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# SOUTH AFRICA

## FINANCIAL SECTOR ASSESSMENT

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**Finance, Competitiveness,  
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Practice and  
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A joint IMF-World Bank mission visited South Africa on February 2020 and continue working remotely until June 2021, to update the findings of the Financial Sector Assessment Program (FSAP) conducted in 2014.<sup>1</sup> This report summarizes the main findings of the mission, identifies key financial sector vulnerabilities, and provides policy recommendations.

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## Glossary

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
AUM	Assets Under Management
CET1	Common Equity Tier 1
CIS	Collective Investment Schemes
COFI	Conduct of Financial Institutions
DSBD	Department of Small Business Development
DIS	Deposit Insurance Scheme
D-SIB	Domestic Systemically Important Bank
ELA	Emergency Liquidity Assistance
ESG	Environmental, Social and Governance
ETP	Electronic Trading Platform
EWI	Early Warning Indicator
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FIC	Financial Intelligence Center
FMA	Financial Markets Act
FMI	Financial Market Infrastructure
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSLAB	Financial Sector Laws Amendment Bill
FSC	Financial Stability Committee
FSCA	Financial Sector Conduct Authority
FSOC	Financial Stability Oversight Committee
FX	Foreign Exchange
GaR	Growth-at-Risk
GDP	Gross Domestic Product
GEPF	Government Employees' Pension Fund
ICR	Interest Coverage Ratio
IFRS	International Financial Reporting Standards
IFWG	Inter-governmental Fintech Working Group
IMF	International Monetary Fund
JSE	Johannesburg Stock Exchange
LCR	Liquidity Coverage Ratio
LGD	Loss Given Default
MMF	Money Market Fund
MSME	Micro, small and medium-sized enterprises
NBFI	Non-Bank Financial Institution

## SOUTH AFRICA

NCR	National Credit Regulator
NDC	Nationally Determined Contribution
NGFS	Network for Greening the Financial Sector
NPL	Non-Performing Loan
NPS	National Payment System
NSFR	Net Stable Funding Ratio
NT	National Treasury
ODP	Over-the-counter Derivatives Providers
PA	Prudential Authority
PD	Probability of Default
RAM	Risk Assessment Matrix
RBA	Risk-Based Approach
RWA	Risk-Weighted Assets
SAM	Solvency Assessment and Management framework
SARB	South African Reserve Bank
SASSA	South African Social Safety Agency
SME	Small and Medium-Sized Enterprises
SOE	State-Owned Enterprises
SSA	Sub-Saharan Africa
TCFD	Task Force on Climate-related Financial Disclosures
USD	United States Dollar
WB	World Bank
WEO	World Economic Outlook

## Executive Summary

**The South African financial system has weathered the shock of COVID-19 but faces growing risks emanating from a weak macroeconomic outlook.** The pandemic crisis hit South Africa hard, with nonresident capital outflows accelerating and the domestic and global slowdown precipitating a 6.4 percent GDP contraction in 2020. A brief period of liquidity stress was managed with new central bank facilities and a lowering of liquidity requirements; and banks proved resilient thanks to sound capital and liquidity buffers. Asset management and pension assets saw falling valuations, but redemption pressures quickly dissipated as markets stabilized. The intensification of the sovereign-financial system nexus emerging from the crisis poses risks going forward, and a resurgence of the pandemic could deteriorate asset quality. Banks are resilient in the FSAP's baseline; however, a medium-term adverse stress scenario would cause a significant decline in capital although most banks would remain sufficiently capitalized. Under stress, banks could face some liquidity gaps, particularly at very short maturities, highlighting the importance of continued close monitoring. The impact of COVID-19 on insurers has thus far been contained, but prudential rules should be strengthened to ensure the measure of capital is sufficiently robust.

**The impact of capital flow volatility on financial markets is mitigated by the flexible exchange rate, low levels of foreign currency exposures and resident capital control restrictions.** Banks have low exposures to foreign currency assets and a large pool of savings in pension, investment funds and life insurances are by rule dedicated to rand investments.<sup>2</sup> These features also deepen interconnectedness and vulnerability to cross-sectoral contagion. Financial institutions may come under increasing pressure to fund SOEs and the sovereign, especially in an adverse scenario.

**Financial sector oversight in South Africa is strong, reflecting a commitment to independent supervision and the implementation of international standards and best practices.** Significant progress has been made since the 2014 FSAP, with the implementation of the “twin peaks”, strengthening of risk-based supervision and additional attention to conduct supervision—strengthened coordination between supervisors, including the National Credit Regulator (NCR), would be important. The regulatory framework for banking, insurance, pension, and securities is aligned with international standards with a few areas for improvement. Cybersecurity supervision has gained traction, with further development of recovery and response capability, third party risk management and greater use of examinations as the next steps.

**Evolving prudential oversight to become more intrusive, particularly in light of the challenging operating environment, and implementing the framework for conduct supervision will be critical.** Broadening the macroprudential toolkit, and enhancing prudential supervision, with greater focus on governance and risk management and less reliance on third party auditors, and introduction of an early warning framework will be critical as financial sector risks intensify. Continuing strong

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<sup>2</sup> Pension, insurance and investment funds are allowed to invest 15 percent in overseas non-rand assets.

supervision of all licensed banks, including those owned by the state, and avoiding prescribed assets while encouraging infrastructure investments will be important to maintaining resilience of the system. The prudential framework for insurers has been significantly strengthened but additional (supervisory) focus on mark-to-market assumptions and use of future profits in capital calculations would further improve resilience. The Financial Sector Conduct Authority (FSCA) needs to transition from a compliance focus to a more active conduct oversight role, adopt a risk-based supervision approach for the pension sector with a greater focus on governance and investment oversight and proactively wind up poorly managed funds. Several fintech developments like crowdfunding, online lending, crypto assets, open banking, alternative data, and non-bank payment service providers remain either unregulated or inadequately regulated<sup>3</sup>. Amendments to the National Payments System (NPS) Act and adoption of the Conduct of Financial Institutions (COFI) bill should be fast-tracked, with an interim strategy for fintech related activities not currently captured by the existing regulatory framework should be developed in the meantime.

**Completing the bank financial safety net framework will improve the authorities' ability to handle shocks.** Finalizing and operationalizing the bank resolution framework, advancing resolvability assessments and resolution planning and establishing the new deposit insurance scheme —while strengthening its financing arrangements— is imperative. Building on supervisory initiatives for home-host collaboration, the authorities should also seek to build capacity for bank resolution across the region. SARB's ELA framework could usefully be extended to the provision of liquidity support to solvent banks facing idiosyncratic shocks. Over the medium term, the legal underpinnings of the SARB's 'lender-of-last-resort' function should

**Climate stress tests showed that in the medium-term risks to balance sheets are small but growing.** Enhancing data gathering and analysis will help the authorities develop a roadmap for supervision and oversight of these risks. Opportunities arising from green finance should be seized, including by enhancing disclosure, finalizing the green taxonomy and issuing 'green' sovereign bonds within the framework of NT's debt management strategy and needed consolidation of benchmark issues.

**Increasing competition and efficiency in the financial sector calls for reforms to foster market entry, level the playing field, and increase capital market financing.** The banking sector shows substantial concentration, high costs and high fees. Moreover, fees structures are complex and extensive, presenting difficulties to make meaningful comparisons. The retail payment systems, the credit reporting system, the gateway for ID verification services and fraud reporting repository are all controlled by a consortium of banks.. Bond markets funding to the non-financial private sector is very limited. Proportional regulatory regimes to facilitate entrance of new players and open banking, subject to strong safeguards, would foster new entrants in the market. The Inter-governmental Fintech Working Group (IFWG) could pursue options to making data (e.g. business registries, tax records, demographic information) available in a digital and automated manner. Beyond access to

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<sup>3</sup> Global regulatory standards are still emerging for some fintech innovations/activities (for example on regulatory standards for crypto assets or stablecoins).

infrastructures, fintechs will also need a voice in the future development of the infrastructure and pricing policies. A centralized and user-friendly product comparison website could make it easier for consumers to search for and compare product offerings in the market. Envisaged amendments to the Financial Markets Act, 2012 (FMA) to remove legal mandates for the use of back office infrastructure of the Johannesburg Stock Exchange (JSE) and barriers to the entry of new participants should be enacted. Efficiency in the government securities market could be improved through the development of the Electronic Trading Platform into the main trading venue.

**Reaching the “last mile” of unbanked adults, increasing the use of digital financial services and MSME access to finance, and addressing persistently high levels of credit impairment are the main financial inclusion challenges facing South Africa.** About four in five South African adults report owning a bank account but the majority use their accounts only once a month as the use of digital financial services is low. Persistently high levels of credit impairment in the consumer credit markets threaten the achievement of responsible and sustainable financial inclusion. Less than 4 percent of formal small and medium-sized enterprises (SME) report having a credit line, well below regional and income peer levels (20-40 percent respectively) with the MSME credit gap estimations ranging at 9-15 percent of GDP.

**Reforms to facilitate entrance of new players targeting underserved segments, leverage social protection programs to enhance financial inclusion, re-design public credit support programs and upgrade financial infrastructure should be prioritized to foster financial inclusion.** The public authorities have launched initiatives to understand Fintech developments but have yet to actively encourage Fintech solutions for financial inclusion, e.g., by identifying financial inclusion as a theme for the regulatory sandbox or using the accelerator process for exploring how fintech could be leveraged for government MSME programs. Amendments to the National Payments Act allowing direct provision of payment services by non-banks and allowing the South African Social Safety Agency (SASSA) to engage them, would leverage social benefit transfers to advance inclusion goals. Public credit support programs should be redesigned in line with international best practices, phasing out direct lending from public development financial institutions. Policy and regulatory reforms are also needed to enhance credit information systems, establish a national credit bureau, improve the secure transactions framework and establish retail payment instruments interoperability. Such reforms should be prioritized in the Financial Inclusion Implementation Strategy currently under development.

**Pension system reform is needed to improve coverage rates for informal workers and adequacy of pension benefits to allow individuals to better manage longevity risks.** Approximately one-third of the working-age population are informal workers with no access to pension savings. Low replacement rates are compounded by the fact that pension benefits can be easily withdrawn before retirement. A non-profit, private-sector umbrella scheme, designed to avoid fiscal support or undue pressures on private sector enterprises, could provide a low-cost, high efficiency scheme for smaller employers to offer to low-income workers. Auto-enrollment of formal sector workers and the introduction of techniques such as auto-escalation of contributions for default funds could help improve formal sector coverage and address benefit adequacy. In addition, reform proposals designed to incentivize greater preservation of benefits should be developed.

<b>Table 1. South Africa: Key Recommendations</b>	
<b>Financial Stability</b>	<b>Timing<sup>1</sup></b>
<b><i>Vulnerabilities analysis</i></b>	
Further strengthen analytical tools, including for stress testing and climate risk analysis, and incorporate results in risk-based supervision (SARB, PA)	MT
<b><i>Financial sector oversight</i></b>	
Continue to broaden the macroprudential toolkit and close data gaps (SARB)	MT
Consider carefully calibrated measures to address sovereign-financial nexus (SARB, NT)	MT
Pursue more structured, intrusive and comprehensive (risk-based) supervision, with more focus on governance and risk management (PA, FSCA)	ST
Continue safeguarding the agencies' operational independence; further strengthen resourcing and enhance coordination (PA, FSCA, NCR NT)	MT
Develop a rigorous framework for early intervention in banks (PA)	MT
Scrutinize insurers' capital calculations, review products with high lapse and surrender rates, conduct industry-wide stress tests and analyze the impact of IFRS 17 adoption (PA, FSCA)	MT
Enact COFI bill to duly underpin conduct supervision; further develop a framework for conduct oversight (Parliament/FSCA, NT)	ST
Strengthen CIS oversight via conduct rules, notification requirements for material changes to prospectuses, and accounting standards; establish responsibilities of manufacturers and distributors, and due diligence requirements for assets held in sub-custody (FSCA)	MT
Strengthen capital requirements, risk and margin management rules for ODP; complete the reporting and supervisory framework (FSCA, PA)	MT
Proactive unwinding of poorly performing pension funds; improve pension trustee training and independence (NT, FSCA)	I
Fast-track the review and promulgation of the NPS Act and COFI bill, with interim measures adopted to buttress supervision and monitoring of Fintechs (NT, FSCA, SARB)	ST/I
Define Fintech supervisory and monitoring approach (FSCA, SARB)	I
Implement a consistent, multi-sectoral regulatory framework that articulates supervisory and oversight expectations for cyber resiliency (SARB, PA)	MT
Improve data collection for climate risk oversight; issue guidelines on climate risk management, governance and disclosure; and develop stress testing capacity (SARB, PA)	MT
<b><i>Financial safety nets</i></b>	
Adopt and operationalize the new resolution and deposit insurance legislation (NT, SARB)	ST
Step up crisis preparedness through resolution planning, resolvability assessments and recurrent simulations. (PA)	ST
<b><i>Systemic liquidity</i></b>	
Extend the SARB's ELA guidance to temporary liquidity support for solvent banks (SARB)	MT
<b>Financial Development</b>	
<b><i>Competition and efficiency</i></b>	
Consider introduction of proportionate regulatory frameworks aligned with the business risk profile of new entrants to facilitate market entry (NT, PA)	MT

