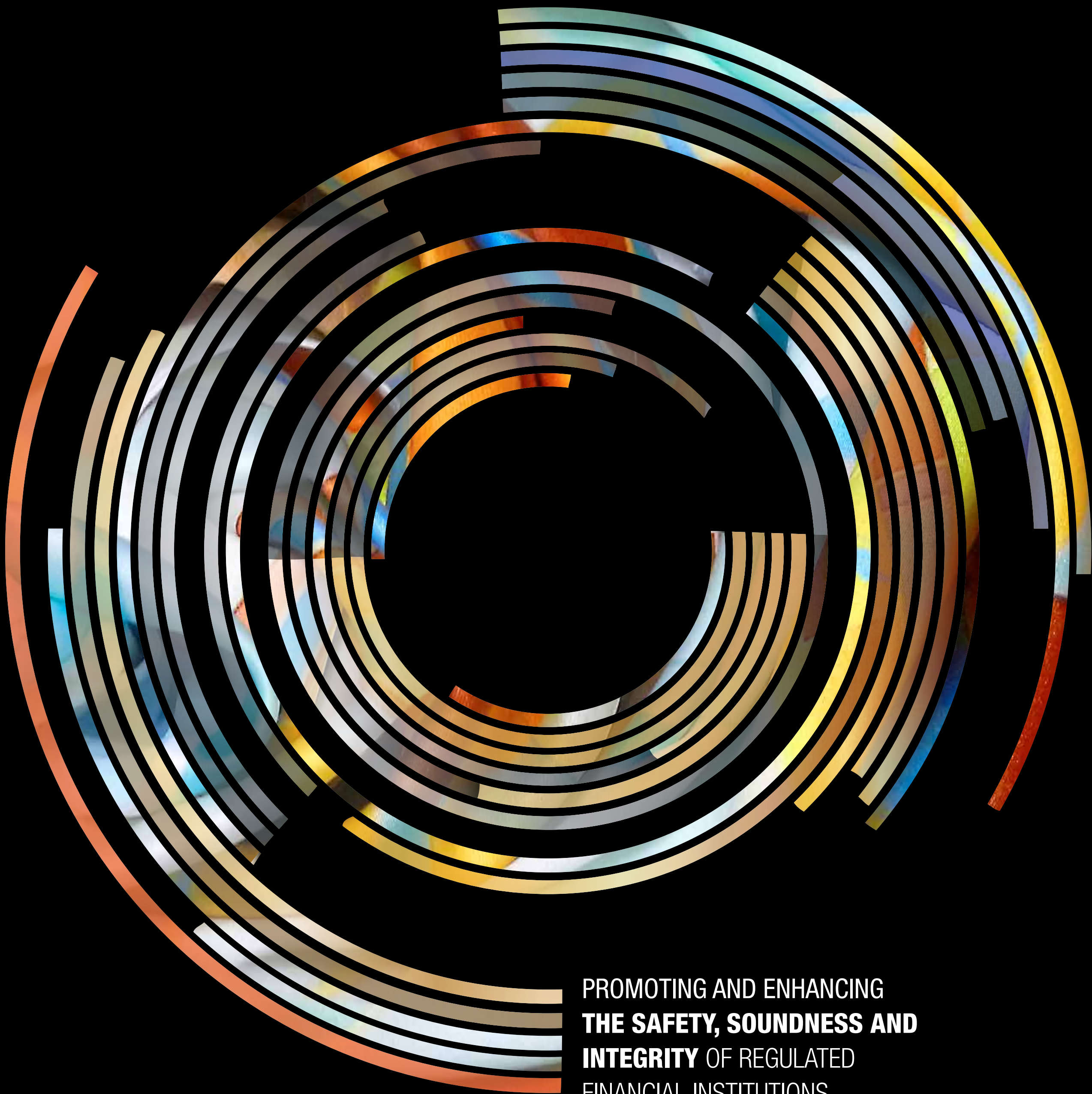
South African Reserve Bank
Prudential Authority

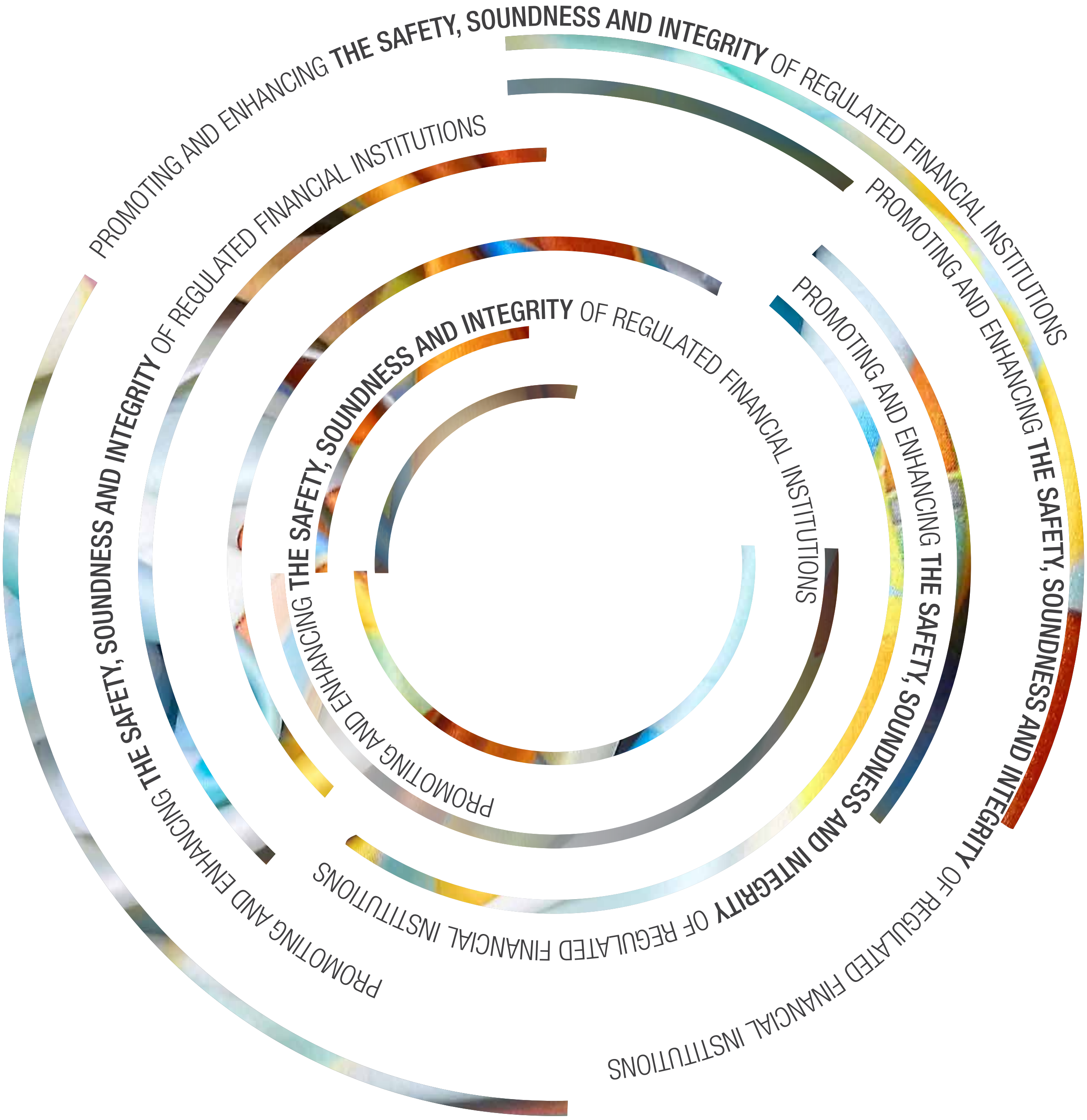


PROMOTING AND ENHANCING **THE SAFETY, SOUNDNESS AND INTEGRITY** OF REGULATED FINANCIAL INSTITUTIONS

PRUDENTIAL AUTHORITY ANNUAL REPORT

2018/19

South African Reserve Bank
Prudential Authority



PRUDENTIAL AUTHORITY ANNUAL REPORT

2018/19

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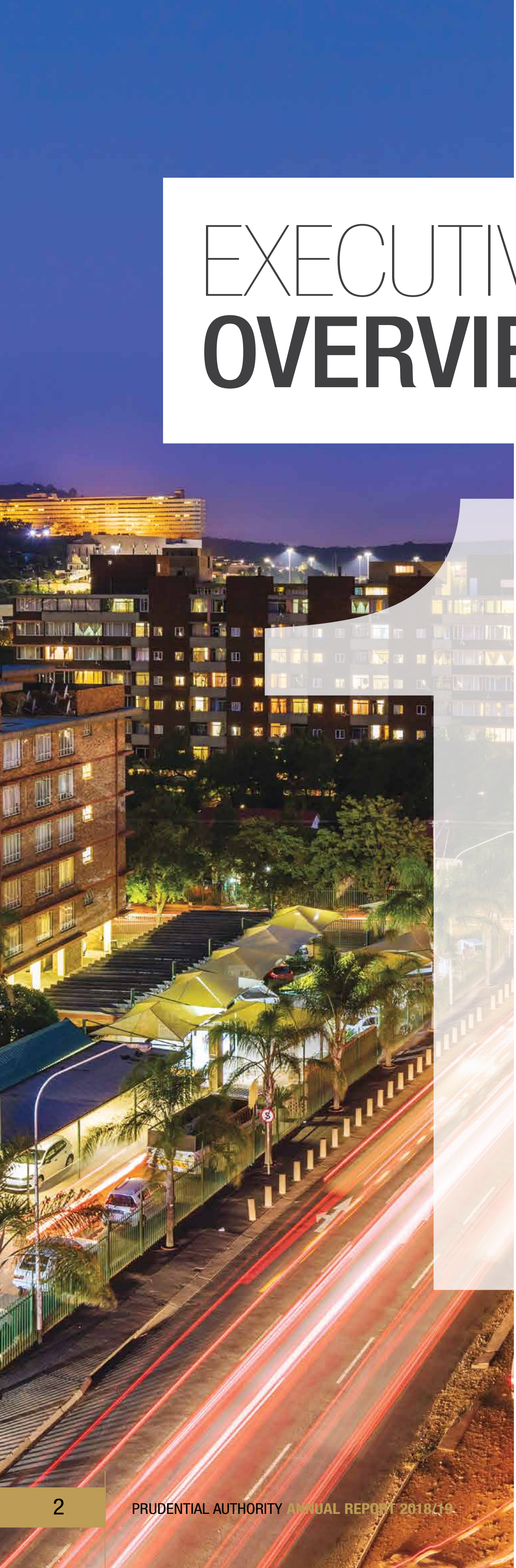


EXECUTIVE OVERVIEW

FOREWORD BY THE CHAIRPERSON OF THE PRUDENTIAL COMMITTEE

I am pleased to present the inaugural Annual Report of the Prudential Authority (PA).

This Annual Report reflects the PA's successful first year of existence (starting on 1 April 2018), which was hallmarked by organisational integration and collaborative efforts with other financial sector regulators and industry players.

The journey began in June 2011 when Cabinet approved the publication of a policy paper titled 'A safer financial sector to serve South Africa better', which proposed the Twin Peaks model of regulation.

The Twin Peaks model seeks to attain regulatory efficiency by creating specialist peaks for prudential and conduct regulation respectively. The foundational legislation underpinning this regulatory approach, namely the Financial Sector Regulation Act 9 of 2017 (FSR Act), was signed into law on 21 August 2017.

The FSR Act makes three significant changes to the South African financial sector regulatory landscape. Firstly, it gives the South African Reserve Bank (SARB) an explicit mandate to lead the process of achieving and maintaining financial stability. Secondly, it establishes a prudential regulator, the PA, to promote the safety and soundness of individual financial institutions. Thirdly, the FSR Act also establishes a market conduct regulator, the Financial Sector Conduct Authority (FSCA), to ensure that customers are treated fairly and that the financial products and services offered by the industry are safe. The PA, the FSCA as well as other financial sector regulators in turn play a major role in supporting the financial stability mandate of the SARB.

The role of the Prudential Committee (PruCo) is to ensure that the management and administration of the PA is effective and efficient. Over the past year, PruCo had robust deliberations in the making of various prudential standards, joint standards and other regulatory instruments related to financial sector laws within the ambit of the PA's scope. The PruCo also adopted the Regulatory Strategy for the PA and finalised several memorandums of understanding (MoUs), as required by the FSR Act. The MoUs are living documents and will be amended as and when required to ensure that the PA finds the most expedient methods to cooperate with industry stakeholders.

The SARB and the PA have made considerable progress towards aligning and embedding a culture that embraces the values of respect and trust, accountability, excellence, integrity and open communication to ensure the successful achievements of the respective mandates. The synopsis I have outlined serves to highlight the volume of planning and execution that has gone into establishing a cross-functional and harmonised organisation such as the PA.

The PruCo is of the view that the PA is well on its way to realising the objectives of the FSR Act through following proper governance and utilising prudential tools that are responsive to the ever-changing financial sector. The PruCo's work will, no doubt, continue to be a demanding task, and requires us to always tread with prudence. We are, however, confident that the PA will continue to work tirelessly in promoting the safety and soundness of the financial institutions it regulates.

E L (LESETJA) KGANYAGO
GOVERNOR OF THE SOUTH AFRICAN RESERVE BANK
AND CHAIRPERSON OF THE PRUDENTIAL COMMITTEE

OVERVIEW BY THE CHIEF EXECUTIVE OFFICER OF THE PRUDENTIAL AUTHORITY

The PA is a juristic person operating within the administration of the SARB. As such, the PA supervises banks, insurance companies, co-operative financial institutions (CFIs) as well as securities and derivative market infrastructures.

The establishment of the PA entailed integrating the Bank Supervision Department (BSD) of the SARB, the Insurance Prudential Supervision teams of the erstwhile Financial Services Board and the CFI Supervisory Unit from the Co-operative Banking Development Agency of National Treasury.

The success of the Twin Peaks framework requires close cooperation and collaboration with National Treasury and other regulators, including the FSCA, the National Credit Regulator and the Financial Intelligence Centre. Over the past year, the PA has signed MoUs with each of these regulators and has put in place the necessary operational procedures to collaborate, including the sharing of data. In several instances, the licensing of financial institutions requires the concurrence of more than one regulator.

Without compromising safety or soundness, regulators are constantly seeking ways to reduce bureaucracy and red tape in the way that financial institutions are regulated. This requires a significant culture change, both within regulators and in the industry. It also requires enhanced cooperation, especially for the collection and analysis of data and the assessment of risk in the sector. In many respects, the integrated supervision of the financial sector is still a work in progress, with much more work ahead. The FSR Act also requires the PA to take into account issues such as transformation, financial inclusion, integrity and competition.

OTHER MAJOR ACHIEVEMENTS OF THE YEAR UNDER REVIEW INCLUDE:

- the implementation of the new Insurance Act 18 of 2017 and related Prudential Standards, also known as the Solvency Assessment and Management (SAM) Project, for insurance companies;
- the publication of the *Regulatory Strategy 2018–2021*, together with the PA's integrated risk-based Supervisory Framework, which serve as the PA's general guidance to achieve its objectives and perform its regulatory and supervisory functions;
- the release of a notice regarding the submission of statutory returns for financial market infrastructures to assess compliance with prudential requirements, as prescribed in the Financial Markets Act 19 of 2012; and
- the publication of a draft Prudential Standard containing Transitional Arrangements for CFIs.

Several new licences for banks, mutual banks, CFIs and insurance companies were issued in the past year, with at least three banks launching their businesses to the public in the first half of 2019. A number of incumbent and newly licensed institutions using new technologies to enhance their customer offerings indicates that the financial sector is both healthy and dynamic.

In March 2018, the Minister of Finance, on the recommendation from the former BSD, placed VBS Mutual Bank (VBS) under curatorship. An external investigation on the period under review revealed significant levels of malfeasance and the possibility of fraud. The SARB was able to refund about 97% of the retail depositors. Following the release of restated financial statements for the 2017 financial year in October 2018, the PA approached the courts to apply for the liquidation of this bank.

The liquidator of VBS continues to work closely with law enforcement authorities to aid in the recovery of money and the prosecution of those responsible for the malfeasance.

What is next for the Prudential Authority?

There are still several elements of the financial sector reform process that must be implemented. Most notably, in the 2019/20 financial year, the PA will issue Prudential Standards for the supervision of financial conglomerates and will begin regulating the fitness and propriety of significant owners. The PA will also continue the work begun in 2018/19 to raise governance standards in the sector.

Furthermore, the PA will continue to influence the development of global regulatory frameworks through its participation in various international committees, most notably the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors and the Technical Committee of the International Organization of Securities Commissions.

Expression of gratitude

My sincere appreciation goes out to the many role players within the SARB who brought the process of establishing the PA to fruition. In particular, the Chairperson of the PruCo, Governor Lesetja Kganyago, has played a pivotal role in overseeing the establishment of the PA and its sound governance. Governor Kganyago, your guidance, support and leadership have been unwavering.

There has also been continual collaboration with our colleagues at the FSCA and National Treasury, without whom this process would not have been possible and with whom we continue on this exciting journey.

To all the other regulators who have so warmly embraced the PA, we look forward to your continued support.

The establishment of the PA on 1 April 2018 would not have been possible without the dedication and hard work of its staff. To every single one of you, I say thank you. It is through your commitment to this process that I am the proud Chief Executive Officer of the PA. It is your efforts that keep our financial system, and the institutions therein, safe and sound. Let us continue this momentum and keep up the great work.

