SOUTH AFRICAN RESERVE BANK
Prudential Authority

Statement explaining the fees proposals by the Prudential Authority for the performance of specific functions under the financial sector laws

July 2023

(DRAFT - FOR PUBLIC CONSULTATION)

*This Note is prepared and published in accordance with and fulfilment of the requirements under section 240 read with section 98 of the Financial Sector Regulation Act, No. 9 of 2017

Contents

1. Purpose

1.1 In terms of section 240 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act), the Prudential Authority (PA) must publish the budget, estimates of expenditure and fees and levies proposals as well as an explanation of the budget, estimates of expenditure and the fees and levies proposals.

1.2 The levies for the first financial year are imposed through the formulas contained in Schedule 1 of the Financial Sector and Deposit Insurance Levies Act, 2022 (Act No. 11 of 2022) (Levies Act). The PA has put together a proposal of fees to be charged for the performance of specific functions, in terms of the FSR Act or other financial sector laws for the 2023/2024 financial year.

1.3 This document accompanies the fees proposed by the PA and seeks to provide an explanation of the PA's fees proposal as required in terms of section 240 of the FSR Act.

1.4 This document is being released for public consultation for six weeks, together with the draft Prudential Authority Fees Determination (PA Fees Determination).

2. Background

2.1 The FSR Act introduced important changes to the regulation and supervision of the South African financial sector. It created a prudential regulator, the PA, which is responsible for regulating banks, insurers, financial conglomerates, co-operative banks and co-operative financial institutions, as well as certain market infrastructures. The FSR Act also established a market conduct regulator, the Financial Sector Conduct Authority.

2.2 One of the fundamental principles as set out in the government's policy document[1] on the regulation and supervision of the financial sector is that regulators should be appropriately and adequately funded to enable them to effectively execute their mandates. According to this policy document, the regulated entities should ideally fund the operational budgets of regulators in a way that eliminates conflict of interest.

2.3 The Basel Committee on Banking Supervision Core Principles for Effective Bank Supervision, as well as the International Association of Insurance Supervisors

[1] A safer financial sector to serve South Africa better released by National Treasury, 23 February 2011.

Insurance Core Principles, require regulators (and supervisors) to have operational independence. This includes the availability of budgetary processes that do not undermine autonomy and the availability of adequate resources to execute their mandate.

2.4 Chapter 16 of the FSR Act, read with the Levies Act and the Financial Sector and Deposit Insurance Levies (Administration) and Deposit Insurance Premiums Act, 2022 (Act No. 12 of 2022) (Levies Administration Act), provides for the imposition and collection of levies from the regulated entities for the funding of the PA and other regulators specified under the FSR Act. Also, the FSR Act enables the PA to determine fees to fund the performance of certain functions thereunder.

2.5 The formulas for the levies that will be imposed on the supervised entities for the 2023/2024 financial year are outlined in Schedule 1 of the Levies Act. However, the PA is in the process of determining the proposed fees to be charged to fund the performance of specific functions in terms of Chapter 16 of the FSR Act.

3. Explanation of how fees are determined

3.1 Under section 237(1)(a) of the FSR Act, fees may be charged by the PA to fund the performance of specific functions under the FSR Act and the relevant financial sector laws. The fees prescribed to date in terms of the relevant financial sector laws will be repealed and replaced by the fees determined in terms of the process outlined in Chapter 16 of the FSR Act.

3.2 Fees related to banks, mutual banks, co-operative banks, and co-operative financial institutions, which are prescribed through either Regulations or Supervisory Rules, have not been reviewed in several years[2]. With the commencement of Chapter 16 of the FSR Act on 1 April 2023, the PA proposes to adjust, for inflation, the current fees prescribed under the Banks Act, the Mutual Banks Act, and the Co-operative Banks Act. The inflation adjustments will be for the period that these fees were last updated.

[2] The Prudential Standard IAF came into effect on 1 January 2020. Section 57(1) of the Co-operative Banks Act, 2007 (Act No 40 of 2007). The prescribed fees for banks have not been updated since January 2008, with the exception of the recent request to update the prescribed fees table to amend the Value Added Tax (VAT) from 14% to 15% as per Regulation 58. The prescribed fees for mutual banks and co-operative banks have not been updated since 1993 and 2010, respectively.

