liquidity positions, such as the CLF.
Continue the strategy to gradually increase foreign exchange reserves and consider establishing standing swap lines with other central banks of the most important settlement currencies—e.g., the Federal Reserve, the ECB, and the Bank of England.	SARB	MT	On-going	The 2 matters are dealt with by SARB's Standing Committee for Banking and Financial Markets (SCBFM) and is work in progress. Foreign exchange swaps were recently used as the key funding instrument, but the FED was excluded due to its disclosure requirements. Also, as a member of the BRICS, South Africa has access to the Contingency Reserve Arrangement.
Continue cautious approach to foreign exchange regime liberalization supported by strengthened monitoring and surveillance with: (i) appropriate timing to minimize the risk that the measures would need to be reversed; and (ii) proper reporting by commercial banks, securities dealers, and other market participants to enable the SARB to take corrective actions in a timely manner.	NT	MT	Ongoing	Generally, South African corporate, institutional investors as well as individuals are allowed to transact in foreign exchange with limited prudential regulation measures aimed at managing South Africa's offshore exposure. The NT remains committed to reforms, but the timing of reforms have been influenced by exceptional external circumstances such as the prolonged use of unconventional monetary policy in leading economies

Key Findings and Recommendations (continued)				
Recommendation	**Agency in Charge**	**Time-frame**	**Progress (Full/Partial/ Ongoing/ Not Implemented)**	**Explanation**
Review all strategies regarding crisis management as part of the work of the FSCF in light of past crisis episodes experienced globally, and consider undertaking a crisis simulation exercise relating to a macro-financial shock, such as a capital outflow or distress in a large financial sector institution.	RB, FSB, NT	ST	Full	The FSB-SA is participating in a Resolution Policy Working Group (supported by the World Bank) consisting of the NT, the SARB and the FSB-SA. All FSCF strategies were recently reviewed in a simulation exercise that was conducted by PWC on the 5 March 2014.
Clarify bank resolution powers by authorizing the registrar of banks, who has extensive powers to safeguard the soundness of the banking system, to directly appoint a curator—limiting the need for the MOF's intervention only in those cases requiring use of public funds.	SARB, NT	MT	On-going	A comprehensive Resolution framework consistent with the Key Attributes is in draft stages.
Foreign Exchange, Capital Markets, and Securities Regulation				
Enhance surveillance of the OTC foreign exchange derivative markets, by systematically pursuing collection and analysis of information on offshore activity.	SARB	MT	On-going	Since the 2008 FSAP, the Securities Services Act No. 36 of 2004 was replaced by the FMA (No. 19 of 2012) in an effort to align securities regulation in South Africa with international developments including G20, Financial Stability Board, IOSCO and also to effect the recommendations stemming from the FSAP exercise. The specific requirements relating to Trade Repositories ("TRs") are still being developed.
Facilitate further development of the stock and bond markets and continue gradual liberalization of exchange controls to attract long-term financing for South Africa's extensive investment needs.	NT, SARB, JSE, FSB	MT	Ongoing	With the help of a consultant from the World Bank, the NT together with the SARB and the FSB have engaged with all relevant stakeholders in the South African bond market regarding the need as well as the appropriate approach that should be taken to improve the efficiency of the local bond markets. These deliberations culminated in an agreement to introduce an Electronic Trading Platform for government bonds supported by best practice monitoring and regulation in the South African bond markets.

Key Findings and Recommendations (continued)				
Recommendation	**Agency in Charge**	**Time-frame**	**Progress (Full/Partial/ Ongoing/ Not Implemented)**	**Explanation**
Consider consolidation of the responsibility for corporate disclosure of listed securities in the FSB.	FSB	MT	On-going	As part of the overall regulatory review to introduce a Twin Peaks regulatory framework for the financial markets in South Africa, consideration is being given to among others, the need for a more intrusive regulatory approach. For the time being FSB continuously engages with JSE on this topic.
Require the ACI to register as a Self-Regulatory Organizations (SRO). The FSB should reexamine whether it should continue to delegate critical responsibilities for the regulation of the unit trust market unless the ACI assumes SRO status and increases its resources and enforcement capacity.	FSB	MT	Full	The Registrar of Collective Investment Schemes has taken over the regulatory functions from ASISA. The development of the relevant regulation on marketing and advertising is being finalized.
Assess ability to effectively oversee continued expansion in the OTC market in equity-linked derivatives within the current structure. Consider improved reporting of OTC trading and position concentration by JSE's member firms, and adoption of margin and concentration rules for member firms trading OTC.	JSE	MT	On-going	The FMA also enables the provision and development of a regulatory framework for OTC derivatives providers under which providers of OTC derivative products will be licensed/authorized. The regulatory framework is currently being finalized.
Effect change in settlement cycle on JSE from T+5 to T+3.	FSB/JSE	MT	On-going	The FSB has made the move towards a T+3 settlement cycle for the equities market a license condition for the JSE and in turn, the JSE has identified the move towards a T+3 settlement cycle as a top priority.
Increase the size of fines that can be imposed by the JSE, the ACI, and the IRBA to a level that provides a meaningful deterrent commensurate with the significance of the misconduct. FSB's policy of "name and shame" should be adopted by these other organizations.	FSB/JSE	MT	Full	The FMA prescribes the maximum amount in respect of fines that can be imposed on issuers and has increased the maximum amount (from R5 million to R7.5 million) that may be levied as was set out in the previous applicable legislation.

Key Findings and Recommendations (continued)				
Recommendation	**Agency in Charge**	**Time-frame**	**Progress (Full/Partial/ Ongoing/ Not Implemented)**	**Explanation**
Financial Sector Supervision and Regulation				
Enhance day-to-day collaboration amongst the staff of the different sectoral regulators, in respect of individual institutions and emerging risk issues.	FSB, SARB, NCR	ST	Full	SARB and FSB have implemented and currently conduct quarterly supervisory colleges for large banking and insurance conglomerates. SARB holds meetings with the NCR as required, but this relationship has been limited by not having a Memorandum of Understanding (MoU). The implementation of the Twin Peaks regulatory will give full legislative force to these changesOn. FSB also holds quarterly meetings with the auditing and accounting bodies.
Increase focus on qualitative standards, including corporate governance, risk management, and internal controls.	FSB	MT	On-going	The FMA gave the power to FSB to move in this front in most areas, with the notable exception of insurance. A special act is in process.
Develop the skills of supervisors to meet the growing complexity of the regulatory requirements and the demands of taking a less compliance-based approach to supervision.	FSB	MT	On-going	Appropriate and on-going training is provided to FSB staff in accordance with an annual training plan, which plan includes training on the risk-based supervisory framework of the FSB-South Africa.
Further develop risk assessment models, taking a more consistent approach across sectors, and the creation of increased central capacity at the main regulators to identify risk and allocate resources flexibly to issues as they arise**.**	FSB,SARB	MT	On-going	The FSB has implemented a comprehensive risk-based prudential supervisory approach. This approach promotes early identification and on-going management of systemic and organizational risks enabling the Registrar to focus its supervisory attention on insurers based on the risk profile of the relevant insurer.
Consider a mechanism for resolving policy disagreements among different regulators and departments and assessing trade-offs among differing policy objectives. The Policy Board for Financial Services and Regulation was created to ensure better coordination, but it plays a purely advisory role to the NT.	SARB, FSB, NT	MT	On-going	The Twin Peaks reform develops a number of mechanisms to resolve policy disagreements, which will take shape on implementation of the new legislation.

Key Findings and Recommendations (continued)				
Recommendation	**Agency in Charge**	**Time-frame**	**Progress (Full/Partial/ Ongoing/ Not Implemented)**	**Explanation**
Consider a more risk-sensitive approach to loans where the borrower has contributed minimum (or zero) equity, including residential mortgage loans with very high loan-to-valuation ratios.	SARB	ST	Full	The credit risk regulatory return (BA200) has been amended (and implemented as of January 2012) to provide an analysis of loan to value (LTV) ratios of the banks. The breakdown requires banks to report credit exposure for LTVs (>80, 80-100; <100).
Insurance and Pensions				
Enhance the supervision of groups. The FSB should extend the reporting currently required only of the largest groups to all groups. To maximize effectiveness in this area, the FSB is likely to require additional powers—e.g., to enforce requirements for unregulated holding companies. The FSB could also further develop its approach to lead regulation, maybe in cooperation with the SARB.	FSB	ST	Partial	Group-wide supervision is currently done on a moral suasion basis. The current approach of the FSB-SA is therefore relatively informal and relies, in respect to information gathering on groups and follow-up action, on the general authority and standing of the regulator rather than specific legislative provisions.
Develop more guidance on governance, risk management, and internal controls. There are limited requirements in this area at present. Setting out detailed expectations of firms would support continued progress at larger firms and spread good practice to smaller firms.	FSB	MT	On-going	The corporate governance, risk management and internal control measures of insurers is regularly assessed by FSB using off-site monitoring, supplemented with on-site visits, even where there are no supervisory concerns. Where there are supervisory concerns, the Registrar advises insurers accordingly. Most concerns that have arisen have been resolved in a timely manner.
Consider further enhancements to its life insurance regulation. The FSB should (i) review whether the margin of solvency remains adequate; and (ii) better integrate stress testing into its reporting and supervisory regime.	FSB	MT	On-going	Monitoring of regulatory capital requirements is strongly embedded in the risk-based supervisory framework.. As insurers move closer to the CAR, supervisory action and intervention is intensified and increased, as and when necessary, in accordance with the FSB-SA's risk-based supervisory framework. All insurers are subject to STs as part of the prescribed annual statutory returns. The major insurance groups are subject to biannual market risk STs.

Key Findings and Recommendations (continued)				
Recommendation	**Agency in Charge**	**Time-frame**	**Progress (Full/Partial/ Ongoing/ Not Implemented)**	**Explanation**
Consider improvements in the effectiveness of market conduct supervision by better integrating market conduct issues into its risk assessment model; and increasing coordination internally with the FAIS teams.	FSB	ST	On-going	JIBAR (which is the key reference rate in the money market and the derivatives market) was revised recently, , a Code of Conduct was finalized by SARB in conjunction with FSB and market participants. The FSB also conducted a gap analysis to monitor compliance with IOSCO principles. The FSB-SA is implementing an approach to market conduct regulation and supervision informed by the concept of TCF. The TCF approach seeks to ensure that fair treatment of customers is embedded within the culture of regulated entities. Despite the fact that the TCF approach has not yet been fully entrenched in the legislative frameworks, the FSB-SA has already begun embedding TCF into its supervisory framework.
Review NT's role and responsibilities in relation to those of the FSB in insurance regulation. Best practice in regulation is for governments to define the consumer protection and other objectives of the regulator, give it appropriate powers, and hold it accountable for delivery. In the consumer protection area, the NT could look to the FSB to take a greater leadership role in policy formulation. This would help the FSB increase its focus on market conduct issues**.**	NT, FSB	MT	Not implemented	
Consider imposing fit and proper requirements for pension fund trustees, and encourage the development of adequate independent trustee training.	FSB	ST	Full	The Pension Funds Act has been amended with effect from 28 February 2014, which provides for the registrar to prescribe minimum criteria which trustees must comply with. The registrar is currently in the process of determining the required skills and training needs which will be prescribed soon.

Key Findings and Recommendations (continued)				
Recommendation	**Agency in Charge**	**Time-frame**	**Progress (Full/Partial/ Ongoing/ Not Implemented)**	**Explanation**
Consider further measures to encourage consolidation of the pension fund sector, such as strengthening governance and risk management requirements and efforts to stress that trustees must consider issues such as the impact on members balances of high cost structures.	FSB	ST	Not-implemented	NT is preparing draft regulations.
Convert the circular on pension fund governance into a regulation, which codifies the duties of trustees, and imposes a range of governance requirements to be enforced by the FSB**.**	FSB	ST	Not implemented	Circular PF 130 is currently under review.
Bring together the different parts of the risk-based model and take into account other factors such as the valuation report provided by defined benefit funds to the FSB Actuarial Division.	FSB	MT	On-going	The regulator is currently in process of reconsidering the risk-based model to be implemented in the Twin Peaks structure. Currently the funding level of a fund is considered in identifying high-risk funds to be subjected to on-site visits.
Consider how retirement savings can be released to members in times of hardship—while keeping the key policy objective of preservation of retirement savings until retirement. This would apply to cases where members become unemployed, are threatened with the loss of their home, have to incur substantial medical expenses, or face disability.	FSB	ST	On-going	Under the current proposals, unemployment, hardship or any of the mentioned incidents will not necessarily be the triggers for accessing preserved retirement savings. Instead, the current proposals recommend that retirement savings be preserved by default when a member changes jobs, but to also enable some limited and unconditional access.
Ensure that pension reform proposals preserve pension savings until retirement, with appropriate safety valves, and that the drawdown of living annuities is more closely aligned with life expectancy.	FSB, NT, SARS	MT	On-going	Currently there are preservation proposals issued for public engagement and debate. Default preservation and limited withdrawals when changing jobs is being proposed (see also above). The industry association (Asisa) provides optimal drawdown guidelines. Further, a regulated drawdown for living annuity is currently being proposed if such an annuity is provided as a default product.

Key Findings and Recommendations (continued)				
Recommendation	**Agency in Charge**	**Time-frame**	**Progress (Full/Partial/ Ongoing/ Not Implemented)**	**Explanation**
Ensure that provident funds move away from providing only lumps sums towards a requirement that they must provide a form of lifetime income.	FSB, NT	MT	Full	Requirement for provident fund members to annuitize a portion of their benefit is already enacted in the Taxation Laws Amendment Act No. 31 of 2013 and will become effective 1 March 2015. The requirement will only apply to new contributions from that date onwards by members who are younger than 55 years on the implementation date and if those new contributions exceed R150 000 and for those who are younger than 55 on 1 March 2015.
Financial Sector Inclusion, Consumer Protection and Housing Finance				
Continue to support efforts to preserve the FSC and enhance its inclusion targets by setting targets that prioritize higher-quality transaction and deposit products, establishing new access targets for using the delivery of social grants and other products to bring unbanked individuals into the formal system, giving attention to bringing down costs and increasing availability, and focusing on improved insurance products with emphasis on simple, flexible long-term products.	NT, DTI	MT	On-going	The Financial Sector Charter has been finalized and the agreement has been gazetted (Q1, 2012), with targets and product standards (for banking and insurance) aimed at increased financial inclusion and impact. The monitoring and reporting process through the Financial Sector Council, involving the industry representative bodies, is in place and will continue until 2018.
Review the mandates, products, and governance of DFIs to maximize their catalytic role.	NT, DTI	MT	FuFull	Completed in 2009
Clarify reckless lending provisions and debt counseling mechanisms under the NCA. This involves specifying to whom the provisions apply, how lenders comply with them, and how borrowers are informed of their rights and responsibilities.	NCR	ST	On-going	Provisions in the National Credit Amendment Bill (awaiting assent by the President) allow for the definition of affordability criteria (in effect the definition of reckless credit) and fit and proper standards for debt counselors.
Use the National Debt Mediators Association code and procedures which are being developed for dealing with the bulk of the cases of over-indebtedness and mandate lenders to participate.	NCR	MT	Not implemented	Approval of the Code of Conduct of Credit Providers to Combat Over-indebtedness (encompassing National Debt Mediators Association initiatives) has been withdrawn by the NCR.