KUBEN NAIDOO
DEPUTY GOVERNOR AND CEO OF THE PRUDENTIAL AUTHORITY

GOVERNANCE STRUCTURES

THE PRUDENTIAL COMMITTEE

The Prudential Committee (PruCo) was established in terms of the Financial Sector Regulation Act 9 of 2017 (FSR Act), and is responsible for the general oversight of the management and administration of the Prudential Authority (PA) to ensure that it is effective and efficient.

The structure of the Prudential Committee

Governor and Chairperson

E L Kganyago

Deputy Governor
Financial Markets

A D Mminele

Deputy Governor
Financial Stability

Vacant*

Deputy Governor
Prudential Cluster

K Naidoo

The PruCo acted for the PA in:

- authorising the Chief Executive Officer (CEO) to sign the FSR Act section 77[1] memorandums of understanding (MoUs);
- adopting the PA's Regulatory Strategy;
- adopting the administrative action procedures of the PA;
- appointing members of PA subcommittees, as required;
- making prudential standards and joint standards as well as other regulatory instruments in terms of the financial sector laws; and
- making determinations on PA insurance fees.

The Adviser to the Governors and the heads of department within the PA are permanent invitees to the PruCo. The PruCo Secretariat administers the records of deliberations held and the decisions taken by the PruCo. During the period under review, 12 official meetings, all of which met the quorum, were held, in accordance with PruCo's work plan and terms of reference (ToR).

* Effective 31 January 2019, Mr F E Groepe resigned as Deputy Governor and as a member of the PruCo.

1 *Section 77 of the FSR Act requires that the financial sector regulators and the South African Reserve Bank enter into one or more MoUs to give effect to the various obligations as outlined in section 76 of the FSR Act.*

THE PRUDENTIAL AUTHORITY MANAGEMENT COMMITTEE

The Prudential Authority Management Committee (PA Manco) is a subcommittee of the PruCo.

The structure of the Prudential Authority Management Committee

Deputy Governor and CEO: Prudential Authority
Kuben Naidoo

The PA Manco is responsible for the general operations and management of the PA regarding policy as well as regulatory and supervisory matters. In addition, the PA Manco provides advisory, technical and administrative support to the PruCo.

The PA Manco, chaired by the CEO of the PA, meets on a monthly basis with all its activities being coordinated by its Secretariat.

Head: Financial Conglomerate Supervision Department
Denzel Bostander

The Financial Conglomerate Supervision Department is responsible for the consolidated prudential supervision of institutions designated as financial conglomerates, as well as for the supervision of anti-money laundering and combating the financing of terrorism.

Head: Risk Support Department
Faizel Jeena

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

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

The Banking, Insurance, Co-operative Financial Institutions and Financial Market Infrastructure Supervision Department is responsible for the prudential supervision of the medium- to smaller-sized banks, insurance companies, cooperative financial institutions as well as securities and derivative market infrastructures, on both a solo and a consolidated basis, where applicable.

Head: Policy, Statistics and Industry Support Department
Unathi Kamlana

The Policy, Statistics and Industry Support Department oversees policy formulation and the development and implementation of regulatory and supervisory frameworks. It also provides operational support, industry analysis and technical support on capital and accounting requirements.

* *Co-operative Financial Institutions*
** *Financial Market Infrastructure*

REVIEW OF 2018/19

REFLECTING ON THE FIRST YEAR OF OPERATION

DELIVERING ON THE PRUDENTIAL AUTHORITY REGULATORY STRATEGY

The Prudential Authority (PA) *Regulatory Strategy 2018–2021* was published on 1 October 2018, in line with the requirements of the Financial Sector Regulation Act 9 of 2017 (FSR Act). The strategy provides market participants and the public with information regarding the PA's approach to regulation and supervision, the principles that guide its regulatory and supervisory decisions, its key priorities over the next three years, and the key outcomes that the PA intends to achieve in order to realise its priorities. This report provides an update on the progress made and the challenges faced in implementing the strategy.

Significant work geared toward strengthening the regulation and supervision of banking institutions is currently underway. While there is still a long road ahead, the PA has started amending the requirements for banks in line with the updated standards from the Basel Committee on Banking Supervision (BCBS). The PA is also in the process of assessing the regulatory framework and requirements for mutual banks and co-operative financial institutions (CFIs).

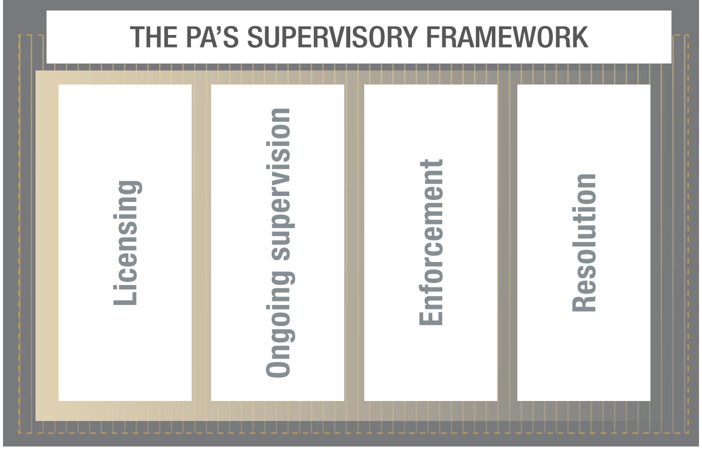
During the period under review, the PA launched engagements with industry to develop the financial conglomerate regulatory framework, which will inform a holistic view and supervision of group-wide activities, intragroup transactions and large exposures.

The newly established team for financial market infrastructure supervision collaborated with the Financial Sector Conduct Authority (FSCA) as well as the National Payment System Department of the South African Reserve Bank (SARB) to develop the PA's prudential regulatory framework, which is aimed at strengthening the resilience of market infrastructures and ensuring that international principles related to them are adhered to, where appropriate.

The PA is also progressing well with embedding the Solvency Assessment and Management (SAM) principles within the prudential regulation and supervision of insurance companies, as enabled through the Insurance Act 18 of 2017 (Insurance Act) and the related Prudential Standards.

The development of a Regulatory Framework as well as the Joint Standard on Significant Ownership has been subject to a first round of public consultation. This work is expected to reach completion in the new financial year.

The PA has finalised and adopted a harmonised Supervisory Framework which is aimed at ensuring a risk-based, outcomes-focused and pre-emptive approach. The framework is based on four pillars derived from the typical life cycle of a financial institution, namely Licensing, Ongoing supervision, Enforcement and Resolution.



To operationalise each pillar, supervisory guidelines and processes are being enhanced to ensure a common understanding and consistent application across the four PA departments to achieve the PA's mandate.

The additional priorities that we have supported, insofar as they pertain to our mandate, include:

- participation in the various subcommittees led by the Financial Sector Transformation Council to update the financial sector codes for the broader financial sector;
- sustainable competition in the provision of financial products and services; and
- financial inclusion as well as developments in financial technology (fintech), in collaboration with the SARB and other financial sector regulators.

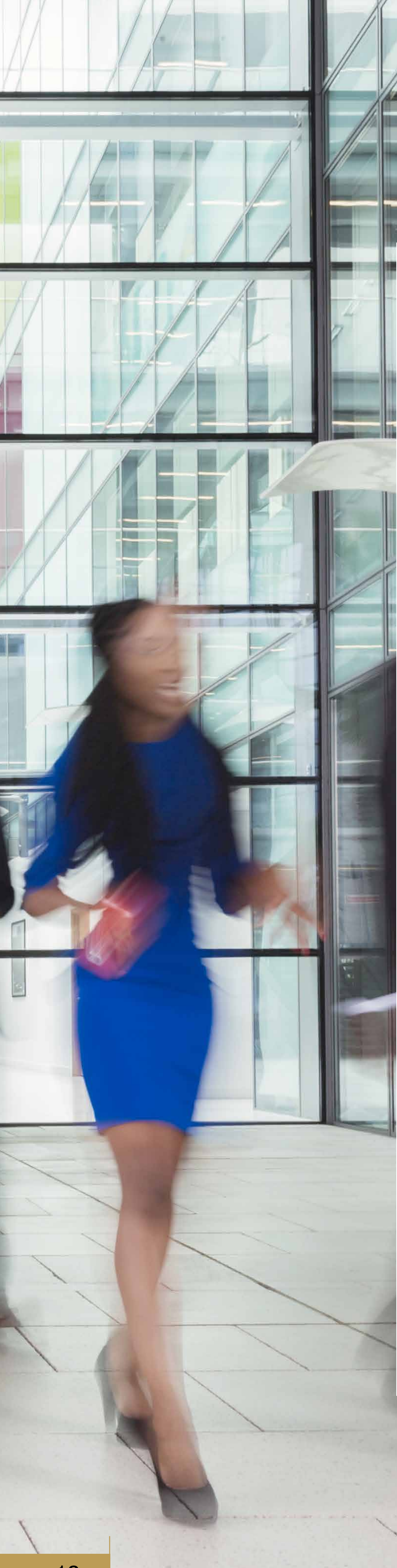
The PA's *Regulatory Strategy 2018–2021* is available on the SARB's website, at **http://www.resbank.co.za/PrudentialAuthority/AboutUs/RegulatoryStrategy/Pages/default.aspx.**

COLLABORATION AND COORDINATION WITH THE SOUTH AFRICAN RESERVE BANK, THE FINANCIAL SECTOR CONDUCT AUTHORITY AND OTHER REGULATORY BODIES

The PA has adopted a collaborative and consultative approach to regulation through engaging other regulators, industry bodies and stakeholders within and outside of the financial sector. It has ensured compliance with internationally agreed standards, insofar as they are appropriate to the local context and contribute to a safer and more sound financial system.

The approach to supervision will be risk-based, outcomes-focused and pre-emptive, underpinned by appropriate supervisory tools. By 1 October 2018, the PA had concluded and published its memorandums of understanding (MoUs) with the FSCA, the National Credit Regulator, the Financial Intelligence Centre (FIC) and the SARB's Financial Stability Department.

The MoUs are available on the SARB's website, at **http://www.resbank.co.za/PrudentialAuthority/FinancialSectorRegulation/Pages/Financial-Sector-Regulation-Act.aspx.**



PARTICIPATION IN DOMESTIC, REGIONAL AND INTERNATIONAL REGULATORY AND SUPERVISORY FORUMS

The PA regulates a financial sector that is also interconnected with international companies and foreign governments, and this requires a prudential framework that is internationally consistent. Global standards and principles assist regulators across the world in, among other things, the oversight of risk management practices within financial institutions and the mitigation of regulatory arbitrage within the respective financial systems.

The PA is a member of a number of domestic, regional and international working as well as consultative groups, supervisory colleges and regulatory forums. Contributions to these groups are drawn from both macroeconomic and microprudential perspectives, to enhance the effectiveness and efficiency of domestic regulatory and supervisory frameworks in line with applicable global standards, principles and best practice.

The PA is also part of regional consultative groups, such as those led by the Financial Stability Board, to discuss macroeconomic and financial market developments and their potential impact on countries in the region, including the challenges from rising government debt levels.

The PA took over the seat on the BCBS previously held by the former Bank Supervision Department (BSD) of the SARB. During the year under review, the PA was also accepted as an associate member of the International Organization of Securities Commissions (IOSCO) and as a principal member to the International Association of Insurance Supervisors (IAIS). It was appointed to the IAIS Executive Committee (Exco) representing the sub-Saharan African region and as the third Vice-Chair to the IAIS Exco representing emerging markets. Membership of the global standard-setters enables the PA to contribute to their work streams (where appropriate) and to keep abreast of the regulatory reform agenda of the Group of Twenty (G20) and the Financial Stability Board.

Ongoing interaction with other regulators and international bodies during the year under review has provided the PA with insights into how other regions and regulators are progressing with, among other things, risk-based approaches, crisis management and resolution frameworks, cyber-risk and resilience, as well as the role and implications of new technologies within the financial sector. All the engagements enable the PA to ascertain the extent to which adopting international standards and principles within the South African regulatory frameworks would be appropriate.

Delivering on the PA strategic focus area (SFA)

By virtue of falling within the administration of the SARB, senior management within the four PA departments was responsible for formulating and monitoring the PA strategy which forms part of the overall strategy of the SARB. The PA's strategic value proposition is to 'Promote and enhance the safety, soundness and integrity of regulated financial institutions' with its strategic objective being to 'develop, improve and integrate the supervision of regulated financial institutions'.

The PA was successfully launched in 2018, and the relevant institutions were gradually integrated into the PA over the course of the reporting year. The strategic programme to establish and embed the PA is largely on track. There were no failures of any systemically important financial institutions (SIFIs), although some smaller institutions were placed under specific regulatory action.

The Prudential Authority's strategic scorecard

Strategic measures	Target (annual)	2018/19 (annual)	2017/18 (annual)	2016/17 (annual)
Percentage of financial institutions that meet or exceed the quantitative prudential standards for SIFIs	100% or under specific regulatory action	Target met 100%	100%	100%
Percentage of financial institutions that meet or exceed the quantitative prudential standards for non-SIFIs	100% or under specific regulatory action	Target partially met 90%	90%	100%
Compliance with sound governance and risk management practices	100% or under specific regulatory action	Target partially met 90%	90%	100%

Unique strategic objective for the PA SFA

Develop, improve and integrate the supervision of regulated financial institutions.

How

By consolidating the prudential regulation and supervision of banking institutions, insurers, financial conglomerates, CFIs and market infrastructures.

Progress made during the year

- √ The PA finalised and adopted the Supervisory Framework.
- √ Certain elements of the regulatory and supervisory framework for financial conglomerates and significant owners have been distributed for external consultation.
- √ The Insurance Act, which contains a risk-based prudential framework for insurers, has been effective from 1 July 2018.
- √ A discussion paper was published on a proposed methodology to determine the SIFIs in South Africa.

THE DOMESTIC REGULATORY FRAMEWORK

The Insurance Act 18 of 2017

The Insurance Act was signed by the President of South Africa in January 2018, and came into effect on 1 July 2018. This marked the biggest legislative overhaul of the insurance industry in 20 years, and brought the South African regulatory and supervisory framework in line with the latest international trends in terms of the principles and standards for insurance supervision.

The Insurance Act adopts a principle- and risk-based framework, and is supported by Prudential Standards that elaborate on the principles enshrined in the Insurance Act. The PA published 42 Prudential Standards, which came into effect on 1 July 2018, to cover the financial soundness, governance and operations of the five types of insurance entities operating in South Africa (i.e. the solo insurers, Lloyd's South Africa, micro-insurers, branches of foreign reinsurers and insurance groups). The last three types of insurers had not been dealt with in earlier legislation, although some insurance group supervision was done before the Insurance Act came into effect.

The PA augmented the implementation of the Insurance Act with various communiqués covering topics such as the conversion of registration, the designation of insurance groups, auditing and disclosure requirements and transitional reporting obligations in terms of Schedule 3 of the Insurance Act. A number of joint communications were also published by the PA and the FSCA, covering topics such as the status of the instruments issued under the Long-term Insurance Act 52 of 1998 (Long-term Insurance Act) and the Short-term Insurance Act 53 of 1998 (Short-term Insurance Act), and cell captive insurance arrangements.

The FSR Act requires the PA to follow a prescribed process when designating financial conglomerates, and that it must consult the FSCA when making such a designation. The PA is currently working with industry representatives to draft Prudential Standards applicable to financial conglomerates. The designation criteria that will assist the PA in identifying and designating financial conglomerates are being developed by the PA. These designation criteria will consider the risk posed by the entities within a group to the eligible financial institution. It is envisaged that the framework for regulating financial conglomerates will be finalised in 2020.

Financial conglomerate supervision

The globalisation of financial markets has contributed to an increase in the complexity, size and number of active financial groups. These financial groups provide a broad range of products and services, including banking, insurance, securities and investment services, which are subject to different sector-specific regulations and are usually provided in a number of jurisdictions.

One issue with such group structures is how a single event affecting one part of the financial sector would have unintended spillover effects within the same group and ultimately in the broader financial system, depending on its size and interconnectivity. Taking into account the risks posed by these large institutions, several countries have developed financial conglomerate supervision frameworks to address these gaps. The FSR Act introduces financial conglomerate supervision in recognition of the fact that the South African financial system is dominated by a few large financial institutions, with associated high levels of interconnectedness and potential contagion.

On 1 March 2019, section 160(1) of the FSR Act came into effect, granting the PA the power to designate members of a group of companies as a financial conglomerate. A financial conglomerate designated in terms of the FSR Act includes both an eligible financial institution and a holding company of the eligible financial institution[2], but need not include all the members of a particular group of companies.

2 *An eligible financial institution is a licensed bank, insurer, market infrastructure or financial institution that is prescribed in regulations as such.*

The Financial Markets Act 19 of 2012

Joint Standard on the Requirements and Additional Duties of a Trade Repository

In August 2018, the PA and the FSCA issued, in terms of the Financial Markets Act 19 of 2012 (FMA), the FMA Joint Standard 1 of 2018: Requirements and Additional Duties of a Trade Repository (TR Joint Standard). This Joint Standard prescribes additional criteria for the licensing of an external trade repository and additional duties of a licensed trade repository. The TR Joint Standard furthermore aims to incorporate the Basel Committee on Payments and Market Infrastructures and IOSCO's Principles for Financial Market Infrastructures, as they relate to trade repositories, into the domestic regulatory framework in order to adopt and apply international standards and give effect to South Africa's international commitments.

The Banks Act 94 of 1990

Directive and guidance note on cloud computing and the offshoring of data

Taking into account the increasing prominence of cloud computing and the offshoring of data in the banking sector, the PA has deemed it necessary to provide guidance to the sector on these matters. Directive 3 of 2018 sets out the PA's requirements with regard to cloud computing and the offshoring of data. In general, this directive allows banks to use cloud computing solutions subject to specific regulatory safeguards. Several institutions were already storing their data offshore, most often through an insourcing relationship with a parent organisation, while domestic banks were increasingly considering extending their use of cloud computing to more significant activities.

