



Ref.: 15/8/1/3

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

Proposed Directive issued in terms of section 6(6) of the Banks Act, 1990

Matters related to the requirements for measuring and controlling large exposures

Executive summary

The Basel Committee on Banking Supervision's (the Committee) standard issued in April 2014 titled "Supervisory framework for measuring and controlling large exposures¹" (revised LEX framework) complements the Committee's risk-based capital standard as the revised LEX framework is designed to specifically protect banks from material losses resulting from the non-performance of a single counterparty or group of connected counterparties which could ultimately threaten the solvency and liquidity of the bank or the banking group.

The Prudential Authority (the Authority) issued proposed amendments to the Regulations relating to Banks (the proposed Regulations) on 29 July 2020, which amongst other things, incorporate the revised LEX framework into the Regulations relating to Banks (the proposed Regulations). The proposed Regulations provide the Authority with enabling provisions to specify conditions or limits in writing for measuring and controlling specific types of large exposures. The revised proposed implementation date of the proposed Regulations is 1 July 2021.

This proposed directive serves to direct banks, branches of foreign institutions and controlling companies (hereinafter collectively referred to as 'banks') to apply the conditions and/ or limits specified in this proposed directive as from the revised proposed implementation date of the proposed Regulations.

1. Introduction

1.1 The revised LEX framework issued by the Committee in April 2014 complements the Committee's risk-based capital standard as the revised LEX framework is designed to specifically protect banks from material losses resulting from the non-performance of a single counterparty or a group of connected counterparties which could ultimately threaten the solvency and liquidity of the bank or the banking group.

¹ Available online at: <https://www.bis.org/publ/bcbs283.htm>

1.2 The Authority issued the proposed Regulations on 29 July 2020, which provide the Authority with enabling provisions to specify conditions and/ or limits in writing for measuring and controlling specific types of large exposures.

1.3 This proposed directive serves to direct banks to apply the conditions and/ or limits specified in this proposed directive as from the revised proposed implementation date of 1 July 2021.

2. Treatment and limits imposed on interbank exposures

2.1 Paragraphs 16 and 17 of the revised LEX framework specify that the sum of all the exposure values of a bank to a single counterparty or to a group of connected counterparties must not be higher than 25 per cent of the bank's tier 1 capital and reserve funds. The limit is set at 15 per cent for a global systemically important bank's (G-SIB) exposures to another G-SIB.

2.2 Paragraph 91 of the revised LEX framework specifies that member countries are at liberty to set more stringent standards, as with any other standards approved by the Committee. In particular, the concern related to contagion has led the Committee to propose a relatively tighter limit on exposures between G-SIBs, in principle, at the jurisdictional level to domestic systemically important banks (D-SIBs). The Committee therefore encourages jurisdictions to consider applying stricter limits to exposures between D-SIBs and to exposures of smaller banks to G-SIBs.

2.3 Paragraphs 65 and 66 of the revised LEX framework specify that only intraday interbank exposures are not subject to the large exposures framework but that in stressed circumstances, supervisors may have to accept a breach of an interbank limit ex post, in order to ensure stability in the interbank market.

2.4 Currently, credit concentration risk is not subject to pillar 1 capital requirements in terms of the capital framework and due to the banks' large exposures to other individual banking counterparties, it is important to limit banking institutions' exposures to each other where possible. One of the reasons why the interbank market in South Africa poses a significant credit concentration risk is due to the larger banking groups in South Africa creating a natural concentration in the interbank market. Therefore, in order to promote the safety and soundness of individual banks and to assist in limiting the systemic impact the failure of one large banking institution could have on the South African banking sector, it is equally important to limit the exposures between these larger banking institutions.

2.5 Previously, no limit was imposed on interbank exposures and in order to provide banks with sufficient time to implement the respective specified large exposure limits on a continuous daily basis, banks would be allowed, for a specified time period, to meet the respective specified limits for exposures, on an average daily balance for the month, where the average daily balance shall be calculated in accordance with the requirements specified in regulation 8 of the Regulations.

- 2.6 Furthermore, in order to provide an institution identified by the Authority or the Reserve Bank from time to time as a D-SIB with sufficient time to reduce their exposures to other systemically important financial institutions, D-SIBs would be required to, through a transitional approach, reduce its maximum exposures to other identified systemically important financial institutions, where, based on an average daily balance for the month, a threshold of 15 per cent of the bank's qualifying common equity tier 1 capital and reserve funds and additional tier 1 capital and reserve funds (qualifying tier 1 capital) would need to be met from 1 January 2025 onwards.