Key Findings and Recommendations (continued)				
Recommendation	**Agency in Charge**	**Time-frame**	**Progress (Full/Partial/ Ongoing/ Not Implemented)**	**Explanation**
Analyze the NCR link to the DTI and determine options for alternative institutional placement. This could include placing the NCR under the remit of the NT.	NCR, NT	MT	Full	This has been contemplated in Twin Peaks reform and will come into force upon implementation of the new legislation.
Introduce a consumer-friendly gateway to the various ombuds schemes.	NCR, NT	MT	Partial	A single entry call centre number has been implemented. Further measures are contemplated under Twin Peaks (Financial Sector Regulation Bill)
Review the resources, staffing, and institutional arrangements of the NCR to ensure they are adequate and appropriate.	NCR	ST	Full	This has been contemplated in Twin Peaks reform and will come into force upon implementation of the new legislation.
Improve access to free credit reports.	NCR	ST	Implemented	Consumers may obtain a current credit report free from all credit bureaus annually
Develop a regulatory framework for CPI-indexed mortgage loans that index both debt and repayments and which could be funded by CPI-indexed bonds.	NT, Housing	MT	On-going	The financial crisis largely caused by mortgage loan incentives has resulted in some re-examination in this area.
Consolidate and track data on overall housing finance debt and related performance including by income level and beyond the sole mortgage loans held by commercial banks.	SARB, FSB, NCR	MT	On-going	SARB analyses mortgage credit exposure of the banking sector as part of the information received for supervision purposes.
Conduct an in-depth analysis of market needs among affordable housing lenders to (i) adjust the mandate, products, and organization of the housing finance DFIs (the priority being to restructure NHFC); (ii) study the feasibility of a simple credit risk-sharing tool for FSC lenders (still limiting government contingencies); and (iii) adjust the program of credit linked subsidies.	NT, Housing	MT	On-going	The development of a financing mechanism to accompany the rationalization of DFIs is currently underway and is being led by the Department of Human Settlements. The proposal to develop public mortgage default insurance was received in light of concerns relating to risk sharing and future capitalization needs. The credit linked subsidy program has been adjusted at two levels since 2012. Further reforms to the subsidy program relates to the purchase of an existing house, to support the creation of a secondary market.

Key Findings and Recommendations (concluded)				
Recommendation	**Agency in Charge**	**Time-frame**	**Progress (Full/Partial/ Ongoing/ Not Implemented)**	**Explanation**
Harmonize the regulations applied to mortgage loans between the NCA and the Home Loan and Mortgage Disclosure Act.	NCR, Housing	MT	Not-implemented	The extensive reporting in the NCA renders the HLAMDA unnecessary.
Revisit land and housing policy tools to allow an expansion of housing supply and reduce the growing affordability gap.	Housing, NT	MT	On-going	The creation of the Urban Settlements Development Grant provided for a new mechanism to support bulk infrastructure and serviced land for low income housing. The Spatial Planning and Land Use Management Act promulgated in 2013 streamlines the fragmented development planning framework.

Annex I. Report on the Observance of Standards and Codes

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

A. Introduction[1]

1. This assessment of the current state of the implementation of the Basel Core Principles for Effective Banking Supervision in South Africa has been completed as a part of a Financial Sector Assessment Program update undertaken by the International Monetary Fund (IMF) during 2014. It reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment. It is not intended to represent an analysis of the state of the banking sector or crisis management framework, which have been addressed in the broader FSAP exercise.

B. Background Information and Methodology

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

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

4. The South African authorities also chose to be assessed against both the Essential and Additional Criteria but rated against only the Essential Criteria. In order to assess compliance, the BCP Methodology uses a set of essential and additional assessment criteria for each principle. Only the essential criteria were used to gauge full compliance with a core principle (CP). The additional criteria are recommended best practices against which the South African authorities have agreed to be assessed but not rated. The assessment of compliance with each CP is made on a qualitative basis to allow a judgment on whether the criteria are fulfilled in practice. Effective

---

[1] This report was prepared by Elizabeth Roberts (external expert) and Mamoru Yanase (IMF), who conducted the assessment. The previous BCP assessment of South Africa was conducted in 2010.

application of relevant laws and regulations is essential to provide an indication that the criteria are met.

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

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

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

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

C. Institutional and Market Structure—Overview

9. The responsibility for the regulation and supervision of banks lies with the SARB. As provided by the Banks Act of 1990 (BA), its authority is exercised through the Registrar of Banks and the Office for Banks, also known as the BSD, which falls under the Registrar's direction. Some important powers formally rest with the MoF, such as issuing regulations and formally making important supervisory actions. As an internal department of the SARB, the organizational governance of the BSD, including the Registrar, follows the rules applicable to the central bank. The Banks Act provides a comprehensive legal framework for banking regulation and supervision in the country. The BSD also has the responsibility for the regulation and supervision of mutual banks as provided by the Mutual Banks Act of 1993. The NCR, which reports to the Minister of Trade &

Industry, has a certain regulatory power over lending activity for consumer protection. The Financial Intelligence Center (FIC) acts as the country's Financial Intelligence Unit (FIU).

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

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

12. **The regulatory and supervisory framework for the financial sector is expected to go through a substantial transformation through the adoption of the Twin Peaks structure.** Under the plan, the prudential regulation and supervision of financial conglomerates, banks, insurance companies, securities exchanges and central counterparties as well as MMFs would be assigned to a single statutory entity located in the SARB, which will be called the PA. The market conduct regulation and supervision of financial conglomerates, banks, insurance companies, securities exchanges and central counterparties as well as MMFs would be assigned to a separate dedicated statutory entity to be situated in the FSB, which will be called the MCA. The NT has published the relevant bill for public consultation early this year, which is expected to be revised further. Amendments to acts regulating financial industries, such as the Banks Act, are expected to take place following the completion of the reorganization.

13. **The financial sector in South Africa is large and sophisticated.** Total financial sector assets of about 298 percent of GDP exceed those of most other EMs. Commercial banks make up the single largest segment of the financial system with assets of slightly more than 112 percent of GDP. But their share in total financial assets has been declining in recent years with the rapid growth of the nonbank financial sector, and currently only comprises less than 40 percent of the total. Close to 95 percent of banking assets is domestic; some of the largest banks shrank their operations in advanced economies and non-African EM economies, but South African banks' exposure to other African countries has expanded rapidly in recent years.

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

15. The banking industry has strong cross-border and cross-sectoral linkages. Three of the five large banks have strong ownership links with the U.K. Barclays, a U.K. global systemically important bank, has a fully-owned bank holding company registered in South Africa, Barclays Africa Group, which owns a majority stake of ABSA Bank. Nedbank is indirectly owned by Old Mutual in the U.K, which also owns a major insurance subsidiary in South Africa. Investec is dual-listed on the JSE and London Stock Exchange and has a parallel structure where the U.K. holding company oversees the group's non-African operations. In addition to Nedbank, all other major banks are also affiliated with insurance companies. For example, Standard Bank Group, the holding company of Standard Bank, has the majority of shares in the Liberty Group, one of the largest insurers in the country. These bank-affiliated insurance companies underwrite a substantial proportion of private pension fund assets, and some banks also own asset management companies that offer unit trusts. These big banks have started to expand to other Sub-Saharan African countries, with Standard Bank and Barclays Africa Group spearheading the move. Four of the top five banks have 39 subsidiaries in 17 sub-Saharan countries. Their sizes of operation in these countries are still very small compared to the entire group, however.

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

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

D. Preconditions for Effective Banking Supervision

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

19. The framework is expected to be reorganized substantially as a part of the move to the Twin Peaks structure. The FSOC, chaired by the SARB Governor and includes the PA and the MCA as a member and a representative from the NT as an observer, will be created and become responsible for monitoring and assessing systemic risks to financial stability, and making recommendations or taking actions to reduce or eliminate these risks. The FSOC is also expected to play a central role in crisis management and resolution.

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

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

22. South Africa has a well-developed system of laws. The Companies Act (CA) was recently updated to incorporate the latest thinking. It includes provisions on bankruptcy/insolvency and related matters. The King Report III, which sets the corporate governance best practice, is applicable to all companies listed on the main board of the JSE. The contract law is also well developed and covers a wide range of matters including, among others, debt, mediation between parties, insurance, and share sales. Consumer protection is addressed in the Consumer Protection Act, which applies to the sale of goods and services, and supplemented by the National Credit Act (NCA) which covers credit agreements. Business laws can be enforced through the courts system or parties can make use of arbitration and mediation for the resolution of disputes. The independence and impartiality of the judiciary have not been questioned, but the efficiency of the courts can be sometimes hampered and efforts for improvement are ongoing.

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

- South Africa has implemented International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) since 2005. The JSE has required listed companies to use IFRS since January 1, 2005.The CA, however, does not require all companies to have their financial statements audited. The CA Regulations permit the use of either IFRS, the IFRS for SMEs, or South African GAAP in specific instances. The Financial Reporting Standards Council, a governmental body formed in 2011, has responsibility as the advisor to the Minister of Trade and Industry on financial reporting standards.

- The Independent Regulatory Board for Auditors (IRBA) is responsible for overseeing registered auditors and audits performed by them. The South African Institute of Chartered Accountants (SAICA) is the national professional organization of Chartered Accountants, with more than 36,000 members. It participates in a number of international accounting bodies, including the trustees of the IFRS Foundation and the IASB. The Auditing and Assurance Standards Board, consists of SAICA and other business bodies, is responsible for ensuring consistency between South African auditing pronouncements and those of the International Auditing and Assurance Standards Board (IAASB). The Consultative Advisory Group advices the IAASB on technical issues, and its members include representatives from the SARB, FSB, JSE, Strate, and Institute of Internal Auditors.

24. South Africa also has a developed financial infrastructure, including a stock exchange, a CSD, a national payment system, and credit bureaus:

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

- The JSE is the primary exchange in South Africa and the largest in Africa. It offers primary and secondary markets for a range of financial products, including equities, bonds and derivatives. SAFCOM, a wholly owned subsidiary of the JSE, is a licensed clearinghouse for derivatives listed on the JSE.

- Strate is the CSD. It provides electronic settlement for securities—including equity, bond and derivative products, such as warrants, Exchange Traded Funds (ETFs), retail notes and tracker funds for the JSE, and money market securities for the South African market, as well as equities for the Namibian Stock Exchange. It also acts as a clearinghouse for some debt trading.

- The South African Multiple Option Settlement (SAMOS) system, owned and operated by the SARB, is the core of the South African national payment system. SAMOS is a real-time gross settlement system, which settles, among others, the rand settlement of all the financial market transactions, interbank transactions and the settlement of foreign exchange transactions with other international banks.

- South Africa has four major credit bureaus with consumer and business credit information. The NCA provides that the Minister of Trade & Industry must publish regulations on how consumer credit information held by credit bureau must be reviewed, verified, corrected and removed. The NCR provides oversight over these credit bureaus. Data contributors to the credit bureaus include banks, credit driven retailers, credit card companies, micro lenders, telecommunication and insurance companies, courts, debt counsellors, debt collectors.

E. Key Findings

25. South Africa has a high level of compliance with the BCPs. The current supervisory regime is based on strong relationships with bank Boards and senior management, as well as with banks' internal and external auditors, supported by intensive qualitative and quantitative analysis. The Registrar of Banks (the head of banking supervision) and his staff in the BSD hold banks to a very high standard of corporate governance and risk management.

26. The South African banking system is highly concentrated with more than 90 percent of banking assets being controlled by the five largest banks. The same laws, regulations and supervisory processes apply to all banking institutions, irrespective of their size. However, under a risk-based system, a much larger percentage of supervisory focus and resources center quite naturally on the largest institutions.

27. The SARB, as a member of the BCBS, is committed to the adoption of international standards and sound practices promulgated by the BCBS, as well as other relevant international standard-setting bodies. The SARB has implemented, or is in the process of implementing, all of the BCBS standards, most notably those related to capital adequacy and liquidity. The SARB is to be commended for its ongoing commitment to adhering to the highest standards for supervision and regulation, and also for encouraging and supporting its supervisory counterparts in neighboring countries in implementing key standards, as appropriate, which should also help to ensure the adequate oversight of South African banks' cross-border operations as they expand.

28. Since the previous assessment conducted in 2010, the BSD has made several significant improvements to its supervisory framework. Most notably, the department has increased supervisory staff by almost 50 percent, and it now includes a corps of risk specialists to complement the analysis teams, and additional on-site inspectors, thereby enabling the BSD to have more direct interaction with the banks and place less reliance on external auditors. In addition, several shortcomings in bank regulations have been addressed since 2010. Cooperation with relevant domestic and foreign supervisors has also been strengthened.

29. There are a few areas in relation to the legal and regulatory frameworks as well as powers that still warrant improvement. These include, among others, legal provisions related to objectives of the supervisory institution and appointment and dismissal of its head, the power to suspend or limit a bank's registration expeditiously, and supervisory techniques to address risks stemming from the non-banking activities of a financial group. While the BSD has been able, for the most part, to work around these weaknesses, amendments to the appropriate laws and regulations should be made as soon as possible. In addition, supervisory techniques to monitor the risk of an entire financial group should be further improved. The SARB anticipates that the laws and regulations will be further strengthened in the next round of amendments expected to take place as part of the restructuring of the financial regulatory system in South Africa.

