FINANCIAL SERVICES

Quarterly Brief

JULY 2023

BANKING

Proposed Directive: Capital treatment of investments in insurance entities by banks

This proposed Directive specifies the manner in which the limited recognition framework provided for in regulations 38 of the Regulations relating to Banks (Regulations) must be applied by banks with significant investments in insurance entities, where the bank owns more than 10% of the issued common share capital or where the entity is an affiliate as envisaged in regulation 38(5)(b)(i) of the Regulations. In terms of this proposed Directive banks shall not apply the threshold deduction method to investments in insurance entities or activities by banks, without the prior written approval and conditions as may be specified in writing by the Prudential Authority (PA).

This directive further stipulates the process that may be used by banks to report variations to the value of the initial investment to the PA.

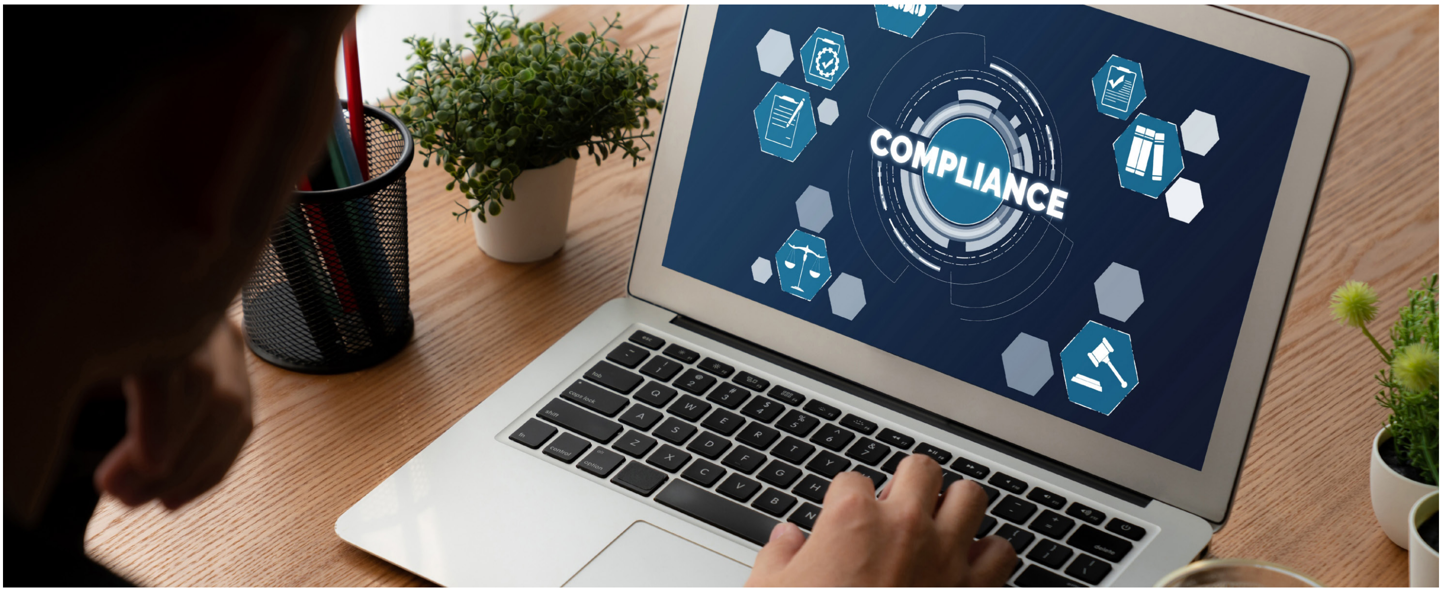
Corporation for Deposit Insurance April 2023 Newsletter

This newsletter marks a momentous occasion and time in the establishment of the Corporation for Deposit Insurance (CODI) and the development of a deposit insurance scheme (DIS) for South Africa. CODI is expected to be fully operational by April 2024, and aims to support the South African Reserve Bank (SARB) in fulfilling its financial stability mandate. It also aims to protect depositors from losing money when their banks fail, especially the smaller more vulnerable depositors.