Guidance Note 5 of 2018 contains supplementary information, and was issued to provide banks with assistance to comply with and better understand the PA's requirements with regard to cloud computing and the offshoring of data. As such, it should be read in conjunction with Directive 3 of 2018.

The Banks Act 94 of 1990

Directive 4 of 2018: Governance

Effective corporate governance in banks and controlling companies is critically important for the proper functioning of the banking sector and the economy as a whole. Given the fundamental deficiencies identified in banks' corporate governance in the build-up to and during the global financial crisis, a new Core Principle on corporate governance (Core Principle 14) was added to the set of Core Principles for effective banking supervision issued by the BCBS in September 2012. In addition, the revised principles on corporate governance for banks, issued by the BCBS in July 2015, confirmed not only that supervisors must have a keen interest in sound corporate governance, as it is an essential element in the safe and sound functioning of a bank and may adversely affect the bank's risk profile if not operating effectively, but also that well-governed banks contribute to the maintenance of an efficient and cost-effective supervisory process and therefore require less supervisory intervention themselves.

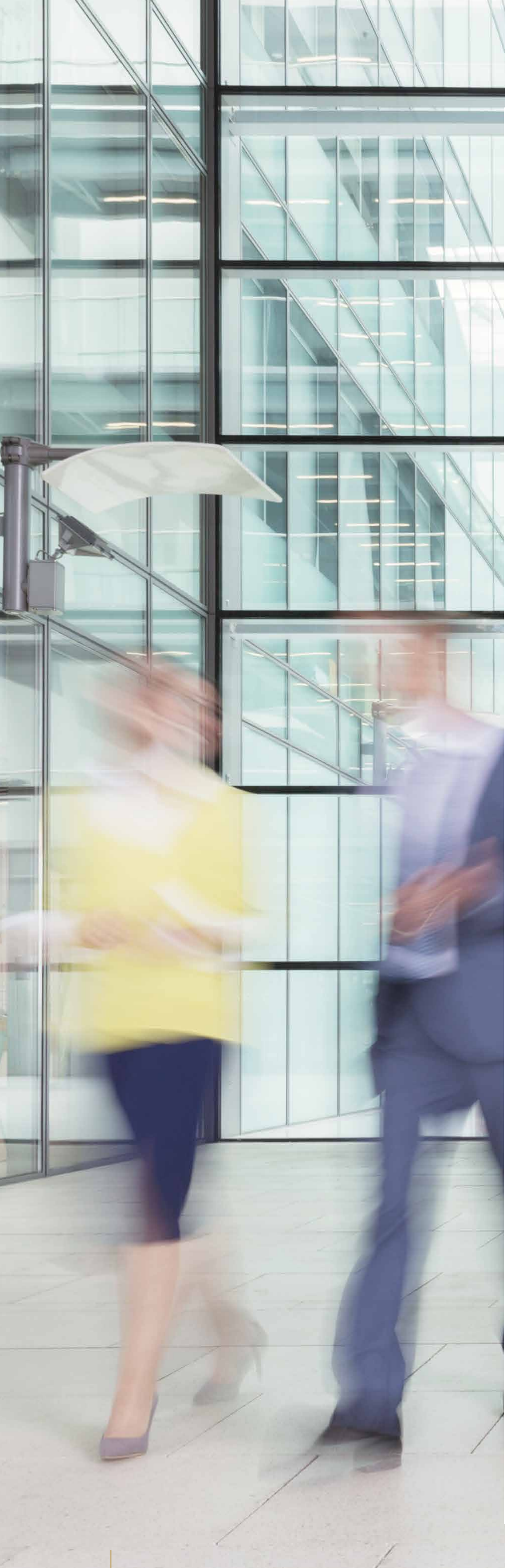
As such, in October 2018, the PA issued Directive 4 of 2018 in terms of section 6(6) of the Banks Act 94 of 1990 (Banks Act) to further promote various matters related to sound corporate governance in banks and controlling companies, including various matters related to the appointment of directors and executive officers.

Directive on the completion of the BA410 return relating to operational risk

Directive 5 of 2018 sets out the new requirements for the provision of returns relating to operational risk in form BA410. The purpose of the BA410 form is to obtain selected information in respect of, among other things, the bank's loss event types, recorded gross losses and the recovery of losses, which information is based on specified business lines and specified loss event types.

The purpose of the directive is to direct banks, controlling companies and branches of foreign institutions to change the frequency for the completion and submission of the BA410 form relating to operational risk from semi-annually to quarterly, starting from Quarter 1 of 2019, being 1 January 2019 to 31 March 2019. Thereafter, banks are directed to submit the relevant BA410 form 20 working days after each relevant quarter on a bank solo basis, and 30 working days after each relevant quarter on a bank consolidated and a controlling company consolidated basis.

The list of all regulatory instruments published by the PA can be found at **http://www.resbank.co.za/PrudentialAuthority/AboutUs/Pages/Legislation.aspx.**



Regulatory Framework for Co-operative Financial Institutions

CFIs, as opposed to co-operative banks[3], are defined in the Co-operative Banks Act 40 of 2007 (Co-operative Banks Act) as a co-operative that takes deposits and chooses to identify itself by the use of the name 'financial co-operative', 'financial services co-operative', 'credit union' or 'savings and credit co-operative'.

The FSR Act made consequential amendments to the Co-operative Banks Act by the introduction of Chapter VIIA, which relates to CFIs. The amendments extended the scope of the Co-operative Banks Act to include the regulation and supervision of CFIs, and appointed the PA as the authority responsible for the Co-operative Banks Act.

Before 1 August 2018, the regulatory framework governing CFIs was captured under the Co-operative Banks Development Agency (CBDA) Rules. The CBDA was appointed as the regulator and supervisor of CFIs in terms of an exemption notice issued in terms of the Banks Act under Government Notice No. 620, and published in *Government Gazette* No. 37903 of 15 August 2014. The Supervision Unit of the CBDA was transferred to the SARB and its staff seconded to the PA on 1 April 2018 to assume the supervisory responsibilities for CFIs. CFIs that were registered by the CBDA have until 1 August 2019 to apply to the PA to be registered under the Co-operative Banks Act.

The rules for CFIs are contained in the CBDA Rules. In this regard, the PA had no legal framework to regulate and supervise CFIs, which necessitated the development of a Prudential Standard under which the PA could register, regulate and supervise CFIs. Prudential Standard TCFI-01: Transitional Arrangements for CFIs, was made by the Prudential Committee (PruCo) on 26 September 2018. The Standard also prescribes the limits in terms of which a CFI is obliged to apply to register as a co-operative bank (R5 million, previously R1 million) as well as the maximum deposit threshold for CFIs (R50 million, previously R30 million).

On 12 March 2019, the PA published Guidance Note 1 of 2019, issued in terms of section 45(e) of the Co-operative Banks Act, relating to CFIs. The purpose of the guidance note is to assist prospective CFIs and those CFIs which were previously registered with the CBDA in completing the application process for registration with the PA. The note provides guidance on the minimum requirements to be registered, and the requirements to register a co-operative with the Companies and Intellectual Property Commission.

In the coming financial year, the PA will publish guidance notes on the CFI model constitution as well as on savings and loan policies. The transitional standard for CFIs will apply until the PA is able to finalise a new regulatory framework for CFIs. This framework will depend on the research instituted by the CBDA on the current state of member-based financial institutions in South Africa.

3 *Please refer to page 22 for further details.*

HIGH-LEVEL OVERVIEW OF THE KEY TRENDS FOR PRUDENTIAL AUTHORITY-REGULATED SECTORS

The PA is currently the lead supervisory authority for entities as tabulated below.

The links for the list of all the entities registered or licensed with the PA as at 31 March 2019 are presented in the appendices.

Entities supervised by the Prudential Authority as at* 31 December 2018, 28 February 2019 and 31 March 2019

Entities per sector	No. of entities	Balance-sheet size R millions		
		Dec 2018	Feb 2019	Mar 2019
Banking sector	**34**			**5 517 433**
Registered banks	19			5 184 645
Local branches of foreign banks	15			332 788
Mutual bank sector	**4**			**3 136**
Co-operative sector	**26**		**369**	
Co-operative banks	4		177	
Co-operative financial institutions	22		192	
Life insurance sector	**73**	**3 004 204**		
Primary insurers	66	2 993 436		
Cell captive entities	7	10 768		
Non-life insurance sector	**86**	**189 983**		
Primary insurers	73	149 882		
Cell captive entities	5	37 584		
Captive insurers	8	2 517		
Reinsurers	**11**	**48 370**		
Life reinsurers	3	7 256		
Non-life reinsurers	3	7 279		
Composite reinsurers	5	33 835		

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

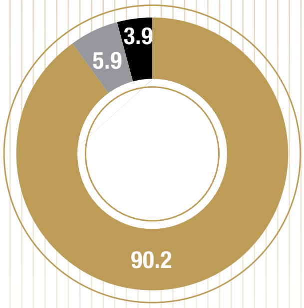
Deposit-taking financial institutions

The South African banking sector is dominated by five large banks, which collectively held 90.5% of the total banking sector assets as at 31 March 2019 (31 March 2018: 90.2%). Local branches of international banks accounted for 5.6% of banking sector assets at the end of March 2019 (March 2018: 5.9%), while other banks represented 3.8% at the end of March 2019 (March 2018: 3.9%).

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

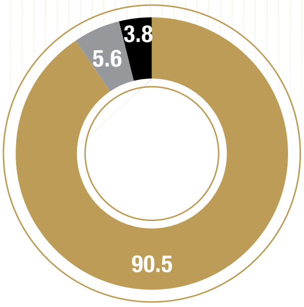
Total banking sector assets

March 2018



- Five largest banks
- Local branches of foreign banks
- Other banks

March 2019



- Five largest banks
- Local branches of foreign banks
- Other banks

Selected indicators for the South African banking sector

	Mar 2018	Mar 2019	Percentage change (%)
Balance sheet			
Total assets (R billions)	5 201	5 654	8.70
Gross loans and advances (R billions)	3 874	4 216	8.81
Total equity (R billions)	449	470	4.72
Profitability			
Cost-to-income ratio (smoothed) (%)	57.24	57.73	0.86
Return on equity (smoothed) (%)	15.78	15.69	-0.57
Return on assets (smoothed) (%)	1.31	1.28	-2.29
Capital adequacy			
Common equity tier 1 capital adequacy ratio (%)	12.88	12.61	-2.10
Tier 1 capital adequacy ratio (%)	13.38	13.33	-0.37
Total capital adequacy ratio (%)	16.24	16.28	0.25
Leverage ratio (%)	6.73	6.44	-4.31
Liquidity			
Liquidity coverage ratio (%)	123.61	142.43	15.22
Net stable funding ratio (%)	109.78	108.09	-1.54
Credit risk			
Impaired advances (R billions)	128	159	23.98
Impaired advances as % of gross loans and advances	3.31	3.77	13.90
Specific credit impairments as % of impaired advances	41.93	45.96	9.61
Portfolio credit impairments as % of gross loans and advances	1.00	1.04	3.66

Total banking sector assets increased from
R5 201 billion
in March 2018 to
R5 654 billion
in March 2019.

The banking sector assets increased to
8.69%
in March 2019 from the previous year, mainly supported by the increase in gross loans and advances.

The year-on-year growth rate in gross loans and advances increased to
8.8%
at the end of March 2019,
compared to **2.4%** a year earlier, largely as a result of an increase in the growth rate of term loans, lease and instalment debtors, loans granted under resale agreements and credit cards.

Equity amounted to
R470 billion
at the end of March 2019
(2018: R449 billion).

Retained earnings and share capital constituted
95.2%
of total equity at the end of March 2019
(2018: 94.5%).

Deposit-taking financial institutions (continued)

The banking sector remained profitable during the period under review, despite a slight decline in the profitability ratios. The 12-month moving average return-on-equity ratio decreased marginally:

15.8% in March 2018

15.7% in March 2019

The return-on-assets ratio narrowed:

1.31% in March 2018

1.28% in March 2019

The 12-month moving average cost-to-income ratio amounted to

57.7%

at the end of March 2019

(2018: 57.2%).

Banks (on a bank solo basis) remained adequately capitalised, with capital adequacy ratios (CARs) well above the minimum statutory requirements. Total capital, tier 1 and common equity tier 1 (CET 1) CARs remained relatively stable at the end of March 2019 compared to March 2018, and amounted to

16.3%, 13.3% and 12.6%

(2018: 16.2%) (2018: 13.4%) (2018: 12.9%)

respectively at the end of March 2019.

The **liquidity coverage ratio** (LCR) minimum requirement was 90% from January 2018 and increased to

100%

at the beginning of January 2019.

The LCR remained above the minimum requirement during the period under review, and amounted to

142.4%

at the end of March 2019

(2018: 123.6%).

mainly due to an increase in high-quality liquid assets.

Impaired advances remained elevated, having increased at an annual rate of

24%

between March 2018 and March 2019

(2018: 19.2%).

This was mainly driven by an increase in specific impairments due to the implementation of International Financial Reporting Standard (IFRS) 9 throughout 2018, with larger corporates moving into the non-performing category.

The ratio of impaired advances to gross loans and advances deteriorated to

3.9%

in March 2019

(2018: 3.3%).

The ratio of specific credit impairment to impaired advances (coverage ratio) increased to

46%

in March 2019

(2018: 41.9%).

The mutual banking sector

Selected indicators for the South African mutual banking sector

	Mar 2018	Mar 2019	Percentage change (%)
Balance sheet			
Total assets (R millions)	3 001	3 136	4.48
Loans and advances (R millions)	2 170	2 079	-4.21
Profitability			
Return on equity (%)	16.10	5.40	-66.46
Return on assets (%)	2.90	1.00	-65.52
Operating expenses to total income (%)	69.80	72.80	4.30
Liquidity			
Average daily amount of liquid assets held to liquid assets requirement (%)	133.25	146.40	9.87
Credit risk			
Gross amount overdue (R millions)	7.99	6.00	-24.97
Gross overdue to loans and advances (%)	3.40	3.90	14.71
Specific provisions to gross amount overdue (%)	83.80	81.10	-3.22
General provisions to loans and advances (%)	0.40	0.40	0.00
Capital adequacy			
Capital adequacy ratio (%)	23.70	23.10	-2.53

The total mutual banking sector **assets** increased to

R3.136 million

in March 2019

(2018: R3.001 million).

The sector remained profitable during the period under review, although a declining trend in profitability was evident throughout the review period. Mutual banks remained adequately capitalised, with the total CAR well above the minimum statutory requirements.

The total CAR for the sector remained stable at

23.10%

at end of March 2019

(2018: 23.70%).

Overdue loans improved in the past year to

R6 million

at end of March 2019

(2018: R8 million).

As at the end of March 2019, specific provisions as a percentage of gross overdue loans stood at

81.10%

at end of March 2019

(2018: 83.80%).

The co-operative financial sector

This sector comprises co-operative banks and CFIs. While co-operative banks have always been regulated by the SARB, through the erstwhile BSD, the PA now regulates both areas, having taken over the regulatory oversight of CFIs from the CBDA.

While a number of CFIs meet the new minimum requirement for registration as a co-operative bank (i.e. having at least 200 members and R1 million in deposits), they fall short in terms of financial acumen, skills, as well as prudential and/or operational requirements. Other CFIs are small and, in most cases, newly registered.

Total assets

48% CO-OPERATIVE BANKS*

52% CFIs

Of the total financial co-operative deposit-taking sector.

The CFIs reflected below were registered by the CBDA, and are in the process of reapplying for registration with the PA.

Selected indicators for co-operative banks and CFIs

	Number		Members		Deposits R millions		Assets R millions	
February*	2018	2019	2018	2019	2018	2019	2018	2019
Co-operative banks	3	4	3 246	4 321	R128.8	R145.3	R153.5	R177.4
CFIs	23	22	24 618	23 170	R128.6	R149.1	R180.4	R192.1
Total	**26**	**26**	**27 864**	**27 491**	**R257.4**	**R294.4**	**R333.9**	**R369.5**

* *The financial year-end of all co-operative banks and CFIs is 28 February.*

Co-operative banks

Selected indicators for co-operative banks

	Feb 2018 (R'000)	Feb 2019 (R'000)	Percentage change (%)
Balance sheet			
Total assets	153 506	177 493	15.63
Total loans	114 914	140 375	22.16
Total liabilities	131 666	146 925	11.59
Total equity	21 840	30 816	41.10
Profitability			
Total income	19 073	23 140	21.32
Total expenses	14 245	16 106	13.06
Operating profit/income before taxation	4 828	5 776	19.64
Cost-to-income ratio (%)	44.9	43.26	-3.65
Capital adequacy			
Total capital adequacy ratio (%)	12.9	15.25	18.22
Asset quality and provisions			
Total delinquent loans	4 663	5 603	20.16
Portfolio delinquent (%)	4.06	3.99	-1.67
Total provisions	4 335	5 376	24.01
Provision as % of total loans	3.77	3.83	1.52

The overall growth in the co-operative banking sector statistics is attributable to the registration of a fourth co-operative bank during 2018.

Net loans amounted to **R140 million** for the period under review (February 2018: R115 million) also due to an increased loan issuance across the portfolio.

22%

The sector remained adequately capitalised, with a CAR of 15.25% as at February 2019, well in excess of the 6% minimum required to be held.

The co-operative banking sector remained profitable in the year under review, with income before taxation increasing by **19.6%**

R5.7 million

(February 2018: R4.8 million).