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

F. Summary of Compliance with the BCP

Core Principle	Overall Comments
1. Responsibilities, objectives, and powers	The BA and associated rules provide a broadly appropriate framework for regulating and supervising banks. It also provides clear responsibilities of and adequate powers to the Registrar of Banks and the Bank Supervision Department. However, the lack of legally defined objectives of the supervisor as well as regulation and supervision of banks is a shortcoming of the current BA and related legislation. The assessors note and welcome, however, the authorities plan to address this issue in the expected Twin

Core Principle	Overall Comments
	Peaks reform. In addition, to further improve the effectiveness and efficiency of the regulatory process, the assessors also recommend the authorities to review the following issues: • The extent of delegation of powers in the Banks Act, with a view to transfer the power to set granular requirements from tier 2 rules (regulations), which need to be issued by the Minister, to tier 3 rules (circulars, directives), which can be issued by the Registrar. This would give more flexibility in fine-tuning the regulatory framework. • The composition of the Standing Committee for the Revision of the Banks Act, with a view to require its members to be not currently involved in not only any regulated entities but also bodies that represent interests of those regulated entities, to insulate the process from direct industry interests. Instead, as experts on financial business, the Committee could include retired officials from the industry or academics.
2. Independence, accountability, resourcing and legal protection for supervisors	The BSD has an appropriate level of resources with highly qualified staff and substantial specialist skills recently added, even though some of them need to accumulate experiences further. The legal protection of the supervisor is also adequate. Its operational independence is fully respected in practice, but there are a few areas where the framework needs to be enhanced to enshrine the operational independence of the supervisor in related legislation and make it fully compliant with the CP. Particularly, regarding the appointment and removal processes of the Registrar, the legal framework should be revised to include (A) a fixed term of the appointment, (B) specific reasons for the removal, and (C) the requirement to publish the reasons for removal, as required in EC2. In terms of the involvement of the Minister in a few supervisory actions, although the assessors understand the supervisor's decisions are respected in practice, there is a need to ensure that the Minister's power is exercised under the principle of constrained discretion. Also, improvements in regulatory frameworks such as those on competition policies that overlap with the banking legislation have possibly reduced the need for the Minister's discretion. The authorities should therefore review the legislation to limit the cases that require the Minister's involvement to those that are absolutely necessary and clarify in the laws objectives for intervention. Regarding the supervisory resources, while the assessors saw the current level as broadly adequate given the limited number of supervised entities, the authorities should review the adequacy of resources reflecting expected changes in the responsibility of the supervisor under the new Twin Peaks structure, taking into account the need for further improvements in its supervisory approach as recommended in CP 8, 9, and 12.
3. Cooperation and collaboration	Legal provisions as well as operational frameworks for cooperation and collaboration with domestic and foreign authorities are in place. Regarding the confidentiality of information, although the assessors view the current legal framework and its practical application provides a

Core Principle	Overall Comments
	reasonable assurance of protecting the confidentiality of supervisory information, the reliance on SARBA Section 33 as well as the manner BA Section 89 is stipulated leave room for the information to be used for non-supervisory purposes. It is therefore recommended the authorities review the relevant provisions of the BA to ensure the confidential information shall only be used for supervisory purposes, unless specifically required by court orders or provisions in other laws.
4. Permissible activities	The Banks Act provides clear definitions of activities that are only permitted to be conducted by registered banks, including taking deposits from the public.
5. Licensing criteria	Provisions in the laws and regulations related to licensing and the process followed by the BSD provide a comprehensive framework to assess the adequacy of new registrations for banks, including foreign bank branches. The BSD adequately assesses applications in practice.
6. Transfer of significant ownership	The power given to the supervisor by laws and regulations as well as the current supervisory practices provide adequate control and oversight regarding significant ownership of a bank and a controlling company.
7. Major acquisitions	The regulatory framework subjects major acquisitions and investments by banks and controlling companies to prior approval by the Registrar. The BSD also has well established supervisory practices to limit and monitor risks arising from such activities.
8. Supervisory approach	The SREP cycle and the risk rating system provide an adequate general framework of supervisory approach for the BSD. These processes focusing on individual banks and banking groups are complemented by sector-wide approaches such as the “flavor of the year” topics as well as enhanced thematic on-site reviews. However, the approaches related to resolution of are still in the process of development. Although those on the recovery plans as well as contingency planning have started, work on resolution plans for systemic banks has yet to begin. The assessors understand the required power will not be given until the expected legislation on bank resolution becomes effective and urge the authorities to enact the bill expeditiously. Another important issue related to this principle is planned transition to the Twin Peaks supervisory structure. The transition should involve not only providing the prudential supervisor responsibility over various financial sector entities, but also improved oversight over systemic risk and wider financial groups. The new prudential supervisor should therefore review the supervisory approach once the organizational changes are completed in order to enable it to have capacity to monitor the prudential risk of the entire financial system as well as that of financial conglomerates. This may require a more formalized framework to detect and assess system-wide and cross-sectoral risks and its integration to supervision of individual financial groups and regulated financial institutions. New tools to address those risks may also need to be added to its arsenal, such as common scenario stress testing across different financial sectors and a risk rating framework that

Core Principle	Overall Comments
	takes into account the entire risk of financial groups. Close cooperation with the planned FSOC and its secretariat will be essential in these endeavors.
9. Supervisory techniques and tools	The BSD has improved its supervisory techniques and tools significantly. In particular, it has moved from a model relying substantially on external auditors for on-site work to one where the BSD's own staff conducts a number of on-site reviews to complement the work of external auditors, including deep-dive reviews that verify banks' actual practices through such means as extensive review of loan files. It has also added a number of risk specialists who conduct on-site reviews on particular risk areas including model validations, but also other topics related to particular risk areas. These improvements, in addition to detailed and intensive off-site analysis and frequent interactions with various levels of banks/banking groups, including their Boards, equip the BSD with wide-ranging high quality techniques and tools that are appropriate for providing oversight of risk profiles and operations of banks and banking groups in South Africa. The assessors encourage the BSD to further continue its effort to enhance its ability to conduct deep-dive on-site reviews and improve tools and technique to assess and monitor spill over risks to the banks from non banking activities in their financial groups.
10. Supervisory reporting	The regulatory framework requires banks and controlling companies to periodically submit a broad range of information. Strong regulatory and supervisory processes exist to ensure accuracy and comparability of submitted returns. Well developed procedures for analyzing collected information and feeding into supervisory actions are in place.
11. Corrective and sanctioning powers of supervisors	While there have been a few significant improvements since the last assessment, the major problem of the need for 30 days prior notice in suspending registration or restricting activities based on BA Sections 23, 24, and 26 has not been changed. The newly introduced power of directives under BA Section 6(6) as well as the application of a motion by the court could address the issue partially. But the former still requires consultation with the relevant bank and the bank may challenge on the ground that a similar due process to that of Section 24 should be required for sanctions with similar effect. The latter is yet untested and relies on a court's judgment, which may take a different position than that of the supervisor. Given supervisors would consider taking such drastic measures only in cases where the risk is imminent and large, impact to the public could be significant, and when the relevant bank is not cooperating with the supervisor, any possible delays in or uncertainty regarding the outcome of the process needs to be avoided. The assessors understand the strong framework for licensing and corporate governance as well as relatively stable structure of the banking industry enables the supervisor to address these issues in a cooperative manner using less formal and stringent measures in most of the cases. However, the supervisor needs to be prepared for cases where these cooperative and more informal measures may not work—the framework for corrective and enforcement actions need to cover such situations. The assessors are thus still of the view that strengthening laws to provide the Registrar with the power to suspend or

Core Principle	Overall Comments
	limit a bank's activities without delay is essential. The lack of ability for the supervisor to fine individuals related to banks, such as Board members and senior management, is another important gap in the current regulatory framework.
12. Consolidated supervision	The supervisory and reporting framework provides an adequate framework for monitoring and assessing risks to banks in South Africa from non-banking and foreign banking operations in banking. However, given the prevalence of conglomerate-type financial groups in South Africa, the authorities should make further effort to monitor and manage risks arising from non-banking activities or parent entities of a financial group (some of which are not bank controlling companies) to which a South African bank belongs. In this regard, the authorities should strengthen its technique, such as group-wide stress testing, to monitor and assess those risks. The authorities should further improve the recovery and resolution planning of large banking groups particularly once the necessary power is given to the supervisor by the expected new legislation. Such planning should also consider scenarios where shocks originate from non banking entities or parent groups.
13. Home-host relationships	The current arrangements and frameworks for cooperation with foreign supervisors are broadly adequate, although cooperation with supervisors in other African countries needs further enhancement as the South African banking groups are expected to continue to expand their operations in these countries. To further improve the effectiveness of cooperation and ensure adequate oversight is carried out on African operations of South African banking groups, the assessors encourage the authorities to continue their efforts to support the capacity building of these supervisors. The authorities also need to finalize their policies and processes on the conduct of on-site reviews/inspections of South African banks' cross-border operations in other African countries and enhance practices, with due consideration to the risk those operations pose to the parent banks. These should in time evolve to incorporate joint supervisory activities with the host supervisors. The supervisor should also enhance its effort in cross-border recovery and resolution planning. Given a few of the big banks have strong ties with the UK, the recovery and resolution plans need to be developed with close collaboration with the UK authorities. Furthermore, as a few South African banking groups' foreign operations in other African groups have become systemically important for some host jurisdictions, in developing recovery and resolution plans of these groups, due regards need to be paid to the impact on these jurisdictions' financial system. This will also require close cooperation with supervisory authorities in these jurisdictions.
14. Corporate governance	Through regulations and practice, the SARB places strong emphasis on sound and effective corporate governance at all banks in South Africa. BSD staff is able to assess the quality of corporate governance at individual banks through regular meetings, as well as review of audit reports and Board and Board committee minutes.

Core Principle	Overall Comments
15. Risk management process	The SARB's SREP cycle places emphasis on verifying that banks have robust risk management policies and procedures. A recent significant increase in supervisory staff has allowed the BSD to form specialized teams to review the major risk categories. While the skills of some of the newer members of these teams are in the process of being strengthened, primarily through on-the-job experience, the teams have enhanced the BSD's understanding of the risks faced by South African banks, most especially at the largest institutions.
16. Capital adequacy	The SARB has adopted or is in the process of adopting the various components of Basel II, 2.5 and III according to or in advance of the schedule established by the Basel Committee. Capital is calculated on a consolidated and solo basis for all banks and the BSD has the authority to impose additional capital requirements on individual banks, as deemed necessary. The BSD has applied the three Basel ratios (CET1, tier 1 and total capital) as well as systemic capital requirements, large bank capital add-ons and a "Board buffer" that ensures that banks do not fall below the minimum requirements. BSD staff regularly assesses banks' capital management and planning, most intensely at the largest internal ratings based banks.
17. Credit risk	Regulation 39 clearly sets out the requirement for adequate policies and procedures related to credit risk management, approved by the Board of directors and effectively implemented by management. BSD staff, including the analyst(s), credit specialist team and on-site review team, takes an active role in assessing the quality of credit risk management at all banks, including as part of the SREP.
18. Problem assets, provisions, and reserves	Through the use of reports submitted on a regular basis, the review of external auditor reports and selected on-site examinations, the BSD monitors problem assets at individual banks. Supervisory staff evaluates the adequacy of banks' provisioning for problem assets on both an individual bank and peer group basis. The assessors encourage the BSD to finalize as soon as possible the draft Directive on restructured credit exposures which will help to prevent banks from using restructuring to improve their classified loan levels.
19. Concentration risk and large exposure limits	Regulations require the Board and senior management to establish and maintain adequate policies and procedures related to concentration risk and large exposures. The BSD utilizes reports received from banks on a quarterly basis to monitor large exposures and risk concentrations. In addition, the BSD monitors Board and management oversight of concentration risk through the SREP and ICAAP reviews.
20. Transactions with related parties	Regulations set out a comprehensive definition of "related person" and require banks and controlling companies to conduct transactions with related parties on an arm's-length basis. In addition, Regulation 39 requires the Board and senior management of a bank to ensure that the monitoring and reporting of individual and aggregate exposures to related persons are subject to an independent individual credit review process.

Core Principle	Overall Comments
	The BSD receives and reviews information on transactions with related parties on a quarterly basis. Any matters of concern would be included as a topic of discussion in prudential meetings held with individual banks. The assessors recommend that the SARB amend its regulations so that the Registrar has the ability to set limits on exposures to any related parties. At this point, it only has the ability to set limits on intragroup transactions and exposures.
21. Country and transfer risks	Since the last BCP assessment, Regulation 39 has been amended to specifically include country and transfer risks. In addition, the BA 210 quarterly report was amended in 2011 and now requires more granular information on bank's country and transfer risks. While the level of country and transfer risk for most banks remains relatively small, the BSD monitors such exposures on an ongoing basis through the SREP and includes this risk category as part of its discussions with bank Boards, management and auditors, as appropriate.
22. Market risk	The SARB has implemented a comprehensive approach to the supervision of market risk, especially at the largest banks that have been approved for the INTERNAL MODELS APPROACH. For most banks in South Africa, market risk remains at rather modest levels.
23. Interest rate risk in the banking book	Banks in South Africa currently deal with minimal interest rate risk in the banking book due to the fact that a large percentage of lending is done on a floating rate basis. The BSD, as part of its SREP, reviews the policies and procedures in place at banks to manage such risk. The BSD also noted that they are giving IRRBB more focus in 2014 and providing additional training to members of the analysis teams. The assessors encourage the BSD to continue with its plans to further strengthen its review of banks' internal interest rate risk measurement systems.
24. Liquidity risk	The BSD has already initiated adoption of the LCR by South African banks and intends to implement the NSFR on schedule as well. This is despite the fact that South Africa (like several other Basel Committee member countries) is disadvantaged by a limited supply of government bonds, an illiquid and small corporate debt market and disintermediation of retail funding through MMFs into the banking sector.
25. Operational risk	The SARB has developed a robust program for assessing the quality of operational risk management at individual banks. This combines on-site and off-site analysis of the systems in place at banks. The BSD has enhanced the specialist team for operational risk, which includes IT experts.
26. Internal control and audit	The BSD closely monitors the adequacy of internal controls and compliance at individual banks. Through such off-site practices as the review of banks' internal reports and regular meetings with Board audit committees, internal auditors and compliance officers, the BSD is able to assess the quality of internal controls and audit at banks.

Core Principle	Overall Comments
27. Financial reporting and external audit	Banks in South Africa are required to publish their financial statements based on IFRS standards, and to have the statements audited. The supervisory process is based, in part, on a strong working relationship between the BSD and banks' external auditors.
28. Disclosure and transparency	The banks in South Africa are required to disclose a wide range of information to the public on a regular basis. As is permitted under the Basel capital framework, Pillar 3 disclosures are not currently audited. Therefore it is important for these disclosures to be reviewed on a consistent basis by BSD staff. Currently, the reports are only reviewed on a sporadic basis. With recent staff increases, the BSD should endeavor to assign the responsibility for reviewing the Pillar 3 disclosures to either analysts or other individuals with the requisite skills. The alternative to a consistent internal review process would be to impose a requirement that the reports be reviewed by the banks' external auditors.
29. Abuse of financial services	The BA and associated regulations as well as the revised Financial Intelligence Centre Act (Act No. 38 of 2001) (FICA) provide a generally adequate framework for supervising banks' policies and processes against abuse of financial services. On the implementation front, the BSD has significantly stepped up its effort for supervision of measures against abuse of financial services, including the AML/CFT measures: a dedicated unit for the AML/CFT issues was established and has been conducting on-site inspections with inspections on large banks completed; administrative fines are recently imposed on some large banks on the AML/CFT issues; and more attention is being paid to these issues in the whole SREP process. However, some weakness still remains. The Guidance Notes issued by the FIC which contain many essential requirements relevant to many ECs in this CP as well as the concept of risk-based approach do not have the legal enforceability under the FICA. Even though they are applied by the BSD in its supervision, their enforceability through the general supervisory power based on the BA has not yet been formally tested. In addition, on-site inspections of all banks are not yet completed.