Proposed Directive: South African domestic systemically important banks (DSIBs) to submit consolidated information

This proposed Directive directs D-SIBs to submit the credit-related statutory BA 200 and BA 210 returns biannually, based on consolidated information, at bank and controlling company level within 30 business days immediately following the period to which the return relates. D-SIBs with year-ends other than June or December are required to submit additional statutory BA returns, as at the D-SIB's year-end.

Where the statutory BA returns on a bank and controlling company consolidated level submitted in terms of this proposed directive coincide with the period ending as at the reporting D-SIB's year-end, the said statutory BA returns shall instead be audited, reviewed, or concluded upon under a limited assurance framework.



Working paper: Dividends policy and pay-outs: evidence from South Africa

The theoretical framework that informing dividend studies makes it difficult to test competing views on dividend behaviour as it is somewhat loose. On one instant it reflects a useful discipline on managerial autonomy to invest; another view is that it represents a constraint on investment due to misinformed or short-term investors. As a first step in researching this issue, this paper estimates a dividend pay-out relationship for South Africa. Estimated results are obtained for separate panels of listed and unlisted non-financial firms. Among the notable results, the paper finds that standard proxies for investment opportunity do not generally find significance. The effect of past profitability, firm size and age are in line with developed country results, but the tendency to smooth dividends seems weaker, particularly for unlisted firms.

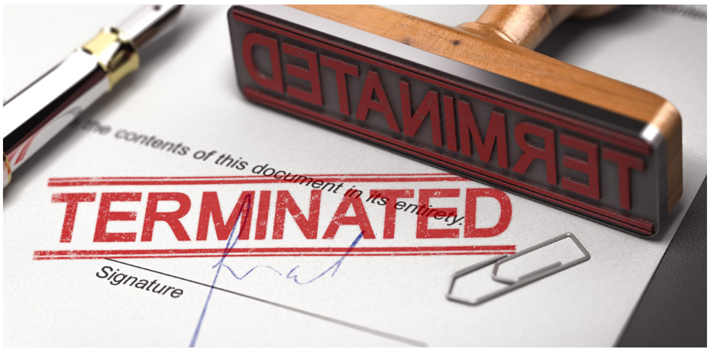
Regulatory treatment of accounting provisions

At the time of transitioning to the International Financial Reporting Standard 9, Financial Instruments (IFRS 9), it was important for regulatory purposes to define which provisions should be regarded as specific provisions (SP) and general provisions (GP). Given that a distinction between GP and SP did not exist under the accounting frameworks, the Basel Committee on Banking Supervision (BCBS) recommended that regulatory authorities provide guidance to banks on how they should classify expected credit losses (ECL) provisions, to ensure the consistency of categorisation in their jurisdictions. The PA, then provided clarity to banks conducting business in South Africa on how to classify ECL provisions. These arrangements were in place for three years.

With the transition period having concluded, this Directive directs banks and auditors of banks regarding the classification of impairments as either general or specific under IFRS 9 post the conclusion of the transition period.

Prudential Standard RA01 - Stays on Early-Termination Rights and Resolution Moratoria on Contracts of Designated Institutions in Resolution

This Standard stipulates the requirements relating to early-termination rights and resolution moratoria on contracts of designated institutions in resolution, in line with international standards and principles, for the orderly resolution of designated institutions. The Standard applies to early-termination rights that arise only because of entry of a designated institution into resolution or in connection with the use of resolution powers by the Reserve Bank in relation to a designated institution and came into effect on 1 June 2023.



Prudential Standard RA02 – Transfers of Assets and Liabilities of a Designated Institution in Resolution