Ensure fair, open and transparent access to critical financial infrastructure through reforms of the NPS Act and enhanced governance arrangements. (SARB, FSCA, NCR, NT)	ST/MT
Progress the work on open finance launched by the FSCA, SARB and NT and implement regulatory changes; enhance accessibility of government data (FSCA, NT) with due regard to the data protection and privacy considerations.	MT
Establish/support establishment of a centralized website to facilitate the comparison of prices and features of common retail products (FSCA)	ST
Amend Financial Markets Act, 2012 to foster competition and further develop domestic capital markets (NT, PA, FSCA)	ST
<b>Financial inclusion and MSME finance</b>	
Enact reforms to the National Payment System Act to provide a direct role for non-banks in the provision of payment services (NT, SARB, Parliament)	ST
Develop and issue regulations prescribing interoperability of retail payments instruments and open banking standards (SARB)	ST
Expand the range of payment service providers and product functionalities used to distribute SASSA social grants (DSD, SASSA)	ST
Improve credit information environment by expanding SME data coverage, including small lenders in credit bureau reporting and incorporating alternative data (NCR, FSCA, SACCRA)	ST
Review the secure transaction framework to ensure extrajudicial execution and create a computerized nation-wider register for movable guarantees (NT, NCR)	MT
Review and redesign public credit support programs, phasing out direct lending and introduce monitoring and evaluation frameworks (NT, DSBD)	ST
<b>Financial sector development</b>	
Implement auto-enrolment and auto-escalation for formal sector employees; develop proposals for preservation of assets; consider establishment of non-profit umbrella pension fund, solely funded by private sector savings, for informal workers (NT)	MT, ST, ST
Develop proposals for partial preservation of pension benefits (e.g. through 'side car' accounts) (FSCA/ NT)	ST
Introduce a green or sustainable taxonomy of green or sustainable economic activities and start monitoring flows. (NT, SARB, FSCA)	ST
Issue guidelines on listed firms' disclosures in line with the FSB TCFD recommendations (FSCA, JSE, NT)	MT

I = immediate; ST = short term (0-6 months); MT = medium-term (6 months – 2 years)

# MACROFINANCIAL SETTING

## A. Financial System Structure

**1. The South African financial system is large and complex.** Banks account for about 130 percent of GDP, with the five largest banks accounting for almost 90 percent of banking sector assets. The insurance sector is also highly concentrated, but insurance companies have an unusually diverse range of business models, with significant variation in risk profiles—which is unique relative to other major insurance markets. Equity and government bond markets are highly developed. Investment funds, with cumulative assets under management (AUM) amounting to 250 percent of GDP are a core part of the financial system, with pension funds holding 40 percent of total AUM. There is a small but growing fintech sector focusing primarily on payments, business-to-business support, and lending activities. Crypto-assets are also emerging<sup>4</sup>. Fintechs generally do not constitute more than 1 percent of their respective markets (5 percent in the case of payments). There are several state-owned financial institutions, although apart from the Public Investment Corporation these are relatively small. All major banks are affiliated with insurance companies; bank-affiliated insurers underwrite a substantial proportion of private pension assets; and large banks own fund managers. Nonbanks are important sources of liquidity for banks. While less than 5 percent of banking sector assets are cross-border operations, these continue to grow and are systemically important in many host countries (e.g., Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Swaziland, Uganda, and Zambia). Thus, domestic shocks could generate outward spillovers, with a significant impact on the region.

## B. Macro Financial Setting

**2. South Africa entered the global pandemic with substantial vulnerabilities.** The fiscal deficit—already high—ballooned due to pandemic-related spending and falling revenues, and public debt rose as a result. Struggling SOEs continued to weigh on public finances; and unemployment, poverty, and inequality were stubbornly high. While the flexible exchange rate, favorable composition of government debt (long maturity and mainly in local currency) and a resilient banking system have thus far acted as shock absorbers, structural weaknesses, if left unaddressed, may put public debt on an unsustainable trajectory and can pose serious risks to the financial sector and wider economy.

**3. Decisive action by the authorities helped dampen the immediate impact of the pandemic.** The global market sell-off in March 2020, coupled with the rating downgrade by Moody's, resulted in capital outflows; a widening of the term spread to historical highs; declining financial asset prices; and temporary liquidity tightening in some money market segments (Figure 1). The authorities' financial sector policy response, broadly aligned with best practice, sought to ease liquidity conditions, provide regulatory flexibility and support affected borrowers (Text Box). Nonfinancial private sector debt-service-to-income remained stable despite economic activity contracting substantially. Bank

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<sup>4</sup> Market-cap of crypto-assets traded was estimated to be ZAR 6.5 Bn and between 1.5 to 2 million customers – IFWG Crypto-assets report (April 2020).

lending held relatively steady; bank and nonbank purchases of sovereign debt increased, in view of more attractive risk-adjusted returns. Downside risks to financial stability remain substantial, however, as also illustrated by recent developments surrounding the Omicron variant.

<b>Text Box. South Africa: Temporary Measures to Offset the Impact of COVID-19</b>	
<b>Monetary Policy Operations</b>	<b>Regulatory Relief</b>
<ul style="list-style-type: none"> <li>• Policy rate cut by a cumulative 275 basis points (bps) to 3.5 percent since March 2020.</li> <li>• Replacement of SARB's end-of-day discretionary supplementary facilities with Intraday Overnight Supplementary Repurchase Operations, offered at the repo rate and allocated on a pro rata basis.</li> <li>• Potential collateral substitution for the weekly main repo operations.</li> <li>• Standing Facility borrowing rate adjusted to the repo rate less 200 bps; and lending rate lowered to the repo rate.</li> <li>• Additional offerings of longer-term refinancing operations with 91-day maturities at the repo rate plus 30 bps. If deemed necessary, maturities can be extended to 364 days.</li> <li>• SARB lending to commercial banks at the repo rate plus 50 bps to support the government's Loan Guarantee Scheme.</li> <li>• New SARB program to purchase government securities in the secondary bond market, across the yield curve.</li> </ul>	<p>The Prudential Authority (PA) introduced:</p> <ul style="list-style-type: none"> <li>• temporary changes to the treatment of restructured loans in good standing before COVID-19 and expected to remain current when the pandemic period ends;</li> <li>• temporary capital and liquidity relief (e.g., reduced Pillar 2A capital requirements, clarified criteria to draw down capital conservation buffers, lowered the liquidity coverage ratio from 100 to 80 percent);</li> <li>• temporary guidance on dividend distribution and cash bonuses (revised in February 2021); and</li> <li>• guidance on the application of IFRS 9 during the pandemic.</li> </ul>
	<b>Support to Vulnerable Borrowers</b>
	<ul style="list-style-type: none"> <li>• Multiple support schemes established, including the COVID-19 Loan Guarantee Scheme, a working capital investment and revolving credit facility backed by the Khula Credit Guarantee, various loan funding facilities and a temporary credit moratorium for MSME.</li> </ul>

<p><b>COVID-19 Secondary Market Bond Purchases by SARB</b> (bn Rand)</p> <table border="1"> <caption>COVID-19 Secondary Market Bond Purchases by SARB (bn Rand)</caption> <thead> <tr> <th>Month</th> <th>Purchases (bn Rand)</th> </tr> </thead> <tbody> <tr><td>Mar-20</td><td>1.0</td></tr> <tr><td>Apr-20</td><td>11.5</td></tr> <tr><td>May-20</td><td>10.0</td></tr> <tr><td>Jun-20</td><td>5.0</td></tr> <tr><td>Jul-20</td><td>2.5</td></tr> <tr><td>Aug-20</td><td>0.5</td></tr> <tr><td>Sep-20</td><td>0.5</td></tr> <tr><td>Oct-20</td><td>0.5</td></tr> <tr><td>Nov-20</td><td>1.5</td></tr> <tr><td>Dec-20</td><td>1.0</td></tr> <tr><td>Jan-21</td><td>0.5</td></tr> <tr><td>Feb-21</td><td>0.5</td></tr> <tr><td>Mar-21</td><td>-2.0</td></tr> </tbody> </table>	Month	Purchases (bn Rand)	Mar-20	1.0	Apr-20	11.5	May-20	10.0	Jun-20	5.0	Jul-20	2.5	Aug-20	0.5	Sep-20	0.5	Oct-20	0.5	Nov-20	1.5	Dec-20	1.0	Jan-21	0.5	Feb-21	0.5	Mar-21	-2.0	<p><b>COVID-19 loan restructurings</b> (bn Rand and percent)</p> <table border="1"> <caption>COVID-19 loan restructurings (bn Rand and percent)</caption> <thead> <tr> <th>Month</th> <th>Corporate (bn Rand)</th> <th>Retail (bn Rand)</th> <th>Total as a % of total loans</th> </tr> </thead> <tbody> <tr><td>Apr 20</td><td>130</td><td>180</td><td>6.5</td></tr> <tr><td>Jul 20</td><td>260</td><td>350</td><td>12.0</td></tr> <tr><td>Oct 20</td><td>200</td><td>280</td><td>8.5</td></tr> <tr><td>Jan 21</td><td>160</td><td>140</td><td>6.0</td></tr> </tbody> </table>	Month	Corporate (bn Rand)	Retail (bn Rand)	Total as a % of total loans	Apr 20	130	180	6.5	Jul 20	260	350	12.0	Oct 20	200	280	8.5	Jan 21	160	140	6.0
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Source: SARB.

## RISKS ASSESSMENT

### A. Financial sector condition and risks

**4. The banking sector has remained resilient throughout the pandemic, but risks are tilted to the downside.** In aggregate, bank capitalization remains comparable to pre-COVID levels (Table 2), despite increasing credit risks and some differences across banks. Liquidity ratios exceed regulatory requirements, which have been lowered during the pandemic. The largest banks, in particular, have performed well in SARB's 2020 stress test.<sup>5</sup> Although banks remain profitable, smaller banks have been particularly impacted by increasing provisioning costs and decreased non-interest income. Compared to peers, the banking system at end 2020 was well capitalized with but relatively high non-performing loans (NPLs) and weak profitability (Figure 2).

**5. The insurance sector appears well-capitalized and the impact of COVID-19 on the insurance sector has been relatively muted.** The insurance sector's capital ratios remain well above regulatory minima but the inclusion of substantial future profits from existing policies, high lapse and surrender rates, and substantial exposure to equities—exceeding thresholds observed in other countries—raises some concern (Figure 3). Tepid business growth is weighing on insurers' profitability, and investment products with guaranteed returns could generate additional pressures if low interest rates persist. Furthermore, the impact of IFRS 17 on the insurance sector's solvency ratios should be carefully monitored.<sup>6</sup>

**6. Investment funds exhibited a mixed performance following the COVID shock.** Collective investment schemes (30% of total sector) and money market funds (MMFs) continued to see a sharp increase in investments despite higher market volatility and an uncertain trading environment supported by central bank actions. Within MMFs, exposures to financial institutions declined significantly from 72 percent in 2019-end to less than 60 percent in 2020-end. Exposure to government and public entity paper rose sharply from 3 percent in 2019 to almost 20 percent, reflecting the growing sovereign-financial nexus. MMFs however, remain vulnerable to large redemptions. Private pension funds (16 percent of total AUM) saw a 3.6 percent year-on-year decline in valuations during 2020. Government pension funds (24 percent of total AUM and 60 percent of pension funds) were relatively more resilient.

**7. Sectoral contagion risks appear limited in all but the most extreme scenarios, despite high interconnectedness.** Increasing inter-bank and inter-insurance exposures indicate that the financial system has become more interconnected since the last FSAP. Simulations of the impact of cascading defaults identify the D-SIBs as the primary source of potential domestic contagion, with capital erosion largely stemming from one bank. Smaller banks are more vulnerable to cascading shocks than larger institutions. Spillovers within the insurance sector are concentrated in a few

<sup>5</sup> [Financial Stability Review 2020, second edition.](#)

<sup>6</sup> IFRS 17 provides consistent principles for the accounting of insurance contracts. It removes existing inconsistencies and seeks to foster meaningful comparability of companies, contracts, and industries.

institutions, with multi-round failures generating modest capital losses. Generally speaking, life insurers are more impacted than non-life insurers.

**8. The increasing sovereign-financial sector nexus poses a growing financial stability risk.**

Financial sector holdings of sovereign debt were broadly comparable to peers before the pandemic but the nexus has strengthened more recently as nonresident investors have exited the bond market, with domestic institutions picking up the slack.<sup>7</sup> Although the sovereign-financial sector nexus strengthened across emerging markets, high fiscal financing needs and volatile nonresident capital flows imply relatively larger risks for South Africa. Fiscal fragilities reduce the credibility of the sovereign backstop should financial sector distress materialize.

**9. Nonfinancial corporates and households remain vulnerable.** At 40 percent of GDP as of Q4-2020, corporate debt is comparable to median peer countries but rising leverage (driven by tight financial conditions and weak profitability), risk concentrations, and relatively high obligations in foreign currency raise concerns—even though financial and natural hedges would attenuate some of the risks (Figure 4).<sup>8</sup> Corporate earnings are showing signs of improvement, and interest coverage ratios are slowly recovering from historically low levels observed during 2020. The corporate default ratio has declined below 3 percent, and corporate NPLs in banks' balance sheets have remained relatively stable. While banks' direct exposures to fragile SOEs are currently small, they may rise if markets become reluctant to hold SOE debt, and banks would face greater pressures to provide additional funding. Moreover, the benefit of government guarantees may diminish if fiscal fragilities continue to mount. Household finances came under severe strain during 2020, with aggregate disposable income dropping as employment reached its lowest point in the past decade. Default ratios for banks' retail portfolios have approached levels observed during the global financial crisis but have since stabilized.

**10. Since the last FSAP, capital flows to South Africa have become more volatile.** Trends reflects the interplay between a higher-than-average sensitivity to external shocks, and a deep domestic investor base that offsets this volatility. Nonresident portfolio debt flows are predominantly in local currency, which makes them highly sensitive to domestic macro weaknesses, as well as external shocks. The drop in foreign participation in the domestic market in South Africa—ahead of the March 2020 sovereign credit rating downgrade and further exacerbated by the pandemic—was absorbed by domestic investors, with SARB's purchases in the secondary market partly enabling domestic banks to absorb primary debt issuances.

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<sup>7</sup> With domestic banks having absorbed 42 percent of the total issuance since January 2020, they now hold around 21 percent of all outstanding domestic sovereign bonds, up from around 17 percent at end-2019). Insurance companies hold another 7 percent (6 percent at end-2019).

<sup>8</sup> Bank lending to the corporate sector has grown by ~9 percent annually since 2014; borrowing via debt securities has been more volatile, with an average annual decline of ~2 percent over the same period.

