

**Statement\* explaining the need for, intended operation and expected impact of the prudential standard for designated institutions in respect of transfer powers in resolution**

**February 2023**

\*This statement is prepared and published in accordance with and in fulfilment of the requirements under section 98(1) of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017)

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## Introduction

* 1. In terms of the Financial Sector Regulation Act No. 9 of 2017 (FSR Act), a regulatory instrument (i.e., a prudential, conduct or joint standard) must not be made unless the maker, in this case, the Prudential Authority (PA) has published -

#### the draft of the regulatory instrument;

#### a statement explaining the need for and the intended operation of the regulatory instrument;

#### a statement of the expected impact of the regulatory instrument; and

#### a notice inviting submissions in relation to the regulatory instrument and stating where, how and by when submissions are to be made.

* 1. In line with the requirements under the FSR Act, the PA has prepared this statement to explain the need for the proposed Prudential Standard on Transfer of assets and liabilities of designated institutions in resolution (the Standard), the expected impact as well as the intended operation of the Standard (Statement).

## The need for the Standard

* 1. Following the 2008 global financial crisis, the Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes), issued by the Financial Stability Board (FSB) in 2011 and revised in 2014, were formally adopted as an international standard in 2015. Transfer powers are one of the general resolution powers stipulated in the Key Attributes.
	2. The Key Attributes set out the core elements that the FSB considers necessary for an effective resolution regime. As such, their implementation should enable resolution authorities to resolve financial institutions in an orderly manner, without unduly exposing taxpayers to loss from solvency support, while maintaining continuity of their critical economic functions.
	3. South Africa as a G20 member is aligning its current resolution framework to the Key attributes through the recently enacted Financial Sector Laws Amendment Act 23 of 2021 (FSLA Act). The Standard gives effect to the requirements of the FSR Act as amended by the FSLA Act (the Act).
	4. Section 166S(2)(a) of the Act confers power to the South African Reserve Bank (Reserve Bank), to transfer, create an interest in or deal with the assets and liabilities of the designated institution in resolution, in any other way. However, the provisions in the Act are set at a principle level which necessitates further guidance, directives, and standards to be made to clarify their practical meaning and effect.
	5. Therefore, the Standard is necessary to set-out the following:

#### requirements that designated institutions need to comply with, including capabilities to build; and

#### safeguards that will apply in executing transfer powers.

* 1. The Standard stipulates the requirements to be complied with by designated institutions to enable the Reserve Bank to prepare for an orderly resolution and execute transfer powers effectively, in line with the international standards and principles, for the orderly resolution of designated institutions.

## The intended operation of the Standard

* 1. The Standard shall apply to all designated institutions, unless exempted by the PA, based on the resolution strategy set by the Reserve Bank. In addition-

#### the requirements in the Standard will only be applicable to designated institutions that have been informed or notified by the Reserve Bank that transfers will form part of their resolution strategy; and

#### the designated institutions will have a minimum of 2 years to comply with the requirements, after being informed or notified as per sub-paragraph (a) above.

* 1. The Standard sets out minimum requirements, for a Separability Analysis and a Transfer Playbook, to be performed by designated institutions.
	2. The aim of a separability analysis is to achieve the following –

#### to identify the central point of the expected application of the resolution tool (which is the assets and liabilities to be transferred, also known as the “transfer perimeter”);

1. to assess legal, operational and other interconnections that the transfer perimeter has with the rest of the designated institution to ensure that these interconnections are dealt with adequately to enable a clean separation (with the least separability barriers) of the transfer perimeter and continuity thereof post separation; and
2. to require capabilities to be developed for designated institutions to adapt their processes, governance protocols and management information systems (MIS) to enable effective execution of the transfer tool.
	1. The aim of a Transfer Playbook (which is an internal document to be used by the designated institution itself) is to operationalise the implementation ability of the resolution transfer tool within the structures of the designated institution. This document will include, at a minimum, governance processes, implementation timelines, mitigating strategies for barriers and communication plans to be followed in executing the transfer tool.
	2. The Standard also sets out general compliance and reporting requirements for designated institutions pertaining to transfers. The Authorities (the PA as directed by the Reserve Bank) will determine the form, manner and period for regulatory reporting and communicate those requirements through the PA’s website.
	3. The effective date of the Standard will be the implementation date at which the resolution provisions in the FSLA Act will come into operation (as per the commencement schedule to be published by the Minister of Finance in the Gazette).