The cost-to-income ratio declined by 3.65% to 43.26% in February 2019 (February 2018: 44.9%).

Delinquent loans accounted for 4% of the co-operative banking sector's gross loans as at the end of February 2019, a decline of 1.67% when compared with February 2018. The sector continued to provide sufficiently for potential losses in accordance with regulatory requirements during the review period.

Co-operative financial institutions

The analysis below relates to the 22 CFIs previously registered and regulated by the CBDA in terms of Exemption Notice 620 of 2014, for periods ended February 2018 and February 2019.

Selected indicators for CFIs

	Feb 2018 (R'000)	Feb 2019 (R'000)	Percentage change (%)
Balance sheet			
Total assets	180 463	192 119	6,46
Total loans	113 405	112 023	-1,22
Total liabilities	139 816	153 431	9,74
Total equity	40 648	38 688	-4,82
Profitability			
Total income	26 729	27 804	4,02
Total expenses	27 522	23 892	-13,19
Operating profit/income before taxation*	-6 958	3 524	150,65
Cost-to-income ratio (%)	101,56	77,92	-23,28
Capital adequacy			
Total capital adequacy ratio (%)	12,93	13,41	3,71
Asset quality and provisions			
Total delinquent loans	10 173	3 293	-67,63
Portfolio delinquent (%)	8,81	2,89	-67,20
Total provisions	2 051	1 816	-11,46
Provision as % of total loans	1,81	1,62	-10,37

* One particular CFI made a large loss

CFIs (continued)

CFIs' total assets continued to grow in 2018, concluding the financial year-end in February 2019 at an annualised growth rate of 6.46%.

Net loans amounted to
R112 million
for the period under review
(February 2018: R113 million)

1.20%

The sector remained adequately capitalised, with a CAR of **13.41%** as at February 2019.

The sector's assets remained concentrated, with the three largest CFIs contributing **75.96%** of the overall net loans.

The co-operative banking sector remained profitable in the year under review, with income before taxation increasing by

R3.5 million
(February 2018: R-6 958 million)

1.51%

The negative income before taxation for the period ending February 2018 related to the losses of one particular CFI.

The cost-to-income ratio improved by **23.28%** to **77.92%** in February 2019.

Delinquent loans accounted for **2.89%** of the CFI sector's gross loans as at the end of February 2019, a decline of **67.2%** when compared with February 2018. The sector continued to provide sufficiently for potential losses in accordance with regulatory requirements during the review period.

Insurers and reinsurers

The insurance sector information is based on the Insurance Act, as implemented on 1 July 2018. As a result, the information is not consistent with what had been reported under the previous Long- and Short-term Insurance Acts. No comparative figures have been provided in this report. The income and expenditure figures are based on aggregated data for the September 2018 and December 2018 quarter-ends (i.e. at half-year), while the solvency and balance-sheet items are as at 31 December 2018.

Life insurers

The net premium income (after deducting premiums for reinsurance) for primary life insurers (those that do not conduct business solely as reinsurers), cell captives and reinsurers was standing at R281 million for the six months ending December 2018. Benefit payments for the same period totalled R225 million.

Insurance companies make a significant portion of their income from investment revenues (both realised and unrealised). The 2018 calendar year saw particular challenges, which included slow economic growth, poor investment returns, and volatility in the exchange rate.

The total assets in respect of the primary life insurers, cell captives and reinsurance industry stood at R3 011 billion as at the end of December 2018. The majority of these assets was invested in investment funds and equities.

Selected indicators for the South African life insurance industry

R millions	Primary	Cell captives	Reinsurers	Total
Income				
Net premiums	275 641	4 115	1 599	**281 355**
Investment income	-26 848	309	217	**-26 322**
Other income	8 992	16	49	**9 057**
Total	257 785	4 440	1 865	**264 090**
Expenditure				
Benefits	223 461	908	1 076	**225 445**
Commission paid/received	9 473	527	-	**10 000**
General expenses	25 905	604	160	**26 669**
Other acquisition costs	3 784	-	-	**3 784**
Other expenses	5 263	3	121	**5 386**
Excess of income over expenditure	**-10 100**	**2 398**	**508**	**-7 194**
Assets	**2 993 436**	**10 768**	**7 256**	**3 011 459**
Liabilities	**2 630 845**	**3 602**	**3 900**	**2 638 348**
Solvency capital requirement cover ratio (median)	1,9	1,1	1,5	**1,5**
Minimum capital requirement cover ratio (median)	4,3	4,1	5,3	**4,3**

Non-life insurers

The gross premiums of primary insurers (those that do not conduct business solely as reinsurers), cell captives, captives and reinsurers in the non-life insurance industry were R75 million for the six months ending December 2018.

The underwriting results (where the underwriting profit is expressed as a percentage of net earned premiums) stood at 10% for the primary insurers, cell captives, captives and reinsurers in the non-life insurance industry as at the end of December 2018. The non-life insurance industry did not experience any catastrophic events during 2018.

The six-monthly operating profits, which included investment income, stood at R7.3 billion as at the end of December 2018, and were also affected by subdued investor sentiments.

Selected indicators for the South African non-life insurance industry

R millions	Primary	Cell captives	Captives	Reinsurers	Total
Income					
Gross premiums	60 016	9 373	875	4 317	**74 582**
Net earned premiums	38 948	5 399	603	1 438	**46 389**
Investment income	2 041	936	67	1 255	**4 300**
Other income	249	8	7	-	**265**
Total	**41 239**	**6 344**	**678**	**2 693**	50 953
Expenditure					
Claims incurred	23 465	2 966	261	606	**27 298**
Commission paid/received	2 580	-14	-41	497	**3 022**
General expenses	10 796	1 019	102	129	**12 046**
Other expenses	1 329,68	26	83	15	**1 454**
Excess of income over expenditure	**3 068**	**2 346**	**272**	**1 447**	**7 134**
Underwriting profit	3 915	129	260	354	**4 658**
Operating profit	5 956	561	327	442	**7 287**
Assets	**149 882**	**37 584**	**2 517**	**7 279**	**197 262**
Liabilities	**85 097**	**23 155**	**845**	**5 731**	**114 828**
Solvency capital requirement cover ratio (median)	1,8	2,1	1,8	1,6	**1,8**
Minimum capital requirement cover ratio (median)	3,8	2,5	3,8	4,5	**3,8**

Composite reinsurers

Five reinsurers are currently classified as composite reinsurers, meaning that they write both life and non-life reinsurance businesses.

The gross premiums for the six months ending December 2018 in respect of the life and non-life businesses totalled R4.9 billion and R6.8 billion respectively.

Total assets

R34 billion

as at the end of December 2018.

Selected indicators for the South African composite insurance industry

R millions	Life	Non-life
Income		
Gross Premiums	4 907	6 784
Net premiums/Net earned premiums	4 683	963
Investment income	543	175
Other income	12	352
Total	**5 239**	**1 490**
Expenditure		
Claims incurred	3 434	924
Commission paid/received	191	-
General expenses	229	24
Other expenses	407	508
Excess of income over expenditure	979	35
Underwriting profit		156
Operating profit		214
Assets		**33 835**
Liabilities		**23 549**
Solvency capital requirement cover ratio (median)		1.5
Minimum capital requirement cover ratio (median)		4.0

Financial market infrastructures

The PA is responsible for the prudential supervision of market infrastructures. This category includes exchanges, central securities depositories, clearing houses, central counterparties (CCPs), and trade repositories.

The reporting templates for market infrastructures' data submissions were published in January 2019, with the first set of data submissions to the PA being due by April 2019. The PA will report on market infrastructures' data in its 2019/20 Annual Report.

Licensed Prudential Authority-regulated market infrastructures

Exchanges	JSE Limited
	A2X (Pty) Ltd
	ZAR X (Pty) Ltd
	4 Africa Exchange (4AX) (Pty) Ltd)
	Equity Express Securities Exchange
Central securities depositories	Strate (Pty) Ltd
	Granite
Clearing houses	Strate (Pty) Ltd
	JSE Clear

LICENSING

Licence management

The FSR Act, read with the applicable financial sector laws, prescribes that a person may not provide, as a business or as part of a business, a financial product, a financial service or a market infrastructure, unless duly licensed in accordance with the FSR Act or another relevant financial sector law. As the responsible authority for banks, insurers and CFIs, the PA has developed and implemented a licensing framework with specific processes to ensure compliance with prudential, legal and governance standards, including the legislative requirement of obtaining the concurrence of the FSCA where it relates to the issuing, varying, suspending or revoking of a licence.

In the period under review, the PA received and considered 27 applications from existing and prospective financial institutions, of which 1 was withdrawn, 7 were approved, 3 were declined, and 16 were in progress as at 31 March 2019.

Applications received in 2018/19

	Received	Withdrawn	Approved	Declined	In progress
Banks, mutual banks and co-operative banks	4	1	2	0	1
Branches	2	0	0	0	2
Representative offices	5	0	4	0	1
Insurers	5	0	1	1	3
CFIs	11	0	0	2	9
Total	**27**	**1**	**7**	**3**	**16**

The PA concurred with the FSCA's decision to vary the licences of two market infrastructures.

Fit and proper governance

The FSR Act, read with the relevant provisions of the applicable financial sector laws, seeks to promote corporate governance by, inter alia, oversight on the fitness and propriety of executive officers and other key individuals to be appointed by the financial institutions regulated by the PA. Accordingly, these financial institutions must obtain prior approval from the PA for such appointments or, where appropriate, simply submit the required notification.

In the period under review, the PA received 532 applications and notifications for such appointments.

Applications and notifications received in 2018/19

Institution	Received	Approved	Declined	In progress
Banks	245	203	19	23
Insurers	287	51	0	236

Regulation of unregistered persons

In respect of insurers, the mandate for the supervision of unregulated insurance activities is split between the PA and the FSCA, as set out in the MoU between the two authorities. The PA is responsible for investigating registered insurers that are conducting business for classes of policies that they are not registered to deal with. The FSCA, on the other hand, is responsible for investigating all such concerns (i.e. entities conducting business without being registered to do so).

During the year under review, one insurance business (Safrican Insurance Company Limited (Safrican)) was investigated, after which a fine was imposed (refer to the section on 'Sanctions and enforcement'). Another business is still in the process of being investigated.

Illegal deposit-taking schemes investigated 1 April 2018 – 31 March 2019

Investigations carried over from the previous financial year	20
New investigations	2
Finalised investigations	16
Current investigations	6

ENFORCEMENT

The Regulatory Action Committee

The FSR Act provides the PA with adequate powers to address non-compliance with the provisions of the FSR Act and other financial sector laws. Enforcement measures, when necessary, may result in the PA taking appropriate regulatory actions against such entities.

The FSR Act also provides that the PA may establish an administrative action committee to consider and make recommendations on regulatory actions, including the imposition of penalties, as provided for by the FSR Act and other financial sector laws. The PA decided not to establish such an administrative action committee, but to utilise its existing internal governance processes to deal with administrative actions, as they are sufficient to ensure compliance with the Promotion of Administrative Justice Act 3 of 2001, as well as with the procedural requirements outlined in the FSR Act and other applicable laws.

The Prudential Authority Sanctions and Enforcement Committee

The PA has at its disposal an adequate range of supervisory tools to bring about timely corrective actions without the need to resort to regulatory actions such as the imposition of administrative penalties.

In general, where areas of concern are identified, on-site inspections or reviews will be initiated and conducted, followed by feedback letters and requests for regular progress reports by the regulated entities to the PA on the required actions. However, if a regulated institution fails to meet its licensing conditions, or if it does not comply with the provisions of a financial sector law, appropriate regulatory actions are taken, where necessary and appropriate.

The Prudential Authority Sanctions and Enforcement Committee (PA Enforcement Committee) has been established to recommend to the Chief Executive Officer of the PA the appropriate regulatory action to be taken. The PA Enforcement Committee is composed of nine members, with the PA's Head of the Sanctions, Enforcement and Resolution Division performing the Secretariat function.

At the end of the period under review, processes were under way to combine the functions of the Prudential Authority Anti-Money Laundering and Combating the Financing of Terrorism Administrative Sanctions Advisory Panel[4] and the PA Enforcement Committee into a single committee.

4 The Anti-Money Laundering and Combating the Financing of Terrorism Administrative Sanctions Advisory Panel was established by the erstwhile BSD and was responsible for providing advice to the Registrar of Banks on decisions to impose administrative sanctions in terms of section 45C of the FIC Act.

Sanctions and enforcement

The PA issued letters to two banks in terms of sections 7 and 52 of the Banks Act respectively. These banks were warned that further non-compliance with the aforementioned sections of the Banks Act may result in administrative penalties.

A recommendation was made to the FSCA to enter into two enforceable undertakings relating to compliance with section 5 of the Insurance Act.

An administrative penalty order of R10 million was imposed on Safrican in terms of section 167(1) of the FSR Act regarding a contravention of section 7 of the Long-term Insurance Act by underwriting sinking-fund policies that the entity was not licensed to underwrite. R5 million of the penalty was suspended for a period of two years, but the remaining R5 million was received by the PA and subsequently transferred to the National Revenue Fund.

Furthermore, an administrative penalty order of R10 million was issued in terms of section 167(1) of the FSR Act regarding a breach of governance standards relating to the non-disclosure of key management personnel's compensation in Grindrod Bank Limited's annual financial statements.

Any person aggrieved by a decision taken by the PA may apply to the Financial Services Tribunal (Tribunal) for reconsideration. As at the end of the period under review, no such applications for review had been lodged with the Tribunal.

Full details on the PA Regulatory Actions are available at **http://www.resbank.co.za/PrudentialAuthority/FinancialSectorRegulation/Pages/Administrative-Penalties.aspx**

Resolution management

The PA is tasked with, inter alia, the promotion of the safety of depositors' funds, the protection of policyholders, and the protection of the interests of members and beneficiaries of financial institutions. This function is essential in ensuring that confidence and trust in the South African financial system is maintained.

Certain measures are necessary for maintaining the continuity of the vital economic functions of financial institutions, which is often in the interest of financial stability. The tools that the PA has at its disposal through the applicable financial sector laws include early regulatory interventions which may, among other things, result in increased capital requirements or agreed restructuring arrangements. In some instances, however, it may be necessary to place a financial institution under curatorship. The process of establishing and refining the legislation, policies and other legal instruments necessary to effectively manage a financial crisis, as well as to effect the orderly resolution of failing financial institutions, is ongoing. The PA is collaborating with the SARB in this regard, and the current developments include the design of a resolution framework and the establishment of South Africa's deposit insurance scheme.

The following entities were placed under curatorship during the period under review:

- VBS Mutual Bank (VBS) was placed under curatorship with effect from 11 March 2018. Liquidity constraints at the mutual bank had resulted in the institution being unable to repay funds when called upon by depositors, which necessitated immediate intervention by the SARB. The appointment of a curator was in the best interests of the public and the mutual bank's depositors. Through the SARB, National Treasury provided a guarantee to facilitate the repayment of up to R100 000 per qualifying retail depositor. While the SARB had envisioned the orderly management of VBS under curatorship, a forensic investigation subsequently commissioned by the PA uncovered evidence of extensive fraudulent activities at the mutual bank. The forensic investigator recommended that criminal charges be pursued against all those who had participated in and benefited from the fraudulent activities resulting in the loss of depositors' funds, which had left VBS insolvent. In this regard, five key individuals were placed under sequestration. VBS was placed under liquidation in October 2018.
- Nzalo Insurance Services Limited and Bophelo Life Insurance Company Limited were placed under provisional winding-up on 12 February 2019 by the Johannesburg High Court after both companies were found to be factually insolvent, with their liabilities far exceeding their assets. Liquidation was considered to be in the best interests of policyholders.
- The FSCA placed Insure Group Managers (IGM), which collects premiums for insurers, under voluntary curatorship with the concurrence of the PA after it was revealed that IGM had a shortfall of R200 million in outstanding premiums due to insurers on 15 September 2018. This action was taken because insurers were collectively owed, in aggregate, in excess of R1.5 billion, of which more than R660 million was overdue.
- Brimstone Investment Corporation Limited decided to place Lion of Africa Insurance Company Limited into a run-off, effective from 12 November 2018. On 13 November 2018, the PA suspended the licence of Lion of Africa Insurance Company Limited in terms of section 27(1)(c) of the Insurance Act.

Resolution management (continued)

The 'new' African Bank Limited (African Bank), which was launched on 4 April 2016, continued to operate in a stable manner in the period under review. As at March 2019, its total assets were reported at R28.2 billion and its total deposits at R17.9 billion. As part of the diversification of its business model, on 21 May 2019 African Bank launched its transactional banking platform, MyWORLD. Under curatorship, Residual Debt Services Limited continued to recover amounts due in respect of the residual book. A third distribution of R650 million was made to senior debt holders in January 2019, bringing the total of the repayments made to date to R1.8 billion. A further repayment of approximately R600 million by the end of July 2019 is anticipated. The indemnity reserve remained fully funded as at March 2019 at R3 billion, and no claims have been made against it to date.

ACCOUNTING AND AUDITING

International Financial Reporting Standard 9

IFRS 9 became effective for the financial years beginning on or after 1 January 2018. The PA continued to engage with banks on the implementation of IFRS 9 throughout 2018, gaining a deeper understanding of the methodologies applied for determining a significant increase in credit risk, the incorporation of forward-looking macroeconomic information, and the definition of 'default' and similar important concepts incorporated in the new accounting standard. The PA also closely monitored the impact of IFRS 9 on impairments and regulatory capital. In the period under review, the total impairments for banks on a solo basis increased by 35% on average on the date of adoption. All banks have remained adequately capitalised subsequent to the implementation of IFRS 9.

