South African Reserve Bank

From the Office of
the Registrar of Banks

D5/2013

2013-04-26

To: All banks, controlling companies, branches of foreign institutions, eligible institutions and auditors of banks or controlling companies

Directive 5/2013 issued in terms of section 6(6) of the Banks Act, 1990

Capital framework for South Africa based on the Basel III framework

Executive summary

The amended Regulations related to Banks (the Regulations), which set out, among other things, the prescribed minimum required capital ratios and various components of the capital requirements, were implemented with effect from 1 January 2013.

This directive serves to inform all relevant persons of matters related to the prescribed minimum required capital ratios and the application of various components of the said capital requirements such as the systemic risk capital requirement (Pillar 2A), the domestic systemically important bank (D-SIB) capital requirement, the countercyclical buffer range and the capital conservation buffer range. This directive also details the phase-in requirements for the prescribed minimum required capital ratios.

This directive replaces Guidance Note 9/2012, issued in October 2012.

1. Introduction

1.1. In view of the implementation of the Basel III framework on 1 January 2013, the South African capital framework is set out in the Regulations, which were implemented with effect from 1 January 2013.

1.2. In order to prevent any potential ambiguity, Annexure A of this directive stipulates the various capital tiers, together with various related elements specified in the Regulations and in the Basel III framework, including the systemic risk capital requirement (Pillar 2A), the bank-specific individual capital requirement (ICR, also known as Pillar 2B), and the phasing in of the related minimum requirements.

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1.3. The phase-in arrangements for the minimum requirements have been set out in Annexure B of this directive to indicate more clearly when and to what extent the requirements become effective.

1.4. The domestic systemically important bank (D-SIB) capital requirement will be finalised and communicated to all banks conducting business in South Africa well in advance of the implementation date of 1 January 2016. The requirement will be specific to each bank or banking group based on criteria related to systemic importance. This minimum requirement will be phased in over a three-year period on a straight-line basis, from 2016 to 2019.

2. Directive - Minimum capital requirements

2.1 Regulation 38(8)(e)(ii) of the Regulations prescribes that the capital requirement for systemic risk (that is Pillar 2A) will be specified by the Registrar of Banks. The Pillar 2A requirement may therefore also be revised from time to time.

2.2 The Pillar 2A capital requirement will be set at 1,5 per cent of risk-weighted exposures for all banks at a total capital level with effect from 1 January 2013, whereafter it will be increased to 2,0 per cent. In order to ensure that factors related to systemic risk are not double counted, the Pillar 2A capital requirement will be adjusted during the phase-in period of the higher loss absorbency (HLA) requirement for D-SIBs, which will come into effect from 1 January 2016, resulting in an appropriate reduction in some components of the Pillar 2A requirement over time.

2.3 In order to assist banks in appropriately managing their capital plans, this Office hereby notifies banks that the combined total capital-adequacy requirement in respect of the Pillar 2A and the HLA requirement for D-SIBs will not exceed 3,5 per cent of a bank's risk-weighted exposure.

2.4 Furthermore, excluding both bank-specific ICR and the countercyclical buffer requirement, the highest minimum total capital-adequacy requirement to be met by any bank or banking group conducting business within South Africa receiving the highest possible HLA requirement for a D-SIB will be 14 per cent at the end of the phase-in period on 1 January 2019.

2.5 This Office will specify the HLA requirement for each individual bank or banking group identified as a D-SIB in terms of regulation 38(8)(e)(vi) of the Regulations. The HLA requirement will accordingly vary between banks identified as D-SIBs. This Office has decided to apply a 'bucketing approach' when assigning the relevant HLA requirement for D-SIBs. Banks and banking groups identified as D-SIBs will be advised in writing by this Office during 2013 of this fact and of the individual HLA requirements assigned to them. The HLA requirement for a D-SIB is regarded as an extension of the capital conservation buffer, and the consequences applicable to breaching the capital-adequacy requirement at the capital conservation buffer level will also apply to breaching the combined total of the capital conservation buffer and the HLA requirement for a D-SIB. The first 50 per cent of the specified D-SIB capital requirement, up to a maximum of 1 per cent of a bank's risk-weighted exposures, must be fully met by common equity Tier 1 capital and reserve funds, and any requirement exceeding the aforementioned requirement may be met by a combination of additional Tier 1 and Tier 2 capital and reserve funds.

2.6 This Office will continue to assess the bank-specific ICR as part of its supervisory review and evaluation processes. These supervisory assessments may attribute ICRs in order to address specific risks identified by this Office in terms of the provisions of regulation 38(8)(e)(iii) read with regulation 38(4) of the Regulations. Any ICR may also be based on the levels of economic capital a bank holds to cover risks not regarded as Pillar 1 risks, as observed in the Internal Capital Adequacy Assessment Process (ICAAP) of a bank. This Office will continue to utilise this supervisory tool to increase or decrease the level of ICR; however, factors that form part of the D-SIB capital framework will no longer form part of the ICR framework.

2.7 Commencing 1 January 2016, if a bank's capital-adequacy ratios fall below the levels set out in Annexure A (South African minima including the countercyclical buffer, the conservation buffer and the HLA requirement for D-SIBs), in the absence of other remedial actions acceptable to the Registrar to improve the bank's capital-adequacy ratios, capital conservation ratios will be imposed that will limit discretionary payments such as dividend distributions. These limits will be increased as a bank's capital levels approach the specified minimum requirements. Once imposed, capital conservation measures will remain in place until such time as minimum required capital-adequacy ratios have been restored. If a bank wants to make payments in excess of distribution limits, sufficient capital will have to be raised to fully compensate for the excess distribution. A bank will be required to discuss this alternative with this Office as part of the bank's ICAAP.

2.8 Banks should maintain an additional discretionary capital buffer above the specified minimum requirements, as envisaged in regulation 38(8)(e)(vii) of the Regulations, to ensure that the execution of internal business objectives or the occurrence of adverse external environmental factors do not prevent banks from operating above the relevant minima. This Office will continue to monitor and assess the adequacy of this internal buffer against a bank's strategy, risk profile and levels of capital.

2.9 As is standard practise in most international jurisdictions and in accordance with Banks Act Circular 5/2011, and to ensure that no confusion exists in the market, banks are advised to continue to refrain from disclosing to the public their ICR (Pillar 2B) or any HLA requirement for D-SIBs as these are bank-specific requirements and are therefore not directly comparable across banks. This Office will issue further guidance regarding the disclosure of capital-related matters at a later stage.

2.10 Finally, banks are advised to take note of the fact that guidance will be provided on specific aspects of the new capital framework, should it become necessary, after the Basel Committee on Banking Supervision has finalised the consultative processes which are currently still under way.

3. Acknowledgement of receipt

3.1 Two additional copies of this directive are enclosed for the use of your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the chief executive officer of the institution and the said auditors, should be returned to this Office at the earliest convenience of the aforementioned signatories.

M A Petros
Deputy Registrar of Banks

The previous directive issued was Directive 4/2013, dated 26 April 2013.

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