

**Regulatory compliance: A framework for South African banks**

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## **DEDICATION**

To my Lord and Saviour all the honor and glory

To my wife, Gretha, for all the support and encouragement

To my children, Rouxlé, Roald, Rowan and Romané for their support

To my parents for their support and encouragement

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## ENGLISH ABSTRACT

### REGULATORY COMPLIANCE: A FRAMEWORK FOR SOUTH AFRICAN BANKS

In April 2005, after lengthy discussions and much debate with banks around the world, the Basel Committee issued its paper entitled "Compliance and the compliance function in banks". This paper provides detailed compliance principles to which banks should adhere. Regulation 47(1) of the Regulations relating to the Banks Act, Act 94 of 1990, states that: *A bank shall establish an independent compliance function as part of its risk-management framework, in order to ensure that the bank continuously manages its regulatory risk, that is, the risk that the bank does not comply with applicable laws and regulations or supervisory requirements.*

The regulations further require that a compliance officer of the bank shall head an independent compliance function and that the compliance function shall have adequate resources. The SARB has expressed its dissatisfaction in the past with the level of compliance among banks in South Africa and has ordered the different boards of directors to rectify the situation as a matter of urgency. This requirement compelled banks to spend more and more money on compliance, resulting in complaints from the banks about the cost of compliance. Media reports focussing on the increase in the cost of compliance have aggravated the situation even further. The cost of compliance is divided into two broad categories, namely the cost associated with performing compliance, and the cost of non-compliance.

The problem that this study thus addresses is how to enable the compliance functions in the banks in South Africa to manage regulatory compliance with the relevant regulatory requirements at a measurable cost. The main objective of this study was therefore to provide a regulatory compliance framework for implementation by banks in South Africa.

In order to achieve the stated objective, a specific methodology was formulated, namely:

- The regulatory universe in South Africa was reviewed in order to identify all the acts that govern the activities of banks.
- The direct cost of non-compliance was identified by reviewing the specific sections of the different acts in the regulatory universe where non-compliance is an offence. Included in this investigation was research into the possible indirect cost of non-compliance such as loss of revenue due to reputational damage caused by a bank's non-compliance.
- Compliance officers of banks in South African were interviewed in order to ascertain the cost of compliance to these banks. Questions aimed at obtaining specific information pertaining to personnel cost, infrastructure cost, direct regulatory cost and operational cost were included.
- A review of the international perspective on regulatory compliance was performed and attention was paid to supervisory structures and current trends in regulatory compliance in the G10 countries.
- A regulatory compliance framework was developed by incorporating the information obtained in the research. This framework was tested against Regulation 47 of the Regulations relating to banks as well as the Basel principles on compliance to ascertain whether it met the specific regulatory standards.
- Legislative changes and other incentives were proposed in order to enhance the management of compliance risk.

## **AFRIKAANSE OPSOMMING**

### **REGULATORIESE VOLDOENING: 'N RAAMWERK VIR SIUD AFRIKAANSE BANKE**

Gedurende April 2005, na vele besprekings en debatte met banke regoor die wêreld, het die Basel Komitee in 'n verslag getiteld "*Compliance and the compliance function in banks*" gepubliseer. Hierdie verslag verskaf detail voldoeningsbeginsels waaraan banke moet voldoen. Regulasie 47(1) van die Regulasies met betrekking tot die Bank Wet: Wet 94 van 1990, stel dit dat: "*n Bank moet 'n onafhanklike voldoeningsfunksie daarstel wat deel sal wees van die riskobestuursraamwerk, ten einde te verseker dat die bank aaneenlopend regulatoriese risiko bestuur. Dit is die risiko dat die bank nie voldoen aan toepaslike wette, regulasies en toesighoudende vereistes.*"

Die regulasies vereis verder dat 'n voldoeningsbeampte aan die hoof van die onafhanklike voldoeningsfunksie sal staan en dat sodanige funksie oor voldoende hulpbronne sal beskik. Die Suid Afrikaanse Reserwe Bank het reeds in die verlede ontevredenheid uitgespreek oor die vlak van voldoening in banke in Suid-Afrika en het beveel dat die Rade van Direkteure die situasie onmiddellik moet regstel. Hierdie vereiste het banke gedwing om meer en meer fondse op voldoening te spandeer, met die gevolg dat banke al hoe meer oor die koste van voldoening begin kla het. Mediaverslae wat gefokus het op die koste van voldoening het die situasie net verder vererger. Die koste van voldoening kan in twee kategorieë verdeel word, naamlik die koste geassosieer met die doen van voldoening en die koste van nie-voldoening.

Die probleem wat hierdie studie dusnaangespreek is hoe om die voldoeningsfunksies van banke toe te rus om te voldoen aan toepaslike wette en regulasies, teen 'n meetbare koste. Die hoofdoel van hierdie studie is dus om 'n voldoeningsraamwerk te

verskaf vir implementering deur banke in Suid-Afrika. Ten einde hierdie doelwit te behaal, is daar 'n spesifieke metodologie geformuleer, naamlik:

- Die regulatoriese heelal in Suid-Afrika is ondersoek ten einde al die wette te identifiseer wat die aktiwiteite van banke beheer.
- Die direkte koste van nie-voldoening is geïdentifiseer deur die spesifieke artikels van verskillende wette in die regulatories heelal te ondersoek waar nie-voldoening 'n oortreding is. Ingesluit by hierdie ondersoek was navorsing oor die moontlike indirekte koste van nie-voldoening soos verlies aan inkomste as gevolg van die skade aan 'n bank se reputasie.
- Daar is onderhoude met voldoeningsbeamptes van banke in Suid-Afrika gevoer om die moontlike koste van voldoening vas te stel. Vrae is ook ingesluit om spesifieke inligting oor koste van personeel, infrastruktuur en operasionele koste te bekom.
- 'n Ondersoek oor die internasionale perspektief van regulatoriese voldoening is gedoen en spesifieke aandag is geskenk aan regulatoriese strukture, asook die nuutste verwikkelinge in regulatoriese voldoening in die G10-lande.
- 'n Regulatoriese voldoeningsraamwerk is ontwikkel deur onder andere die inligting te gebruik wat uit die navorsing bekom is. Hierdie raamwerk is getoets aan die hand van die vereistes van Regulasie 47, asook die Basel beginsels ten einde vas te stel of hierdie spesifieke vereistes nagekom is.
- Wetlike veranderinge en ander aansporings is voorgestel ten einde die bestuur van voldoeningsrisiko te bevorder.

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## CHAPTER ONE

### INTRODUCTION

#### 1.1 BACKGROUND

The Basel Committee on Banking Supervision (“the Basel Committee”) issued a discussion paper on compliance risk and the compliance function in banks during October 2003 (BIS, 2003:1). The purpose of this paper was to stimulate debate on the introduction of principles that could promote sound practices in banks and banking groups. The Basel Committee also, for the first time ever, formulated a definition of a bank’s compliance function, and this reads as follows (BIS, 2003:3):

*An independent function that identifies, assesses, advises on, monitors and reports on the bank’s compliance risk, that is, the risk of legal or regulatory sanctions, financial loss, or loss to the reputation a bank may suffer as a result of its failure to comply with all applicable laws, regulations, codes of conduct and standards of good practice.*

In April 2005, after lengthy discussions and much debate with banks and regulators around the world, the Basel Committee issued the final paper titled “Compliance and the compliance function in banks”. The paper provided detailed compliance principles to which banks were expected to adhere to in order to enhance compliance in banks and banking groups. The Committee’s paper (BIS, 2005:7) stipulated specifically that the board of directors of a bank is ultimately responsible for their particular bank’s compliance with all relevant acts and regulations. It further stipulated that compliance should become part of the culture of a bank (BIS, 2005:7) and that the bank’s compliance function should be adequately resourced (BIS, 2005:8).

During 2004, the Banking Supervision Department of the South African Reserve Bank (“SARB”) expressed its dissatisfaction with the apparent culture of non-compliance in some of the banks in South Africa (SARB, 2005b:11). In order to solve this apparent problem, the SARB expanded its annual

supervisory process by also focussing on the banks' compliance functions in terms of Regulation 47 of the Regulations relating to Banks (SARB, 2005b:43).

Regulation 47 Regulation 47(1) of the Regulations relating to the Banks Act ("the regulations"), Act 94 of 1990 (SARB, 2000:188), states that:

*"a bank shall establish an independent compliance function as part of its risk management framework, in order to ensure that the bank continuously manages its regulatory risk; that is, the risk that the bank does not comply with applicable laws and regulations or supervisory requirements."*

The regulations also require that a compliance officer of the bank should head the independent compliance function in a bank and that the compliance function shall have adequate resources (SARB, 2000:188).

The SARB further announced, also during 2004, the commencement of a review process to assess compliance with corporate government principles on banking institutions in South Africa (SARB, 2004a). This study was completed during 2005 and the results were published by the SARB (SARB, 2005a). In the report, it was specifically mentioned that the compliance function of the banks in South Africa was not fully functional yet and that adequate resources were a problem (SARB, 2005:61).

Adding to the SARB's report and aggravating the situation even further, media reports stated that the cost of compliance was already much too high in South Africa (Makuna, 2005:1). South African regulatory authorities agreed with this opinion and acknowledged that there was a definite need to reduce the cost of compliance (Kieswetter & Gordhan, 2005:2).

Makuna (2005:1), however, mentioned that although the cost of compliance could be too high, there was still a definite need for regulatory authorities and supervisory activities in South Africa. Makuna (2005:1) further asserted that

the challenge to banks in South Africa was to ensure compliance with acts and regulations in their organisations at an acceptable cost.

## **1.2 PROBLEM STATEMENT**

The South African regulatory environment, as in the rest of the world, is constantly changing. Among these changes is the introduction of the new Basel II Accord for banks in 2008, which creates an additional burden on the banks. Basel II can also further increase the cost of compliance significantly. Current compliance costs are already estimated to be significant (Bevilacqua, 2003:3) and it is often the case that compliance costs are more severe on the smaller banks as these smaller banks have to comply with the same requirements as the larger banks (Davie, 2004:1).

The cost of compliance can be divided into two broad categories, namely the cost associated with reaching compliance, that is operational cost, and the cost of non-compliance. The operational cost of compliance is a cost that a bank has to incur given the specific regulatory requirements. This operational cost could differ from bank to bank, as the banks' activities could be different. The cost of non-compliance can be severe to a bank (Sinha, 2006). Makuna (2005:1) is, however, of the opinion that the cost of performing compliance is in most instances lower than the cost of non-compliance.

The problem that this study thus addresses is how to enable the compliance functions in the banks in South Africa to manage regulatory compliance with the relevant regulatory requirements at a measurable cost.

## **1.3 OBJECTIVE OF THE STUDY**

In order to address the problem mentioned in 1.2 above, the objective of this study is the development of a compliance framework of which the cost can be measured and is based on the current regulatory compliance universe in South Africa.