In terms of Directive 5 of 2017, banks were required to provide the PA with special-purpose financial information on the IFRS 9 opening adjustment, together with an audit opinion expressed in terms of the International Standard on Auditing 805 (Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement) within five months of the adoption of IFRS 9. In most cases, this information was duly received by the PA and did not raise any significant concerns with regard to the implementation of the standard.

The PA continues to monitor international developments with regard to IFRS 9 through its membership of the Accounting Experts Group, which is a subgroup of the BCBS dedicated to the accounting and auditing issues affecting banks.

PREPARATION FOR THE FINANCIAL ACTION TASK FORCE EVALUATION

As a member of the Financial Action Task Force (FATF), South Africa will be taking part in a Mutual Evaluation developed by the FATF to assess its technical compliance with the FATF Recommendations, and whether and to what extent its anti-money laundering and combating the financing of terrorism (AML/CFT) system is effective.

The FATF methodology comprises two components:

- a technical compliance assessment, which addresses the specific requirements of the FATF Recommendations, principally as they relate to the relevant legal and institutional framework of the country, and the powers and procedures of the competent authorities; and
- an effectiveness assessment, which seeks to assess the adequacy of the implementation of the FATF Recommendations. The effectiveness assessment is therefore aimed at determining the extent to which the legal and institutional framework is producing the expected results.

In early March 2019, the FATF visited South Africa to prepare the country for the assessment. The technical compliance assessment was a desktop exercise that started in March 2019 with South Africa having to complete a technical assistance questionnaire. This will be followed by an on-site assessment in October or November 2019. Assessors from the FATF, the International Monetary Fund (IMF) and the Eastern and Southern Africa Anti-money Laundering Group (ESAAMLG) will visit South Africa to interview various stakeholders, including the SARB, the FIC, the FSCA and the private sector (including banks and insurers).

THE PRUDENTIAL AUTHORITY'S REGULATORY FOCUS IN 2019/20

THE FINANCIAL SECTOR ASSESSMENT PROGRAMME 2020

The PA is due for a Financial Sector Assessment Programme review from the IMF and the World Bank in 2020. Planning has already commenced. At the time of drafting this report, the IMF and the World Bank were in the process of finalising the agenda of the discussion topics and a timeline for the mission.

THE FINANCIAL MARKETS ACT 19 OF 2012

The Joint Standard on Margin Requirements

On 8 April 2019, the PA and the FSCA published the revised Joint Standard on the margin requirements for non-centrally cleared over-the-counter (OTC) derivative transactions (Joint Standard on Margin Requirements) for a final round of public consultation. This Joint Standard is intended to incorporate the internationally agreed standard on margin requirements for non-centrally cleared OTC derivative transactions, as prepared by the BCBS and IOSCO, into the domestic regulatory landscape in order to mitigate the potential systemic risks from such transactions, and to reduce contagion and spillover effects to the South African financial system.

The intention of the PA and the FSCA is for the Joint Standard on Margin Requirements to be implemented on 1 September 2019.

Regulatory frameworks for market infrastructures

The PA and the FSCA are in the process of developing the required regulatory frameworks as contemplated in the FMA. These regulatory frameworks include the preparation of an equivalence framework to assess the equivalence of a foreign country's regulatory framework, the finalisation of application forms for new types of market infrastructures, and the determination of eligibility criteria for OTC derivative transactions to be mandated for central clearing. The FSCA has been designated as the responsible authority for the FMA, and the PA works closely with the FSCA in the development of the regulatory frameworks for market infrastructures in South Africa.

THE BANKS ACT 94 OF 1990

The PA continues to strive to ensure that the legal framework for the regulation and supervision of banks and banking groups in South Africa remains relevant and current. Ideally, the legal framework pertaining to banking regulation should reflect both local and international market developments, and should comply with applicable international regulatory and supervisory standards and best practice. The PA therefore reviews banking legislation on an ongoing basis, including the Banks Act, the Regulations issued in terms thereof, and other pieces of banking-related legislation. It then makes recommendations to the Minister of Finance to effect the necessary amendments, if any.

Amendments to the Banks Act 94 of 1990

The Financial Matters Amendment Bill was passed by Parliament on 28 March 2019 and has been submitted to the President of the Republic for assent. The Financial Matters Amendment Bill seeks to amend, among other things, the Banks Act to regard national state-owned companies as public companies for the purpose of the application of the Banks Act, and also to determine the qualifying prerequisites for these companies and their holding companies to apply for the establishment as a bank.

Amendments to the Regulations relating to Banks (Regulations)

As part of the internationally agreed regulatory reforms to promote the safety and soundness of the international financial system, the BCBS has issued various new and revised frameworks and requirements during recent years, including the so-called Basel III post-crisis regulatory reform package, for implementation by member jurisdictions.

During the past year, the PA held extensive discussions with all relevant key players regarding the implementation of relevant internationally agreed regulatory reforms in South Africa. On 29 November 2018, the PA issued Guidance Note 6 of 2018, which sets out the proposed implementation dates in respect of specified regulatory reforms over the next few years.

In order to ensure adequate engagement and that the potential impact, costs and benefits of the proposed regulations are duly considered and measured, the PA will in future issue a statement of expected impact together with the proposed amendments to the Regulations, along with an invitation for all interested persons to submit their comments.

On 14 December 2018, the PA issued a directive on the proposed amendments to the Regulations, inviting all interested persons to submit their comments on the proposed amendments to the Regulations to the PA by no later than 31 January 2019.

The proposed amendments to the Regulations that were issued for comment related primarily to the following key areas:

- incorporating into the Regulations all the substantive requirements relating to the revised Basel III net stable funding ratio framework, of which some components are currently contained in the Regulations while other components are currently contained in directives;
- removing from the Regulations all the detailed disclosure requirements currently specified in the Regulations, and consolidating all said disclosure requirements issued by the BCBS as part of the first and second phases of the revision to the Pillar 3 disclosure requirements into a single directive; and
- incorporating into the Regulations further relevant revised requirements related to corporate governance.

Subsequently, the PA reviewed the comments received from key interested parties and updated the proposed amendments to the Regulations accordingly. Once approved by the PruCo, the updated proposed amendments to the Regulations will be submitted to National Treasury and the Minister of Finance for consideration and approval.

During the first quarter of 2019, the PA also prepared a further set of proposed amendments to the Regulations with a proposed implementation date of 1 October 2019, primarily dealing with the following new and revised frameworks issued by the BCBS:

- a capital standard for bank exposures to CCPs;
- the standardised approach for measuring counterparty credit risk exposures; and
- capital requirements for banks' equity investments in funds.

During May 2019, the PA issued a directive related to the additional set of proposed amendments to the Regulations (with a proposed implementation date of 1 October 2019). The directive invited all interested persons to submit their comments on the proposed amendments to the Regulations to the PA by no later than 12 June 2019.

The PA continues to monitor the developments relating to G20 discussions as well as the press releases, publications and directives issued by the BCBS and the Financial Stability Board, in order to identify further areas that may necessitate amendments and/or refinements to the Regulations.

THE MUTUAL BANKS ACT 124 OF 1993

During the financial year under review, the PA commenced with identifying the challenges being experienced under the current mutual banks framework, as well as the best approach to make supervision more relevant to the current ownership structures of mutual banks. The PA subsequently drafted a policy note highlighting the challenges and limitations of the current mutual banks legislative framework, with proposed recommendations for addressing these. This policy note is being finalised internally and will ultimately be submitted to National Treasury for consideration.

THE INSURANCE ACT 18 OF 2017

Audit Standards

The PA has prescribed that, in terms of section 47 read with section 44 of the Insurance Act, an insurer must have the information submitted to the PA for supervisory purposes to be audited every year. Consequently, the PA is currently drafting Prudential Standards that will prescribe the auditing requirements for the Quantitative Reporting Templates (QRTs) submitted to the PA for supervisory purposes.

Five Prudential Standards will be issued, one for each category of insurance firms, namely solo insurers, insurance groups, branches of foreign reinsurers, micro-insurers and Lloyd's South Africa. These Prudential Standards will be referenced to audit reports that will be issued by the Independent Regulatory Board for Auditors (IRBA). The PA is working closely with the IRBA, the audit profession and the insurance industry to develop these Prudential Standards on Auditing and the audit reports relating to QRTs.

Public Disclosure Standards

The PA will be issuing a Prudential Standard on Auditing and Public Disclosures for public consultation in due course.

Cell Captive Governance Standards

The PA has commenced with policy and regulatory work on cell captives, in collaboration with the FSCA. Industry consultation has also commenced in order to shape appropriate policy and regulatory positions for South Africa.

Solvency Assessment and Management Phase II and guidance to be issued in terms of the Financial Soundness Standards

When the Insurance Act and the associated Prudential Standards were promulgated, certain aspects of the SAM framework were identified as requiring further policy development, given that these aspects had not been completed and had not been incorporated by the time the legislative framework was finalised. These include guidance notes to clarify and aid with the interpretation of the Financial Soundness Standards, and further research that may result in possible amendments to these standards. During the year under review, the PA commenced with the roll-out of the next phase of SAM by prioritising these aspects in collaboration with stakeholders in the industry to facilitate the implementation of the next phase.

INTERNATIONAL DEVELOPMENTS

KEY INTERNATIONAL DEVELOPMENTS, RECOMMENDATIONS AND FOCUS AREAS

Fundamental review of the trading book

In January 2016, the Basel Committee on Banking Supervision (BCBS) published the revised standard on 'Minimum capital requirements for market risk', also known as the fundamental review of the trading book. The revised Market Risk Framework specified stricter criteria for assigning instruments to the trading book, overhauled the internal models approach to better address the risks observed during the crisis, reinforced the approval processes for the use of internal models, and introduced a new risk-sensitive standardised approach. In the course of monitoring the implementation and expected impact of the standard, the BCBS identified a number of issues that needed to be addressed prior to its implementation. In December 2017, the Governors and Heads of Supervision (GHOS) announced an extension of the standard's implementation from the original 1 January 2019 deadline to 1 January 2022.

Subsequently, in March 2018, the BCBS published a consultative document to propose improvements to the standard in an effort to address the issues it had identified and to propose a simplified alternative to the standardised approach for banks with smaller or simpler trading activities. Having considered the responses to the consultative document, in November 2018 the BCBS agreed on a set of revisions to the Market Risk Framework in the Minimum Capital Requirements Standard for Market Risk, which was endorsed by the GHOS in January 2019.

In 2018, the Prudential Authority (PA) undertook various supervisory initiatives to assess the progress made by banks in preparation for the upcoming reform. Engagements with industry regarding different aspects of the standard occurred through industry interactions facilitated by the Banking Association South Africa (BASA). The capital impact of the standard was also monitored through quantitative impact studies. The PA will continue its supervisory efforts with banks in their efforts to be ready for implementation in 2022.

Basel III: Large Exposure Framework[5]

In April 2014, the BCBS issued a paper titled 'Supervisory framework for monitoring and controlling large exposures' (Large Exposures Framework). In order to assess and ascertain the potential impact of implementing the BCBS framework for the large exposures in South Africa on banks, information was gathered from banks, both on a solo and on a consolidated basis. This information will assist in determining how the Large Exposures Framework should be incorporated into South Africa's domestic legislation.

As per Guidance Note 6 of 2018 issued by the PA, the proposed implementation date for the Large Exposures Framework in South Africa is 1 April 2020.

Basel III: Revisions to the Securitisation Framework[6]

In December 2014 (revised in July 2016), the BCBS issued a paper titled 'Revisions to the Securitisation Framework' (revised Securitisation Framework). The revised Securitisation Framework includes the alternative capital treatment for 'simple, transparent and comparable' (STC) securitisations. The BCBS, together with the International Organization of Securities Commissions (IOSCO), issued the criteria for identifying STC securitisations in July 2015.

In order to assess and ascertain the potential impact of implementing the revised Securitisation Framework in South Africa, the PA began the process of gathering the pertinent information from banks. This information will assist the PA in determining how the revised Securitisation Framework should be incorporated into South Africa's domestic legislation.

As per Guidance Note 6 of 2018 issued by the PA, the proposed implementation date for the revised Securitisation Framework in South Africa is 1 April 2020.

The PA also began the process of drafting proposed revisions to the Regulations relating to Banks to take into account the revised Securitisation Framework.

5 *https://www.bis.org/publ/bcbs283.pdf*

6 *https://www.bis.org/bcbs/publ/d374.pdf and https://www.bis.org/bcbs/publ/d332.htm*

Capital requirements for bank exposures to central counterparties

A central counterparty (CCP) refers to a clearing house which interposes itself between counterparties to contracts traded in one or more financial markets. In essence, the CCP becomes the buyer to every seller and the seller to every buyer, thereby ensuring the future performance of open contracts. The BCBS's framework for the capital treatment of bank exposures to central counterparties (BE-CCPs) relies on the release of the Principles for Financial Market Infrastructures by the IOSCO and the Committee on Payment and Settlement Systems to enhance the robustness of CCPs and other essential infrastructures that support global financial markets. The framework is aimed at supporting the broader policy efforts advanced by the Group of Twenty (G20) leaders and the Financial Stability Board, particularly those relating to the central clearing of standardised over-the-counter (OTC) derivative contracts.

Capital requirements for equity investments in funds

The Financial Stability Board has undertaken efforts to strengthen the oversight and regulation of shadow banking, and agreed to review the risk-based capital requirements for banks' exposures to equity investments in funds (CREIF). The proposed framework consists of three approaches, each with varying sensitivity. Banks have a choice between the 'look-through approach', the 'mandate-based approach' and the 'fall-back approach'. The degree of conservatism increases with each successive approach. The intention is to ensure that banks have appropriate incentives to enhance their risk management.

Standardised approach to counterparty credit risk

The standardised approach to counterparty credit risk (SA-CCR) is a measurement of counterparty credit risk that calculates the exposure at default of derivatives and long-settlement transactions. The intention of the SA-CCR is to be a risk-sensitive methodology that differentiates between margined and non-margined trades, and recognises netting benefits. The SA-CCR will apply to OTC derivatives, exchange-traded derivatives and long-settlement transactions. The SA-CCR is a direct replacement of the current counterparty credit risk framework.

It is intended that the BE-CCP, the CREIF and the SA-CCR be implemented on 1 October 2019. Engagements with banks have been conducted through specific on-site and off-site interactions. In addition, banks continue to be engaged in public forums such as industry meetings at BASA.

The International Association of Insurance Supervisors Common Framework for the Supervision of Internationally Active Insurance Groups

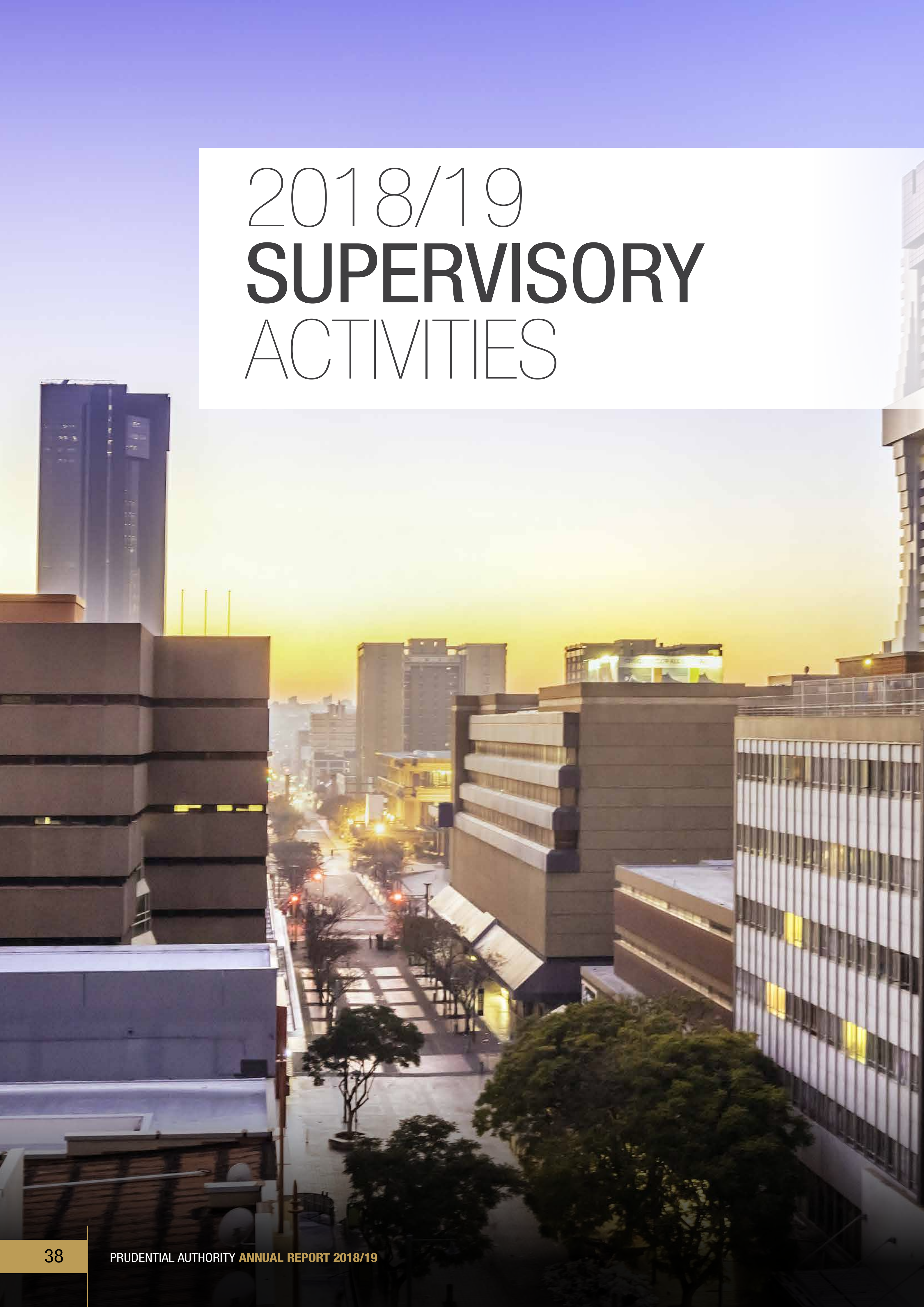
The International Association of Insurance Supervisors (IAIS) is a voluntary membership organisation of insurance supervisors and regulators from more than 200 jurisdictions. Its mission is to promote the effective and globally consistent supervision of the insurance industry. The IAIS is the international standard-setting body responsible for developing principles, standards and other supporting material for the supervision of the insurance sector, and coordinates its work with other international financial policymakers and associations of supervisors.