## Expected impact of the Standard

* 1. The perspective of the Authorities is that the cost of implementing this standard will vary across designated institutions based on factors such as -

#### whether transfer tools will form a part of the resolution strategy;

#### whether transfer tools will be the main resolution tool or will only be used to complement other resolution tool(s) in the strategy (such as bail-in); and

#### the status or readiness of designated institutions in terms of capabilities to enable the preparation and execution of the resolution tool (such as Management Information System capabilities).

* 1. The expected benefit of the Standard is an overall increase in the credibility of the resolution process (where transfer tools are envisaged as part of the resolution strategy). This is due to adequate preparedness to execute the transfer tool, increased resolvability and separability barriers mitigated, applying safeguards where counterparties could be undermined by a partial transfer, and designated institutions’ readiness to execute a transfer tool within their structures.
	2. As part of the consultation process, and to assist the Reserve Bank and the PA to assess the expected impact of the Standard, a set of questions was included under Section C of Annexure C - Comments Template to solicit industry inputs on the expected impact of implementing the Standard. The comments received from the respondents were analysed and a summary of the key concerns as well as the approach that will be undertaken by the Authorities to mitigate the identified factors are as follows –
1. The respondents expressed that the overall objective of the Standard is relevant for ensuring financial stability and that the core elements would enable an effective resolution. On the downside, respondents raised concerns about the cost and effort required to achieve full compliance. While some of the respondents stated that it was difficult to consider costs and quantify the impact without knowing the resolution strategy to be applied by the Reserve Bank, however, 7 out of the 8 respondents stated that they expect additional costs to be imposed by the Standard.

#### In general, the expected costs for most respondents are related to IT and infrastructure (where system developments and enhancements would be necessitated), human resources, consultation fees, training and legal fees.

#### In order to mitigate against some of the above-mentioned concerns, a designated institution will only be required to comply with the requirements in the Standard once the Reserve Bank informs them that the transfer resolution tools(s) will form part of their resolution strategy. In addition, once informed that the transfer resolution tools will form part of the strategy, the relevant designated institution will have a minimum of 2 years (with a possible phased approach) to comply with the requirements in the Standard. The Authorities are of the view that this will provide sufficient time to the designated institution to comply with the Standard.

#### Furthermore, to mitigate against the additional resources that would be required, for instance with regards to the cost and effort that would be required to produce a separability analysis and a transfer playbook, the Authorities will apply the principle of proportionality (i.e. the requirements will be fit for purpose and relevant to the size, type, and nature of the financial institution and its operations). Designated institutions will also be allowed to leverage off existing processes (where possible) and not unnecessarily duplicate efforts to comply with the requirements.

#### With regards to the estimation of the time that would be required to comply with the requirements of the Standard, the 4 respondents to the question indicated a preferred period running from 12 months to 5 years. The Authorities have proposed a 2-year transitional period. This balances the need to allow the designation institutions sufficient time to be ready as well as ensure that the transfer resolution tool is also available in the overall resolution strategy within a reasonable period.

#### The main advantages or benefits of the Standard were cited by the industry to include -

#### alignment of the transfer resolution strategies with international benchmarks designed to enable the resolution authority to execute its transfer powers (and alignment with international standards and principles overall);

#### an opportunity for designated institutions to assess their operating models and interdependencies;

#### additional insight to be unearthed through transfer playbooks;

#### economical functioning of the designated institution in resolution which ultimately impacts customers and the economy as a whole; and

#### appropriate and relevant resolution plans in preparation for a potential resolution event.

* 1. From the summarised comments above, it is clear that the respondents see value in the Standard by recognising that it will enable an effective resolution and stating that it is aligned to international best practice that enables the resolution authority to execute an effective transfer resolution tool.
	2. The general concerns raised revolve around the operational complexities, the additional resources that would be required and the timelines for implementation. Despite the concerns raised, the respondents acknowledge that the costs have dependencies such as the resolution strategy (i.e., whether transfer tools are envisaged in the resolution strategy) and the nature of the assets and liabilities to be transferred.
	3. Based on the concerns raised in the impact assessment, the Authorities made additional changes to the application section of the Standard to give designated institutions a minimum period of 2 years to comply with requirements after they have been informed that transfer tools will form part of their resolution strategy.
	4. Overall, the implementation of the Standard with sufficient clarity regarding the resolution strategy for designated institutions and sufficient timelines to implement the requirements can be reasonably expected to yield more benefits than costs.

## Conclusion

* 1. The resolution transfer powers provided for in the Standard are a key element of South Africa’s resolution framework. The Standard will enable the Reserve Bank, as the resolution authority, to execute the relevant resolution strategy by transferring the assets and liabilities of designated institutions to ensure an orderly resolution.