## B. Stress Tests

**11. Solvency stress testing of banks revealed strong balance sheets in the baseline but serious decline in an adverse scenario.** The tests, using a three-year horizon, were conducted on financials for the six largest banks as of December 2020, using a Common Equity Tier 1 (CET1) hurdle rate of 4.5 percent. Simulations suggest that banks could recover well from the pandemic as economic activity rebounds but may face significant capital erosion if stressed conditions persist. Capitalization under the baseline scenario could improve by more than 200 basis points (bps), driven by improving net interest income; some reduction of risk-weighted assets (RWA) in 2021; declining provisioning costs; and modest losses on sovereign exposures. Under the adverse scenario, however, capitalization could decline by 250-340 bps, with an aggregate capital shortfall of 0.6–0.8 percent of GDP by 2023 and one bank breaching minimum requirements.<sup>9</sup> Capital erosion is driven by reduced net interest income as NPLs increase; elevated loan loss provisions; and losses on sovereign exposures (fair value through profit or loss or through other comprehensive income). Stress test results should be interpreted with caution, as the macroeconomic outlook remains subject to substantial uncertainty and credit risks may evolve differently in the current environment from what is implied by historical patterns. Sensitivity analyses of real estate, and sovereign spreads and portfolio concentrations show potential large capitalization losses in a worsening environment. Concentration risk analysis reveals that the combined default of banks' five largest private sector exposures as of December 2020 could erode up to 10 percent of bank capital.

**12. Pandemic policies and responses by the industry appear to have provided temporary breathing space and helped protect bank capital since the start of the pandemic<sup>10</sup>.** Three counterfactual experiments were considered, involving (i) adjusted probability of default (PD) calculations to strip out the potential moderating effect of pandemic policies; (ii) a simulated migration of 1/3 of the remaining stock of COVID-19 restructured exposures to non-performing loans; and (iii) lower deposit rates offered by banks experiencing large declines in net income lower to improve spreads. The first two counterfactuals point to higher recapitalization needs of 0.3 and 0.15 percent of GDP, respectively by 2023, suggesting that COVID-19 policies have supported capital buffers. The modeled pricing mechanism in the deposit market would help reduce the computed capital shortfall by 0.1 percent of GDP in 2023.

**13. The liquidity stress test analysis reveals that some banks may be vulnerable to liquidity shocks.** While all banks met the Basel LCR requirements at the onset of the pandemic, some saw their ratios decline below the Basel requirement, in line with the regulatory flexibility afforded by the PA. Simulations entailing larger shocks than those envisaged under the Basel rules would result in some banks having LCR ratios below the Basel threshold. While the LCR is expected to be met in a single currency, a breakdown by currency conducted by the FSAP team suggests that multiple banks are vulnerable to USD-related funding pressures, although FX exposures are relatively small. The cash flow

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<sup>9</sup> Two versions of the adverse scenario were considered, using different calibrations of the satellite models linking deposit rates and lending rates to macroeconomic conditions.

<sup>10</sup> Both relief for restructured loans and the liquidity ratio are now set to expire in April 2022.

analysis revealed a small net funding gap of some 2 percent of assets at 1–7 days maturity, concentrated in two banks, under the baseline. This gap widens to about 10 percent under a severe scenario. Two banks have also net funding gaps at longer maturities as well. While all banks meet the regulatory requirements set by the PA, two banks' NSFR are slightly below the 100 percent thresholds under the Basel III parameters.

**14. Cross-sectoral linkages are an important source of contagion.** Banks' reliance on funding from insurers is high by global standards, and funding from investment funds ranks one of the highest amongst emerging market peers. Contagion risks are also relevant for money market funds, where almost 90 percent of the total assets are concentrated in investments within the large banks. In the adverse scenario, cross-sectoral exposures led to multiple rounds of cascading defaults and indirect spillovers, substantially increasing the magnitude of spillovers. Most of the cross-sectoral exposure resides in the large banks, making them more vulnerable to shocks from the rest of the financial system.

**15. A corporate stress test and comparative analyses confirm the build-up of risks.** Scenario-based stress tests of publicly listed corporates and Eskom, the electricity public utility, suggest that in the baseline scenario, firms with interest coverage ratios (ICR) <1 would represent 30–35 percent of outstanding corporate debt in 2021 and 2022. Under the adverse scenario, almost 40 percent of firms, accounting for than 40 percent of the debt stock in 2022, would remain vulnerable with an ICR<1. Under the adverse scenario, vulnerabilities of large corporates can translate into significant credit risks for the banking system

## C. Climate Change Risks

**16. Climate change has a potential negative impact on the banking sector.** The country's arid climate, geographical position and high dependence on fossil fuel production and consumption renders it vulnerable to both physical and transition risks. Physical risks largely stem from severe droughts, with several banks having relatively large exposures to drought-sensitive sectors in affected provinces; and insurance companies facing increased underwriting risks. Transition risks area also notable, both from a technology perspective and a policy dimension due to high carbon emissions and a large carbon pricing gap.

**17. Analysis of stress testing of climate risks points to non-negligible implications for the financial sector.** Difference-in-difference econometric analysis suggests that banks already assign significantly higher PDs (about 5 percentage points on average) to sectors more vulnerable to water shortages in affected provinces. Underwriting risks, however, appear manageable due to the relatively small and geographically diversified exposures of insurers. Using firm-level data, the stress tests utilized two scenarios, i.e., one focusing on the technological transition to green energy which estimates the incremental increase in expected default frequency and defaulted debt from permanently higher electricity prices; and one that seeks to estimate the increase in production costs resulting from a carbon tax increase (absent any pass-through to end users). Results suggest that a shift from coal-based energy production could contribute to sustained price hikes that can squeeze

NFCs' margins and increase credit risks. A rapid carbon price increase to a mid-point estimate needed to stabilize emissions could, under severe assumptions, result in a doubling of corporate debt at risk.

## FINANCIAL SECTOR OVERSIGHT

### A. System-Wide Oversight and Macroprudential Policies

**18. Institutional arrangements for managing systemic risks are in place, but powers could be expanded.** The SARB is the designated macroprudential authority, with the Governor—advised by the interagency Financial Stability Oversight Committee (FSOC) and SARB's internal Financial Stability Committee (FSC)—the main decision-maker. While this setup is likely to support the authorities' willingness to act, the ability to do so is somewhat constrained as SARB's hard powers are mostly limited to systemically important financial institutions, as identified by the Governor. To attain more wide-ranging authority, the Governor must designate an event 'systemic', which can be associated with stigma and unintended side-effects. Ensuring that SARB has adequate powers without the need for such designation would improve the use of macroprudential measures and reduce the risk of adverse market reaction.

**19. SARB's systemic risk monitoring capacity is well-advanced, although data gaps exist, but the macroprudential toolkit is narrow.** As is common, SARB relies on a variety of macro financial indicators (summarized in a heat map), stress tests, and analytical tools, and produces an assessment in the Risk and Vulnerabilities Matrix. However, SARB has limited access to micro data, especially for borrowers, which entails some limitations for analysis of tail risks and guidance on calibration of borrower-based tools. South Africa macroprudential policy toolkit is relatively narrow, lacking corporate, household, and non-banking sector liquidity tools. Work underway to broaden the toolkit and close data gaps should be completed. In addition to developing borrower-based tools, the adoption of measures to address the sovereign-financial nexus would further strengthen system resilience

### B. Systemic Liquidity Management

**20. The SARB's framework for systemic liquidity management functions well, with opportunities for improvement with additional tools.** SARB follows financial market developments closely and has the ability and track record of managing system-wide liquidity needs, aided by the 'closed rand' system that has acted as shock absorber in times of stress. Detailed findings include the following.

- *A gradual migration of NT's operational rand liquidity balances from the largest banks to SARB would reduce risks.* Outstanding balances reinforce the too-big-to-fail conundrum, generate competitive distortions, and can undermine asset allocation as sizable withdrawals may not be possible without jeopardizing banks' liquidity positions. Distributing cash balances among a larger

group of banks, as part of a diversification strategy, can complicate cash management and is not recommended.

- *Planned revisions of SARB's overnight benchmark interest rate should be completed as soon as practicable.* Reform proposals outlined in SARB's consultation paper are welcome and should help promote pricing efficiency in the domestic financial markets.<sup>11</sup>
- *SARB's framework for the provision of emergency liquidity assistance can be further strengthened.* Recently issued internal guidance for liquidity support to banks that have become (or are expected to become) non-viable helps to ensure policy consistency, but additional efforts remain necessary to extend the guidance to solvent but temporarily illiquid banks, outside of resolution—including strengthened capacity to undertake solvency and viability assessments. In due course, legal changes remain advisable to fully align the legislation with best practices.<sup>12</sup>

## C. Financial Supervision and Regulation

**21. South Africa has a robust regulatory framework, underpinned by a substantially overhauled supervisory architecture.** Since the implementation of the Twin Peaks' model in 2018, prudential regulation and supervision of banks, insurance companies and market infrastructures are conducted by the Prudential Authority (PA), operating autonomously within SARB's administration. The Financial Sector Conduct Authority (FSCA), an independent agency, is responsible for market conduct regulation and supervision of market participants and structures, as well as prudential supervision of pension schemes and investment funds. The National Credit Regulator (NCR) supervises and regulates the consumer credit industry (including credit providers and credit bureaus). Responsibilities for anti-money laundering and combating the financing of terrorism (AML/CFT) are discharged by the Financial Intelligence Center (FIC) mandating supervisory bodies to ensure compliance with its requirements.

**22. The FSAP reviewed the regulatory frameworks and supervisory practices for all segments of the financial system.**

- *Banking.* The regulatory framework for banks is strong, with the adoption of enhanced capital and liquidity standards having proved fortuitous as the COVID-19 crisis hit. The PA is currently working strengthen requirements on corporate governance, large exposures, transactions with related parties, and the treatment of problem assets. To enhance effectiveness, the PA should (i) pivot towards a more structured and intrusive approach, with a recalibrated mix between on-site and off-site supervision and an expansion of risk specialists and a greater focus on governance and risk management; (ii) reduce reliance on external auditors; (iii) introduce a structured framework for early intervention; and (iv) further influence industry behavior by clarifying supervisory expectations.

<sup>11</sup> [Consultation paper on selected interest rate benchmarks in South Africa.](#)

<sup>12</sup> Also see the findings of the 2014 FSAP on ELA in [IMF Country Report No. 14/340.](#)

- *Insurance.* The introduction of the risk-based Solvency Assessment and Management framework (SAM) and establishment of group-wide supervision are key milestones for the insurance sector. However, discount rates of insurance liabilities under SAM are calibrated from sovereign bond yields without credit risk adjustments. Insurance supervision would benefit from enhanced monitoring, industry-wide stress testing and impact studies of IFRS 17 adoption; with a stronger focus on investment risks for life insurers' high exposure to equities, and greater scrutiny of the quality of capital resources (i.e., in view of the inclusion of substantial future profits from existing policies); and potential liquidity risks associated with high lapse and surrender rates.
- *Securities*<sup>13</sup>: CIS managers and distributors operate under a comprehensive regulatory, albeit with some areas for regarding best execution requirements, rules precluding churning, and accounting principles for funds. CIS manufacturers and distributors duties should be clarified, and suitability assessment requirements harmonized for all entities marketing. Also, there should be regulatory limits on the right for CIS' depositories to re-use CIS assets, and a requirement for depositories to perform some due diligence when CIS assets are held in sub-custody. The FSCA has put in place an effective risk-based supervision of CIS managers, which could be enhanced with some macro financial elements. Authorities should also clarify requirements applicable for risk, internal audit and compliance functions, and related governance aspects for compliance officers to be able to perform their function in a fully independent way. The FSCA needs to finalize a reporting and supervisory framework for ODP and strengthen some licensing requirements.
- *Pensions:* The Pensions Fund Act complies with high-level principles of international good practice but detailed regulations in several areas (e.g., on valuation standards and the use of derivatives) need to be issued. The forthcoming COFI Bill and Conduct of Business Standards should address many of the market conduct issues and give the FSCA the powers to transition from a compliance to a more active conduct oversight role – which is much needed. The FSCA should strengthen its risk-based supervision approach, with a greater focus on governance and investment oversight and intervene more proactively to wind up inefficiently run, poorly managed funds. Pension fund governance could be strengthened through greater fee transparency and reporting; improving the quality of trustee training; and strengthening the independence of trustees. Proposed amendments to regulation 28 introducing a bucket for infrastructure investments and an increased limit for private equity funds (currently 10 percent) would help support developmental goals without the negative effects of asset prescription.

**23. In addition, the FSAP conducted targeted reviews of the authorities' supervisory and regulatory practices pertaining to fintech, cyber resilience and climate change.**

- *Fintech.* Building on the ongoing analysis, undertaken by the financial authorities in South Africa legal and policy framework reform would be needed to support fintech development. Several fintech developments like crowdfunding, online lending, crypto assets, open banking, alternative

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<sup>13</sup> Securities oversight assessment focused on collective investment schemes, identified as an area of opportunity in the last IOSCO assessment, and over-the-counter derivatives which are now covered by the IOSCO principles.

data, and non-bank payment service providers remain either unregulated or inadequately regulated. Interim measures to establish authority to manage new fintech entrants are needed. Fintech-related supervision and monitoring should inter alia include: (i) collecting additional data needed to better assess risks; (ii) evaluating the effectiveness of internal controls of regulated entities with respect to fintech partnerships and outsourcing arrangements; (iii) supervisory approach for authorized or regulated fintechs; and (iv) developing an approach to monitor developments outside the regulatory perimeter and if deemed necessary bring those activities under regulatory purview.