## **1.4 METHOD OF INVESTIGATION**

A specific research methodology has been developed that will be used to achieve the set objective of the study and this specific methodology includes the following components:

### **1.4.1 Defining the regulatory universe**

Two specific components in the South African regulatory universe are important to the supervision of the activities of financial institutions. These components are the different acts in South Africa and the different supervisory bodies in South Africa.

The South African regulatory universe will be reviewed in terms of the different acts as from 30 June 2006 in order to identify and list which of these acts govern the general activities of banks in South Africa. The acts in the list will be those that have the most severe impact on the activities of a bank and that have to be administered centrally in the bank and not by the different divisions in the bank. It is further emphasised that there could be acts in existence not included in the final list. These acts cannot be discarded and compliance with these should be performed on a divisional level in a bank as it could only apply to the specific activities of such a division.

The study will furthermore identify and review the supervisory activities of the regulators of financial institutions in South Africa and will identify all the acts directly administered by these regulators.

### **1.4.2 Calculating the cost of non-compliance**

The list of identified acts, as mentioned in 1.4.1 above, will be subjected to further revision in order to identify the specific sections of the different acts where non-compliance is a criminal offence. The review will also focus on the penalties and fines that can be imposed in cases of non-compliance. Included in this section is further research into the possible indirect cost of non-

compliance. The indirect cost of non-compliance refers to the loss of revenue due to reputational damage caused by a bank's non-compliance.

### **1.4.3 Measuring the cost of compliance**

In order to understand and measure the cost of compliance to the banking sector in South Africa, the compliance officers of a number of banks in South African Banks will be interviewed. These interviews will be conducted using a specifically compiled questionnaire and bank-specific information will remain confidential. The information obtained will be presented for the South African banking sector as a whole and no bank in South Africa will be named.

Information pertaining to, amongst others, the following will be obtained:

- Personnel costs;
- Infrastructure costs;
- Direct regulatory costs; and
- Operational costs.

### **1.4.4 An international perspective**

A review of the international perspective on regulatory compliance will be conducted with specific attention to the supervisory structures and current trends in regulatory compliance in the G10 countries.

### **1.4.5 Constructing a regulatory compliance framework.**

The results of the research mentioned in 1.4.1, 1.4.2, 1.4.3 and 1.4.4 above will be used to create a regulatory compliance framework. The compliance framework will be tested against the current South African regulatory requirements in order to ascertain whether the framework meets all the set requirements. A benefit analysis will be performed on the framework.

#### **1.4.6 Possible legislative changes and other incentives**

Changes to current legislation could possibly be used to incentivise banks to enhance their regulatory compliance. The study will explore and set forth possible changes and enhancements to the current legislation as well as other possible incentives.

### **1.5 STRUCTURE OF THE STUDY**

In order to meet the stated objective, the study has been structured as follows:

#### **1.5.1 Chapter One: Introduction**

Chapter One details the background to the study, defines the problem to be addressed, sets out the objectives of the study, indicates the method of investigation applied in the study, provides the compliance structure and proposes possible changes to current legislation to enhance compliance in banks.

#### **1.5.2 Chapter Two: Defining the regulatory universe**

The purpose of Chapter Two is to review the current South African regulatory universe as at 30 June 2006 in order to identify and list those acts that govern the activities of banks in South Africa. A specific review methodology is applied and the acts listed will be those that have the most severe impact on the activities of a bank and that have to be administered centrally in a bank.

#### **1.5.3 Chapter Three: The cost of non-compliance**

The purpose of Chapter Three is to review and arrive at an understanding of the true cost of non-compliance. The JSM Group (2005:1) defines the direct cost of non-compliance as fines, settlement costs and legal costs. As a first step, all the acts that have been identified in Chapter Two will be reviewed in order to identify the sections in the different acts where non-compliance is a

criminal offence. Details regarding the nature of non-compliance instances classified as offences will be provided for each of the acts. The penalties attached to these offences will be identified, whether it is prison sentences, fines, or a combination thereof. The next step will be to determine the indirect cost of non-compliance where the indirect cost is defined by the JSM Group (2005:1) as costs and losses relating to damaged reputation and brands.

#### **1.5.4 Chapter Four: The cost of compliance**

In order to gain insight into the situation in South Africa, a survey will be conducted amongst banks regulated by the South African Reserve Bank as well as the audit firms in South Africa. The results will be used as a basis for creating a compliance framework with the purpose of reducing the compliance burden and compliance costs facing banks in South Africa.

The purpose of this chapter is therefore to discuss the types of compliance costs, the scope of the survey, the actual questionnaire used, the information obtained as well as conclusions drawn from the results.

#### **1.5.5 Chapter Five: Regulatory frameworks and compliance:**

##### **An international perspective**

Chapter Five presents a review of the international perspective on regulatory frameworks and compliance. Specific attention will be paid to the supervisory structures and current trends in regulatory compliance in the G10 countries. The purpose of this chapter is to identify possible solutions that have already been introduced successfully by these countries.

#### **1.5.6 Chapter Six: The compliance framework**

Chapter Six focuses on the compliance divisions of banks. The purpose of this chapter is to utilise all the information presented in Chapters Two, Three, Four and Five in order to construct a compliance. To this end, the study will use the defined compliance universe, information on the cost of compliance,

information on the cost of non-compliance, survey results as well information pertaining to international trends. A benefit analysis of the framework will also be performed.

### **1.5.7 Chapter Seven: Summary, conclusions and recommendations**

Chapter Seven presents a summary of the investigation into compliance with emphasis on the findings as well as the conclusions drawn from the results obtained. Specific recommendations that can possibly be instituted by banks in order to enhance compliance activities in these banks will be set forth.

## **1.6 SUMMARY**

The Basel Committee set the standard concerning compliance in banks throughout the world in June 2005, through the publication of the paper "Compliance and the compliance function in banks". This paper not only provided detailed compliance principles to which banks should adhere, but also stipulated the duties of the board of directors and senior management with regard to compliance.

Regulators around the world are now enforcing these principles on banks and compliance now plays a significant role in supervisory programmes. The result of this situation is that such programmes create an additional burden on the banks and could further increase the cost of compliance significantly.

The problem that the study addresses is how to enable the compliance function in banks in South Africa to meet all the regulatory requirements at a measurable cost. In order to address this problem, the main objective of this study is to provide a regulatory compliance framework for use by South African banks.

The methodology set out and followed in this study in order to achieve the mentioned objective of the study includes defining the regulatory universe in South Africa, calculating the cost of non-compliance, measuring the cost of

compliance, presenting an international perspective on compliance and the creation of a regulatory compliance framework.

The results obtained in this study are summarised in the last chapter, which also includes recommendations that can be instituted by banks in South Africa in order to enhance compliance activities at acceptable cost.

The next chapter is the first step of the study where the regulatory universe in South Africa is reviewed and defined.

## CHAPTER TWO

### DEFINING THE REGULATORY UNIVERSE

#### 2.1 INTRODUCTION

The South African Banks Act (RSA, 1990a:11) defines the business of a bank as “[t]he acceptance of deposits from the general public, the soliciting of, or advertising for deposits and the utilization of money accepted by way of a deposit”. The only deciding difference between a banking entity and a non-banking entity is therefore the right to obtain deposits from the public.

Any company wanting to conduct the business of a bank should apply to the Registrar of Banks under Section 17 of the Banks Act (RSA, 1990a:23). An annual licence fee is payable under Section 35 (RSA, 1990a:34). The bank is therefore granted approval by the Registrar to conduct banking business and to provide certain products and services to customers. These include, amongst others, transactional services, loans, deposit accounts and credit cards. Banks have traditionally derived income from providing these products and services to customers.

The Basel Committee on Banking Supervision (BIS, 2001:1) states: “*Over the last couple of years, large, internationally active financial institutions have engaged in increasingly complex and diverse activities.*” Banks have therefore turned to other sources of income as competition in the market increased. FirstRand Bank (2005:122), for example, lists its sources of income for the financial year as being transactional income, interest income and other non-interest income. Non-interest income is divided into fees and commission and trading income. In order to generate this income, FirstRand Bank (2005:123) has performed activities not normally associated with traditional banking. These activities included trading in securities, investments in private equity and other investment-related activities.

It was thus established that banks, as seen from the example of FirstRand Bank, have entered into markets as participants that are not governed by the Banks Act. For example, trading in securities is governed by, amongst others, the Insider Trading Act (RSA, 1998b). Banks therefore have to comply with the requirements of different acts depending on the nature of their activities.

Two specific components in the South African Regulatory Universe are important with regard to the supervision of the activities of financial institutions. These components are the different acts in South Africa and the different supervisory bodies ("Regulators") in South Africa. In this chapter, the supervisory activities of the Regulators of financial institutions in South Africa are presented and the acts directly administered by these regulators are discussed.

However, the main purpose of this chapter is to provide a review of the current South African regulatory universe as at 30 June 2006 in order to identify and create a list of acts governing the general activities of banks in South Africa. The acts in the list will be those which have the most severe impact on the activities of a bank and which have to be administered centrally in the bank and not by the different divisions in the bank. It must be emphasised that acts could exist that are not included in the final list of acts. These acts cannot be discarded and compliance with these acts should take place on a divisional level in a bank. Depending on the governance structure of the bank, reporting on the level of compliance with these acts should still take place.

A specific methodology was created to identify these acts. To this end, a number of steps need to be followed, namely:

- Step one: Identifying the general activities of a bank;
- Step two: Identifying the different categories into which the acts in South Africa can be categorised and then comparing the identified general activities of a bank to each of the categories of acts;

- Step three: Comparing the identified general activities of a bank to each of the acts in the different sub-categories;
- Step four: Reviewing the different sub-categories for completeness and reviewing other sources to identify and add acts not yet categorised;
- Step five: Listing the particular acts governing the identified general activities of a bank;
- Step six: Reviewing the provisional list and identifying the acts that have to be administered centrally in the bank; and
- Step seven: Providing final list of acts to be administered centrally in the bank.

The list of acts, as identified when applying the methodology detailed above, will be used in the next chapter as the basis to calculate the cost of non-compliance with these acts.

## **2.2 REGULATORY UNIVERSE IN SOUTH AFRICA**

### **2.2.1 General**

The Basel Committee on Banking Supervision (BIS, 2006:1) states that:

*An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the overall exercise of its duties. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorisation of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.*

South Africa as a country complies in the main with this principle. Firstly, in terms of regulators, the South African Reserve Bank (“SARB”) through its Bank Supervision department supervises the activities of all the registered banks, whether locally or foreign owned, in South Africa. In addition, the

Financial Services Board (“FSB”) is another independent regulatory institution established by statute to oversee the South African non-banking financial services industry in the public interest.

Secondly, a regulatory framework exists in South Africa to supervise the activities of financial institutions. The SARB administers the Banks Act (RSA, 1990a) as well as the Mutual Banks Act (RSA, 1993b). The FSB administers acts governing the activities of Insurers, Pension Funds, Friendly Societies and Collective Investment Schemes (FSB, 2005:94).

