SAICA
THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS

FINANCIAL SERVICES

Quarterly Brief

SEPTEMBER 2021

REGULATED INDUSTRIES

Draft guidance: Section 252 of the Financial Sector Regulation Act, 2017 (Informal consultation) - ADVOCACY

SAICA has been engaging with the Prudential Authority (PA) on the need for guidance on Section 252 of he Financial Sector Regulation Act, No. 9 of 2017 (FSRA). The section requires an auditor of a licensed financial institution to submit a written report on any reportable matter (as described in section 252(1)(a)(i) and (ii)) to the PA, the governing body of the financial institution and in the case of a financial conglomerate, the holding company of the financial institution. The section is reminiscent of section 45 of the Auditing Profession Act 26 of 2005.

The PA is working on guidance note that is aimed at providing much needed clarity on this requirement, including on the interpretation of "financially unsound', which is not defined in the FSRA, the period within which such report is to be submitted, as well as the format of such submission.

Guidance will also provided on how to apply the requirements of this section in the case of joint audit engagements as well as include an illustrative reporting template. SAICA commented on the draft guidance shared by the PA. The comment letter was drafted with contribution from the SAICA Banking, Retirement Funds, Insurance and the Investment Management Project Groups. SAICA will monitor developments with this guidance notice until a final document is published by the PA. The submission was made on 9 April 2021 and is available on the SAICA website for perusal.

Quarterly Asset Allocation Reports - ADVOCACY

SAICA noted through industry engagements that auditors within the insurance, retirement funds and asset management fraternity had some concerns on procedures they have to perform as per the factual findings reporting to the South African Reserve Bank's (SARB) Financial Surveillance Department. Auditors are required to execute a number of agreed upon procedures on the asset allocation reports which financial institutions are required to submit to the SARB at the end of each calendar quarter. The quarterly reports provide the SARB with a primary mechanism for monitoring compliance with section B.2(H) of the Currency and Exchanges Manual for Authorised Dealers and in reporting on asset allocations. The 'look-through' principle is applied to investments in collective investments schemes, long-term insurance policies and other investment products.

Members can access SAICA's submission here

Engagements are underway with the regulator, along with the IRBA to update the reports

Prudential Standards for Financial Conglomerates - REGULATORY UPDATE

The Prudential Authority (PA) is empowered by the Financial Sector Regulation Act No. 9 of 2017 (FSRA) to designate a group of companies as a financial conglomerate and to regulate and supervise such institutions. The FSRA defines a financial conglomerate as a group of companies designated as such in terms of section 160 of the Act. The PA is issuing prudential standards which holding companies of financial conglomerates must comply with.

In 2020, the PA consulted on the draft standards, which are currently being finalised, barring the capital requirements standard (FC01) which will be subject to a field-testing process from 1 January 2022.

The capital standard was published in July 2021 for another round of consultation. The PA will be hosting a seminar on the draft capital standard (and reporting template) with the designated financial conglomerates, selected financial entities supervised by the PA, consultants, audit firms, actuaries and industry associations during October 2021. The PA will only finalise the capital requirements standard once the field testing exercise has been concluded to its satisfaction.

THE FOLLOWING STANDARDS ARE INCLUDED IN THIS SUITE OF PRUDENTIAL STANDARDS:

1. Prudential Standard FC01
   - Capital requirements for financial conglomerates
2. Prudential Standard FC02
   - Intragroup Transaction and Exposures
3. Prudential Standard FC03
   - Auditor requirements for holding companies of financial conglomerates
4. Prudential Standard FC04
   - Governance and risk management for financial conglomerates
5. Prudential Standard FC05
   - Risk concentrations for financial conglomerates

EVENTS

Past Event

Banking Seminar 2021

SAICA hosted its first Banking Seminar on 21 May, where experts shared their views and insights on a range of topics including the state of the banking industry, regulatory update, fintech, digital transformation and the economic outlook. Contact SAICA Events to obtain access to the recording.

Upcoming Events

Series & Seminars

Event name	Date
2021 TechTalk Series	2nd Thursday of each month
Insurance Seminar	Wednesday, 29 September 2021
Medical Schemes Seminar	Thursday, 21 October 2021

BANKING

Recent developments

Revised Illustrative Regulatory Reports

The Regulation 46 revised illustrative audit reports were updated and published in March 2021. The illustrative reports are updated from time to time and agreed upon between SAICA, the Prudential Authority (PA) and the Independent Regulatory Board for Auditors (IRBA). They are updated in light of the ongoing regulatory changes to align the Regulations relating to Banks with the Basel III framework. The illustrative reports are available on the IRBA website and are effective for engagements with periods ending on or after 1 January 2021. The PA also issued a directive on reporting requirements in terms of regulation 46 of the Regulations relating to Banks (Directive 3/2021), which should be read together with the illustrative audit reports.