G. Recommendations to Improve Compliance with the BCPs

Core Principle	Recommendations
1. Responsibilities, objectives and powers	Define objectives of the supervisor in the legal framework. Review the extent of delegation of powers in the Banks Act, with a view to transfer the power to set granular requirements from tier 2 rules (regulations), which need to be issued by the Minister, to tier 3 rules (circulars, directives), which can be issued by the Registrar. Review the composition of the Standing Committee for the Revision of the Banks Act, with a view to require its members to be not currently involved in not only any regulated entities but also bodies that represent interests of those regulated entities, to insulate the process from direct industry interests. Instead, as experts on financial business, the Committee could

Core Principle	Recommendations
	include retired officials from the industry or academics.
2. Independence, accountability, resourcing and legal protection for supervisors	Revise the legal framework for the head of the supervisor to include (A) a fixed term of the appointment, (B) specific reasons for the removal, and (C) the requirement to publish the reasons for removal. Review the legislation to limit the cases that require the Minister's involvement to those that are absolutely necessary and clarify in the laws objectives for intervention. Review the adequacy of resources reflecting expected changes in the responsibility of the supervisor under the new Twin Peaks structure, taking into account the need for further improvements in its supervisory approach.
3. Cooperation and collaboration	Review the relevant provisions of the BA to ensure the confidential information shall only be used for supervisory purposes, unless specifically required by court orders or provisions in other laws.
8. Supervisory approach	Enact legislation to provide the supervisor power related to resolution of banks expeditiously and develop resolution plans. The new prudential supervisor should review the supervisory approach once the organizational changes are completed in order to equip it with capacity to monitor the prudential risk of the entire financial system as well as that of financial conglomerates.
9. Supervisory techniques and tools	Continue the effort to enhance the supervisor's ability to conduct deep-dive on-site reviews. Improve tools and technique to assess and monitor spill over risks to the banks from non banking activities in their financial groups.
11. Corrective and sanctioning powers of supervisors	Strengthen laws to provide the supervisor with the power to suspend or limit a bank's activities without delay. Provide the power to fine individuals related to banks.
12. Consolidated supervision	Strengthen the supervisory technique, such as group-wide stress testing, to monitor and assess risks arising from non-banking activities or parent entities of a financial group in which a South African bank belongs. Improve the recovery and resolution planning of large banking groups particularly once the necessary power is given to the supervisor by the expected new legislation. Such planning should also consider scenarios where shocks originate from non banking entities or parent groups.
13. Home-host relationships	Continue efforts to support the capacity building of host supervisors of African operations of South African banking groups to further improve the effectiveness of cooperation and ensure adequate oversight of those operations. Finalize policies, processes and practices to conduct on-site reviews/inspections of South African banks' cross border operations in

Core Principle	Recommendations
	other African countries. Enhance its effort in cross-border recovery and resolution planning with close collaboration with the UK authorities as well as paying due regards to the impact on financial systems of jurisdictions where South African banks' operations are significant. This will also require close cooperation with supervisory authorities in these jurisdictions.
18. Problem assets, provisions, and reserves	Finalize as soon as possible the draft Directive on restructured credit exposures which will help to prevent banks from using restructuring to improve their classified loan levels.
20. Transactions with related parties	Amend the Regulations so that the Registrar has the ability to set limits on exposures to any related parties.
23. Interest rate risk in the banking book	Continue with the plans to further strengthen its review of banks' internal interest rate risk measurement systems.
28. Disclosure and transparency	Review Pillar 3 disclosures consistently either by the BSD's internal staff or by requiring external auditors to do it.
29. Abuse of financial services	Proceed with the planned revision of the FICA to incorporate the risk-based approach to the AML/CFT issues and ensure the enforceability of a number of essential elements currently included in the FICA Guidance Notes. Continue the current effort on the AML/CFT on-site inspections to cover all banks expeditiously and improve approaches and techniques based on the lessons learned.

H. Authorities' Response

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

ASSESSMENT OF INSURANCE CORE PRINCIPLES

A. Summary[3]

32. Insurance regulatory and supervisory regime in South Africa is in transition. Currently, the FSB regulates the non-banking financial services industry, including the insurance sector, in South Africa. With the goal of achieving a safer financial sector to serve South Africa better, the Government has proposed major changes in the financial sector. As part of the regulatory reforms, a Twin Peaks supervisory structure will be adopted, with functional separation of prudential and market conduct mandates. Market realities in the insurance sector pose significant regulatory challenges, which are well recognized by the authorities. These considerations include the dominance of financial conglomerates, high market concentration, demands of an economically diverse consumer base, high unemployment and slow growth in recent years.

33. The authorities have been proactive in updating and/or formalizing the regulatory regime to better reflect current international best practices, which are well progressed. The key regulatory initiatives include the implementation of a formal group supervision framework, a risk-based SAM regime and TCF approach to CoB supervision. The FSB-SA will have formal legal authority to supervise insurance groups including direct powers over a group holding company.

34. While the proposed regulatory enhancements will bring the regulatory regime in line with the international standards promulgated by the IAIS, there is scope for fine-tuning. Supervisory intensity and effectiveness could be enhanced by more intensive on-site visits with a baseline supervision cycle that are proportionate to the risk profiles of insurers and reinsurers as well as a more holistic supervision approach for insurance groups. There is also scope to strategize an appropriate risk-based supervisory cycle to cover the large number of financial service providers. Pending the implementation of the Twin Peaks, the operational independence and supervisory resources of the FSB-SA could be further strengthened. Going forward, the implementation of the enhanced regulatory regime as well as more effective and holistic supervision under the Twin Peaks hinges on the adequacy and quality of supervisory resources of the FSB-SA.

B. Introduction and Scope

35. South Africa's regulatory regime and supervisory practices were assessed against the standards of the International Association of Insurance Supervisors (IAIS). The assessment was undertaken against the IAIS Insurance Core Principles (ICPs) issued in October 2011, as revised in October 2013. Specific principles apply to the supervision of intermediaries. The scope of the assessment covers the prudential and market conduct supervision exercised by the FSB-SA.

[3] This report was prepared by Mala Nag (IMF) and Su Hoong Chang (external expert), who conducted the assessment. The previous ICP assessment of South Africa was conducted in 2008.

36. The assessment is based solely on the laws, regulations and other supervisory requirements and practices that were in place at the time of the assessment in May 2014. The authorities provided a self-assessment and provided the assessors with examples of actual supervisory practices and assessments, which enhanced the assessment process. Technical discussions with and briefings by officials from the FSB-SA enriched this report; as did discussions with industry participants.

C. Market and Institutional Setting

37. The insurance sector is an important pillar of the financial system in South Africa. In 2013, assets held by insurers accounted for nearly 23 percent of financial sector assets in South Africa. As at end-2013, there were 78 long-term insurers, 87 short-term insurers, 6 reinsurers and 11 captive insurers (excluding cell captive insurers). The long-term insurance sector is highly concentrated with the top five conglomerates dominating the market with over 73 percent of total industry assets in 2013 while the short-term insurance industry is less concentrated. The insurance sector is adequately served by a wide range of intermediaries, with approximately 10,992 FSPs as at March 31, 2014.

38. The key exposures of long-term insurers are market and lapse/surrender risks while short-term insurers have to confront difficult market conditions and difficult underwriting exposures. Nonetheless, a recent ST conducted by FSB-SA found that only two small insurers demonstrated an inability to remain solvent under an adverse market risks scenario. It was observed that as unemployment increased, many insurance policies lapsed as policyholders cashed in their savings or switch to other investment instruments. Short-term insurers are exposed to premium pricing and reserving risk, severe catastrophe risks, both natural and man-made, and counterparty default risks. The FSB-SA's combined ST scenario revealed that a few short-term insurers might be under solvency strains although this is still being investigated.

39. Considerable inter-linkages within the financial system exist as a result of the ownership structures. There are a few large conglomerate groups where domestic banks indirectly own two of the larger long-term and three short-term insurers. While the non-financial sector entities, including manufacturing and industrial entities, indirectly own many insurance entities, a number of insurance groups are dominated by securities firms mostly offering unit-linked and other retirement investment products, often targeted at high net worth clients. The move to a Twin Peaks supervisory structure is intended to enhance supervision at the conglomerate level and improve CoB supervision.

40. Due to the dominance and interconnectedness of the major financial conglomerates in the South African market, one of the biggest risks to the stability of the insurance sector is a default by one of the major banks. In addition to cross-ownership and equity investments, long-term insurers are a major source of funding for banks. Shocks in one sector, can be transmitted through the financial system, potentially becoming systemic. It was also noted that insurers see diversified cash management as a challenge against a backdrop of concentrated banking system, particularly for short-term insurers given their significant share of deposits and MMFs in the banking system.

D. Key Findings

41. The FSB-SA has introduced a risk-based supervision framework, which has been evolving to improve supervisory intensity and effectiveness. In this regard, there is scope for more intensive on-site visits with a baseline supervision cycle that are proportionate to the risk profiles of insurers and reinsurers. This would also include a systematic approach to evaluating the nature of supervision of reinsurers and other counterparties used by insurers. Group supervision should cover all insurance groups with holistic off-site monitoring of intra-group transactions and aggregate group exposures, including joint on-site visits of financial conglomerates. To improve supervisory effectiveness, the FSB-SA is advised to strategize an appropriate risk-based supervisory cycle to cover the large number of FSPs. It is also advisable for the FSB-SA to adopt a more structured macro-prudential surveillance framework that also considers cross-sectoral inter-linkages and system-wide market conduct issues.

42. The authorities have made good progress in updating and/or formalizing the regulatory regime to bring the regulatory regime in line with the international standards promulgated by the IAIS. Nonetheless, there is scope for fine-tuning in the following areas:

a) A proportionate licensing and supervisory approach for friendly societies and clearer boundaries between medical schemes and insurance products;

b) Priority of ranking for policyholders in the event of winding-up;

c) Enhance the proposed group supervision framework by establishing explicit requirements on intra-group transactions and risk exposures e.g., intra-group reinsurance;

d) Provide explicit CoB requirements on product development and provide the supervisor with the authority to require notification of certain types of new insurance products and prohibit certain products that do not meet prescribed standards;

e) Public disclosure requirements for all insurers and clear legal authority to supervise compliance;

f) Address the remaining legal deficiencies in the AML-CFT regime;

g) Appropriate indicators for assessing systemic risk of insurers and reinsurers; and

h) A crisis management and resolution framework to deal with cross-border crisis effectively.

43. Pending the implementation of the Twin Peaks, the FSB-SA could be further strengthened by: a) formalizing the objectives for insurance supervision and the legal authority for group-wide supervision in the legislation; b) strengthening operational independence to minimize undue political or industry interference; and c) reviewing the adequacy of supervisory resources and augment skill sets in light of current and impending regulatory initiatives. It is important that the FSB-SA continues its positive engagement with domestic and international counterparts to ensure effective supervisory cooperation.

E. Summary of Compliance with the ICPs

Insurance Core Principle	Overall Comments
1. Objectives, Powers and Responsibilities of the Supervisor	The FSB-SA is the primary authority responsible for insurance supervision and its powers are clearly defined in legislation. Although the objectives of insurance supervision are not explicitly stated in the legislation, the Mission and Vision statement of the FSB-SA gives effect to the objectives of insurance supervision. The authorities have made good progress in identifying the changes required to align insurance supervision with international standards.
2. Supervisor	The existing governance structure of the FSB-SA and its Board are adequately defined including internal governance procedures. There is effective communication and prompt escalation of significant issues to appropriate levels within the FSB-SA. As some Board members are related to regulated entities, they may not be fully independent from commercial interests. The FSB-SA consults widely when introducing regulatory reforms. The FSB-SA has added significant resources to its Insurance Division over the last four years; however, it was noted that additional skilled staff will be needed to effectively implement the regulatory reform agenda and supervise complex conglomerates.
3. Information Exchange and Confidentiality Requirements	The FSB-SA is empowered to coordinate, collaborate and share information exchange information with other domestic and foreign regulators and does so in practice, with appropriate regard to the need to safeguard confidential information. Written agreement or strict reciprocity is not required for information exchange. The FSBA was amended recently to further facilitate information exchange and strengthen confidentiality requirements.
4. Licensing	The licensing framework is clear and transparent. Various mechanisms including the Licensing Committee and rights of appeal against a decision of the FSB-SA help ensure that the framework is consistently applied. Although current legislation does not specifically include licensing requirements relating to governance, risk management and group structure, its Risk-Based Supervisory Framework practices informs the licensing decision.
5. Suitability of Persons	The scope of suitability requirements apply to board of directors, senior management and significant owners. However, Key Persons in Control Functions are not covered directly. (ICP 8) This regulatory gap will be addressed in the upcoming proposed Board Notice. The FSB-SA is able to compensate for some of the gaps by means of its Risk-Based Supervisory Framework practices which include review of control functions.
6. Changes in Control and Portfolio Transfers	The Insurance Acts set clear ownership and control thresholds above which approval is required. The FSB-SA has the authority to approve or deny

Insurance Core Principle	Overall Comments
	proposals for portfolio transfers, and to acquire or increase controlling interests in an insurance company. These are assessed, based on the same criteria as those for a new license application and take policyholder interests into account. While insurers are not explicitly required to notify the FSB-SA in the case of a significant decrease in the ownership, below the pre-determined control levels, such cases are usually identified through FSB-SA's risk-based supervisory process.
7. Corporate Governance	There are no explicit corporate governance requirements in the Insurance Acts or regulations. The FSB-SA relies on the registration requirements for insurers as the high-level legal basis to supervise insurers' governance practices. The FSB-SA does not have a formal role in checking insurers' observance with the King III best practice principles on a "apply or explain" basis. The FSB-SA reviews insurers' corporate governance through qualitative questionnaires and discussions during on-site visits. The FSB-SA is in the process of issuing a Board Notice to establish explicit governance requirements for insurers. A comprehensive corporate governance framework at the group level is expected to be implemented in 2016.
8. Risk Management and Internal Controls	The Insurance Acts or supervisory guidelines do not at present specifically require insurers to establish, and operate within, effective systems of risk management and internal controls. While the regulatory requirements relating to the role of statutory actuaries and outsourcing are comprehensive, there are no explicit requirements on insurers to establish risk management, compliance and internal audit functions. King III partly addresses the role for internal audit on an apply-or-explain basis. The FSB-SA reviews insurers' risk management and internal controls as part of its risk-based supervision. The proposed Board Notice will establish comprehensive provisions for risk management and internal controls.
9. Supervisory Review and Reporting	The risk-based approach helps the FSB-SA to prioritize supervisory focus and to allocate supervisory resources. The FSB-SA has adequate documentation and follow-up processes for off-site monitoring and on-site visits and refines the risk-based supervisory process continuously. Due to significant interconnectedness with other financial sectors, the FSB-SA recognizes the need for more standardized reporting of intra-group transactions and aggregate risk exposures, including joint inspections for all insurance groups. Given the absence of group market conduct requirements, supervision in this area will need further attention. Since lapse rates, surrenders and churning issues have been challenging from a prudential and market conduct perspective, the planned introduction of a dedicated quarterly CoB return, for supervisory monitoring and enforcement actions, is a positive step.
10. Preventive and Corrective Measures	The Insurance Acts and the Financial Institutions (Protection of Funds) Act also provide a sufficiently wide range of remedies to address non-compliance with the Acts by insurers. The FSB-SA Risk-Based Supervisory Framework supports early intervention and its approach to progressive escalation of actions or remedial measures at various stages depending on the severity of the situation. Once issues are identified, the FSB-SA has adequate powers to initiate timely and proportionate preventive and