It was also established that there is a sharing of relevant information between regulators as the FSB has concluded several bilateral Memorandums of Understanding with SARB and other regulators in 42 different jurisdictions (FSB, 2005:94).

## **2.2.2 Regulators in South Africa**

The most important regulators of financial institutions in South Africa are the following:

- **South African Reserve Bank: Bank Supervision Department**

The SARB is responsible for the regulation and supervision of banks in South Africa. Its sole purpose is to establish a sound, efficient banking system in the interest of the depositors of banks and the economy as a whole. This function is performed by issuing banking licences to banking institutions, and monitoring their activities in terms of either the Banks Act, 1990 (RSA, 1990a), or the Mutual Banks Act, 1993 (RSA, 1993b).

The supervisory approach and processes are primarily risk-based. The SARB performs quantitative analyses on statutory returns and other financial information submitted by banks. These analyses and the information gathered through prudential meetings form the basis of further and regular interaction and discussions with the appropriate risk managers of banks. As a result, the

SARB is able to risk-rate individual banks as being of high, medium or low risk. Qualitative analyses form an intrinsic part of the supervisory programme for each individual bank and banking group and include structured meetings with the chief executive officer, external and internal auditors, risk managers and other executive officers (SARB, 2005:9)

- **Financial Services Board**

The FSB's mission (2005:3) is to promote sound and efficient financial institutions and services together with mechanisms for investor protection in the financial markets under their supervision. The objectives of the risk-based approach to supervision are to identify, as efficiently as possible, the areas of a regulated institution's operation that present the greatest financial risk to its continued viability, and to encourage the relevant institution to manage its risks. Risk-based supervision is consistent with international best practice and over time the approach can be expected to promote market integrity, and contribute to the management of systemic risk.

The FSB (2005) administers the following acts of Parliament:

- Pension Funds Act, Act 24 of 1956;
- Friendly Societies Act, Act 25 of 1956;
- Financial Services Board Act, Act 97 of 1990;
- Financial Supervision of the Road Accident Fund Act, Act 8 of 1993;
- Supervision of Financial Institutions Rationalisation Act, Act 32 of 1996;
- Long-term Insurance Act, Act 52 of 1998;
- Short-term Insurance Act, Act 53 of 1998;
- Inspection of Financial Institutions Act, Act 80 of 1998;
- Financial Institutions (Protection of Funds) Act, Act 28 of 2001;
- Financial Advisory and Intermediary Services Act, Act 37 of 2002;
- Collective Investment Schemes Control Act, Act 45 of 2002;
- Securities Services Act, Act 36 of 2004; and
- Financial Services Ombud Schemes Act, Act 37 of 2004.

The FSB is therefore, along with the SARB, one of the principal regulators of a bank's variety of activities. The FSB also administers the activities of other self-regulating bodies such as the Johannesburg Stock Exchange, the Bond Exchange of South Africa and the South African Futures Exchange.

It was established that banks trading in any of the above-mentioned regulatory bodies' instruments have to be members of such a body and are therefore subject to the particular requirements of such a body.

- **South African Revenue Services**

The South African Revenue Service ("SARS") was established by legislation to collect revenue and ensure compliance with tax laws (SARS, 2005:1). Its vision is to be an innovative revenue and customs agency that enhances economic growth and social development, and supports South Africa's integration into the global economy in a way that benefits all citizens (SARS, 2005:2).

SARS (2005) administrates the following acts of Parliament:

- South African Revenue Services Act, Act 34 of 1997;
- Income Tax Act, Act 58 of 1962; and
- Value added tax Act, Act 89 of 1991.

- **National Treasury**

The National Treasury (2003:1) aims to promote economic development, good governance and social progress, and aims towards raising living standards through accountable, economic, efficient, equitable and sustainable management of public finances.

The National Treasury is, together with other government bodies, responsible for developing and maintaining the legislative and regulatory frameworks in South Africa. There are close ties between the SARB, the FSB and the National Treasury. An example of this is that the Minister of Finance is the ultimate administrator of the Banks Act, 1990 (1990a:14).

- **Financial intelligence centre**

The Financial Intelligence Centre (“FIC”) is a regulatory body in South Africa that was established to identify the proceeds of unlawful activities and to combat money laundering activities (RSA, 2001b:1). The FIC was established under the Financial Intelligence Centre Act, 2001, in February 2002.

Accountable institutions are required to meet “know your client”, record-keeping and reporting obligations. These institutions also need to develop and implement internal rules and controls to facilitate compliance with these requirements. Information obtained from accountable institutions is forwarded to law enforcement agencies, related authorities and other supervisory bodies.

## **2.3 THE METHODOLOGY APPLIED TO IDENTIFY THE ACTS GOVERNING THE GENERAL ACTIVITIES OF A BANK**

In order to achieve the main goal set for this chapter, a specific methodology was developed to identify all the acts that govern the general activities of a bank. The steps in the methodology are discussed below.

### **2.3.1 Step one: Identifying the general activities of a bank**

It was noted that the banks in South Africa have diversified their activities in order to satisfy the needs of customers, and in the process, generate additional income. The starting point of this methodology is to identify these general activities in order to identify the different pieces of legislation that regulate such activities.

The banks' annual reports were reviewed as the different banks provide a structure of their activities in their annual reports. An example of this is the financial reporting structure as provided in the ABSA Bank 2004 Annual Report (Absa, 2004:112 - 113). These structures will be used to compile a list of general activities undertaken by banks in South Africa. The different acts will then be reviewed based on this list of activities.

### **2.3.2 Step two: Identifying the different categories into which the acts in South Africa can be categorised and then comparing the identified general activities of a bank to each of the categories of acts**

The South African Legislative Universe comprises of different types of acts governing different types of activities undertaken by individuals, companies, funds and other entities.

In order to identify the acts applicable to the general activities of a bank, the study will use the classification of acts created by Guarantee Trust Systems (2006). The different activities will then be compared to these categories in order establish which categories could be applicable to the general activities of a bank.

Guarantee Trust Systems (2006) has divided the acts in South Africa into 14 different categories, namely:

- Accounting, Finance and Tax acts;
- Agricultural acts;
- Arts, Culture and Heritage acts;
- Business and Insurance acts;
- Education acts;
- Environmental and Tourism acts;
- Housing acts;
- Industrial, Health and Safety acts;
- Justice Departments acts;
- Labour and Employment acts;
- Miscellaneous acts;

- National Intelligence acts;
- Public Work acts; and
- Road Traffic acts.

The study will provide the results in a table to facilitate referencing. In the table, the categories of acts will be listed in the first column and in the second column the applicability of the category is given (YES or NO) as well as the reason for this decision.

### **2.3.3 Step three: Comparing the identified general activities of a bank to each of the acts in the different sub-categories**

Guarantee Trust Systems (2006) not only classifies the acts into different categories but also provides details of the different acts in each category. The general activities of a bank will therefore be compared to the acts in each of the categories in order establish which of these categories could be applicable to these activities of a bank.

The results for each category will again be presented in a table to facilitate referencing. In these tables, the specific of acts will be listed in the first column and in the second column the applicability of the specific act is given (YES or NO) as well as reason for the decision.

### **2.3.4 Step four: Reviewing the different sub-categories for completeness and reviewing other sources to identify and add acts not yet categorised**

The next step in the process is to ensure that the different acts listed by Guarantee Trust (2006) are a complete and an accurate reflection of the legislative universe for banks in South Africa as at 30 June 2006. Alternative sources of information will be reviewed to ensure completeness.

In the event of any acts being uncovered that are not in the list of acts, such acts will be reviewed in order to ascertain whether it is applicable to the

general activities of a bank. Any applicable acts will then be added to the final list.

### **2.3.5 Step five: Listing the acts governing the identified general activities of a bank**

This step entails the compilation of the provisional list of acts that could be governing the general activities of a bank. All the acts identified in step four above will be included in this list. This list will therefore form the basis of the next step where all the acts will be reviewed again to identify those acts that have to be administered centrally in the bank.

### **2.3.6 Step six: Reviewing the provisional list and identifying the acts that have to be administered centrally in the bank**

A total number of 14 different categories of acts were found in the legislative universe in South Africa (Guarantee Trust Systems, 2006) and monitoring compliance with all of these acts could be a near impossible task for a single person or division. A course of action could be to monitor compliance with some of these acts centrally in a bank. "Centrally" in this sense could mean a compliance department in a bank at head office level, which can monitor compliance with acts that have a bearing across the bank and that govern the general activities of all the divisions of the bank. This step will therefore identify those acts, which fall into this category of monitoring.

The results are presented in a table to facilitate referencing. In the table, specific acts are listed in the first column and the general activities of a bank in the subsequent columns. The table then indicates which act is applicable to which activity.

### **2.3.7 Step seven: Providing final list of acts to be administered centrally in the bank**

As a last step, a list of acts is provided that would be applicable to the general activities of a bank. This final list will form the basis of the compliance risk-management framework.

## **2.4 IDENTIFYING LEGISLATION USED TO SUPERVISE BANKS**

### **2.4.1 Identify the general activities of a bank**

It was noted that the banks' annual reports usually provide a structure of the banks' activities in general. The annual reports of a number of banks in South Africa were reviewed in order to identify the general activities of a typical bank in South Africa.

It was found that the general activities of the banks largely correspond with one another, especially the activities of ABSA Bank, Nedbank, Standard Bank and First National Bank. For purposes of this study, the general activities as stated by ABSA (2004:112 – 113) were selected.

The following activities are listed:

- Personal banking: Personal financial services, retail banking services, micro loans, home loans and credit card services.
- Commercial banking: Business banking, vehicle and asset finance.
- Wholesale banking: Corporate and merchant banking activities, trading and investment solutions and international operations.
- Financial services: Life insurance, short-term insurance, advisory services, fund management, trust services and investment management services.
- Other services: that includes real estate management.

**2.4.2 Identify the different categories into which the acts in South Africa can be categorised and then compare the general activities of a bank to each of the categories of acts**

The following table indicates which of the mentioned categories of acts could be applicable to the activities of a bank.

