

Appraising the regulatory framework of the new South African Deposit Insurance System*

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SUMMARY

South Africa has recently established its first deposit insurance body, the Corporation for Deposit Insurance (the Corporation), as part of the Twin Peaks regulatory reforms following the 2008/09 Global Financial Crisis (Crisis). The primary responsibilities of the Corporation are to establish, maintain and administer a deposit insurance fund to protect the banks' covered depositors and inform the depositors of its benefits and limitations, should a bank be placed into resolution. The rationale behind the protection of depositors is premised on the need to maintain confidence and financial stability in the banking sector. This article appraises the features of the new deposit insurance system as enshrined in the Financial Sector Laws Amendment Act 2021 (FSLA Act). The article evaluates whether the new framework for the protection of depositors aligns with international standards, particularly the International Association of Deposit Insurers' Core Principles for Effective Deposit Insurance Systems. The pertinent question is whether the current features of South Africa's deposit insurance are optimally designed to ensure its effectiveness. The article ends with practical suggestions for strengthening the South African deposit insurance framework to ensure its optimal alignment with international good practice.

1 Introduction

In recent decades, and especially during the 2008 Global Financial Crisis, it has become evident that not only are banks "special" given their critical role in the financial system, but their insolvency is also "special" given the impact that a bank failure may have on financial stability. It has further become evident that normal commercial insolvency procedures, which are subject to appeals and reviews, may be too protracted and can lead to loss of value hence they are not best suited to dealing with failing

* This article derives from my Doctoral thesis titled "A deposit guarantee framework for South Africa: a comparative appraisal". See Matasane *A deposit guarantee framework for South Africa: a comparative appraisal* (LLD Dissertation 2023 UP).

banks.¹ Therefore, dealing with a bank failure thus requires a unique approach that entails swift action, preferably by the bank supervisor who is aware of the special character and role of banks. Such regulators must be capable of taking appropriate, calculated actions to prevent loss of value and maintain financial stability whilst also protecting depositors. Addressing the question of why bank failure merits a different approach, Hupkes points out that: "the common answer is that banks play a special role in a country's economy in that, collectively, their functions are so important as to constitute a type of public service."²

The regulatory paradigm following the Crisis places significant emphasis on ensuring financial stability as a core pursuit. As a result, it prioritises achieving the 'orderly resolution' of financial institutions as the final part of a financial safety net arrangement. This arrangement includes a robust prudential regulation and supervision, a timely and self-corrective early intervention, as well as a well-conceptualised explicit deposit insurance framework to minimise the potential for bank failure and where banks do fail, to operate in tandem with a comprehensive orderly resolution framework.

As with most financial sectors, South Africa's financial sector has become more globally connected and concentrated, potentially exposing the country to significant financial risks.³ The Crisis was a systemic failure of global proportions which not only revealed the shortcomings in the financial regulatory frameworks and policies of the most advanced economies around the world but also exposed the fundamental weaknesses of globalization and of economic models and assumptions.⁴ The aftermath of the Crisis saw governments reviewing their country's financial regulation frameworks in a bid to create a more robust banking system for the future. Consequently, South Africa, as a G20 member that committed itself to the post-crisis international financial reform agenda,⁵ joined in the momentum to adopt an explicit deposit insurance system.

However, it was only in 2018 that the South African government introduced the Financial Sector Laws Amendment Bill 2018 which

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- 1 Randell "Legal aspects of bank resolution: designing the powers and solutions" *Paper presented at conference on "Operational Aspects of Bank Resolution and Restructuring" at the European Bank for Reconstruction and Development*, London, 19 March 2012 at 1. See also Nyaude *Regulatory Measures to address bank failures in Zimbabwe* (LLD Dissertation 2021 UP) 306. See further Nyaude and Van Heerden "Bank resolution in South Africa: Recent developments" 2023 *International Insolvency Review* 3.
 - 2 Hüpkes "Insolvency – why a special regime for banks?" 2005 *Current Developments in Monetary and Financial Law* 3.
 - 3 Demircuc-Kunt & Kane "Deposit Insurance: Handle with care" 2003 *Central Bank of Chile Working Paper No 227* 6.
 - 4 Tettey *Managing Bank Resolution in South Africa* (Master of Management dissertation 2014 University of Witwatersrand).
 - 5 The G20 Seoul Summit Leaders' Declaration <http://www.g20.utoronto.ca/2010/g20seoul.html#:~:text=To%20provide%20broader%2C%20forward%2Dlooking,fossil%20fuel%20price%20volatility%3B%20safeguard/> (last accessed 2023-04-04).

incorporated provisions on a comprehensive deposit insurance framework. Subsequently, the aforesaid Bill was updated and issued in 2020 and signed into law in 2021 as the Financial Sector Laws Amendment Act 23 of 2021 (FSLA Act), introducing a comprehensive deposit insurance system for South Africa which is yet to be put into operation. This paper appraises the framework for the South African explicit deposit system as set out in the FSLA Act 2021. The paper also investigates whether the anticipated approach to the protection of depositors during a bank failure aligns with international standard-setting bodies such as the International Association of Deposit Insurers' (IADI's) Core Principles for Effective Deposit Insurance Systems. Finally, the paper makes recommendations for reform.

2 Overview of the South African Banking Sector

The South African banking sector is highly competitive and concentrated with the four largest banks relatively accounting for approximately 90% market share in the banking sector, making these banks systemically important in the South African financial system.⁶ Before South Africa's move to a Twin Peaks model, the South African Reserve Bank (Reserve Bank), as the central bank of South Africa, executed its mandate of bank supervision through its Bank Supervision Department set up the Office for Banks headed by the Registrar of Banks.⁷ As the prudential regulator of banks, the Reserve Bank had wide investigative powers and could conduct on-site and off-site supervision to enforce compliance with the provisions of the Banks Act.⁸ It further had comprehensive enforcement powers that it could apply, inter alia, where banks failed to meet the conditions for their continued licensing or prudential requirements.⁹

6 Ifeacho & Ngalawa "Performance of the South African Banking sector since 1994" 2014 *Journal of Applied Business Research* 1184.

7 S 3 of the Banks Act 94 of 1990. See also De Jager "The South African Reserve Bank: blowing winds of change (part 2)" 2013 *SA Merc LJ* 506; See also International Monetary Fund Country Report No 14/340 *South Africa Financial System Stability Assessment* 2014 <https://www.imf.org/external/pubs/ft/scr/2014/cr14340.pdf> (last accessed 2021-04-03) (hereinafter IMF 14/340) 55; Van Niekerk *The role of the central bank in the promotion and maintenance of financial stability-a comparative appraisal* (LLD thesis 2018 UP) 81. See also De Jager "The South African Reserve Bank: an evaluation of the origin, evolution and status of a central bank (part 1)" 2006 *SA Merc LJ* 159; De Jager "The South African Reserve Bank: an evaluation of the origin, evolution and status of a central bank (part 2)" 2006 *SA Merc LJ* 274; Bekink and Botha "The role of a modern central bank in managing consumer bankruptcies and corporate failures: a South African public-law angle of incidence" 2009 *SA Merc LJ* 74.

