Banking regulation in South Africa in light of the 2020 Covid-19 pandemic

by

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Summary

Towards the end of 2007 through to 2008, the greater part of the world was hit by an economic stress period which culminated in the Global Financial Crisis (GFC). The major causes identified included a lack of corporate governance in financial institutions and a lack of capital buffers during stress periods.

Post the GFC, authorities had to come up with measures to avoid future collapses of financial institutions, banks in particular. The G20 member states with 28 countries currently, including South Africa, was established. Their common purpose was to improve banking regulations to be in line with international standards, with the sole intention of avoiding systemic failures in future.

The member states adopted the Basel Committee Regulatory Framework commonly referred to as Basel III to be uniformly applied. Although the Committee recommendations were not legally binding, they were strongly recommended to be applied by all member states.

Eleven years after the GFC, the world has been hit by the Covid-19 pandemic, which imposed severe stress on economic activities. This dissertation will look into South Africa's specific regulatory measures adopted and implemented in compliance with international standards and recommendations. The intention is to measure compliance, compare and contrast if any, with other member states in terms of implementation.

As the measures were specific for mainly the banking industry, the dissertation will focus on how South African banks responded to the stress event, Covid-19. The level of response is viewed in the context of relief measures and if the capital buffers are in line with international standards.

The dissertation will not measure the effectiveness of these measures, solely because Covid-19 is an unprecedented event. However, it will be mentioned what has transpired thus far which does give an indication of what the areas of improvement could be; and recommendations will thus be made.

The main focus will be on what regulatory measures are in place and how these have been implemented, compared with other G20 member states, to establish uniformity and compliance with international standards.

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Table of content

Declaration ... **i**

Summary ... **ii**

Acknowledgements ... **iii**

Table of content ... **iv**

Chapter 1: Introduction ... **1**

Chapter 2: The relevant legislation ... **3**

1.1 Introduction ... **3**

1.2 Constitution of the Republic of South Africa ... **3**

1.3 South African Reserve Bank Act ... **4**

1.4 Financial Sector Regulation Act ... **5**

1.5 Analysis of the Constitution, the SARB Act and the FSRA in the context of Covid-19 ... **11**

1.5.1 Supremacy of the Constitution ... 11

1.5.2 Role of the South African Reserve Bank ... 12

1.5.3 Financial Sector Regulation Act ... 15

1.6 Conclusion ... **17**

Chapter 3: Financial stability of financial institutions ... **18**

3.1 Introduction ... **18**

3.2 Prudential Authority ... **18**

3.2.1 Retention of the solvency capital requirement ... 23

3.2.2 Reporting requirements ... 24

3.2.2.1 Regulatory reporting ... 24

3.2.2.2 Own Risk and Solvency Assessments (ORSA) ... 25

3.3 Basel Committee on Banking Supervision ... **25**

3.3.1 Basel I: the Basel Capital Accord ... 27

3.3.2 Basel II: the new capital framework ... 27

3.3.3 Towards Basel III ... 28

3.3.4 Capital adequacy ... 31

3.4 Conclusion ... **34**

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Chapter 4: Global responses to the effects of Covid-19 36
4.1 Introduction 36
4.2 Bank exposure to Covid-19 in United States of America 36
4.3 United Kingdom Covid-19 response 39
4.4 Government of Germany's response to Covid-19 41
4.5 French Covid-19 response 43
4.6 Italy's Covid-19 response 43
4.7 Canada's Covid-19 Response 44
4.8 Conclusion 44
Chapter 5: Conclusion 46
Bibliography 48
Academic Journals 48
Case law 48
Legislation 48
Internet Sources 48
Other 49

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Chapter 1:
Introduction

A common denominator amongst banking institutions, regardless of where they are in the world, is the requirement to maintain appropriate levels of capital to be able to function optimally. The successes and failures of a banking institution often depend on capital adequacy.

Towards the end of 2007 right through to 2008, a greater part of the world went through an economy stress period which was called the Global Financial Crisis (GFC). Although two isolated incidents, "the losses in U.S. financial system- namely subprime residential mortgages and the collapse of the Lehman Brothers Investment Bank"[1] culminated to the financial crisis, they shared one impact, namely a deterioration of capital.

The 2007-2008 GFC was a game changer as far as banking regulations are concerned. Authorities globally had to come up with measures to avert the systematic effects should another financial crisis occur in future. Often the contributory factors of economic downturns are beyond the control of the financial institutions. However, lessons learnt post GFC indicated that banks can implement specific measures to better deal with stress periods as and when it occurs.

Regarding the causes identified, a lack of sufficient corporate governance and inadequate capital buffers for stress periods emerged as the main ones. Activities of banks are not confined to respective countries; banks have an international obligation as well. It is for that reason that banking issues in one country do not end there but often cause a chain reaction that ultimately affects the rest of the world.

The 2007-2008 GFC did not affect South Africa as adversely as many other parts of the world, but the country did take a resolution to reinforce its banking regulations and align them with international standards. In most countries, a central bank plays a major role in regulating and monitoring the economic activities and financial stability. South Africa too has a central bank, the South African Reserve Bank (SARB), which is entrusted with the financial stability of the country. Section

[1] F.S. Mishkin " Over the Cliff: From the Subprime to the Global Financial Crisis"(2011) 25 *Journal of Economic Perspectives 49-70.*

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224(2) of the Constitution of the Republic of South Africa, 1996 has entrusted this institution with independence.

Regulatory measures adopted in South Africa to avert systematic failures included the role of the SARB as mandated by the SARB Act 89 of 1990, the Financial Sector Regulation Act of 2017 to regulate all financial institutions as well as the Basel III regulatory framework which aimed at capital adequacy and capital buffers in banks specifically. The Prudential Authority was entrusted with the prudential supervisory function, which addressed matters like corporate governance.

The Basel Committee set minimum requirements as far as capital adequacy and more resilient capital buffers are concerned. However, authorities were allowed to increase these to be in line with their respective country's needs. The Committee's recommendations were not legally binding but highly recommended to be uniformly applied.

The focus of this paper is on South Africa's regulatory measures in the context of Covid-19 pandemic and some of the G20 member states. The main area of focus is the analysis and application of these measures to the current financial stress period. The aim is to discuss adherence to the required international standards, which will be measured by the responses adopted by South Africa to the stress period and lastly, recommendations will be made with regard to the future.

The analysis will include the SARB Amendment Act of 2010, the FSRA of 2017, the Constitution of the Republic of South Africa, 1996, Basel III and its new capital requirements as well as responses of other G20 member states to Covid-19. The dissertation seeks to answer the question whether or not measures adopted post GFC were effective and if they are sustainable for future systemic events.

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Chapter 2:
The relevant legislation

1.1 Introduction

Lax regulations identified as the contributory cause of the 2007-2008 GFC did not mean there were no regulations at all, but simply the fact that the regulations in place were not tailored to deal with averting systematic failures. The purpose of this chapter is to deal with those South African banking regulations introduced and amended with particular reference to provisions aimed at managing future financial crisis like the present, namely Covid-19.

In response to the causes of the 2007-2008 GFC, South Africa, although not adversely affected at the time, resolved to also review and align its banking regulations. These were modelled on and aligned with international standards. The sole aim was for the country to be able to avert systemic failure of our financial institutions should an event with similar effects hit our shores.

This chapter will discuss the sources of law applicable to financial regulation, namely the Constitution, SARB Act and Financial Sector Regulation Act.

1.2 Constitution of the Republic of South Africa

Chapter 1 of the Constitution of the Republic of South Africa, 1996 contains the founding provisions of the Constitution. In terms of section 1:

> "The Republic of South Africa is one, sovereign, democratic state founded on the following values
> (c) Supremacy of the constitution and the rule of law."

The authority conferred on the Constitution is based on the founding provisions and cannot be undermined or overlooked. Therefore, any interpretation and application of any law is done in line with the Constitution, otherwise it is rendered invalid.[2]

[2] Section 2 of the Constitution.

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According to section 223 of the Constitution, “The South African Reserve Bank is the central bank of the Republic and is regulated in terms of an Act of Parliament.” Section 225 further provides as follows:

> “The powers and functions of the South African Reserve Bank are those customarily exercised and performed by central banks, which powers and functions must be determined by an Act of Parliament and must be exercised or performed subject to the conditions prescribed in terms of that Act.”

An Act of Parliament is required to be assented to by the President.[3]

1.3 South African Reserve Bank Act

The South African Reserve Bank Act 90 of 1989 (the SARB Act), as amended in 2010, sets out two primary objectives of the Reserve Bank. In terms of section 3:

> “(1) The primary objective of the Bank shall be to protect the value of the currency of the Republic in the interest of balanced and sustainable economic growth in the Republic.
>
> (2) In addition, the Bank is responsible for protecting and maintaining financial stability as envisaged in the Financial Sector Regulation Act, 2017.”

The fact that the content of section 3(2) is not stipulated in the Constitution does not render it invalid. Section 225 of the Constitution is broad enough to accommodate additional powers given to the Reserve Bank, as long as they are determined and exercised as prescribed by an Act of Parliament.

According to section 4(2) of the SARB Act:

> “(a) The Governor shall be a person of tested banking experience.”

The section further requires each board member to be a person who possesses the necessary skills and be able to act as would be expected of a person holding a similar position. In other words, the person appointed to the position is required to exercise his or her duties with a degree of care, skill and diligence that may be reasonably expected from a person holding that position.

[3] Section 84(2)(a) of the Constitution.

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The requirement for banks to hold minimum reserve balances is contained in the Banks Act 94 of 1990.[4] The amended SARB Act, which had to be brought in line with the new measures aimed at improving banking regulation, included certain criteria to be met. The criteria are set out in sections 12, 14 and 15 of the FSRA.

1.4 Financial Sector Regulation Act

In maintaining financial stability as envisaged in the Financial Sector Regulation Act 9 of 2017 (FSRA), the Reserve Bank is responsible for protecting and enhancing financial stability.[5] By virtue of being a creature of statute, the SARB had to have the additional powers conferred to it by an Act of Parliament, the FSRA in this case.

The main objective of the FSRA is to achieve a stable financial system.[6] The system has to work in the interests of financial customers and support a balanced and sustainable economic growth in the Republic.[7] One of the contributory factors that culminated in the 2007-2008 GFC was somewhat lack of corporate governance. Lehman Brothers Investment Bank held in their balance sheet more debt than assets. This means that the bank was no longer financially stable and it did not have enough capital to absorb normal and abnormal losses.

The state of the books of Lehman Brothers Investment Bank was an open secret in the financial markets. It also did not help that with too much risk exposure, the bank was not willing to employ other means to balance its books, rendering it a candidate for financial instability.[8] The business conduct of Lehman painted a picture that the bank did not have accountability in their management. It was thus important that the FSRA addressed this aspect.