3. Application of the LEX requirements on intragroup exposures

- 3.1 Essential criteria 5 of Core Principle 20 of the Core Principles for Effective Banking Supervision issued by the Committee (Core Principles), which deals with transactions with related parties, requires that laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralisation of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.
- 3.2 Paragraphs 8 and 9 of the revised LEX framework specify the application of the large exposure framework to types of concentration risk other than a single counterparty or a group of connected counterparties and indicate that intragroup exposures have not been included in the scope of the revised LEX framework, although it could be considered as another source of concentration risk that might potentially endanger banks' survival.
- 3.3 Consequently, regulation 24(6)(c)(vii) of the proposed Regulations specifies that a bank shall manage its intragroup exposures in such a manner that the aggregate amount of its exposure to entities within the group complies with such conditions or limits as may be specified in writing by the Authority from time to time, in addition to any conditions or limits that may be specified in these Regulations or by the board of directors of the relevant bank or controlling company.
- 3.4 The Authority acknowledges the interconnectedness between entities within the group, but also acknowledges that for the large exposure requirements, intragroup exposures cannot necessarily and in all cases be regarded as a group of connected counterparties and be regarded as a single counterparty. Therefore, as specified in the proposed Regulations, the Authority proposed the insertion of an enabling provision to specify conditions where certain intragroup exposures would not be subject to all of the large exposure requirements.

4. Application of the LEX requirement on foreign subsidiary of a controlling company required to report on a solo basis

- 4.1 Core Principle 12 of the Core Principles, which deals with consolidated supervision, states that an essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide.
- 4.2 Essential criteria 5 of Core Principle 12 of the Core Principles requires the supervisor to review the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group, and to take appropriate supervisory action.
- 4.3 As such, regulation 24(6)(a) of the proposed Regulations requires a bank or controlling company to calculate and report its credit concentration risk at every relevant tier within the banking group, that is, as a minimum, at every relevant branch, bank solo and consolidated level, in accordance with the relevant requirements.
- 4.4 The Authority acknowledges that foreign subsidiaries would be subject to the regulatory requirements and concentration risk requirements as imposed by the prudential supervisors in the countries where they operate (host supervisor) and that the controlling company would be subject to regulatory requirements and concentration risk requirements as imposed by the Authority as the home supervisor.
- 4.5 However, foreign subsidiaries are exposed to concentration risk similar to any other separately capitalised institution or bank, which might potentially endanger their survival and ultimately the survival of their bank controlling companies or potentially even the wider banking group. Therefore, in order for the Authority to monitor and supervise concentration risk within a foreign subsidiary in accordance with the requirements specified in the revised LEX framework read with the Core Principles, the large exposure limit imposed on the said foreign subsidiary shall be based on the foreign subsidiary's own qualifying Tier 1 capital. However, should the host supervisor specify limits higher than 25 per cent for concentration risk, the foreign subsidiary will be allowed to exceed the imposed large exposure limit of 25 per cent specified by the Authority, provided that the exposure in excess of the limit shall be risk weighted at 1250 per cent and held by the relevant controlling company.

5. Directive

Based on the aforesaid and in accordance with the provisions of section 6(6) of the Banks Act 94 of 1990, from the revised proposed implementation date of the proposed Regulations from 1 July 2021 onwards, banks are hereby directed to ensure that:

- 5.1 For the purpose of regulation 24(6)(c)(iv)(A)(i) of the proposed Regulations, a bank shall manage its business in such a manner that the aggregate amount of its concentrated credit exposure, calculated in accordance with the relevant requirements specified in subregulation (6) to an institution identified by the

Authority or the Reserve Bank from time to time as a D-SIB or a domestic systemically important financial institution (D-SIFI), complies with the requirements specified below:

- 5.1.1 For the period from 1 July 2021 to 31 December 2024, the aggregate exposure does not at any time on an average daily balance basis for the month (calculated in accordance with the requirements specified in regulation 8 of the Regulations) exceed 25 per cent of the sum of the bank or controlling company's qualifying tier 1 capital, as reported in item 77 of the form BA 700, as at the end of the reporting date immediately preceding the reporting date to which the current form BA 210 relates.
- 5.1.2 From 1 January 2025 onwards, the aggregate exposure does not at any time exceed 25 per cent of the sum of the bank or controlling company's qualifying tier 1 capital, as reported in item 77 of the form BA 700, as at the end of the reporting date immediately preceding the reporting date to which the current form BA 210 relates.
- 5.2 For the purpose of regulation 24(6)(c)(iv)(A)(ii) of the proposed Regulations, following the 12th month after the date that the bank or controlling company itself has been identified as a D-SIB or D-SIFI, the aggregate amount of its concentrated credit exposure calculated in accordance with the relevant requirements specified in subregulation (6) to an institution identified by the Authority or the Reserve Bank from time to time as a D-SIB or D-SIFI, complies with the requirements specified below:
 - 5.2.1 For the period from 1 July 2021 to 31 December 2022, the aggregate exposure does not at any time on an average daily balance basis for the month (calculated in accordance with the requirements specified in regulation 8 of the Regulations) exceed 20 per cent of the sum of the bank or controlling company's qualifying tier 1 capital, as reported in item 77 of the form BA 700, as at the end of the reporting date immediately preceding the reporting date to which the current form BA 210 relates, provided that the maximum daily exposure shall at no stage exceed 25 per cent of the aforementioned sum of the bank or controlling company's qualifying tier 1 capital.
 - 5.2.2 For the period from 1 January 2023 to 31 December 2024, the aggregate exposure does not at any time on an average daily balance basis for the month (calculated in accordance with the requirements specified in regulation 8 of the Regulations) exceed 18 per cent of the sum of the bank or controlling company's qualifying tier 1 capital, as reported in item 77 of the form BA 700, as at the end of the reporting date immediately preceding the reporting date to which the current form BA 210 relates, provided that the maximum daily exposure shall at no stage exceed 20 per cent of the aforementioned sum of the bank or controlling company's qualifying tier 1 capital.
 - 5.2.3 From 1 January 2025 onwards, the aggregate exposure does not at any time on an average daily balance basis for the month (calculated in accordance with the requirements specified in regulation 8 of the Regulations) exceed 15 per cent of the sum of the bank or controlling company's qualifying tier 1 capital, as reported in item 77 of the form BA 700, as at the end of the reporting date immediately preceding the reporting date to which the current form BA 210 relates, provided that the maximum daily exposure shall at no stage exceed 18

per cent of the aforementioned sum of the bank or controlling company's qualifying tier 1 capital.

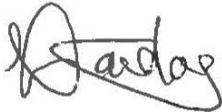
- 5.3 For the purpose of regulation 24(6)(c)(iv)(B)(i) of the proposed Regulations, a bank other than a D-SIB or a G-SIB shall manage its business in such a manner that the aggregate amount of its concentrated credit exposure, calculated in accordance with the relevant requirements specified in subregulation (6) to an institution identified as and included in the list of G-SIBs (which includes any branch of a G-SIB), published by the Financial Stability Board (FSB) from time to time, complies with the requirements specified below:
 - 5.3.1 For the period from 1 July 2021 to 31 December 2024 the aggregate exposure does not at any time on an average daily balance basis for the month (calculated in accordance with the requirements specified in regulation 8 of the Regulations) exceed 25 per cent of the sum of the bank or controlling company's tier 1 capital, as reported in item 77 of the form BA 700, as at the end of the reporting date immediately preceding the reporting date to which the current form BA 210 relates.
 - 5.3.2 From 1 January 2025 onwards, the aggregate exposure does not at any time exceed 25 per cent of the sum of the bank or controlling company's qualifying tier 1 capital, as reported in item 77 of the form BA 700, as at the end of the reporting date immediately preceding the reporting date to which the current form BA 210 relates.
- 5.4 For the purpose of regulation 24(6)(c)(iv)(B)(ii) of the proposed Regulations, a bank identified as a D-SIB shall manage its business in such a manner that the aggregate amount of its concentrated credit exposure, calculated in accordance with the relevant requirements specified in subregulation (6) to an institution identified as and included in the list of G-SIBs (which includes any branch of a G-SIB), published by the FSB from time to time, complies with the requirements specified below:
 - 5.4.1 For the period from 1 July 2021 to 31 December 2022, the aggregate exposure does not at any time on an average daily balance basis for the month (calculated in accordance with the requirements specified in regulation 8 of the Regulations) exceed 20 per cent of the sum of the bank or controlling company's qualifying tier 1 capital, as reported in item 77 of the form BA 700, as at the end of the reporting date immediately preceding the reporting date to which the current form BA 210 relates, provided that the maximum daily exposure shall at no stage exceed 25 per cent of the aforementioned sum of the bank or controlling company's qualifying tier 1 capital.
 - 5.4.2 For the period from 1 January 2023 to 31 December 2024, the aggregate exposure does not at any time on an average daily balance basis for the month (calculated in accordance with the requirements specified in regulation 8 of the Regulations) exceed 18 per cent of the sum of the bank or controlling company's qualifying tier 1 capital, as reported in item 77 of the form BA 700, as at the end of the reporting date immediately preceding the reporting date to which the current form BA 210 relates, provided that the maximum daily exposure shall at no stage exceed 20 per cent of the aforementioned sum of the bank or controlling company's qualifying tier 1 capital.