- *Cyber resilience.* The development of a cross-sectoral framework for cybersecurity, based on binding prudential standards, combined with an increased intensity and frequency of onsite examinations, would aid resource allocation and ensure consistency in cyber risk management. Moreover, amendments of the NPS Act are needed to formally adopt the CPMI-IOSCO Principles for Financial Market Infrastructures (FMI), and establish adequate regulatory, supervisory, and oversight powers for SARB. Service providers should be assessed against the CPMI-IOSCO Assessment Methodology for Oversight Expectations Applicable to Critical Service Providers.
- *Climate change risks.* While the financial sector’s climate change awareness is currently high concrete initiatives to mitigate risks remain scarce. SARB has made significant progress since joining the Network for Greening the Financial System (NGFS) in 2019, including on a governance structure and strategy on climate risk. Further efforts to expand climate change risks in stress testing and supervision remain important, including by issuing guidelines on climate risk management, governance and disclosure; and integrating climate change risks in supervisory dialogue, onsite inspections and supervisory ratings. Expanding climate risk stress testing; issuing guidelines for climate risk management; and climate and environmental risks in the supervisory process is recommended. Data on sectoral and regional exposures should also be collected by supervisors.

**24. South Africa has a solid legal framework for AML/CFT but needs to pursue money laundering (ML) and terrorist financing (TF) more proactively and improve the implementation of a risk-based approach.** South Africa has suffered from a sustained period of ‘state capture,’ resulting in substantial corruption proceeds and some key AML/CFT agencies being undermined. Remedial efforts are in train, but further steps remain necessary to pursue ML and TF, in line with the country’s risk profile. The application of a risk-based approach to AML/CFT by businesses and supervisors should be improved, market entry controls strengthened, and the gap in sectoral coverage closed—notably by extending the perimeter to virtual assets service providers.

#### **D. Crisis Management and Financial Safety Nets**

**25. Reforms of the financial safety net that have been pending for multiple years should be brought to a swift conclusion.** Draft amendments, first published in 2018<sup>14</sup>, are expected to

<sup>14</sup> [Financial Sector Laws Amendment Bill](#).

strengthen the framework for dealing with failing banks, by designating SARB as resolution authority for banks and systemically important nonbank financial institutions, introducing new resolution powers, and establishing a deposit insurance scheme (DIS).<sup>15</sup> The authorities should (i) prioritize the adoption of the legislation and continue efforts to operationalize it (e.g., develop a resolution manual, build payout capabilities for the DIS, ascertain ‘single customer view’ deposit data); (ii) advance preparedness through resolvability assessments and resolution planning (notably for systemically important institutions), and conduct recurrent simulation exercises; and (iii) finalize loss-absorbing requirements for systemic banks.<sup>16</sup> Considering the challenges associated with bail-in, the authorities are also advised to establish a mechanism for the provision of temporary public funding to facilitate resolution, sourced from NT and subject to strict preconditions that minimize moral hazard. To strengthen the DIS’ funding structure—considering that partial reliance on interest-bearing deposits from the banks increases costs and can fuel procyclicality if banks would be required to account for impairments following bank failures—the authorities should consider determining a funding target for the (nonrepayable) ‘equity’ tranche, to be met via *ex ante* industry contributions.

**26. The D-SIB’s pan-African footprint sets a high bar for cross-border cooperation.** Building on supervisory initiatives for home-host collaboration, the authorities should promote close cooperation on recovery and resolution planning. Existing memoranda of understanding should be expanded with crisis management protocols, and SARB could initiate cross-border crisis management exercises to help build capacity across the region. The authorities should satisfy themselves that framework conditions for effective cross-border cooperation are in place (e.g., information exchange, obligations to consider the cross-border impact of resolution actions, processes to give effect to foreign resolution measures).

## FINANCIAL SECTOR DEVELOPMENT

### A. Competition and Efficiency

**27. The banking sector is highly concentrated, with interest rate spread decomposition revealing high overhead costs and fees.** Among competition indicators, the share of assets held by top 3 and top 5 banks show high levels and have changed marginally over the decade (Figure 6). The Hirshman-Herfindahl index points to moderate concentration overall but is higher compared to peer and advanced economies and for specific segments (the non-financial corporates, mortgages and

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<sup>15</sup> The [Financial Stability Board’s Peer Review for South Africa](#), published in March 2020, found that “...The authorities have applied the lessons from recent bank failures to inform the proposals for adoption of a resolution regime broadly aligned with the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions, while proposals for the introduction of a deposit insurance system demonstrate their commitment to implement the IADI Core Principles for Effective Deposit Insurance Systems”.

<sup>16</sup> A [discussion paper](#) was published by SARB in May 2021.

credit card loan segments).<sup>17</sup> Banks' market power based on the Lerner index decreased slightly since 2016 and is in line with world median value.<sup>18</sup> Overheads costs and profit are an important component of lending rates in South Africa, pointing to persistent operational inefficiencies<sup>19</sup>. The cost to income ratio is the highest among peers and non-interest income has also remained higher than in peer countries. Fee income makes up almost a third of bank income.

**28. Fees structures are complex and extensive prompting the need for user-friendly price comparison tools to improve transparency and competition** Account offerings particularly for middle income segment involve complex pricing bundles based on transaction type, volumes, access channel and are often linked to reward programs. Such fees structures make it difficult for customers to make meaningful comparisons across similar products. The average monthly account cost ranges from 2.1-6.1 percent of income depending on the customer income and account usage (2020 Solidarity Bank Charges report). The average monthly cost for four banks with comparable accounts for low-transaction accounts rose 40 percent between 2015 and 2020.<sup>20</sup> A centralized and user-friendly product comparison website could make it easier for consumers to compare product offerings and increase competition among providers. FSCA should establish or support the establishment of such comparison tools as done by other financial regulators (e.g. Canada, Hungary, Malaysia, Mexico, UK).

**29. To achieve a balance between competition and stability, the PA and NT should consider proportionate regulatory frameworks aligned with the risk profile of new entrants.** Two digital banks were granted a banking license and a third one is expected to enter soon the market. However, the full potential of these banks is yet to be seen. Banking licenses allowing institutions to conduct limited banking business such as payment services under a simplified oversight framework proportional to its risks (business, integrity, consumer protection etc.) —without diluting necessary safeguards to ensure financial stability—could be considered. There is a strong interest from telecom companies to partner with these monoline payment banks.

**30. Allowing non-banks fair access to critical financial infrastructure, which is currently owned by banks and incumbents, should be pursued by policies and regulations to promote competition.** The retail payment systems, the credit reporting system, the gateway for ID verification services and fraud reporting repository are all controlled by a consortium of banks. In the current environment, payment services fintechs have to partner with banks; even if they were allowed to offer services independently, they would need direct access to the retail payment systems and possibly even settlement accounts at SARB. These issues are acknowledged and are included in SARB's National

<sup>17</sup> The overall HHI for assets in South Africa remained in the range of 1762-1885, peer countries and advanced economies show lower values. For example, India HHI for assets was at 740 in 2019, Thailand at 1286 and Indonesia 1577 (both for 2016), while the median for the European Union stood at 1224 (2020). Detailed analysis of competition indicators an industry fees is included in the Technical Note on Financial Sector Competition and Efficiency.

<sup>18</sup> The Lerner Index directly measures pricing power by examining the price markup over marginal cost of producing an additional unit of output. South Africa value was at .25 while the world median value was at .32 according to the World Bank Global Financial Development Database.

<sup>19</sup> See Technical Note on Competition and Efficiency for details in the interest rate decomposition exercise.

<sup>20</sup> Standard Bank PAYT, Absa Transact, FNB Easy, and Capitec R2000 balance.

Payment System Framework and Strategy – Vision 2025. However, implementation of proposed reforms is still pending. The NPS amendments provide a direct role to non-banks in the provision of payment services while related reforms would streamline access to payment systems for non-banks. Beyond access to infrastructures, fintechs will also need a voice in the future development of the infrastructure, the pricing policies and more generally in their governance.<sup>21</sup>

**31. The authorities should leverage ongoing legal reforms to develop a regulatory framework for open banking and improve accessibility of government data.** Open Banking could strengthen competition and catalyze further responsible innovation with due regard to the data protection and privacy. Leveraging on the reforms under the COFI bill and the recently adopted legal framework for data protection and privacy regulations, the authorities should consider introducing open banking reforms to help address the current risks with screen scrapping and other data extraction and sharing approaches and increase competition. Open banking regulations need to cover a set of critical topics – (i) minimum set of data and transaction services that will need to be offered; (ii) which institutions are mandated to offer these services and for what type of products and accounts; (iii) which institutions are allowed to access these services and what would be the regulatory framework for them; (iv) minimum authentication requirements with respect to securing consent of customers; and (v) governance arrangements for monitoring and implementing the necessary industry level infrastructure for this. Furthermore, the IFWG could pursue options to making data (e.g. business registries, tax records, demographic information) available in a digital and automated manner.<sup>22</sup>

**32. Fixed income markets play a limited role as a source of long-term financing and liquidity to the private corporate sector, despite being sizable and relatively well developed.** The breadth and depth of the market is limited; bond-market financing has been largely concentrated in banks, NBFIs such as insurance groups and large SOEs; private sector and other large corporates issues are notably absent as issuers. Reduced attractiveness of bond market financing is likely associated with (i) inefficiencies leading to higher transaction costs and competitive barriers from the existing legal framework;<sup>23</sup> (ii) a concentrated financial market structure dominated by banks, by large investors (i.e. top 10 pension funds that represent 30 percent of the industry), and by issuers in financial services and SOEs (top 10 issuers representing 51 percent of issuance); and (iii) a deterioration in overall macroeconomic fundamentals of South Africa. Additionally, a low savings ratio has led to lower market activity on new listings and trading, resulting in more market volatility and vulnerabilities.

**33. On the supply side, there is a lack of a well-structured pipeline of projects in both infrastructure and SMEs, as well as a lack of suitable instruments and vehicles to invest in them.** The Government has initiated critical upstream work towards developing a pipeline of strategic public

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<sup>21</sup> Currently, the PASA, a self-regulatory organization for the payments market, and BankServ as an operator of key payment systems are fully controlled by banks. Appointment of independent directors to the boards of key infrastructure to chair critical committees (e.g membership committee and pricing committee) or regulatory approval for any changes rules related to membership and pricing could be considered.

<sup>22</sup> FSCA envisages undertake this work in 2022 building on its past work on alternative data and open finance study.

<sup>23</sup> For example, the FMA has underscored the continued dominance of the JSE.

infrastructure projects, but project preparation cycles are relatively long. The nature of the underlying assets (e.g., infrastructure, climate, social) requires more flexible and tailor-made instruments that would deviate from traditional listed securities. Proposed changes to Regulation 28 that allow institutional investors and fund managers to increase their exposure to unlisted instruments and vehicles would support a stronger focus on infrastructure finance, provided parallel work is conducted to improve the supply of suitable projects.<sup>24</sup>

**34. The ongoing review and amendment of the new FMA is essential to open competition and reduce inefficiencies to the South African financial market and re-align the self-regulatory framework.** The objective of the reform is to align the FMA with best practices under international standards<sup>25</sup> in order to support a more competitive and more developed local capital market. Despite the launch of four new equity exchanges over the last years, their volumes remain insignificant, partly reflecting existing regulatory constraints. Of particular relevance are the following changes being proposed; (i) removing any legislative clauses that have led to inefficiencies, higher costs and redundancies such as the current reporting or mandated use of reporting and back-office infrastructure of the JSE; (ii) removing anti-competitive barriers to entry for new participants, (e.g., exchange license for all trading platforms and current Self-Regulatory Organization regime); (iii) a financial market conduct perspective for all FMIs that would be regulated with a view to achieving market efficiency, integrity and competitiveness.

**35. Development of the Electronic Trading Platform (ETP) for government bonds into the main trading venue would improve market efficiency and price formation.** Since its launch in 2018, the ETP has improved pricing transparency and price formation but secondary market trading is insignificant. The ETP could provide a platform for market making to increase trading volumes (i.e., liquidity) and pricing efficiency to support a more developed yield curve with adequate liquidity distributed across the benchmark securities. This also has a broader impact on the development of South Africa's corporate bond market in deriving a reliable and low 'risk-free' price-reference for non-government bonds across the maturity spectrum of the yield curve. The authorities should consider elaborating a comprehensive strategy taking into account all existing trading venues for government bond markets (the ETP, domestic OTC reported through JSE, and international OTC). Market participants operate with consistent strategies across these trading venues, but the NT does not have a system in place to oversee and assess trading strategies across all venues. This limits NT's capacity to identify critical price and trading information that should inform its issuance policy and secondary market strategy to increase the role of the ETP (e.g. benchmarks to be issued, new instruments in the ETP, adjustments to primary dealers rules).

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<sup>24</sup> The proposal envisions an explicit investment bucket for infrastructure investments and an increased limit for private equity funds (currently 5 percent).

<sup>25</sup> IOSCO, Markets in Financial Instruments Directive (MiFID).

## B. Financial Inclusion and Access to Finance

**36. South Africa has made significant progress in expanding access to financial services for individuals but usage of financial services and access to finance by small firms need further advancements.** Approximately four in five South African adults report owning a bank account. A broader metric that includes access to regulated, non-bank financial services indicates that 91 percent of adults are “formally included.” Both indicators have risen substantially in the past decade, but progress has slowed in recent years as reaching the ‘last mile’ of unbanked individuals is increasingly complex. However effective usage of accounts and digital payments is much lower with 60 percent of banked adults using their accounts only once a month. While overall credit to the private sector as share of GDP remains robust in South Africa, the share of bank lending to small and medium enterprises (SMEs) as registered by SARB stands at only 12 percent in 2020. Less than 4 percent of formal SMEs in South Africa report having a credit line, well below regional and income peer levels (20 and almost 40 percent respectively). SMEs report access to finance as a main business constraint, second only to access to electricity. Estimates of the MSME credit gap between supply and demand are substantial, varying between 9 and 15 percent of GDP (Figure 7). Financial inclusion has been a policy priority in South Africa since 2004 and a National Financial Inclusion Strategy Implementation is under development. To support economic growth and job creation, South Africa’s National Development Plan 2030 emphasizes the importance of strengthened financial services to bring down their cost and improve access for small and medium sized businesses.