The preamble of the FSRA states one of the objectives being, “to establish a system of financial regulation by establishing the Prudential Authority and the Financial Sector Conduct Authority, and conferring powers on these entities”.[9] In other words, this Act can be said to be the primary legislation that directly addressed future measures to be taken in averting systematic failure.

[4] Section 70A.
[5] Section 11(1) of the FSRA.
[6] Section 7(1).
[7] Section 7(1).
[8] FS Mishkin “Over the Cliff: From the Subprime to the Global Financial Crisis” (2011) 25 *Journal of Economic Perspectives* 49-70.
[9] Act 9 of 2017, Preamble.

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This Act further fosters co-operation, consultation and collaboration among the key sectors of financial stability, which are the National Credit Regulator, the Financial Intelligence Centre and other organs of state in relation to financial stability.[10]

At the heart of the Act is the goal to provide a "regulatory and supervisory framework that aimed at promoting financial stability, safety and soundness of financial institutions and confidence in the financial system".[11] Faced with the task of incorporating, enforcing and "achieving a stable financial system that works in the interests of financial customers and that supports balanced and sustainable economic growth in the Republic",[12] the Act had to be specific in what was expected from whom. Furthermore, there are provisions aimed at ensuring compliance and adherence. Non-compliance is penalised according to the provisions of the Act as well.

Chapter 2 of the Act deals with financial stability. The Reserve Bank is tasked with this responsibility. The importance of the provision of financial stability is the fact that it correlates to section 4(2)(a) of the SARB Act, the specific requirement that the Governor should be a person of tested banking experience and further that members of the Board should be individuals who possess necessary skill and care and are able to act as would be expected of any reasonable person holding the same position. This requires pro-activeness from the Governor and the board members.

Needless to say, the responsibility for financial stability is one that is very tricky, if not impossible, to find a balance on. The main reason for this is the fact that generally the markets are fragile. More often the instability of the economy is as a result of issues that a financial institution has no control over. Issues like political instability and the current Covid-19 pandemic usually cause the markets to react negatively.

Section 12 of the FSRA requires of the central bank to closely monitor and keep under review amongst others:

"(i) the strengths and weaknesses of the financial system; and

(ii) any risks to financial stability, and the nature and extent of those risks, including risks that systemic events will occur and any other risks

[10] Act 9 of 2017, Preamble.
[11] Section 7(1)(a), (b) and (h).
[12] Section 7(1).

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> contemplated in matters raised by members of the Financial Stability Oversight Committee or reported to the Reserve Bank by a financial sector regulator."

One thus appreciates the rationale behind the establishment of the Financial Stability Oversight Committee (section 20), the Financial Sector Conduct Authority (section 56), the Prudential Authority (section 32) and other bodies to work with the SARB because the task is too big to be entrusted to one body. The significance of collaboration and co-operation can never be over-emphasised.

Section 13(1) and (2) of the FSRA provides for a financial stability review. The Reserve Bank is expected to make an assessment of the financial stability of the country at least every six months. The importance of this review assessment is the fact that risks to financial stability is done on at least a 12 months projection. Current trends are assessed on a probability basis for the period of the next 12 months from the date of the assessment. The report does not end with the Reserve Bank but gets submitted to Financial Stability Oversight Committee and the Minister of Finance who then reviews and comments on it.

Section 1 of the FSRA defines a systemic event as:

> "an event or circumstances, including one that occurs or arises outside the Republic that may reasonably be expected to have a substantial adverse effect on the financial system or on economic activity in the Republic, including an event or circumstance that leads to a loss of confidence that operators of, or participants in, payment systems, settlement systems or financial markets, or financial institutions, are able to continue to provide financial products or financial services, or services provided by a market infrastructure".

Section 14(1) to (7) lays out the steps leading to and procedure to be followed in declaring a systemic event. In order to curb the rapid spread of Covid-19, the government was forced to declare a state of disaster in terms of the Disaster Management Act, 2002 and subject the country to a lockdown period. The period of lockdown level 5 meant a disruption from normal business activities, resulting in an economic downturn. The Covid-19 pandemic and the effects it posed on the economy, was reasonably expected to have a substantial adverse effect on the financial system. It may however be noted that even though preparedness and anticipation of a systemic event is the primary objective in financial stability, the magnitude and intensity of Covid-19 has been unprecedented.

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Before the pandemic, South Africa already had a fragile economy, as per the 16 January 2020 MPC statement. However, in the 21 January 2021 MPC statement, a much better picture is painted. There are a couple of positives that are noted, such as: "compared to the outflows experienced in March and April 2020, capital flows to emerging markets have generally picked up in 2021".[13] And: "In recent months, notable strengthening of the markets has been seen".[14]

The SARB in pursuing its mandate for financial stability as per the Constitution and the FSRA, has a responsibility of conducting a financial stability review on a quarterly basis. The review aims to communicate assessments and analysis of potential risks to financial system stability.[15] The first quarter MPC meeting held in March 2020, the state of disaster was already declared. The main thing on the agenda was how to respond to the situation. The second quarter MPC meeting held in May 2020, the country was already on hard lockdown and impact of economic downturn already manifesting. However, "In the third quarter of 2020, the South African economy grew by 66.1% quarter on quarter, seasonally adjusted and annualized, compared to the Bank's expected 50.3% growth. The growth rate for the full year is now expected to be -7.1%, compared to the contraction of 8.0% expected at the time of the November MPC meeting."[16] The GDP is now expected to grow by 3.6% in 2021 and by 2.4% in 2022 compared to the 3.5% and 2.4% respectively, as anticipated in the November MPC meeting.[17] Overall, risks to the domestic growth outlook are assessed to be balanced.[18]

Since the Reserve Bank has the responsibility of dealing with financial instability, a response is required from it. Section 15(1) and (2) of the FSRA details the functions of the Reserve Bank. It provides as follows:

"15 (1) The Reserve Bank must take all reasonable steps-

[13] https://www.resbank.co.za/en/home/publications/publication-detail-pages/statements/monetary-policy-statements/2021/MPC-January/MPC-January-2021 accessed 23.02.2021.
[14] https://www.resbank.co.za/en/home/publications/publication-detail-pages/statements/monetary-policy-statements/2021/MPC-January/MPC-January-2021.
[15] https://www.resbank.co.za/content/dam/sarb/publications/reviews/finstab-review/2020/financial-stability-review-2nd-edition-2020/Second%20edition%202020%20Financial%20Stability%20Review.pdf accessed 30.03.2021
[16] https://www.resbank.co.za/en/home/publications/publication-detail-pages/statements/monetary-policy-statements/2021/MPC-January/MPC-January-2021
[17] https://www.resbank.co.za/en/home/publications/publication-detail-pages/statements/monetary-policy-statements/2021/MPC-January/MPC-January-2021
[18] https://www.resbank.co.za/en/home/publications/publication-detail-pages/statements/monetary-policy-statements/2021/MPC-January/MPC-January-2021

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(a) to prevent systemic events from occurring; and
(b) if a systemic event has occurred or is imminent, to-
(i) mitigate without delay the adverse effects of the event on financial stability; and
(ii) manage the systemic events and its effects.

(2) When acting in terms of subsection(1), the Reserve Bank must have regard to the need to-
(a) minimise adverse effects on financial stability and economic activity;
(b) protect, as appropriate, financial customers; and
(c) contain the cost to the Republic of the systemic event and the steps taken."

The Governor has the responsibility to monitor the trends as far as the economy is concerned and to act should a need arise. He or she nevertheless cannot do so without consulting with the Minister of Finance. Section 16 of the FSRA clearly states that whatever decisions the Governor takes, he or she has to inform the Minister and subsequently obtain approval from the Minister.

Section 16(2) of the FSRA provides as follows:

"The Reserve Bank may not, except with the Minister's approval, take a step in terms of section 15 that will or is likely to-
(a) bind the National Revenue Fund to any expenditure;
(b) have a material impact on the cost of borrowing for the National Revenue Fund; or
(c) create a future financial commitment or a contingent liability for the National Revenue Fund."

The Act requires the financial sector regulators in terms of section 16(2)(b) to issue the Governor with a directive in writing, including directions aimed at:

"(i) Preventing or reducing the spread of risk, weakness or disruption through the financial system or;
(ii) Increasing the resilience of financial institutions to risk, weakness or disruption."

It is important to outline the mandate of the Financial Stability Oversight Committee (FSOC) as provided for in the FSRA, since it works closely with the main role players in financial stability, which is the Reserve Bank and the Minister of Finance.

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Part 3 of the FSRA contains the establishment of the FSOC. Section 20(2) provides as follows:

> "The primary objectives of the Financial Stability Oversight Committee are to-
> (a) support the Reserve Bank when the Reserve Bank performs its functions in relation to financial stability; and
> (b) facilitate co-operation and collaboration between, and co-ordination of action among, the financial sector regulators and the Reserve Bank in respect of matters relating to financial stability."

The functions of the FSOC, as provided by section 21, are to:

> "(a) to serve as a forum for representatives of the Reserve Bank and of each of the financial sector regulators to be informed, and to exchange views, about the activities of the Reserve Bank and the financial sector regulators regarding financial stability;
> (b) to make recommendations to the Governor on the designation of systematically important financial institutions;
> (c) to advise the Minister and the Reserve Bank on-
> (i) steps to be taken to promote, protect or maintain, or to manage or prevent risks to, financial stability; and
> (ii) matters relating to crisis management and prevention;
> (d) to make recommendations to other organs of state regarding steps that are appropriate for them to take to assist in promoting, protecting or maintaining, or managing or preventing risks to financial stability".

The committee is expected to meet every six months or at any time when the Governor decides to convene a meeting. The Governor may also convene a meeting when requested to do so by the Chief Executive Officer (CEO), the Commissioner or the CEO of the National Credit Regulator.[19]

Section 83(1) of the FSRA established the Financial Sector Inter-Ministerial Council. In terms of this section,

> "the objective of the Inter-Ministerial Council is to facilitate co-operation and collaboration between Cabinet members responsible for administering legislation relevant to the regulation and supervision of the financial sector by providing a forum for discussion and consideration of matters of common interest."

[19] Section 24(1), (2) (a) and (b).

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1.5 Analysis of the Constitution, the SARB Act and the FSRA in the context of Covid-19

1.5.1 Supremacy of the Constitution

The Constitution is supreme. Therefore, all law and conduct must comply with the provisions of the Constitution.[20]

A recent case where the court grappled with a matter on constitutional supremacy was the matter between the SARB and the Public Protector.[21] The Reserve Bank had brought an urgent application to set aside the remedial action taken by the Public Protector, Ms Mkwebane. The remedial action contained in paragraph 7.2 of the final report directed that certain steps should be taken to amend section 224 of the Constitution with a view to altering the primary objective of the Reserve Bank.