8 Ss 11-12 of the Reserve Bank Act 89 of 1990.

9 Ss 23-29 of the Banks Act 94 of 1990 (cancellation of a bank's registration and withdrawal of its license); s 26 (restriction of certain activities of banks); s 74 (failure or inability to comply with prudential requirements); s 90 (offences and penalties).

The Reserve Bank's robust approach to banking regulation was instrumental in keeping the banking industry largely safe and sound without continuous widespread bank failures.¹⁰ Experience has shown that even relatively small failures can lead to large, and often unexpected, financial burdens on individuals, governments, and society.¹¹ In any modern economy, banks are a channel for various financial contracts that must be honoured and renewed over time to enable the economy to function properly.¹² A bank failure can cause major commotion for substantial numbers of individuals and businesses if they suddenly find themselves unable to access their funds, make payments, or draw on their existing credit lines.¹³

Although some South African banks did fail in the past, South Africa did not experience extended periods of bank failures. Despite all these failures, South Africa never operated an explicit deposit insurance framework. This meant that in the event of bank failure, there was a possibility, but not a guarantee, that the bank would be bailed out with public funds to maintain financial stability and protect depositors. Having had a robust bank regulatory framework over many years, the need for a deposit insurance framework was simply not perceived as a matter of pressing urgency. In fact, the large banks that dominated the banking sector were well-capitalised and safe and sound hence depositors' money was generally not regarded to be at risk. Thus, requiring protection under a deposit protection framework that would impose levies and premiums on banks, thereby slicing into the capital they could use to earn greater profits, was not on top of the regulatory agenda. In the absence of an explicit deposit protection framework in the South African banking industry, there was thus only 'implicit' deposit insurance operating on the principle of constructive ambiguity.

The lack of a specific and privately funded deposit insurance system in South Africa has, however, been viewed as a deficiency in the framework of the financial safety net aimed at promoting financial stability.¹⁴ Despite not experiencing the same level of financial impact as other nations, the Crisis has influenced the trajectory and paradigm shift of financial sector regulation in South Africa given that the country committed itself at the G20 summit in Seoul in 2010 to align with the

10 According to the South African Reserve Bank (SARB) *Discussion Paper*, bank failures in South Africa are "a rare event." See South African Reserve Bank (SARB) Financial Stability Board "Ending too big to fail: South Africa's intended approach to bank resolution" 2019 10.

11 Havemann "The South African small banks' crisis of 2002/3" 2021 *Economic History of Developing Regions* 313.

12 Hoskin & Woolford "A primer on Open Bank Resolution" 2011 *RBNZ Bulletin* 3.

13 As above.

14 South African Reserve Bank (SARB) "Designing a deposit insurance scheme for South Africa – A Discussion Paper" 2015 <https://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf> (last accessed 2023-04-20) at 8.

international financial reform agenda.¹⁵ Consequently, South Africa initiated extensive reforms to its financial regulation approach following a review that began in 2007 and gained momentum after the Crisis.

At the heart of these reforms was a move from a silo sectoral model of financial regulation towards a Twin Peaks model of financial regulation by objective,¹⁶ as encapsulated in the Financial Sector Regulation Act 2017 (FSR Act) which eventually came into operation in August 2017 and sets out the architecture of the South African Twin Peaks Model. The overriding objective for the adoption of the Twin Peaks model in South Africa was to ensure a safe, sound and more efficient financial sector in the interests of all South Africans by minimising the possibility of threats to financial stability¹⁷ and protecting customers by ensuring that financial institutions treat them fairly.¹⁸

The South African Twin Peaks model comprises three peaks, namely the newly established Prudential Authority¹⁹ and the newly established Financial Sector Conduct Authority,²⁰ as twin regulators responsible for prudential and market conduct regulation respectively, with the Reserve

15 "G20 Seoul Summit Leaders' Declaration" 2010 <http://www.g20.utoronto.ca/2010/g20seoul.html> (last accessed 2020-04-04). See also the G20 Seoul Summit Action Plan and Table containing policy commitments by G20 members at 38 available at https://www.mofa.go.jp/policy/economy/g20_summit/2010-2/commitments.pdf (last accessed 2021-02-07) at 4.

16 Godwin "Introduction to special issue – the twin peaks model of financial regulation and reform in South Africa" 2018 *Law and Financial Markets Review* 151-153.

17 In terms of ss 4(1)(a)-(c) of the FSRA, financial stability means "the ability by financial institutions to generally provide financial products and financial services, and of market infrastructures to generally perform their functions and duties in terms of financial sector laws without interruption; the capability of financial institution to provide financial products and financial services and of market infrastructures to continue to perform their functions and duties in terms of financial sector laws, without interruption despite changes in economic circumstances; and there is general confidence in the ability of financial institutions to continue to provide financial products and financial services; and the ability of market infrastructures to continue to perform their functions and duties without interruption, regardless of the changes in economic circumstances".

18 S 7 (1) of the FSRA sets out the objectives of the Act. See also South Africa National Treasury "New Twin Peaks Regulators Established" 2018 https://www.treasury.gov.za/twinpeaks/Press%20release%20Twin%20Peaks%20implementation%20March2018_FINAL.pdf (last accessed 2023/03/01) at 1.

19 The Prudential Authority was established in terms of s 32(1) of the FSRA to promote and enhance the safety and soundness of financial institutions that provide financial products and securities; to promote and enhance the safety and soundness of market infrastructures; to protect financial customers against the risk that those financial institutions may fail to meet their obligations; and to assist in maintaining financial stability. See s 33 of the FSR Act for the objectives of the PA.

20 The Financial Sector Conduct Authority is a public entity for purposes of the Public Finance Management Act established in terms of s 56(1) of the FSRA.