**37. Fintech vision document clearly articulates the vision of harnessing the potential of fintech for advancing financial inclusion, however implementation is lagging.** Fintech developments are showing promise in advancing financial inclusion goals. Digital banks<sup>26</sup> and Fintechs have offered new services prompting incumbent banks to develop new products to target the unbanked and underbanked individuals and SMEs. Fintech approaches have also made it easier for individuals to compare and buy insurance products, improve the efficiency of claims processing and launched new tailored products. The public authorities have acknowledged the potential of fintech and have launched initiatives to understand the Fintech developments, establish co-ordination framework and innovation facilitators but have not embarked on efforts to actively encourage Fintech solutions. The authorities could consider using the IFWG regulatory sandbox to actively encourage Fintech solution to address common challenges such as those around financial inclusion. Further authorities could engage in a detailed analysis of the specific financial inclusion challenges that fintech can help address and what more can be done to enable leveraging fintech approaches.

**38. Development of an ecosystem of financial service providers serving lower income households and MSMEs as well as leveraging social protection programs could enhance financial inclusion and usage of financial services.** Fintechs and cooperative banking institutions play a relatively limited role in financial inclusion as most individuals and firms operate with banks. Authorities should enact the transformational changes to the legal and regulatory framework governing the National Payments System—including by allowing for the direct participation of non-

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<sup>26</sup> Digital banks include Tyme Bank, Discovery Bank and Bank Zero.

banks in the provision of payment services—as proposed by SARB. Cooperative banking institution stakeholders should finalize and implement a strategy to develop the sector and contribute to financial inclusion. In this context, the feasibility of integrating cooperative banking institutions into the national payment system and forthcoming deposit protection scheme should be assessed, with a short/medium term focus on cooperative banks. SASSA administers the social protection program, covering around 11 million individuals, which is disbursed into bank accounts. Recipients can choose a bank, otherwise they receive a SASSA Visa card issued by Post Bank as default option (73 percent of total beneficiaries) with limited transactability<sup>27</sup>. The lack of any feasible option of using the SASSA card account for person-to-person payments limits the positive impact it can have on financial inclusion forcing card holders to use cash for purchases in the informal sector or distributing funds among family members. SASSA should be allowed to engage other banks and non-bank players to contribute to digitization of the social benefit transfers. The Postbank account features should be enhanced with new functionalities and SASSA could also evaluate lifting the restrictions on using the benefit transfer account for receiving other incoming transfers and removing the fees for balance enquiry and declined transactions

**39. Persistently high levels of credit impairment in the consumer credit market should be addressed to ensure sustainable financial inclusion.** South Africa’s consumer credit market is highly regulated and conforms with several “good practices” for financial consumer protection. The number of credit-active consumers has steadily increased in recent years but this trend has been accompanied by persistently high levels of credit impairment. Unsecured credit and credit facilities jointly represent 50 percent of past-due loans despite comprising only 26 percent of the total loan portfolio (by volume), however data gaps limit an analysis of the market dynamics in these product segments<sup>28</sup>. Trends of financial distress and over-indebtedness are inextricably linked to social and economic conditions, as well as the COVID-19 pandemic. Financial sector authorities should address persistently high rates of credit impairment via data-driven and risk-based supervision, recruitment and retention of supervisory staff with critical skills, improved credit bureau reporting, innovations in creditworthiness assessments including alternative data, and a comprehensive analysis of the unsecured and credit facilities product segments. Improved coordination and clear delineation between the institutional mandates of FSCA and NCR is also necessary to enable effective market conduct regulation and supervision. More broadly, the authorities should advance the development of the legal and institutional framework for market conduct via enactment of the COFI Bill.

**40. Public institutions operate several small MSME credit support programs that should be redesigned in line with international best practices.** Government programs include both direct and

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<sup>27</sup> SASSA account holders have access to ATMs and POS terminals across the country at a cost (suspended temporarily during the pandemic), but they cannot receive credit transfers, other than from SASSA. They can make credit transfers to other accounts inside or outside Postbank, but because of the lack of online/mobile banking options, it is only possible manually, after filling out a form. They are also unable to use real-time clearing (RTC), the instant payments system or approve direct debit mandates.

<sup>28</sup> For example, NCR does not collect/publish data on the distribution of the unsecured credit portfolio across types of lenders, which limits the identification of the types of lenders that may be driving high levels of financial distress among borrowers of unsecured credit.

wholesale lending and guarantees and amount to 0.36 percent of GDP or 2.8 percent of outstanding credit to SMEs. Public partial credit guarantees are available from the Small Enterprise Finance Agency, operating under the Department of Small Business Development (DBSD), via the Khula Credit Guarantee scheme.<sup>29</sup> However, experience shows that these schemes have been underutilized due to many firms not meeting the eligibility criteria or the bank's risk criteria. Overall effectiveness of public support programs is generally unclear in the absence of published data on NPLs and monitoring and evaluation frameworks that include rigorous impact evaluation studies on their effect on firm productivity and employment. Also, there is a need to improve coordination of public credit support programs and business development services to enhance firm performance. Authorities should consider consolidation of smaller programs and redesign program features, especially for guarantee programs and those involving direct credit, in line with international best practices. New programs, except in crisis circumstances, should be piloted, evaluated and scaled up if proved effective. The authorities could consider allowing fintech companies to tap the existing MSME credit programs of the Government to deliver credit to specific MSME segments that might be better reached by fintechs and phase out direct lending programs.

**41. Reform of South Africa's financial infrastructure should be prioritized in the Financial Inclusion Implementation Strategy.** Comprehensive and well-functioning credit reporting systems are critical to support credit origination for individuals and SMEs. The current credit information environment can be strengthened by (i) mandating the reporting of MSMEs and commercial credit information to credit bureaus; (ii) enhancing the use of alternative data;<sup>30</sup> and (iii) providing an enabling legal framework for the planned central credit register. Gaps in the current framework for secured transactions impede the use of movable assets as collateral. Lenders are experiencing challenges with the perfection of interests in movable property (which often requires a court process) and there is no centralized, computerized nation-wide movable assets registry. A reform of the secured transactions framework is needed to unlock receivables financing and facilitate its electronic trading. While there is a growing convergence on QR code standards used in South Africa, there is still some fragmentation with lack of standardization potentially reducing the impact of the upcoming Rapid Payments system. The SARB should take steps to convert existing closed-loop systems to become open-loop systems or to be able to become interoperable with the open loop systems. The authorities should consider prioritizing these reforms in the Financial Inclusion Implementation Strategy currently under development.

## C. Pension Sector Development

**42. The COVID-19 pandemic heightened the debate on the preservation of pension assets.** Unions and other groups called for workers to be allowed emergency access to their pension savings to provide support during the period of lockdown and economic hardship. The FSCA did issue several communiques on contribution suspensions and other temporary relaxation to regulatory

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<sup>29</sup> The government's COVID-19 Loan Guarantee Scheme, established in 2020, closed at end-June.

<sup>30</sup> This would cover data that are not traditionally housed within a credit bureau environment, e.g., data generated using mobile phones, metadata from the internet and app usage.

requirements to guide employers. The lack of preservation of pension benefits remains an ongoing challenge and a root cause of the low benefit levels in the country. Proposals for mandatory preservation have met considerable resistance given the unemployment situation in the country and the lack of comprehensive social security. Structural reforms designed to incentivize greater preservation of benefits during the COVID recovery period and in the future should be considered (e.g. access for strictly defined hardship purposes or certified usage; introduction of ‘side-car’ accounts; review of tax incentives)<sup>31</sup>.

**43. Improving the replacement rates delivered by occupational pensions require, in addition to the preservation of benefits, reforms to address low contribution rates, reduce costs and enhance investment returns delivered by pension funds.** Occupational pension funds provide savings for retirement, helping smooth consumption and reducing individuals’ longevity risks<sup>32</sup>. Aside from the GEPF occupational pensions deliver on average a 30 percent replacement rate.<sup>33</sup> The efficiency of the occupational sector and its ability to deliver adequate pensions is particularly important in South Africa due to the level of the old-age grant (estimated at 18 percent replacement rate by the OECD). In addition to benefit preservation, behavioral economic techniques such as auto-escalation of contributions could be introduced for occupational funds which could help address benefit adequacy.<sup>34</sup>

**44. Structural reforms will also be required to tackle the issue of low coverage of the pension system—particularly amongst low-income workers.** Coverage levels of formal sector workers in South Africa are reasonably high, with around two-thirds being members of a pension plan. Even so, still only around half of employers offer their workers access to a pension plan and access before retirement of pension savings is significant. Auto-enrolment for all formal sector workers could be used to fill in the gaps in pension coverage for formal sector workers. The main coverage challenge stems from the fact that the informal sector workforce (approximately one-third of the working age population) in the country has no access to pension savings. The government may wish to consider providing support for the establishment of a non-profit, private sector umbrella scheme, which would be set up to provide a low-cost, high efficiency scheme for smaller employers to join and could offer a scheme specifically designed to meet the needs of low-income workers.<sup>35</sup> Given South Africa’s precarious fiscal situation and corporate sector fragilities, such a scheme would need to be designed to encourage individual savings (e.g. using behavioral economic techniques and digital access to target groups with some capacity to save for the longer-term).

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<sup>31</sup> See summary of World Bank recommendations for pension policy responses to the COVID-19 pandemic: <https://blogs.worldbank.org/psd/pension-payments-and-pandemics-four-potential-policy-responses>

<sup>32</sup> For an individual, ‘longevity risk’ is the likelihood that one will outlive one’s financial resources.

<sup>33</sup> GEPF delivers on average a 70 percent replacement rate to public sector employees with a full career, but even for this fund pension received by some members is much lower.

<sup>34</sup> See Save More Tomorrow campaign, <http://www.shlomobenartzi.com/save-more-tomorrow>.

<sup>35</sup>The UK has successfully introduced such auto-enrollment policies and established the National Employment Savings Trust (NEST) to allow small employers to fulfill their statutory duties. See World Bank report on informal sector pensions <https://openknowledge.worldbank.org/handle/10986/32179>.

## D. Green Finance Development

**45. The authorities should explore ways to deepen financial markets to support green and resilient investment.** A roadmap on Financing a Sustainable Economy was published by NT in 2020, with subsequent work being geared towards providing a comprehensive framework and platform to align the financial sector with climate targets.<sup>36</sup> To ensure its successful implementation, authorities should pursue several initiatives to address green finance barriers:

- **Improve the business case for green projects** by providing clarity on credible, long-term climate and energy plans. For example, the government should lay out a long-term pathway to carbon neutrality and climate resilience by advancing the National Climate Change Bill;<sup>37</sup> strengthen the carbon tax by phasing out fossil fuel-related allowances and consider tax increases; and stimulate investment in renewable energy by advancing the successful Renewable Energy Independent Power Producers Procurement Program.
- **Advance work on a National Climate Finance Strategy** that could provide clarity on the financing gap for the Nationally Determined Contribution (NDC),<sup>38</sup> the role of private investment, the pipeline of investable projects, and ways to leverage government spending.
- **Foster transparency by introducing climate risk disclosures and a green taxonomy.** Disclosure requirements for listed firms, in line with the TCFD recommendations, should be introduced, preferably through enforceable regulation.<sup>39</sup> Advancing the introduction of a green taxonomy, currently being prepared by the NT, could support disclosures and help standardize green financial products.<sup>40</sup>
- **Stimulate the use of innovative green finance instruments** through increased issuance of sovereign green bonds (withing the framework of NT's debt management strategy), engagement in blended finance arrangements, and further exploration of potential incentives for using green loans (e.g., green mortgages, energy efficiency loans). Although the banking sector has been involved in financing renewables, product innovation is lagging other markets.
- **Implement NT's National Disaster Risk Finance strategy to boost financial resilience to climate shocks through enhanced use of risk financing instruments.** Linked to this initiative, the NT and the Department of Agriculture, Land Reform and Rural Development are reviewing a

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<sup>36</sup> <http://www.treasury.gov.za/publications/other/Sustainability%20technical%20paper%202020.pdf>; <https://sustainablefinanceinitiative.org.za/>

<sup>37</sup> DFFE and the Presidential Commission on Climate has initiated this work. <https://www.climatecommission.org.za/>

<sup>38</sup> NDCs embody efforts by each country to reduce national emissions and adapt to the impacts of climate change. The Paris Agreement requires each country to prepare, communicate and maintain successive NDCs. South Africa's first NDC was submitted to the UN in 2016, and an [updated draft NDC](#) has been published in 2021 for consultation.

<sup>39</sup> The TCFD developed climate-related financial risk disclosures to investors and other stakeholders, for use by companies.

<sup>40</sup> In June 2021, NT has issued draft Green Finance Taxonomy for public consultation.

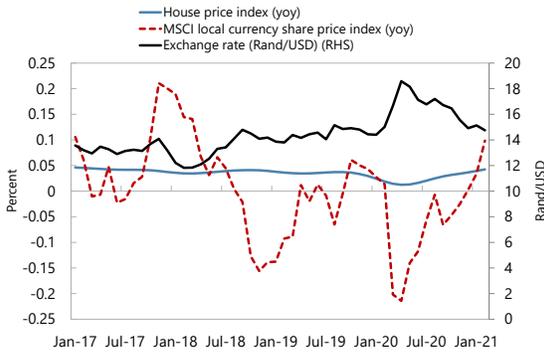
pilot agriculture insurance program. Expediting the launch of this program would reduce Government's financial exposure to drought and budget volatility, while shielding farmers from the financial implications of drought.

