South African Reserve Bank

Financial Stability Department

Discussion document

The deposit insurance funding model and the implications for banks

1 September 2020

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1. Executive summary[1]

When the South African Reserve Bank (SARB) published the paper titled *Designing a deposit insurance scheme for South Africa – a discussion paper* (2017 paper) in May 2017, the paper contained proposals for the key design features of a deposit insurance scheme (DIS) for South Africa, including some initial options for the funding of the deposit insurance fund (DIF). Subsequently, significant consultation with banks, through the Banking Association of South Africa (BASA) took place, resulting in a more cost-effective model of funding. Although the funding model has been informally shared with banks, this discussion paper provides banks with the opportunity to formally comment on the revised funding model.

The Financial Sector Laws Amendment Bill (FSLAB) contains high-level provisions relating to the funding of the DIF, but detailed rules have to be developed as part of secondary legislation to ensure that all stakeholders, especially banks, as members of the Corporation for Deposit Insurance (CoDI), have certainty about CoDI's funding model and the implications thereof. The funding policy proposals consider country-specific characteristics as well as applicable international standards, such as the Core Principles for Effective Deposit Insurance Systems (Core Principles) and other guidance issued by the International Association for Deposit Insurers (IADI).

The FSLAB provides preference to covered depositors in liquidation. This means that CoDI will be likely to recover most of the funds paid out to the covered depositors of a failed bank, from liquidation proceeds. This fact, as well as input provided by banks regarding the accounting requirements for different funding mechanisms, forms the basis of the funding model presented in this paper.

The most common practice of funding a new pre-funded DIS is to collect premiums to build a fund to a targeted overall amount over a couple of years. During the build-up period, the DIS remains underfunded. Sometimes new deposit insurance schemes receive seed capital from their government or from international organisations, which has not been the case in South Africa. The funding model proposed for South Africa is

[1] On 8 April 2020 the South African Reserve Bank (SARB) published a discussion document titled *A discussion document: coverage and reporting rules for deposit insurance in South Africa* (the coverage paper). The coverage paper outlined the series of deposit insurance discussion papers to be published during 2020. This is one of the discussion papers and provides details of the funding model for the CoDI and the obligations it will put on banks. The proposals in this discussion paper build on the proposals in the coverage paper in terms of deposit insurance submissions, the rules for the calculation of covered deposits and membership of CoDI.

somewhat unique, designed to overcome an underfunded situation in a cost-effective manner, while still allowing CoDI to fulfil its obligations. The proposed funding model has been subject to a peer review by the Financial Stability Board and IADI, as well as a Financial Sector Assessment Programme (FSAP) review by the International Monetary Fund (IMF) and World Bank. The policy proposals set out in this document have also been reviewed by a group of consultants, appointed by the World Bank to provide guidance and input on the establishment of CoDI.

The funding model will be subject to review, from time to time, as better empirical information becomes available. Once the deposit insurance fund (DIF) has built up its own funds sufficiently, as set out in this paper, further refinement such as differentiated funding obligations will also be considered.

1.1 Policy objective

In terms of the FSLAB, CoDI's objective, upon its establishment, will be to support the SARB in fulfilling its objective of, and responsibility for, protecting and enhancing financial stability. To fulfil its policy objective, one of CoDI's functions will be to establish, maintain and administer the DIF in the interest of the holders of covered deposits. To meet its policy objective, CoDI will have to build up a sufficiently large DIF to be able to protect the covered depositors of a bank when it fails[2].

1.2 Structure of the discussion paper

This discussion paper is structured as follows:

Section 2 discusses CoDI's tiered funding model. It also covers the emergency funding available to CoDI, and future revisions to the funding model.

Section 3 discusses CoDI's establishment and factors relating to its governance and administration, which will affect its operational costs and the levy to be paid by members.

Section 4 covers the processes for the calculation and payment of members' financial contributions to CoDI, including payments in specific situations.

[2] CoDI will pay out covered depositors of a failed bank when the Resolution Authority decides on a closed resolution strategy, but can also contribute to the resolution of a bank when an open resolution strategy is followed. A discussion paper focusing on payout will cover the uses of CoDI's funds during resolution and will be published later.

Section 5 covers potential non-compliance, by members, with CoDI's requirements and CoDI's treatment thereof.

Section 6 sets out the way forward.

1.3 Request for comments

Comments are invited on all the proposals in this paper. Comments received will be used to finalise the proposals. Once the FSLAB is promulgated, the provisions of the FSLAB, together with these proposals will form the basis of secondary legislation.

All comments should be sent to CoDI@resbank.co.za for the attention of the Head: Financial Stability Department. The closing date for comments is Friday, 16 October 2020.

2. The DIF and the funding of payout

According to the Core Principles, a deposit insurer must be funded by the banking industry. CoDI will require funding from its members for two reasons. The first reason, discussed in this section, is to build a DIF, supplemented with emergency funding arrangements, to be used for the fulfilment of its mandated function of either paying out the covered deposits of a failed bank or to support a resolution strategy or action with funding support[3]. The second reason, discussed in section 4, is to collect levy income from members to cover its operational costs.

CoDI's proposed funding model was changed after the publication of the 2017 paper and the finalisation of the FSLAB. The FSLAB contains amendments to the Insolvency Act 24 of 1936 (Insolvency Act), and introduces preference for covered deposits in liquidation, as depicted in This higher ranking for CoDI in the creditor hierarchy should result in CoDI recovering most of the funds paid out to the covered depositors of a failed bank.

[3] The payout discussion paper, to be published later, will provide more details about the use of CoDI's funds in resolution, including the role CoDI could play in different resolution strategies and conditions for the use of CoDI's funds.

Figure *1* below. Clause 166AD of the FSLAB specifies that CoDI will assume the rights and remedies of a covered depositor of a bank in resolution once it has paid out funds to such a depositor. This higher ranking for CoDI in the creditor hierarchy should result in CoDI recovering most of the funds paid out to the covered depositors of a failed bank.