The Public Protector has powers in terms of section 182(1) of the Constitution to investigate, report and take appropriate action on any conduct that is alleged or suspected to be improper or to result in any impropriety or prejudice. In *Economic Freedom Fighters v Speaker, National Assembly and Others*[22] the majority judgment acknowledged that "the Public Protector's power to take remedial action is wide but certainly not unfettered. The remedial action is always open to judicial scrutiny, not inflexible in its application, but situational. What remedial action to take in a particular case will be informed by the subject-matter of the investigation and the type of findings made."

The Reserve Bank had brought an urgent application to court for the review and set aside of the PP's report in view of the provisions of PP Act that decisions are binding.

The reference with regard to the supremacy of the Constitution was brought about in the judgment.[23] The Reserve Bank drew the PP's attention of the contents of section 224(2) of the Constitution and argued that the Reserve Bank is not part of government or the National Treasury:[24]

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[20] Section 1 and 2 of the Constitution.
[21] *South African Reserve Bank v Public Protector and Others* 2017(6) SA 198 (GP).
[22] *Economic Freedom Fighters v Speaker, National Assembly and Others* 2016 (3) SA 580 (CC) para 71.
[23] *South African Reserve Bank v Public Protector and Others* 2017 (6) SA 198 (GP) para 27.
[24] *South African Reserve Bank v Public Protector and Others* 2017 (6) SA 198 (GP) para 27.

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> “(2) The South African Reserve Bank, in pursuit of its primary object, must perform its functions independently and without fear, favour or prejudice”.[25]

In his founding affidavit, the Governor of the Reserve Bank, Mr. Lesetja Kganyago, had pointed out that “the ratings agencies made it clear that the independence of the Reserve Bank and its policy framework are among the strongest pillars supporting the South African economy and underpinning their rating assessment”.[26]

According to the Governor, as long as the remedial action remained in place, it held the risk of causing further currency depreciation, further ratings downgrades and significant capital outflows.[27]

In *Economic Freedom Fighters v Speaker National Assembly and Others,* the court held: “The power to take remedial action is primarily sourced from the supreme law itself. And the powers and functions conferred on the Public Protector by the Act owe their very existence or significance to the Constitution. Just as roots do not owe their life to the branches, so are the powers provided by national legislation incapable of eviscerating their constitutional forebears into operational obscurity.”[28]

In the High Court judgment, Murphy J reviewed and set aside the remedial action in the Public Protector’s Report.[29] The Public Protector case was the first one that was seen as challenging the independence of SARB, which is affirmed by the provision of the Constitution.[30]

1.5.2 Role of the South African Reserve Bank

Section 224 of the Constitution provides a primary object of the South African Reserve Bank and section 225 provides the powers and functions, which powers and functions must be determined by an Act of Parliament and must be exercised or performed subject to the conditions prescribed in terms of the Act.

As straightforward as it may sound, financial stability is a very scientific concept, which in general is “more controversial, less quantifiable and more difficult to define”.[31] In broad terms, it means “the joint stability of the key financial institutions

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[25] Section 224 of the Constitution.
[26] *South African Reserve Bank v Public Protector and Others* 2017 (6) SA 198 (GP) para 6.
[27] *South African Reserve Bank v Public Protector and Others* 2017 (6) SA 198 (GP) para 7.
[28] *South African Reserve Bank v Public Protector and Others* 2017 (6) SA 198 (GP) para 64.
[29] *South African Reserve Bank v Public Protector and Others* 2017 (6) SA 198 (GP) para 60.3
[30] Section 224 (2) Constitution of the Republic, 1996.
[31] Financial Stability; https://www.resbank.co.za/Financial%20Stability/Pages/FinancialStability-Home.aspx accessed 18.08.2020.

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and the financial markets in which they operate".[32] "Stability of financial institutions is further defined in the sense of having sufficient capital to absorb normal and sometimes abnormal losses, and sufficient liquidity to manage operations and volatility in normal periods."[33] A financial institution is financially stable if its operations are capable of running uninterrupted and unaffected by either factors within their control or outside their control.

In essence, the stability of financial markets is not a guarantee of no disruption to the economy, but it means that, should an event happen or is imminent which endangers the stability of the economy, the effects are manageable to avoid detrimental, disastrous effects which can cause an immediate collapse of the economy. In financial terms, it can be equated to managing systematic risk.[34] As explained by the SARB:

> "Financial instability would ultimately manifest itself through systemic risk, banking failures, intense asset-price volatility, interest and exchange rate volatility and a collapse of market liquidity."[35]

The SARB's monetary policy has the primary objective to "achieve and maintain price stability in the interest of sustainable and balanced economic development and growth".[36] Price stability, in turn, "reduces uncertainty in the economy and, therefore, provides a favorable environment for growth and employment creation".[37] In this regard, the SARB has full operational autonomy.[38]

The rationale for focusing on financial stability is "to create a sustainable level of economic growth through investment, employment and production".[39] The central bank is thus tasked with a dual responsibility; contribution towards the achievement

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[32] Financial Stability; https://www.resbank.co.za/Financial%20Stability/Pages/FinancialStability-Home.aspx accessed 18.08.2020.

[33] Financial Stability; https://www.resbank.co.za/Financial%20Stability/Pages/FinancialStability-Home.aspx accessed 18.08.2020.

[34] S 12 of the FSRA.

[35] Financial Stability; https://www.resbank.co.za/Financial%20Stability/Pages/FinancialStability-Home.aspx accessed 18.08.2020.

[36] Monetary policy; https://www.resbank.co.za/MonetaryPolicy/Pages/MonetaryPolicy-Home.aspx accessed 18.08.2020.

[37] Monetary policy; https://www.resbank.co.za/MonetaryPolicy/Pages/MonetaryPolicy-Home.aspx accessed 18.08.2020.

[38] Monetary policy; https://www.resbank.co.za/MonetaryPolicy/Pages/MonetaryPolicy-Home.aspx accessed 18.08.2020.

[39] Rationale for a financial stability focus; https://www.resbank.co.za/Financial%20Stability/Pages/Rationale-for-a-financial-stability-focus.aspx accessed 18.08.2020

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and secondly maintenance of a stable financial system.[40] The importance of the relationship between monetary policy and financial stability is that the central bank has to ensure these policies do not result in financial instability.

So, what has been the response of the SARB to Covid-19? In the report published on its website,[41] the SARB has taken four major steps, operating within its mandate and using monetary policy and regulatory tools at its disposal, with a commitment to limit the impact of the crisis on South Africa's economy and financial stability.

Firstly, there was a significant reduction in the repo rate. Currently the repo rate stands at 3.5% per annum as of 2 March 2021,[42] a decrease from 6.5% per annum on 1 January 2020.[43] The effect of a reduced repo rate is that it makes it more affordable for borrowers to meet their financial obligations, as it results in a decrease in monthly repayments. Furthermore, it makes finances more easily accessible to consumers, as banks also decrease their lending rate.

Secondly, additional liquidity has been made available to the banking sector. The SARB did this by increasing the size and duration of repo facilities by purchasing government bonds, thus enabling the continued smooth functioning of financial markets.[44]

Thirdly, the SARB partnered with banks and National Treasury to implement a loan guarantee scheme for small and medium-sized enterprises: "Businesses with an annual turnover of less than R300 million are eligible to apply for a guaranteed loan. Funds borrowed through this scheme can be used for operational expenses such as salaries, rent and lease agreements, and contracts with suppliers."[45]

Finally, the Prudential Authority is supporting banks in responding to the needs of their customers. In effect, "the support takes the form of regulatory relief measures

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[40] Rationale for a financial stability focus; https://www.resbank.co.za/Financial%20Stability/Pages/Rationale-for-a-financial-stability-focus.aspx accessed 18.08.2020.

[41] https://www.resbank.co.za/en/home/publications?sarbweb=3b6aa07d-92ab-441f-b7bf-bb7dfb1bedb4&sarblist=21b5222e-7125-4e55-bb65-56fd3333371e&sarbitem=9868 accessed 30.03.2021

[42] https://www.resbank.co.za/en/home/what-we-do/statistics/key-statistics/current-market-rates accessed 02.03.2021.

[43] Our response to Covid-19; https://www.resbank.co.za/Publications/Media/Pages/Our-response-to-COVID-19.aspx accessed 18.08.2020.

[44] Our response to Covid-19; https://www.resbank.co.za/Publications/Media/Pages/Our-response-to-COVID-19.aspx accessed 18.08.2020.

[45] Our response to Covid-19; https://www.resbank.co.za/Publications/Media/Pages/Our-response-to-COVID-19.aspx accessed 18.08.2020.

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and guidance to banks in managing the crisis".[46] These relief measures include "capital relief on restructured loans that were in good standing before Covid-19 crisis, lower liquidity coverage ratio and lower capital requirements".[47]

To elaborate on the last aspect, most banks set the relief measure on a three months period.[48] However, it became apparent that in the three months period the economy was not closer to recovery, which could have enabled the consumers to meet their financial obligations.

The SARB is a creature of statute. Therefore, all relief measures adopted in response to Covid-19 are prescribed by the SARB Act. For example, the buying of government bonds from financial institutions is provided for by the Act.[49] It is however noted that section 10(f)(i), which provides for powers and duties of the bank, is not being applied in the SARB's response to the Covid-19. This section empowers the SARB to grant loans and advances, provided that unsecured credit is granted to the Government of the Republic.

1.5.3 Financial Sector Regulation Act

Birthed after the 2007-2008 GFC, the FSRA sought to provide the financial sector with stability and assist with the economic growth of the Republic. The Act did not only provide tightened regulations but also expanded the scope of financial regulators.

The FSRA is the primary source for the financial sector, which includes banks. The purpose of the FSRA is not to undermine legislation like the Banks Act, but to offer optimum functionality of relevant legislation as well as to offer support structures.

The broader application of the FSRA in the context of Covid-19 will be discussed in the following chapter. Therefore, the next chapter will deal with the Prudential Authority which is one leg of the South African Twin Peaks Model, and the Basel III regulatory framework principles.

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[46] Our response to Covid-19; https://www.resbank.co.za/Publications/Media/Pages/Our-response-to-COVID-19.aspx accessed 18.08.2020.
[47] Our response to Covid-19; https://www.resbank.co.za/Publications/Media/Pages/Our-response-to-COVID-19.aspx accessed 18.08.2020.
[48] https://www.absa.co.za/media-centre/press-statements/2020/covid-19-payment-relief-plan/
[49] S 10(j) of the South African Reserve Bank Amendment Act 4 of 2010.