Table 2.1: Applicability of act categories to the general activities of a bank

<b>NAME AND DESCRIPTION OF ACT CATEGORY</b>	<b>APPLICABLE TO A BANK</b>
<b><u>Accounting, Finance and Tax acts:</u></b> Acts to regulate institutions/persons in terms of accounting, finance and tax.	<b><u>Yes:</u></b> Banks are institutions with activities that involve accounting, finance and tax.
<b><u>Agricultural acts:</u></b> Acts to regulate institutions/persons in terms of agriculture, agricultural co-operations and related activities.	<b><u>No:</u></b> Banks are not agricultural co-operations and do not perform activities related to these.
<b><u>Arts, Culture and Heritage acts:</u></b> Acts to regulate activities relating to arts, culture and heritage.	<b><u>No:</u></b> Banks are not involved in arts, culture and heritage.
<b><u>Business and Insurance acts:</u></b> Acts to regulate institutions/persons in terms of business and insurance.	<b><u>Yes:</u></b> Banks are involved in business and insurance.
<b><u>Education acts:</u></b> Acts to regulate institutions/persons in terms of educational matters/institutions.	<b><u>No:</u></b> Banks are not directly involved in educational matters.
<b><u>Environmental and Tourism acts:</u></b> Acts to regulate institutions/persons in terms of environmental and tourism matters.	<b><u>No:</u></b> Banks are not directly involved in environmental and tourism matters.
<b><u>Housing acts:</u></b> Acts to regulate institutions/persons in terms of housing matters in general	<b><u>Yes:</u></b> Banks are involved in the financing of loans to clients to buy houses.
<b><u>Industrial, Health and Safety acts:</u></b> Acts to regulate health and safety aspects of people in their working environment.	<b><u>Yes:</u></b> Banks have staff working in buildings and other places of work.

Table 2.1: Applicability of act categories to the general activities of a bank (continued)

<p><b><u>Justice Departments acts:</u></b> Acts to regulate the activities of the South African Justice Departments.</p>	<p><b><u>No:</u></b> Banks are not part of the South African Justice Departments.</p>
<p><b><u>Labour and Employment acts:</u></b> Acts to regulate the labour and employment activities of workers.</p>	<p><b><u>Yes:</u></b> Banks have staff and these acts govern the labour and employment activities of these people.</p>
<p><b><u>Miscellaneous acts:</u></b> Acts regulating a variety of activities.</p>	<p><b><u>Yes:</u></b> Banks could be subject to the requirements of these acts.</p>
<p><b><u>National Intelligence acts:</u></b> Acts regulating National Intelligence activities.</p>	<p><b><u>No:</u></b> Banks are not involved in National Intelligence.</p>
<p><b><u>Public Work acts:</u></b> Acts regulating Public Works activities.</p>	<p><b><u>No:</u></b> Banks are not involved in Public Works activities.</p>
<p><b><u>Road Traffic acts:</u></b> Acts regulating Road Traffic in South Africa.</p>	<p><b><u>No:</u></b> Banks are not involved in Road Traffic in South Africa.</p>

Source: Author (2008)

In Table 2.1, the different categories of acts were compared to the general activities of a bank in order to establish which of these categories have to be managed by a bank from the centre. It should be noted, however, that if a category is discarded because of this reason it might nonetheless be possible that the specific category could still be applicable to the specific activities of a specific business unit in a bank. That specific category of acts will then be used by that specific business unit only and managed as such.

An example of this would be if the bank has a business unit dedicated to agricultural activities. This unit will focus its compliance risk management on these agricultural acts although this specific category has been eliminated from the list in Table 2.1. Other banking services such as loans to farmers will be dealt with under those applicable acts at a central level.

## 2.4.3 Compare the general activities of a bank to each of the acts in the different sub-categories

### 2.4.3.1 Accounting, Tax and Finance category

The following table indicates which of the Accounting, Tax and Finance acts could be applicable to a bank.

Table 2.2: Different acts in the Accounting, Tax and Finance category

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Administration of Estates Act, 1965</u></b> To consolidate and amend the law relating to the liquidation and distribution of the estates of deceased persons, the administration of the property of miners and persons under curatorship, and of derelict estates; to regulate the rights of beneficiaries under mutual wills made by any two or more persons; to amend the Mental Disorders Act, 1916; and to provide for incidental matters.</p>	<p><b><u>Yes:</u></b> Banks do administrate the estates of the deceased.</p>
<p><b><u>Close Corporations Act, 1984</u></b> To provide for the formation, registration, incorporation, management, control and liquidation of close corporations; and for matters connected therewith.</p>	<p><b><u>No:</u></b> Banks are not directly involved in the formation of closed corporations.</p>
<p><b><u>Companies Act, 1973</u></b> To consolidate and amend the law relating to companies; and to provide for matters incidental thereto.</p>	<p><b><u>Yes:</u></b> A bank is a company.</p>
<p><b><u>Estate Duties Act, 1955</u></b> To impose an estate duty upon the estates of deceased persons, to repeal the Death Duties Act, 1922, and to provide for matters incidental thereto.</p>	<p><b><u>Yes:</u></b> Banks do administrate the estates of the deceased.</p>

Table 2.2: Different acts in the Accounting, Tax and Finance category  
(continued)

<p><b><u>Exchange Control Amnesty Act, 2003</u></b> To provide for exchange control amnesty with accompanying tax measures in respect of voluntary disclosure by an applicant of any contravention of the Exchange Control Regulations or failure to comply with the provisions of the Estate Duty Act, 1955.</p>	<p><b><u>No:</u></b> Act could be applicable to clients at a divisional level in a bank, but not at a central level.</p>
<p><b><u>Financial Advisory and Intermediary Services Act, 2002</u></b> To regulate the rendering of certain financial advisory and intermediary services to clients; to repeal or amend certain laws; and to provide for matters incidental thereto.</p>	<p><b><u>Yes:</u></b> Banks render financial advisory/intermediary services to clients.</p>
<p><b><u>Financial Intelligence Act, 2001</u></b> To establish a Financial Intelligence Centre and a Money Laundering Advisory Council in order to combat money laundering activities; to impose certain duties on institutions and other persons who might be used for money laundering purposes; to amend the Prevention of Organised Crime Act, 1998, and the Promotion of Access to Information Act, 2000; and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks render services to clients and certain of these duties are imposed on institutions and other persons under this Act with regard to money laundering activities.</p>
<p><b><u>Income Tax, 1962</u></b> To consolidate the law relating to the taxation of incomes and donations, to provide for the recovery of taxes on persons, to provide for the deduction by employers of amounts from the remuneration of employees in respect of certain tax liabilities of employees, and to provide for the making of provisional tax payments and for the payment into the National Revenue Fund of portions of the normal tax and interest and other charges in respect of such taxes, and to provide for related matters.</p>	<p><b><u>Yes:</u></b> Banks are employers and do deduct amounts from the remuneration of staff in respect of certain tax liabilities of staff and pay such amounts to the Government.</p>
<p><b><u>Inspection of Financial Institutions Act, 1998</u></b> To provide for the inspection of the affairs of financial institutions; the inspection of the affairs of unregistered entities conducting the business of financial institutions; and for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks are registered financial institutions.</p>

Table 2.2: Different Acts in the Accounting, Tax and Finance category  
(continued)

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>National Student Financial Aid Scheme Act, 1999</u></b> To establish the National Student Financial Aid Scheme (“NSFAS”); to provide for the management, governance and administration of the NSFAS; to provide for the granting of loans and bursaries to eligible students at public higher education institutions and for the administration of such loans and bursaries; to provide for the recovery of loans; to provide for the repeal of the Provision of Special Funds for Tertiary Education and Training Act, 1993; and to provide for matters connected therewith.</p>	<p><b><u>No:</u></b> Banks are not involved in the NSFAS.</p>
<p><b><u>South African Revenue Services Act, 1997</u></b> To make provision for the efficient and effective administration of the revenue-collecting system of the Republic and the control over import and export, manufacture, movement, storage or use of certain goods and, for this purpose, to re-organise the South African Revenue Service and to make provision for the establishment of advisory committees and to provide for incidental matters.</p>	<p><b><u>No:</u></b> Banks are taxpayers and collect tax, but they are not directly involved with the activities of the South African Revenue Service.</p>
<p><b><u>Stamp Duties Act, 1968</u></b> To consolidate and amend the law relating to stamp duties; and to amend the Marketable Securities Act, 1948.</p>	<p><b><u>Yes:</u></b> Banks deal in securities and other documentation that often require duty stamps.</p>
<p><b><u>Tax on Retirement Funds Act, 1998</u></b> To provide for the taxation of interest and rental income of retirement funds and untaxed policyholder funds of insurers; and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Retirement Funds are administered by banking groups.</p>
<p><b><u>Uncertified Securities Tax Act, 1998</u></b> To provide for the Levying of an uncertified securities tax in respect of the issue of, and change in beneficial ownership in, any securities which are transferable without a written instrument and are not evidenced by a certificate; and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks can transact in any securities, which are transferable without a written instrument.</p>

Table 2.2: Different Acts in the Accounting, Tax and Finance category  
(continued)

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Usury Act, 1968</u></b> To provide for the limitation and disclosure of finance charges levied in respect of money lending transactions, credit transactions and leasing transactions and for matters incidental thereto; and to repeal the Usury Act, 1926.</p>	<p><b><u>Yes:</u></b> Banks are registered credit providers.</p>
<p><b><u>Value-Added Tax Act, 1991</u></b> To provide for taxation in respect of the supply of goods and services and the importation of goods; to amend the Transfer Duty Act, 1949, so as to provide for an exemption; to amend the Stamp Duties Act, 1968, so as to provide for an exemption from stamp duty and to disclose the levying of certain stamp duties; to repeal the Sales Tax Act, 1978; and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks render services to clients that are subject to Value-Added Tax.</p>

Source: Author (2008)

#### 2.4.3.2 Business and Insurance acts category

The following table indicates which of the Business and Insurance acts could be applicable to a bank.

