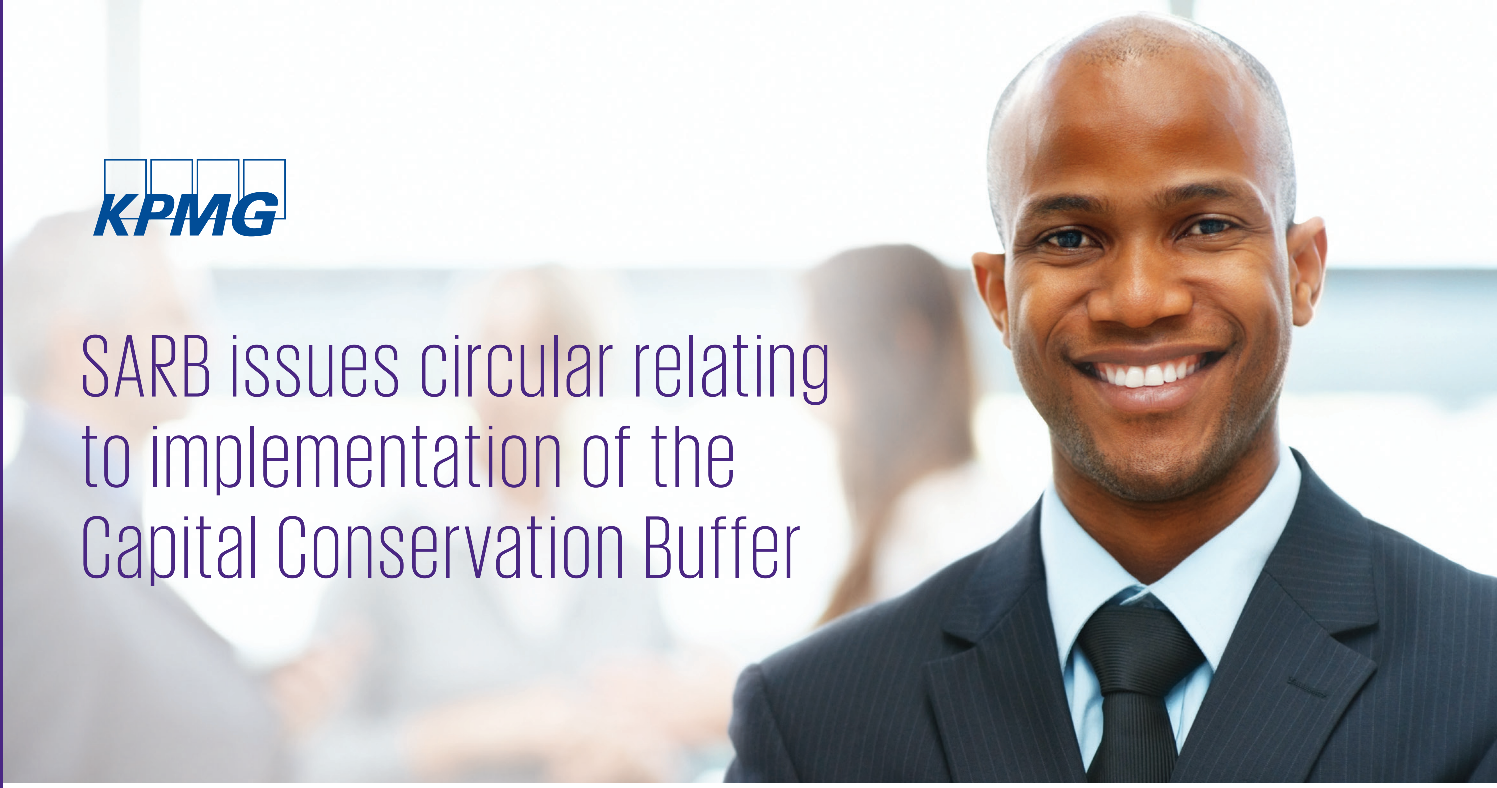

SARB issues circular relating to implementation of the Capital Conservation Buffer

In terms of Basel III timelines, application of the Capital Conservation Buffer (CCB) started on 1 January 2016 with full implementation expected to have been achieved by 2019. In Banks Act Circular 4 of 2016, the South African Reserve Bank (SARB) is reiterating these timelines and the key aspects of the Basel III implementation of the CCB.

The key aspects that stand out are as follows:

- The implementation will be phased in evenly from 1 January 2016 to 1 January 2019 when it is expected to be at 2.5 percent.
- The intention is to address the quantity of capital available for loss absorbency.
- The composition of the CCB will only be core capital (i.e. common equity tier 1 capital and reserve funds). The emphasis of this is that of the long term nature of such capital and its sustainability, and is intended to address the issue of the quality of the capital.
- This capital buffer is expected to be accumulated during boom periods preparing for potential stress periods. This primarily addresses the problem of counter cyclicality as envisaged in Basel III.
- These capital buffers will be utilised during periods of stress and will be communicated in writing by the Regulator as and when such occurrences take place.
- It is important to note that the Regulator will restrict the distribution of capital in the event that any institution finds itself operating within the CCB range. This will be effective for the duration that the institution is within this range and will only be lifted once the bank has regularised the anomaly.
- It should also be noted that these requirements will be different for each bank depending on its minimum capital requirements and the pillar 2A add-ons. The bank specific requirements will be communicated individually for each institution.

It is critical that the SARB has released this circular as it serves as an important reminder of the key milestones required in order to be fully compliant with the CCB during the phase in period and, ultimately, on 1 January 2019. As banking institutions compile their capital plans, they will have to be cognisant of these requirements. Given the structural rigidity of capital, forward planning is key in order to implement strategies to ensure full compliance by each institution. Shareholders of these institutions will also be watching this development with keen interest as it will potentially determine the ability of banks to declare dividends.

The Internal Capital Adequacy Assessment Process (ICAAP) has always been for banks but this will definitely place some added attention to the process. It will be interesting to see how banks adapt their strategies and how they build them into their ICAAP processes as 1 January 2019 approaches. The intention of the Regulator is good, that is, to improve the banking sector’s shock absorbing ability in order to navigate an adverse impact on the real economy. However, for banks it may be a painful journey.