Figure 1: Amended creditor hierarchy after the promulgation of the FSLAB

Secured creditors (up to the value of the security)
Preferred creditors
Covered deposits
Unsecured creditors (including uncovered deposits and non-qualifying debt instruments)
Flac instruments[4]
Regulatory debt instruments (in the order determined by the regulatory framework)

Source: SARB, 2019: 20

Furthermore, consideration was given to reduce the direct impact of CoDI's funding on banks' profitability by allowing a portion of the members' funding contributions to be accounted for as an asset on members' balance sheets, instead of being expensed through their income statements. This resulted in a tiered funding structure, as set out below.

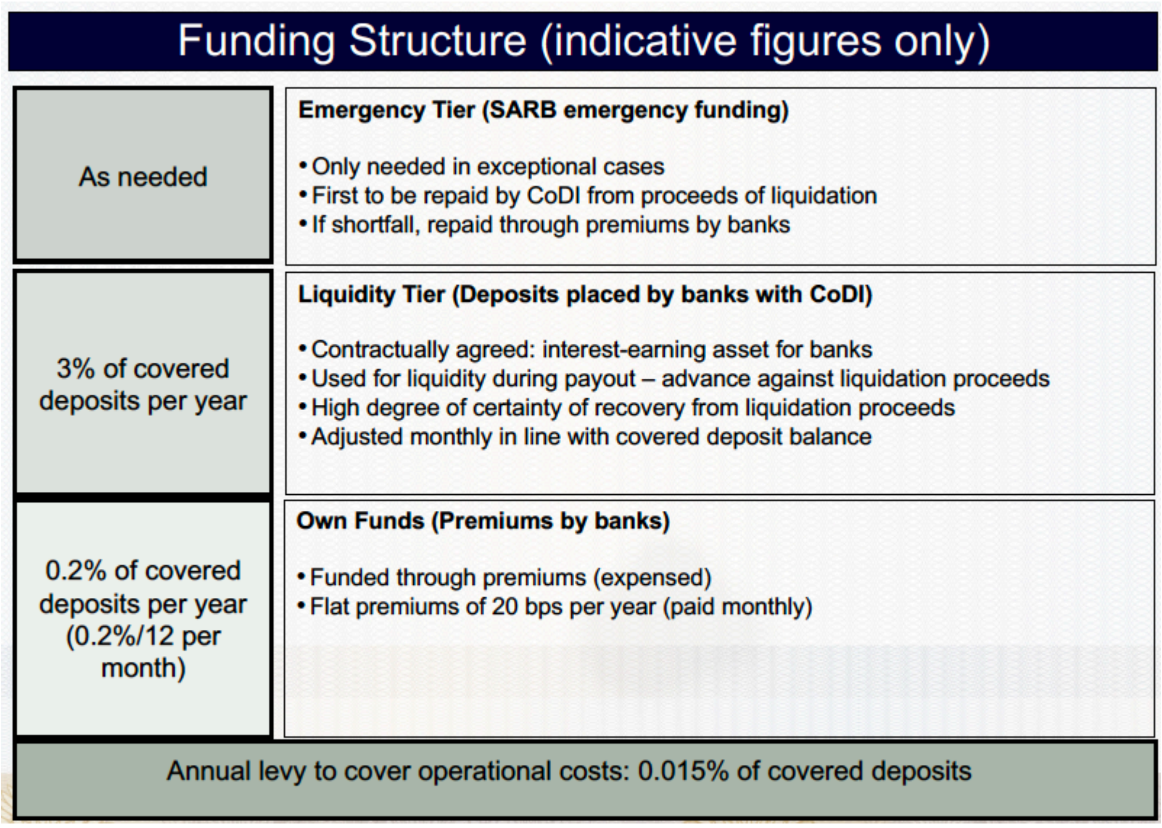
2.1 The funding model for CoDI

The funding model for CoDI is comprised of three tiers (as depicted in Figure 2 below) as follows:

- a tier consisting of the DIF's own funds, built up through monthly premiums;
- a tier consisting of a liquidity tier, which includes contractual deposits placed by members with CoDI; and
- an emergency funding facility provided by the SARB.

[4] Flac instruments as defined in the FSLAB

Figure 2: Tiered funding structure



The DIF will consist of the liquidity tier and CoDI's own funds, including the return earned by CoDI on the investment of these funds[5]. To determine the size of these two tiers, the Resolution Planning Division within the Financial Stability Department modelled the estimated payout amounts and proceeds from liquidation of several smaller banks[6] where liquidation will be the most likely resolution strategy should these banks fail. Payout amounts were estimated from the results of previous surveys of banks' covered deposits, and liquidation values were estimated by assigning recovery rates to the different asset categories reported in the regulatory returns, ranging from the highest quality assets (such as high-quality liquid assets) with a 100% recovery rate, to the lowest quality unsecured but performing loans, assuming a 30% recovery rate.

[5] This will include the return on CoDI's own funds plus CoDI's portion of the return on the liquidity tier.
[6] Large banks have been declared significantly important financial institutions (SIFIs) and will, where possible, follow an open-bank resolution strategy.

2.1.1 Liquidity tier

The liquidity tier will be the primary source of funds for payout of a failed bank's covered depositors for the first five years as CoDI builds the tier consisting of its own funds. CoDI will use the liquidity tier for liquidity purposes during a payout, in effect serving as an advance against the liquidation proceeds, to be recovered rather than representing a permanent loss of funds. After the first five years of CoDI's establishment, the failed bank's deposit and CoDI's own funds will be used before dipping into the liquidity tier.

The liquidity tier will be funded through interest-bearing deposits by CoDI's member banks, and this has to be maintained on a continuous basis. These deposits could be accounted for as assets on members' balance sheets. From the analyses performed, deposits of 3% of each member's covered deposits will be required to cover the simultaneous failure of a number of small banks. If CoDI pays out the covered deposits of a failed bank from its liquidity tier, CoDI will take the covered deposits' place in the creditor hierarchy. Because of the high preference CoDI will have in liquidation, the assumed recovery rates should be sufficient to replenish the liquidity tier in most cases.