Insurance Core Principle	Overall Comments
	corrective measures.
11. Enforcement	The FSB-SA has sufficiently wide range of enforcement powers, which have been frequently applied in practice. The Enforcement Committee (EC) within the FSB-SA adjudicates on all alleged contraventions and is empowered to impose unlimited penalties, compensation orders and cost orders. The criteria that guide sanctions are clear, objective and publicly disclosed. In practice, the FSB-SA has taken enforcement actions against several insurers, including the 3 insurers that failed.
12. Winding-up and Exit from the Market	The Insurance Acts provide for clear triggers for the FSB-SA to take action in case of an insurer becomes financially unsound. The winding-up regime has been tested with the failure of three insurers in the past five years. However, policyholders do not currently have priority of claims over unsecured creditors in the event of the winding-up of an insurer. The FSB-SA is participating in a Resolution Policy Working Group (supported by the World Bank) consisting of the NT, the SARB and the FSB-SA. The Working Group is considering improvement to the prevailing legislative frameworks for the resolution of financial institutions, including the establishment of a policyholder protection scheme.
13. Reinsurance and Other Forms of Risk Transfer	The FSB-SA reviews the proposed reinsurance arrangements of an applicant as part of the licensing process. Insurers may only obtain relief in respect of "approved reinsurance policy" when calculating their technical provision. However, other on-going regulatory requirements on insurers' reinsurance operations, including intra-group reinsurance transactions, have not been established. There is also no regulatory policy on the treatment and accounting for alternative risk-transfers (ART). The FSB-SA review insurers' reinsurance arrangements as part of its off-site analysis and verifies the reinsurance program during on-site visit. However, it does not specifically assess cedants' liquidity management with respect to reinsurance.
14. Valuation	The valuation regime is intended to be prudently realistic and is based on financial reporting standards, subject to prudential filters for assets and prudent valuation methodologies for certain types of assets and technical provisions prescribed by the FSB-SA. Long-term insurers must observe the standard actuarial practices issued by the ASSA in the estimation of technical provisions. The methodologies for estimating technical provisions of long-term insurers take into account the relevant underlying risks. They must use best-estimate assumptions, take into account policyholders' reasonable expectations and maintain explicit compulsory and discretionary margins. For short-term insurers, there is no requirement to have an explicit margin over current estimate but an implicit margin is incorporated via the use of prudent factors and the policy of no discounting.
15. Investment	The FSB-SA has established requirements on the investment activities of insurers including eligible assets; diversification requirements; non-admitted assets for solvency purposes; prohibition against encumbrances of assets; use of nominees as well as investments in derivatives. The proposed Board Notice will enhance the regime by establishing explicit requirements on insurers to have an explicit investment policy and explicit asset-liability

Insurance Core Principle	Overall Comments
	management (ALM) policy.
16. Enterprise Risk Management for Solvency Purposes	Pending the implementation of SAM, the Insurance Acts and supervisory guidance do not address regulatory requirement relating to Enterprise Risk Management (ERM) and ORSA (Own Risk and Solvency Assessment). In the interim, the FSB-SA has introduced semi-annual economic STs for the six largest long-term and short-term insurers, and annual economic and insurance ST for all insurers. The FSB-SA reviews insurers' ERM framework and is closely monitoring insurers' progress in terms of ORSA. The Pillar II Readiness exercise in 2012 revealed that while insurers have made progress on ERM issues, almost 85 percent of the insurers were either weak or needed improvement with respect to ORSA preparations. A follow-up Pillar II readiness review is underway.
17. Capital Adequacy	The current solvency regime is transparent and the requirements are more risk-based for long-term insurers compared to short-term insurers. In practice, the CAR has proven to be largely sufficient in preventing insurer failures or losses to policyholders, largely because of the prudence built into the calculation of technical provisions. While the insurance laws only provide a single point of supervisory intervention, continuous monitoring by the FSB-SA allows early identification of potential breaches of CAR which facilitates timely intervention. As insurers move closer to the minimum CAR, supervisory action and intervention will be triggered and intensified if necessary.
18. Intermediaries	The FSB-SA has detailed requirements for licensing FSPs, who are subject to risk-based ongoing supervision. Adequate requirements are in place for FSPs to ensure that they conduct business in a professional and transparent manner. Disclosure requirements are adequate and sufficient safeguards are in place to protect client funds. The FSB-SA has also taken actions against unlicensed individuals and entities. However, the potential for mis-selling and poor outcomes for policyholders seems to persist. The TCF initiative currently underway is expected to bring benefits and the FSB-SA has begun embedding TCF into its regulatory and supervisory framework, which includes explicit minimum governance requirements.
19. Conduct of Business	There are processes in place to review that customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied. The authorities are addressing the current regulatory gaps by engaging with the market conduct participants to improve CoB practices.
20. Public Disclosure	The Insurance Acts do not have explicit public disclosure requirements, although the adoption of IFRS partly addresses the standards under this ICP. Unless an insurer is listed, there is no obligation to make the financial statements available to persons other than persons that have a beneficial interest in the insurer. The FSB-SA does not monitor the disclosures made by insurers to market participants. Under the SAM framework, public disclosure requirements will be established as part of Pillar III requirements.
21. Countering Fraud in	The FSB-SA has minimal direct legislative powers in respect of insurance

Insurance Core Principle	Overall Comments
Insurance	fraud. Nonetheless, fraud in general constitutes a criminal offence under the common law and the Criminal Law imposes sanction against fraud. FSPs are required to address risks (including fraud risks) that result in financial loss to clients and others. The FSB-SA checks whether insurers and FSPs have implemented fraud prevention measures although there has not been a thorough examination in this area.
22. Anti-Money Laundering and Combating the Financing of Terrorism	The legislative framework of the AML-CFT regime comprises the FICA, the MLTFC Regulations and Exemptions in Terms of the FICA. The AML-CFT regime covers long-term insurers and FSPs. The FIC has issued directives and Guidance Notes relating to the AML-CFT obligations of accountable institutions. However, some parts of the guidelines issued by the FIC are not legally enforceable due to the current legal gaps in the AML-CFT regime. The FSB-SA is a designated AML-CFT competent authority and is empowered to conduct AML-CFT on-site inspections and impose administrative sanctions. Assessing the compliance by long-term insurers and FSPs with their AML-CFT obligations is embedded in the FSB-SA's risk-based supervisory approach. Insurers and FSPs submit suspicious transactions reports to the FIC directly. The FSB-SA is authorized to cooperate and exchange information with relevant authorities (ICP 3) and has a MoU with the FIC. However, disclosure of information to a foreign FIU may only be provided pursuant to a written agreement and subject to reciprocity.
23. Group-wide Supervision	The FSB has been developing its approach to group supervision in the past few years. In practice, group-wide supervision is informal and relies, in respect to information gathering on groups and follow-up action, on FSB-SA's general authority and standing rather than on specific legislative provisions. Despite the informality, the FSB-SA has been able to cooperate and coordinate conglomerate supervision with the SARB on systemic issues on a regular basis. To date, the FSB-SA has focussed on a few large conglomerates and its supervision relies mainly on some financial indicators.
24. Macroprudential Surveillance and Insurance Supervision	The FSB-SA uses information from its supervisory analysis and external sources to identify/assess the extent to which macro-economic vulnerabilities and financial market risks (both local and international) impinge on the financial condition of insurers and the stability of the insurance sector as a whole. While there is no formal process to assess the potential systemic importance of insurers, the FSB-SA supervises the major and potentially systemic insurance groups more closely. Under the proposed Twin Peak supervisory structure, the SARB will serve as the macro-prudential supervisor.
25. Supervisory Cooperation and Coordination	Despite the lack of a formal framework, the FSB-SA is able to coordinate and cooperate with other relevant supervisors on insurance groups in practice through its general standing and the willing participation of the insurance groups concerned. The FSB-SA has hosted one supervisory college as the group-wide supervisor and plans to host supervisory colleges for four other insurance groups for which it is the *de-facto* group-wide supervisor. Legislative provisions are pending to enhance the framework for

Insurance Core Principle	Overall Comments
	cooperation and coordination in group-wide supervision.
26. Cross-border Cooperation and Coordination on Crisis Management	The FSB-SA has demonstrated its ability and willingness to support and participate in resolving crisis situations. However pre-crisis preparation, coordination and cooperation should be enhanced. While the current legislative framework does not hinder cooperation and coordination in a crisis, the gaps noted should be addressed to facilitate more effective cross-border crisis management.

F. Recommendations to Improve Observance of the ICPs

Insurance Core Principle	Recommendations
1. Objectives, Powers and Responsibilities of the Supervisor	The authorities are encouraged to expedite the finalization of the proposed Financial Sector Regulation Bill and the Insurance Bill that establish the objectives of insurance supervision and confer legal authority on the FSB-SA to conduct group supervision.
2. Supervisor	The authorities are advised to: a) revise criteria for appointment of Board members to ensure there is no undue political or industry interference; b) expedite the legislative amendments to have explicit legal provisions regarding the appointment and dismissal of the head of the supervisor and members of its governing body; c) review the adequacy of supervisory resources; d) consider exempting the supervisors from the government's austerity measures and administrative guidance; and e) consider how best to enhance the effectiveness of the internal audit functions.
4. Licensing	The authorities are recommended to expedite legislative amendments to formalize the licensing requirements relating to governance, risk management and group structure; review current exemptions for friendly societies and adopt proportionate approach for these entities; and formulate clearer boundaries between medical schemes and insurance products that should be supervised under the Insurance Acts.
6. Changes in Control and Portfolio Transfers	The authorities are recommended to introduce a definition of "significant" owner based on control and percentage; and expedite legislative amendments to authorize the FSB-SA to approve any significant increase above the predetermined control levels and to approve any significant decreases as well.
7. Corporate Governance	The implementation of the proposed Board Notice, the Financial Sector Regulation Bill and the Insurance Bill will address the current regulatory gaps. The FSB-SA is advised to plan for adequate supervisory resources to implement the enhanced corporate governance framework effectively.
8. Risk management and Internal Controls	The implementation of the proposed Board Notice will address the current regulatory gaps on risk management and internal controls. It is advisable that the FSB-SA provides guidance to short-term insurers on monitoring potential ML/TF risks, which will contribute the authorities' review of the

Insurance Core Principle	Recommendations
	ML/TF risk profile of the short-term insurance industry (ICP 22).
9. Supervisory Review and Reporting	The effectiveness of on-going supervision could be strengthened by ensuring that three year supervisory cycle is completed for all insurers and reinsurers and more intensive on-site visits for the more complex insurers. Appropriate group supervision plan is required that covers all insurance groups in a risk-based proportionate manner, including joint on-site visits of financial conglomerates. Increasing off-site monitoring of intra-group transactions and aggregate group exposures and limits and establishing procedures for insurer/groups to report group related risks and risk direction for off-site monitoring is important. Also instituting procedures to capture CoB risks in the current RAD such that both prudential and CoB supervision form part of the risk assessment and ensuring adequate skilled supervisory resources are in place.
12. Winding-up and Exit from the Market	It is recommended that the authorities expedite the changes to the legislative framework such that high legal priority is given to the protection of the rights and entitlements of policyholders.
13. Reinsurance and other Forms of Risk Transfer	The implementation of the proposed Board Notice will address most of the current regulatory gaps on reinsurance. In addition, the FSB-SA is advised to: a) adopt a systematic approach to evaluating the nature of supervision of reinsurers and other counterparties used by insurers; b)formulate clear policy position on the treatment and accounting for ART; c) establish explicit requirements on reinsurance with related companies, including management of liquidity, concentration, and contagion risk as well as potential conflicts of interests; and assessing the acceptability of reinsurance with related companies based on both qualitative (e.g., purpose) and quantitative criteria.
14. Valuation	The valuation regime under the SAM Framework will be based on economic valuation, with explicit margins over current estimate for technical provision.
15. Investment	The proposed Board Notice provisions governing insurers' investment activities and ALM will address most of the current regulatory gaps. The authorities are advised to formulate appropriate investments requirements at the insurance group level.
16. Enterprise Risk Management for Solvency Purposes	The proposed Board Notice covering risk management and the implementation of the SAM Framework will significantly enhance the regulatory regime for ERM.
17. Capital Adequacy	The impending implementation of the SAM Framework and the Insurance Bill, including financial soundness requirements for insurance groups, will bring the solvency regime in line with ICP 17.
18. Intermediaries	The authorities are encouraged to actively monitor persistence rates of intermediaries; ensure governance requirements for intermediaries are effectively embedded and enforced to better protect policyholders; consider ways to simplify the FSP structure to have greater focus on

Insurance Core Principle	Recommendations
	supervising insurance intermediaries to improve policyholder protection; consider establishing cyber-surveillance to enhance the detection and the prevention of illegal sale of insurance products via internet, social networking services, and mobile telephony; and ensure adequate resources for more robust implementation of recent legislative amendments and effective supervision of intermediaries.
19. Conduct of Business	The authorities are advised to expedite the current CoB initiatives which will address the gaps including explicitly require insurers to take into account the interests of different types of customers when developing and marketing insurance products; provide explicit CoB requirements on insurance product development and provide the supervisor with the authority to require notification of certain types of new insurance products and prohibit certain products that do not meet prescribed standards; have appropriate governance framework on strengthening conflict of interest; and review the adequacy of supervisory resources.
20. Public Disclosure	Authorities should establish explicit public disclosure requirements in line with ICP 20 that are applicable to all insurers and provide clear legal authority to the FSB-SA to supervise compliance with the requirements.
21. Countering Fraud in Insurance	The Board Notice proposed by the FSB-SA will require insurers to establish an explicit insurance fraud risk management policy, including prompt reporting to the relevant authorities, in line with ICP 21.
22. Anti-Money Laundering and Combating the Financing of Terrorism	The proposed Board Notice will enhance measures that insurers must take in respect of managing risks associated with ML-FT. In addition, the authorities are advised to a) expedite the passage of the amendments to the main AML-CFT legislation to address the remaining technical deficiencies in the AML-CFT regime; b) consider how best to improve supervisory coordination and engagement of the industry to facilitate effective compliance by insurers and FSPs with their AML-CFT obligations; and c) Periodically assess the potential ML-FT risk in the short-term insurance industry to take account of evolving ML-FT typologies and consider whether to apply the FINANCIAL ACTION TASK FORCE standards to short-term insurance.
23. Group-wide Supervision	The authorities should establish clear and consistent regulatory regime for group-wide supervision to provide explicit powers to enforce group-wide supervision (including reporting requirements at both solo and consolidated levels); approving intra-group transactions and cross-shareholdings to prevent concentration risk, risk of contagion, and double gearing of capital; a more formal risk assessment program for heads of group; and group-wide market conduct requirements. Cross-sectoral coordination mechanisms could be enhanced and formalised, particularly with respect to groups majority-owned by securities entities.
24. Macroprudential Surveillance and Insurance Supervision	The authorities are advised to formulate macro-prudential surveillance framework appropriate to the nature, scale and complexity of the insurance sector under the Twin Peaks supervisory structure. The considerations include: developing more robust indicators for assessing systemic risk of

Insurance Core Principle	Recommendations
	insurers and reinsurers; taking account of cross-sectoral linkages e.g., cross-shareholdings across the sectors, *bancassurance*, linked policies; and inclusion of risks arising from system-wide market conduct issues, including reputational risks.
26. Cross-border Cooperation and Coordination on Crisis Management	It is important that the FSB-SA continues to engage the relevant supervisory colleges on the preparations and common tools for managing a cross-border crisis and identifying (and resolving) barriers to efficient and internationally coordinated resolutions. The work of the Resolution Policy Working Group would inform the formulation of a crisis management and resolution framework that will deal with cross-border crisis effectively. The framework should explicitly address: plans and tools for dealing with insurers in crisis as well as requirements for insurers to provide information in a timely fashion and to maintain contingency plans and procedures which should be tested and reviewed regularly.