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1.6 Conclusion

The purpose of the amended SARB Act and the promulgation of the FSRA were to bring banking regulations in line with global standards. These standards primarily required financial institutions to be able to have measures in place to cushion the economy from systemic failures.

As mentioned above, it has only been 11 years down the line since the GFC. South Africa had its own challenges with the economy when the pandemic struck. This was confirmed by the Reserve Bank Monetary Policy for January 2020. Although the MPC had projected growth in the second quarter, this unfortunately did not happen because of the pandemic.

It is most likely too early to establish whether the SARB Act and the FSRA provisions have proven to be effective, and to what extent. On face value and procedurally, one may assume that it did respond to the immediate need that it was designed for. However, on final conclusion of this paper, this will be addressed in full. This will include a discussion of the economy, which shrunk by 51%, analysed in the context of systemic failure which the legislation discussed in this chapter aimed to avert.

The next chapter will deal with the prudential regulation of financial institutions also prompted by lessons learnt post the 2007-2008 GFC.

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Chapter 3:
Financial stability of financial institutions

3.1 Introduction

Financial stability as defined by the Act means the ability of financial institutions to operate without interruption, to be able to provide financial products and financial services, and market infrastructures to generally perform without interruption, regardless of changes in economic circumstances.[50]

The purpose of the revised and internationally aligned financial regulations was to be able to achieve financial stability. One of the lessons learnt from GFC was the importance of the well-being of financial institutions hence the need for improved regulations.

In this chapter, the Prudential Authority in South Africa, one leg of South Africa's Twin Peaks model, and the Basel Committee Framework on Banking Supervision, will be discussed. These are the measures adopted in South Africa in averting systemic failure in response to the 2007-2008 GFC. These have now also become relevant in the context of Covid-19.

3.2 Prudential Authority

The Prudential Authority (PA) is the authority established in terms of section 32 of the FSRA. Section 32 provides as follows:

> "(1) An authority called the Prudential Authority is hereby established.
> (2) The Prudential Authority is a juristic person operating within the administration of the Reserve Bank."

The objective of the PA, as set out in section 33 of the FSRA, is to:

> "(a) promote and enhance the safety and soundness of financial institutions that provide financial products and securities services;
> (b) promote and enhance the safety and soundness of market infrastructures;
> (c) protect financial customers against the risk that those financial institutions may fail to meet their obligations; and
> (d) assist in maintaining financial stability."

[50] Section 4(1) (a) and (b) of Act No.9 of 2017.

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In achieving this objective, section 34 provides for the PA's functions as follows:

"(1) (a) regulate and supervise, in accordance with the financial sector laws-
(i) financial institutions that provide financial products or securities services; and
(ii) market infrastructures;
(b) co-operate with and assist the Reserve Bank, the Financial Stability Oversight Committee, the Financial Sector Conduct Authority, the National Credit Regulator and the Financial Intelligence Centre, as required in terms of this Act;
(e) support financial inclusion;
(f) regularly review the perimeter and scope of financial sector regulation, and take steps to mitigate risks identified to the achievement of its objective or the effective performance of its functions; and
(g) conduct and publish research relevant to its objective.
(2) The Prudential Authority must also perform any other function conferred on it in terms of any other provision of this Act or other legislation.
(3) The Prudential Authority may do anything else reasonably necessary to achieve its objective, including-
(a) co-operating with its counterparts in other jurisdictions; and
(b) participating in relevant international regulatory, supervisory, financial stability and standard setting bodies.
(4) When performing its functions, the Prudential Authority must-
(a) take into account the need for a primarily pre-emptive, outcomes focused and risk-based approach, and prioritise the use of its resources in accordance with the significance of risks to the achievement of its objective; and
(b) to the extent practicable, have regard to international regulatory and supervisory standards set by bodies referred to in subsection (3)(b), and circumstances in the Republic.
(5) The Prudential Authority must perform its functions without fear, favour or prejudice."[51]

The FSRA placed the PA within the SARB.[52] The 2007-2008 GFC brought corporate governance issues to the fore.[53] Most bank failures are caused by weaknesses in bank governance.[54] As stated by Bossu and Chew, a lack of management with accountability emerged the strongest on the GFC. Insufficient board oversight of senior management, inadequate risk management and unduly complex bank

[51] Act 9 of 2017.
[52] Section 32 (2).
[53] W. Bossu and D. Chew "But we are different!"; 12 Common Weaknesses in Banking Laws, and what to do about them *IMF Working Paper* WP/15/200.
[54] Bossu and Chew *IMF Working Paper* WP/15/200 page 23 paragraph 38.

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organisational structures were highlighted as problematic.[55] As alluded by Mishkin, the manner in which Lehman Brothers conducted its banking affairs and risk exposures, it was an open secret in the financial markets that if any investment bank would run into trouble, Lehman would be on top of the list.[56] It is important for any investor to first have confidence in the institution in which he or she invests. Market surveys play a crucial role. A reputable investment automatically attracts more investors, and for a banking institution this is equally crucial. For a bank to be able to operate optimally, it has to have capital. The more capital the bank has and the more reputable it is, the more it can grow its profits.[57]

A bank has deposits that are short-term liabilities and assets that are long-term loans. A bank run occurs when a large number of customers decide to withdraw their money from the bank at the first sign of the bank being in trouble. When that happens it becomes a challenge for the bank to immediately convert their long term assets to cash.[58] This is a typical example of financial instability because when customers have withdrawn their cash, the bank is left with only long-term loans. These are not immediately convertible to cash. "The lack of effective risk management which transpired with the subprime mortgage crisis, meant banks would be unable to convert long-term assets into cash."[59]

The depth and duration of the economic downturn from the Covid-19 crisis remains uncertain. This is according to the PA report published by the SARB.[60] The national lockdown meant a "screeching halt" on the operation of many businesses, which was essential and unavoidable. The chain reaction caused by this was the loss or reduced income for consumers and the loss or reduced profits for businesses. "The pandemic has had a knock-on effect on economic activity and is expected to weaken banks' risk profiles or risk-weighted assets and reduce banks'

[55] Bossu and Chew *IMF Working Paper* WP/15/200 p 23, 38.
[56] F.S. Mishkin " Over the Cliff: From the Subprime to the Global Financial Crisis" (2011) 25 *Journal of Economic Perspectives Pages 49-70*
[57] Bossu and Chew *IMF Working Paper* WP/15/200.
[58] F.S. Mishkin " Over the Cliff: From the Subprime to the Global Financial Crisis" (2011) 25 *Journal of Economic Perspectives 49-70.*
[59] F.S. Mishkin " Over the Cliff: From the Subprime to the Global Financial Crisis"(2011) 25 *Journal of Economic Perspectives 49-70.*
[60] Prudential Authority Annual Report 2019/2020, chapter 4 page 16.

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profitability, which would negatively affect the ability of banks to meet their minimum capital requirements."[61]

With the adjusted regulatory requirements during the pandemic to enable consumers to still be able to access financial products, the likelihood of banks' risk profiles being compromised is unavoidable. On the other hand, the inability of consumers to meet their financial obligations will have a negative effect on the bank's balance sheet. To avoid this, the PA has allowed a slight adjustment of regulatory measures so as to strike a balance.

The loss or reduced income means consumers and businesses will be unable to meet their financial obligations. Failure to meet financial obligations will negatively impact on banks long term assets, the loans. To ensure continuous financial stability, measures needed to be implemented, measures which would ensure that, despite economic downturn, financial institutions are still able to provide their services.

> "South Africa's response has included a reduction in interest rates, an injection of liquidity into financial markets and significant regulatory relief for banks. More recently, several fiscal and tax measures were announced, supporting households and firms. These measures have helped stabilize markets, enabling banks to continue to operate by extending credit (long-term assets) to support their customers. A government -guaranteed loan scheme for small businesses will complement the measures already taken by banks to support their customers during these trying times."[62]

The PA implemented policy interventions applicable to banks, which were approved by the Prudential Committee during the stress period, and these were:[63]

- reducing the systemic risk add-on, from 1% of total capital to 0%;
- providing clear criteria on how banks can utilize their capital conservation buffer (that is, the loss-absorbing capital built up by banks for periods of economic stress);

[61] https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/2020/10227 accessed 18.01.2021.
[62] https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/2020/10227 accessed 18.01.2021.
[63] https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/2020/10227 accessed 18.01.2021.

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- reducing the minimum liquidity coverage ratio requirement (that is, the ratio of liquid assets that a bank has to maintain in relation to its anticipated outflows) from 100% to 80%; and
- amending Directive 7 of 2015, whereby loans that were restructured as a result of the impact of Covid-19 will not attract a higher capital charge relating to the resultant credit exposures.

The PA issued Guidance Note 3 of 2020 setting out the expectations of the PA when banks apply the requirements of International Financial Reporting Standard (IFRS) 9 to restructured credit exposures during the Covid-19 crisis.[64] As mentioned earlier, the PA was established to work with SARB in averting future systemic failures. The regulatory framework and guidelines the body had in place, had never been put in practice. It was thus imperative that guidance should be provided. As explained by the SARB: "This guidance was important as it informed the banking sector on how it would account for and calculate the expected credit losses over its business cycle during this time. The PA also issued Guidance Note 4 of 2020 with recommendations for executive officers and material risk takers on the distribution of dividends on ordinary shares and the payment of cash bonuses."[65]

The regulation of the financial sector has expanded to even include insurance companies. The object of the FSRA amongst others "is to achieve a stable financial system that works in the interests of financial customers [...] by establishing a regulatory and supervisory framework that promotes the safety and soundness of financial institutions."[66] The Act further defines financial products as-

> "(b) a long term-policy as defined in section 1 (1) of the Long-term Insurance Act or life insurance policy as defined in section 1 of the Insurance Act;
> (c) a short-term policy as defined in section 1(1) of the Short-term Insurance Act or non-life insurance policy".[67]

Chapter 6 of Insurance Act 18 of 2017 makes provision for financial soundness of insurance companies. On the governance frameworks of insurance companies and

[64] https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/2020/10227 accessed 18.01.2021.
[65] https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/2020/10227 accessed 18.01.2021.
[66] Section 7(1)(b) FSRA.
[67] Section 7(1)(c) FSRA.