The FSLAB[7] specifies that members of CoDI – with covered deposit balances – must maintain a minimum amount in the DIF for liquidity purposes and that interest must be paid to members on the amount held. The funding of the liquidity tier is a provision in the FSLAB and does not depend on the passing of the Financial Sector Laws Levies Bill (Levies Bill). The details of the minimum amount to be held and the interest earned will be specified by CoDI, in the secondary legislation. The size of the liquidity tier can range between 0% and 3.5% and CoDI will specify the size annually, based on its requirements.

Deposits comprising the liquidity tier will be rolled over on a monthly basis, and adjusted for changes in members' covered deposit balances. If the member's covered deposit balance[8] increased from one month to the next, the member will need to top up the deposit amount it has placed with CoDI, while a decrease in the covered deposit balance will result in the member receiving a refund from the deposit with CoDI.

If a member did not report covered deposits in its deposit insurance submission, no deposit amount will be required.

[7] Clause 166BH (Fund Liquidity)
[8] More details on the calculation of members' contributions are provided in section 4.

Example 1 explains how the monthly adjustments in members' deposits with CoDI would work.

Example 1: Example of adjustments to the deposit members place with CoDI

If a bank tenders its end-March deposit insurance submission during April, CoDI will process the submission. If the amount already deposited with CoDI is less than the required amount as per the latest deposit insurance submission, CoDI will issue a payment instruction to the member by the end of April to top up the deposit with the difference by the end of May. If the required deposit amount is lower than the deposit with CoDI, CoDI will refund the member with the difference by the end of May.

These deposits will be maintained as long as a member remains a registered bank, but will be repaid if a member voluntarily returns its banking licence to the PA. However, if the member fails, its deposit with CoDI will be used together with other funds from the DIF to pay out the member's covered depositors.

Further details on the deposits that banks will place with CoDI for the liquidity tier will be published in future. This will contain the details required in terms of clause 166BH (Fund Liquidity) of the FSLAB, including the terms and conditions, regulatory reporting considerations and the interest banks will earn on their deposits.

2.1.2 The DIF's own funds

The analyses showed that only in the case of a small number of banks is CoDI expected to experience a shortfall in the proceeds of liquidation with which to replenish the funds paid out[9]. For the first five years, the potential shortfalls will be funded from CoDI's own funds, which will be a loss-absorbing tier built from premiums paid by members. After the first five years, the liquidity tier will be used for shortfalls, after utilising the failed bank's deposit and CoDI's own funds first.

Members will have to expense the premiums through their income statements and will have no future claim[10] on the contributions once paid.

[9] There is a high degree of uncertainty in estimating liquidation values from the regulatory returns. As part of the implementation of the resolution framework, a more sophisticated model to determine more accurate estimations of liquidation values for individual banks will be developed. This information will enable a further refinement of estimated recovery rates and the calibration of the different funding tiers of the DIS will be adapted accordingly, if required.

[10] With the exception of corrections for underpayments and overpayments discussed in paragraph 5.3.

In future, CoDI will have a range for premiums to allow for flexibility to adjust the premium for the following purposes:

- the introduction of differentiated premiums for members; or
- ex-post premium contributions.

Recoveries may take several years, which may necessitate ex-post premiums after a payout has occurred since the DIF would need to be replenished and the SARB may need to be repaid for emergency funding provided (depending on the size of the failed bank's covered deposit base). At present, the Levies Bill specifies that the premium will be 0.2% of all members' covered deposits per year, but payable monthly. The premium will remain at 0.2% per year until the target fund size has been achieved; CoDI has reviewed its funding needs; or a differentiated premium structure has been introduced.

The frequency of premiums has been aligned to the frequency of the deposit insurance submissions. Each member must pay the premium amount in full each month.

For banks that do not have any covered deposits, there is no premium amount payable.

Example 2 explains the process to be followed for the payment of premiums.

Example 2: Example of premium payments

If a bank tenders its deposit insurance submission for end-March during April, CoDI will process the submission and invoice the bank by the end of April. The premium payment will be due by the end of May, based on the member's covered deposit balance for March.

In terms of the FSLAB, CoDI must publish, on its website and in the Register maintained by National Treasury,[11] the premiums collected.

2.1.3 Emergency funding

Although this is expected to be a rare exception, it is possible that the DIF may not be large enough to payout covered depositors. In such a case, CoDI will be able to use

[11] Register refers to the Financial Sector Information Register referred to in section 256 of the Financial Sector Regulation Act 9 of 2017 (FSR Act).

an emergency funding facility from the SARB, to partly fund the payout. The availability of the emergency funding facility from the SARB alleviates the need to maintain an excessively large and costly fund that may only be required in very rare instances.

In many jurisdictions the Ministry of Finance (Ministry) provides emergency funding to the deposit insurer. However, as most of the funds paid out by CoDI are likely to be recovered, and because CoDI will be a fully-owned subsidiary of the SARB, the SARB will provide CoDI with emergency funding.

As a central bank, the SARB is in the best position to provide such liquidity in terms of its existing processes and the provisions of the South African Reserve Bank Act 89 of 1990 (SARB Act). CoDI's claim against the estate of a failed bank will serve as collateral for the loan. There will be an agreement between the SARB and CoDI to establish this facility, agree on the process for utilising this facility, and the terms and conditions applicable. The SARB will be refunded from future premiums and/or liquidation proceeds from the failed bank, depending on the circumstances.

2.2 Target fund size

CoDI's target fund size for the DIF will be 4%, consisting of the 3% of the liquidity tier plus 1% in the tier with the DIF's own funds. The liquidity tier will be in place from the date that banks are required to maintain deposits at CoDI. The DIF's own funds will be built up over a period of five years. The intention is to change the composition of the DIF over time by gradually reducing the size of the liquidity tier as the DIF's own funds grow.