Table 2.3: Different acts in the Business and Insurance category

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Banks Act, 1990</u></b> To provide for the regulation and supervision of the business of public companies taking deposits from the public and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Public companies obtain banking licenses under Section 17 of the Banks Act.</p>

Table 2.3: Different acts in the Business and Insurance category (continued)

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Competition Act, 1998</u></b> To provide for the establishment of a Competition Commission responsible for the investigation, control and evaluation of restrictive practices, abuse of dominant position, and mergers; and for the establishment of a Competition Tribunal responsible to adjudicate such matters; and for the establishment of a Competition Appeal Court; and for related matters.</p>	<p><b><u>Yes:</u></b> Activities of a bank could lead to that bank being the subject of an investigation under this act.</p>
<p><b><u>Consumer Act (Unfair Business Practices), 1988</u></b> To provide for the prohibition or control of certain business practices; and for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Activities undertaken by a bank could lead to that bank being the subject of an investigation under this act.</p>
<p><b><u>Electronic Communications and Transactions Act, 2002</u></b> To provide for the facilitation and regulation of electronic communications and transactions; to provide for the development of a national e-strategy for the Republic; to promote universal access to electronic communications and transactions and the use of electronic transactions by SMMEs; to provide for human resource development in electronic transactions; to prevent the abuse of information systems; to encourage the use of e-government services; and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks are involved in electronic transactions.</p>
<p><b><u>Insider Trading Act, 1998</u></b> To prohibit individuals who have inside information relating to securities or financial instruments from dealing in such securities or financial instruments; to provide for criminal and civil law penalties for such dealing; to empower the Financial Services Board to investigate matters relating to such dealing, to institute proceedings in relation thereto and to administer the proof of claims and distribution of payments received as a result of any such proceedings; to establish the Directorate as a committee of the Financial Services Board for exercising the power to institute proceedings; and to repeal a section of the Companies Act, 1973.</p>	<p><b><u>Yes:</u></b> Banks are trading in securities or financial instruments.</p>

Table 2.3: Different acts in the Business and Insurance category (continued)

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Long-Term Insurance Act, 1998</u></b> To provide for the registration of long-term insurers; for the control of certain activities of long-term insurers and intermediaries, and for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks are involved in long-term insurance and do often act as insurance intermediaries.</p>
<p><b><u>Lotteries Act, 1997</u></b> To regulate and prohibit lotteries and sports pools; to establish a National Lotteries Board; consequentially to amend the Post Office Act, 1958, the Gambling Act, 1965, and the Gambling Act, 1982 (Ciskei), and to repeal the State Lotteries Act, 1984 (Ciskei), and the Lotteries Decree, 1989 (Transkei); and to provide for matters connected therewith.</p>	<p><b><u>No:</u></b> Banks are not involved in pools and lotteries.</p>
<p><b><u>Medical Schemes Act, 1998</u></b> To consolidate the laws relating to registered medical schemes; to provide for the establishment of the Council for Medical Schemes as a juristic person; to provide for the appointment of the Registrar of Medical Schemes; to make provision for the registration and control of certain activities of medical schemes; to protect the interests of members of medical schemes; to provide for measures for the co-ordination of medical schemes; and to provide for incidental matters.</p>	<p><b><u>Yes:</u></b> Banks are involved in medical schemes and the bank staff members are members of such schemes.</p>
<p><b><u>National Gambling Act, 1996</u></b> To make provision for the regulation and co-ordination of certain matters relating to casinos, gambling and wagering; for that purpose to make provision for the promotion of uniform norms and standards applying generally throughout the Republic; to make provision for the establishment of the National Gambling Board; and to make provision for matters connected therewith.</p>	<p><b><u>No:</u></b> Banks are not involved in gambling.</p>
<p><b><u>National Small Business Act, 1996</u></b> To provide for the establishment of the Advisory Body and the Ntsika Enterprise Promotion Agency; to provide guidelines for organs of state in order to promote small business in the Republic; and to provide for matters incidental thereto.</p>	<p><b><u>No:</u></b> Banks are not involved in the establishment of this advisory body at a central level, but some divisions could be.</p>

Table 2.3: Different acts in the Business and Insurance category (continued)

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Non-Profit Organisations Act, 1997</u></b> To provide for an environment in which non-profit organisations can flourish; to establish an administrative and regulatory framework within which non-profit organisations can conduct their affairs; to repeal certain portions of the Fund-raising Act, 1978; and to provide for matters connected therewith.</p>	<p><b><u>No:</u></b> Banks are not non-profit organisations as defined by this act.</p>
<p><b><u>Short-Term Insurance Act, 1998</u></b> To provide for the registration of short-term insurers; for the control of certain activities of short-term insurers and intermediaries; and for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks are involved in short-term insurance and could act as insurance intermediaries.</p>
<p><b><u>Statistics Act, 1999</u></b> To provide for a Statistician-General as head of Statistics South Africa, who is responsible for the collection, production and dissemination of official and other statistics, including the conducting of a census of the population, and for co-ordination among producers of statistics; to establish a Statistics Council and provide for its functions; to repeal certain legislation; and to provide for connected matters.</p>	<p><b><u>No:</u></b> Banks do not collect official statistics but rather provide relevant statistics to the relevant bodies.</p>
<p><b><u>Unemployment Insurance Act, 2001</u></b> To establish the Unemployment Insurance Fund; to provide for the payment from the Fund of unemployment benefits to certain employees, and for the payment of illness, maternity, adoption and dependant's benefits related to the unemployment of such employees; to provide for the establishment of the Unemployment Insurance Board, the functions of the Board and the designation of the Unemployment Insurance Commissioner; and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks must provide for some unemployment benefits to their employees.</p>
<p><b><u>Unemployment Insurance Contributions Act, 2002</u></b> To provide for the imposition and collection of contributions for the benefit of the Unemployment Insurance Fund, and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks must collect contributions from staff for the Unemployment Insurance Fund.</p>

Source: Author (2008)

### 2.4.3.3 Housing acts category

The following table indicates which of the housing acts could be applicable to a bank.

Table 2.4: Different acts in the Housing category

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Abolition of Certain Title Conditions Act, 1999</u></b> To provide for the abolition of certain conditions in terms of which the consent or permission of the holder of an office under the Republic, the former Union of South Africa or any <i>dominium</i>, colony or republic which preceded the former Union of South Africa, is required for the alienation or transfer of immovable property from one person to another; and to provide for matters connected therewith.</p>	<p><b><u>No:</u></b> Banks are not involved in this act at a central level, but some divisions could be.</p>
<p><b><u>Estate Agency Affairs Act, 1976</u></b> To provide for the establishment of an Estate Agency Affairs Board and an Estate Agents Fidelity Fund; for the control of certain activities of estate agents in the public interest; and for incidental matters.</p>	<p><b><u>No:</u></b> Banks are not involved in this act at a central level, but some divisions could be.</p>
<p><b><u>Housing Act, 1997</u></b> To provide for the facilitation of a sustainable housing development process; for this purpose to lay down general principles applicable to housing development in all spheres of government, to define the functions of national, provincial and local governments in respect of housing development and to provide for the establishment of a South African Housing Development Board, the continued existence of provincial boards under the name of provincial housing development boards and the financing of national housing programmes; to repeal certain laws; and to provide for matters connected therewith.</p>	<p><b><u>No:</u></b> Banks are not involved in this act at a central level, but some divisions could be.</p>
<p><b><u>Housing Consumer Protection Measures Act, 1998</u></b> To make provision for the protection of housing consumers; and to provide for the establishment and functions of the National Home Builders Registration Council.</p>	<p><b><u>No:</u></b> Banks are not involved in this act at a central level but some divisions could be.</p>

Table 2.4: Different acts in the Housing category (continued)

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Rental Housing Act, 1999</u></b> To define the responsibility of Government in respect of rental housing property; to create mechanisms to promote the provision of rental housing property.</p>	<p><b><u>No:</u></b> Banks are not involved in this act at a central level, but some divisions could be.</p>
<p><b><u>Sectional Titles Act, 1986</u></b> To provide for the division of buildings into sections and common property and for the acquisition of separate ownership in sections coupled with joint ownership in common property.</p>	<p><b><u>Yes:</u></b> Banks do the finance of sectional title property and are the owners of such property.</p>

Source: Author (2008)

#### 2.4.3.4 Industrial, Health and Safety acts category

The following table indicates which of the industrial, health and safety acts could be applicable to a bank.

Table 2.5: Different acts in the Industrial, Health and Safety category

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Compensation for Occupational Injuries and Diseases Act, 1993</u></b> To provide for compensation for disability caused by occupational injuries or diseases sustained or contracted by employees in the course of their employment, or for death resulting from such injuries or diseases; and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks have employees who may be disabled due to occupational injuries or diseases sustained.</p>
<p><b><u>Disaster Management Act, 2002</u></b> To provide for an integrated and co-ordinated disaster management policy that focuses on preventing or reducing the risk of disasters, mitigating the severity of disasters, emergency preparedness, rapid and effective response to disasters and post-disaster recovery.</p>	<p><b><u>No:</u></b> Banks do have their own integrated disaster management policies, but are not directly involved with this act.</p>

Table 2.5: Different acts in the Industrial, Health and Safety category  
(continued)

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Explosives Act, 2003</u></b> To consolidate the laws relating to the manufacture, storage, sale, transport, importation, exportation and the use of explosives.</p>	<p><b><u>No:</u></b> Banks are not involved in this act.</p>
<p><b><u>Mental Health Care Act, 2002</u></b> To provide for the care, treatment and rehabilitation of persons who are mentally ill; to set out different procedures to be followed in the admission of such persons; to establish Review Boards in respect of every health establishment; to determine their powers and functions; to provide for the care and administration of the property of mentally ill persons; to repeal certain laws; and to provide for matters connected therewith.</p>	<p><b><u>No:</u></b> Banks are not involved in this act.</p>
<p><b><u>Mine Health and Safety Act, 1996</u></b> To provide for protection of the health and safety of employees and other persons at mines.</p>	<p><b><u>No:</u></b> Banks are not involved in this act.</p>
<p><b><u>National Nuclear Regulator Act, 1999</u></b> To provide for the establishment of a National Nuclear Regulator in order to regulate nuclear activities, for its objects and functions, for the manner in which it is to be managed and for its staff matters; to provide for safety standards and regulatory practices for protection of persons, property and the environment against nuclear damage; and to provide for matters connected therewith.</p>	<p><b><u>No:</u></b> Banks are not involved in this act.</p>
<p><b><u>Nuclear Energy Act, 1999</u></b> To provide for the establishment of the South African Nuclear Energy Corporation Limited, a public company wholly owned by the State.</p>	<p><b><u>No:</u></b> Banks are not involved in this act.</p>
<p><b><u>Occupational Health and Safety Act, 1993</u></b> To provide for the health and safety of persons at work and for the health and safety of persons in connection with the use of plant and machinery; the protection of persons other than persons at work against hazards to health and safety arising out of, or in connection with, the activities of persons at work; to establish an advisory council for occupational health and safety; and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks have to provide for the health and safety of their staff at work.</p>

Table 2.5: Different acts in the Industrial, Health and Safety category  
(continued)

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Tobacco Products Control Act, 1993</u></b> To prohibit or restrict smoking in public places; to regulate the sale and advertising of tobacco products in certain respects and to prescribe what is to be reflected on packages; and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks have to prohibit and or restrict smoking in their buildings.</p>

Source: Author (2008)

#### 2.4.3.5 Miscellaneous category

The following table indicates which of the miscellaneous acts could be applicable to a bank.

Table 2.6: Different acts in the Miscellaneous category

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Immigration Act, 2002</u></b> To ensure that immigration to and from the Republic of South Africa takes place only at ports of entry and illegal crossing of the borders is deterred, detected and punished.</p>	<p><b><u>No:</u></b> Banks are not involved in this act.</p>
<p><b><u>National Sport and Recreation Act, 1998</u></b> To provide for the promotion and development of sport and recreation and the co-ordination of the relationships between the Sports Commission, national and recreation federations and other agencies.</p>	<p><b><u>No:</u></b> Banks are often sponsors of sports and sporting events, but banks are not involved in this act.</p>
<p><b><u>Promotion of Access to Information Act, 2000</u></b> To give effect to the constitutional right of access to any information held by the State and any information that is held by another person and that is required for the exercise or protection of any rights; and to provide for matters connected therewith.</p>	<p><b><u>Yes:</u></b> Banks have clients and staff members are thus involved in this act.</p>
<p><b><u>Postal Services Act, 1998</u></b> To make new provision for the regulation of the South African postal services.</p>	<p><b><u>No:</u></b> Banks are not involved in this act.</p>

Source: Author (2008)

### 2.4.3.6 Labour and Employment category

The following table indicates which of the labour and employment acts could be applicable to a bank.

