
CHAPTER 1

REGISTRAR'S REVIEW

INTRODUCTION

Many important changes occurred during the past year, the first being a new democratically elected government taking up office in May 1994. In July 1994, the Minister of Finance, Mr D L Keys, announced his resignation, and Mr C F Liebenberg was appointed as Minister of Finance with effect from 15 September 1994. The previous Registrar of Banks, Dr J H van Greuning, resigned with effect from the end of August 1994, and has taken up a post at the World Bank, in Washington, DC, as Senior Financial Sector Specialist. The appointments, effective as from 1 January 1995, of myself as Registrar of Banks and of Mr C L Oosthuizen as Deputy Registrar were confirmed in November 1994.

In general, and especially during the period covering the aforementioned changes, financial market conditions were fairly volatile, but the banking sector managed to maintain growth and profitability during the past year.

KEY ROLE OF BANKS AND RATIONALE FOR BANK SUPERVISION

It is widely recognised that banks play a key role in a country's financial system and national economy, and that banks differ from other profit-seeking business undertakings. While banks are managed with a view to generating profits and banks' shareholders expect a reasonable return on their investments, there are also strong public-interest considerations inherent in the operations of banks.

It is these public-interest considerations that provide the rationale for the supervision and regulation of banks. In particular, four factors are responsible for banks throughout the world being accorded a higher degree of official supervision and regulation than other business enterprises:

- Banks are the principal depository for the general public's liquid funds. The safety and ready availability of these funds for transactions are the responsibility of the banks' management and are essential to the *stability* and *efficiency* of the financial system.
- Banks employ the general public's funds to make loans and investments, thereby allocating scarce savings to

productive uses within the economy. In a market economy, this process should work to channel funds to the economic sectors that will make the most *efficient* and *productive* use of the funds.

- Banks serve as the main conduit for *monetary policy* between the central bank and the economy. A strong and adaptable banking system is needed to transmit the impulses of monetary policy to the whole financial system – and, ultimately, to the economy at large – without friction and delay.
- Banks provide the backbone for the national payment mechanism – commercial bank money is used for most payments, and most money-transfer services are provided by banks. A *reliable* and *efficient* payment mechanism is thus an essential component of any well-functioning industrial economy.

The above factors make banks not only an indispensable component of the financial system, but also a potential source of systemic instability. If there were no danger of systemic risk and of bank crises – risks that are inherent in a free-market system – there would be no need or scope for supervision.

CHALLENGES FACING BANK SUPERVISORS

One of the biggest challenges facing not only the South African bank supervisory authority, but bank supervisors worldwide, is the growing *internationalisation* of banks and banking groups. As a result of South Africa's re-entry into international financial markets, locally registered banks are increasingly expanding their operations into foreign countries, while, at the same time, foreign banks are seeking to expand their operations into this country.

Consequently, all the supervisory authorities concerned – in their capacities as both home-country supervisor and host-country supervisor – will have to place increasing emphasis on the *consolidated supervision* of banks' cross-border establishments. In the coming year, this Department will therefore give a great deal of attention to the adaptation and refinement of its standards regarding the consolidated supervision of South African banks' activities, including operations abroad, in order to comply with international standards, particularly those set by the Basle Committee on Banking Supervision, and the full implementation of such standards.

The internationalisation of banks, coupled with the need for effective consolidated supervision, brings with it a need to build up more open and closer *relationships* with other supervisory authorities. Within the African context, this process is being supported and aided by the Department's membership of the East and Southern Africa Banking Supervisors Group and its activities in this body, on which more detail is provided in Chapter 2.

Also of importance in the supervisory context are the demands being placed on South African banks with regard to *social upliftment*, particularly with regard to the provision of housing to disadvantaged communities, which lies at the core of the Government's Reconstruction and Development Programme, commonly known as the RDP. In order to provide loan finance to the lower end of the housing market, the then Minister of Housing, the late Mr Joe Slovo, signed an agreement with the Association of Mortgage Lenders in late October 1994. In terms of the agreement, all the parties concerned have certain obligations:

- Government and community leaders will have to help restore both a culture of payment for services rendered and the rule of law, as well as combat crime and violence and use the RDP to upgrade the public environment. It is envisaged that a period of up to 12 months will be required for this purpose.
- Communities will have to become involved in the process of reconstruction and demonstrate civil responsibility to a level that will allow the enforcement of civil and criminal law.
- The banking sector will have to resume lending to the lower end of the housing market and demonstrate to the Government, by means of a confidential reporting system, that it is performing in a socially responsible manner. Guidelines to be applied in credit extension to individuals will have to be made available to the public, but the responsibility for credit extension will remain that of the lender. For the 1995 calendar year, lending institutions have pledged to grant 50 000 loans, ranging from R10 000 to R100 000 and totalling between R1,5 billion and R2 billion, depending on demand and the construction industry's ability to meet the demand.

The agreement provides for a mortgage indemnity scheme ("MIS"), whereby the Government guarantees losses in

cases when lending institutions cannot repossess the properties of mortgage defaulters. The MIS cover, which will not be offered in high-risk areas, will apply for three years, but might be extended in areas where the due process of law cannot be applied.

Other key factors of the agreement are:

- The concept of "rightsizing", which includes the rescheduling of bonds and the placing of former borrowers in accommodation that they can afford.
- The linking of loans to savings, where possible, so that potential borrowers can meet banks' lending requirements.
- Fixed instalment loans, for which detailed financial modelling will be done. It will have to be made clear to borrowers in this loan category why they have to pay a higher interest rate than borrowers in the fluctuating instalment category.