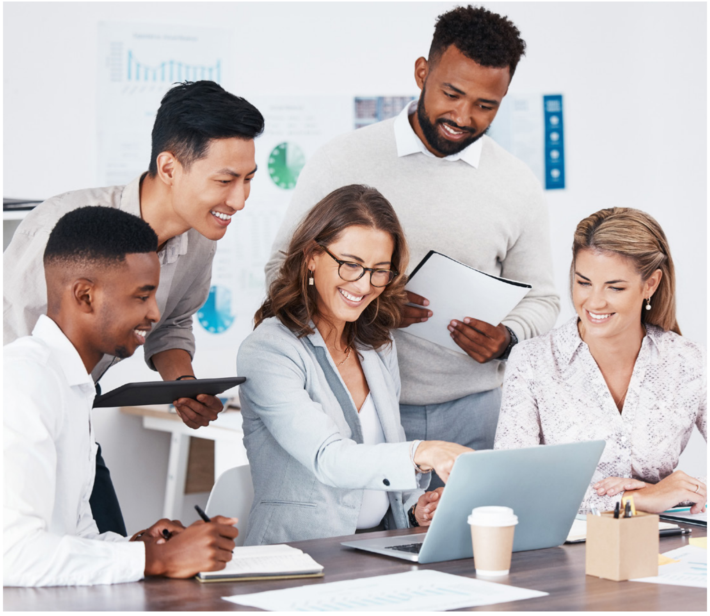
The Standard sets-out requirements that designated institutions need to comply with, including capabilities to build to enable the execution of transfers in resolution. In addition, it provides for safeguards to be applied particularly in partial transfers, to protect the integrity of certain financial arrangements such as netting agreements to avoid unintended consequences of partial transfer strategies in resolution. The Standard came into effect on 1 June 2023.

Directive - Principles for operational resilience

In March 2021, the BCBS issued a paper on principles for operational resilience. These principles aim to strengthen banks' ability to withstand operational risk-related events that could cause significant operational failures or wide-scale disruptions in financial markets. The PA decided that these principles need to be implemented by banks conducting business in South Africa and has published this directive to direct banks to assess the adequacy and robustness of the their current policies, processes, and practices against the principles for operational resilience issued by the BCBS, and to ensure that all principles contained in the BCBS paper are addressed either through internal resources or by means of outsourcing/third party agreements without undue delay. All banks must comply with these requirements on or before 31 December 2024.

Proposed Directive - Directors and Executive Officers of Co-operative Financial Institutions (CFIs)

Sections 40B(1)(a) and (b) of the Co-operative Banks Act require, among other things, that in order to qualify for registration, or to continue to be registered, a CFI must demonstrate, to the satisfaction of the PA on an ongoing basis that it has the requisite experience, knowledge, qualifications and competence to give effect to its obligations; and has sufficient human, financial, and operational capacity to function efficiently and competently. In this proposed Directive, CFIs are directed to complete a statement and declaration regarding the fitness and propriety of current or proposed directors, managing directors or executive officers. This must be submitted to the PA within six months of the date of this Directive.



Draft Prudential Standard CODI 1 – Fund liquidity

The Standard sets out the requirements applicable to the funds to be held by banks that hold covered deposits, in the account of the Fund for purposes of the Fund liquidity of the CODI's funding model in accordance with subsection 166BH of the FSR Act. This Standard is set to commence on 1 April 2024.

Amendments to Joint Standard 2 of 2020: Margin Requirements for non-centrally cleared over-the-counter derivative transactions