Table 2.7: Different acts in the Labour and Employment category

NAME AND DESCRIPTION OF ACT	APPLICABLE TO A BANK
<p><b><u>Basic Conditions of Employment Act, 1997</u></b> To give effect to the right to fair labour practices referred to in section 23(1) of the Constitution by establishing and making provision for the regulation of basic conditions of employment.</p>	<p><b><u>Yes:</u></b> Banks do employ people and have to comply with the requirements of this act.</p>
<p><b><u>Employment Equity Act, 1998</u></b> To provide for employment equity; and to provide for matters incidental thereto.</p>	<p><b><u>Yes:</u></b> Banks do employ people and have to comply with the requirements of this act.</p>
<p><b><u>Labour Relations Act, 1995</u></b> To give effect to section 27 of the Constitution, to regulate the organisational rights of trade unions and to promote and facilitate collective bargaining at the workplace.</p>	<p><b><u>Yes:</u></b> Banks do recognise labour unions and negotiate with them on a number of staff issues.</p>
<p><b><u>Skills Development Act, 1998</u></b> To provide an institutional framework to devise and implement national, sector and workplace strategies to develop and improve the skills of the South African workforce.</p>	<p><b><u>Yes:</u></b> Banks do employ people and have to comply with the requirements of this act.</p>

Source: Author (2008)

### 2.4.4 Review the different sub-categories for completeness and review other sources to identify and add acts not yet categorised

Other available sources containing information on the legislative universe in South Africa were reviewed and this revision has revealed that there are other acts that are not categorised by Guarantee Trust Systems (2006).

The following acts were identified which could be added to the list of acts to be managed centrally in a bank:

- The National Credit Act (RSA, 2005) was promulgated to promote a fair and non-discriminatory marketplace for access to consumer credit and, for that purpose, to provide for the general regulation of consumer credit and improved standards of consumer information. Comins reports (2006:5) that the National Credit Act replaces the Usury Act. The National Credit Act is therefore added to the list of acts governing the general activities of a bank and the Usury Act removed.
- The Mutual Banks Act (1993b) was promulgated to provide for the regulation and supervision of the activities of juristic persons doing business as mutual banks; and to provide for matters connected therewith. The requirements are therefore applicable to a bank in the event of it being licensed as a mutual bank.

The Mutual Banks Act (RSA, 2003:8) defines a mutual bank as:

*A juristic person, the members of which-*

*(i) qualify as such by virtue of their being shareholders in that juristic person: and*

*(ii) are entitled to participate in the exercise of control in a general meeting of that juristic person; and is provisionally or finally registered as a mutual bank in terms of this Act.*

It was established that there are only two mutual banks in South Africa (SARB, 2006:5). It was also found that the Mutual Banks Act is very similar in nature to the Banks Act and that it is therefore not necessary to add this act to the list of acts governing the general activities of a bank. It should, however, be added to the list of acts of a mutual bank.

#### **2.4.5 Provisional list of acts governing the activities of a bank**

The following table indicates which of the acts identified in the study above are applicable to the activities of a bank.

Table 2.8: Acts governing the activities of a bank

<b>NAME OF ACT</b>
Administration of Estates Act, 1965
Banks Act, 1990
Basic Conditions of Employment Act, 1997
Companies Act, 1973
Compensation for Occupational Injuries and Diseases Act, 1993
Competition Act, 1998
Consumer Act (Unfair Business Practices), 1988
Electronic Communications and Transactions Act, 2002
Employment Equity Act, 1998
Estate Duties Act, 1955
Financial Advisory and Intermediary Services Act, 2002
Financial Intelligence Act, 2001
Income Tax, 1962
Insider Trading Act, 1998
Inspection of Financial Institutions Act, 1998
Labour Relations Act, 1995
Long-Term Insurance Act, 1998
Medical Schemes Act, 1998
National Credit Act, 2006
Occupational Health and Safety Act, 1993
Promotion of Access to Information Act, 2000
Sectional Titles Act, 1986
Short-Term Insurance Act, 1998
Skills Development Act, 1998
Stamp Duties Act, 1968
Tax on Retirement Funds Act, 1998
Tobacco Products Control Act, 1993
Uncertified Securities Tax Act, 1998
Unemployment Insurance Act, 2001
Unemployment Insurance Contributions Act, 2002
Value-Added Tax Act, 1991

Source: Author (2008)

#### **2.4.6 Review the provisional list and identify the acts that can be administered centrally in the bank**

For an act to be administered centrally, that specific act should be applicable to all five activities of a bank as indicated in the table below. In this table, the provisional list of acts identified above is compared to the five categories of activities of a bank.

Table 2.9: Identifying the acts that can be administrated centrally in a bank

<b>NAME OF ACT</b>	<b>Personal</b>	<b>Commer cial</b>	<b>Whole- sale</b>	<b>Finan cial</b>	<b>Other</b>
Administration of Estates Act, 1965	x				
Banks Act, 1990	x	x	x	x	x
Basic Conditions of Employment Act, 1997	x	x	x	x	x
Companies Act, 1973	x	x	x	x	x
Compensation for Occupational Injuries and Diseases Act, 1993					x
Competition Act, 1998	x	x	x	x	x
Consumer Act (Unfair Business Practices), 1988	x	x	x	x	x
Electronic Communications and Transactions Act, 2002	x	x	x	x	x
Employment Equity Act, 1998	x	x	x	x	x
Estate Duties Act, 1955	x	x	x		
Financial Advisory and Intermediary Services Act, 2002	x	x	x	x	x
Financial Intelligence Act, 2001	x	x	x	x	x
Income Tax Act, 1962	x	x	x	x	x
Insider Trading Act, 1998		x		x	x
Inspection of Financial Institutions Act, 1998		x		x	x
Labour Relations Act, 1995	x	x	x	x	x
Long-Term Insurance Act, 1998	x	x	x		
Medical Schemes Act, 1998	x	x	x	x	x
National Credit Act, 2006	x	x	x	x	x
Occupational Health and Safety Act, 1993	x	x	x	x	x
Promotion of Access to Information Act, 2000	x	x	x	x	x

Table 2.9: Identifying the acts that can be administrated centrally in a bank  
(continued)

NAME OF ACT	Personal	Commer cial	Whole -sale	Finan cial	Other
Sectional Titles Act, 1986	x				x
Short-Term Insurance Act, 1998	x	x	x		
Skills Development Act, 1998	x	x	x	x	x
Stamp Duties Act, 1968	x				x
Tax on Retirement Funds Act, 1998	x	x	x		
Tobacco Products Control Act, 1993	x	x	x	x	x
Uncertified Securities Tax Act, 1998	x	x	x		
Unemployment Insurance Act, 2001	x	x	x	x	x
Unemployment Insurance Contributions Act, 2002	x	x	x	x	x
Value-Added Tax Act, 1991	x	x	x	x	x

Source: Author (2008)

#### 2.4.7 Final list of acts to be administrated centrally in the bank

With reference to the table above and the criteria set in the current study, the acts listed below are those acts identified in the South African legislative universe that can be administered at a central level in a bank. The list is by no means in order of importance but is rather in alphabetical order.

1. Banks Act. (RSA, 1990a);
2. Basic Conditions of Employment Act. (RSA, 1997);
3. Companies Act. (RSA, 1973);
4. Competition Act. (RSA, 1998a);
5. Consumer Act (Unfair Business Practices). (RSA, 1988);
6. Electronic Communications and Transactions Act. (RSA, 2002b);
7. Employment Equity Act. (RSA, 1998g);

8. Financial Advisory and Intermediary Services Act. (RSA, 2002c);
9. Financial Intelligence Act. (RSA, 2001b);
10. Income Tax. (RSA, 1962);
11. Labour Relations Act. (RSA, 1995);
12. Medical Schemes Act. (RSA, 1998e);
13. National Credit Act. (RSA, 2005);
14. Occupational Health and Safety Act. (RSA, 1993c);
15. Promotion of Access to Information Act. (RSA, 2000);
16. Skills Development Act. (RSA, 1998h);
17. Tobacco Products Control Act. (RSA, 1998g);
18. Unemployment Insurance Act. (RSA, 2001c);
19. Unemployment Insurance Contributions Act. (RSA, 2002d); and
20. Value-Added Tax Act. (RSA, 1991).

## **2.5 SUMMARY**

In this chapter, the current South African regulatory universe as at 30 June 2006 was reviewed. The main purpose was to identify and list which of the acts in this regulatory universe govern the general activities of banks in South Africa. A specific methodology was developed and used in order to achieve the stated goal.

The acts identified in this chapter were those that have the most severe impact on the activities of a bank and that have to be administered centrally in the bank and not by the different divisions in the bank. It was further noted that there are acts in existence that were not listed in the final list to be administered centrally in a bank. These acts cannot be discarded and compliance with these acts should take place at a divisional level in a bank as they could apply to the specific activities of that division in a bank.

The list of acts, as identified and listed, forms the basis for remainder of the study in that it will be used to construct the organisational structure for the compliance division of a bank. These listed acts identified in this chapter will

be reviewed in the next chapter to order establish the cost of non-compliance with the requirements of the different identified acts.

## CHAPTER THREE

### COST OF NON-COMPLIANCE

#### 3.1 INTRODUCTION

Over the past number of years, financial services companies have scrambled to put together responses to the growing number of regulatory requirements and the fact that non-compliance often occurs (Sinha, 2006). It was also noted that the consequences of non-compliance are varied (Policy Matter, 2005:1) and that the executives of these companies have the ultimate responsibility for non-compliance and can even face a jail terms or individual fines as a result of the bank's non-compliance (Sinha, 2006).

During 2004, the largest civil penalty against a United States financial institution was registered when Riggs Bank was fined for violations under the United States Banks Secrecy Act. Riggs Bank was fined US\$ 25 million for numerous violations of this act as well as the failure to report suspicious transactions (World-Check, 2006:6). Apart from the direct cost of the fine, Riggs suffered extensive damage to its reputation resulting in a loss of clients and income.

The question is therefore whether any bank in South Africa can afford to be the next major bold headline in the newspapers because of non-compliance with acts and regulations.

Harman (2005:67) states that one of the primary reasons for companies to violate laws is their unwillingness to spend the money necessary to comply with laws. Another reason mentioned by this author is that many requirements may be very complex or extremely cumbersome, resulting in companies not complying with every detail of the act in question. Compliance is about not only complying with the law, but also understanding and evaluating risks (World-Check, 2006:11).