Proposed implementation dates in respect of specified Basel regulatory reforms

Following the 2007/8 global financial crisis, the Basel Com- mittee on Banking Supervision (BCBS) issued various new or amended frameworks, standards or requirements for imple- mentation by member jurisdictions. They were issued in order to address shortcomings identified in the pre-crisis regulatory framework.

Some of the Basel III frameworks have been issued and al- ready implemented in South Africa while there are some which are yet to be implemented.

In light of COVID-19, standard-setting bodies of prudentially regulated institutions announced measures to mitigate the impact that the outbreak of Covid-19 has on preparations by regulators and institutions towards the implementation of the respective new or amended frameworks, standards or requirements. The BCBS therefore announced a deferral of the implementation timeline of the outstanding Basel III standards in response to the COVID-19 pandemic, among other measures.

The PA decided to revise the proposed implementation dates of the outstanding regulatory reforms in South Africa based on industry comments and requests as well as other relevant factors. Guidance Note 4/2021 was issued in July 2021 to replace Guidance Note 7/2020 and outlines the revised proposed dates for the different regulatory reforms.

IFRS 9 information template

The Prudential Authority (PA) is currently finalising the IFRS 9 supplementary reporting templates. The PA is considering comments received from industry, consultation with various inter nal stakeholders on the information needs of the PA as well as feedback received from the International Monetary Fund and World Bank during the Financial Sector Assessment Program which was conducted recently. The PA also noted data security concerns raised by the industry with regard to using Microsoft Excel-based templates and is working on a system solution. Further details in this regard will be communicated by the PA in due course.

Loan Guarantee Scheme

SA SMME COVID-19 Impact Report

The COVID-19 Loan Guarantee Scheme, which was established to support small businesses experiencing financial distress as a result of the COVID-19 pandemic, concluded on 11 July 2021.

OTHER DEVELOPMENTS OF INTEREST

Central Bank Digital Currency (CBDC)

BIS Paper

The South African Reserve Bank (SARB) announced in May that it was commencing with a study to investigate the feasibility, desirability and appropriateness of a central bank digital currency (CBDC) as electronic legal tender. It said, in a statement, that the objective of the feasibility study was to con sider how the issuance of a general-purpose CBDC will feed into the SARB's policy position and mandate.

A CBDC would differ from cryptocurrencies as it would be a centralised digital currency which the SARB would probably operate on a limited access blockchain network, if it chooses to apply (or rely on?) blockchain technology. It is worth noting that there are only two CBDCs that have been launched so far. It has become undeniable that digital currency is part of the future of how people transact as the world continues moving towards a digital economy. Central banks of some other nations are also researching CBDCs.

The Bank for International Settlements (BIS), together with the International Monetary Fund (IMF) and World Bank, published a paper on CBDC designs and the extent to which they could be used for cross-border payments. This would be one of many complexities to take into account with the introduction of a CBDC.

The SARB expects to conclude the feasibility study in 2022. It specifically mentioned in the statement that at this stage it has not made any decision to issue a retail CBDC.

Crypto Assets

CAR IFWG paper BCBS paper

The Crypto Assets Regulatory Working Group of the Intergovernmental Fintech Working Group (IFWG) published a position paper in June 2021 on crypto assets. The paper essentially recommends for South Africa to bring crypto assets within the regulatory sphere. It recommends for this to be achieved through the regulation of crypto asset service providers.

In relation to crypto assets, the Basel Committee on Banking Supervision (BCBS) also issued a consultative document in June and is seeking views on a preliminary proposal for the prudential treatment of crypto asset exposures. Submissions can be made on this paper by 10 September 2021.

Conduct Standard for Banks

The Financial Sector Regulation Act No. 9 of 2017 (FSRA) empowers the Financial Sector Conduct Authority (FSCA) to regulate and supervise the conduct of banks in relation to the provision of financial products and services.

The FSCA consequently developed and issued a conduct standard for banks in July 2020 whose main objective is ensuring the fair treatment of customers of banks. It said this was the first step towards rolling out a comprehensive market conduct regulatory framework for the banking sector.