2.3 Revisions to the funding model

CoDI will perform analyses to review its funding needs and funding model at least every five years. Revisions to the funding model could include:

- reducing the size of the liquidity tier (based on more advanced modelling as better information from the implementation of the resolution framework becomes available);
- reducing or removing the liquidity tier when the DIF's own funds has built up sufficiently;

- adjusting the size of the premiums and levies based on CoDI's funding and operational requirements;
- aligning to new guidelines and principles published by IADI; and
- adopting differentiated funding obligations for banks with different risk profiles and/or resolution plans.

Feedback item 1

- Is the funding model and the purpose of the different tiers clear?
- Are there any aspects of the funding model that should be explained in more detail?

3. Financing of CoDI's governance, administration and operational costs

The governance and administration of CoDI, as contained in the FSLAB, have been designed to strike a balance between operational efficiency and the containment of administrative costs, as set out in the subsequent paragraphs.

Upon the promulgation of the FSLAB, CoDI will be established as a creature of statute and a subsidiary of the SARB[12]. The SARB will be CoDI's only shareholder with an initial share capital of R1 000 000. The board of directors (board) of CoDI will have the discretion to increase the share capital at any time[13]. CoDI can only be wound up by, or on authority of, an Act[14].

3.1 CoDI's board

Through its board, CoDI will be responsible for managing its own affairs, including the DIF, efficiently and effectively through the establishment of appropriate governance systems and processes[15]. In terms of clause 166AH of the FSLAB, five members of the board will be appointed to the board, by virtue of the position they hold namely:

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[12] Not all the provisions pertaining to CoDI in the FSLAB will be effective upon its promulgation. CoDI's implementation will take place based on a phased implementation schedule to be determined by the Minister of Finance (the Minister). Details about the phased implementation approach will be communicated to members once finalised.
[13] Clause 166AR: Share capital
[14] Clause 166AW (Winding up of Corporation)
[15] Clause 166AH (Governance of Corporation)

- the Chief Executive Officer (CEO) of the Prudential Authority (PA);
- the Commissioner of the Financial Sector Conduct Authority;
- the CEO of CoDI;
- the Group Chief Financial Officer of the SARB; and
- a deputy governor of the SARB.

Two other members will be appointed by the Governor of the SARB, with concurrence of the Minister. The eighth member of the board should be a representative from the National Treasury, appointed by the Director-General. This composition of the board implies that, at most, two board members will receive additional compensation for their appointment, and only if they are not already employed by the SARB or any of the regulators.

CoDI will have its own CEO, who will be appointed by the board. The FSLAB also stipulates the process for the appointment of the CEO, qualifying and disqualifying criteria for the appointment of the CEO, terms of office, and process for the removal of the CEO.

3.2 Staffing

The FSLAB allows CoDI to determine its needs for personnel, accommodation, facilities, resources and other services it may require to function effectively. CoDI may enter into agreements or contracts for the appointment of people and for any service or resources it may need in the performance of its functions.

The FSLAB requires the SARB to provide CoDI with personnel, accommodation, facilities, use of assets, resources and other services required by CoDI and agreed to by the SARB. The personnel that the SARB provides to CoDI will be on a secondment basis, and CoDI will be responsible to compensate the SARB for the cost of staffing. However, by leveraging off the SARB's human resources management policies and capacity, such costs will be limited to direct compensation costs.

In terms of staffing, CoDI's staff complement will be relatively small – this will be to ensure that it remains cost-effective as members will be funding CoDI's operational costs. Limiting the staff numbers means that, for the collection and processing of depositor information as well as for the facilitation of payout in the event of a bank failure, CoDI will rely on its systems.[16] The SARB has undertaken to provide CoDI's start-up costs, including funding for CoDI's core systems, without requiring CoDI to repay these funds. Any future system changes and enhancements will be paid for using the annual levy members will pay to CoDI.

3.3 Outsourcing of support functions

To further limit operational costs, CoDI's support functions will, in accordance with the FSLAB, be outsourced to various departments within the SARB. Outsourced functions will include the following:

- management of CoDI's investments by the Financial Markets Department;
- banking services and financial record keeping by the Financial Services Department;
- maintenance and information technology support by the Business Solutions and Technology Department;
- legal advice and consulting services by the Legal Services Department;
- compliance and risk management services by the Risk Management and Compliance Department;
- internal audit services by the Internal Audit Department; and
- physical space, furniture and other facilities by the Corporate Services Department.

The details of these services and their associated costs will be formalised in a management agreement between CoDI and the SARB. CoDI's board will regularly evaluate the management agreement, the quality and the costs of the services provided by the SARB to CoDI, to ensure that CoDI's requirements are met at reasonable cost.

3.3 Financial reporting

As a subsidiary of the SARB, CoDI will have the same financial year as the SARB (1 April to 31 March)[17]. CoDI will be required to compile audited annual financial

[16] More details about CoDI's systems and their functions will be provided in the data definition and reporting requirements and payout discussion papers to be published later.
[17] Clause 166AS (Financial year of Corporation)

statements (AFS) and an annual report. Copies of CoDI's annual report and AFS[18] will be submitted to the SARB and the Minister. The Minister will table CoDI's annual report in Parliament.

3.4 Operational costs

Members will pay an annual levy to CoDI as an expense (through their income statements. The levy will be used to fund CoDI's operations and will include items such as staff costs, public awareness costs and a fee payable to the SARB for the provision of support services to CoDI. CoDI will establish a reserve fund to provide for the maintenance, enhancements and upgrades of CoDI's systems or other potential large expenses to avoid increasing the levy percentages too often.

In the future, CoDI will have a range for levies to enable it to adjust the levy members have to pay periodically, based on its requirements. Currently, the Levies Bill provides for the levy percentage at 0.015% per year of a member's covered deposits, with a minimum levy amount of R1 000 per year. This percentage is based on estimations of CoDI's operational budget upon its establishment. CoDI's full operational costs will only become known once it becomes operational. One example of an expense where the costs were unknown when the initial estimates were done is the cost relating to the SARB's support services.

All annual levy payments will be due by the end of May, based on each member's March covered deposit balance[19]. A member should pay its annual levy in one payment. Example 3 explains how the annual levy payments will work.