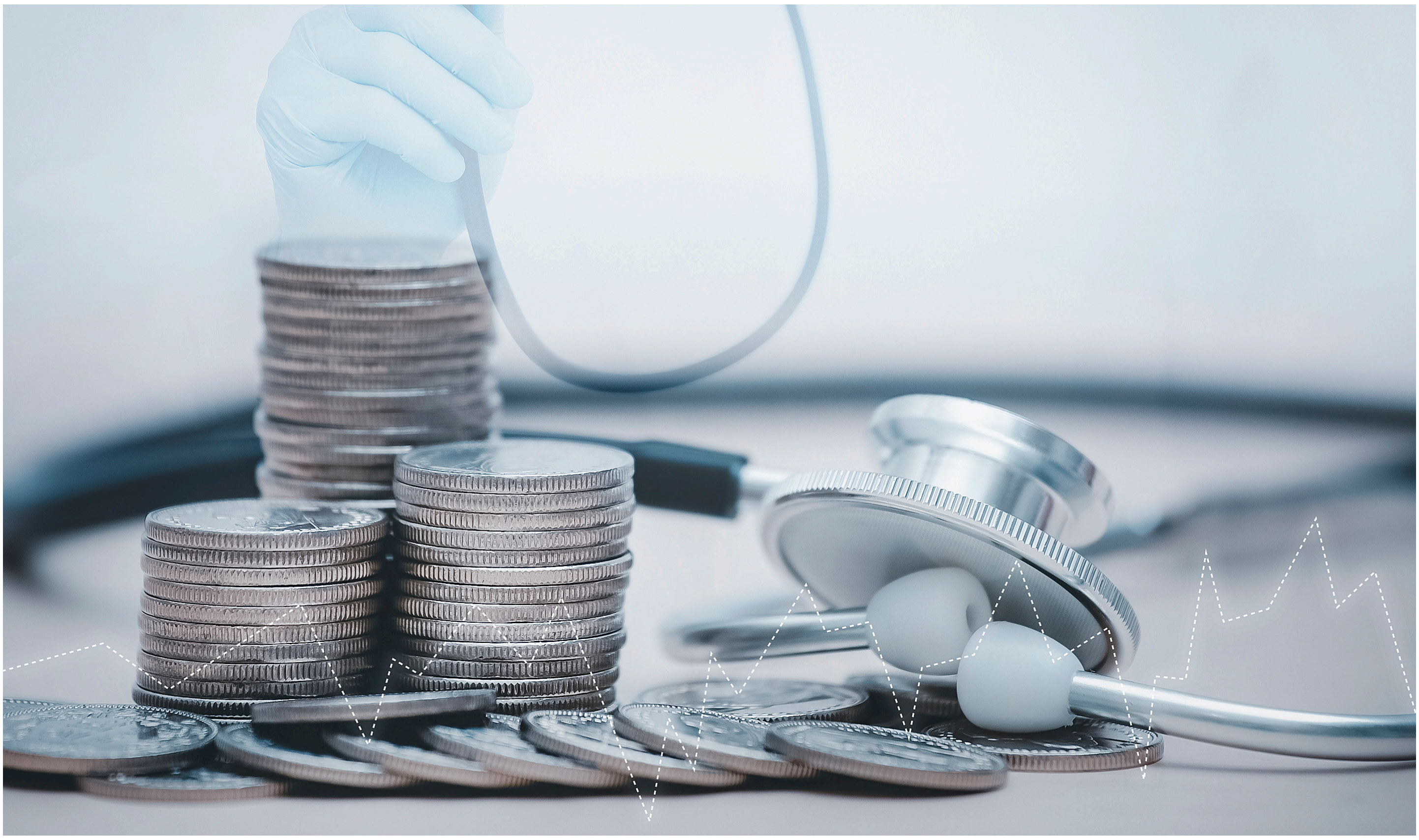
The proposed amendments to the Joint Standard are intended to provide the PA and the Financial Sector Conduct Authority (FSCA) (the Authorities), acting jointly or independently, with the power to determine additional reporting requirements as may be necessary to enable them to determine conditions for the use of specified collateral.

Further refinements were proposed to be made to the Joint Standard for clarity and drafting changes to align the terminology in the Joint Standard to that of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act).

MEDICAL SCHEMES

Imposition of levies for medical schemes 2023/24

The CMS confirmed the imposition of levies on medical schemes. The levy amount to be paid with effect from 01 April 2023 is R44.06 per member per year. The levy shall be paid in two equal instalments, the first of which shall be paid no later than 31 May of the levy year, and the second of which shall be paid not later than 31 July of the levy year. Interest on overdue levies will be charged at the rate applicable to a debt owing to the state.



INSURANCE

IFRS 17 – *Insurance Contracts* resources

Access the IFRS 17 resources including the guides, webinars, and educational material.

FSCA Conduct Standard 1 of 2023: Conditions for Investment in Derivatives Instruments for Pension Funds (Conduct Standard)

In order to balance the benefit with the possible risks associated with investing in derivative instruments, the Financial Sector Conduct Authority (FSCA) deems it appropriate to prescribe conditions for pension funds when investing in derivative instruments as part of its investment strategy. The Conduct Standards sets conditions relating to permissible uses of derivative instruments, net derivative positions coverage, allowable counterparties, and the calculation of exposure to derivative instruments, amongst other things.

