Banking Supervision in South Africa

by Christo Weise

INTRODUCTION

Banking supervision has been part of the functions of the South African central bank, that is the South African Reserve Bank, since 1987. Prior to this date, it was a function of the Department of Finance, a Government department. Whether or not the function of banking supervision belongs in the central bank is a question that is being widely debated in South Africa and, indeed, world-wide.

On assuming responsibility for the banking supervision function in 1987, the then Head of Banking Supervision regarded a change in the regulatory approach as necessary. In view of the magnitude of the task, it was decided to implement this task in three phases:

- The rewriting of the legal framework to adopt a risk-based banking act was identified as the first phase of the task.
- The design of an information database for use by the supervisors, so that the financial risks managed by the banking system would be more apparent and reflected more appropriately, was identified as the second phase.
- The last phase was seen as the adaptation of bank supervision procedures to enable risk-based management information to be utilised for the evaluation of the quality and effectiveness of risk management in each bank.

These three phases have been substantially completed, but are, however, receiving ongoing attention, and are adopted or updated where necessary.

CHRISTO WEISE is Deputy Registrar, Bank Supervision, of the South Africa Reserve Bank.

MISSION AND PHILOSOPHY OF THE BANK SUPERVISION DEPARTMENT

The mission of the Bank Supervision Department is:

"To create an environment that will facilitate the optimisation of the quality and effectiveness of risk management in banks ".

The philosophy of the Department may be stated as follows:

"The interests of depositors cannot be guaranteed by the Bank Supervision Department. This responsibility can reside only with the boards of directors and management of the banks themselves. However, we believe that the execution of the Department's mission can and should make a contribution to a healthier and sounder banking system in which depositors will enjoy greater protection".

The Bank Supervision Department firmly believes in a market-oriented, risk-based approach to supervision. To this end, the returns that the Department receives from the banking sector are based on management information that the management and directors of banking institutions can use to make decisions. Furthermore, the Department is acutely aware of the costs of regulation and strives to ensure that the benefits that result from regulation exceed the costs to the institutions involved.

RAPIDLY CHANGING BANKING ENVIRONMENT

The banking environment in South Africa, in keeping with the rest of the world, is changing rapidly. Financial innovation requires both the management of banks and the authorities to assess their actions continually. However, a factor that has perhaps played an even greater role as a driving force in the financial sector than financial innovation is deregulation.

Although the pace of deregulation has been somewhat slower in South Africa than in certain other parts of the world, the banking sector in South Africa is now starting to feel the effects of deregulation. Competition between financial institutions is intensifying, and as banks progress further towards meeting the Basle capital requirements, it is expected that the competition for bank capital will also intensify.

A consequence of the increased competition within the financial sector in South Africa has been a rationalisation of the sector. Banks have strived to attain critical mass and reach economies of scale and, in the process, reduce operating costs.

A further development in the South African context is the changing political environment. This has permitted South African banks to extend their activities overseas and into several African countries. With this expansion, however, come further responsibilities for both management and the supervisory authorities. Banks' management need to be aware of the added risk that they are taking on when expanding, and the banking supervisor has to ensure that all international guidelines are complied with.

ROLES AND RESPONSIBILITIES OF THE KEY PLAYERS IN THE RISK-MANAGEMENT PROCESS

As stated in the philosophy of the Bank Supervision Department, the Department does not and cannot guarantee the interests of depositors. The primary responsibility for depositor protection resides with the boards of directors and management of the banks themselves.

There are, however, a number of other key players in the risk-management process. In essence, the risk-management process is a partnership between the following key players:

Shareholders' responsibility:

- Board of directors
- Management
- Audit committee and internal auditors
- External auditors

Other stakeholders:

- General public (which includes depositors, financial analysts, the financial press and rating agencies)
- Supervisory authorities

Only if all the respective role players understand their responsibilities and duties in the risk-management process and each carries out its duties responsibly and with due regard to the other key players, can the risk-management process be effective.

A RISK-MANAGEMENT APPROACH TO BANKING SUPERVISION

The primary business of banks is that of managing risks. With this in mind, the Bank Supervision Department has adopted a risk-management approach to the supervision of banks in South Africa.

Such an approach entails a focus on and analysis of the key risks inherent in the business of banking. These risks are:

- Solvency risk (capital adequacy);
- Liquidity risk;
- Interest-rate risk;
- Price risk;
- Credit risk (including counterparty risk);
- Currency risk;
- Operational risk.