Example 3: Example of levy payments

If a member tenders its end-March deposit insurance submission during April, CoDI will process the submission and invoice the member by the end of April. The levy payment will be due by the end of May, based on the member's covered deposit balance for March.

[18] Clause 166AU (Bookkeeping and auditing) and 166AV (Annual Report)
[19] Aligned to CoDI's financial year end of March.

A member with no covered deposits for the March reporting period must pay a fixed levy of R1 000 to be a member of CoDI. If a member has covered deposits but the calculation results in a levy amount of less than R1 000, the minimum amount of R1 000 will be payable by the member.

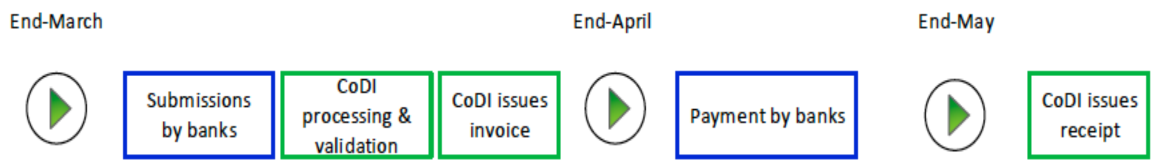
CoDI cannot use funds from the DIF (own funds or the liquidity tier) to cover its operational expenses. The actual operational cost for CoDI will be firmed up after the establishment of CoDI and the annual levy percentage in the Levies Bill will be adjusted, when necessary, based on CoDI's requirements. For example, if system changes are required and the reserve fund built up by CoDI is insufficient, the levy will be adjusted upwards.

If the levy income in a financial year exceeded CoDI's operational expenses, the FSLAB[20] will allow for the surplus funds to be credited to the DIF.

4. Calculation of members' financial obligations and treatment thereof in special situations

All members must provide CoDI with a deposit insurance submission, on a monthly basis. Figure 3 provides an example of the process to be followed for payments. Once CoDI's system has calculated (granular reporting banks) or verified (single customer view (SCV) reporting banks) each bank's covered deposit balance, it will calculate their respective financial obligations. CoDI will invoice all members by the end of the month following the month to which the submission related.

Figure 3: Example of a March reporting period to reflect the timelines between submissions, invoicing and payments



All members will have to pay the outstanding amount by the end of the following month. This means that members' financial contributions to CoDI will be due approximately eight weeks (two months) after the month-end to which the deposit insurance

[20] Clause 166AT (Surplus funds)

submission related. Payments can be made using a credit transfer[21]. After receiving payment by a member, CoDI will issue the member with a receipt.

For the interest that members will earn on their deposits with CoDI, CoDI will provide a statement to the bank and pay the funds into the account specified by the member. The timelines for the payment of interest to banks will be the same as for the financial contributions by banks to CoDI, that is, payment of interest will be done within eight weeks of the reporting month's end.

Feedback item 2

The adjustment in the deposits that banks will place with CoDI will take place monthly. Banks will also receive interest on their deposits, on a monthly basis. The two will be done through two separate flows of funds.

- Would banks prefer the adjustment to the deposits to be done quarterly – based on the end-of-quarter covered deposit balance?
- Would banks prefer netting the interest earned and the deposit adjustment?
- For banks who are South African Multiple options Settlement System (SAMOS) participants, would the use of the Payment Clearing House payment mechanism be preferred as it may reduce the administrative burden for CoDI and banks?

The systems development for data collection and reporting of CoDI and that of members might not be completed by the time the FSLAB is promulgated and CoDI is established. In that case, CoDI may require banks to submit an estimate of its covered deposit balance using a proxy value. Details about the possible proxy will be communicated to banks in due course.

The following paragraphs describe the treatment of levies, premiums and deposits by members for specific types of situations.

[21] CoDI will provide payment details to all members before its establishment.

4.1 First year of establishment of CoDI

If CoDI is established on a date other than the start of its first financial year, a pro-rata levy amount will be calculated for the remaining months of the financial year. Premiums will be pro-rata as well, as premiums will only be payable for the remaining months of CoDI's financial year. Example 4 illustrates the payment processes to be followed if CoDI is established during its financial year, that is, 1 September.

Example 4: Pro-rata payments for CoDI's first financial year

If CoDI is established during its first financial year[22], for example, on 1 September, members will submit their first deposit insurance submission to CoDI based on the September balances during October.

After processing the submissions, CoDI will calculate members' contributions based on the September covered deposit balances:

- **Levies:** Since members' covered depositors would have been protected by CoDI from 1 September, members will pay a pro-rata percentage (7/12 months of CoDI's financial year) of the annual levy amount, based on the covered balances in the first (September) deposit insurance submission. CoDI will issue an invoice by the end of October for payment by the end of November. The levy payments will be due four weeks after the invoice has been issued, that is, by 30 November.
- **Premiums:** CoDI will issue an invoice to each member by the end of October and the premium for the September month-end will be due by 30 November.
- **Deposits amount:** CoDI will issue a payment instruction to each member by the end of October and members will have to deposit the funds with CoDI by 30 November.

Adjustments to the deposit balance will be monthly and will commence with the October deposit insurance submission.

4.2 Newly registered banks

A newly registered bank will automatically become a member of CoDI. It will be expected to tender its first deposit insurance submission at the end of its first month of

[22] The establishment of CoDI and the commencement of banks' financial and reporting responsibilities to CoDI will be determined in the implementation schedule.

operation as a bank. The covered deposit balance reported will be used to calculate the annual levy, monthly premium and deposit to be placed with CoDI as illustrated in Example 5.