In response to the increasing globalisation in the insurance sector as well as the key lessons learned from the most recent global financial crisis, the IAIS issued the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), which establishes supervisory standards focusing on the effective group-wide supervision of internationally active insurance groups (IAIGs).

The ComFrame provides quantitative and qualitative supervisory requirements tailored to the international activity and size of IAIGs. It seeks to assist supervisors in addressing group-wide activities and risks, identifying and avoiding supervisory gaps, and coordinating supervisory activities effectively and efficiently between the group-wide and other involved supervisors.
The ComFrame also aims to provide a basis for comparing IAIG supervision across jurisdictions. However, it does not create a one-size-fits-all approach to IAIG supervision.

As part of the ComFrame, the IAIS is developing a risk-based global insurance capital standard (ICS), which will be used during a five-year monitoring period from 2020 for confidential reporting to group-wide supervisors and for discussion in supervisory colleges. The ICS will not be used as a group-wide prescribed capital requirement (PCR) during the monitoring period but, in the second phase of the implementation of the ICS, the ICS will be implemented as a group-wide PCR.

2018/19 SUPERVISORY ACTIVITIES



OVERVIEW OF SUPERVISORY ACTIVITIES

Ongoing supervision comprises various tools that are used by the Prudential Authority (PA) for prudential supervision. The 2018/19 prudential activities for each financial institution were based on a supervisory plan informed by the PA supervisory priorities, risk assessments, consideration of emerging themes, and trends within the regulated industries. The PA executed on this plan by holding prudential meetings with boards of directors and board subcommittee members, executive management, heads of control functions, and the auditors of the regulated financial institutions.

Other activities included both on-site prudential interventions as well as off-site analysis of data relating to the registered entities (as reported under the section 'Review of 2018/19'). The frontline teams serve as the first point of contact into the PA and are responsible for maintaining the relationships with supervised entities.

Over and above these activities, particular supervisory emphasis was placed on the banking sector, where ‘auditor independence’ and ‘low default portfolios’ (the latter being covered under the paragraph 'Risk reviews – Credit risk') were identified as ‘flavour of the year’ topics.

BANKS

Auditor independence

Section 64(2) of the Banks Act 94 of 1990 and sections 94(7) and 94(8) of the Companies Act 71 of 2008 (Companies Act) stipulate that a bank’s Audit Committee is required to ensure that the appointed auditors remain independent. The matter of auditor independence is also specifically addressed in various papers issued by the Basel Committee on Banking Supervision (BCBS), which cover matters related to auditors and the audit committees of banks, specifically the BCBS guidance on external audits of banks' released during March 2014 and the 'corporate governance principles for banks' published in July 2015.

High levels of audit quality, enhanced by auditor independence, are important prerequisites to sound reporting and oversight, and are crucial in assisting the prudential regulator in fulfilling its mission to promote the safety and soundness of the domestic financial system in the interest of financial stability.

Furthermore, in light of the increased focus being placed on auditors and the audit profession in recent months, the PA continued to monitor developments pertaining to the strengthening of auditor independence and the quality of audits as a key responsibility of the audit committee of a bank, to ensure that the requirements surrounding auditor independence and quality of the external audit are met.

Auditor independence and audit quality were therefore chosen as a flavour-of-the-year topic for 2018, and audit committees were asked to present on this topic during the PA’s meetings with banks’ boards of directors.

In general, the presentations made by banks’ audit committees showed a high level of awareness with regard to auditor independence and audit quality. In particular, the provision of non-audit services by external auditors was, in most cases, well monitored with policies in place that limit the auditors’ revenue from non-audit services. Compliance with section 90(2) of the Companies Act with regard to independence requirements was also receiving satisfactory attention by audit committees. Where deficiencies were noted, these were communicated to the banks concerned, and the PA will continue to monitor progress in that regard. Overall, the PA was satisfied that audit committees understand the need for auditor independence in positively contributing towards quality audits of their organisations, as well as the need to closely monitor the work of external auditors to ensure a robust audit process.

INSURERS

Progressive compliance with the Insurance Act 18 of 2017

Insurers who on 1 July 2018 did not comply with the financial soundness requirements published in respect of the Insurance Act 18 of 2017 (Insurance Act) had to submit to the PA a scheme or a strategy to address their solvency shortcomings. The PA engaged a number of insurers in this regard, with various actions still under consideration.

Process for the conversion of registrations under the Long-term Insurance Act 52 of 1998 and the Short-term Insurance Act 53 of 1998 to licences under the Insurance Act 18 of 2017

Schedule 3 to the Insurance Act provides for transitional arrangements to facilitate its implementation, and also provides for the following:

- Every previously registered insurer that was, immediately before the effective date of the Insurance Act, registered as a long-term insurer or a short-term insurer under the Long-term Insurance Act 52 of 1998 or the Short-term Insurance Act 53 of 1998 respectively shall continue to exist as an insurer, as if they had been licensed under the Insurance Act. They may continue to conduct the insurance business for which they had been registered until their registration is converted to a licence under the Insurance Act, subject to and in accordance with the governance, financial soundness, security, reporting and public disclosure obligations imposed under the Insurance Act.
- The PA must, within a period of two years from the effective date, convert the registration of all previously registered insurers to a licence in accordance with the Insurance Act. The process must be reasonable and fair, allow for sufficient engagement with previously registered insurers, and include the requirement that the insurers demonstrate that they have a plan to meet their stated commitments in terms of transformation of the insurance sector.

During the period under review, the governance structures and related processes for the conversion of registrations into licences were established. Insurers were invited to participate in two of the three phases to enter the conversion process.

Phase 1 (1 July 2018 to 1 January 2019):

Conversion of the registrations of dormant insurers and insurers who want to become micro-insurers or cell captive insurers. A number of insurers submitted their conversion information during Phase 1, with one insurer engaged as part of a PA supervisory visit.

Phase 2 (1 January 2019 to 1 October 2019):

Conversion of the registrations of captive insurers, insurers conducting only reinsurance, and insurers conducting only linked insurance business. A number of insurers submitted their conversion information during Phase 2.

Phase 3 (1 October 2019 to 31 July 2020):

Conversion of the registrations other than those referred to in phases 1 and 2 above.

Designation of insurance groups and controlling companies

The Insurance Act empowers the PA to designate insurance groups and to license controlling companies. The PA may designate a person as an insurer. The PA may also designate a juristic person that is part of a group of companies and a person that is related to this juristic person as an insurance group.

During the period under consideration, the internal processes, procedures and governance for the designation of insurance groups were established.

The PA is in the process of designating insurance groups and, in the period under review, exempted all the pure captive insurers conducting first-party business from the requirements of insurance group supervision. The PA also designated three insurance groups. Concurrence is necessary from the Financial Sector Conduct Authority (FSCA) on all exemptions, as per the memorandum of understanding.

For the full list of group designations, please refer to the appendices.

FINANCIAL MARKET INFRASTRUCTURES

The Financial Market Infrastructure Division within the PA is responsible for the prudential regulation and supervision of the securities and derivatives market infrastructures, as defined in the Financial Sector Regulation Act 9 of 2017 (FSR Act). The PA's market infrastructure supervisory scope was driven by the nature of the market infrastructures within the South African landscape and the relevance of their risk profiles in line with the PA's prudential mandate. In the interest of the safety and soundness of the financial system, as outlined in the FSR Act, the PA and the FSCA require varying degrees of oversight over all the market infrastructures in order to be satisfied that the market infrastructures meet their prudential requirements. The coordinated effort of the PA and the FSCA has structured each licensed market infrastructure's ongoing supervision into risk-based and forward-looking supervisory planning, execution, reporting and follow-up phases.

During this financial year, the market infrastructure supervisory framework was finalised in consultation with the FSCA by distinguishing between the PA's prudential responsibilities and the FSCA's conduct supervision over the same regulated market infrastructures. In terms of its supervisory programme, the PA began conducting supervisory meetings with market infrastructures relating to their individual financial landscape, internal audit, compliance, liquidity risk, counterparty credit risk, market risk, credit risk, capital, operational risk and information technology (IT) risk profiles.

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

Banking and insurance sectors' readiness for the implementation of the Financial Intelligence Centre Amendment Act 1 of 2017

The PA issued a formal communiqué to the banking and insurance sectors following the promulgation of the Financial Intelligence Centre Amendment Act 1 of 2017 (FIC Amendment Act) on 26 April 2017 and published it in the *Government Gazette* on 2 May 2017, which brought the amendments into effect. The purpose of the correspondence to the accountable institutions (AIs) supervised by the PA was to communicate the transition period until 2 April 2019 for the AIs to align procedures, policies and systems, and to train employees to ensure that the AIs fully implement the provisions of the Financial Intelligence Centre Act 38 of 2001, as amended (FIC Act). The AIs were further requested to provide quarterly reports on their progress in implementing the amended FIC Act provisions, which they subsequently did in their final progress reports on 31 March 2019.

On-site inspections

The PA follows a money laundering/terrorism financing (ML/TF) risk-based approach (RBA) to determine which banks or insurers to inspect during a year. Anti-money laundering/combating the financing of terrorism (AML/CFT) on-site inspections were conducted in terms of section 45B of the FIC Act.

The most pertinent findings arising from the on-site inspections conducted during 2018 indicated that financial institutions required an enhanced focus on, and enhanced controls to be able to comply with, the FIC Act. This applied to various areas, but in particular to the following:

01 The documentation and implementation of client identification and verification (CIV) and record-keeping procedures

02 The implementation of efficient working methods for detecting and investigating suspicious and unusual transactions

03 The implementation of effective controls for identifying and reporting cash threshold transactions, suspicious and unusual transactions, and property associated with terrorism and related activities

The PA also assessed banks' adopted AML/CFT RBAs due to the changes in legislation, including their treatment of high-risk customers such as politically exposed persons in line with the Financial Action Task Force. Recommendations, over and above testing banks' compliance with the FIC Act.

The table below reflects the details of the inspections conducted and also provides a comparison of the inspections conducted in 2017 and 2018.

On-site inspections

Size	2017	2018
Large banks	0	1
Small banks	6	4
Foreign subsidiaries	2	1
Total	**8**	**6**

CONSOLIDATED SUPERVISION

The PA's consolidated supervision is a comprehensive approach to evaluate the strength of an entire group. It considers all the risks that may affect a bank, regardless of whether these risks are booked in the bank or in affiliated entities.

In the period under review, the PA conducted supervisory colleges with identified banks and insurance companies in order to enable them to interact with one of their regulators. This provided a platform for understanding each financial institution and the entities within its group structure, its governance frameworks and how it supports the group strategy (setting and execution thereof), and its business models. The discussions also provided grounds for sharing knowledge, clarifying supervisory expectations, engaging on supervisory issues, and addressing the challenges and emerging risks being experienced among regulators.

Supervisory colleges not only place the PA's focus on current issues or challenges, but also expand the supervisory lens to pre-empt future events. This, in turn, enables the PA to hold more specific engagements with the regulated institutions, which assists them in keeping abreast of current events and developing more responsive risk management practices.

RECOVERY PLANNING

During 2018, the PA and the Resolution Planning Division of the Financial Stability Department (FinStab) continued prior years' working sessions with banks to identify and address gaps in banks' recovery plans. Furthermore, focus was also placed on offshore entities' recovery plans.

Work is underway to strengthen the resolution framework for the South African market. The framework will apply to all banks, non-bank systemically important financial institutions and their holding companies. The provisions within the framework will give effect to the policy proposals contained in the 2015 discussion paper titled 'Strengthening South Africa's resolution framework for financial institutions', and will also be worked into the amendments to the FSR Act.

To this end, the Financial Sector Laws Amendment Bill (Bill), setting out the legal provisions for the envisaged resolution framework, was published in September 2018. In terms of the Bill, the South African Reserve Bank (SARB) will be designated as the resolution authority, with the Governor ultimately responsible for its functions. The amendments are aimed at strengthening the ability of the SARB to manage an orderly resolution of a failing financial institution while working together with the PA in ensuring that depositor funds are protected.

RISK REVIEWS

Credit risk

The macroeconomic environment continues to contribute to increasing consumer pressure, leading to reduced disposable income. With household debt remaining persistently high and consumers' reduced ability to service debt commitments, impaired advances have continued to grow. The implementation of International Financial Reporting Standard (IFRS) 9 has further increased these levels as a result of the increase in specific impairments for both corporate and retail exposures.

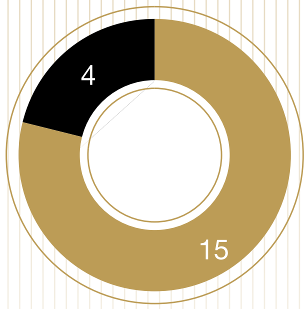
Under the regulatory framework employed in South Africa, banks can choose from the following three methodologies to calculate their minimum required regulatory capital relating to credit risk:

- the standardised approach (STA), including the simplified STA;
- the foundation internal ratings-based (FIRB) approach; and
- the advanced internal ratings-based (AIRB) approach.

The number of banks registered in South Africa, using each of the aforementioned approaches, is depicted on the right. In the period under review, none of the banks used the FIRB approach.

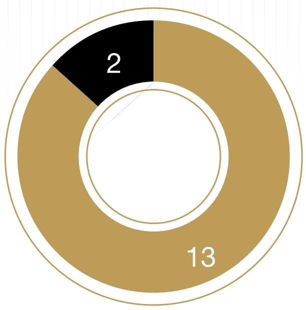
Reporting methods applied by banks as at 31 December 2018

South African-registered banks



STA
AIRB

Foreign branches



STA
AIRB

Internal ratings-based approach application

A bank that intended seeking approval for the use of the internal ratings-based (IRB) approach lodged its application with the PA during 2016. The application was assessed against a clearly laid-out and comprehensive set of criteria, which included the ability and capacity of the particular bank to adopt and implement the targeted approach soundly, effectively and efficiently.

Since the implementation of Basel II in 2008, insight into the IRB framework has deepened and the supervisory approach has evolved. This IRB application benefited from more than 10 years of institutional experience. Accordingly, the detailed and robust review process has evolved into three main stages:

Stage 1 included an off-site documentation review to better understand the modelling approaches, the data inputs, the validation results and the governance processes followed to approve the models assessing the effective challenge by independent committees through the governance process, right up to the board-designated committee.

Stage 2 included on-site meetings with the objective of performing verification work in establishing the nature and extent of compliance with the minimum IRB requirements. This entailed detailed walk-throughs comprising end-to-end demonstrations of the development and validation processes as well as demonstrations using actual client-level information of the recovery default flagging and recovery procedures followed for clients. In addition to in-depth technical reviews of banks' models, senior management's understanding and use of the models in the banks' business were also viewed as paramount to IRB approval.

Stage 3 included additional off-site analytical work of requested development datasets for all the models to independently replicate and re-enact some of the key features of the models. This gave the PA comfort on the accuracy of the information included in the model documentation, but also an independent view of the soundness of the models. While ensuring that the transition in the reporting format did not create disruptions or adversely impact on data quality, the review also focused on the switch-over process by analysing six months' parallel reporting.

The PA's views and recommendations regarding the IRB application were assessed during February 2019 by the PA's internal review panel. Approval was granted to the bank to calculate its minimum capital requirements in respect of credit risk for the retail portfolios using the AIRB approach and for the wholesale business using the FIRB approach as from April 2019.

Model changes

During 2018, the PA received 22 notifications of non-material changes and 9 submissions of material changes to banks' IRB rating systems. The PA continued to follow a robust review and approval process, as highlighted in the *2013 Bank Supervision Department (BSD) Annual Report*.

Low default portfolio thematic review

The implementation of the IRB approach in South Africa has brought significant benefits to the banking sector. Apart from introducing a risk-sensitive approach for calculating capital requirements, it has also encouraged the implementation of more sophisticated internal risk management practices in banks. In no small measure, this has contributed to the overall stability and soundness of the banking sector.

Despite the many benefits, implementation challenges have been evident over the years. The pertinent questions that these challenges raise are about the credibility and reliability of the credit risk models supporting the implementation of banks' IRB approach. While the principles-based approach of the IRB framework has made for flexible and less prescriptive capital requirements calculations, this seems to have come with the costs of inconsistent and incomparable capital ratios.

As highlighted in the *2017 BSD Annual Report*, the PA conducted the probability of default and loss given default benchmarking exercise in 2012 and 2018 to assess the extent of the variability of risk-weighted assets (RWAs) among AIRB banks. The 2018 exercise revealed that, even for a similar set of entities, banks assign vastly different risk-parameter estimates, which in turn affect RWAs and capital requirements, and hence reveal more the diverse modelling and rating practices in the sector and less the credit risk inherent to these entities.

These inconsistencies and incomparability point to two main possible causes:

01 Banks interpret the IRB requirements differently, which then translates to their models and in turn produces variances in results.