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insurance groups, the Governance and Operational Standard for Insurers, together with the Governance and Operational Standards for Insurance Groups, issued in terms of the Insurance Act 18 of 2017, the PA's expectations for good governance and prescribed the minimum requirements.[68] The intention was to:

- create awareness of international principles relating to governance;
- determine the commitment from insurers and insurance groups to comply with these principles; and
- consider amendments to regulatory instruments or further supervisory interventions.[69]

The PA is tasked, among other things, "with promoting the safety of depositor and policyholder funds and the interests of members and beneficiaries of financial institutions. This function is essential in ensuring that there is confidence and trust in the South African financial system".[70]

The PA, in its regulatory response to Covid-19, identified certain immediate priorities that warranted further consideration by insurers, while acting in a responsible manner towards their shareholders, other stakeholders and, most importantly, their policyholders. These were based on the provisions of the Insurance Act 8 of 2017.[71] In assisting insurers, the Prudential Authority undertook the below measures:

3.2.1 Retention of the solvency capital requirement

The Solvency Capital Requirement (SCR) is, by design, a risk-based and risk-sensitive framework that provides information that is important to both the insurer and Prudential Authority, as this information relates to the insurer's financial soundness as well as the risks that it is more exposed and more sensitive to.[72] The SCR can also be viewed as a buffer designed to absorb losses from severe stress

[68] https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/2020/10227 accessed 18.01.2021.
[69] https://www.resbank.co.za/en/home/publications/publication-detail-pages/reports/pa-annual-reports/2020/10227 accessed 18.01.2021.
[70] https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/functions-of-the-prudential-authority accessed 20.01.2021.
[71] Section 3 (a)-(e).
[72] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.

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events, such as the Covid-19 pandemic, that has severely impacted the investment market and is also expected to put a strain on underwriting activities, although arguably not the severity envisaged in the SCR calibration.[73]

The Prudential Authority accepts that, while adjustments to the parameters prescribed in the Financial Soundness Standards (FS Standards) are possible, such adjustments would most certainly have unintended consequences and adverse knock-on effects, including a reduction in the value of the SCR regime and a limitation of the supervisory powers of the Prudential Authority.[74] In light of such unintended consequences and adverse knock-on effects, the PA decided to retain the SCR as set out in the FS Standards.[75] The information provided by the SCR is sufficient to enable effective supervision. Without this information, the insurer, the PA and other stakeholders, including investors and policy holders, cannot make informed decisions.[76]

The PA will permit insurers that are experiencing conditions of financial unsoundness, that is, SCR ratios below 100% due only to the impact of Covid-19, to continue operations without exercising regulatory action.[77] However, should these drop below 100%, the PA will intensify supervisory activities in line with its prudential mandate, taking into account the temporary supervisory intervention triggers.[78] Furthermore, Minimum Capital Requirement (MCR) ratios below 100% will not be tolerated and will be met with stringent supervisory intervention by the PA.[79]

3.2.2 Reporting requirements

3.2.2.1 Regulatory reporting

The PA acknowledged the difficult operating environment that can no longer be regarded as business-as-usual. Insurers were thus directed to take note of published communiques by the Authorities, namely:

- Prudential Authority: *Impact of Covid-19 on PA reporting timelines*

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[73] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.
[74] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.
[75] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.
[76] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.
[77] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.
[78] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.
[79] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.

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- Financial Sector Conduct Authority: *FSCA Communication 9 of 2020*[80]

The importance and relevance of the above documents relates to the regulation of insurance companies as financial institutions offering financial products. The extension of financial institutions which now includes insurance companies means the financial regulations applying to banks, apply to insurance companies as well.

3.2.2.2 Own Risk and Solvency Assessments (ORSA)

The Prudential Authority reminded insurers to review their ORSA policies and out-of-cycle ORSA triggers and, if relevant, to submit these out-of-cycle ORSA reports to the Prudential Authority at their earliest convenience.[81] By nature of their business, insurers are required by to have ORSAs.[82] The rationale behind this policy requirement is the nature of the business. Insurance companies bring together people who are exposed to the same risk. Although it rarely happens that all insured people suffer loss as a result of the risk insured at the same time, insurers nevertheless need to make provision for such. The Covid-19 pandemic's adverse impact on insurers has been unprecedented and most likely not featured in the ORSAs of many insurers. As is, the PA expects that it will most definitely have an impact on the ORSA processes of all insurers.[83]

With the above, the PA expected insurers to ensure that their assessment of their overall solvency needs takes into consideration a few factors. These were the extent, magnitude and duration of the impacts of Covid-19 on the economy as well as uncertainty on insurers' solvency positions.[84]

3.3 Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision traces its origins as far back as 1974. The name originates from the city where the committee was established, Basel in Switzerland. From its inception back in 1974, "the committee was designed as a forum for regular cooperation between its member countries on banking supervisory

[80] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.
[81] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.
[82] Insurance Act 17 of 2018, chapter 6.
[83] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.
[84] South African Reserve Bank Prudential Authority, Joint Communication 1 of 2020.

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matters.[85] Its aim was and still is to enhance financial stability by improving supervisory knowhow and the quality of banking supervision worldwide".[86]

As a by-product of the financial market turmoil in the 1970s, the main objective of this Committee has been and continues to be to identify issues that need to be improved in the financial sector regulations. From the inception, the Committee identified that banks, no matter where they are in the world, share similar regulatory challenges. These challenges are often the result of failures in the banking system which subsequently results in financial market turmoil. The main objective of this Committee is thus "to achieve its aims by setting minimum standards for the regulation and supervision of banks; by sharing supervisory issues, approaches and techniques to promote common understanding and to improve cross-border cooperation; and by exchanging information on developments in the banking sector and financial markets to help identify current or emerging risks for the global financial system."[87] The idea behind it was the fact that the more countries were involved in sharing their challenges and exchanging ideas, the better it will be to identify common problems and thus universal solutions.

The Committee has a membership which by 2014 included 28 jurisdictions, South Africa being one of them.[88] The representation of countries had to be by the bodies entrusted with financial stability in each country. A central bank is the apex of the banks everywhere in the world. This qualifies it to be entrusted with the most important and delicate responsibilities. "Countries are represented on the Committee by their central bank and also by the authority with formal responsibility for the prudential supervision of banking business in cases where this is not the central bank."[89] The Reserve Bank in S A is entrusted with financial stability and prudential regulation.

The decisions of the Committee have no legal force. The reason is mainly the fact that it is an advisory Committee established to assist financial institutions through regulations to better manage identified common causes of collapses in financial markets. "The Committee formulates supervisory standards and guidelines and recommends sound practices in the expectation that individual national

[85] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015) page 1.
[86] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015) page 1.
[87] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[88] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[89] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).

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authorities will implement them".[90] "While full, timeous and consistent implementation of the Committee's standards by members is encouraged, in 2012, the Committee began monitoring implementation to improve the resilience of the global banking system, promote public confidence in prudential ratios and encourage a regulatory level playing field for internationally active banks".[91]

From the period when the Basel Committee started, the Committee seeks to continuously improve banking supervision regulations, the recent one being in September 2012 with 29 principles. [92]

3.3.1 Basel I: the Basel Capital Accord

Capital has been and continues to be the backbone for operations in every banking institution. It was thus important that regulatory framework that the Committee comes up with, aims to safeguard capital.

When the Committee commenced its work; A capital measurement system commonly referred to as the *Basel Capital Accord* (1988 Accord) was approved by the G10 Governors and released to banks in July 1988.[93] The 1988 Accord called for a minimum capital ratio of capital to risk-weighted assets of 8% to be implemented by the end of 1992.[94] Because this was the first regulatory framework to be implemented, it had to be monitored to assess if it did achieve yielded results. "The Accord was always intended to evolve over time and in 1996 the Committee refined the framework to address risks other than credit risk, which was the focus of the 1988 Accord."[95] This means that, in the period of four years, the Committee realised a need for another regulatory measure. They realised there was a gap needed to be filled in as far as addressing risks in a banking institution was concerned.

3.3.2 Basel II: the new capital framework

Given the fact that the work of the Committee was on-going, in June 1999, the Committee issued a proposal for a new capital adequacy framework to replace the

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[90] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[91] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[92] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[93] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[94] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[95] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).

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1988 Accord.[96] Therefore, the *Revised Capital Framework* was released in June 2004, generally known as Basel II.[97]

> "The revised framework comprised three pillars, namely:
> I. minimum capital requirements, which sought to develop and expand the standardised rules set out in the 1988 Accord;
> II. supervisory review of an institution's capital adequacy and internal assessment process; and
> III. effective use of disclosure as a lever to strengthen market discipline and encourage sound banking practices."[98]

As explained by the Committee: "The new framework was designed to improve the way regulatory capital requirements reflect underlying risks and to better address the financial innovations that had occurred in recent years."[99]

3.3.3 Towards Basel III

The Committee constantly reviewed the regulatory framework. It thus did not come as a surprise that in 2008, a need for a move to Basel III was already identified. The risk exposure factors mainly identified with Lehman Brothers Investment Bank prompted the need to have strengthened regulations.

Research conducted shortly before the GFC indicated that there was already trouble brewing. The kind of trouble indicated a missing piece of the puzzle. This was later identified as a lack of sufficient appropriate regulations to supervise and monitor financial institutions. "The banking sector had entered the financial crisis with too much leverage and inadequate liquidity buffers."[100] What the banks kept on their balance sheet as assets did not match up to their liabilities. What appeared as assets was actually incurred and backed by debt, and the risk exposure was too much. The likelihood of insolvency of the banks was much higher yet a bank is an institution that should always be safeguarded from failure, hence there were and still are banks that are referred to as TBTF (Too big to Fail.) "These defects were accompanied by poor governance and risk management, as well as inappropriate

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[96] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[97] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[98] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[99] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[100] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).

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incentive structures."[101] Something or someone had to remedy this, assist banks to save themselves while they still could.

Responding to these risk factors, "the Basel Committee issued the *Principles for sound liquidity risk management and supervision* in the same month that Lehman Brothers failed."[102] In July 2009, the Committee issued a further package of documents to strengthen the Basel II capital framework.[103] The enhanced Basel framework revised and strengthen the three pillars established by Basel II.[104]

It also extended the framework with several innovations, namely:[105]

- an additional layer of common equity, the capital conservation buffer that, when breached, restricts payouts of earnings to help protect the minimum common equity requirement;
- a countercyclical capital buffer, which places restrictions on participation by banks in system wide credit booms with the aim of reducing their losses in credit busts;
- a leverage ratio, a minimum amount of loss-absorbing capital relative to all of a bank's assets and off-balance sheet exposures regardless of risk weighting (defined as the "capital measure" (the numerator) divided by "exposure measure" (the denominator) expressed as a percentage);
- liquidity requirements, a minimum liquidity ratio, the liquidity coverage ratio (LCR), intended to provide enough cash to cover funding needs over a 30-day period of stress; and a longer-term ratio, the net stable funding ratio (NSFR), intended to address maturity mismatches over the entire balance sheet; and
- additional proposals for systemically important banks, including requirements for supplementary capital, augmented contingent capital and strengthened arrangements for cross-border supervision and resolution.

Capital and its importance in the operation of a bank had to be given a new meaning, the one that would resonate with the extended framework. Banks had to first

[101] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[102] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[103] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[104] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[105] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).