In the words of the Chief Executive of The Council of Southern African Bankers, Mr P J Liebenberg, "the real breakthrough is that the agreement involves all the parties". In the same way, the success of the agreement will depend on all parties fulfilling their obligations, as sketched above.

The role of the bank supervisory authority with regard to the agreement will be to assist, wherever possible, in the promotion of the necessary sound risk-management policies within the banking sector.

SUPERVISORY AND REGULATORY FOCUS

The current rapid growth in the use of derivative products, together with the globalisation of banking and capital-market activities, is occurring at the expense of traditional banking business. As banks continue to move away from their traditional activities, the focus of bank supervision and regulation has to be adjusted accordingly.

Firstly, there has to be a greater focus on the supervision, as opposed to the regulation, of banks – although the regulatory framework will also have to be updated and amended on an ongoing basis to keep pace with developments in the banking sector and supervisory

practice. Secondly, it will become increasingly important for supervisors to exercise sound judgement, since they will be required to assess an individual bank's business strategy in the light of the bank's management capabilities and overall market conditions, as well as the adequacy of systems and control related thereto.

Supervisors will have to understand the risks involved as banks develop new funding and trading strategies, new risk-management techniques and new organisational structures, as well as increased risk appetites and increasingly complex risks, in response to a rapidly changing competitive and technological environment. Consequently, there will also have to be a greater focus on appropriate market-related training for supervisory staff.

INVESTOR PROTECTION

The question of whether some form of deposit insurance and investor protection should be implemented in South Africa was raised owing to the losses suffered by depositors and investors in recent years that resulted from the failure of a number of banks and other financial entities.

As is reported in Chapter 2, the Bank Supervision Department hosted a workshop on 2 September 1994, with the objective of, *inter alia*, opening the debate on deposit insurance; a working committee has since been established to undertake an in-depth investigation of the issue.

DERIVATIVES

It is widely recognised that existing accounting, statutory-reporting and public-disclosure standards and practices with regard to derivatives are not as comprehensive, consistent or informative as they might be. Standards and practices have not kept pace with rapidly changing technologies, and current reporting and disclosure standards do not provide a sufficiently accurate picture of a bank's risk profile. Consequently, it is difficult to make meaningful comparisons between derivative activities and the riskiness of these activities.

With a view to encouraging public disclosure by banks, the Bank for International Settlements published a discussion paper – commonly known as the Fisher report – in September 1994, in which a framework is recommended

for the disclosure of market risk and credit risk, based on a bank's internal risk-management and performance-assessment system. The initiatives that have been announced by the relevant national accounting bodies and the Group of Thirty, and which are intended to improve disclosure relating to derivatives, are very encouraging and are endorsed by the Bank Supervision Department.

MONEY LAUNDERING

South Africa, as one of the world's emerging financial centres, has an important role to play in combating money laundering. At its meeting in August 1994, the Standing Committee for the Revision of the Banks Act, 1990, raised the concern that South Africa had the potential to become a money-laundering "mecca" owing to the opening up of the country's financial markets.

Since the existing South African legislation touches on money laundering only in so far as it relates to drug trafficking, the Department plans to host a workshop on money laundering during the first half of 1995, with the objective of, *inter alia*, opening the debate on this topic, on which more detail is provided in Chapter 2.

ISSUES THAT WILL RECEIVE PARTICULAR ATTENTION DURING 1995

During 1995, the Department will focus its attention on, *inter alia*:

- Counterparty risk, specifically as regards the formulation of capital requirements for this risk and the implementation thereof, as well as the incorporation of such requirements in the Regulations relating to Banks.
- Market risk, particularly as regards capital requirements for this risk, in line with the work on models for the management of market risk being done by the Basle Committee on Banking Supervision.
- Payment systems – as a result of the growing internationalisation of banks and the blurring of boundaries between financial markets, the payment system is the most likely means through which an initially isolated financial problem could become a generalised crisis, both at a local and an international level.

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- ❑ Derivatives and consolidated supervision as flavour-of-the-year topics.
 - ❑ Hosting and presentation of the second ESAF Course in Banking Supervision, which will be held during the last three weeks of September 1995.
 - ❑ Broadening the current (mainly off-site) approach to supervision to one that is more orientated towards future requirements and that includes a larger on-site component.
 - ❑ Visits to the offshore operations of South African banks and their host regulators, for which a need has arisen in view of the increasing importance of consolidated supervision and the expansion abroad of South African banks.
 - ❑ Training, particularly as regards on-site supervision, risk management and the interaction between the different risks.
 - ❑ Holding a workshop on money laundering during the first half of 1995.

CONCLUSION

I wish to record my sincere appreciation to the former and the current Minister of Finance, and the former and the

current Deputy Minister of Finance, for their valued inputs and prompt responses to requests in terms of statutory requirements, as well as for the co-operation received from the Chairman of the Policy Board for Financial Services and Regulation, the Governor and Deputy Governors of the South African Reserve Bank, the senior executives of banking institutions, The Council of Southern African Bankers and the four banking associations, the Standing Committee for the Revision of the Banks Act, 1990, the staff of the South African Reserve Bank, particularly the staff of the Bank Supervision Department, and the many individuals with whom this Office has had contact during the year.

With the co-operation of everyone involved in the banking industry, both in the private and the public sector, I look forward to meeting the challenges that lie ahead in our constantly developing and changing business and political environment.

C F Wiese

Registrar of Banks, and General Manager: Bank Supervision Department