Bank, as central bank,²¹ and apex peak tasked with financial stability.²² As part of its comprehensive stability mandate which has now for the first time been captured explicitly in legislation,²³ the FSR Act requires the Reserve Bank to take all reasonable steps to prevent systemic events²⁴ from occurring and to swiftly reduce the adverse effects of such a systemic event if it has occurred or is impending, as well as to manage the systemic event and its effects.²⁵ Note should further be taken that, in the Twin Peaks model introduced by the FSR Act, the Reserve Bank no longer has a mandate of prudential supervision of banks as this mandate has now been given to the Prudential Authority.²⁶

In alignment with the international financial reform agenda,²⁷ the Reserve Bank together with the National Treasury, inter alia, embarked on a regulatory journey to establish a new legislative framework that would facilitate the resolution of failing institutions in an orderly and transparent manner aimed at reducing the use of government funding to bail out such institutions.²⁸ This new resolution framework would be a crucial pillar of the Reserve Bank's expanded and explicit financial stability mandate.²⁹ In tandem with the establishment of this new resolution framework, South Africa also sought to introduce a legislative

21 As indicated, the Currency and Banking Act 31 of 1920 established the SARB as South African Central Bank. Currently, the SARB is regulated under the South African Reserve Act 90 of 1989 while its position as central bank is entrenched in s 223 of the Constitution of the Republic of South Africa 1996.

22 See ss 32-34 of the FSR Act 2017 regarding the establishment, objective and functions of the PA and ss 56-58 regarding the establishment, objectives and functions of the FSCA. The framework for the SARB's financial stability mandate is captured in ss 11-31 of the FSR Act 2017. See further Van Heerden & Van Niekerk "The Financial Stability Mandate of the South African Central Bank in the Post-Crisis landscape" 2018 *Journal of International Banking Law and Regulation* 414.

23 S 11 of the FSRA read with ss 12-19.

24 A systemic event is defined in terms of s 1 of the FSRA as "an event or circumstance, 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."

25 S 15(1)(a) and (b)(i)-(ii) of the FSRA.

26 See ss 33 and 34 of the FSRA. See further Van Heerden & Van Niekerk "The role of the SARB as central bank in the South African Twin Peaks model" in Godwin & Schmulow (eds) *The Cambridge Handbook of Twin Peak Financial Regulation* (2020) 153.

27 See National Treasury A safer financial sector to serve South Africa better (February 2011) <http://www.treasury.gov.za/documents/national%20budget/2011/A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf> (accessed 2020-09-22).

28 South African Reserve Bank *Financial Stability Review* 2 ed (2017) 28.

29 SARB *Financial Stability Review* (2017) 28. This new resolution regime has been incorporated into the FSRA through the Financial Sector Laws Amendment Act 23 of 2021 as Chapter 12 A, comprising ss 166A-166Z.

framework for an explicit deposit insurance scheme which is the focus of this paper.

3 IADIs' Core Principles as a Benchmark for Effective Deposit Insurance Systems

In the international arena, the focus on explicit deposit insurance systems as a measure to protect depositors has been on compliance with international best practice principles and standards. In particular, the Core Principles for Effective Deposit Insurance Systems (Core Principles) were established in the aftermath of the Crisis³⁰ by international organizations such as the Financial Stability Board,³¹ the International Monetary Fund,³² and the World Bank³³ who advocated for the strengthening of global safety nets. Their argument was based on the significance of close cooperation in crisis management, which demanded a more robust depositor protection system, improved international regulatory standards, and strengthened toolkits for bank resolution.³⁴ Hence, in 2009, International Association of Deposit Insurers and the Basel Committee on Banking and Supervision came together and issued the first Core Principles for Effective Deposit Insurance Systems (Core Principles) which were later revised in 2014.³⁵

30 In 2009, IADI and the BCBS came together and embarked on a journey to establish an internationally agreed set of principles to serve as a benchmark for countries wishing to establish EDIS and those wishing to review their existing ones. This resulted in the development of the IADI Core Principles for Effective Deposit Insurance Systems which were subsequently revised in 2014.

31 The Financial Stability Board (FSB) is an international body that monitors and makes recommendations about the global financial system. Its mandate is to promote international financial stability by coordinating national financial authorities and international standard-setting bodies as they work toward developing a strong regulatory, supervisory and other financial sector policies. For more information on the FSB, visit <https://www.fsb.org/> (last accessed 2023-04-05).

32 The International Monetary Fund (IMF) is an organisation of countries working together to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. For more information on IMF visit: www.imf.org (last accessed 2023-04-06).

33 The World Bank is an international financial institution that provides loans to countries of the world for capital projects. For more information on the activities of the World Bank <https://www.worldbank.org/en/home> (last accessed 2023-04-06).

34 IADI "Deposit Insurance and Bail-in: Issues and Challenges" 2016 *Research Paper prepared by the Core Principles and Research Council Committee International Association of Deposit Insurers* https://www.iadi.org/en/assets/File/Public_Consultation/Bail-in_Research_Paper_Final_Draft_for_IADI_Public_Consultation.pdf (last accessed 2023-06-23) at 7.

35 IADI "Core Principles for Effective Deposit insurance systems" 2009 <https://www.bis.org/publ/bcbs151.pdf> (last accessed 2023-06-23).

These Core Principles were designed to serve as a benchmark for jurisdictions to use in appraising the quality of their deposit insurance systems and for identifying gaps in their deposit insurance practices as well as measures to address them.³⁶ The Core Principles comprise wide-ranging issues - including mandate and powers, funding, pay-out capacity and contingency planning, and crisis management of the deposit insurance system and its staff.³⁷ Since their adoption, the Core Principles have supported many deposit insurance-related reforms worldwide and set up new schemes.³⁸

Core Principle 1 addresses the public policy objectives of a deposit insurer.³⁹ This Core Principle requires that the main public policy objective for any deposit insurer should be the reimbursement of depositors after a bank fails and contribution to the stability of a financial system.⁴⁰ According to the IADI, there should be a legislation or policy document that clearly defines and publicly discloses these objectives.⁴¹ The important standard for this Core Principle is, among other things, consistency between the design of the deposit insurance system and its public policy objectives, a review outlining the extent to which the deposit insurance system meets its public policy objectives should be undertaken; and, that the incorporated additional public policy objectives should not be in conflict with the two primary objectives of protecting depositors and contributing to the stability of the financial system.⁴²

Core Principle 2 relates to the mandate and powers of the deposit insurer. This mandate and powers should support the public policy objectives and should be overtly defined and formally specified in legislation.⁴³ The mandate should expound on the role and responsibilities of the deposit insurer within the financial safety net, while the powers should give deposit insurers the authority to finance reimbursements, enter into contracts, set internal operating budgets and procedures, and access timely and accurate information to ensure that they can meet their obligations to depositors as quickly as possible.⁴⁴ Accordingly, there should be consistency between the mandate given to the deposit insurer and the stated public policy objectives and the

36 IMF and the World Bank, in the context of the Financial Sector Assessment Program (FSAP), to assess the effectiveness of jurisdictions' deposit insurance systems and practices, also use the Core Principles. See IADI Core Principles (2014) 5.