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understand how important their financial welfare was and that it was actually in their hands to make this happen and stop expecting financial bail outs.

"The tightened definitions of capital, significantly higher minimum ratios and the introduction of a macro-prudential overlay, represented a fundamental overhaul for banking regulation."[106] It was time for new beginnings, time for banks to take responsibility for their own financial wellness, time to realize they were actually more capable of succeeding without bail outs. However, these could be achieved by constant supervision and monitoring by those in charge for safeguarding financial stability.

The main intention of the Basel III regulatory framework was to create more resilient capital buffers during stress periods. Extending credit is very risky for any type of business, but at the same time there are more returns on credit granted. What the banks had overlooked was the first part and focused on the second part. What Basel III aimed to achieve was to strike a balance between the two: take on risk but be mindful of how much. Make provision for continuous operation with or without returns from extended credit. With the 2007 GFC it emerged that banks were over exposed in credit risk and "had built up excessive on-and off-balance sheet leverage".[107] Basel III also introduced the weighing of the risk on assets, most possibly to prevent accumulation of too much leverage on assets that are by their nature high risk. As most banks did not hold sufficient capital buffers to absorb any credit losses, a need for a strong and resilient banking system emerged stronger.[108]

In addressing market failures, the Committee introduced a number of reforms to strengthen bank-level, or micro-prudential, regulation to help raise resilience of banking institutions.[109] Because of the interrelatedness of these micro and macro-prudential approaches to supervision, a greater resilience at the individual bank level which would reduce the risk of system-wide shocks was an anticipated outcome.[110]

Capital liquidity requirements meant banks had to hold capital to a certain threshold level.[111] To work out the bank's available capital, common equity tier 1

[106] Basel Committee on Banking Supervision, a brief history of the Basel Committee (2015).
[107] Basel III: A global regulatory framework for more resilient banks and banking systems, Dec 2010 (revised 2011.) page 1.
[108] Basel III: A global regulatory framework for more resilient banks and banking systems, page 1.
[109] Basel III: A global regulatory framework for more resilient banks and banking systems, page 2.
[110] Basel III: A global regulatory framework for more resilient banks and banking systems, page 2.
[111] Banks Act, section 70 (2) (a) (i) and (2A) (a) (i).

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capital and common equity tier 1 unimpaired reserve funds are divided by the risk-weighted assets.[112]

Section 1(a) and (b) of the Banks Act provides a definition of the meaning of common equity tier capital. To prevent too much leverage by banks and to force banks to take responsibility for their financial soundness, the Committee prescribed the allocation of capital. "Common Equity Tier 1 must be at least 4.5% of risk weighted assets at all times. Tier 1 Capital must be at least 6.0% of risk-weighted assets at all times. Total Capital (Tier 1 Capital plus Tier 2 Capital) must be at least 8.0% of risk-weighted assets at all times."[113]

The common equity tier 1 capital, are those shares representing the most subordinated claim in the event of liquidation.[114] Usually these are the shareholders of the bank as these shares meet the criteria for classification as common shares for regulatory purposes.[115] A common equity tier 1 unimpaired reserve fund means "share premium arising from the issue of instruments or shares, and percentage of accumulated other comprehensive income and other disclosed reserves."[116] Tier 2 capital means those shares or instruments that are subordinated to depositors and general creditors.[117]

A bank's balance sheet is made up of debtors (assets) and creditors (liabilities) Assets refer to what people owe to the bank, such as long-term loans (mortgage, vehicle finance, overdraft etc.) and what the bank owns which could be, buildings, government bonds, other financial assets. Liabilities are the creditors of the bank.

For the bank to manage a financially healthy balance sheet in accordance with the Basel III requirements, it has to reduce its risk exposure by holding capital to a certain prescribed minimum percentage and not beyond. This percentage can be adjusted to be above the required minimum. The Basel requirement is 8%, while South Africa operates on an adjusted 10%. In terms of the Basel III requirements, the 8% is made up of 6% which is tier 1 and 2% tier 2.

3.3.4 Capital adequacy

[112] Regulation 38(8) (a) and (e) (i).
[113] Basel III: A global regulatory framework for more resilient banks and banking systems, page 12.
[114] Banks Act 94 of 1990, section 1.
[115] Basel III: A global regulatory framework for more resilient banks and banking systems, page 13.
[116] Banks Act 94 of 1990, section 1.
[117] Banks Act 94 of 1990, section 1.

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In accordance with Principle 16 of the Core Principles of Effective Banking Supervision (2012), which deals with capital adequacy:

> "The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. For internationally active banks, capital requirements are not less than the applicable Basel standards."

The Banks Act defines "allocated capital and reserve funds" as follows:

> "such amount of qualifying capital and reserve funds as may be approved and assigned by the board of directors of a bank as capital and reserve funds designated to provide for the risks pertaining to the particular nature of such bank's business as contemplated in section 70 (2) , 70 (2A) or 70 (2B), as the case may be".

In terms of Regulation 38(8):[118]

"(a) for the purposes of determining in form BA 700 the minimum amount of-

(i) allocated qualifying common equity tier 1 capital and reserve funds, additional tier 1 capital and reserve funds and tier 2 capital and reserve funds required to support risks other than market risk and required to be maintained by a bank in terms of section 70 of the Act, a bank shall calculate the said amount, amongst others, in accordance with the relevant provisions specified in subregulation (3)(a) read with the provisions of subregulations (2) (a), (2) (b), (2) (d) and (2) (e) above;

(ii) allocated qualifying common equity tier 1 capital and reserve funds, additional tier 1 capital and reserve funds and tier 2 capital and reserve funds required to support market risk and required to be maintained by a bank in terms of section 70 of the Act, a bank shall calculate the said minimum amount, amongst others, in accordance with the relevant provisions specified in subregulation (3) (b) read with subregulation (2) (c) above."

...

(e) a bank shall have in place robust policies, processes and procedures to ensure that the bank continuously maintains-

(i) the relevant minimum required percentage of qualifying common equity tier 1 capital and reserve funds, additional tier 1 capital and reserve funds and tier 2 capital and reserve funds to risk-weighted exposure".

[118] Regulations Relating to Banks 2012 (amended 2016).

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The Committee introduced a framework which aimed to promote the conservation of capital and the build-up of adequate buffers that can be drawn down in periods of stress.[119] The extended framework aimed to give supervisors stronger tools to promote capital conservation in the banking sector.[120]

As outlined in Basel III, the extended framework had five components. The first one was the additional layer of common equity: the capital conservation buffer of 2.5%. The second one is the countercyclical capital buffer of (0-2.5%). The Committee introduced a number of measures to reduce the procyclical dynamics and promoting countercyclical buffers.[121] The measures would help ensure that the banking sector serves as a shock absorber, instead of a transmitter of risk to the financial system.[122] This framework allows the PA to intervene and force banks to start saving whilst things are still good.

The third one is the leverage ratio of 3% in terms of which banks are required to not fall below the required percentage. The fourth one is the liquidity requirement which refers to amount of liquid assets which can be easily and quickly accessible. Two minimum standards for funding liquidity were developed: (i) liquidity coverage ratio for 30 days of stress and (ii) net stable funding ratio for longer term.[123] The LCR (liquidity coverage ratio) "would help ensure that global banks have sufficient unencumbered, high-quality liquid assets to offset the net cash outflows it could encounter under an acute short-term stress scenario."[124] This measure reflected the intention of the Committee to make banks take full responsibility and not rely on bail outs should there be a problem. "High-quality liquid assets should be unencumbered, liquid in markets during a time of stress and, ideally be central bank eligible."[125] This way the banks would take cognisance of their risk exposure, consider the leverage element when extending credit. The NSFR (net stable funding ratio) "which required a minimum amount of stable sources of funding at a bank relative to the liquidity profiles of the assets, aimed to limit over-reliance on short-term wholesale funding

[119] Basel III: A global regulatory framework for more resilient banks and banking systems, page 6.
[120] Basel III: A global regulatory framework for more resilient banks and banking systems, page 6.
[121] Basel III: A global regulatory framework for more resilient banks and banking systems, page 5.
[122] Basel III: A global regulatory framework for more resilient banks and banking systems, page 5.
[123] Basel III: A global regulatory framework for more resilient banks and banking systems, page 8.
[124] Basel III: A global regulatory framework for more resilient banks and banking systems, page 9.
[125] Basel III: A global regulatory framework for more resilient banks and banking systems, page 9.

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during times of buoyant market liquidity." "It also aimed to encourage better assessments of liquidity risk across all on-and off-balance sheet items."[126]

The fifth one is an additional buffer for SIFIs (Systemically important financial institutions). A financial institution is designated as a SIFI by the Governor in terms of section 29 of the FSRA. The Act requires the Governor before designating a financial institution a SIFI to at least take into account specific factors.[127] Because these financial institutions are regarded as too big to fail, an additional liquidity buffer was added for them.

The Banks Act makes provision for the minimum liquid assets a bank in the Republic should hold.[128]

> "A bank shall comply with the provisions of any Notice issued by the Governor of the Reserve Bank under section 10A of the South African Reserve Bank Act, 1989 (Act No.90 of 1989), regarding the determination of the minimum reserve balance to be held with the Reserve Bank".[129]

Regulation 27(3)(a) to (b) "makes provision for the minimum level one high-quality liquid assets, (5) period of maintenance of prescribed minimum reserve balance and liquid assets and (6) available unencumbered assets, including matters related to assets pledged or otherwise encumbered."

Subsection (a)(ii) and (iii) further provides minimum level one high quality assets to be held for purposes of complying with the provisions of section 72(1) of the Act.[130]

In line with the extended framework of Basel III as far as liquidity requirements are concerned, the Basel Committee aimed to prevent the unyielded results of failure of financial institutions. It aimed to instil responsibility and accountability to banks and to make banks realise they only had themselves to save.

3.4 Conclusion

The prudential aspect of banking regulations played a major role in the reactionary measures to the Covid-19 pandemic. The current financial crisis was the first

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[126] Basel III: A global regulatory framework for more resilient banks and banking systems, page 9.
[127] section 29 (3) (a) – (g).
[128] section 72(1)- (4).
[129] Regulation 27 (2).
[130] Regulation 27, Minimum reserve balance and liquid assets- Directives and interpretation for completion of monthly return concerning minimum reserve balance and liquid assets.

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exposure for South Africa after the implementation of the PA. It was thus imperative to lay out the legislative provisions and discuss them in the context of measures adopted to establish compliance.

The extended South African requirement for capital adequacy has enabled the country to absorb financial stress to an extent and still be compliant with Basel minimum level requirements. The economic downturn resulting from Covid-19 has had far reaching consequences, resulting in an adjustment of the leverage ratio by the PA. This was an acknowledgement that it is not business as usual, but it did not mean financial institutions could be complacent.