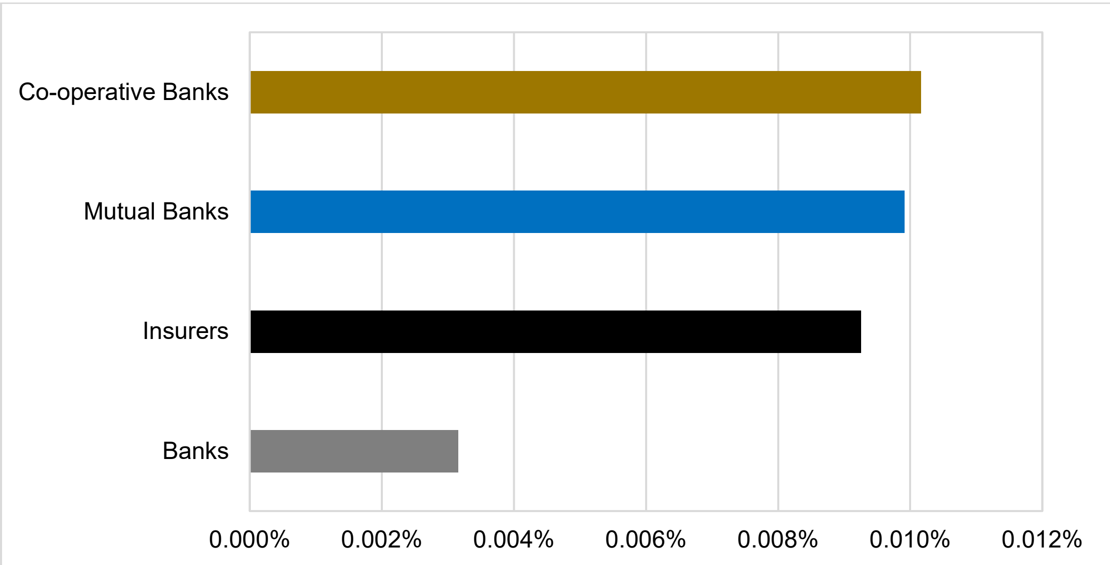
3.3 The PA proposes not to make any adjustments to the fees prescribed under the Prudential Standard Insurance Application Fees (IAF) that were set in 2020[3]. The Prudential Standard IAF sets out the fees payable for specific applications in terms of the Insurance Act, 2017. The Prudential Standard IAF was put in place as an interim measure pending the commencement of Chapter 16 of the FSR Act. Once the PA determines the fees in terms of Chapter 16 of the FSR Act, the Prudential Standard IAF will also be repealed.

3.4 The principle of proportionality was applied in the determination of the proposed fees for the different types of entities supervised by the PA. This is aimed at supporting financial inclusion and financial sector transformation objectives, as required in terms of the FSR Act.

4. The expected impact on the industry

4.1 The average annual fees received during the 2020/2021 and 2021/2022 financial years was approximately R5,3 million from the commercial banks, R6.6 million from the insurers and R1 thousand from the co-operative banks.

Figure 1: Ratio of fees to total operating expenses per sector



4.2 Anticipating the same level of fee collection for the 2023/2024 financial year, but only adjusting the fees by inflation, the fees that banks pay constitute a small fraction of the total funding of the PA. When compared to the total operating costs of the supervised entities, these account for between 0.01% and 0.03% of the total

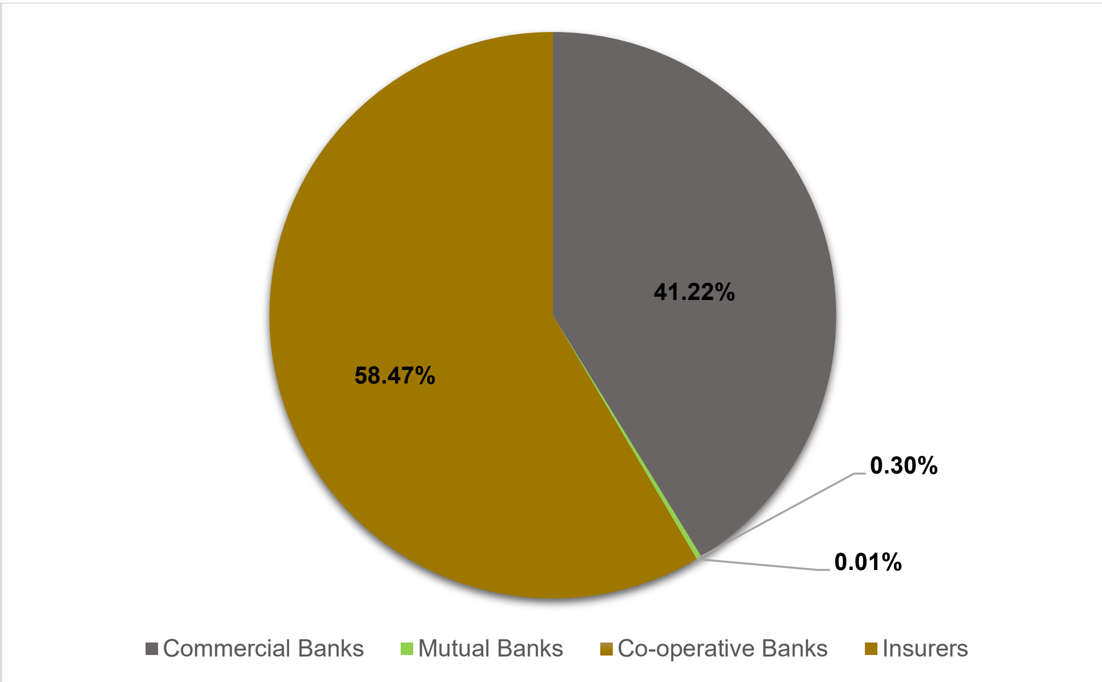
[3] The Prudential Standard IAF came into effect on 1 January 2020.

operating costs of the different categories of the supervised entities. The fees that the PA proposes to charge are insignificant when compared to the total operating costs of the supervised entities (see Figure 1).