37 Nolte & Khan "Deposit Insurance Systems: Addressing emerging challenges in Funding, Investment, Risk-based Contributions & Stress Testing" 2017 Financial Sector Advisory Centre (Fin SAC), World Bank Group 3.

38 Nolte & Khan (2017) 3.

39 IADI (2014) Core Principle 1.

40 IADI Core Principles (2014) 18.

41 As above.

42 As above.

43 IADI Core Principles (2014) 19.

44 Basel Committee on Banking Supervision (BCBS) & IADI *A Handbook for the Assessment of Compliance with the Core Principles for Effective Deposit Insurance Systems* (2016) 25.

powers, roles and responsibilities of the deposit insurer, and alignment between the powers and the mandate as well as public policy objectives.⁴⁵

Core Principle 3 talks about the governance of the deposit insurer. This Principle emphasises the independence, transparency, accountability, and freedom of the deposit insurer from unwarranted political and industry influence.⁴⁶ According to this Principle, the effectiveness and independence of deposit insurance depend on its ability to operate within a clear and discrete legal framework that plainly sets out its mandate, powers, responsibilities and accountabilities.⁴⁷ IADI believes that having a separate, operationally independent,⁴⁸ and, accountable⁴⁹ deposit insurance system that works within the financial system safety net might be the best practice model available.⁵⁰

Core Principle 4 tackles the deposit insurer's relationships with other safety-net participants. In terms of this Principle, a formal and comprehensive framework is a prerequisite for every deposit insurer to ensure close coordination of activities and ongoing information sharing between the deposit insurer and other financial safety-net participants.⁵¹ This need for coordination and goodwill among the financial safety net participants is attributed to the potential conflicts between them.⁵² Therefore, promoting a smooth coordination of activities by clearly putting in place a clear division of powers and responsibilities regarding the intervention of troubled banks is a crucial component for deposit insurers.⁵³

Core Principle 5 deals with cross-border issues and entails that formal information sharing and coordination arrangements should be put in place among relevant deposit insurers where there is a material presence of foreign banks in a jurisdiction.⁵⁴ Core Principle 6 addresses the deposit insurer's role in contingency planning and crisis management.⁵⁵ According to this Principle, there should be contingency planning and crisis management policies and procedures in place for every deposit

45 As above.

46 Principle 3 of the IADI Core Principles (2014) 21.

47 Norton "Global financial sector reform: the single financial sector regulator model based on the United Kingdom FSAs experience – a critical reevaluation" 2005 *The International Lawyer* 52.

48 See IADI *Governance of Deposit Insurance Systems – Guidance Paper* (2009) 4.

49 IADI (2009) 5.

50 See Canada Deposit Insurance Corporation (CDIC) APEC Policy Dialogue on Deposit Insurance: Policy Conclusions Paper 2004 <https://www.iadi.org/en/assets/File/Core%20Principles/APECPolicyDialoguePaper.pdf> (last accessed 2023-07-10) at 3.

51 Principle 4 of the IADI Core Principles (2014) 23.

52 APEC *Policy Dialogue on Deposit Insurance* (2004) 9.

53 See APEC *Policy Dialogue on Deposit Insurance* (2004) 10.

54 Principle 5 of the IADI Core Principles.

55 Principle 6 of the IADI Core Principles.

insurer to ensure that it can effectively respond to the risk of, and actual, bank failures and other events.

Core Principle 7 mandates compulsory membership in a deposit insurance system for all banks, including state-owned banks.⁵⁶ The Principle requires compliance by all banks, with the supervisory and membership requirements upon entry to a newly established deposit insurance system.⁵⁷ However, if a bank has failed to comply but was allowed entry into the system, such a bank should have a credible plan to address any deficiencies within a prescribed period.⁵⁸ Upon cancellation of membership because of revocation or surrender of a bank's license, immediate notice should be given to depositors to notify them that the existing deposits will continue to be insured up to a specified deadline.⁵⁹

Core Principle 8 proposes a detailed level and scope of deposit insurance coverage, which should be limited, credible, and should cover a large majority of depositors while also leaving a substantial amount of deposits exposed to market discipline should be adopted by policymakers.⁶⁰ Accordingly, this Principle further demands the availability and accessibility of funds from deposit insurers to guarantee speedy repayment of depositors' claims.⁶¹ The importance of this Principle cannot be overemphasized because the whole idea of protection of depositors' funds relies on the availability of funds to reimburse depositors in the event of a bank failure. Therefore, it is important for deposit insurers to clearly set out in legislation emergency funding arrangements as well as pre-arranged and assured sources of liquidity funding.⁶²

Core Principle 10 recommends that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.⁶³ According to this Principle, depositors have the right to be informed and educated about matters related to deposit insurance as they affect access to savings not covered under the deposit insurance limit.⁶⁴ To this effect, every deposit insurer should design public awareness programmes to inform depositors about, inter alia: the scope of deposit insurance coverage; a list of banks that are members of the deposit insurance system and how they can be identified; deposit

56 Principle 7 of the IADI Core Principles.

57 As above.

58 As above.

59 As above.

60 Principle 8 of the IADI Core Principles (2014) 27.

61 Principle 9 of the IADI Core Principles (2014) 29.

62 As above.

63 Principle 10 of the IADI Core Principles (2014) 32.

64 IADI "Enhanced Guidance for Effective Deposit Insurance Systems: Public Awareness of Deposit Insurance Systems" 2012 https://www.iadi.org/en/assets/File/Papers/Approved%20Guidance%20Papers/IADI-Public_Awareness_Enhanced_Guidance_Paper.pdf (last accessed 2023-07-09) at 9.

insurance coverage level limits; and other information such as the mandate of the deposit insurer.⁶⁵

Core Principle 11 deals with legal protection and stipulates that the deposit insurer and individuals working both currently and formerly for the deposit insurer should be discharged from liability arising from actions, claims, lawsuits, or other proceedings for their decisions, actions, or omissions taken in good faith in the normal course of their duties.⁶⁶ It is important to note, in this regard, that legal protection does not include damages or other awards against such individuals and cover costs including funding defense costs as incurred.⁶⁷ Core Principle 12 requires the deposit insurer or other relevant authority, to seek legal redress against those parties at fault in a bank failure.⁶⁸ Redress includes, in this case, personal or professional disciplinary measures including fines or penalties, criminal prosecution, and civil proceedings for damages against persons responsible for the failure of a bank.⁶⁹

According to the Core Principles, every deposit insurer should be part of the framework within the financial safety net that provides for the early detection of, and timely intervention in financially distressed banks.⁷⁰ As such, Core Principle 13 recommends a clearly defined qualitative and/or quantitative standard to be used as a trigger for timely intervention and corrective action.⁷¹ The Core Principles advocate for the protection of depositors and a stable financial system through an effective failure resolution regime that includes a special resolution regime.⁷² In this regard, resolution procedures should follow a defined creditor hierarchy in which insured deposits are protected from sharing losses and shareholders take first losses.⁷³