02 A key ingredient for developing robust IRB models is the availability of reliable historical default and loss data, which are not always internally available, particularly for the majority of wholesale portfolios. This, in turn, results in subjective or expert judgement-driven methodologies and reliance on external data sources with little or no relevance to internal portfolio risk dynamics.

It is against this background that the PA undertook a review of selected wholesale portfolios in the second half of 2018. The review was specifically targeted at those portfolios regarded as low default, in that they generally exhibit few default and loss events and in turn challenge the development of robust IRB models. It was also an exercise to gather evidence of the industry's modelling practices and the challenges experienced by banks in this regard, with a view to developing appropriate policy interventions to address the inconsistencies in RWA and capital calculations.

Market risk

The year 2018 could be characterised as a year of two halves, with geopolitical factors as the main driver. The United States (US) and China imposed trade tariffs on each other, which raised concerns of a global growth slowdown. The local market cheered for the new President of South Africa, coining the term 'Ramaphoria'. The rallying call ignored the global geopolitical tensions and helped South Africa avoid a downgrade by ratings agency, Moody's[7], which opted to change the country's outlook from negative to stable.

The other half of the year saw the euphoria slowly dissipate as the true state of the economy was unveiled. The economy fell into a technical recession and took a backseat to global geopolitical tensions. A crisis in Turkey led to an emerging market rout, with the rand weakening by 8.5% against the US dollar in one week.

These topical issues were factored into discussions with banks at their scheduled supervisory meetings.

Methodologies to calculate the minimum required regulatory capital relating to market risk

Under the regulatory framework employed in South Africa, banks can choose from the following two methodologies to calculate their minimum required regulatory capital relating to market risk:

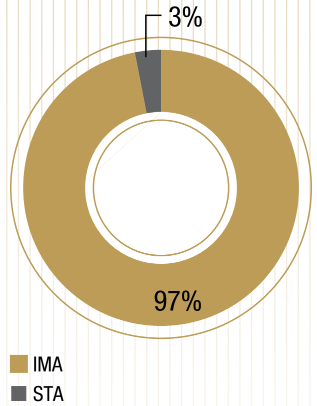
- the STA; and
- the internal models approach (IMA).

The risk-weighted exposure for the above-mentioned two approaches, in addition to the proportion of banks per approach, is depicted on the right.

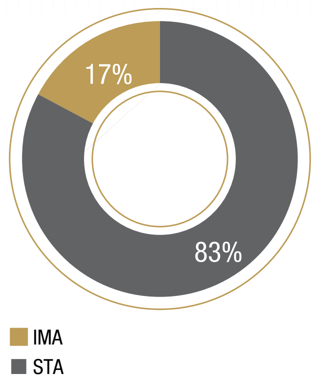
7 *Moody's Corporation being the parent company to Moody's Investors Service Incorporated and Moody's Analytics Incorporated*

Market risk methodologies applied by banks as at 31 December 2018

Risk-weighted exposure per regulatory approach



Number of banks per regulatory approach



Market risk reviews

The PA performed both compliance-based and risk-focused supervision of market risk, counterparty credit risk and equity risk in the banking book during the period under review. The market risk and counterparty credit risk reviews conducted in 2018 focused on banks using the IMA. Equity risk in the banking book reviews were mainly focused on the larger South African banks.

Key findings

Market liquidity varied with market uncertainty, making it difficult for banks to find direction during the period under review. The trend is expected to continue going forward. This has resulted in banks applying a conservative approach to the amount of risk being brought onto their books, relying on client flow for revenue. The emerging market contagion, which has resulted in the sell-off of riskier assets, has posed challenges for those banks that experienced increased difficulties in setting strategies.

Operational and information technology risk

Operational risk

Operational risk and IT risk continued to be of material concern nationally and internationally. Fraud and improper business conduct incidents were the main contributors to the global operational risk incidents experienced during the year. Domestically, the frequency of industry-wide operational risk losses decreased while the severity increased marginally. The leading bank gross operational risk losses that occurred locally related mostly to execution and process errors.

Investment in digital products and services, both globally and locally, continues to grow in line with the rapid technological innovation and the unrelenting sophistication of cyberattacks.

Regulatory change, increased industry competition, lower profitability and cyber-risks were top concerns on the international insurance scene, while digital and cyber-risk topped the agenda in the South African context as exposure to these risks gets exacerbated by the extensive use of outsourcing arrangements.

Methodologies to calculate the minimum required regulatory capital relating to operational risk

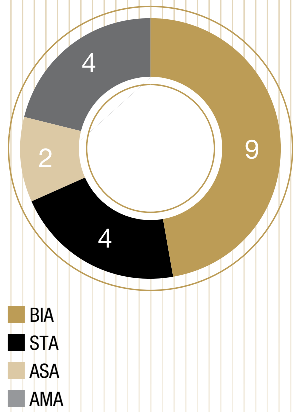
The current regulatory framework in South Africa allows registered banks to select from the following four methodologies to calculate their minimum required regulatory capital relating to operational risk:

- the basic indicator approach (BIA);
- the STA;
- the alternative standardised approach (ASA); and
- the advanced measurement approach (AMA).

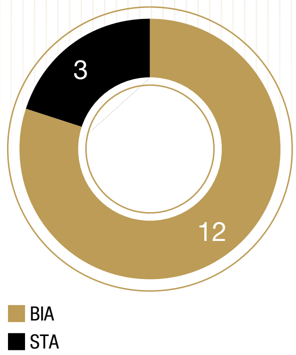
The 34 registered banks, using each of the aforementioned approaches, is depicted on the right.

Operational risk calculation methods used by South African-registered banks and branches of foreign banks

South African-registered banks



Branches of foreign banks



In addition to the banking regulatory framework, the Insurance Act makes provision for insurance entities to also utilise specific approaches to calculate their regulatory operational risk capital.

Insurance entities licensed under the Insurance Act, other than micro-insurers, Lloyd's South Africa and the branches of foreign reinsurers, are required to calculate the regulatory capital requirement relating to operational risk using the standardised formula or the internal model to determine the solvency capital requirement.

All the registered insurance entities have adopted the standardised formula.

Operational risk reviews

The PA performed focused operational risk reviews at selected banks during the period under review. The scope of the reviews extended to a selected few insurance entities and market infrastructures to gather an understanding of the landscape.

Topics from an operational risk banking perspective included strategic objectives, governance structures, human resources, IT systems used, and frameworks and policies. The discussions included outsourcing and top operational risks. Risk and control self-assessments (RCSAs), key risk indicators (KRIs) and internal loss data within the corporate business units were included as additional themes that received attention.

The key findings were:

- **Operational risk governance structures, human resources, frameworks and policies:** Banks continued to maintain sound governance structures by taking conscious risk approaches that allowed them to take decisions that were agile and aligned to their respective risk strategy and risk appetite. Data-enabled risk management tools were utilised for risk analysis and insight to enhance processes within banks. Furthermore, banks have been exploring and assessing the impact of innovation and emerging technologies on their operations.

  The PA has been concerned about the practice of 'co-mingling' in the first and second lines of defence, which was being addressed. Banks were cautioned against this practice as it would have an impact on the independence of the oversight functions.

- **Outsourcing:** Banks provided an overview of their IT- and non-IT-related material outsourcing and how they managed and monitored external service providers and critical third-party arrangements. Banks were advised to stay abreast of the risks that could arise from subcontracting arrangements and to monitor such exposure, if any should arise.

  The PA observed that banks experienced challenges with the management of third-party service providers. However, banks indicated that appropriate governance structures had been put in place to manage and mitigate the risks identified.

- **Overview of RCSAs and KRIs:** Banks provided an explanation for the management and monitoring of RCSAs as well as the KRI process. Banks indicated that the process included an independent analysis and challenge by the second line of defence.

  The PA was, however, concerned about the level of involvement of the lines of defence in the development and completion of RCSAs within some of the banks. These banks were cautioned against this practice as it would impact the independence of the levels of defence.

- **Internal loss data:** Banks provided a high-level overview of the internal loss data process. Discussions covered the data collection thresholds, reconciliations, boundary events, material incidents as well as review, verification and validation. The banking industry had experienced a slight increase in the gross loss amount for the period under review, with the inverse observed for the number of losses.

- **Top operational risks:** Banks indicated that the top operational risks for 2018 identified internationally had also applied to their environment. In addition, banks highlighted that the top business risks identified within their organisations were similarly aligned. These risks were closely monitored and reported to relevant committees.

  The PA confirmed that short- and medium-term operational risk supervisory programmes would include a focus on strengthening the supervision of insurances entities and market infrastructures.

Information technology risk

With the wider scope of supervising insurance entities and market infrastructures, the PA's immediate strategy was to comprehend these entities' landscapes. A cloud exposure questionnaire was issued to insurance entities to gain better insight into their use of the cloud platform.

The PA continued to collaborate and cooperate with the SARB's fintech programme with regard to its engagement model, areas of interest and expectations. The key focus areas were divided into three pillars, namely crypto-assets, innovation facilitators, and data collection work streams.

The PA further maintained its membership at the Operational Risk Subcommittee of the Financial Sector Contingency Forum, where various aspects of a systemic nature were discussed, including the drive to create cyber-structures in the industry. The PA is also an observer at the Information Technology Risk Task Group (ITRTG), established under the auspices of the Banking Association South Africa (BASA). The aim of the ITRTG is to promote, coordinate and drive initiatives that enhance the legislative framework in the field of IT and IT risk. Membership of international bodies, such as the Operational Resilience Group and the Information Technology Supervisors Group, has assisted the PA in aligning its views on global IT supervisory practices and experiences to the local environment.

The short- and medium-term IT supervisory programmes will focus on bolstering the supervision of insurance entities and market infrastructures. In addition, the PA will remain involved in both local and international initiatives to supervise and provide guidance on IT risk in the financial services sector. The PA has continued to collaborate with the banking industry with regard to the establishment of a reporting process for material IT and cyber-incidents.

Information technology risk reviews

Various focused IT risk on-site visits were conducted at banks, with fewer interactions at insurance entities and market infrastructures at this stage. Topics included strategic objectives, governance structures and human resources, as before. Information security and cybercrime, operational resilience, projects as well as emerging technologies were additionally incorporated.

The summary of the key findings from these reviews was as follows:

- Deficiencies in user access and identity management have remained a concern across the banking industry and continued to receive focused attention.
- There is a lack of adequate cybersecurity skills, both locally and internationally.
- Most of the supervised insurance entities have deployed an outsourced service model.
- Similarly to the banking industry, the management of outsourced and third-party service providers has remained a concern.
- The second line of defence still seemed inadequate across the banking industry. Some of the banks were, however, strengthening their governance models and tailoring them to their operations, and enforcing adequate segregation of duties.
- Most of the supervised entities were transitioning to an agile projects management framework.
- Some banks had conducted proofs of concept for emerging technologies, (i.e. Big Data, machine learning, blockchain, robotics and digitisation).

The PA will continue to monitor the control environment within supervised entities to ensure that appropriate and sufficient action is taken to minimise control failures.

Risk data aggregation and risk reporting

The risk data aggregation and risk reporting principles (RDARR Principles) were introduced to strengthen banks' risk data aggregation capabilities and internal risk reporting practices.

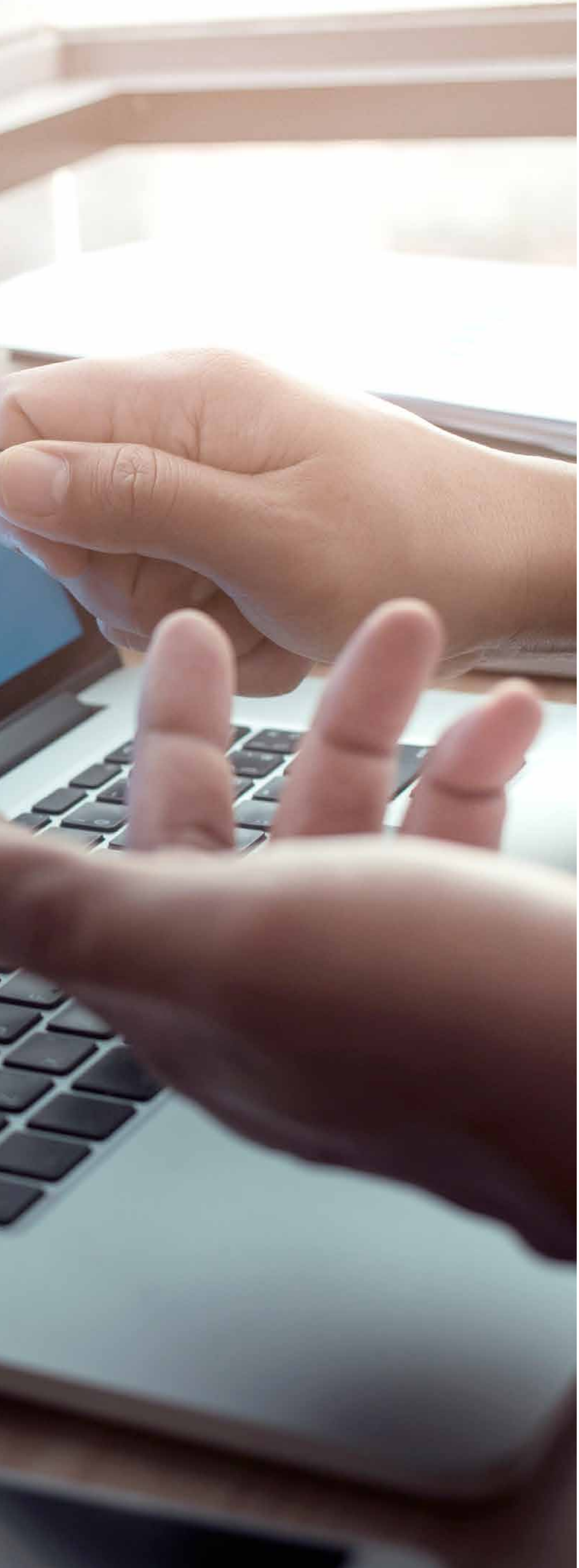
The PA has maintained interactions with banks and will continue to do so until all banks are fully compliant with all the RDARR Principles in line with the roadmaps received, which will in some cases last until 2021 and 2022. Use tests were introduced during the year under review, with some banks able to demonstrate implementation thus far.

Even though most of the banks in South Africa appear to be taking the requirements very seriously, the industry findings and challenges include the following:

- Frameworks, policies and procedures are either incomplete or not comprehensive enough.
- Roles, responsibilities, ownership, monitoring and escalation channels relating to data quality management issues are not yet clarified.
- Data governance structures are either incomplete or in the process of being finalised.
- Data architecture is still fragmented and lacks an authoritative source for specific data.
- There is heavy reliance on manual processes (especially in the smaller banks).
- There is scarcity of resources and key-staff dependency.
- Consideration of the RDARR Principles under stress periods was still in the process of being developed.

Asset and liability management risk

Asset and liability management (ALM) is the administration of policies and procedures that address the financial risks associated with changing interest rates and other factors that can affect a financial institution's liquidity. ALM seeks to limit the risk to financial institutions to acceptable levels in accordance with the PA's supervisory review process, by monitoring and addressing the risk created by a mismatch between their assets and liabilities.



BANKS

During the year under review, the PA evaluated the adequacy of banks' liquidity position against the implementation of the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). As part of this process, the PA addressed various LCR and NSFR design issues as well as interpretation and implementation challenges across the banking industry. The PA was also involved in the review of banks' recovery and contingency plans to assess the ability of banks to manage stress events due to market forces.

The PA continued to participate in planned liquidity risk simulation exercises at banks. These exercises were facilitated by an independent external party to assess the adequacy and effectiveness of banks' liquidity buffer to extreme but plausible market events. The key message from these liquidity risk simulation exercises was the notion that liquidity risk is a consequential risk – the proximate cause of a failure. Banks should therefore manage their liquidity risk position from an enterprise-wide perspective.

According to the Basel Core Principles, a supervisor is required to determine that banks have in place certain minimum standards. During this period, the PA conducted several reviews covering both the major banks and smaller individual banks to evaluate their current risk management practices. This was achieved through a questionnaire sent to the institutions requesting information on their policies, procedures and internal controls relating to funding, liquidity risk and interest rate risk in the banking book (IRRBB), and then by engaging with these institutions in focused discussions based on their responses.

BANKS (CONTINUED)

IRRBB is the current or prospective risk to both the bank's capital and its earnings, arising from movements in interest rates. A fair number of engagements with the banking sector were held to consider their respective IRRBB methodologies, with a special focus on delta net interest income and delta economic value of equity (EVE).

Key take-outs from the EVE reviews are the challenges around the comparability of EVE results to be disclosed to the public, as each bank uses its own methodology. Other challenges were the stripping of commercial margins as well as the profiling of non-maturity deposits and yield curve construction.

INSURERS AND MARKET INFRASTRUCTURES

The PA engaged with insurers and market infrastructures to understand their business models with the view of more efficient ALM risk supervision in compliance with the Solvency Assessment and Management (SAM) framework and the Financial Markets Act 19 of 2012. The PA subsequently generated initial regulatory returns to assess and monitor the inherent risk in the asset and liability mix. Further engagements were held on the own risk and solvency assessment (ORSA) process with a view to enriching the liquidity risk management framework.

Insurance risk

Concurrent to the transition into the Insurance Act, applications that had been submitted based on the previous insurance legislative framework needed to be finalised with inputs from the actuarial risk support function. In terms of applications submitted under the new legislative framework from a life insurance perspective, these included insurers' applications for approval to implement an iterative approach in calculating their solvency capital requirement and risk margin, as well as requests for approval to use an alternative interest rate term structure. From a non-life insurance perspective, these included an application made for the approval of a partial internal model in respect of an insurer's solvency capital requirement.