G. Authorities' Response

44. **The FSB-SA would like to thank the Assessors for the report on the detailed assessment of the IAIS Insurance Core Principles.** We believe the report is comprehensive and displays a good understanding of the FSB-SA regulatory and supervisory frameworks (both existing and planned). The assessment was extremely useful exercise in terms of providing an independent and objective benchmarking of the standards of insurance regulation and supervision in South Africa against international standards.

45. **The report accurately reflects the various ways in which the FSB-SA is already well-advanced in addressing some of the identified gaps in our regulatory framework and supervisory practices.** The assessment was a useful tool in the refinement of the regulatory and supervisory framework enhancements currently underway.

ASSESSMENT OF IOSCO PRINCIPLES

A. Summary[4]

46. While South Africa's level of implementation of the IOSCO Principles is complete in several areas, there is room for enhancement. The legal framework is robust and provides the authorities with broad supervisory, investigative and enforcement powers. There are arrangements for on-site and off-site monitoring of regulated entities. The powers to cooperate with domestic and foreign counterparts are extensive. Accounting and auditing standards are high, as is the disclosure regime that applies to listed companies in practice. The market infrastructure is robust for the current, largely domestic, character of direct market participants.

47. The securities regulatory structure is complex. Responsibility is divided across several authorities with differing mandates and resources that report to two different government ministries. These same structural challenges are evident within the FSB, where supervision is divided on a sectoral basis that may not reflect the way some important market participants carry on business. The proposed Twin Peaks structure is expected to address at least some of this complexity. However, where responsibilities continue to be shared there is a potential for both gaps and duplication. The FSB should ensure that there is a common understanding among the relevant regulators of the scope, depth and focus of their supervision, particularly with the JSE and the SARB.

48. Some areas of supervision and enforcement require strengthening. The FSB should ensure that the scope of regulation and intensity of supervision are more uniform across its divisions. In particular, the CIS framework is notably less comprehensive and intrusive than that in other areas. The disclosure regime for unlisted companies and CIS has substantive gaps, as do the CIS valuation and accounting standards. The capital and reporting requirements for FSPs should be strengthened. The FSB should also pursue the use of all of its available enforcement authority, including by continuing to pursue more criminal prosecutions. Recent initiatives to build effective relationships with other responsible authorities should help in this regard.

49. Certain aspects of the FSB's governance structure raise concerns about its independence, although there were no indications of any interference with its day-to-day operations. The presence of industry members on certain Board Committees and the authority of the MoF to remove a Board or Executive Committee member for reasons other than misconduct or incompetence may be perceived as a threat to the FSB's independence. The government has recognized the need for greater regulatory independence, which is reflected in the governance models set out in the Twin Peaks bill. The independence of the IRBA should also be strengthened.

[4] This report was prepared by Eija Holttinen (IMF) and Tanis MacLaren (external expert), who conducted the assessment. The previous IOSCO assessment of South Africa was conducted in 2010.

B. Introduction

50. An assessment of the level of implementation of the IOSCO Objectives and Principles of Securities Regulation (IOSCO Principles) was conducted in South Africa from May 6 to 23, 2014.

C. Information and Methodology Used for Assessment

51. The assessment was made on the basis of the IOSCO Principles approved in 2010 and the Assessment Methodology adopted in 2011. As has been the standard practice, Principle 38 was not assessed due to the existence of separate standards for securities settlement systems and central counterparties.

52. The IOSCO Assessment Methodology requires that assessors not only look at the legal and regulatory framework in place, but also at how it has been implemented in practice. The ongoing GFC has reinforced the need for assessors to make a judgment about supervisory and other operational practices and to determine whether they are sufficiently effective. Among other things, such a judgment involves a review of the inspection programs for different types of supervised entities, the cycle, scope and quality of inspections, as well as how the relevant authorities follow up on findings, including by using enforcement actions.

53. The assessment was based on several sources. These comprise (i) a self-assessment and additional written responses prepared by the authorities; (ii) reviews of the relevant legislation and regulations; (iii) meetings with the management and staff of the FSB, the Company and Intellectual Property Commission (CIPC), the IRBA, the National Prosecuting Authority (NPA) and the South Africa Police Services (SAPS); and (iv) meetings with market infrastructures and market participants, including the JSE, Strate, the ASISA, the Financial Intermediaries Association of Southern Africa, securities brokers, fund management companies, asset managers, issuers, an audit firm, and a Credit Rating Agency (CRA).

54. The assessors want to thank the South African authorities and market participants for their cooperation and willingness to share information. The views of authorities and market participants on the current status and the best way forward for the regulation and supervision of the South African securities markets provided an essential input to the conclusions of the mission. In the organizational side, our particular thanks go to Annah Manganyi of the FSB.

D. Institutional and Market Structure—Overview

Regulatory Structure

55. The securities regulatory and supervisory responsibilities in South Africa are divided among several public authorities and market infrastructures. While the FSB is responsible for supervising collective investment scheme (CIS) managers and exchanges, the supervisory responsibility for market intermediaries is divided between the FSB and the JSE. The FSB has no role in issuer supervision, which is undertaken by the JSE for listed companies and by DTI's CIPC for unlisted companies. Audit oversight is the responsibility of IRBA. The functions and powers of the FSB and the Registrar are set out in the Financial Services Board Act (FSB Act) and in various sectoral Acts, such as the Financial Markets Act (FMA) and the Collective Investment Schemes Control Act (CISCA). In his capacity as the Executive Officer of the FSB, the Executive Officer acts as the Registrar of CIS, Securities Services, CRAs and FSPs under the respective sectoral Acts.

56. In addition to the JSE, other market infrastructures are also obliged to undertake certain self-regulatory responsibilities under the FMA. Strate, the South African CSD for listed equity securities and government and corporate debt securities, is a market infrastructure licensed under the FMA. Two clearing houses have been licensed by the FSB: Strate (for bonds) and SAFCOM (for derivatives). The self-regulatory responsibilities of Strate are more limited than those of the JSE, and relate to monitoring and disciplining its participants' compliance with the FMA and its own rules and directives.[5]

57. The CIPC and JSE share the responsibility for issuer regulation, supervision and enforcement. The CIPC is responsible for the incorporation and registration of all companies (including listed and non-listed public companies) in South Africa. It is also responsible for monitoring public companies' compliance with the CA disclosure requirements. The JSE through its Listing Requirements regulates initial and periodic disclosure requirements for listed issuers. The Takeover Regulation Panel (TRP), created by the CA, has the authority to enforce South African laws concerning mergers, acquisitions and changes in corporate control. Under the CA, the TRP is a separate body from the DTI with specified responsibilities.

58. The SARB has limited securities supervisory responsibilities. Banks have to be authorized as FSPs, if they provide financial services requiring a license under the Financial Advisory and Intermediary Services Act (FAIS Act). In such cases the supervisory responsibilities are divided between the FSB and SARB, with the FSB being responsible for supervising and enforcing compliance with the FAIS Act. Investment banks' merchant banking services to clients other than pension funds and natural persons have been exempted from the FAIS Act; as such, the SARB has regulatory responsibility for such exempted functions.

New legislation

59. Since the last IOSCO assessment, two new relevant Acts have come into force. On June 3, 2013, the FMA replaced the Securities Services Act (SSA). The FMA primarily focuses on the licensing and regulation of market infrastructures (exchanges, CSDs, clearing houses and trade repositories) and on the prohibition of insider trading and other market abuses. Further, the FMA provides a framework for regulating OTC derivatives in South Africa under regulations that can be

---

[5] SAFCOM does not have any self-regulatory responsibilities because it is an associated rather than an independent clearing house under the FMA (see Principle 9).

issued by the MoF. The Credit Rating Services Act (CRSA) came into effect on April 15, 2013. This Act introduced a framework for the registration and supervision of CRAs in South Africa.

60. The General Amendment Act,[6] which came into force on February 28, 2014, also introduced some relevant regulatory changes by amending all the Acts applicable to the FSB activities. Among other changes, it aligned the supervisory powers of the Registrar, provided for enhanced protection of information and sharing of information provisions, clarified and extended the consumer education and protection mandate of the FSB, and extended the Registrar's powers to act swiftly to prevent the failure of any financial institution.

Market Structure

Market infrastructures

61. The JSE is the only securities exchange in South Africa. It is a public company listed on the JSE main list.[7] SAFCOM, a wholly-owned subsidiary of the JSE, clears JSE derivatives transactions. The JSE manages the pre-settlement process for equities trades and can require margin to cover open positions. Settlement of equity and bond trades takes place at Strate that is also the CSD for both markets. Strate is jointly owned by the JSE (44.6 percent) and the four largest South African banks each owning 12–15 percent.[8]

62. Key market information on the most important products traded on the JSE is provided in the following table:

Annex Table 1. Key Market Information

	12/2011	12/2012	12/2013
Shares			
Number of listed shares	406	402	389
Market capitalization (billion USD)	1,175	988	1,015
Market capitalization as percent of GDP	191.3	267.09	291.97
Market capitalization of top 10 issuers (billion USD)	414	474	546
New listings	16	14	13
Annual turnover (billion USD)	454	419	409
Annual turnover of top 10 issuers (billion USD)	229	198	186
Average daily trading volume (number of shares)	287,019,977	247,374,883	255,567,541
Average daily turnover (million USD)	1,823	1,674	1,635

[6] Financial Services Laws General Amendment Act 45 of 2013.

[7] Any holding in excess of 15 percent, but not exceeding 49 percent of the JSE share capital must be approved by the Registrar. A holding of more than 49 percent requires the approval of the Minister of Finance under Section 67(5)(a) of the FMA.

[8] In addition, Citibank owns 0.1 percent of Strate's shares.

Annex Table 1. Key Market Information (Concluded)

	12/2011	12/2012	12/2013
Bonds			
Number of listed bonds	135	152	133
Market capitalization (billion USD)	184	221	188
Market capitalization as percent of GDP	50.71	59.60	54.10
New listings	732	896	815
Annual turnover (billion USD)	2,883	2,801	2,001
Average daily turnover (million USD)	11,579	11,203	8,002
Equity derivatives			
Annual turnover (billion USD)	598	515	520
Average daily trading volume (number of contracts)	597,682	547 894	869,886
Average daily turnover (million USD)	2,400	2,061	2,078
Number of exchange members	126	126	120
Interest rate and currency derivatives			
Annual turnover (billion USD)	43	55	78
Average daily trading volume (number of contracts)	60,681	77,631	152,835
Average daily turnover (million USD)	171	220	314
Commodity derivatives			
Annual turnover (billion USD)	55	62	50
Average daily trading volume (number of contracts)	11,513	11,998	11,153
Average daily turnover (million USD)	219	249	201

Sources: FSB and JSE.

JSE members

63. The number of JSE members has remained stable over the past three years. While the JSE Equities Rules limit the activities of equity members principally to trading on that market, the derivatives rules allow a broader range of members, including banks, asset managers and end-users.

Annex Table 2. Number of JSE Members by Market

	2011	2012	2013
Equities	63	61	62
Equity Derivatives	126 (9)	126 (9)	120 (10)
Interest Rate and Currency Derivatives	98 (6)	98 (6)	102 (6)
Commodity Derivatives	100 (5)	100 (5)	92 (5)
Bonds	46	47	49

Source: JSE.
Note: Number of clearing members in each category shown in brackets; there are no clearing members on the Equities Market.

64. Cross-border activities are limited. Direct membership by foreign firms on the JSE is prohibited, but the most active equities trading members are subsidiaries of foreign investment banks. Foreign subsidiaries of member firms are not regulated by the JSE, so it does not have routine access to information on these activities. Local members do not appear to have significant operations abroad.

65. The percentage of firms owned domestically other than by financial institutions is higher than in many jurisdictions. Domestic private or listed companies own almost half the firms (48 percent). Only 25 percent are owned by domestic banks or insurance companies and 27 percent are owned by foreign banks or investment firms.

Annex Table 3. Ownership of JSE Equity Firms

Ownership of JSE Equity Firms	Percentage of Firms
Local banking groups	19
Local listed companies	8
Local insurance groups	6
Local private ownership	40
Foreign banking groups	19
Foreign investment firms	8

Source: JSE.

Other intermediaries

66. The number of FSPs licensed under the FAIS Act has been stable over the past four years. The only category where there has been any substantive change is Category I FSPs (chiefly advisers and financial planners), where the decline can be ascribed to consolidation and increasing costs of compliance.

Annex Table 4. Financial Services Providers Licensed under the FAIS Act (By Category)

Category of Firm	Number of Firms as of March 31			
	2011	2012	2013	2014
Category I (Advisers and others)	11,322	10,333	10,164	10,152
Category II (Discretionary)	551	561	585	613
Category IIA (Hedge Fund)	117	118	117	113
Category III (Administrative)	23	22	24	27
Category IV	38	56	68	87
Total number of authorized firms	12,051	10,790	10,958	10,992

Source: FSB.

CIS

67. The fund management industry is significant with assets under management (AUM) reaching ZAR 1.5 trillion (USD 161 billion) at the end of 2013. These AUM were managed by

48 fund managers in a total of 1,084 portfolios.[9] MMFs play an important role at 17 percent of total AUM in local CIS. In addition, unregulated hedge funds manage approximately USD 10 billion of assets, primarily in trusts and partnerships. The development of the AUM of the South African regulated CIS in the past three years is presented in the following table.

Annex Table 5. Assets under Management in South African Collective Investment Schemes (Billion ZAR)

	2011	2012	2013
South African Funds[10]	956	1,160	1,373
Equity	214	253	297
Multi-asset	283	394	627
Real Estate	32	47	48
Money Market	253	245	257
Other Interest Bearing	173	221	143
Other Funds	55	70	126
Total	1,011	1,230	1,499

Source: ASISA.

E. Preconditions for Effective Securities Regulation

68. The preconditions for effective securities regulation appear to be in place in South Africa. Foreign issuers can access the markets under similar conditions to domestic issuers, although this is infrequently done. The authorization process does not distinguish between domestic and foreign intermediaries that want to provide investment services.

69. The companies legislation is modern and includes provisions pertaining to the management of the company, rights of shareholders, duties of directors and officers, preparation and audit of company accounts and proceedings of shareholder meetings. Public companies, whether listed or unlisted, are subject to additional requirements in many areas, such as the accounting standards that must be used. The companies legislation contains detailed rules governing takeovers and related significant transactions. These have the force of law and are administered by the TRP. It also governs the liquidation, winding up and restructuring of insolvent companies. New provisions were introduced in the companies legislation that are designed to facilitate restructuring the finances and operations of companies thereby avoiding liquidation. The Insolvency Act[11] is old, but has been updated to address issues such as the protection of customers' assets held by intermediaries and giving the exchange and clearing systems the ability to close out or unwind incomplete transactions on the insolvency of a market participant.