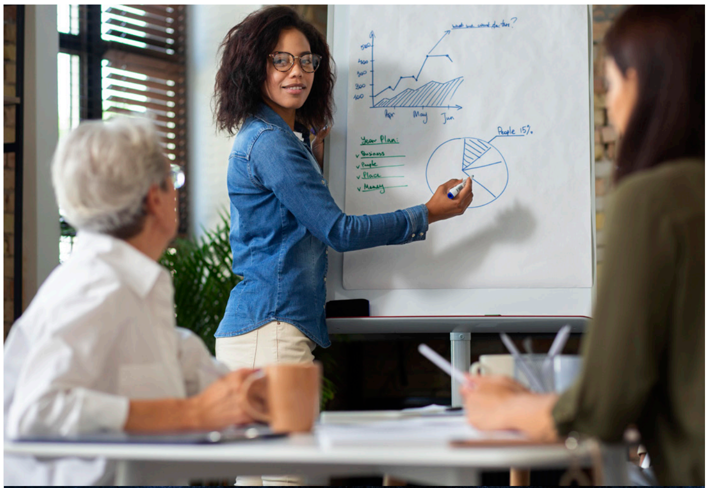
The calculation of late payment interest by pension funds

The FSCA has received requests from industry for clarification of the calculation of late payment interest (LPI) as contemplated in the Pension Funds Act, 1956 (PFA) and FSCA Conduct Standard 1 of 2022 (RF): Requirements related to the payment of pension fund contributions, more specifically from which date the late payment interest starts running. It appears that there is uncertainty within the industry regarding the interpretation as to whether the LPI starts running from the 1st day or the 8th day following the expiration of the period in respect of which the contributions were due and payable, or if there is another interpretation.

This communication provides clarity and indicates that late payment interest must be calculated from the day after the seventh day referred to in section 13A(3)(a)(i) of the PFA.

Draft Conduct Standard: Financial institutions providing financial education initiatives

This Conduct Standard is only applicable where a financial institution provides or offers a financial education initiative, including the provision of a financial education initiative by a service provider on behalf of the financial institution. Financial institutions that are providing financial education initiatives are required to take reasonable steps to ensure appropriate standards of behaviour, put in place governance and oversight arrangements when developing financial education content, implementing, monitoring, evaluating, and reporting on consumer financial education activities. Adherence to these proposed requirements will ensure that all financial education initiatives developed by financial institutions are of a similar standard, creating consistency across the sector.

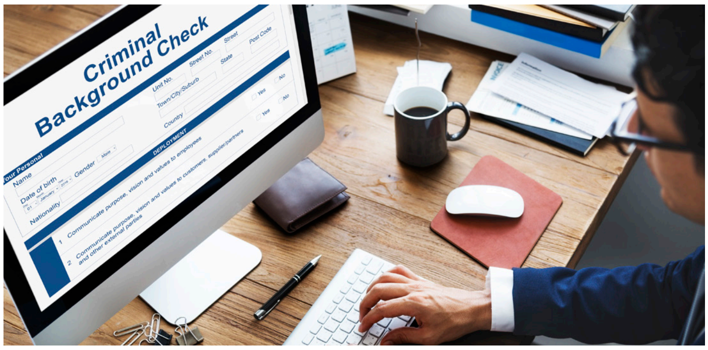


Draft Conduct Standard: Requirements relating to the reporting and disclosure of short sales

The objective of the draft Conduct Standard is to enhance confidence, efficiency, and integrity in the South African financial markets by providing greater transparency to both investors and the FSCA in respect of short selling activities and to support a fair and efficient market and financial stability. This draft is intended at to setting out the minimum requirements relating to the reporting and disclosure of short sale. It will thus deal with short sale transactional reporting and public disclosure as well as short sale positional reporting and public disclosure.

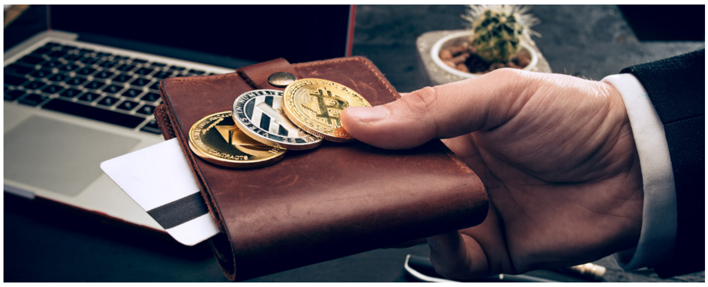
Changes to criminal verification checks in respect of Collective Investment Schemes (CIS)

The FSCA has implemented a revised process for conducting criminal verification checks through the use of an independent service provider. Accordingly, upon receipt of an application for registration as a CIS manager, or approval of a change in the directors or shareholding of the CIS manager in terms of section 42 and 43 of the Collective Investment Schemes Control Act, No. 45 of 2002 (CISCA), all verification checks in respect of such applications will now be conducted by Managed Integrity Evaluation (Pty) Ltd (MIE).