4.3 The overall fees for banks and mutual banks in particular are estimated to decrease in 2023 as a result of the newly enacted Levies Administration Act, which repeals the requirement for banks and mutual banks to pay an annual licensing fee. This will reduce the overall fees payable by banks and mutual banks by approximately 97%.

4.4 Based on the fees collected in the previous two financial years, banks contribute about 41% and the insurance sector contribute about 59%. Co-operative banks and mutual banks account for less than 1% of the total fees collected by the PA.

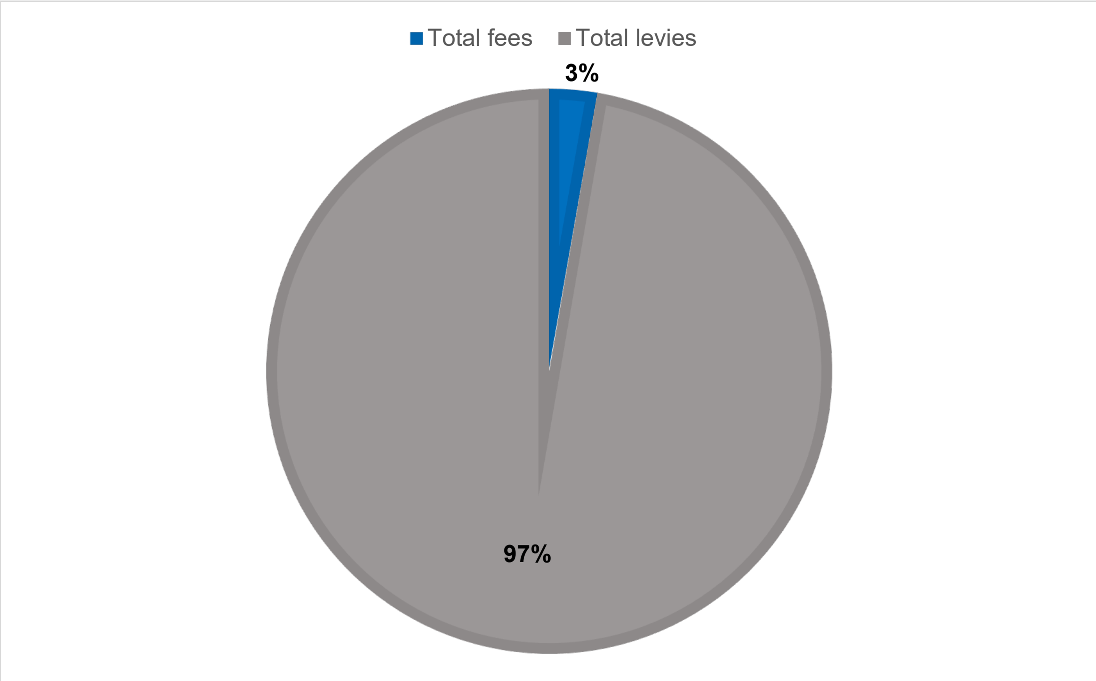
Figure 2: Fees by category of financial institutions



4.5 The charging of fees is modelled around the user-pay principle. Supervised entities that do not request the PA to undertake specific functions will not pay any fee(s) to the PA. The costs associated with the ongoing supervision and regulation of the financial sector by the PA will be funded from the levies and not the fees.

4.6 As depicted in Figure 3, fees account for approximately R14 million and levies R500 million of the total revenue collected by the PA. Therefore, 97% of funding will comprise levies and fees will only account for 3% of the total funds collected by the PA.

Figure 3: Composition of fees in total funding of the PA



4.7 The PA's view is that the proposed fees will not impact the supervised entities in any material way. This is due to the fact that fees for deposit-taking institutions are only being adjusted for inflation and that the annual licensing fees will be done away with. In addition, the fees for insurers are being maintained at the same level as previously determined in 2020 through the Prudential Standard IAF.

5. Operational and administrative matters

5.1 A supervised entity charged a fee may offer to pay the fee in specified instalments, and if the offer is made, the PA may accept the offer accept a modified offer; or reject the offer.

5.2 The PA is also required to notify the person who made the offer, of its decision, accordingly.

5.3 The collection of fees will be automated, and the PA will communicate further details in this regard at a later stage.

6. Conclusion

6.1 An effective regulatory and supervisory system requires that regulators are adequately funded in a manner that allows them to effectively discharge their respective responsibilities. The FSR Act and the Levies Act provide for such a mechanism aimed at ensuring that the PA is adequately funded. In addition, the FSR Act provides for a transparent process for the determination of levies and fees, sound governance, and budgetary processes that do not undermine the independence of the PA.