[9] Several portfolios may be managed under the same scheme.

[10] South African funds refer to funds that have invested their assets in South Africa.

[11] Act No. 24 of 1936.

70. There are dedicated independent tribunals and courts to deal with securities related matters. The judiciary's independence is protected by the Constitution. There are specialized tribunals to facilitate the resolution of disputes, particularly over the exercise of regulatory powers. There is also a specialized commercial crimes court in place.

71. The accounting and auditing standards are of a high and internationally acceptable quality. All public companies, whether listed or unlisted, are required to prepare their financial statements in accordance with the IFRS as issued by the IASB. The ISA issued by the IAASB have been officially adopted.

F. Main Findings

72. Principles for the regulator. The securities regulatory and supervisory responsibilities are defined in various Acts and allocated to several authorities and market infrastructures. This applies also within the FSB, where different Divisions led by Deputy Registrars operate fairly independently. The complex division of responsibilities may lead to regulatory gaps and inconsistencies. Supervisory cooperation is intended to reduce the risks from the current fragmented model, and includes monitoring systemic risk and assessing the regulatory perimeter. However, optimal structures are not yet in place. The FSB has sufficient powers, authority and funding to meet its responsibilities; ensuring sufficient staff expertise in the transition to the new Twin Peaks structure is a challenge. There may be, at a minimum, an appearance of undue political or commercial influence in the FSB decision-making due to the current ministerial appointment process and certain governance arrangements. Some FSB internal policies and practices require strengthening and harmonizing across the organization. There are requirements in place to address conflicts of interest of supervised entities.

73. Principles for self-regulation. The JSE and Strate are under statutory obligations to undertake certain important self-regulatory responsibilities. Intermediary activities covered by their supervision are exempt from supervision by the FSB. The FSB assesses their self-regulatory capacity and arrangements upon licensing and on an ongoing basis. Conflicts of interest between the JSE's and Strate's commercial and self-regulatory functions must be managed in a manner satisfactory to the FSB.

74. Principles for enforcement. The FSB has broad powers to inspect, investigate and conduct surveillance of securities markets and activities. It has comprehensive powers to take action against anyone who breaches the laws it administers. The FSB's risk-based system drives its supervisory program, which consists of off-site supervision and on-site inspections including full reviews, thematic reviews, and ad-hoc visits. The FSB's EC has wide powers to impose sanctions and has obtained significant monetary sanctions. All sanctions imposed by the EC are published as are most others imposed by the Registrars. Criminal cases have been referred for investigation and prosecution, but very few have led to convictions. The record-keeping requirements under CISCA are minimal and the depth of CIS supervisory activities could be enhanced.

75. Principles for cooperation. The FSB has the ability and capacity to share information and cooperate with other authorities domestically and internationally. It is a signatory to many Memoranda of Understanding (MOUs), including the IOSCO Multilateral MOU (MMOU) and a number of bilateral MOUs with its international counterparts, and has a record of active cooperation. It participates in several domestic supervisory colleges involving financial groups. It does not require the permission of any outside authority to share or obtain information, nor does it require an independent interest in the matter to assist.

76. Principles for issuers. The initial disclosure requirements for securities to be listed on the JSE are satisfactory, as are most of the continuous disclosure requirements. There are significant gaps in both the initial and continuous disclosure requirements applicable to unlisted public companies, such as no requirement to provide public disclosure of material changes or prepare interim financial statements. The reporting deadlines for financial statements are slow by international standards, although in practice JSE issuers report more promptly. Public company shareholders are treated equitably with respect to voting and the ability to participate in any takeover bid. Full information must be provided for any takeover bid and the price paid to shareholders must be equivalent. There are extensive disclosure requirements for substantial shareholders, directors and other parties. All public companies in South Africa are required to prepare their financial statements in accordance with the IFRS as issued by the IASB. There are processes in place to review their financial statements to ensure standards are met.

77. Principles for auditors, CRAs, and other information service providers. IRBA supervises auditors of public companies. Its responsibilities include the registration, inspection, and discipline of auditors. IRBA's independence could be enhanced by a broadened funding model and limitations on the participation of auditors on its governance bodies. There are extensive requirements for auditors to be independent of the entities they audit; these requirements are enforced by IRBA. The financial statements of public companies must be audited in accordance with the ISA as issued by the IAASB. The regulatory framework for CRAs complies with international standards and the FSB is currently launching its CRA supervisory program. Analytical or evaluative service providers are not relied on and are not required to be authorized.

78. Principles for collective investment schemes. Regulatory requirements apply to registration of CIS managers and trustees and approval of the CIS deed. Regulation of conflicts of interest, record-keeping and CoB is insufficiently granular. The FSB's intensity of supervision on CIS managers and trustees would benefit from enhancement. CIS are subject to investment limits and restrictions and managers are required to segregate client assets and funds. Related party custody is prohibited in practice. Limited public disclosure requirements apply to CIS and accounting standards for CIS are not specified. Valuation of CIS assets is largely regulated in a very general manner, leaving significant room for discretion and placing the responsibility on appropriate valuations on trustees. MMFs apply constant NAV, and permit longer maturity investments than recommended by IOSCO. Hedge fund regulation complies with IOSCO minimum requirements through requirements imposed on the hedge fund manager as an FSP.

79. Principles for market intermediaries. A framework is in place at the FSB and JSE for licensing and applying on-going requirements on market intermediaries. License applicants are subject to a detailed review process to ensure they are fit and proper. There are initial and ongoing capital requirements for all types of intermediaries. The JSE's capital formula is risk-based and timely reporting requirements apply. The JSE also directly monitors members' capital daily. While certain categories of FSPs are subject to higher minimum capital amounts, the capital formula that applies to FSPs is not sensitive to the full range of risks and focuses on solvency and liquidity. Routine reporting by these firms is limited. Market intermediaries are required to have risk management and internal control systems in place, but there is no requirement that these systems be reviewed on behalf of the firm by an objective party. Regulations address proper protection of clients, including requirements for business conduct and segregation of clients' assets. There is no written plan in place at the FSB or JSE for dealing with a firm failure, but each has extensive powers to intervene to protect clients and the market.

80. Principles for secondary markets. Exchanges are subject to comprehensive regulatory requirements as a condition for licensing and on an ongoing basis. The JSE, as the only exchange, is responsible for market surveillance and supervision of its members. The FSB performs detailed supervision of the JSE, conscious of the potential for regulatory capture arising from such close involvement. Sufficient pre- and post-trade transparency requirements apply under the JSE Rules. Insider trading, market manipulation and disclosure of false and misleading information are prohibited and subject to both administrative and criminal sanctions. Monitoring, investigations and enforcement require cooperation between several authorities. There has been only one criminal conviction for market abuse (fraud). The JSE closely monitors open positions in equity and derivatives markets and can take prompt action when needed. Covered short selling is permitted, but there are no disclosure requirements to the regulator or the market.

G. Summary Implementation of the IOSCO Principles

Principle	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated.	The FSB's and the Registrar's regulatory and supervisory responsibilities are set out in the FSB Act, the Protection of Funds Act, the Inspection of Financial Institutions (Act No. 80 of 1998) and the various sectoral Acts. Legislation also assigns specific responsibilities to the FSB Directorate of Market Abuse (DMA) and EC. Under the FMA, market infrastructures (the JSE and Strate) have important self-regulatory responsibilities. The Registrar has a wide exemption power both generally and in relation to specific entities and activities; the exercise of this power is not uniformly transparent across the FSB. The regulatory treatment of economically equivalent products has until recently been subject to limited regulatory attention. Responsibilities for certain sectors—in particular market intermediaries and issuers—are assigned to multiple authorities, creating a complex regulatory system with potential for gaps and inconsistencies. Cooperation arrangements aim at ensuring coordination.
Principle 2. The Regulator	The MoF has extensive powers to appoint and remove the FSB Board,

Principle	Findings
should be operationally independent and accountable in the exercise of its functions and powers.	Appeal Board and DMA members and the majority of the Executive Committee members. The current appointment process may create, at a minimum, the appearance of indirect political influence in the FSB decision-making. Similar issues relate to industry representation in some of the Board Committees. The FSB is subject to sufficient accountability to the Parliament and the MoF. It publishes an annual report, but there is no FSB wide approach to the publication of supervisory and enforcement measures. The FSB is funded through fees and levies from supervised entities, and its budget is approved by its Board. However, the MoF approves the fees of the FAIS Registrar, constituting an important part of the overall FSB budget. There are immunity provisions in the FSB Act to protect the FSB and its staff. Appropriate administrative procedures are applied to supervisory and enforcement duties.
Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.	The FSB has sufficient powers, authority and funding to meet its responsibilities. While its staffing level is appropriate for its current functions, attracting and maintaining sufficient expertise in certain areas has been a challenge. The sectoral legislation assigns most of the decision-making powers to the Registrar. These powers are largely delegated to the Deputy Registrars and the Divisions managed by them, which has been conducive to a siloed approach to decision-making. Board Committees advise the Divisions in regulatory, enforcement and licensing decisions. The FSB is active in investor education.
Principle 4. The Regulator should adopt clear and consistent regulatory processes.	Currently the sectoral Acts apply different requirements to the rulemaking processes, even though in practice approaches across Divisions have largely converged. A new framework governing the FSB's rule-making process, including stakeholder consultation and publication, is under preparation. Both the FSB and market infrastructures apply appropriate consultation practices in their regulatory processes. The public access to legislation and FSB regulatory measures is incomplete, due to the need to subscribe to a commercial service for full access and the structure of the FSB website.
Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.	The FSB Staff Code of Conduct provides a framework for dealing with staff conflicts of interest. Under their contracts of employment, FSB employees must not hold or trade the shares of regulated entities. The Staff Code of Conduct is less restrictive in this regard, and it does not apply to the FSB Board, Board Committee and DMA members. The Code of Conduct is enforced. Strict confidentiality provisions apply to the FSB staff and management.
Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.	The FMA assigns specific responsibilities to the Registrar and the relevant market infrastructures for systemic risk monitoring and cooperation between the relevant authorities. Similar obligations are not included in the other Acts. The processes to monitor, mitigate and manage systemic risk are currently being established and enhanced. They include bilateral cooperation between the FSB and SARB and the multilateral activities of the FSCF. This forum includes representation from the public sector and market infrastructures and participants. So far there have been limited discussions on systemic risk possibly arising from securities markets beyond trading and post-trading systems.

Principle	Findings
Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.	Reflecting the FSB's sectoral approach, the Divisions have primarily concentrated on their respective sectors when policing the regulatory perimeter. Lately, joint projects both within the FSB and between various authorities have been increasingly organized. However, the authorities are lacking a holistic process for reviewing the regulatory perimeter in relation to all products, entities and activities.
Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	There are processes and requirements in place to address conflicts of interest and misalignment of incentives. The FSPs, JSE and JSE members, and Strate and Strate participants are subject to requirements on the avoidance, mitigation, management and disclosure of conflicts of interest.
Principle 9. Where the regulatory system makes use of SROs that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	The FMA assigns wide self-regulatory responsibilities to market infrastructures. As the JSE and Strate undertake these responsibilities, their members and participants are largely exempted from direct FSB supervision. The FSB assesses market infrastructures' self-regulatory capacity and arrangements, including through rule approval, reporting requirements, review of the JSE and Strate self-assessments and on-site visits. The JSE and Strate are subject to similar professional standards and procedural requirements as the FSB. There are specific requirements for managing the conflicts of interest between their commercial and self-regulatory functions.
Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance powers.	The FSB has broad powers to inspect, investigate and conduct surveillance of securities markets and activities. The record-keeping requirements under CISCA are minimal.
Principle 11. The Regulator should have comprehensive enforcement powers.	The FSB has comprehensive powers to investigate and take action against anyone who breaches the legislation it administers. It also has powers to take action against FSPs for non-compliance with other laws.
Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	The FSB has a risk-based supervisory program, which consists of off-site supervision and on-site inspections including full reviews, thematic reviews, and ad-hoc visits. The EC has wide powers to impose sanctions and has proved successful in obtaining monetary sanctions, largely through settlements. All sanctions imposed by the EC are published as are most others imposed by the Registrars. Some criminal matters have been referred for investigation and prosecution, but very few have led to convictions.
Principle 13. The Regulator should have authority to share both public and non-public information with	The FSB has the ability and capacity to share information and cooperate with other authorities domestically and internationally. It can share confidential information with any other authority and has a record of active

Principle	Findings
domestic and foreign counterparts.	cooperation.
Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.	The FSB is a signatory to many MOUs, including the IOSCO MMOU and a number of bilateral MOUs with its international counterparts. It participates in several domestic supervisory colleges involving financial groups.
Principle 15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	The FSB has shared information under the IOSCO MMOU. It does not require the permission of any outside authority to share or obtain information, nor does it require an independent interest in the matter to assist.
Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	The initial disclosure requirements for a public offer of securities to be listed on the JSE are satisfactory, as are most of the continuous disclosure requirements thereafter. There are significant gaps in both the initial and continuous disclosure requirements applicable to unlisted public companies, such as no requirement to provide interim financial statements or make public disclosure of material changes. Unlisted entities (other than companies and CIS) offering their securities to the public do not appear to be required to make any disclosure, either initially or thereafter. The reporting deadlines for public company financial statements are slow by international standards, although in practice JSE issuers report more promptly.
Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.	Public company shareholders are treated equitably with respect to voting and the ability to participate in any takeover bid. Full information must be provided for any takeover bid and the price paid to shareholders must be equivalent. There are extensive disclosure requirements for substantial shareholders, directors and other parties.
Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	All public companies in South Africa are required to prepare IFRS compliant financial statements. The JSE has a process in place to review the listed company financial statements to ensure accounting standards are met. The CIPC has started a similar program for unlisted public companies. The IRBA also conducts periodic reviews.
Principle 19. Auditors should be subject to adequate levels of oversight.	Auditors of public companies are subject to appropriate oversight. Auditors must register with the IRBA, a statutory body. Its responsibilities include registration, inspection, and discipline of auditors, as well as setting standards of professional competence, ethics, and conduct. Its independence from the profession could be strengthened. The resources at IRBA are not sufficient for the tasks assigned.

Principle	Findings
Principle 20. Auditors should be independent of the issuing entity that they audit.	There are extensive requirements for auditors to be independent of the entities they audit. These requirements are enforced by IRBA. However, the obligations to disclose promptly a change of auditor are incomplete.
Principle 21. Audit standards should be of a high and internationally acceptable quality.	The financial statements of public companies must be audited in accordance with the ISA as issued by the IAASB.
Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.	Credit ratings used for regulatory purposes must be issued or endorsed by authorized domestic or foreign CRAs. The CRSA and the CRA Rules implement the IOSCO Code of Conduct Fundamentals for CRAs. Four CRAs have been registered in South Africa, the last two in early May 2014. The FSB is implementing its supervisory plan.
Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.	Analytical or evaluative service providers are not relied upon to any significant degree. Research reports generally are issued only by JSE member firms, have limited circulation and limited impact in the jurisdiction. The provision of research alone would not constitute 'advice' under the FAIS Act or JSE Rules and therefore would not require specific authorization.
Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a CIS.	CIS managers and trustees have to be registered under CISCA, and the Registrar verifies that CIS asset managers have been authorized under the FAIS Act. The registration of the CIS manager is conditional on the Registrar approving the CIS deed and any supplemental deeds. The FSB's powers to supervise delegated activities were recently enhanced. Regulation of conflicts of interest, record-keeping and CoB is insufficiently granular. While CIS managers are subject to regular on-site visits, the depth of the reviews is not comparable to those applied to other FSB supervised entities. The FSB has not conducted on-site reviews of trustee activities.
Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.	CISCA does not require any particular legal form for a CIS, but in practice all of them are unit trusts. Any changes to the deed are notified to investors as part of the requirement to obtain approvals for deed amendments. CIS are subject to investment limits and restrictions. CISCA includes segregation requirements for client assets and funds. The Registrar does not in practice permit a CIS manager's related party to act as the trustee of its CIS, although CISCA does not appear to extend the prohibition beyond the manager's parent company and subsidiaries. There are no specific requirements on the use of sub-custodians beyond the trustee maintaining full responsibility for delegated activities.