The far reaching consequences of Covid-19 cannot be compared to the 2007-2008 GFC, but the lessons from the GFC have better equipped us to deal with current financial crisis. The next chapter deals with the response of other G20 member states in so far as compliance with Basel III regulatory framework requirements is concerned.

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Chapter 4:
Global responses to the effects of Covid-19

4.1 Introduction

The Coronavirus pandemic has had a universal devastating economic effect. While some first world countries were likely to be not as hard hit as the second or third world countries like those in Africa, the bottom line remains that everyone has been economically affected.

The purpose of this dissertation is to look into the banking regulations in light of Covid-19, especially in South Africa. However, to conclude and evaluate whether or not we have been successful, where we fell short and how can we improve, it is imperative to look into the response of other G20 member states, how they have responded to the financial effects of Covid-19. The purpose is mostly focused on the application and implementation of Basel III principles as recommended after the 2007-2008 GFC.

4.2 Bank exposure to Covid-19 in United States of America

US banks hold about $18.6 trillion in assets, with more than $2.5 trillion in home loans and more than $1.8 trillion in consumer loans, equalling 13.6% and 9.9% of total assets, respectively.[131] In terms of the Basel III regulatory framework, a bank has to hold a total of 8% on capital. Banks held more than $1.7 trillion in Tier 1 capital, an important regulatory capital measure, giving a Tier 1-to-total asset ratio of 9.7%.[132] This essentially meant that US banks held in excess a 1.7% of the capital buffer, which placed them in an advantage for a stress period. "Compared to recent history, these represent a relatively low exposure to home loans and a typical exposure to consumer loans, but a relatively high capitalisation level. These conditions suggest the banking industry is comparatively well positioned to withstand losses on household debt."[133]

[131] D Perkins & Gnanarajah R " Bank exposure to COVID-19: Mortgages and Consumer Loans" (2020) *Congressional Research Service* 1-5
[132] D Perkins & Gnanarajah R " Bank exposure to COVID-19: Mortgages and Consumer Loans" (2020) *Congressional Research Service* 1-5.
[133] D Perkins & Gnanarajah R " Bank exposure to COVID-19: Mortgages and Consumer Loans" (2020) *Congressional Research Service* 1-5.

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"Once it became clear that the Covid-19 outbreak would have serious financial ramifications for households and businesses, the federal agencies that regulate banks and credit unions in the US – responded in two general ways. First, they implemented measures to encourage banks to work with customers affected by Covid-19; and secondly, they adjusted bank regulation related to capital, liquidity and supervision."[134] This measures would ensure financial stability while still keeping within prudential regulations.

The US government created taxpayer-backed "safety nets" to prevent banks from failing and to protect depositors.[135] To reduce the likelihood that these safety nets needed to be used, regulatory agencies implemented "safety and soundness" regulations, which included rules relating to banks' capital and liquidity.[136] In response to Covid-19, bank regulators have made certain adjustments to banking regulation and supervision.[137]

Covid-19 caused a drastic reduction of the economy and created a lot of uncertainties about the future. It was inevitable for some depositors to withdraw their savings, either because they could not see the future and lost an interest for saving or because of reduced or no income. "These have a knock-on effect on the liquidity of the banks, as it reduces capital."[138]

"As the buffers are depleted and capital levels get closer to the minimums, banks could respond by making fewer or no new loans because those new assets would increase the amount of capital the bank has to hold.[139] This in turn would decrease the amount of credit available in the economy, potentially hastening, deepening or causing a recession. Bank regulators have taken steps to reduce the likelihood that this occurs."[140]

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[134] A.P.Scott.& D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1-3.

[135] A.P. Scott & D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1-3.

[136] A.P. Scott. & D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1-3.

[137] A.P. Scott & D.W. Perkins " Banking Regulators' Response to COVID-19." (2020)*Congressional Research Service* 1-3.

[138] A.P. Scott. & D.W. Perkins " Banking Regulators' Response to COVID-19." (2020)*Congressional Research Service* 1-3.

[139] A.P. Scott & D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1-3.

[140] A.P. Scott & D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1.3.

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The foundation was now laid for either the central bank or those entrusted with Prudential Authority in the US to act, to alleviate the situation and preserve financial stability of the country in the midst of everything.

"As part of an announcement on 17 March 2020, bank regulators released a statement encouraging banks to use their capital and liquidity buffers to support continued lending."[141] This measure was similar to one adopted by PA in South Africa, which allowed adjusted regulatory requirements without being complacent but as an acknowledgement that current conditions cannot be regarded as business as usual. "On 19 March, agencies released a clarification on the buffer statement that included a Q&A document. These guidance documents reminded banks that the purpose of the buffers is to ensure that banks can keep lending during distressed times, noted how much capital and liquidity are currently in the bank system, and encouraged banks to continue lending prudently."[142] The PA in SA also released a communique to a similar effect.

"Bank regulators also issued a rule change regarding how capital is measured to make it easier for banks to comply with capital rules that can place restrictions on a bank's dividend payments and other capital distributions. Under this new rule, banks have an option to count more of their net income from the past year as 'eligible retained earnings' that count toward meeting capital requirements."[143] Our PA also supported SA banks by offering regulatory relief measures and also guidance on how to proceed with business cautiously.

As the effects and events of the pandemic unfolded, central banks and Prudential Authorities where these were not operating as a single body, deliberated and announced on further measures respective countries sort to adopt. In the US, "On 23 March, the Federal Reserve announced that the new definition would also be applied to the total loss-absorbing capacity rules that the largest US banks and US operations of foreign banks face. The rules require those banks to hold certain types and amounts of capital and debt.[144]" The PA guidance offered in SA was more or

[141] A. P.Scott.& D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1.3.
[142] A.P. Scott & D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1-3.
[143] A.P. Scott & D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1-3.
[144] A.P. Scott.& D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1-3.

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less the same with the one offered by the Federal Bank in US. This highlighted the macro-prudential element of banking supervision intended by the Committee; banks could only act on guidance and instruction from the PA.

A further announcement was released: "On 24 March, the Federal Reserve also announced that it would delay the upcoming implementation of a rule that would change the methodology used to determine how much liquidity the US operations of foreign banking organisations have through temporary overdrafts on their Federal Reserve accounts, citing changing priorities stemming from the pandemic.[145] The effective date was rescheduled from 1 April to 1 October. In addition, the Federal Reserve has encouraged banks that need liquidity to borrow from its discount window."[146]

On the same date of 24 March, "the Federal Reserve also announced adjustments to its supervisory activities and priorities in response to the uncertainties created by Covid-19. All in all, the Federal Reserve's focus shifted to monitoring efforts to understand "the challenges and risks that the current environment presents".[147] Although regulations were adjusted in lieu of the effects of the pandemic and meant to avoid systematic failures while ensuring financial stability, the authorities did not "take their feet off the pedal"; banks were still being monitored and supervised closely.

4.3 United Kingdom Covid-19 response

When the Bank of England's Financial Policy Committee (FPC) met in March 2020, it was already against the backdrop of the Covid-19 pandemic. The FPC took action consistent with its remit to respond to the financial stability risks associated with Covid-19.[148]

The central bank for the United Kingdom had to adopt measures for financial stability during the economic downturn caused by Covid-19. Their financial stability

[145] A.P.Scott & D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1-3.
[146] A.P. Scott &D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1-3. .
[147] A.P. Scott. & D.W. Perkins " Banking Regulators' Response to COVID-19." (2020) *Congressional Research Service* 1-3..
[148] Financial Policy and Record, March 2020: https://www.bankofengland.co.uk/financial-policy-summary-and-record/2020/march-2020 accessed 10.04.2021.

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measures had to ensure banks continue to provide the financial services expected from them.

As one of the G20 member states, these measures had to be in line with the Basel Committee regulatory framework, Basel III. In cognisance of the Basel III capital liquidity ratio, the Bank of England adopted the following measures: "At its Policy meeting on 9 March, the FPC reduced the UK CCyB (Counter Cyclical Capital Buffer) rate to 0% of banks' exposures to UK borrowers with immediate effect. The rate had been 1% and had been due to reach 2% by December 2020."[149] The FPC expected to maintain the zero% rate for at least 12 months.[150]

Further, on 11 March: "cut its benchmark interest rate by half a percentage point, to 0.25%, revived a program to support lending to small and midsize businesses, and reduced capital requirements to further boost credit."[151] A similar measure of interest rate cut was also noticed in SA. The benefit of a reduced interest rate is that it makes it easier for consumers to access loans at a reduced rate, and reduces financial strain on consumers.

On 17 March the bank "Unveiled a package of 350 billion pounds ($424 billion) to support the economy; it included 330 billion pounds of guaranteed loans for businesses that need cash to pay rent or suppliers, 20 billion pounds of tax cuts and grants for businesses in 2020, a three –month mortgage payment holiday for borrowers affected by the virus, (a similar measure adopted by SA banks)."[152]

"At its Policy meeting on 19 March, the FPC reviewed developments and actions since its meeting on 9 March. The FPC welcomed the announcement by HM Treasury and the Bank of England of a Covid Corporate Financing Facility (CCFF) to provide additional help to firms to bridge through Covid-19-related disruption to their cash flows"[153] On the same date, "cut its benchmark rate by 15 basis points to 0.1% in mitigating the impacts of Covid 19 on British economy, added 200 billion pounds ($232 billion) to its asset purchase program (including sovereign and private debt),

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[149] Financial Policy and Record, March 2020: https://www.bankofengland.co.uk/financial-policy-summary-and-record/2020/march-2020 accessed 10.04.2021

[150] Financial Policy and Record, March 2020: https://www.bankofengland.co.uk/financial-policy-summary-and-record/2020/march-2020 accessed 10.04.2021

[151] J. Jackson " Global Economic Effects of COVID-19" (,2020) *Congressional Research Service* page 77.

[152] J. Jackson " Global Economic Effects of COVID-19" (2020) *Congressional Research Service* page 78.

[153] Financial Policy and Record, March 2020: https://www.bankofengland.co.uk/financial-policy-summary-and-record/2020/march-2020 accessed 10.04.2021

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increased its banks' borrowing allowance under the Term Funding Scheme for Small and Medium Enterprises from 5% to 10% of participants' stock of real economy lending, and cancelled its 2020 stress test of the 8 major UK banks."[154]

On the Policy meeting on 19 March the FPC, "together with the PRC, agreed to cancel its 2020 annual stress test of major UK banks and building societies. The decision to cancel the 2020 stress test will help lenders focus on meeting the needs of UK households and businesses via the continuing provision of credit"[155]

The FPC meeting held in October 2020, the Bank of England revealed that UK Banks have emerged much stronger during the Covid-19 pandemic as compared to the GFC.[156] In conclusion, with Covid-19 still on-going globally, relief measures get adjusted accordingly as and when it is required and sustainable.