Example 5: Example of payments by a newly registered bank

A bank receives its banking licence from the PA at the end of February. It immediately becomes a member of CoDI. It starts operating as a bank during March. The member submits its first deposit insurance submission for the March month-end to CoDI during April. The following will apply:

- **Levies:** The member will pay the pro-rata minimum levy amount of R1 000 for the one month it will be a member of CoDI before CoDI's year-end at the end of March (that is, 1/12 x R1 000) unless the calculation of the levy as a percentage of its covered deposits exceeds the minimum levy amount of R1 000, in which case the pro-rata percentage of the higher amount will be paid to CoDI.
- **Premium:** The monthly premium will be calculated as a percentage (0.2/12 times the covered deposit balance) of the member's covered deposit balance for March. If there were no covered deposits, then no premium is payable by the member for March.
- **Deposit:** The deposit that the member will be required to place with CoDI will be 3% of its covered deposit balance by the end of May. In subsequent months, this amount will be adjusted based on the covered deposit balance confirmed/calculated by CoDI for the member. If there were no covered deposits, then the member does not place a deposit with CoDI for the March reporting period.

4.3 Deregistered banks

If a member fails or deregisters as a bank, the member will remain liable for any unpaid levies for which CoDI has already invoiced the member. A pro-rate percentage of annual levy will be due to the member if it deregisters or fails after the payment of the annual levy. Example 6 illustrates the principles to be applied for a bank that deregisters during CoDI's financial year.

Example 6: Example of the treatment of the financial obligations of a deregistered bank

If a member's official date of deregistration is end-June, for example, the member would still have submitted a deposit insurance submission for June and its covered deposits would have been protected during June. It is likely that such a member would have either none or a small covered deposits balance on its balance sheet at this time as a condition for deregistration. CoDI will prioritise the submission, processing and invoicing for this member to avoid administrative delays with the deregistration process. The following will apply for its financial obligations to CoDI: • **Levies:** The member would already have paid its annual levy to CoDI at the end of May. CoDI will refund a pro-rata portion of the levy to the deregistered member, provided that it does not reduce the annual levy paid by the member to below the minimum levy amount of R1 000. • **Premiums:** The member will pay its final premiums based on the June covered deposit balances. • **Deposit:** CoDI will repay the deposit to the member. No adjustment to the deposit balance would be made based on the last deposit insurance submission. CoDI will repay the deposit balance as soon as the deregistered entity has paid any outstanding amounts to CoDI (such as the final premium amount).

4.4 Local branches of foreign banks

Upon CoDI's establishment, all local branches of foreign banks will become members of CoDI and will be subject to the same reporting and financial obligations as other members.

After CoDI's establishment, local branches of foreign banks that are members of a foreign DIS can apply to CoDI for an exemption from CoDI's requirements. After receiving such an application, CoDI will engage with the foreign DIS to determine the rights and responsibilities of each DIS when either the head office of the local branch or the local branch itself fails. Equivalence of coverage will be a consideration in this process.

Until the local branch of a foreign bank receives an official exemption from CoDI, the bank must comply with all CoDI's requirements. It will submit monthly reports and pay the annual levy, monthly premiums and maintain and adjust the deposit with CoDI.

4.5 A bank with a suspended banking license

In the coverage paper (SARB, 2020: 11), the proposal was made that a bank with a suspended license would cease to be a member of CoDI. The PA is most likely to suspend a bank's banking license to encourage the bank to address concerns raised by the PA. This bank is likely to still have covered deposits even if it cannot operate as a bank. As such, the revised proposal is for a bank with a suspended license to remain a member of CoDI until the PA officially cancels its licence or deregisters the bank. As such, a bank with a suspended licence will continue to submit its monthly submission of covered deposit data, pay its annual levy and monthly premiums to CoDI, and maintain and adjust its deposit with CoDI.

4.6 Mergers and acquisitions

The coverage paper (SARB, 2020: 12) proposed a six-month transition period following a merger or acquisition transaction during which the affected banks will continue reporting separately to CoDI. During the transition period, the banks involved will also separately continue their normal financial contributions to CoDI.

Example 7 illustrates how the levies, premiums and deposits by members will be affected by mergers or acquisition.

Example 7: Examples of financial contributions for members involved in mergers and acquisitions

Acquisition

Bank A decides to acquire Bank B and to continue operating under Bank A's banking licence. Bank B will cease to exist once the transaction has been finalised. If the effective transaction date is assumed to be the end of June, the six-month transition period requiring separate reporting for both banks will be for the month-ends of July to December. The following will apply:

	Trransition Period								
Reporting month	July	Aug	Sep	Oct	Nov	Dec	***Jan***	***Feb***	***Mar***
Bank A (levies)	-	-	-	-	-	-	-	-	-
Bank B (Levies)	-	-	-	-	-	-	Refund	Refund	Refund
Bank A (Premiums)	Pay	Pay	Pay	Pay	Pay	Pay	Pay	Pay	Pay
Bank B (Premiums)	Pay	Pay	Pay	Pay	Pay	Pay	N/A	N/A	N/A
Bank A (Deposit)	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment
Bank B (Deposit)	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Refund	N/A	N/A

- **Levies:** Both banks would already have paid their annual levies to CoDI at the end of May. From February of the following year, only Bank A will report to CoDI (based on its January figures). If no new banking license has been issued during this transaction, then Bank A will pay its next annual levy to CoDI at the end of May the following year. Since the transition periods ends with the reporting month-end of December, Bank B will receive a pro-rata refund of its annual levy for the months of January, February and March, since its depositors were covered separately up to the end of December, provided that the pro-rate refund does not reduce the annual levy paid by Bank B to below the minimum levy of R1 000.
- **Premiums:** Banks A and B will pay premiums based on the monthly covered deposit balances reported in the deposit insurance submissions for the month-ends from July to December. From the January month-end of the following year, only Bank A will report to CoDI and continue paying premiums on the covered deposits reported in its deposit insurance submissions.
- **Deposit:** Banks A and B will continue to adjust their deposit balances with CoDI during this transition period. From the January month-end of the following year, only Bank A will report to CoDI and adjustments to its deposit with CoDI will be made based on its monthly deposit insurance submissions. Bank B's remaining deposit will be repaid, provided that there are no outstanding financial contributions to CoDI.