## ANNEX 1. Figures and Tables

**Figure 1. South Africa: Market Developments**

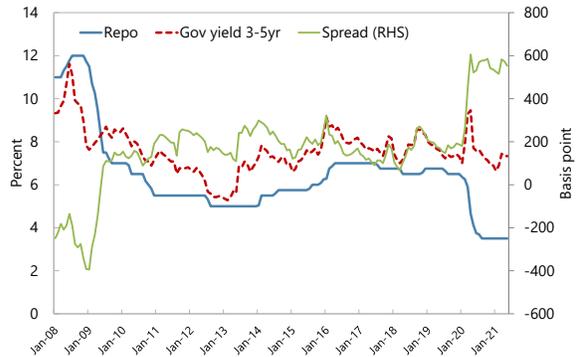
Asset markets have partly recovered from the pandemic shock.

**Assets Prices**



Shorter-term bond yields have almost returned to pre-COVID-19 levels but term premia remain elevated.

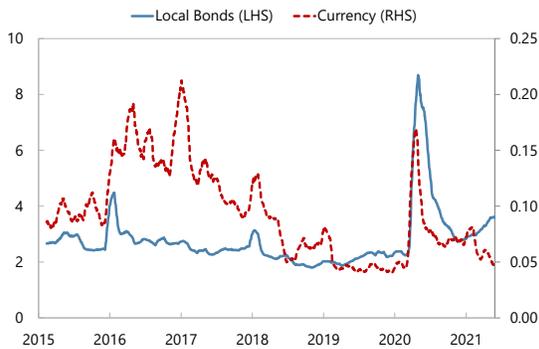
**Interest rates**



Bid-ask spreads sharply widened at the onset of the pandemic and declined thereafter but remain high.....

**Bid-Ask-Spreads**

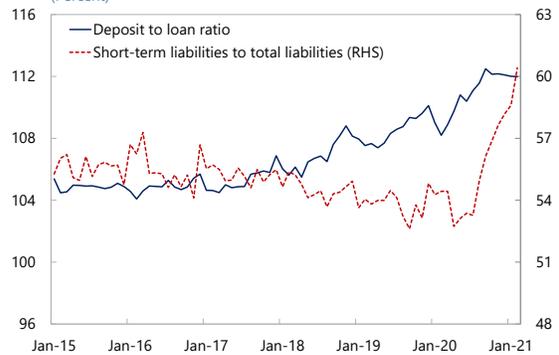
(Basis points)



... while deposits increased, the maturity of funding decreased

**Liquidity Indicators**

(Percent)



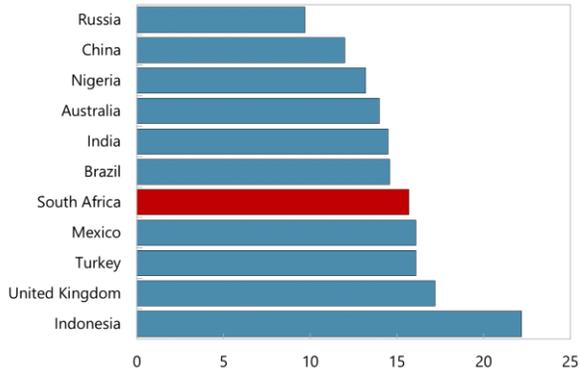
Sources: Haver Analytics and IMF staff calculations.

Note: Bid-ask spreads capture the difference between buying and selling quotes in respective markets.

**Figure 2. South Africa and Peer Countries: Financial Soundness Indicators**  
(In percent, as of end-2020)

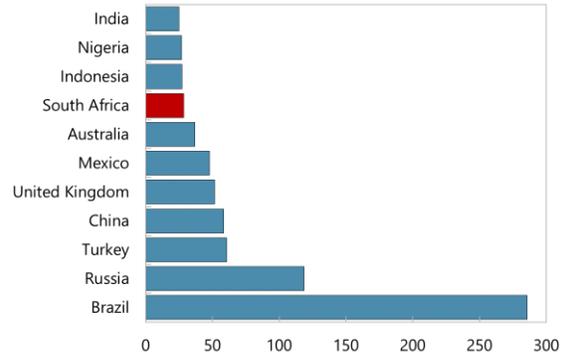
**Tier 1 Capital to Risk-Weighted Assets**

(In percent)



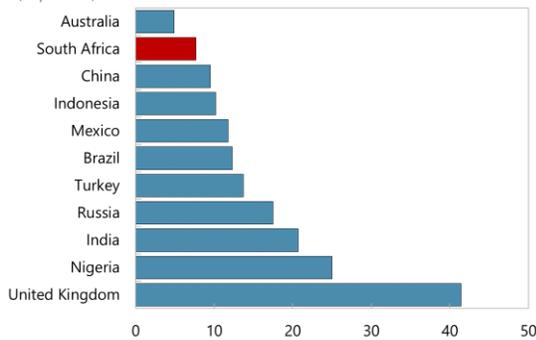
**Liquid Assets to Short-term Liabilities**

(In percent)



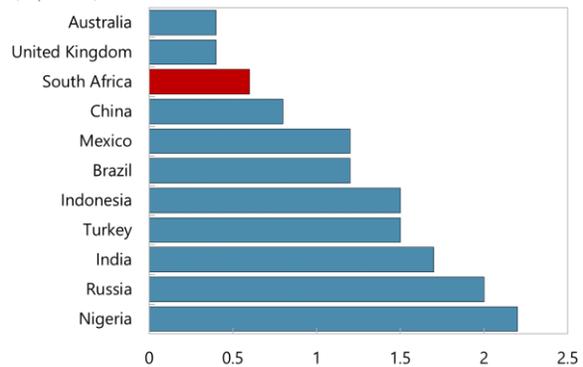
**Return on Equity**

(In percent)



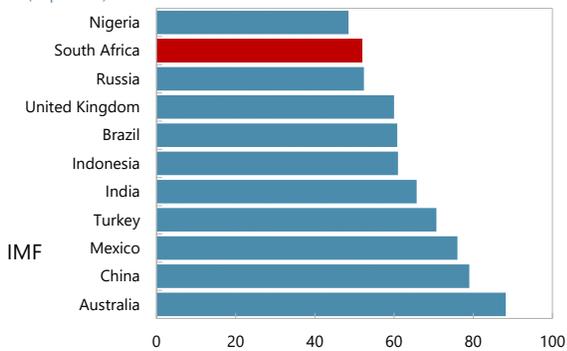
**Return on Assets**

(In percent)



**Interest Margin to Gross Income**

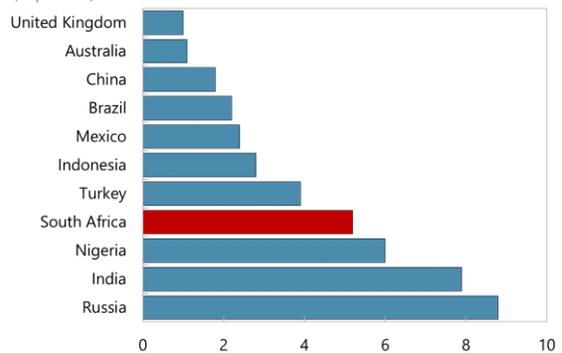
(In percent)



Sources:

**NPLs to Total Gross Loans**

(In percent)

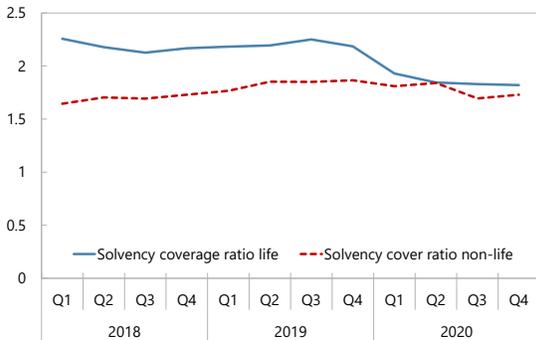


IMF  
Financial Soundness Indicators.

**Figure 3. South Africa: Insurance Sector Developments**

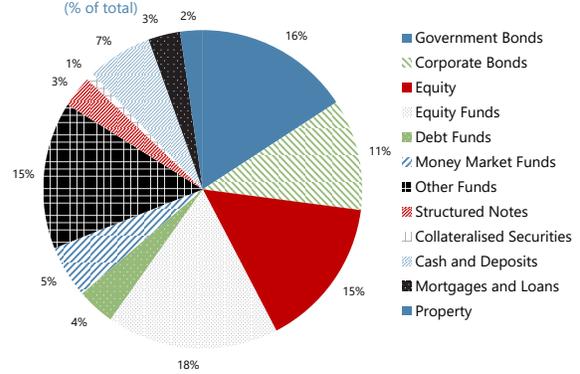
*Solvency ratios remain high and stable*

**Capitalization requirements**  
(in percent)



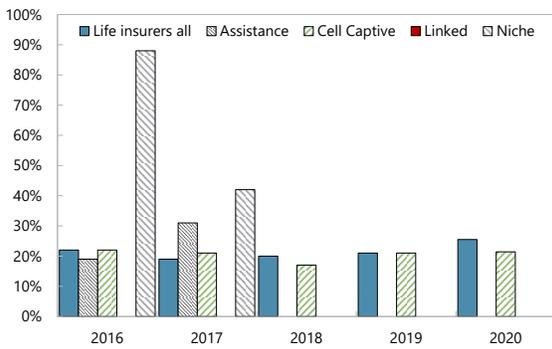
*Substantial exposure to equities poses a risk to life insurers*

**Asset allocation to non-linked products (life)**  
(% of total)



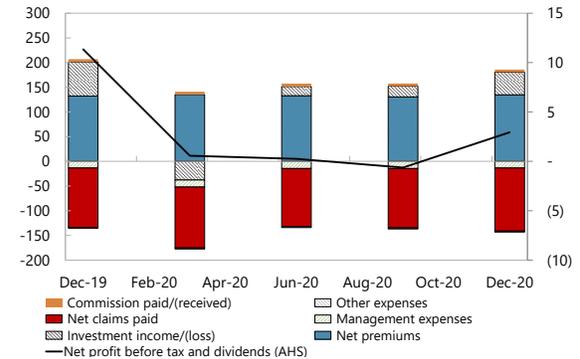
*Life insurers are suffering from high lapse rates*

**Lapse rates**  
(in percent)



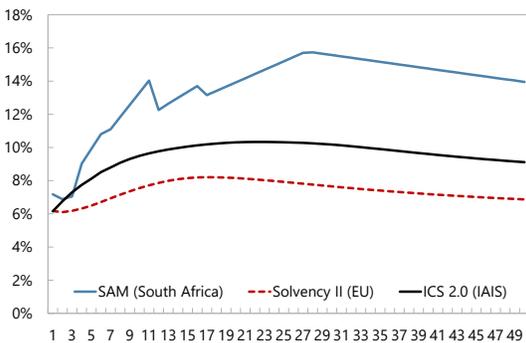
*Investment losses reported in March 2020 were short-lived*

**Life insurance profit drivers**  
(Billion rand)



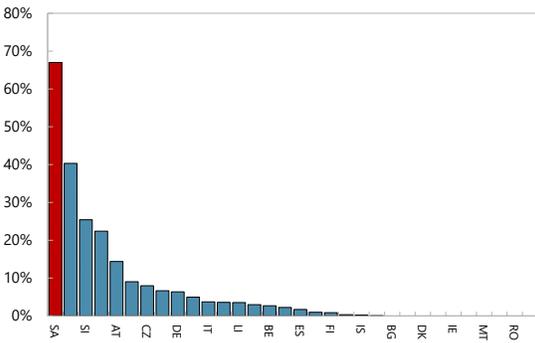
*Risk-free rates are substantially higher than international comparators*

**Risk-free rates**  
(in percent)



*Life insurers rely extensively on future profit*

**Future profits over capital resources**  
(in percent)

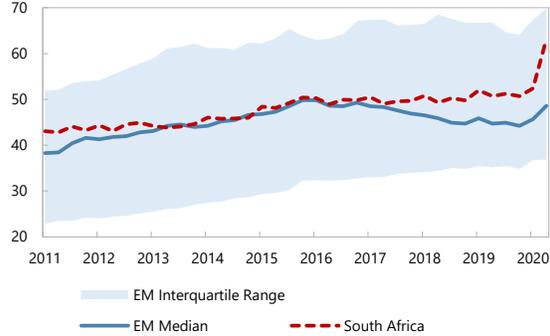


Source: SARb and IMF staff calculations.

**Figure 4. South Africa: Nonfinancial Corporate Sector**

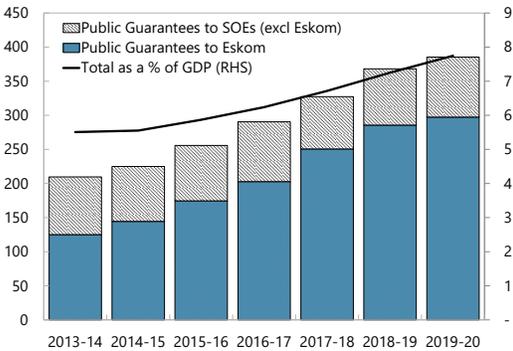
Corporate sector indebtedness for South Africa is increasingly deviating from international peers...

**Non-financial Corporate Debt**  
(percent of GDP)



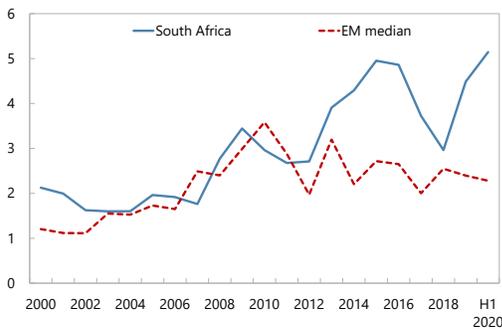
...posing risks to government finances through extensive guarantees to SOEs.

**Guaranteed SOE debt**  
(bn Rand and percent of GDP)



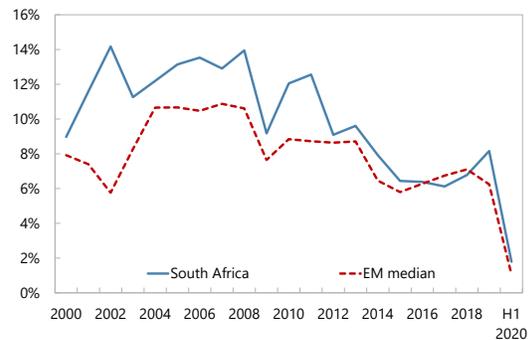
Improving liquidity has provided an important buffer...