Core Principle 14 addresses the reimbursement of depositors. It states that the deposit insurer should be able to reimburse depositors' insured funds promptly to contribute to financial stability.⁷⁴ Ideally, compensation should be done within seven working days or within a clearly stipulated time frame.⁷⁵ To provide depositors with prompt access to their funds, the deposit insurer should, inter alia: have access to depositors' records at all times; have the authority to undertake advance or preparatory examinations; and have a range of reimbursement options.⁷⁶ The final Principle recommends that the deposit insurer

65 Principle 10 of the IADI Core Principles (2014) 32.

66 Principle 11 of the IADI Core Principles (2014) 34.

67 As above.

68 Principle 12 of the IADI Core Principles (2014) 35.

69 As above.

70 Principle 13 of the IADI Core Principles (2014) 36.

71 As above.

72 Principle 14 of the IADI Core Principles (2014) 37.

73 As above.

74 Principle 15 of the IADI Core Principles (2014) 38.

75 As above.

76 As above.

should have, by law, the right to recover its claims according to the statutory creditor hierarchy.⁷⁷

4 South Africa's Paradigm Shift to Explicit Deposit Guarantee System

It is widely acknowledged that bank failures are inevitable even in a well-regulated financial system like South Africa. This was evidenced during the Crisis where, globally, many banks either failed or received financial aid, which inflicted severe losses on global financial systems.⁷⁸ While South Africa remained unharmed, a review of South Africa's resolution framework in 2009/10 conducted by the World Bank's Financial Sector Reform and Strengthening Initiative programme and a thematic peer review by the Financial Stability Board in 2012 exposed gaps in several areas where South Africa's 'conventional' resolution powers did not comply with the "Key Attributes for Effective Resolution Regimes for Financial Institutions" which were issued in 2011 by the Financial Stability Board and later revised in 2014.⁷⁹ The International Monetary Fund later confirmed these gaps in its Financial Stability Assessment Program in 2014.⁸⁰

One of the gaps identified was the absence of an explicit and privately funded deposit insurance fund that could reimburse depositors in the event of a bank failure or that could assist in funding the chosen resolution option.⁸¹ Following these reviews, South Africa embarked on a journey of reform that culminated in the publication of a policy document entitled "Strengthening South Africa's Resolution Framework for Financial Institutions" (the Policy Document), which set out the motivation and proposals for a strengthened framework for the resolution of designated financial institutions in South Africa including proposals for the introduction of an explicit deposit insurance system.⁸² This Policy document was followed by a discussion paper titled

77 Principle 16 of the IADI Core Principles (2014) 41.

78 Papanikolaou "To be bailed out or to be left to fail? A dynamic competing risks hazard analysis" 2018 *Journal of Financial Stability* 61.

79 The aim of a proficient resolution regime is to facilitate the orderly resolution of financial institutions, minimizing systemic upheaval and shielding taxpayers from losses. This is achieved by safeguarding crucial economic activities through mechanisms that enable shareholders, as well as unsecured and uninsured creditors, to bear losses in accordance with the established. See Financial Stability Board "Key Attributes for effective resolution regimes for Financial Institutions" (2014) 3. See also SARB "Designing a deposit insurance scheme for South Africa – a discussion paper" (2017) 3.

80 SARB (2017) 14.

81 As above.

82 According to Francois, the establishment of explicit deposit insurance scheme will ensure that depositors who are most exposed to an asymmetry of information and thus least able to hedge themselves against financial loss in the event of a bank failure. See SARB "Opening remarks by Francois Groepe, Deputy Governor of the South African Reserve Bank, at the public

'Designing a deposit insurance scheme for South Africa – a discussion paper' which contained the proposals for the key design features of the proposed explicit deposit insurance system. These two papers were anticipated to function as a comprehensive regulatory foundation of deposit insurance to minimise the social and economic cost of bank failures.⁸³

Following the Policy documents, the Financial Sector Laws Amendment Bill 2018 was tabled before Parliament in August 2018 to give effect to the proposals contained in the policy documents. A revised version of this Bill was issued in 2020 and was eventually enacted as the FSLA Act 2021. The FSLA Act introduces a comprehensive deposit insurance framework into Chapter 12A of the FSR Act (being the framework Act that introduced South Africa's new Twin Peaks model of financial regulation in 2017). Notably, the FSLA Act also introduced a comprehensive new bank resolution regime for South Africa, which, like the new deposit insurance system, is captured in the FSR Act. These two new frameworks will operate in tandem to ensure that depositors' interests are protected during bank resolution - whether through pay-outs to depositors if a bank is liquidated or through funding for other resolution measures obtained from the Corporation for Deposit Insurance.

5 The Features of South African Deposit Insurance and their compliance with IADI Core Principles for effective deposit insurance Systems

5.1 Public policy objectives

The objective of the Corporation, as set out in section 166AF (2) of the FSR Act, is to provide deposit insurance and carry out its functions to support the Reserve Bank in fulfilling its financial stability mandate.⁸⁴ To achieve this objective, the Corporation is assigned with, inter alia:⁸⁵ the establishment, maintenance, and administration of the Deposit Insurance Fund established in terms of section 166BC of the FSR Act in the interests of holders of 'covered deposits' and the promotion of awareness among financial customers of the protections afforded by the deposit insurance framework set out in Chapter 12A of the FSR Act. This

workshop on proposals to establish a deposit insurance scheme for South Africa" 2017 <https://www.resbank.co.za/en/home/publications/publication-detail-pages/speeches/speeches-by-governors/2017/506> (last accessed 2023-07-12) at 2.

83 SARB (2017) 1.

84 S 11 of the FSRA read with s 3(2) of the Reserve Bank Act, 90 of 1989 and s 224 of the Constitution, 1996.

85 S 166AF (2)(a) - (b) of the FSRA as introduced by the FSLAA 2021.

objective is further confirmed by section 166AF which requires the Corporation to apply the Fund to ensure that depositors have reasonable access to their covered deposits by reimbursing the bank in resolution for payments made to depositors; or for reimbursing depositors of covered deposits or for making payment in terms of an agreement related to a transaction mentioned in section 166S (1). The reimbursement of depositors' funds is a clear indication of protection of depositors' interests, which in turn, will bolster depositors' confidence in the banking system, thereby contributing to the stability of the financial system. However, it is submitted that better alignment with the public policy objectives, as recommended by IADI, would be achieved if the objectives were rephrased to clearly reflect that the protection of depositors and financial stability are both main objectives.