The purpose of this chapter is therefore to determine the cost of non-compliance with the acts identified in Chapter Two. A methodology was developed to achieve this specific purpose. This methodology consists of two components, namely identifying the direct cost of non-compliance with the mentioned acts and then reviewing methods to calculate the indirect cost of non-compliance.

- Direct cost of non-compliance

The JSM Group (2005:1) defines the direct cost of non-compliance as fines, settlement costs and legal costs. A revision was conducted of all the acts that have been identified in the previous chapter in order to identify the sections in the different acts where non-compliance is a criminal offence. Details on the nature of the non-compliance that are classified as offences are provided for each of the acts. The penalties attached to these offences are also provided.

- Indirect cost of non-compliance

The JSM Group (2005:1) defines indirect cost of non-compliance as costs relating to damaged reputation and brands. It was noted that in most cases, the companies suffering from damage to reputation were not even aware of the fact that non-compliance has occurred (Peter, 2005:2). The indirect cost of non-compliance is a serious threat to any bank and in some extreme cases, such as Arthur Anderson, such non-compliance can lead to the demise of the company.

A review of applicable literature on the banking sector was conducted in order to establish how the banks are able to calculate the indirect cost of non-compliance. Some clarification on these methods of calculation is provided in this chapter.

### 3.2 DIRECT COST OF NON-COMPLIANCE

The findings of the review on the applicable sections and accompanying offences of each act are presented in the tables below.

#### 3.2.1 Banks Act, 1990

The following table details the offences because of non-compliance with the different sections of the Banks Act, 1990.

Table 3.1: Detail of offences in the Banks Act, 1990

<b>Section</b>	<b>Detail of offences</b>
1(1A)(c)	Furnishing the Registrar with untrue or misleading information with the intention to mislead the Registrar in determining whether the person is fit and proper.
1(1A)(d)	Refusal or failure to furnish information to the Registrar to determine whether the person is fit and proper.
7	Failure to furnish information to the Registrar.
7(3)	Conducting a due diligence audit on the financial position of a bank without prior notification to the Registrar.
7(4)	Failure to furnish a report to the Registrar on a due diligence audit on the financial position of a bank.
7(5)	Unauthorised disclosure of information on a due diligence audit on the financial position of a bank.
11(2)	Conducting the business of a bank without being a public company of registered as a bank.
17(6)	Commencing the business of a bank before furnishing the Registrar with proof that the conditions of Section 70 of the Banks Act (Prudential requirements) have been met.
18A(7)	A foreign institution conducting the business of a bank in South Africa by means of a branch without having obtained the Registrar's written authorisation.
21	Furnishing the Registrar with untrue or misleading information in its application in order to establish or register a bank.
22(3)	A person who is registered as a bank or branch of a foreign bank using a name for such bank or branch other than the name authorised by the Registrar.
22(4)	A person who uses a name that infers that such person is a bank or in any other manner purports to be a registered bank.
22(8)	An unregistered person who in respect of any business uses the words "bank", "deposit-taking institution" or "building society".

Table 3.1: Detail of offences in the Banks Act, 1990 (continued)

<b>Section</b>	<b>Detail of offences</b>
32(4)(a)	Failure to repay any deposits to the depositors upon the lapse of such a person's registration.
34	A foreign institution establishing a representative office in South Africa without the written consent of the Registrar.
35	Failure to obtain a business licence from the Registrar against payment of the prescribed licence fees.
37(1)	Obtaining, without prior written approval, shares in a bank or controlling company that amounts to more than 15 per cent of the total nominal value of all shares issued by such bank or controlling company.
38(1)	Issue to a person or register shares in the name of a person who is not the beneficial shareholder.
39	Failure by a person to furnish the bank or controlling company with the information required to fulfil the requirements of Section 38 of the Banks Act.
41	A person casting a vote or receiving a dividend payable on any share that is in contravention of any provision of the Banks Act.
42(1)	Exercising control over a bank without being a public company and registered as the controlling company of such a bank.
52(1)	Establishing subsidiaries, branch offices, representative offices, other interests and controlling companies without the prior written approval of the Registrar.
52(4)	Failure to notify the Registrar with regard to representative offices of change in chief executive officer, change of address or closing down of such an office.
53	Failure to disclose shareholding and other interests in subsidiaries, trusts and other undertakings.
55	Reconstruction within the group of companies without the prior written approval of the Registrar.
58	Failure to furnish information to the Registrar regarding directors and officers as referred to in Section 215 of the Companies Act.
59	Failure to furnish the Registrar with a return regarding its shareholders.
60(5)	Furnishing information to the Registrar regarding directors knowing that it is untrue or misleading.
60(5)(a)(i)	Failure to notify the Registrar of the nomination of a person to be appointed as a non-executive director.
60(5)(b)(i)	Failure to notify the Registrar of such nomination 30 days prior to the proposed appointment.
61(2)	Failure to apply for approval for the appointment of an auditor in accordance with the provisions of Chapter X of the Companies Act.
65	Failure to forward copies to the Registrar of notices, reports, returns or statements as required by the Companies Act.

Table 3.1: Detail of offences in the Banks Act, 1990 (continued)

<b>Section</b>	<b>Detail of offences</b>
66	Non-disclosure of the amount of issued share capital in any statement concerning authorised share capital.
67	Failure to mention the name of a shareholder that holds more than 25 per cent of the issued shares in a bank.
69A(14)	Failure or refusal by a person to co-operate with a commissioner investigating the affairs of a bank under curatorship.
70(2), 70(2A), (2B), 70(A)	A bank failing to meet its required minimum share capital and unimpaired reserve funds.
72	A bank failing to meet its required minimum liquid asset requirement.
73	A bank failing to meet its required large exposure requirement.
74(3)	A bank that pays dividends while a shortfall on its prudential requirements as per Section 70 and 72 exists.
75	Failure to furnish the prescribed returns to the Registrar.
76	Failure to heed the restrictions on investments, loans and advances to subsidiaries.
77	Failure to heed the restrictions on investments, loans and advances to certain associates.
78(1), (2), (3)	A bank involved in undesirable practices.
79	The issue of shares, debentures, negotiable certificates of deposit and share warrants without the written approval of the Registrar.
80	Performing activities prohibited by the Registrar.
82(3)	A person who fails to comply with the Registrar's right to exact information by unregistered persons.
83(3)(a)	Failure to repay money unlawfully obtained.
84(2), (8)	Prohibition on the management and control of repayment of money unlawfully obtained.

Source: Author (2008)

### 3.2.2 Basic Conditions of Employment Act, 1997

The following table details offences because of non-compliance with the different sections of the Basic Conditions of Employment Act, 1997.

Table 3.2: Detail of offences in the Basic Conditions of Employment Act, 1997

<b>Section</b>	<b>Detail of offences</b>
43	Employing a child who is under 15 years of age; or who is under the minimum school-leaving age in terms of any law, if this is 15 or older. Having a child in employment that is inappropriate for a person of that age; or places at risk the child's well-being, education, physical or mental health, or spiritual, moral or social development.
44	Employing a child in non-compliance of regulations to prohibit or place conditions on the employment of children who are at least 15 years of age and no longer subject to compulsory schooling in terms of any law.
46	Assisting an employer to employ a child in contravention of this Act; or discriminating against a person who refuses to permit a child to be employed in contravention of this Act.
48	Using forced labour.
90(1)	Disclosing information acquired while exercising or performing any power or duty in terms of this Act which relates to the financial or business affairs of any other person.
90(3)	Releasing details of any medical examination performed in terms of this Act except if required by law or court order; or if the employee has in writing consented to the release of that information.
92	Obstructing or attempting to influence improperly a person who is performing a function in terms of this Act.

Source: Author (2008)

### 3.2.3 Companies Act, 1973 as amended in 2004 (Act 20 of 2004)

The following table details offences because of non-compliance with the different sections of the Companies Act, 1973.

Table 3.3: Detail of offences in Companies Act, 1973

Section	Detail of offences
15A	Failure to adhere to a notice by the Minister in writing prohibiting the company from disclosing, or from stating in any document of the company particular information concerning the affairs or business of the company, or that of any of its subsidiaries.
37	Failure by any director or officer of a company to declare and/or authoring or permitting or is a party to the employment of funds of a company in a loan or security to any company which is its holding company or subsidiary.
38	Giving, directly or indirectly, by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of any shares of the company, or in the event of a subsidiary company, its holding company.
46	Failure to comply with any order issued by the Registrar for the change of a name or translated name of a company or a shortened form of a name or translated name of a company.
49	Failure to meet the formal requirements regarding the names of companies or in any way using a name in contravention of this Act.
50	Failure to comply with the requirements regarding the display of the name on the outside of its registered office, not mentioning the name and registration number in legible characters in all notices and other official publications, not using the abbreviations "Ltd." or "Bpk." and using the shortened form of the name or translated name unless it is used in conjunction with the name or translated name.
51	Trading or conducting business under a name or title of which the word "Limited" or "Incorporated" is the last word.
58	Failure to lodge an altered memorandum.
67	Not recognising the members' rights to copies of memorandum and articles.
68	Failure to issue copies of memorandum or articles that embody alterations.
80	Paying commission to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any shares of the company, or of his procuring or agreeing to procure subscriptions, whether absolute or conditional without its disclosure in a statement in the prescribed form.
81	Failure to disclose in the prospectus the discount allowed on the issue of shares or of so much of that discount as has not been written off at the date of the issue of the prospectus.
90	Making any payment to shareholders with reasonable grounds for believing that the company is, or would - after the payment - be unable to pay its debts or the consolidated assets after the payment will be less than the consolidated liabilities.

Table 3.3: Detail of offences in Companies Act, 1973 (continued)

Section	Detail of offences
93	Failure to keep at its registered office or at the office where it is made up, a register of allotments of shares.
96	Not adhering to the time limit when completing and readying for delivery the certificates of all shares, the debentures or the certificates of all debenture stock allotted.
98	Failure to give notice in the prescribed form to the Registrar specifying the details of any redeemable preference shares that were redeemed.
102	Failure to lodge with the Registrar, in the prescribed form, the particulars of the consent authorising the variation of the rights attached to any class of shares of the company.
112	Failure to comply with the requirements relating to the register of members, index to register of members, branch registers in foreign countries and provisions as to branch register.
113	Refusing to allow the inspection of the register of members after a written request to that effect has been delivered.
131	Failure to comply with the requirements regarding the register of pledges, cessions, bonds and the registering of debenture-holders.
132	Intention to defraud, forge, alter, offer, utter or dispose of, knowing it to be forged or altered, any certificate as to shares, debentures or other securities, any broker's transfer form, certified broker's form, share warrant or coupon issued.
139	Refusal to send to the transferor and the transferee notice of the refusal if a company refuses to register a transfer of any shares or debentures.
140A	Failure to disclose a beneficial interest in securities as required.
141	Making an offer of shares for sale to the public, distributing or publishing any such material which in its form and context is calculated to be understood as an offer as aforesaid without it being accompanied by a statement containing the particulars required.
143	Offering to the public any shares of any company or body corporate which is not a company or external company within the meaning of this Act.
145	Offering to the public the subscription for shares without an accompanying prospectus complying with the requirements of this act and registered in the Companies Registration Office.
145A	Issuing, distributing or delivering, or causing to be issued, distributed or delivered a letter of allocation unless it is accompanied by such documents as are required and have been approved by the stock exchange concerned.