**Corporate sector liquidity**  
(cash to short-term debt)



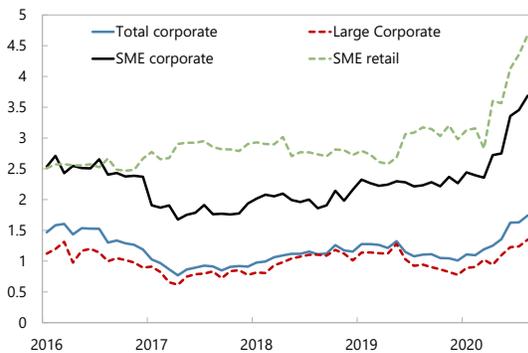
...but declining profitability, following the COVID-19 poses debt servicing challenges.

**Corporate sector profitability**  
(EBIT over assets, in percent)



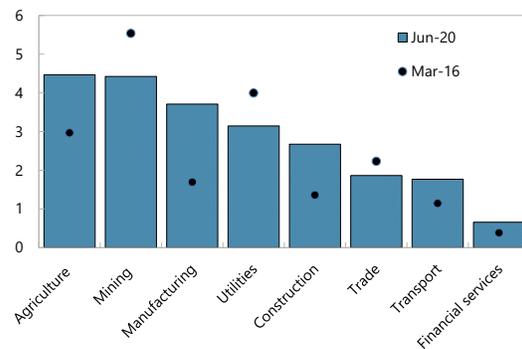
NPL ratios continue to increase, in particular for SME...

**Corporate NPLs**  
(percent of total loans)



...with the construction, utilities and transport sector being particularly impacted by the pandemic.

**Corporate NPL by sector**  
(percent of total loans)

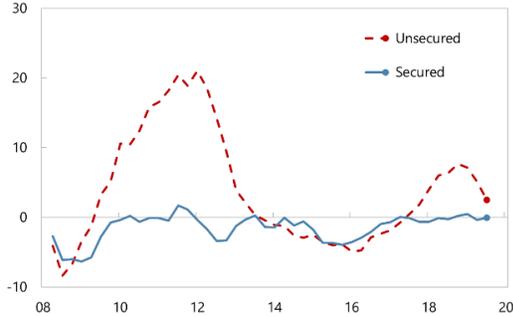


Sources: Bloomberg, Capital IQ, SARB and staff calculations.

**Figure 5. South Africa: Household Sector**

*Household credit growth has decelerated amidst the pandemic...*

**Real Consumer Credit Growth by Type**  
(Percent, year on year, 2020Q2)



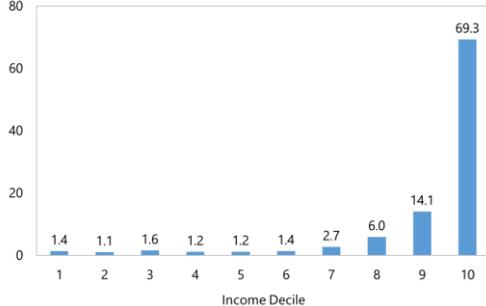
*The sharp rise in household debt-to-income, following the COVID-19 outbreak, has largely reversed...*

**Household Debt to Income**  
(Percent, 2020 Q2)



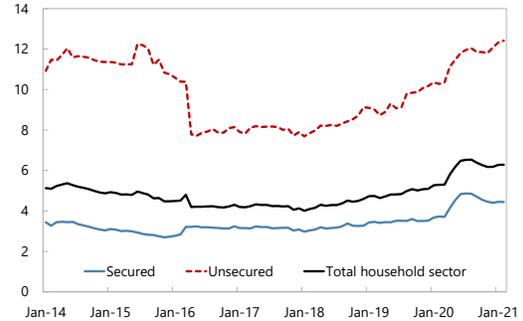
*Debt is mostly incurred by higher income households in absolute terms...*

**Distribution of Household Debt by Income**  
(Percent of total, Wave 5)



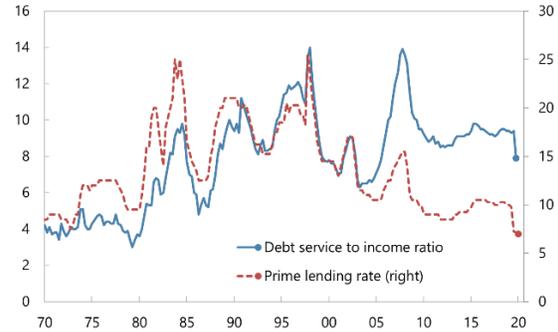
*...while NPL ratios have been trending up.*

**Household NPLs**  
(percent of total loans)



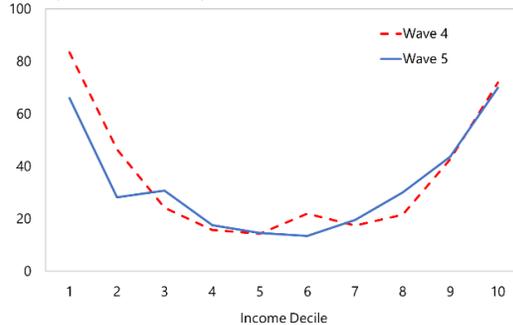
*...as large interest rate cuts have helped contain debt burdens.*

**Household Debt Service Cost and Interest rates**  
(Percent, 2020 Q2)



*...but lower income households are as indebted relative to income as higher income households.*

**Household Debt to Income by Income Decile**  
(Percent, Waves 4 and 5)



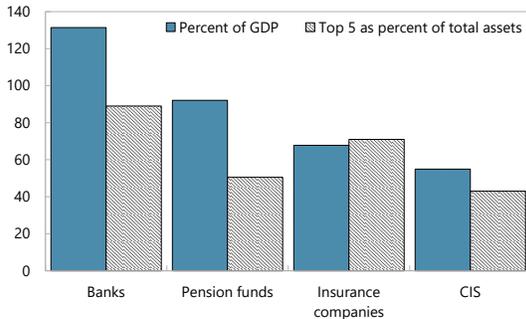
Sources: IMF Financial Soundness Indicators, Haver, National Credit Regulator, South African Reserve Bank, IMF Staff.

**Figure 6. South Africa: Banking Sector Competition and Efficiency**

High concentration has been a persistent feature of the financial sector.

**Financial sector concentration**

(in percent)

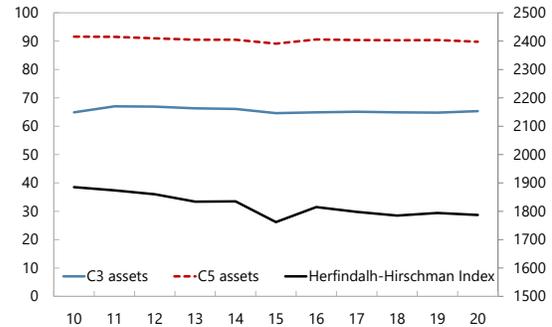


Sources: SARB, FSCA, ASISA, Stats SA, WB staff calculations

Market shares of assets and deposits by the top banks are above country peers.

**Market concentration**

(in percent)

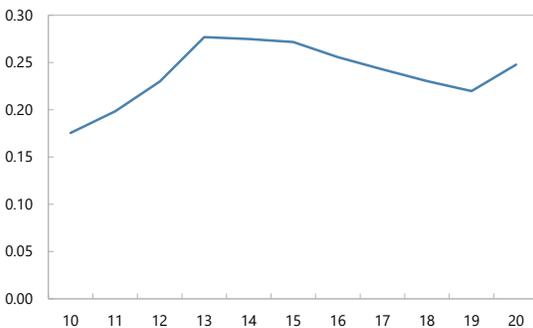


Sources: SARB, WB staff calculations

Bank's market power, based on the Lerner index, decreased slightly since 2016.

**Lerner index**

(in percent)

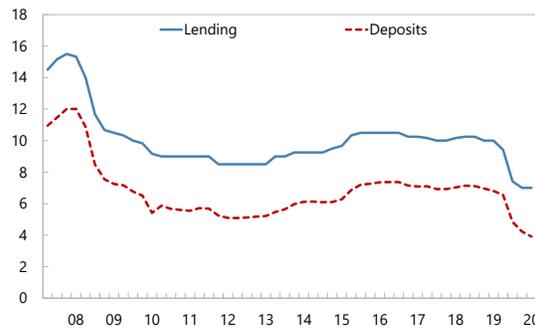


Sources: Fitch Connect, WB staff calculations

Interest rates and interest rates spreads have remained stable and are in line with peer countries.

**Interest rates**

(in percent)

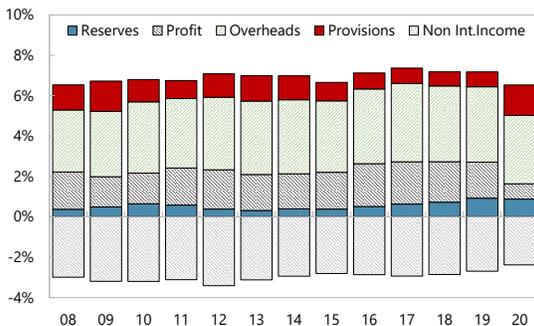


Sources: IMF International Financial Statistics

Overheads and profit remained high, pointing to persisting operational inefficiencies.

**Interest rate spread decomposition**

(in percent)

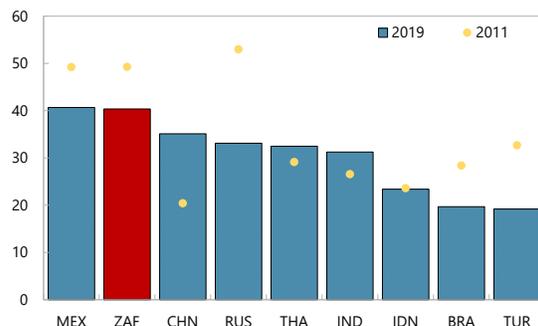


Sources: SARB, WB staff calculations

Non-interest income and bank fees have remained higher than in peer countries.

**Non-interest income**

(percent of total income)

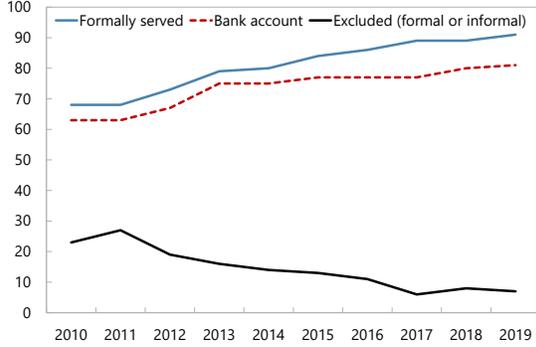


Sources: Fitch Connect

**Figure 7. South Africa: Financial Inclusion and Access to Finance**

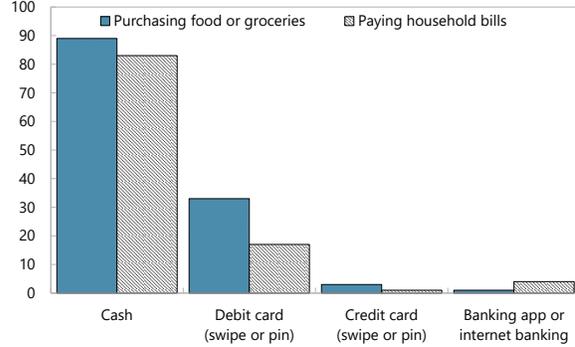
*Financial inclusion has increased since 2010 but progress has slowed in recent years*

**Adults using Financial Services**  
(in percent)



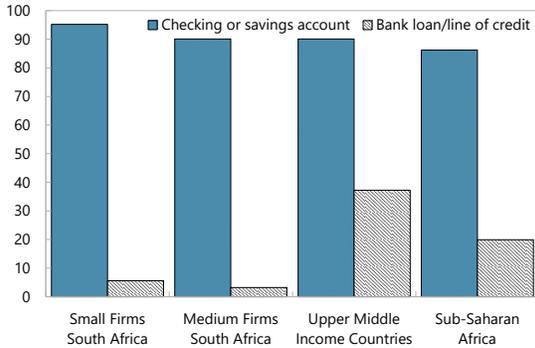
*Most South Africans rely on cash for common transactions*

**Use of Digital Payments and Cash**  
(in percent)



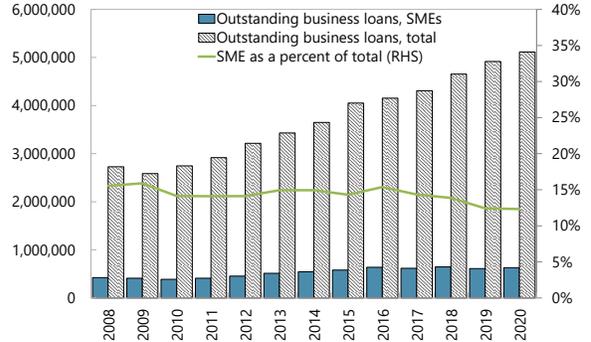
*Formal SMEs with credit are far below regional and income benchmarks*

**SME Banking Account and Loan Usage**  
(percent of firms)



*The share of bank lending to SMEs has declined*

**SME Loans and Total Outstanding Business Loans**  
(million Rand, percent)



Sources: FinScope 2019, SARB, WB Enterprise Survey 2020.