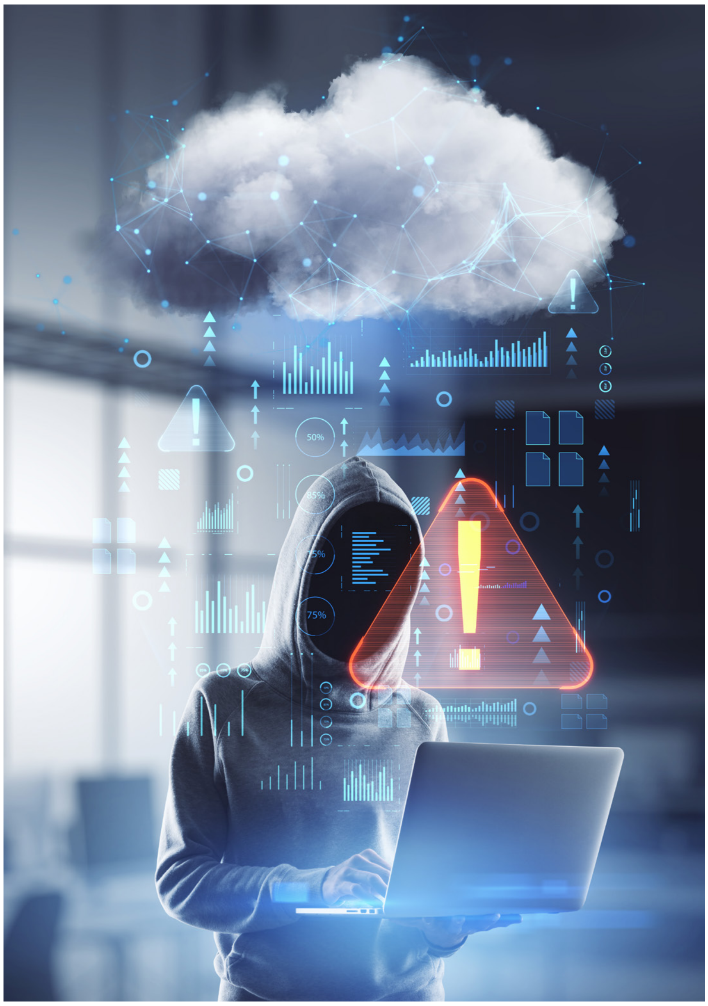
Exemption of persons rendering a financial service in relation to crypto assets from certain requirements, 2023 (Exemption)

This Exemption exempts licensed Crypto Asset FSPs and their key individuals and representatives from certain requirements of, amongst others, the General Code of Conduct for Authorised Financial Services Providers and Representatives, 2003 (General Code of Conduct) and the Determination of Fit and Proper Requirements for Financial Services Providers, 2017 (Determination).