5.2 Mandates and powers

The mandate of the Corporation is set out in section 166AG read with section 166AA and specifies the various manners in which the Corporation must apply the Fund during resolution. According to the Policy Document,⁸⁶ the Corporation is set to operate a 'pay-box' plus mandate which gives the Corporation the power to facilitate speedy compensation to depositors during a bank resolution, set the operational budgets, and get access to information required to meet its financial obligations to depositors. The Policy Document indicated further that the Corporation would not only have the power to reimburse depositors but would also have a say in resolution and in particular, the Corporation will actively take part in:⁸⁷

- (a) Facilitating depositors' payout and taking their place in a 'liquidation waterfall';⁸⁸
- (b) Providing full or partial funding for the cost of a purchase and assumption resolution;⁸⁹
- (c) Reimbursing depositors who have been written off through bail-in.⁹⁰

Considering the above, the Corporation's mandate and powers, as required by Core Principle 2, are clearly defined and formally specified and are aligned with the Core Principles.

86 SARB *Designing a Deposit insurance scheme for South Africa* (2017) 44.

87 As above.

88 A liquidation waterfall basically refers to the hierarchy of claims in liquidation. The Corporation's actions will be subject to the rule that no creditor should be worse off because of resolution actions than would have been the case in liquidation. In essence, the Corporation will be expected to respect the creditor hierarchy in the Insolvency Act 24 of 1936. See SARB *Ending too big to fail: South Africa's intended approach to bank resolution* (2019) 19.

89 The FSLAB required the Corporation to provide funding for the cost of purchase and assumption resolution of a failed institution.

90 The FSLAB introduced a new tranche of loss-absorbing instruments, referred to as 'Flac' instruments, which will be subordinated to unsecured liabilities and be clearly intended for bail-in resolution. See SARB *Ending too big to fail* (2019) 15.

5 3 Governance

In terms of section 166AH of the FSLA Act, the Corporation is expected to appoint a Board of Directors who will manage its affairs, including the Fund, and will be required to establish and implement appropriate and effective governance systems and processes, taking into account internationally accepted standards. In particular, the appointed Board is responsible for the supervision and administration of the Corporation to ensure that it operates efficiently and effectively.⁹¹ The Board is set to act on behalf of the Corporation and perform the following:⁹²

- (i) authorise the CEO to sign memoranda of understanding and amendments on behalf of the Corporation.
- (ii) appoint members of relevant committees and provide directions on how such committees should conduct their work.
- (iii) make determinations on how to apply the Fund during bank resolution.
- (iv) determine the deposit insurance levy for the purposes of Financial Sector and Deposit Insurance Levies (Administration) and Deposit Insurance Premiums Bill 2022;⁹³ and
- (v) perform any other matter assigned to it in terms of financial sector law.

However, the Corporation has been established and positioned within the Reserve Bank, apparently as its subsidiary in terms of section 166AE which merely states that “[The] Corporation for Deposit Insurance is hereby established” without stating whether it is indeed a subsidiary of the Reserve Bank and a separate juristic person. In this regard, the operational independence of the Corporation is not so clear given that the Reserve Bank as well as the Government hold the shares in the Corporation. There is consequently a danger that the Government may require the Corporation to provide resolution funding in instances where it is not appropriate or refrain from providing such funding to facilitate an orderly bank resolution where it would indeed be appropriate. It is therefore submitted that the operational independence of the Corporation is not closely aligned with that of the international best practice.

5 4 Cooperation and collaboration with financial sector regulators and SARB

The Corporation is mandated, in terms of section 166BA, to cooperate and collaborate with other financial sector regulators as well as the

91 S 166AJ (a) of the FSRA as introduced by the FSLAA 2021.

92 S 166AJ (b)(i)-(v) of the FSRA as introduced by the FSLAA 2021.

93 The Financial Sector and Deposit Insurance Levies (Administration) and Deposit Insurance Premiums Bill has been accepted by the National Council of Provinces and is currently awaiting Presidential assent. See South Africa National Treasury Memorandum on the Objects of the Financial Sector and Deposit Insurance Levies (Administration) and Deposit Insurance Premiums Bill, 2022 <https://www.parliament.gov.za/bill/230064#:~:text=To%20provide%20for%20the%20collectionand%20Deposit%20Insurance%20Levies%20Act%2C.pdf> (last accessed 2023-10-02).

Reserve Bank to assist it to exercise its powers and perform its functions in terms of the FSR Act.⁹⁴ This includes providing assistance and information and promptly reporting any matter of which it becomes aware that affects or may affect the performance of any of these powers or functions.⁹⁵ In light of this, the South African deposit insurance system appears well aligned with the requirements of Core Principle 4 regarding the cooperation of deposit insurers with other safety net participants. As a new scheme, being able to cooperate with other financial safety-net participants, will ensure that the Corporation can identify emerging financial risks in banks early and hence will be able to act well in time to alert the Reserve Bank and Prudential Authority thereof and thereby assist in preventing banking crises. It will also facilitate swift depositor reimbursement or swift funding of resolution actions where necessary.

5 5 Cross-border coordination

The issue of cross-border coordination is an important consideration in South Africa. Over the past decade, South African banks have spread to various countries and some foreign banks have also been established in South Africa, thus increasing the risk of inter-country financial contagion.⁹⁶ Accordingly, the new deposit insurance framework as enshrined in Chapter 12A of the FSR Act contains provisions for cross-border coordination between the Corporation and deposit insurers and safety net participants in foreign jurisdictions in which the South African banks operate as well as foreign jurisdictions with banks in South Africa.⁹⁷ Although not stated in the FSR Act, to be appropriately aligned with the Core Principles, these Memorandums of Understanding (MoU) will have to undergo a regular review to ensure that they sufficiently take into account resolution-related information requirements.

5 6 The Corporation's role in contingency planning and crisis management

Chapter 12 of the FSR Act does not allude to the exact role of the Corporation in contingency planning and crisis management as recommended by Core Principle 6. In this regard, it is thus not clear at this stage what role the Corporation will play in contingency planning and crisis management, but the exact nature of this role can be expected to be clarified only once Chapter 12A is in operation and the Corporation has been established. These arrangements will likely be set out in an MoU between the Corporation and other safety net participants given the emergency nature of contingency planning and crisis management that would require it to be captured in soft law instruments such as MoU that

94 S 166BA (1) of the FSRA as introduced by the FSLAA 2021.

95 As above.

96 Mortlock, Casal & Berg "Financial safety nets and bank resolution frameworks in Southern Africa" 2019 *The World Bank Group* 6.

97 S 166BB of the *Financial Sector Regulation Act*.

can be changed quickly and without protracted Parliamentary intervention.