Principle	Findings
Principle 26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a CIS for a particular investor and the value of the investor's interest in the scheme.	There are very limited disclosure requirements for other CIS than CIS in property that are all listed and subject to the JSE requirements. For others, the deed provides some information required under Principle 26 following a standard template, but it is not required to be publicly disclosed. For non-listed CIS, there is currently no requirement for an offering document or equivalent, and managers of CIS in securities have been exempted from the CISCA content requirements for advertisements and the need to lodge advertisements with the Registrar. No specific accounting standards apply to CIS. Investors are required to receive an annual portfolio report.
Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a CIS.	The requirements for valuing CIS assets are largely very general, and do not sufficiently address a situation where liquid market prices are not available. The deed is required to include only very limited provisions on how the CIS assets are to be valued. The trustee is obliged to ensure that unit prices are calculated in accordance with CISCA and the deed. MMF assets are valued at amortized cost, and the maximum maturities permitted for MMF assets are longer than recommended by IOSCO. CISCA requires CIS units to be subscribed and redeemed at unit NAV, and the circumstances enabling the suspension of redemptions are prescribed. There are no regulatory requirements on pricing errors.
Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.	The regulation of hedge funds currently relies on requiring the hedge fund asset manager to be authorized as an FSP. This complies with the IOSCO minimum requirement, although the hedge funds themselves are not regulated and there are no specific requirements on hedge fund administration. As FSPs, hedge fund managers are subject to sufficient prudential, conflict of interest and client asset protection requirements. They are supervised following the general risk-based approach to FSP supervision. Hedge fund investor disclosure requirements are prescribed.
Principle 29. Regulation should provide for minimum entry standards for market intermediaries.	A framework is in place at the FSB for licensing and to apply on-going requirements for market intermediaries under the FAIS Act. Applicants are subject to detailed off-site reviews before licensing. On-site visits are routinely performed as part of the authorization process for the higher risk categories. The JSE has similar processes and standards in place for applicants and members.
Principle 30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	There are initial and ongoing capital requirements for all types of intermediaries. The capital formula that applies to JSE members is based on the EU Capital Adequacy Directive and extensive timely reporting requirements apply. The JSE also directly monitors equities members' capital daily. The capital formula for FSPs is insufficiently risk-sensitive and focuses on solvency and liquidity. Certain categories of FSPs are subject to higher minimum amounts but these amounts do not vary based on the nature or size of positions. Routine reporting by these firms is limited.
Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards	Market intermediaries are required to have risk management and internal control systems. FSPs and JSE members' auditors are required to report annually on the treatment of client assets at the firm. Otherwise there is no compulsory review on behalf of the firm of the internal controls by an objective party. There are regulations for proper protection of clients,

Principle	Findings
for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.	including requirements for segregation of clients' assets and business conduct rules, such as know your client and suitability. The rules regarding conflicts of interest and protection of client assets are extensive.
Principle 32. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.	There is no written plan at the FSB for dealing with a failure of an FSP. However, the FSB has extensive powers to restrain conduct, to ensure clients' assets are properly managed and to obtain relevant information. It has the authority to go to court to expeditiously appoint a curator for the insolvent firm. It has used these powers in practice. The JSE has no plan, but has extensive powers to deal with a failure. There are guarantee funds available in the event of losses at JSE member firms, but not for FSPs. FSPs are required to maintain professional indemnity and fidelity insurance. Where a failure has cross-border implications, information sharing MOUs are in place.
Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	Exchanges are required to be licensed, and the licensing criteria and process are set in detail in the FMA and a Board Notice. The only licensed exchange is the JSE, but the Registrar is analyzing some trading platforms operated by public companies making a market in their own shares to determine whether they should be licensed.
Principle 34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	The JSE is responsible for market surveillance and supervising its members' compliance with the FMA, the JSE Rules and the JSE Directives. The FSB itself does not conduct real-time market surveillance, but regularly reviews trading in JSE shares. It investigates improper market conduct referred by the JSE. The FSB attends all JSE Board, Board Committee and Advisory Committee meetings and reviews documents, reports and the JSE yearly self-assessment. On-site visits are also conducted. The FSB is conscious of the potential for regulatory capture arising from its close involvement with the JSE.
Principle 35. Regulation should promote transparency of trading.	Sufficient pre- and post-trade transparency is required by the JSE Equities Rules. The rules contain limited exceptions on pre-trade transparency for hidden orders and certain off-order book trade types that comply with specific conditions. According to the JSE, most equities trading is undertaken through the central order book. All trades, including off order book ones, are subject to immediate post-trade transparency.
Principle 36. Regulation should be designed to detect and deter manipulation and	Insider trading, market manipulation and disclosure of false or misleading information are prohibited in the FMA. A front running prohibition applies to FSPs, whereas front running by exchange members is not specifically

Principle	Findings
other unfair trading practices.	addressed. Market abuse is subject to both administrative and criminal sanctions. The potential for market abuse is monitored by the JSE that refers any suspicious activity to the FSB. Decisions on investigations and administrative enforcement actions are taken by the DMA and EC, respectively. Administrative sanctions have been imposed, but there has been only one criminal conviction for market abuse.
Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	The JSE closely monitors open positions in both equity and derivatives markets, and can take various actions, if a member is not able to meet its settlement obligations or post required margin. Default procedures are in place and disclosed through the JSE rules. Naked short selling is prohibited, and covered short selling is defined narrowly. There are no reporting requirements to the JSE, FSB or the market on short selling, and the JSE and the FSB do not undertake any particular surveillance of short selling.

H. Recommended Action Plan to Improve Implementation of the IOSCO Principles

Principle	Recommended Action
Principle 1	• The authorities should ensure that the future legislation applicable to the new Twin Peaks structure harmonizes the regulatory, supervisory and enforcement responsibilities and powers across the sectors. The consistent implementation of these powers and responsibilities should be supported by an appropriate organizational structure and processes. • The FSB should ensure that sufficiently harmonized regulatory requirements are applied to economically equivalent products. • The FSB should make information on all the exemptions granted available on the official website, as required by Section 21 of the FSB Act.
Principle 2	• The authorities should ensure that the upcoming Twin Peaks legislation and the governance arrangements of the conduct and prudential authorities provide sufficient political and commercial independence to them. This includes introducing clear limitations on the reasons for the removal of the members of the authorities' relevant governance bodies. • The government should remove the requirement for the MoF to approve the fees charged under the FAIS Act. • The FSB should develop an FSB wide policy for the publication of supervisory and enforcement measures.
Principle 3	• The authorities should ensure that the future Twin Peaks legislation and its implementation within the conduct authority support a more coordinated approach to supervision and decision making than

Principle	Recommended Action
	currently. • The FSB should seek to maintain and attract sufficient expertise to the authority.
Principle 4	• The authorities should ensure that the code of norms and standards under section 18(3) of the FSB Act is finalized and published as soon as possible. • The authorities should harmonize the current requirements for the FSB's rule-making processes across the various sectors. The processes should include appropriate, harmonized approaches to assessing the cost of compliance with regulation. • The FSB should improve public access to legislation and to its own regulatory measures by posting copies on the FSB website in an easily identifiable location and removing the need to subscribe to a commercial service.
Principle 5	• The FSB should align the requirements for the holding of and trading in securities in the contract of employment and Staff Code of Conduct and ensure that the restrictions apply to all securities, not only shares. • The FSB should apply appropriate securities holding and trading restrictions to all persons that may have access to confidential supervisory information, such as the FSB Board, Board Committee and DMA members.
Principle 6	• The FSB should develop holistic, organization wide arrangements for monitoring, mitigating and managing systemic risk possibly arising from securities markets, ensuring that the approach extends beyond the current focus on trading and post-trading systems. • The FSCF, FSOC and any dedicated macroprudential function to be established in the future should ensure that they adopt and maintain a broad approach to analyzing systemic risks, ensuring that those possibly arising from securities markets are sufficiently covered.
Principles 7, 8 and 23	• The authorities should ensure that that there is a sufficiently holistic process in place to ensure that products, entities and activities do not inadvertently fall outside the regulatory perimeter as a result of the current complex division of regulatory and supervisory responsibilities. • The FSB should consider putting in place an FSB-wide pro-active process to survey the marketplace to ensure issues of concern, such as emerging conflicts of interest, are identified and addressed early. • The FSB should ensure that the role of analysts and providers of other evaluative services is part of the overall perimeter of regulation review process.
Principle 10	• The authorities should consider imposing more detailed record-

Principle	Recommended Action
	keeping requirements for CIS managers. • The CIS Registrar should have the same authority to demand any information from CIS managers as is in place under the FMA and FAIS Act, and CISCA should be amended accordingly.
Principle 11	• The FSB should ensure that the sanction publication practices of the CIS Division are aligned with those of other Divisions.
Principles 12 and 24	• The FSB, and particularly its Enforcement Unit, should continue to work on building cooperative arrangements with the criminal enforcement authorities. • The Registrar of CIS should enhance the depth of the on-site visits in CIS managers to align the approach with the processes applied by other Registrars and conduct on-site visits in CIS trustees.
Principles 16, 18 and 20	• The government should amend the CA provisions to shorten the deadline for publishing audited annual financial statements to 120 days or less. The CA should also be amended to require publication of interim financial statements at least semi-annually, within a reasonable period after the period end. • The government should amend the CA to require public companies to make prompt public disclosure of material changes, including a change in auditor. • The JSE is encouraged to make the de facto 90-day deadline for audited financial statements a firm requirement. It should consider whether the Alt^x issuers should adhere to the same time frame or be given somewhat longer. • The JSE should also consider shortening the reporting period for interim statements of JSE companies; 60 days or less is a more common period for main listings on major exchanges.
Principle 19	• The government should expand the IRBA's authority to share information, particularly on a proactive basis with other regulators. • The government should consider enhancing the independence of IRBA by amending its funding model to include additional sources, such as levying a fee on public companies. • The authorities should consider reducing the participation of registered auditors (RAs) on IRBA committees responsible for investigations and disciplinary matters. • The government should include provisions permitting the IRBA to indemnify directors and staff for their legal costs.
Principle 22	• The FSB should fully implement its supervisory plan, by conducting sufficient on-site visits and other ongoing supervision of CRAs.
Principle 24	• The FSB should significantly enhance the conflict of interest, record-keeping and CoB requirements applicable to CIS managers, in

Principle	Recommended Action
	line with the requirements of the IOSCO Assessment Methodology and those that apply to other sectors.
Principle 25	• The government should clarify the drafting of the prohibition of related party custody to ensure that all related companies are excluded from providing trustee services to a CIS manager. • The authorities should consider the need to enhance the requirements for the use of sub-custodians.
Principle 26	• The authorities should expeditiously: • Require an offering document for all CIS; • Require CIS accounts to be prepared in accordance with high quality, internationally acceptable accounting standards; • Require the use of standard formats for CIS initial and periodic disclosures to investors; and • Ensure they apply sufficient requirements to be able to identify inaccurate, false or misleading advertisements.
Principle 27	• The authorities should significantly enhance the regulatory requirements on the valuation of all types of CIS assets and determine the high quality accounting standards to be used in such valuations. • The FSB should consider, whether constant NAV MMFs may be converted to floating/variable NAV funds. Alternatively, the FSB should introduce additional safeguards as recommended by IOSCO to continue to permit the use of constant NAV. • The authorities should ensure that there are sufficient regulatory requirements for the disclosure of CIS unit prices and the frequency of calculating the CIS NAV. Treatment of pricing errors should be subject to explicit regulatory requirements.
Principle 30	• The FSB should adopt a more risk-sensitive capital formula for FSPs that varies directly based on the risks undertaken by the firm, with riskier activities and securities and larger positions attracting higher initial and on-going capital requirements, regardless of the FSP's licensing category. Exposures to all related companies should be deducted when calculating capital. • The FSB should require FSPs to update their accounting records on a more timely basis. More frequent capital reporting should be required of all FSPs, except those that only carry on limited activities, such as advising only. • The FSB should consider including a new early warning obligation on FSPs to give immediate notice to the FSB when the firm's capital has declined below an early warning threshold, such as 10 percent over the minimum required, or there has been any other material adverse change in or threat to its financial position. • The JSE should consider amending its capital requirements to

Principle	Recommended Action
	address exposures of the firm to off-balance sheet transactions and to any related company.
Principle 31	• The FSB and JSE should require FSPs and members to have a periodic review of their internal controls and risk management conducted by someone who can render an independent assessment, preferably an external expert such as an auditor. • The FSB and JSE should examine the division of responsibility for the supervision of JSE members that are also FSPs to ensure there is a common understanding of their respective responsibilities and that there are no gaps in or duplication of efforts in that supervision. • The FSB and JSE should routinely share inspection reports regarding firms that are JSE members and FSPs. • The FSB and JSE should consider requiring firms to put in place written account agreements for all accounts.
Principle 32	• Each of the FSB and JSE should have written plans in place outlining what actions will be taken (and by whom), if and when one of their respective regulated entities is in financial difficulty.
Principle 36	• The FSB, the SAPS and the NPA should continue to work towards the objective to enhance the use of criminal enforcement to combat market abuse. • The government is encouraged to consider extending the prohibition of insider trading to unlisted derivatives that have a listed security or derivative as an underlying instrument.
Principle 37	• The JSE and/or the FSB should introduce a short selling reporting regime and increase the monitoring of short selling activities.

I. Authorities' Response

81. NT would like to express its appreciation for the report on the detailed assessment of the IOSCO objectives and principles of securities regulation. South Africa finds the report very comprehensive and believes it displays a good understanding of the FSB and other regulators and market infrastructure responses. In our view the report is balanced, constructive and contains sections that are useful for purposes of future improvements on the areas that have been identified for enhancement. Of course the enhancement measures may take various other forms not necessarily mentioned in the report. South Africa has not questioned any of the ratings, but has provided comments for consideration on certain principles. Our supervisor, the FSB has raised with the FSAP team concerns about possible lack of consistency in the assessment methodology of principles between the 2008 and 2014 FSAPs. In particular, the document makes specific reference to the CIS assessments, where there had been downgrades even though neither the principles nor the legislation and practice changed over the 6 year period. It could be argued that had the grading in 2008 been similar to 2014, measures would have been put in place to address the shortcomings.