In addition to an analysis of the above-mentioned risks, an analysis is done of the balance-sheet structure and the profitability of each individual bank. Because off-site supervision is conducted, it is important that the information received from banking institutions reflects the type of information that the management and directors of banks use in the decision-making process. This information is then subjected to sensitivity analysis and dynamic modelling techniques in order to arrive at information that reflects the potential for profit or loss as a result of the various positions taken in each risk area. Furthermore, the inter-relationships between the various risks are always borne in mind, to enable a holistic view of each institution.

The above-mentioned approach can be further explained by looking at the practicalities involved. These are set out below:

Gathering of Information

Information for further analysis is gathered from the following sources:

- Risk-based statutory returns;
- Verbal and written communication with banks and other persons;
- Monitoring of the financial media;
- Correspondence and discussions with other supervisory authorities.

Analysis of Information

As explained above, each risk area is analysed, while it is borne in mind that the risks are not mutually exclusive. In this way, a holistic view can be obtained of the institution.

Compilation of Micro Report

A micro report on each individual bank is compiled on a quarterly basis. For the intervening months, exception reports are produced.

Meetings with Risk Managers

Once micro reports on each institution have been compiled, meetings are held with the managers of the individual risk areas within the institutions concerned.

Risk Assessment

Subsequent to the discussions with the banks' risk managers, a formal risk assessment of each bank is done. For obvious reasons, this assessment is very confidential.

➪ 34

NATIONAL HOUSING FORUM . . .
➪ 13

intentions of the new government of national unity. The NHF could become party to a statutory body on housing policy or could dissolve entirely, leaving its members as interest groups who will lobby the government in respect of their individual interests. Whatever the possibilities, however, it seems likely that the success of the Forum in bringing together key housing interests in an extremely heterogeneous society will contribute to a more effective, legitimate and accountable housing process in South Africa in the future. ■

NOTES

[1] Urban Debate 2010, Vol.9: *Housing for All: Proposals for a National Urban Housing Policy*, Urban Foundation, 1990.

[2] Friedman, Steven: *The Elusive Community: The Dynamics of Negotiated Urban Development*, p.60, Centre for Policy Studies Research Report No.28, February 1993.

[3] Urban Debate 2010, Vol.9: *Housing for All: Proposals for a National Urban Housing Policy*, Urban Foundation, 1990.

[4] National Discussion Forum Memorandum to CODESA, February 1992.

[5] ibid.

[6] Cargill, Jenny: *Toward Interim Government: National Forum on Housing Likely to be First Tangible Expression*, p.3, Finance Week, October 31 - November 6, 1991.

[7] Friedman, p.56-57.

BANKING SUPERVISION . . .
➪ 15

Presentations to Boards of Directors

The Head of the Banking Supervision Department also makes annual presentations to the boards of directors of all banks. These presentations consist of an overview of the banking sector as a whole, as well as a discussion of each risk area in the individual bank, based on the information submitted to the Department by the bank concerned.

Macro Report

A macro report reflecting the latest developments in the banking sector as a whole is compiled on a monthly basis.

Annual Report

The annual report of the Registrar of Banks, which is laid before Parliament on an annual basis, reflects not only the latest trends in the banking sector, but also the direction in which the regulatory environment in South Africa is heading.

Disclosure

The Bank Supervision Department strives to ensure that a proper framework exists for disclosure in the banks' annual financial statements, in accordance with generally accepted accounting practice, to enable depositors to form an informed opinion on the financial soundness of particular banks.

CONCLUSION

The rapidly changing financial environment in South Africa and the rest of the world poses new challenges for the management of banks and banking supervisors. These challenges require new approaches and innovative thinking in order to ensure that the risk-management process continues to be conducted effectively.

Furthermore, all key players in the risk-management process need to be aware of how their responsibilities change as a result of environmental changes, so that effective contributions can be made to the entire risk-management process. ■

HOUSING ASSOCIATIONS . . .
➪ 23

CONCLUSION

Housing associations have grown rapidly in recent years. However, the period of accelerating growth has now come to an end and associations need to consolidate. Associations have become much more integrated into the private sector in recent years and are beginning to take on some of the private sector values and lose their distinctiveness. This trend is likely to continue over the next few years. If housing associations are forced to compete with the private sector generally for housing association grant from the Corporation, this transformation will be completed fairly rapidly. ■