5 7 Membership

It is envisaged that a bank becomes a member of the Corporation upon its registration or on the day that such a bank obtains its license to operate as a deposit-taking institution and is allowed to hold covered deposits.⁹⁸ Alternatively, a bank which was licensed or registered in terms of a relevant financial sector law before the establishment of the Corporation will become a member of the Corporation once the latter is established.⁹⁹ The FSLA Act makes it mandatory for a bank, when applying for a bank license or registration, to provide the responsible authority with information that will enable it to meet the requirements¹⁰⁰ of the Corporation.¹⁰¹ Although the Corporation has no power to grant new licenses, it is evident from the provisions of the Act that no new bank license application will be approved if a new bank does not meet the requirements for membership of the Corporation. However, the new deposit insurance system does not appear fully compliant with Core Principle 7 as Chapter 12A of the FSR Act does not make provision for termination of membership of the Corporation, nor does it specify what will happen to the covered deposits if a bank loses its license.

5 8 Coverage

The new regime caps the protection of covered deposits of a bank in resolution at a certain maximum amount. The FSLA Act thus does not specify a blanket amount that will apply to all depositors. However, for purposes of section 166AB(1) of the Act, the FSR Act Regulations (Regulations) have proposed that the maximum amount the Corporation may apply from the Fund in respect of a qualifying depositor of a bank in resolution for their qualifying deposit balance is R100 000 (one hundred thousand Rand).¹⁰² According to the Regulations, this amount may be reviewed and updated at least every five years from the date of its establishment.¹⁰³ It is submitted that the aspects of deposit coverage are aligned with the deposit insurance system's public policy objectives and related design features.

98 S 166AG (1) of the FSRA as introduced by the FSLAA 2021.

99 S 166AG (2) of the FSRA as introduced by the FSLAA 2021.

100 The provision is not clear on the requirements of CODI. However, it is suspected that the requirements referred to here are the requirements for becoming a member of CODI, inter alia, obtaining a bank license and registering a bank in terms of the relevant legislation.

101 S 166AG (3) of the FSRA as introduced by the FSLAA 2021.

102 National Gazette 50311 Financial Sector Regulation Act (9/2017) Deposit Insurance Regulations Government Notice 4532.

103 Regulation 5 of the Financial Sector Act Regulations 2023.

5 9 Sources and uses of funds

In terms of section 166BC (1), the Corporation is allowed to charge member banks certain deposit insurance levies¹⁰⁴ to fund the Corporation's operations and the administration of the Fund. These deposit insurance levies are payable to the Corporation at the time specified by the Corporation per the legislation that empowers the imposition of these levies, once enacted.¹⁰⁵ Section 35 of the FSLA Act has introduced some new definitions into section 1 of the FSR Act which deal specifically with levies and premiums. A deposit insurance levy is defined as a 'levy of that name that may be imposed by legislation under section 166BC'. A deposit insurance premium means 'a premium imposed by legislation in accordance with section 166BG'. The South African deposit insurance system is thus largely compliant with Core Principle 9 although it can be expected that it will take some years to establish a sufficiently large Deposit Insurance Fund through collecting premiums from member banks hence the Reserve Bank's commitment as central bank to provide the deposit insurance system with some initial 'seed funding'.

5 10 Public awareness

Provision is made in the functions of the Corporation for the promotion of public awareness. In terms of the published Regulations, the Corporation must develop and publish, through any channel it considers appropriate, "details of the protections afforded by the Corporation, the process, and conditions for reimbursement as well as information on its operations."¹⁰⁶ In addition, Regulation 24 requires the Corporation to provide banks with information about deposit insurance to distribute to their depositors together with "standardized material" to communicate their membership of the Corporation to their depositors and offer training or training materials on depositor protection to their depositors.¹⁰⁷ It appears that the Corporation's public awareness provisions are compliant with the Core Principles.

5 11 Legal Protection

The FSLA Act makes provision for immunity in relation to any loss or damage suffered or incurred by any person arising from a decision taken or action performed in good faith in the exercise of power or performance of a function in terms of a financial sector law to include:¹⁰⁸ the Corporation; a Board member; a staff member of the Corporation; a

104 S 1 of the FSRA, as amended by the FSLAA, defines a deposit insurance levy as "a levy of that name that may be imposed by legislation in accordance with [s] 166BC."

105 S 166 BC(2) of the FSRA as introduced by the FSLAA 2021.

106 Reg 3 of the Financial Sector Act Regulations 2023.

107 Reg 4.

108 S 285 of the FSRA 2017 as amended by the FSLAA 2021.

resolution practitioner appointed for a designated institution¹⁰⁹ in resolution; and a person appointed or delegated by a financial sector regulator; or the Reserve Bank or the Corporation.¹¹⁰ However, there is no specific mention made as to whether such immunity covers current and previous persons in the capacities mentioned as aforementioned. This makes the Corporation fall short in compliance with Core Principle 11.

5 12 Dealing with parties at Fault during a bank failure

The FSLA Act also deals with the parties at fault in a bank failure in section 135A.¹¹¹ The title of this provision in the Act is 'Investigation into designated institutions in resolution' and states that the appointed investigator in the resolution of a designated institution must conduct the investigation in accordance with the provisions contained in Chapter 12A and, within the period specified by the Reserve Bank in the appointment, report to it whether, in the investigator's opinion, the designated institution should-

- (i) "be wound up;
- (ii) remain in resolution for a specified period or until a specified event occurs, or ceases to be in resolution;
- (b) any business of the designated institution was, before it was placed in resolution, carried on negligently, recklessly, or fraudulently; and
- (c) proceedings, including criminal proceedings, should be instituted against any person in connection with the conduct of the business of the designated institution before it was placed in resolution."¹¹²

The South African resolution regime thus complies with Core Principle 12.

5 13 Early and timely intervention

In South Africa, the Prudential Authority is tasked with bank supervision in accordance with the Banks Act 90 of 1994. The Prudential Authority undertakes periodic stress testing to facilitate early detection of bank stress.¹¹³ The FSR Act has also given the Prudential Authority a wide

109 A designated institution has been defined in s 29(A)(1) of The FSLAA 23 of 2021 as each of the following: a bank; a SIFI; a payment system operator and participants of a systemically important payment system; a company that is a holding company of a bank or a SIFI, or a payment system operator of a systemically important payment system; and subject to any determination, if a bank or a SIFI is a member of a financial conglomerate, each of the other members of the financial conglomerate. See South African Reserve Bank: Financial Stability Department *Ending too big to fail: South Africa's intended approach to bank resolution* (2019) 9.