4.4 Government of Germany's response to Covid-19

Germany's Covid-19 response was based on the collective decisions adopted by EU (European Union) Member States. The EU operated on a budget amongst its member states. "In March 2020, the European Commission launched the Coronavirus Response Investment Initiative (CRII). Its centrepiece was to allow Member States to retain unspent cohesion policy pre- financing, which represents a departure from the normal rules and gives the countries concerned access to additional liquidity totalling €8 billion.1 Furthermore, fund resources could be provided more swiftly. Available resources from the structural and investment funds could be used to respond to the coronavirus crisis in many different ways. One of the new aspects was the ability to provide small and medium- sized enterprises with working capital support".[157] On 13 March, the Government of Germany "pledged to provide unlimited liquidity assistance to German companies hit by the pandemic. (The measure envisaged an expansion of loans provided by KfW, the state development bank, and will allow companies to defer billions euros in tax payments.)

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[154] J. Jackson " Global Economic Effects of COVID-19" (2020)*Congressional Research Service* page 77.

[155] Financial Policy and Record, March 2020: https://www.bankofengland.co.uk/financial-policy-summary-and-record/2020/march-2020 accessed 10.04.2021.

[156] Financial Policy and Record, October 2020: https://www.bankofengland.co.uk/financial-policy-summary-and-record/2020/october-2020 accessed 10.04.2021

[157] https://www.bundesbank.de/resource/blob/831226/a569592c0a71b7c5c2494f6acace6a75/mL/2020-04-eu-haushalt-finanzierung-data.pdf accessed 10.04.2021

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The government also indicated that it would boost investments by €3.1 billion per year (about $3.5 billion) between 2021 and 2024."[158]

On 23 March the government "agreed to a package worth more than 750 billion euros ($808 billion) to mitigate the damage of the Covid-19 outbreak. This included 600 billion-euro rescue fund (400 billion euros in guarantees, 100 billion euros in loans through state-run development bank KfW, and 100 billion euros earmarked for equity stakes in companies.)"[159]

The German Federal Cabinet and the Parliament decided on a supplementary budget of 156 billion euros, from which aid programs were to be financed as well as foreseeable tax losses.[160] Social protection was granted to certain population groups as well as support for companies. Companies were primarily provided with easier access to loans and guarantees.[161]

The Federal Government extended the existing funding programs of the Kreditanstalt fur Wiederaufbau (KfW) to a broader target group and decided to improve the conditions and the guarantee programs of the guarantee banks.[162] The European Commission notified of aid in the form of guarantees on loans administered by the federal and regional authorities, the promotional banks, the federal and the regional authorities, and the guarantee banks. The aid would be provided in the form of subsidised interest rates for loans and guarantees on loans.[163]

Companies affected by the Covid-19 pandemic could also receive interest free deferrals from tax liabilities from authorities until the end of 2020. In addition, the tax authorities refrained from enforcement measures and late payments of overdue tax debts. Federal funds amounting to €50 billion were made available to cover all relief measures adopted to counter the effects of Covid-19 pandemic.[164]

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[158] J. Jackson " Global Economic Effects of COVID-19" (2020)*Congressional Research Service* page 61.
[159] J. Jackson " Global Economic Effects of COVID-19" (2020) *Congressional Research Service* page 61.
[160] B. Linke, "Germany: Covid-19: Germany's Covid-19 Measures and State Aid Control", (2020) *EUR.St.AID L.Q* 87.
[161] B. Linke, "Germany: Covid-19: Germany's Covid-19 Measures and State Aid Control", (2020) *EUR.St.AID L.Q* 87.
[162] B. Linke, "Germany: Covid-19: Germany's Covid-19 Measures and State Aid Control", (2020) *EUR.St.AID L.Q* 87
[163] B. Linke, "Germany: Covid-19: Germany's Covid-19 Measures and State Aid Control", (2020) *EUR.St.AID L.Q* 87
[164] B.Linke, "Germany: Covid-19: Germany's Covid-19 Measures and State Aid Control", (2020) *EUR.St.AID L.Q* 87.

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4.5 French Covid-19 response

Two of the significant announcements which were made by the French Government in response to Covid-19 in March were firstly: "on March 16 announced that the government would guarantee 300 billion euros in bank loans for small and medium-sized businesses."[165] Secondly, on 17 March it was announced that it would spend 45 billion euros ($50 billion) to help small businesses and employees struggling with the Covid-19 outbreak, through an expanded partial-unemployment package in which the state pays the salaries of employees who are not needed during the crisis.[166]

4.6 Italy's Covid-19 response

As far as the Government of Italy's response to Covid-19 stimulus package is concerned, the Central Bank of Italy had this to say on the country's economic outlook: "for the Italian economy, which was practically stationary in 2019, notwithstanding the significant progress it had made in areas such as international competitiveness, corporate indebtedness, and the state of its banking system, the forecasts point to the strongest contraction since the end of the Second World War".[167]

Be that as it may, the Government needed to come up with some measures to assist the banks, consumers, companies to mitigate the devastating effects of Covid-19. "On March 11; Announced two packages worth 25 billion euros ($28.3 billion): A package worth 12 billion euros will provide extra funding for the health system as well as a mix of measures to help companies and households, including freezing tax and loan payments and boosting unemployment benefits to ensure no jobs were lost. The government also indicated that payments on mortgages will be suspended across Italy. ABI, Italy's banking lobby, said lenders would offer debt moratoriums to small firms and households grappling with the economic fallout from the virus."[168]

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[165] J. Jackson " Global Economic Effects of COVID-19" (2020)*Congressional Research Service* page 60.

[166] J. Jackson " Global Economic Effects of COVID-19" (,2020) *Congressional Research Service* page 60.

[167] The 2019 Annual Report at a glance; https://www.bancaditalia.it/pubblicazioni/relazione-annuale/2019/sintesi/index.html?com.dotmarketing.htmlpage.language=1 accessed 10.04.2021

[168] J. Jackson " Global Economic Effects of COVID-19" (2020)*Congressional Research Service* page 65.

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A further announcement was on 6 April, the government announced "new emergency decree aimed at granting liquidity and bank loans worth more than 400 billion euros to companies hit by Covid-19. The new legislation, combined with a previous stimulus package in March, would allow banks to offer credit totalling over 750 billion euros ($809.78 billion)."[169]

4.7 Canada's Covid-19 Response

The major impact that Covid-19 had on the Canadian Economy was "a collapse in oil prices which had an unprecedented economic impact."[170] Needless to say, the central bank had the responsibility of ensuring financial stability in the country and thus measures had to be taken to counter the devastating economic effects posed by Covid-19.

The point of departure was the interest rate: "on the 4th of March the Bank of Canada lowered its target for the overnight rate by 50 basis points to 1.25% (setting the bank rate to 1.5% and the deposit rate to 1%)".[171] On 12 March it "announced that it will broaden the scope of the current Government of Canada bond buyback program and temporarily add new Term Repo operations."[172] A further announcement on 13 March: "lowered its benchmark overnight rate to 1.25% from 1.75% in response to the epidemic."[173] A further rate cut was seen on 27 March: "cut its overnight interest rate by 50 basis points to 0.25%, its lowest level since June 2010 and the third cut in March, to support an economy hit hard by the outbreak of Covid-19."[174]

4.8 Conclusion

A couple of similar measures were taken by some of the G20 member states. The first one was the repo rate cut. The benefit of a reduced repo rate is that it assists consumers to easily access finance as banks also lower their lending rate. Secondly,

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169 J. Jackson " Global Economic Effects of COVID-19" (2020) *Congressional Research Service* page 65.

170 Monetary Policy Report, https://www.bankofcanada.ca/2020/04/mpr-2020-04-15/ accessed 10.04.2021

171 J. Jackson " Global Economic Effects of COVID-19" (2020)*Congressional Research Service* page 55.

172 J. Jackson " Global Economic Effects of COVID-19" (2020)*Congressional Research Service* page 55

173 J. Jackson " Global Economic Effects of COVID-19" (2020)*Congressional Research Service* page 55.

174 J. Jackson " Global Economic Effects of COVID-19" (2020) *Congressional Research Service* page 56.

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it brings a reduction on the amount consumers have to pay to service their debts. Lastly, it does achieve the objective of financial stability as banks are still able to continue providing their normal services.

Payment holiday was also offered by the UK and Italy. The purchasing of government bonds which was another measure adopted by SA, was also adopted by the US and the UK. Financial subsidies to small businesses was another common measure adopted. The financial assistance offered to businesses to avoid retrenchments and to ensure businesses still survived, is also amongst the common ones.

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Chapter 5:
Conclusion

The mandate of the Reserve Bank and Financial Sector Regulation authority is to ensure financial stability. Financial stability as defined by the Act means the ability of financial institutions to be able to still provide the financial services despite economy disruptions.

The purpose of Basel III regulatory framework was to create more resilient capital buffers for banks and to ensure capital adequacy. Pre 2007 GFC, SA did not have a Prudential Authority which assists with regulatory supervision. This was established by the FSCA and had its first exposure of assisting with averting systematic effects with Covid-19. The FSCA also introduced stability of all financial institutions, not only the banks.

As mentioned earlier, South Africa was not affected by the 2007-2008 GFC but nevertheless adopted policy changes in the financial sector to be able to deal with any financial crisis. In line with international standards, South Africa became a member state of the G20 which adopted recommendations of the Basel Committee, designed as a forum for regular cooperation between its member countries on banking supervisory matters.

The chief purpose and objective of the Committee is to enhance financial stability by improving supervisory knowhow and the quality of banking supervision worldwide.[175] It was for the same objective that South Africa's improved regulations had to be in line with the Basel III requirements, with the aim to avoid systematic failures.

The MPC report published by the SARB in 2021 has noted some positives. However the road to economic recovery is a journey. As far as financial stability is concerned, as a country we are managing. Our banks are still able to offer the normal services. The lowest interest rate which is currently sitting on 3.5% enables consumers to easily access finance should they need to and still be able to service their debt at reduced rate. The benefit is availability of finances for household needs.

The next question to answer is if lessons learnt from the 2007 GFC and causes identified have been of relevance to the current period. Financial institutions not

[175] Basel Committee (2015) History.

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holding resilient capital buffers was one of the areas identified. SA has benefited from this measure as the 8% capital adequacy ratio requirement banks advised to hold, ours has been set to 10%. This has enabled our banks to absorb the first initial economic shock and still maintain the required level.

In conclusion, the globally aligned banking regulations have assisted in averting systemic failure as intended. We will not emerge from this without "any side-effects or scotch free" as a country; however we are also not in a hopeless financial stability situation either.

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