The conduct standard comes into operation as follows:

Sections 3 to 6 of the conduct standard became effective in March 2021. These covered: Culture and governance; Design, suitability and performance requirements for financial products and service; Additional requirements in respect of retail financial customers and Advertising.

The last sections of the standard (7 - 10) came into effect on 1 July 2021 and cover Disclosures; Complaints; Refusal, withdrawal or closure of financial products or services by the bank and Termination, closure or switching of financial products or services by the customer.

Joint audits for insurers

A discussion paper was issued by the Prudential Authority (PA) outlining the requirements for the appointment of joint auditors and to obtain input from auditors and regulated institutions regarding the proposed scope and application of the joint audit requirement for insurers and insurance groups as well as the effective date. The paper explored the applicability of joint audits within the banking industry, highlighting commonalities with the insurance industry as being complexity in nature of business, requiring specialised skills and resources and impact on financial stability. In proposing joint audits, the PA considered some alternative measures and why these were not sufficient.

The measures included the combined assurance model, which entails that assurance is provided by risk and opportunity line functions, specialist functions, internal audit, external audit and governing bodies. The PA noted that its core reliance in this regard in terms of independent assurance is on the external audit function and given the nature, complexity and size of some of the insurers, the PA believes that the external audit function, as an independent function, should be executed jointly, as part of the combined assurance model.

A shared or subcontracted audit was also considered whereby the PA felt it was similar to a single audit and thus not addressing its concerns.

Companies Act requirements in section 91, setting out auditor rotation requirements were also considered whereby the PA believes partner rotation does address independence and also ensures that a new auditor is appointed within a reasonable timeframe in order to reduce the risk of long association. However, the PA believed that the independence is addressed at an individual level and not at firm level and did not address its objectives.

On audit committee oversight, the PA acknowledges the critical role played by the committee in ensuring governance and believes that the appointment of joint auditors will result in a more robust audit process, which will support the PA and the audit committees of regulated institutions to duly discharge their respective responsibilities.

Joint audits will be applicable to institutions that are regarded to be systemically important, these are institutions that are deemed to be significant from a financial stability perspective. Systemically important financial institutions are determined by taking the following factors amongst others into account; size, complexity and interconnectedness. The South African Reserve Bank has not yet designated any insurer or insurance group as systemic. The discussion paper further states that the PA may apply its discretion in including or excluding a regulated institution from the joint audit requirement based on qualitative factors such as the range and complexity of products/portfolios, type and number of entities within the insurance group and geographical footprint.

The challenge with the PA enforcing joint audits for insurers at the proposed applicable date for financial years commencing on or after 1 January 2023, is that the industry will be undergoing two other major changes at that time. These are the Mandatory Audit Firm Rotation (MAFR) rule which will be effective for financial years commencing on or after 1 April 2023, as well as IFRS 17 *Insurance Contracts* which is effective ffor annual reporting periods beginning on or after 1 January 2023. From engagements with industry members and auditors, they both welcome joint audits however most are concerned on the timing thereof due to the many legislation changes they have had to adjust to and implement within their organisations.

Upon reviewing comments received from insurers, auditors and other stakeholders, the PA has resolved to taking the concerns raised by the industry into consideration prior to finalising this requirement.

SAICA's comment letter on the joint audits can be accessed here.

Prudential Standards on audit requirements for entities registered in terms of the Insurance Act, 2017

The Prudential Authority (PA) issued the Prudential Standards on audit requirements for Insurers, Insurance groups, Lloyds, Microinsurers and Branches for public comment in May 2020.

The reports are in line with Insurance Core Principle (ICP) 9 which requires that supervisors establish documented requirements for the submission of regular qualitative and quantitative information on a timely basis from all insurers operating in their jurisdictions as well an external audit opinion to be provided on annual financial statements. The audit requirements are meant to provide comfort that the information reported for supervisory purposes is complete, consistent and can be relied upon to be presenting a true and fair view of the business of the insurers, insurance groups, microinsurers, branches and Lloyd's.

The Prudential Standards have gone through the final internal reviews and governance process at the PA and will now be submitted to Parliament. The targeted effective date is for financial periods ending on or after 1 January 2022.

In July 2021, the PA issued a draft Prudential Standard on Public Disclosure for insurers for informal comment on or before 1 September 2021. The draft standard can be accessed here.

Proposed amendments to the Policyholder Protection Rules (PPRs)

Draft amendments

The FSCA has published proposed amendments to the PPRs for public comments. Submissions can be made by 10 September 2021. It states in the communication that the objective of the proposed amendments is to give effect to certain necessary enhancements to the 2017 PPRs, informed by supervisory findings on the implementation of and compliance with the 2017 PPRs as well as a number of regulatory and supervisory projects undertaken over the past two years.