110 See International Monetary Fund (IMF) *South Africa Financial Sector Assessment Program: Financial safety net, bank resolution, and crisis management framework – Technical note* (2015) IMF Country Report No 15/53 34.

111 See s 50 of the FSLAA.

112 This provision basically mirrors the Commission of Inquiry into a failed bank's affairs, previously captured in the repealed s 69A of the Bank's Act 94 of 1990.

range of enforcement powers in sections 141 to 153, some of which can be used for purposes of early intervention in a bank failure, such as removing some persons from the board of directors. Although the Banks Act provides for regular supervisory powers by the Prudential Act it does not however contain a provision that sets out a broad range of early intervention measures. The new resolution regime also does not contain any such provision. Accordingly, it cannot be said that the South African regime is fully compliant with Core Principle 13.

5 14 Failure resolution

As already mentioned, the FSLA Act has also introduced a new comprehensive resolution regime, thus significantly improving South Africa's bank failure resolution regime. According to this new regime, the Reserve Bank, as the resolution authority, is expected to develop resolution planning for all designated institutions.¹¹⁴ The FSLA Act also introduces new powers for executing a bank resolution, including the power of statutory bail-in,¹¹⁵ the power to establish a bridge bank institution,¹¹⁶ and the power to transfer all or part of a bank's assets and liabilities to such a bridge bank.¹¹⁷ Provision is also made for the interaction between the deposit insurance system and the new resolution regime to ensure optimal bank resolution.

From the perspective of the new explicit South African deposit insurance framework, alignment with Core Principle 14 has been achieved as it will be implemented simultaneously with the new bank resolution regime inserted as Chapter 12A into the FSR Act. As required by Core Principle 14 the new bank resolution regime also provides for a defined creditor hierarchy which insulates covered deposits against losses and requires shareholders to take first losses through the application of the bail-in tool provided in section 166U and section 166S, respectively, of the FSR Act.

5 15 Reimbursements

The Corporation is set to operate a "pay-box" plus mandate. According to this mandate, the Corporation will be able to facilitate prompt reimbursements of depositors, set the operational budgets, and get

113 IMF "Financial Sector Assessment Program: South Africa; Financial Safety Net and Crisis Management" 2022 <https://www.imf.org/-/media/Files/Publications/CR/2022/English/1ZAFEA2022005.ashx> (accessed 11 December 2022).

114 SARB *Ending too big to fail* (2019) 28.

115 S 166R and 166S of the FSLAA 2021 empowers the SARB to write-down the shares of the designated institution, issue new shares in the designated institution, write-down the liabilities of the designated institution subject to exclusions as well as to convert debt instruments to equity.

116 S 166R of the FSLAA 2021 authorizes the SARB to transfer any or all of the assets and/or liabilities and to conduct a sale, merger or similar arrangement.

117 SARB *Ending too big to fail* (2019) 14.

access to information required to meet its financial obligations to depositors. The mandate also gives the Corporation the power to reimburse depositors and to have a say in the resolution. In particular, the Corporation will be able to take part in:¹¹⁸

- (a) Facilitating depositors' payout and taking their place in a "liquidation waterfall";¹¹⁹
- (b) Providing full or partial funding for the cost of a purchase and assumption resolution;¹²⁰
- (c) Reimbursing insured depositors who have been written off through bail-in;¹²¹
- (d) Funding the transfers to a bridge bank or the sale to a private sector entity;¹²²
- (e) Funding an open bank resolution.¹²³

Since the main objective of the South African deposit insurance system is to put systems in place to be able to effect payouts to depositors, it was proposed that such payouts would be made within 20 working days after the closure of a bank for deposit accounts where ownership is easily identifiable.¹²⁴ It is clear from the new deposit insurance framework read together with the new bank resolution framework introduced that section 166A aims to ensure, through the application of the Fund by the Corporation, that depositors have reasonable access to their deposits. Thus, the South African deposit insurance system can be said to be largely compliant with Core Principle 15.

5 16 Recoveries

Recoveries by the Corporation are addressed by section 166Y of the FSLA Act, in relation to subrogation of claims which makes it clear that the Corporation will be substituted for depositors in respect of claims that the

118 SARB *Designing a Deposit insurance scheme for South Africa* (2017) 30.

119 A liquidation waterfall basically refers to the hierarchy of claims in liquidation. CODI will be expected to respect the creditor hierarchy in the Insolvency Act 24 of 1936. See SARB: Financial Stability Department *Ending too big to fail: South Africa's intended approach to bank resolution* (2019) 19.

120 The FSLAB required the Corporation to provide funding for the cost of purchase and assumption resolution of a failed institution.

121 The FSLAB introduced a new tranche of loss-absorbing instruments, referred to as "Flac" instruments, which will be subordinated to unsecured liabilities and be clearly intended for bail-in resolution. See SARB *Ending too big to fail* (2019) 15.

122 As the designated resolution authority, the SARB will have the ability to restructure a designated institution in resolution. In this regard, section 166R of FSLAB empowers to transfer any or all of the assets and/or liabilities as well as conduct a sale, merger or similar arrangement. See also SARB *Ending too big to fail* (2019) 18.

123 In an open-bank resolution, the bank is allowed to continue to function in its existing form under its own license. See generally SARB *Ending too big to fail* (2019) 21.

124 SARB, *Designing a deposit insurance scheme for South Africa* (2017) 44.

Fund had paid out. In this regard, it is submitted that the new South African deposit insurance system is compliant with Core Principle 16.

6 Conclusion and Recommendations

The new South African deposit insurance system is largely compliant with all 16 Core Principles for Effective Deposit Insurance. However, there are several aspects in which the new deposit insurance regime falls short of full compliance with the Core Principles. Consequently, the following recommendations are made for future policy considerations.

- It is recommended that the provision in the legislation stating the Corporation's objectives be amended to clearly reflect that depositor protection and the promotion of financial stability are both main objectives of the Corporation.
- Safeguards should also be put into the legislation to guard against the spending of the Corporation's funding on directions of the Reserve Bank or government in instances where it is not justified to ensure that the Corporation's operational independence is not compromised.
- Provision should be made in the legislation for the Corporation to change the basis on which premiums are levied at a later stage should it so wish as a risk-based premium will be fairer and will instill greater market discipline.
- The legislation must clearly state the instances in which the Corporation can terminate a bank's membership and should also indicate the effect that this will have on the said bank's insured deposits (i.e. that their deposits will still be protected until a specified deadline) and impose an obligation on the Corporation to notify depositors of the termination of a bank's membership only after sufficient and swift provision had been made to protect the said deposits in a manner that would prevent a bank run.
- The legislation should specify the sanctions for failure by a member bank to comply with its obligations in respect of deposit insurance levies and premiums.