- 5.4.3 From 1 January 2025 onwards, the aggregate exposure does not at any time on an average daily balance basis for the month (calculated in accordance with the requirements specified in regulation 8 of the Regulations) exceed 15 per cent of the sum of the bank or controlling company's qualifying tier 1 capital, as reported in item 77 of the form BA 700, as at the end of the reporting date immediately preceding the reporting date to which the current form BA 210 relates, provided that the maximum daily exposure shall at no stage exceed 18 per cent of the aforementioned sum of the bank or controlling company's qualifying tier 1 capital.
- 5.5 For the purpose of regulation 24(6)(c)(vii) of the proposed Regulations, a bank shall manage its intragroup exposures in such a manner that the aggregate amount of its exposure to entities within the group complies with the requirements specified below:
- 5.5.1 Unless otherwise specified in writing by the Authority, intragroup exposures risk weighted at 0 per cent in terms of regulation 23(6)(j) of the Regulations, will be exempted from the large exposure limit.
- 5.5.2 For the period 1 July 2021 to 31 December 2024, for intragroup exposures other than intragroup exposures risk weighted at 0 per cent in terms of regulation 23(6)(j) of the Regulations, the bank or controlling company would not be required to determine the connectedness of the intragroup entities, however the aggregate exposure to each intragroup entity must comply with the large exposure limit specified in regulation 24(6) of the proposed Regulations.
- 5.5.3 Where the bank or controlling company is of the opinion that the large exposure limit specified or imposed would not be appropriate for a certain intragroup entity, the bank or controlling company shall demonstrate to the satisfaction of the Authority that due to the existence of specific circumstances, a different large exposure limit or treatment should be considered.
- 5.6 For the purposes of regulation 24(7)(a)(iii) of the proposed Regulations, in the case of a foreign subsidiary of a controlling company required to report on a solo basis, where the Authority is also responsible for the supervision of the controlling company, the specified amount as contemplated in section 73(1)(a) of the Banks Act, 1990 shall for reporting purposes be 10 per cent of the sum of the qualifying tier 1 capital of the relevant foreign subsidiary.
- 5.7 For the purposes of regulation 24(7)(c)(iii) of the proposed Regulations, in the case of a foreign subsidiary of a controlling company required to report on a solo basis, the specified percentage and the specified amount shall, unless specifically otherwise directed in writing in specific cases, be the relevant percentage of the sum of the qualifying tier 1 capital and reserve funds of the foreign subsidiary, provided that when the host supervisor specifies limits higher than 25 per cent for concentration risk, the exposure may exceed the 25 per cent limit specified by the Authority, but the amount in excess of the specified limit of 25 per cent of the sum of the qualifying tier 1 capital and reserve funds of the foreign subsidiary shall be risk weighted by the controlling company at 1250 per cent. The additional risk weighted exposure amount shall

then be held by the controlling company and reported as risk weighted exposure held in respect of concentration risk on the form BA700.

6. Invitation for comment

6.1 Banks, controlling companies, branches of foreign institutions and other interested persons are hereby invited to submit their comments in respect of the proposed directive to: SARB-PA@resbank.co.za and to este.nagel@resbank.co.za, for the attention of Ms Esté Nagel, by no later than 16 April 2021.



Kuben Naidoo
Deputy Governor and CEO: Prudential Authority

Date: 16 March 2021

Annexure 1

1 July 2021 - 31 December 2022		Exposure to		
		Banks other than a D-SIB or a G-SIB	D-SIB	G-SIB
		Exposure as % of bank's qualifying common equity tier 1 capital and reserve funds and additional tier 1 capital and reserve funds		
Exposure of	Banks other than a D-SIB or a G-SIB	25%	Monthly average of 25%	Monthly average of 25%
	D-SIB	25%	Monthly average of 20% Maximum of 25% during the month	Monthly average of 20% Maximum of 25% during the month
	G-SIB	25%	25%	15%

1 January 2023 - 31 December 2024		Exposure to		
		Banks other than a D-SIB or a G-SIB	D-SIB	G-SIB
		Exposure as % of bank's qualifying common equity tier 1 capital and reserve funds and additional tier 1 capital and reserve funds		
Exposure of	Banks other than a D-SIB or a G-SIB	25%	Monthly average of 25%	Monthly average of 25%
	D-SIB	25%	Monthly average of 18% Maximum of 20% during the month	Monthly average of 18% Maximum of 20% during the month
	G-SIB	25%	25%	15%

1 January 2025 onwards		Exposure to		
		Banks other than a D-SIB or a G-SIB	D-SIB	G-SIB
		Exposure as % of bank's qualifying common equity tier 1 capital and reserve funds and additional tier 1 capital and reserve funds		
Exposure of	Banks other than a D-SIB or a G-SIB	25%	25%	25%
	D-SIB	25%	Monthly average of 15% Maximum of 18% during the month	Monthly average of 15% Maximum of 18% during the month
	G-SIB	25%	25%	15%