The Actuarial Division within the PA also compiles and publishes monthly risk-free ratings for the insurance industry. During the year under review, members of the division, participated in the sessional meetings of the Actuarial Society of South Africa where average valuation basis presentations were made about the key features of the experiences of insurers and the state of the industry as a whole for 2017.

From a strategic perspective, the Actuarial Division provided support in respect of the development and implementation of SAM, dealt with ad hoc queries, and initiated work on further topics identified but not completed under SAM prior to its commencement.

Capital management

In 2018, the PA continued to conduct focused reviews on the internal capital adequacy and assessment processes (ICAAPs), in particular, to follow up on prior ICAAP recommendations, risk appetite, credit risk economic capital estimations, capital management, stress testing, the validation of economic capital, and model risk.

On-site reviews conducted in the year under review highlighted the following aspects:

- Banks' regulatory capital planning was robust and underwent regular challenging by management. The forecast regulatory capital and leverage ratios indicated that South African banks remained well capitalised. However, a number of banks were encouraged to place more focus on economic capital planning and its stress testing, which would inform the levels of buffers in preparation for the 2019 Basel III end-state minimum requirements.
- Banks continued to enhance their stress-testing methodologies and processes.
- The development of a model risk framework continued to be part of future ICAAP initiatives for most banks.
- The estimated impact of IFRS 9 and IFRS 16 over the three-year phased period has been incorporated by most banks in their ICAAPs.

On the insurance side of capital management, the PA assisted both internally and externally with the practical and interpretational aspects of implementing the Insurance Act. Insurers queried aspects of the Insurance Act and submitted various applications in an effort to comply with the Insurance Act. The application for approval to encumber assets received focused attention, as a number of insurers were querying the requirement and application of the relevant section in the legislation.

The review of ORSAs continued in a similar fashion to the mock ORSAs submitted by insurers before the Insurance Act was in effect. The PA did not apply a specific focus as the ORSA process and report is still in a maturing phase. Rather, it reviewed ORSAs to monitor consistency with the principles and guidelines of ORSAs, and for similarities and consistency with ICAAPs.

Pillar 3: Disclosure

In accordance with Principle 28: Disclosure and Transparency of the Core Principles for Effective Bank Supervision, the supervisor determined that banks and banking groups should regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies, and corporate governance policies and processes.

During the period under review, the PA continued to review banks' compliance with the Pillar 3 disclosure requirements, with a focus on the implementation of the consolidated and enhanced disclosure framework. The PA will continue monitoring banks' compliance and engaging banks on Pillar 3 matters, and will continue interactions through the BASA, to ensure full compliance with the updated disclosure framework.

The ongoing revision of the Pillar 3 disclosure framework by the BCBS has resulted in additions and changes to the disclosure requirements. In August 2018, the BCBS also issued a technical amendment relating to Pillar 3 disclosure requirements on the regulatory treatment of accounting provisioning. The additional amendments to the Pillar 3 standard apply to banks using an expected credit loss accounting model after this date, and to those banks that use transitional arrangements for the regulatory treatment of accounting provisions.

In December 2018, the BCBS issued a document titled 'Pillar 3 disclosure requirements – updated framework'. The updated framework sets out the new disclosure requirements. The PA will issue a directive to implement the disclosure requirements at a future date.

Climate change

The PA is a member of the Sustainable Insurance Forum (SIF), which is a leadership group of insurance supervisors and regulators working together to strengthen their understanding of and responses to the sustainability issues facing the insurance sector, including climate change.

During 2017 and 2018, SIF focused its efforts on exploring climate-related issues, culminating with the release of a document titled 'Joint SIF-IAIS issues paper on climate change risks to the insurance sector'. This paper recognised that the complex, interrelated, non-linear and dynamic challenges presented by climate risks require a strategic response from insurers across business lines, levels of management and the broader insurance value chain. The paper also recognised the importance of the recommendations and supplemental guidance of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TFCFD), which has set up a global voluntary framework for the identification, assessment, management and public disclosure of climate-related risks and opportunities in mainstream financial filings.

At the 2018 International Association of Insurance Supervisors (IAIS) annual conference, the Chair of the IAIS Executive Committee requested that the SIF work with the IAIS to develop an issues paper on TFCFD implementation for the insurance sector in 2019. To this end, the PA distributed a survey to the South African insurance sector during February 2019 to gather a representative view of insurers' awareness, understanding, levels of uptake and implementation of the TFCFD recommendations. The results of this survey will be used to inform the forthcoming IAIS/SIF issues paper on TFCFD implementation, complementing other sources of information on current market practices. They will also aid the PA in understanding the industry's awareness around climate change risks, and will help to inform its future supervisory approach.

FINANCIAL ACCOUNTS

THE PRUDENTIAL AUTHORITY'S FINANCIAL ACCOUNTS

In terms of section 55 of the Financial Sector Regulation Act 9 of 2017 (FSR Act), the South African Reserve Bank (SARB) is required to prepare financial accounts for the Prudential Authority (PA) for each financial year in a manner that reflects the direct costs that accrue to the PA. As the PA comprises four departments housed within the SARB, it follows the same financial reporting framework and basis of presentation as that of the SARB.

Once the new Financial Sector Levies Bill is promulgated, the necessary levies will be collected from regulated financial institutions, as envisaged in the FSR Act. Levies will serve as the basis to recover the direct operating costs of running the PA, and not in return for any direct service that will be provided.

Fees (R6.45 million) are transaction-based and charged to fund the PA's performance of specific functions under the FSR Act and other relevant sector laws.

Penalties are raised for non-compliance by persons within the regulated sector should they be found guilty of contravening a financial sector law or an enforceable undertaking accepted by the PA. The PA deducts from this total all the costs incurred in making and enforcing the administrative penalty order. The remaining balance (if any) after applying this deduction is paid into the National Revenue Fund (NRF). The PA also has a responsibility in terms of the Financial Intelligence Centre Act 38 of 2001, as amended (FIC Act), to ensure that banks and life insurance companies comply with the FIC Act. The PA has authority in terms of section 45C of the FIC Act to impose administrative sanctions on these entities if and when they fail to comply with a provision, order, determination or directive made in terms of this Act. The SARB issues notices with said penalties to the relevant entities but does not account for the penalties in its financial statements, as the penalties imposed are paid directly to the NRF. Total penalties issued on behalf of National Treasury in this regard amounted to R15 million for the year ended 31 March 2019.

Personnel and operating costs (R324 million) consist only of the direct costs related to the administration of the PA. Although the PA uses the various support departments of the SARB and incurs costs from these services (such as legal services, information technology, risk management, compliance, internal audit, human resources, international economic relations and policy, security and facilities), these costs were borne by the SARB for the year ended 31 March 2019.

For the full set of financial accounts, please refer to the SARB's *Annual Report 2018/19*
https://www.resbank.co.za/Publications/Reports/Annual-Reports.aspx

ADDITIONAL INFORMATION

APPENDICES

REGISTERED FINANCIAL INSTITUTIONS REGULATED BY THE PRUDENTIAL AUTHORITY

A list of all the banks, branches of foreign banks, foreign-controlled banks, locally controlled banks, mutual banks and representative offices in South Africa can be accessed at

http://www.resbank.co.za/PrudentialAuthority/Deposit-takers/Banks/Pages/South-African-Registered-Banks-and-Representative-Offices.aspx.

A list of all the co-operative banks in South Africa can be accessed at

http://www.resbank.co.za/PrudentialAuthority/Deposit-takers/Co-operativeBanks/Pages/Licensing.aspx.

A list of all the insurers in South Africa can be accessed at

http://www.resbank.co.za/PrudentialAuthority/Insurers/Post%20Insurance%20Act/Pages/default.aspx.

REGISTRATIONS AND NAME CHANGES

Financial institutions registered during 2018/19

Insurers	Effective date
Swiss Re Life and Health Africa Limited	26 April 2018
Mutual banks	**Effective date**
Bank Zero Mutual Bank	17 August 2018
Representative offices	**Effective date**
Metbank Limited	29 November 2018
Barclays Bank Plc	29 November 2018
Macquarie Bank Limited	30 November 2018
Bank Julius Baer & Co Limited	8 March 2019
Co-operative banks	**Effective date**
Webbers Employees Savings and Credit Co-operative Bank	29 November 2018

Financial institutions that changed names during 2018/19

Banks and controlling companies		
Old name	**New name**	**Effective date**
Barclays Africa Group Limited	Absa Group Limited	11 July 2018
The South African Bank of Athens Limited	GroBank Limited	17 August 2018
Commonwealth Bank of South Africa Limited (trading as TymeDigital by CommonwealthBank SA)	Tyme Bank Limited	27 November 2018
Insurers		
Old name	**New name**	**Effective date**
Swiss Re Life and Health Africa Limited	Swiss Re Africa Limited	18 June 2018
Regent Life Assurance Company Limited	Hollard Specialist Life Limited	29 June 2018
Regent Insurance Company Limited	Hollard Specialised Insurance Limited	29 June 2018
Prescient Life Limited	27Four Life Limited	14 December 2018
Representative offices		
Old name	**New name**	**Effective date**
Bank of Tokyo Mitsubishi	MUFG Bank Limited	7 February 2019

DE-REGISTRATIONS OR THE WITHDRAWAL OF LICENCES

Financial institutions that deregistered or had their licences withdrawn during 2018/19

Insurers	Effective date
Emeritus Reinsurance Company SA Limited	26 September 2018
Sasguard Insurance Company Limited	14 March 2019
Etana Insurance Company Limited	26 March 2019
Sunderland Marine Africa Limited	26 March 2019

TRANSFER OF BUSINESS

Insurers that transferred their business during 2018/19

Insurers	Effective date
Emeritus Reinsurance Company SA Limited to First Reinsurance Company (Pty) Limited	21 June 2018
Regent Insurance Company Limited (changed name to Hollard Specialist Insurance Limited) to Hollard Insurance Company Limited	5 November 2018
Sasguard Insurance Company Limited to Centriq Insurance Company Limited	14 December 2018

EXEMPTIONS AND EXCLUSIONS FROM THE APPLICATION OF PRUDENTIAL AUTHORITY LEGISLATION

http://www.resbank.co.za/PrudentialAuthority/Deposit-takers/Banks/Pages/South-African-Registered-Banks-and-Representative-Offices.aspx.

DESIGNATION AS AN INSURANCE GROUP

Financial institutions that were designated as an insurance group during 2018/19

Absa Financial Services Limited
Johannesburg Insurance Holdings (Pty) Limited
AIG Life South Africa Limited
AIG South Africa Limited

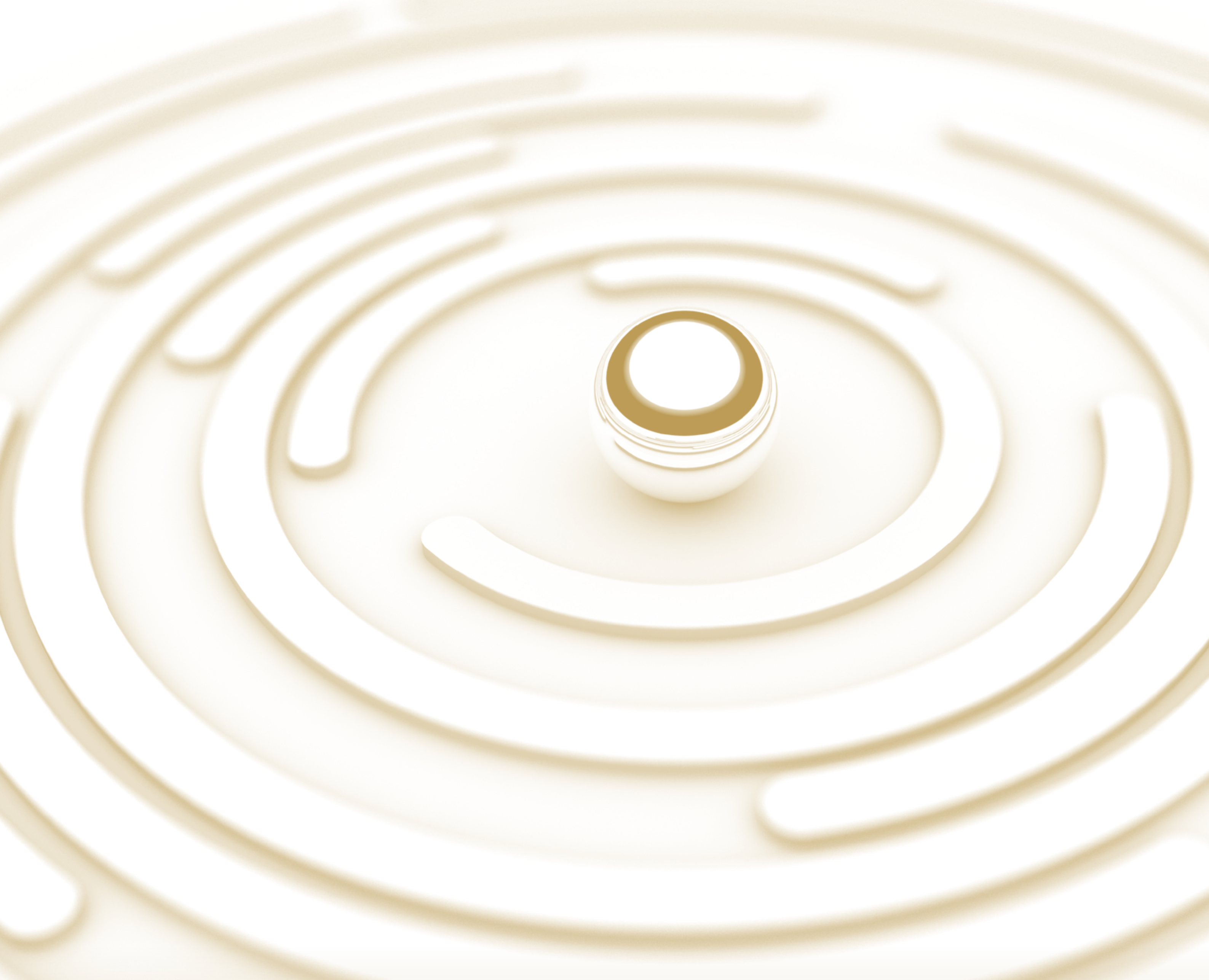
ABBREVIATIONS

African Bank	African Bank Limited
AI	accountable institution
AIRB	advanced internal ratings-based approach
ALM	asset and liability management
AMA	advanced measurement approach
AML	anti-money laundering
ASA	alternative standardised approach
Banks Act	Banks Act 94 of 1990
BASA	Banking Association South Africa
BCBS	Basel Committee on Banking Supervision
BE-CCP	bank exposure to central counterparties
BIA	basic indicator approach
BSD	Bank Supervision Department
CAR	capital adequacy ratio
CBDA	Co-operative Banks Development Agency
CCP	central counterparty
CEO	Chief Executive Officer
CET	common equity tier
CFI	co-operative financial institution
CFT	combating the financing of terrorism
ComFrame	Common Framework for the Supervision of Internationally Active Insurance Groups
Companies Act	Companies Act 71 of 2008
Co-operative Banks Act	Co-operative Banks Act 40 of 2007
CREIF	capital requirements for banks' exposures to equity investments in funds
EVE	economic value of equity
Exco	Executive Committee

ABBREVIATIONS (continued)

FATF	Financial Action Task Force
FIC	Financial Intelligence Centre
FIC Act	Financial Intelligence Centre Act 38 of 2001, as amended
FIRB	foundation internal ratings-based [approach]
FMA	Financial Markets Act 19 of 2012
FSCA	Financial Sector Conduct Authority
FSR Act	Financial Sector Regulation Act 9 of 2017
G20	Group of Twenty
GHOS	Governors and Heads of Supervision
IAIS	International Association of Insurance Supervisors
IAIG	internationally active insurance groups
ICAAP	internal capital adequacy and assessment process
ICS	insurance capital standard
IFRS	International Financial Reporting Standard
IGM	Insure Group Managers
IMA	internal models approach
IMF	International Monetary Fund
Insurance Act	Insurance Act 18 of 2017
IOSCO	International Organization of Securities Commissions
IRB	internal ratings-based approach
IRBA	Independent Regulatory Board for Auditors
IRRBB	interest rate risk in the banking book
IT	information technology
ITRTG	Information Technology Risk Task Group
KRI	key risk indicator
LCR	liquidity coverage ratio
Long-term Insurance Act	Long-term Insurance Act 52 of 1998
MoU	memorandum of understanding
NRF	National Revenue Fund
NSFR	net stable funding ratio
ORSA	own risk and solvency assessment
OTC	over the counter
PA	Prudential Authority
PA Enforcement Committee	Prudential Authority Sanctions and Enforcement Committee
PA Manco	Prudential Authority Management Committee
PCR	prescribed capital requirement

PruCo	Prudential Committee
QRT	Quantitative Reporting Template
RBA	risk-based approach
RCSA	risk and control self-assessment
RDARR Principles	risk data aggregation and risk reporting principles
Regulations	Regulations relating to Banks
RWA	risk-weighted asset
SA-CCR	standardised approach to counterparty credit risk
Safrican	Safrican Insurance Company Limited
SAM	Solvency Assessment and Management
SARB	South African Reserve Bank
SFA	Strategic Focus Area
Short-term Insurance Act	Short-term Insurance Act 53 of 1998
SIF	Sustainable Insurance Forum
SIFI	systemically important financial institution
STA	standardised approach
STC	simple, transparent and comparable
TFCFD	Task Force on Climate-related Financial Disclosures
TR Joint Standard	Joint Standard 1 of 2018: Requirements and Additional Duties of a Trade Repository
Tribunal	Financial Services Tribunal
US	United States
VBS	VBS Mutual Bank



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