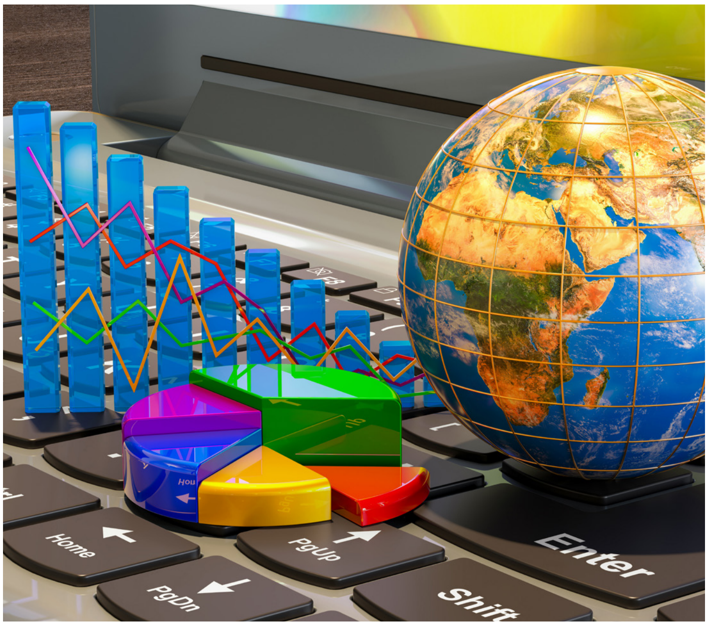


Draft position paper on Open Finance

In 2020 the FSCA published an assessment of the Open Finance landscape, including international review and survey of local industry participants. Fostering engagement amongst stakeholders. Drawing on these learnings, the FSCA is aiming for an approach to Open Finance in South Africa that drives sustainable innovation, financial inclusion, and competition, while at the same time protecting financial customers. Noting that the FSCA is one role player in the Open Finance regulatory ecosystem, a distinction is made between the steps to be taken as a conduct regulator to mitigate conduct and consumer protection risks brought about through data sharing, and national policy decisions relating to mandating Open Finance (or Open Banking). There are various Open Finance use-cases that leverage consumer financial data to offer innovative and personalised financial services and products. This draft Position Paper considers five such use-cases including account aggregation, financial management, payment initiation, alternative lending and insurance. The paper further illustrates potential risks emanating from Open Finance. These risks include amongst others, risks related to privacy and protection of personal data, misconduct, operational and cybersecurity, and fraud.



Proposed updates to the International Valuation Standards (IVS)



The proposed changes have been developed by the International Valuation Standards Council (IVSC) Standards Review Board and Technical Boards, which consist of leading valuation experts from around the world, working together to enhance the standards. These updates take into account various factors, such as ongoing changes in global markets and valuation practices, increasing use of technologyand data sources, growing demand for clarity in valuation processes, and the need to address new types of assets and liabilities, including environmental, social, and governance (ESG) factors. The consultation, commenced on 28 April 2023 and closed on Friday 28 July 2023, was seeking feedback aimed at enhancing the clarity, usefulness, and overall effectiveness of the IVS in promoting consistency and confidence in global valuations. The IVS are expected to be published in January 2024, with an effective date of July 2024.

IVSC Valuation Webinar Series 2023 – 7-15 June 2023

Listen to this informative webinar on the macroeconomic outlook, where leading experts from around the world shared their insights and predictions on the global economy. With the unprecedented challenges faced by businesses and economies, there has never been a more important time to stay up to date on macroeconomic trends and predictions. This webinar explores topics such as the impact of inflation, and the potential effects of ongoing geopolitical tensions on global markets. Don't miss this opportunity to gain valuable insights and perspectives from a panel of international experts including leading economist and political experts.