Guidance note on loss absorbing capacity of deferred taxes (LAC DT)

ASSA Note

The Actuarial Society of South Africa (ASISA) released a guidance note earlier in the year on the loss absorbing capacity of deferred taxes (LAC DT), outlining considerations when companies perform the LAC DT calculations.

Solvency Assessment and Management matters - Phase 2

Prudential Communication

The Prudential Authority is addressing some industry ques- tions relating to SAM calculations. Providing clarity on the application of FSI 2.2, 2.3, 4.1 and FPP111 within the context of resolving selected items with regards to the SAM Phase 2 matters and confirm its standce on the application of selected matters contained in FPP 111. These being guidance on treatment of cash, cash instruments and short-term deposit; guidance relating to the illiquidity premium and requirements of maintaining the related assets set put in FSI 2.2-Section 13.4a and treatment of short-term investment instruments as it relates to FSI 4.1

RETIREMENT FUNDS

Retirement funds as a guarantee for loans

The COVID-19 pandemic has forced many individuals to significantly adjust their lifestyles. The personal finances of most South Africans have been greatly impacted by job losses, salary cuts or no bonuses/increases, so much so that their livelihoods have taken a significant knock.

There are also concerns regarding government institutes who owe staff members their salaries as well as the unemployment rate rising to a staggering 32.6% in the first quarter of 2021, while 46.3% is the official unemployment rate of youth (aged 15 to 34 years) who are meant to be the main participants in the economy.

BATTLING WITH MONEY HABITS

South Africa has long been battling with its money habits, and it has been proven that we are not a nation that saves money, which will no doubt also cause a long-term financial burden on government when South Africans who do contribute to the economy reach retirement age.

The National Treasury has also alluded to this in the introduction of policies such as the tax-free savings accounts (TFSA) whereby they are trying to entice citizens to save more for their retirement.

REGULATORY UPDATES

Investment in infrastructure

National Treasury published the draft amendments to Regulation 28 (Reg 28) of the Pension Funds Act following announcements that government is reviewing the regulations to make it easier for retirement funds to invest in infrastructure.

Reg 28 reduces excessive and concentration risk to member savings and ensures protection by limiting the extent to which retirement funds may invest in a particular asset or in particular asset classes. This changes are necessitated by the need for increased investment in infrastructure given the current low economic growth climate. The current regulation does not define 'infrastructure' as a specific category, which is currently spread across a number of asset classes like equity, bonds, loans and private equity.

Consequently, current data from retirement funds does not record the exact investment in infrastructure. The proposed amendment therefore introduces a more precise definition of infrastructure to enable much better data and measurement.