Merger

Bank A and Bank B merge to become Bank C (new banking licence) and the effective transaction date is assumed to be end-June. Covered depositors at Bank A, Bank B and Bank C will be covered separately for the transition period and therefore separate deposit insurance submissions from all three members will be required for the month-ends from July to December. Bank C will be a registered bank from the effective date which is end-July and will be required to comply with the same requirements as other members, including reporting to CoDI and payment of its financial obligations. The following will apply:

	Trransition Period								
Reporting month	July	Aug	Sep	Oct	Nov	Dec	***Jan***	***Feb***	***Mar***
Bank A (Levies)	-	-	-	-	-	-	Refund	Refund	Refund
Bank B (Levies)	-	-	-	-	-	-	Refund	Refund	Refund
Bank C (Levies)	Pay	-	-	-	-	-	-	-	-
Bank A (Premiums)	-	-	-	-	-	-	N/A	N/A	N/A
Bank B (Premiums)	-	-	-	-	-	-	N/A	N/A	N/A
Bank C (Premiums)	Pay	Pay	Pay	Pay	Pay	Pay	Pay	Pay	Pay
Bank A (Deposit)	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Refund	N/A	N/A
Bank B (Deposit)	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Refund	N/A	N/A
Bank C (Deposit)	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment	Adjustment

- **Levies:** Banks A and B would have paid their annual levy to CoDI at the end of May. Bank C will be expected to pay its annual levy to CoDI at the end of August based on the July figures (9/12 x annual levy percentage x covered deposits with the minimum being R1 000). Banks A and B will cease to exist at the end of the six-months reporting period, at the end of December, and will receive pro-rata refunds of their annual levy to CoDI provided that it does not reduce the annual levy paid by Banks A and B to below the minimum levy amount of R1 000.
- **Premiums:** Each of these banks (Banks A, B, C) will pay premiums on a monthly basis and based on the covered deposits reported in their deposit insurance submissions. From the January month-end onwards, only Bank C will do deposit insurance submissions and pay premiums on the covered deposit balance reported in these submissions.
- **Deposit:** Bank C's first submission, during August, will be used as a basis for calculating the amount the bank would have to deposit with CoDI. Banks A, B and C will have adjustments to their deposits with CoDI during the transition period based on the covered deposits reported in their deposit insurance submissions. From the January month-end onwards, only Bank C will do deposit insurance submissions and have adjustments to its deposit with CoDI, on a monthly basis, based on the covered deposit balance reported in these submissions. Banks A and B's deposit with CoDI will be refunded after their

last deposit insurance submission to CoDI, provided that there are no outstanding financial contributions from them.

Feedback item 3

- Is the treatment of levies, premiums and the deposits clear from the above examples?
- Are there any other special situations that could impact on the financial obligations of a bank that have not been covered?

5. Non-compliance with submissions and payments by banks

This section deals with potential non-compliance, by members, with their financial obligations to CoDI, and proposals for the treatment of under and overpayments by members. It is important to note that if a member cannot submit its deposit insurance submission due to technical or systems issue on CoDI's side, no penalties will be charged.

Any non-compliance to CoDI's requirements, by a member, will be reported to the PA if the relevant member has not become compliant within a 10-day period.

5.1 Late deposit insurance submission or invalid data deposit insurance submissions

Should a member not submit its deposit insurance submission during its allocated submission period, the member must apply to CoDI for an extension of the period of submission and provide justification for its delayed submission. A member will be given until the end of the month, following the month-end to which the submission relates, to make its deposit insurance submission to CoDI. If the submission is outstanding at the end of this period, CoDI will impose an administrative penalty of 5% of the premium due for the specific reporting month, calculated on a weekly basis from the date the submission was due. Penalties will be payable within five working days of CoDI sending an invoice to the member. CoDI will invoice the member only after receiving the outstanding deposit insurance submission. Example 8 demonstrates how this principle would be applied in practice.

Example 8: Example of administrative penalty for outstanding deposit insurance submissions

Bank A must tender its June deposit insurance submission during the third week of July. Bank A does not make its submission and does not apply to CoDI for an extension for its submission. The final date that Bank A could submit its deposit insurance submission without incurring an administrative penalty is 31 July. If Bank A only submits its deposit insurance submission on 8 August, it would have incurred a penalty of 5% of the premium that is payable for that reporting month, calculated on a weekly basis. Since the submission was seven days late, one week's penalty would be payable. If CoDI processes Bank A's June submission and invoice Bank A on 15 August, Bank A will have to pay the administrative fee, outstanding premium and deposit adjustment within five working days. During this time, Bank A will be expected to continue with its regular deposit insurance submissions and payments for premiums and deposit adjustments.

If a bank tenders its monthly deposit insurance submission with invalid data[23] to CoDI, the member will be liable for the same penalty as for a late submission to CoDI since the submission cannot be used by CoDI, and the member will have to resubmit the deposit insurance submission for that reporting period.

5.2 Non-payment of compulsory financial contributions

If a member does not pay its annual levy, monthly premium, deposit adjustments or administrative penalties to CoDI within the prescribed payment period (one month after CoDI issued an invoice or payment instruction), the member will be liable for the outstanding levy, premium or deposit adjustment in addition to an administrative fee of 10% of the outstanding amount per day, accruing on a daily basis from the date on which the amount became due.

The administrative penalty will be capped at the original amount payable by the member, that is, the maximum administrative penalty will be equal to the original amount payable. An example of this is provided in Example 9.

[23] CoDI will define invalid data and levels of materiality for errors on the deposit insurance submissions to provide guidance to banks.

Example 9: Example of the administrative penalty for outstanding compulsory financial contributions

Continuing with Example 8 above, Bank A has to pay its administrative penalty for the late submission of its June deposit insurance submission to CoDI within five days of the invoice being issued by CoDI. If Bank A does not pay within the five working days, but only in 15 working days, a second administrative penalty will be payable to CoDI. CoDI will invoice Bank A for this administrative penalty within three working days of receiving the payment and Bank A will have to pay the outstanding administrative penalty within five working days. During this time, Bank A will be expected to continue with its regular deposit insurance submissions and payments for premiums and deposit adjustments.