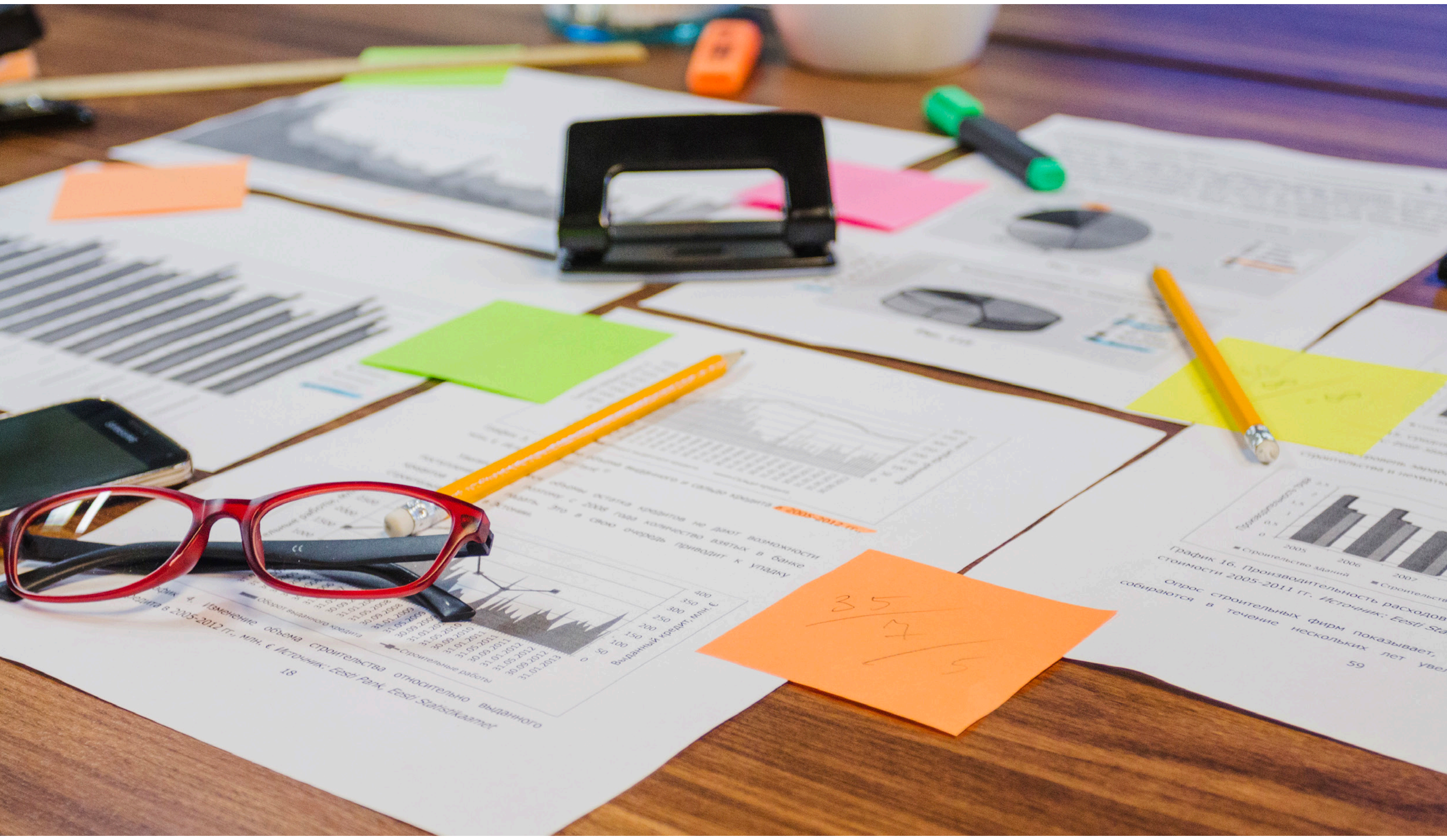
Perspectives Paper: Deciphering Technology

The introduction of new technology often marks the beginning of a new era; railroads, electrification, and combustion engines produced momentous changes even before the advent of the "digital revolution". The current wave of innovation is one of the factors behind the rise of intangible assets, which now account for a larger proportion of corporate assets than tangible ones. This transformation towards more intangible assets has had profound effects on the valuation of assets and businesses. In this series of Perspective Paper, the IVSC addresses the topic of technology valuation.

This paper defines technology as it pertains to valuation, lists salient features of technology that are critical in a valuation and outlines the ways in which IVS can be deployed to better manage technology valuation risk.

IFRS FOUNDATION WORK PLAN

- Amendments to the Classification and Measurement of Financial Instruments
- Annual Improvements to IFRS Accounting Standards —Cost Method (Amendments to IAS 7)
- Annual Improvements to IFRS Accounting Standards—Credit Risk Disclosures (Amendments to Illustrative Examples accompanying IFRS 7)
- Annual Improvements to IFRS Accounting Standards—Determination of a 'De Facto Agent' (Amendments to IFRS 10)
- Annual Improvements to IFRS Accounting Standards —Disclosure of Deferred Difference between Fair Value and Transaction Price (Amendments to Illustrative Guidance accompanying IFRS 7)
- Annual Improvements to IFRS Accounting Standards —Gain or Loss on Derecognition (Amendments to IFRS 7)
- Annual Improvements to IFRS Accounting Standards —Hedge Accounting by a First-time Adopter (Amendments to IFRS 1)
- Annual Improvements to IFRS Accounting Standards —Lessee Derecognition of Lease Liabilities (Amendments to IFRS 9)
- Annual Improvements to IFRS Accounting Standards —Transaction Price (Amendments to IFRS 9)
- Climate-related Risks in the Financial Statements
- International Applicability of the SASB Standards



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