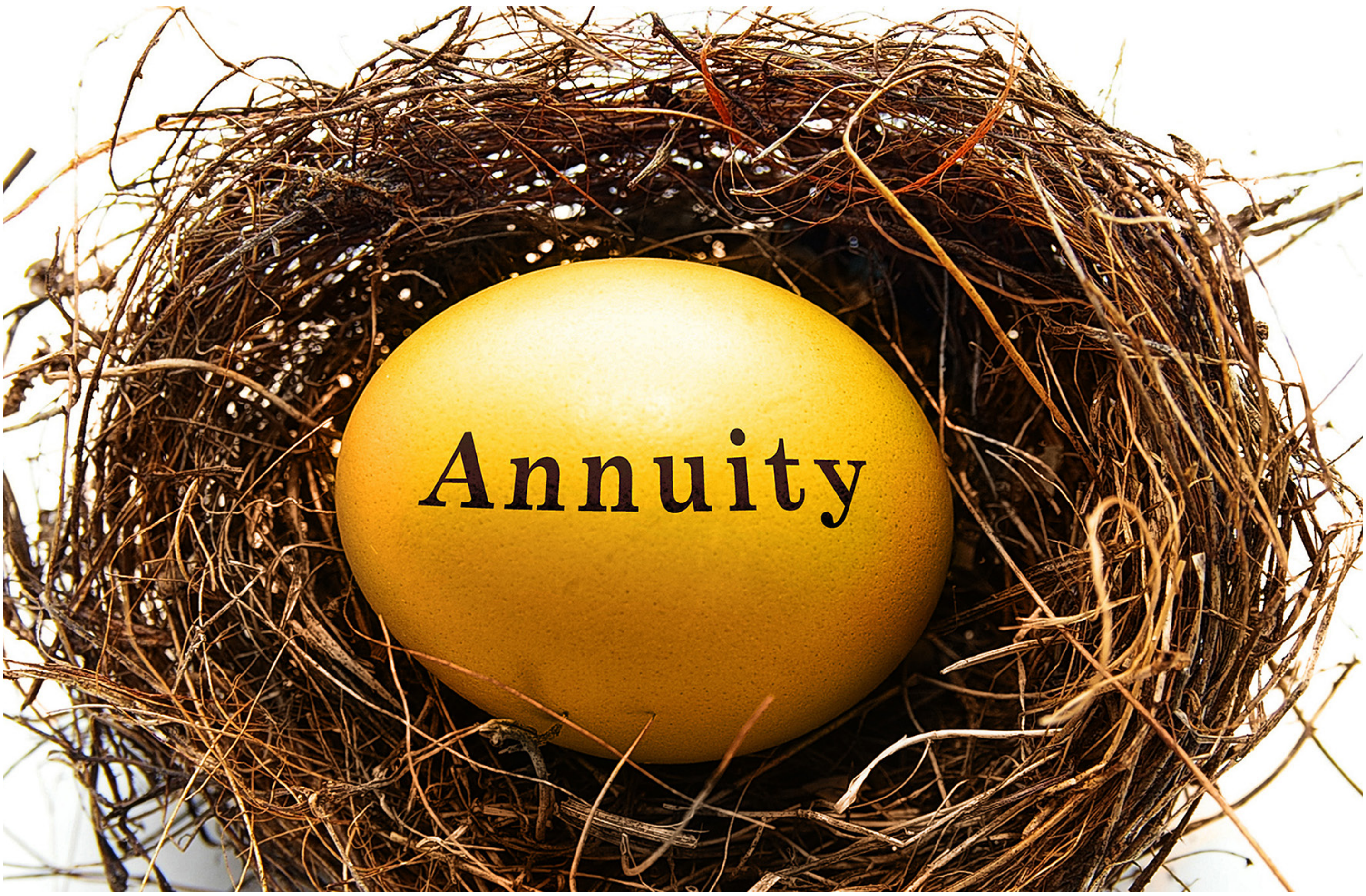
It is proposed that the overall investment in infrastructure across all asset categories, may not exceed 45% in respect of domestic exposure and an additional limit of 10% in respect of the rest of Africa; and limit aggregate exposure per issuer or entity to 25% of the total assets of the fund.

The decision to invest in any asset class, including infrastructure, remains that of the board of trustees of retirement funds.

Increased de-minimus amount

Effective 1 March 2021, the de-minimus amount in relation to withdrawals from retirement savings for members with paid up annuities has increased from R7 000 to R15 000. This came into effect from 1 March 2021.

The legislation has also been amended to include the definition of "Retirement annuity fund" as - A retirement fund established for the purpose of providing life annuities for the members of the retirement annuity fund or annuities for the dependants or nominees of deceased members where a member may elect to receive a lump sum payment up to one-third of the member's individual account of the member's benefit upon retirement.



RECENT DEVELOPMENTS

Revised Regulatory Reporting Requirements for retirement funds (RRR)

FSCA is in the process of revising and updating the RRR, the revisions are intended at streamlining and combining the RRR with the financial statements.

At the inception of the amendments the intension was to cross referencing IFRS and applicable standards, then also focus on special purpose items such as contributions, transfers etc.

During engagements SAICA noted the implications of IFRS minus with some auditors specifically confirming they do not provide audit opinions on IFRS minus. The amendment to include the latest regulation 28 changes in terms of of disclosure of infrastructures at an asset class level.

The FSCA is close to completion in terms of the standard and it can be issued at any stage now for public comments.

VALUATIONS

The International Valuation Standards (IVS) have been updated!

The updated standards are available on the SAICA website. They will become effective from 31 January 2022 but early adoption is encouraged.

The International Valuation Standards Council's Standards Review Board hosted a webinar on August 24, 2021 to outline key updates and discuss why they have been introduced.

IFRS WORK PLAN PROJECTS TO WATCH

- Business Combinations under Common Control
- Classification of Debt with Covenants as Current or Non-current (IAS 1)
- Financial Instruments with Characteristics of Equity
- Goodwill and Impairment
- Initial Application of IFRS 17 and IFRS 9 - Comparative Information (Amendments to IFRS 17)
- Lack of Exchangeability (Amendments to IAS 21)
- Post-implementation Review of IFRS 9—Classification and Measurement
- Dynamic Risk Management

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