5.3 Under or overpayments made by banks

CoDI may refund or give credit for any overpaid amounts by a member in respect of a particular reporting period provided that the claim by the member bank is made within six months after the beginning of the period to which the overpayment relates. A bank can claim by contacting CoDI and providing evidence supporting the claim. The overpayment by the member bank could have been due to a calculation mistake or incorrect submission by the member bank, or a calculation mistake by CoDI. If CoDI detects that a bank has been overcharged, it will inform the bank and initiate a refund. Example 10 shows how this principle would be applied.

Example 10: Example of an overpayment by a bank to CoDI

Bank A submitted its March deposit insurance to CoDI. A month later, at the end of April, the bank discovers a significant mistake in the March 2020 submission. Bank A engages with CoDI about resubmitting its March submission. After the resubmission, the covered deposit balance decreased significantly. CoDI updates the calculations of the annual levy, premium and deposit amount. The difference will be repaid to Bank A within four weeks of CoDI's updated invoices. The same principle will apply if Bank A's mistake resulted in a higher covered deposit balance after the resubmission – Bank A would have to pay the additional amounts in terms of the updated invoices issued by CoDI.

If Bank A only discovered the mistake in November of the same year, more than six months would have passed since it submitted its March deposit insurance submission. In this case, CoDI will not allow a resubmission.

Similarly, CoDI can invoice and expect payment of any underpaid amounts by a member bank in respect of a particular period, provided that CoDI submits a claim by contacting the bank with details of the underpayment within six months after the beginning of the period to which the underpayment relates. Underpayment by member banks can occur due to a calculation mistake by the member bank, CoDI or due to incorrect information submitted by the member bank to CoDI. A bank can also inform CoDI if it has made a mistake and underpaid, in which case the bank would have to pay the difference to CoDI.

Feedback item 4

- Are the examples relating to non-compliance issues clear?
- Are there other instances of non-compliance that should be considered?

6. Investments by CoDI

IADI's guidelines for the investments of a DIS' funds will be considered in the development of CoDI's investment mandate. The SARB's Financial Markets Department will manage CoDI's investments in line with the investment mandate set by CoDI's Investment Committee. To invest CoDI's funds, the Investment Committee will consider the following general principles:

- the preservation of the DIF's own funds and the maintenance of CoDI's liquidity; and
- the development of adequate risk management policies and procedures, internal controls, disclosure and reporting systems.

CoDI will not invest any of its funds in its members as the failure of any member where funds have been invested will result in the funds remaining in the estate of the failed bank and not available for use by CoDI.

The Investment Committee will decide on the interest rate to be paid on members' deposits placed with CoDI. As mentioned in paragraph 2.1.1 above, the interest and other details about the deposits that banks will place with CoDI will be published in a separate discussion paper, in future.

7. Taxation

CoDI’s taxation status will impact its operational set-up and members’ treatment of expenses relating to CoDI. As mentioned in the 2020 budget review (National Treasury, 2020: 133), the Ministry is considering CoDI’s taxation status and will have discussions with the South African Revenue Services and the SARB in this regard. However, the Ministry has indicated that it will only be able to make a final decision on any tax concessions for CoDI and/or the DIF once the FSLAB has been promulgated.

8. The way forward

Comments on this discussion paper should be received by Friday, 16 October 2020, where after the proposals in this paper will be finalised for inclusion in the secondary legislation for CoDI to be issued after the promulgation of the FSLAB. Further engagements between CoDI and the banks will take place on the deposits for the liquidity tier of the funding model and the taxation status of CoDI.

A discussion paper covering the use of the DIF for payout and resolution support will be published in future.

Abbreviations

AFS	Annual Financial Statements
BASA	Banking Association of South Africa
Board	board of directors
CEO	Chief Executive Officer
CFIs	Cooperative Financial Institutions
CoDI	Corporation for Deposit Insurance
Coverage paper	A discussion document: coverage and reporting rules for deposit insurance in South Africa
Core Principles	IADI's Core Principles of Effective Deposit Insurance Systems
DIF	Deposit Insurance Fund
DIS	Deposit Insurance Scheme
FSLAB	Financial Sector Laws Amendment Bill
IADI	International Association of Deposit Insurers
Levies Bill	Financial Sector Levies Amendment Bill
Minister	Minister of Finance
Ministry	Ministry of Finance
National Treasury	National Treasury [of South Africa]
PA	Prudential Authority
PCH	Payment Clearing House
RA	Resolution Authority
SAMOS	South African Multiple Options Settlement System
SARB	South African Reserve Bank
SARB Act	South African Reserve Bank Act 90 of 1989
SIFI	Systemically Important Financial Institution

Terms and definitions

Bank(s)	Banks registered in terms of the Banks Act 94 of 1990, Mutual Banks Act 24 of 1993 and the Co-operative Banks Act 40 of 2007 (see also member(s)/member bank(s))
Closed resolution	The failed bank is liquidated and CoDI pays out the covered depositors of the failed bank
Covered deposits per bank	The total of all covered balances for a specific bank, including the covered balance for simple accounts and the covered balance for all complex accounts. The covered deposits per bank will be used as the basis for the calculation of all the contributions the bank is required to make to CoDI
Creature of statute	An agency that would not have existed, but for a legislative act that brought it into being (Black's Law Dictionary)
Curator	Individual or entity appointed to manage the affairs of an individual that is mentally and legally incapable of managing their own affairs
Depositor	The person who or business that is legally entitled to the funds in an account. For simple accounts, the depositor and account holder are the same. For complex accounts, the depositor is the ultimate beneficiary to the account
Granular reporting of depositor information	View of all the qualifying accounts held by a bank, but it has not been aggregated per qualifying depositor when reported to CoDI
Member(s)/member bank(s)	Banks registered in terms of the Banks Act 94 of 1990, Mutual Banks Act 124 of 1993 and the Co-operative Banks Act 40 of 2007 (see also bank(s))
Open bank resolution	The bank is not liquidated and depositors continue to have access to their deposits. CoDI will not payout depositors, but can contribute funds to support resolution strategy, subject to the conditions in the FSLAB
Single customer view	Aggregated view of all the qualifying accounts for a single qualifying depositor

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