Table 1. South Africa: Selected Economic Indicators, 2018–23

Social Indicators						
GDP		Poverty (percent of population)				
Nominal GDP (2020, billions of US dollars)	335	Lower national poverty line (2015)				40
GDP per capita (2020, in US dollars)	5,625	Undernourishment (2019)				7
Population characteristics		Inequality (income shares unless otherwise specified)				
Total (2021, million)	60	Highest 10 percent of population (2014)				51
Urban population (2020, percent of total)	67	Lowest 20 percent of population (2014)				2
Life expectancy at birth (2019, number of years)	64	Gini coefficient (2014)				63
Economic Indicators						
	2018	2019	2020	2021	2022	2023
				Est.	Proj.	
<b>National income and prices (annual percentage change unless otherwise indicated)</b>						
Real GDP	1.5	0.1	-6.4	5.0	2.2	1.4
Real GDP per capita	0.0	-1.3	-7.8	4.1	0.6	-0.1
Real domestic demand	1.6	1.1	-8.0	5.7	4.7	1.8
GDP deflator	4.0	4.5	5.3	6.0	2.9	4.7
CPI (annual average)	4.6	4.1	3.3	4.4	4.5	4.5
CPI (end of period)	4.9	3.7	3.2	5.0	4.5	4.5
<b>Labor market (annual percentage change unless otherwise indicated)</b>						
Unemployment rate (percent of labor force, annual average)	27.1	28.7	29.4	33.4	34.3	36.1
Unit labor costs (formal nonagricultural)	4.6	4.5	3.7	4.4	4.5	4.5
<b>Savings and Investment (percent of GDP)</b>						
Gross national saving	13.3	13.3	14.7	16.4	14.1	13.8
Public (incl. public enterprises)	1.3	1.0	-3.5	-2.0	-0.2	0.4
Private	12.0	12.3	18.2	18.4	14.3	13.4
Investment (including inventories)	16.5	16.0	12.7	13.5	15.0	15.2
Public (incl. public enterprises)	4.8	4.3	3.9	3.5	3.6	3.6
Private	11.0	11.1	9.8	9.7	10.1	10.3
<b>Fiscal position (percent of GDP unless otherwise indicated) 1/</b>						
Revenue, including grants 2/	26.4	26.9	25.2	25.1	26.1	26.2
Expenditure and net lending	30.2	31.7	36.0	33.6	33.1	32.5
Overall balance	-3.7	-4.8	-10.8	-8.4	-7.0	-6.4
Primary balance	-0.3	-1.1	-6.6	-4.1	-2.2	-1.2
Structural balance (percent of potential GDP)	-3.5	-3.9	-5.2	-4.8	-5.1	-5.2
Gross government debt 3/	51.6	56.3	69.4	68.8	72.3	74.9
Government bond yield (10-year and over, percent) 4/	9.4	9.0	10.1	9.7	...	...
<b>Money and credit (annual percentage change unless otherwise indicated)</b>						
Broad money	5.6	6.1	9.5	8.5	4.2	4.2
Credit to the private sector	5.5	5.5	1.0	6.2	0.5	1.3
Repo rate (percent, end-period) 4/	6.8	6.5	3.5	3.5	...	...
3-month Treasury bill interest rate (percent) 4/	7.2	7.1	4.5	3.8	...	...
<b>Balance of payments (annual percentage change unless otherwise indicated)</b>						
Current account balance (billions of U.S. dollars)	-13.1	-10.6	6.6	11.9	-3.8	-6.3
percent of GDP	-3.2	-2.7	2.0	2.9	-0.9	-1.4
Exports growth (volume)	2.8	-3.4	-12.0	12.2	1.8	3.1
Imports growth (volume)	3.2	0.5	-17.4	15.1	11.3	4.4
Terms of trade	-2.1	4.2	10.1	7.6	-5.7	0.2
Overall balance (percent of GDP)	0.2	0.5	-1.0	1.1	-0.1	-0.2
Gross reserves (billions of U.S. dollars)	51.6	55.1	55.5	60.0	59.8	58.7
in percent of ARA (w/o CFMs)	72.1	74.3	75.0	80.9	80.6	79.2
in percent of ARA (w/ CFMs)	78.8	81.7	82.4	89.0	88.7	87.1
Total external debt (percent of GDP)	42.6	47.6	56.4	45.1	44.2	43.5
Nominal effective exchange rate (period average) 5/	-0.1	-5.1	-11.3	8.5	...	...
Real effective exchange rate (period average) 5/	1.7	-0.2	-10.2	10.7	...	...
Exchange rate (Rand/U.S. dollar, end-period) 5/	14.4	14.0	14.7	14.6	...	...

Sources: South African Reserve Bank, National Treasury, Haver, Bloomberg, World Bank, and Fund staff estimates and projections.

1/ Consolidated government as defined in the budget unless otherwise indicated.

2/ Revenue excludes "transactions in assets and liabilities" classified as part of revenue in budget documents. This item represents proceeds from the sales of assets, realized valuation gains from holding of foreign currency deposits, and other conceptually similar items, which are not classified as revenue by the IMF's Government Finance Statistics Manual 2014.

3/ Central government.

4/ As of September, 2021.

5/ As of October 19, 2021.

**Table 2. South Africa: Banking Soundness Indicators, 2018–21**

	2018	2019	2020	2021 1/
	(Percent)			
<b>Capital adequacy</b>				
Regulatory capital to risk weighted assets	16.1	16.6	16.6	17.3
<i>of which Tier 1 capital</i>	14.9	15.6	15.7	16.4
Capital to total assets	8.4	8.5	7.9	8.3
<b>Asset quality</b>				
Nonperforming loans to total of loans	3.7	3.9	5.2	5.2
Nonperforming loans net of provisions to capital	17.8	18.1	25.6	23.3
<b>Earnings, profitability, and efficiency</b>				
Return on assets	1.7	1.5	0.6	0.9
Return on equity	19.8	17.6	7.7	11.8
Interest margin to gross income	50.0	52.8	52.0	55.3
Trading income to total income	6.7	5.4	6.1	8.1
Non-interest expenses to gross income	52.8	54.0	61.5	64.7
Personnel expenses to non-interest expenses	51.9	44.2	41.5	49.0
<b>Liquidity</b>				
Liquid assets to total assets	15.6	15.0	15.2	15.8
Liquid assets to short-term liabilities	31.1	30.2	28.6	28.8
Customer deposits to total loans	55.7	57.4	61.0	61.4
<b>Exposure to FX risk</b>				
Net open FX position to capital	0.7	0.9	0.7	0.8
Foreign-currency-denominated loans to total loans	9.4	8.3	8.7	7.5
Foreign-currency-denominated liabilities total liabilities	8.0	7.4	6.4	6.2
<b>Sectoral distribution of loans and advances</b>				
Residents	89.3	90.0	86.8	87.4
Central Bank and other financial corporations	15.7	15.1	15.8	15.2
General government	0.5	0.6	0.5	0.5
Nonfinancial corporations	34.0	34.0	31.5	31.8
Households	39.1	40.2	38.9	40.0
Nonresidents	10.7	10.0	13.2	12.6
<b>Derivatives</b>				
Gross asset position in financial derivatives to capital	41.9	51.2	104.2	74.9
Gross liability position in financial derivatives to capital	42.9	49.3	100.3	70.9
<b>Real Estate Market</b>				
Residential real estate price growth 2/	3.8	3.5	2.5	4.3
Residential real estate loans to total loans	24.0	24.2	23.6	24.5
Commercial real estate loans to total loans	7.5	8.0	8.0	8.1
<b>Household debt 3/</b>				
Household debt to GDP	43.3	43.8	44.3	45.0
Household debt to disposable income	72.7	73.2	75.4	75.3
Household debt service to disposable income	9.3	9.4	7.7	7.7

Sources: Financial Soundness Indicators Database, Haver, and IMF staff calculations.

1/ As of May, 2021.

2/ As of September, 2021.

3/ As of March, 2021.

## ANNEX 2. Implementation of the 2014 FSAP Recommendations

Recommendations	Status
<p><b>Twin Peaks Reform:</b> Define clear and comprehensive institutional, governance, and accountability arrangements for prudential and market conduct regulation.</p> <p>Publish a roadmap for regulatory reform, with adequate resource allocation, monitoring, and evaluation, to carefully implement the move to twin peaks and minimize transition risks.</p>	<p>The Financial Sector Regulation act (FSR Act) that came into effect in April 2018 established the PA and the FSCA, and conferred powers on each entity. The PA is established as a juristic person operating within the administration of SARB, while the FSCA is established as a juristic person and a national public entity for purposes of the Public Finance Management Act. The FSR Act sets out the objectives, functions, governance arrangements and resource requirements for both agencies, as well as the requirements for collaboration and co-ordination (including requirements to establish memoranda of understanding) in order to reduce (the risk of) regulatory and supervisory duplication.</p> <p>The PA published its regulatory strategy for the period 2018-2021 in September 2019, while FSCA's regulatory strategy was publicly issued in October 2018. In broad terms, the respective regulatory strategies set out the agencies' key priorities for the next three years; the intended outcomes of each agency's strategy; the guiding principles and matters that the agencies will consider when performing their respective functions; their approaches to administrative actions; and how they will give effect to requirements transparency, openness to consultation, accountability, consistency with international standards and general performance of their functions.</p>
<p><b>Microprudential:</b> Strengthen group-wide supervision of financial conglomerates, focusing on interconnectedness by monitoring intra-group transactions and aggregate exposures, and conducting joint on-site visits.</p> <p>Clarify objectives and strengthen the operational independence of all financial sector supervisors in the relevant legislation in line with international standards.</p> <p>Enhance regulatory requirements of CIS. Introduce variable net asset valuation. Strengthen the supervision of CIS managers.</p>	<p>The PA and FSCA continue to cooperate, and the process of cooperation has been formalized through the implementation of the MoU, as well as monthly coordination meetings and sessions at the executive level.</p> <p>The FSR Act provides a basis for the regulation and supervision of financial conglomerates. The PA is currently developing the accompanying regulatory framework and intends to release a draft set of prudential standards for public consultation in 2020. A Conglomerate Supervision Department has been established within the PA.</p> <p>A draft standard relating to Net Asset Valuation and Pricing for CIS portfolios was published for public consultation in June 2017. After extensive industry consultation, a revised draft of the NAV Standard was submitted to NT in August 2019 for tabling in Parliament. The standard will be supported by a</p>

Recommendations	Status
Fully implement the Solvency Assessment and Management (SAM) regime and Treating Customers Fairly Initiative (TCF); give high priority in legislation to protecting policyholder rights and entitlements.	Guidance Notice that is currently under development by the FSCA.  The introduction of the SAM framework in July 2018 marked the biggest legislative overhaul of the insurance industry in 20 years. The Insurance Act adopts a risk-based framework that is supported by Prudential Standards (42 to date) that cover financial soundness, governance and operations of the different types of insurance entities operating in South Africa. 'Treating customers fairly' requirements are already being implemented by the FSCA, ahead of the finalization of a new Conduct of Financial Institutions Bill (published for public comment in 2018).
<b>Macprudential:</b> Continue building a top-down stress test framework for banks and insurers. Give SARB more resources for data collection and analysis.	The 2018 TD and BU stress tests were completed successfully, with the results having been discussed in SARB's 2018 Financial Stability Review). The current stress testing framework (limited to the banking sector) was developed with technical assistance from the IMF and has been peer reviewed by the Deutsche Bundesbank. The development of an insurance stress test framework has commenced. SARB has approved additional resources to assist with data collection and analysis.
<b>Financial Safety Nets:</b> Introduce a resolution regime compliant with the Key Attributes. Make SARB the resolution authority of all banks and SIFIs.  Adopt depositor preference and introduce an ex- ante funded deposit insurance scheme, with a back-up credit line from the NT.  Remove constraints to early intervention powers and improve legal protection for resolution officials.	In August 2015, NT, SARB, and FSB jointly published a discussion paper on a new resolution framework for financial institutions in South Africa. A policy paper proposing the establishment of a deposit insurance scheme has been published in May 2017. Once promulgated, the Financial Sector Laws Amendment Bill, published for comments in September 2018, will formally designate SARB as resolution authority and establish the Corporation for Deposit Insurance.
<b>OTC Derivatives Market:</b> Improve data collection and enhance surveillance of the OTC derivatives market.	South Africa has taken various steps to effect OTC reforms in the domestic legislative landscape. Amendments to the FMA create an empowering framework for the licensing, regulation and supervision of central counterparties (CCP). In addition, ministerial regulations have been issued to, amongst other, (i) establish ODP as a type of regulated person under the FMA; (ii) require the reporting of OTC derivative transactions to a licensed trade repository or licensed external trade repository; (iii) flesh out the regulatory framework for CCPs; and (iv) empower the PA and FSCA to determine eligibility criteria for

Recommendations	Status
<p>Consider establishing a local CCP, with credit lines to the central bank and securities collateral placed at a central securities depository to reduce dependency on local banks.</p>	<p>OTC derivative transactions that should be subject to mandatory clearing. The PA and FSCA are in the process of finalizing a Joint Standard on margin requirements for non-centrally cleared OTC derivative transactions.</p> <p>Any Clearing House performing the functions of a CCP must comply with any requirements imposed by regulatory standards. JSE Clear has already been recognized as an associated clearing house that is performing the functions of a CCP, and the PA and the FSCA are currently developing the necessary application forms for the licensing of a CCP or external CCP. The PA and the FSCA are also engaging the NT on the optimal design and market structure in respect of local versus foreign market infrastructures in the South African market. A regulatory framework for trade repositories is in place but no such entities are currently active in South Africa.</p>
<p><b>Competition:</b> Adopt the international best practices on provision and disclosure of market information to retail customers and to potential entrants into the payments and clearance systems.</p> <p>Adopt a rules-based entry and exit framework, and lower entry hurdles to the financial system.</p>	<p>The CPMI-IOSCO Principles for Financial Market Infrastructures (PFMIs) have not been formally adopted into domestic law in relation to payment systems. However, work is ongoing to finalize the National Payment Systems Act, which will provide SARB with the explicit basis for the adoption and implementation of the PFMIs.</p> <p>Furthermore, the revised NPS Act will address entry and exit frameworks for participants (including nonbanks) into the payment, clearing and settlement systems in line with international standards.</p>