Table 3.3: Detail of offences in Companies Act, 1973 (continued)

<b>Section</b>	<b>Detail of offences</b>
146	Making any offer to the public for the sale of any shares which have been, or have been agreed to be, allotted by the company concerned with a view to all or any of them being offered to the public without a prospectus complying with the requirements of this act and registered in the Companies Registration Office.
146A	Failure to lodge an application with the Registrar to issue a letter of allocation.
147(2)(a)	Issuing, distributing or delivering any form of application in respect of shares of a company, without the form being attached to a prospectus which has been registered in the Company's Registration Office.
147(2)(b)	Issuing, distributing or delivering any form of application in respect of shares of a company without the form bearing on the face of it the date of registration of the prospectus.
148	Issuing a prospectus in terms of this Act where the prospectus does not contain a fair presentation of the state of the affairs of the company, the shares of which are being offered and not stating at least the matters specified in, and set out the reports referred to in, Part I and Part II of Schedule 3 of this Act.
149	Issuing a prospectus not stating on the face of such prospectus that a copy thereof has been registered as required by this Act and not specifying or referring to statements included therein specifying any documents required by Sections 151 and 152.
156	Issuing a prospectus more than three months after the date of the registration thereof.
162	Publishing a prospectus and/or a report accompanying such prospectus containing a statement which is untrue.
164	Allotment of shares offered to the public for subscription and the acceptance of any offer to purchase any shares offered for sale to the public without the company having received the application concerned before the expiration of a period of four months after the date of registration of the prospectus.
165	Allotment of shares on any application made in pursuance of a prospectus for subscription without the amount being stated in that prospectus as the minimum amount which in the opinion of the directors of the company concerned must be raised by the issue of share.
166	Allotment or acceptance of shares without the application form being attached to the prospectus.
168	Not adhering to the minimum interval before the allotment or the acceptance of shares.

Table 3.3: Detail of offences in Companies Act, 1973 (continued)

<b>Section</b>	<b>Detail of offences</b>
169	Issuing a prospectus containing a statement to the effect that application has been or will be made for permission for the shares offered thereby to be dealt in on a stock exchange without complying with the requirements of such stock exchange.
170	Failure to have a postal address to which all communications and notices may be addressed; and a registered office to which all communications and notices may be addressed and at which all process may be served.
171	Failure to state the names of directors on trade catalogues, trade circulars and business letters of the company.
172	Commencement of business or exercising any borrowing powers without the Registrar having issued a certificate entitling the company to commence business.
179	Not holding general meetings known as such and described in the notices calling such meetings annual general meetings.
181	Refusal to call general meetings upon requisition by members.
185	Failure to circulate any notices of meetings, resolutions and statements as requested by members.
186	Failure to give notice to its members as to a resolution of which special notice is required to be given in terms of any provision of this Act shall have effect unless notice of the intention to move it has been given to the company not fewer than twenty-eight days before the meeting at which it is moved.
189	Allowing representation of members at meetings by proxies in contravention of the requirements of this Act.
192	Failure to grant an adjournment of the meeting upon any ground stated by a member at any meeting of a company.
200(5)	Failure to embody in or to annex to every copy of the articles issued after the registration of the resolution a copy of every special resolution.
200(6)	Default in lodging with the Registrar a copy of any particular special resolution, and notice or consent.
204	Failure to keep minutes of meetings of companies.
206	Refusing members the right to inspect minute books.
207	Circulating a report of the proceedings at any meeting of a company at the expense of the company without it containing a fair summary of all material questions and comments, relevant to any matter before the meeting.
211(6)	Failure to give consent to act as director or officer.

Table 3.3: Detail of offences in Companies Act, 1973 (continued)

Section	Detail of offences
211(7)	Publishing the name of any person as a director of the company when such person is not a director or has not validly been appointed as director of the company.
213	Any person accepting an appointment or acting as a director of a company whilst not having obtained such qualification shares.
215	Failure to have a register of directors and officers or not entering in the said register the name and date of appointment of the auditor of the company and the date and particulars of any change of such name and date of appointment.
216(5)	Failure by directors and others to the duties of the company in respect of the register.
218	Acting or being a director of a company after being disqualified from being appointed or acting as a director of any company.
219	Being a director of a company or participating in the management of any company after the Court made an order directing that, for such period as may be specified in the order, a person, director or officer shall not without the leave of the Court be a director of a company.
222	Provision in any memorandum or articles or in any resolution of a company authorising the directors to allot or issue any shares or debentures convertible into shares of the company at the discretion of the directors, authorising the allotment or issue of any such shares or debentures to any director of the company or his nominee, or to any body corporate which is or the directors of which are accustomed to act in accordance with the directions or instructions of such director or nominee, or at a general meeting of which such director or his nominee is entitled to exercise or control the exercise of one-fifth or more of the voting power, or to any subsidiary of such body corporate.
226	Making a loan to any director or manager or the company or its holding company or any other company which is a subsidiary of its holding company or provide any security to any person in connection with an obligation of such director, manager, company or other body corporate.
234	A director of a company not declaring his interest and full particulars thereof in a company as provided in this Act.
237	A director not declaring his interest and full particulars thereof at a meeting of directors as prescribed by Section 235 before entering into any proposed contract on behalf of the company.
238	Failure to state the full particulars of the interest in a contract by the director concerned, if such a director is in any way, whether directly or indirectly, materially interested in a contract or proposed contract which is placed before the company at any meeting thereof for confirmation or authorisation.

Table 3.3: Detail of offences in Companies Act, 1973 (continued)

<b>Section</b>	<b>Detail of offences</b>
239	Not recording declarations of interest in the minutes of the meeting at which the declaration was made or recorded in the minutes of the first meeting of directors held after the date of that declaration.
242	Failure to comply with any requirement in this Act with regard to the keeping of minutes of directors' and managers' meetings.
245	Failure to comply with any requirement in this Act with regard to the attendance register of directors' and managers' meetings.
249(1)	Making a false statement in any statement, return, report, certificate, financial statement or other document required by or for the purposes of any provision of this Act, whether in non-electronic or electronic format.
250	Concealing, destroying, mutilating, falsifying or making any false entry in or, with intent to defraud or deceive, making any erasure in any book (including any minute book), register, document, financial record or financial statement of any company.
251	Making, circulating or publishing any certificate, written statement, report or financial statement in relation to any property or affairs of the company.
252	Not lodging a copy of any order made which alters or adds to or grants leave to alter or add to the memorandum or articles of a company with the Registrar for registration.
253	Failure to provide information to the Registrar concerning shares and members as requested.
255	Failure to provide any information required under this section and which the person is able to provide.
256(5)	Disposing of any shares which are subject to restrictions or of any right to be issued with any such shares.
256(6)	A company and any director or office who knowingly participates in issuing shares in contravention of the said restrictions in this section.
260	Failure to produce all books and documents of or relating to the company or other body corporate, in his custody or under his control at the request of an inspector.
268(c)	Failure to appoint a secretary within two months of being ordered to do so by the Registrar or the Court.
268H	Failure to state the first names, or the initials thereof, and the surname of the secretary of a public company on every trade catalogue, trade circular and business letter bearing the company's name.
268I	Failure to notify the Registrar of the resignation or removal of a secretary.

Table 3.3: Detail of offences in Companies Act, 1973 (continued)

<b>Section</b>	<b>Detail of offences</b>
269	Failure to appoint an auditor within 21 days of the incorporation date of the company.
271	Not notifying Registrar within seven days where the company fails to appoint an auditor.
275	Being appointed as an auditor of a company whilst being a director, officer or employee of the company who is not qualified to act as such under the Public Accountants' and Auditors' Act, 1991 (Act No. 80 of 1991).
276(5)	Failure to lodge a return in respect of particulars pertaining to the auditor of the company.
284	Failure to keep in one of the official languages of the Republic such accounting records that fairly present the state of affairs and business of the company and explain the transactions and financial position of the trade or business of the company.
286	Failure to take all reasonable steps to comply with the requirements as to matters to be stated in annual financial statements.
287	Issuing incomplete financial statements and circulars.
288	Failure to lay group statements before the annual general meeting of a company.
291	Not obtaining approval from the Registrar where group annual financial statements are not dealing with a subsidiary.
295	Failure to disclose loans to and security for the benefit of directors and managers.
297	Failure by a director or past director of a company to disclose directors' emoluments and pensions.
298	Issuing, circulating or publishing a copy of any annual financial statements, or group annual financial statements which have not been approved and signed as required by this Act.
299	Failure to present to the annual general meeting a report by the directors with respect to the state of affairs, the business as well as the profit or loss of the company or of the company and its subsidiaries, if any.
302	Failure to send the annual financial statements to members and Registrar of Companies.
308	Failing to comply with any requirements with regard to half-yearly interim reports, provisional annual financial statements, form and contents of interim report and provisional annual financial statements and copies of interim report and provisional annual financial statements to be lodged with Registrar.
309	Failure to provide copies of annual financial statements and interim reports.

Table 3.3: Detail of offences in Companies Act, 1973 (continued)

Section	Detail of offences
311	Failure to attach a copy of an order of court to every copy of the memorandum of the company issued after the date of the order in connection with the compromise and arrangement between company and its members and creditors.
312(4)	Default in complying with the duty to give notice to the company of such matters as may be necessary for the purposes of this section of the Act.
312(5)	Failure to notify the company with information with regard to personal compromises and arrangements as required by this Act.
331(1)	Issuing or sending to any person in the Republic any trade catalogue, trade circular or business letter bearing the company's name without the names of its directors, their nationality if not South African, the names of its local managers and its local secretary being stated therein.
333(1)	Failure to comply with the requirements placed on external companies in terms of auditors, directors, accounting records and financial statements.
356	Failure to give notice of the winding-up of a company.
357	Failure to give notice of the winding-up of a company to certain officials.
363	Failure to lay a statement as to the affairs of the company before a meeting convened for the purpose of passing a resolution for the voluntary winding-up of a company.
363A	Failure to notify the liquidator by registered post of a new residential or postal address within fourteen days after such change.
365	Giving or offering a reward with a view to securing a nomination or appointment as a company's liquidator.
414	Failure to attend the first and second meetings of creditors of the company or any subsequent meetings in the event of any winding-up of a company unable to pay its debts.
418	Refusing an examination by commissioners.
421	Failure by a liquidator to furnish a statement as to which director, in his opinion, was the effective cause of the company being unable to pay its debts.
424	Knowingly conducting business recklessly or with such intent.
440D	Giving false evidence, after having been sworn or having made affirmation, before the panel or a committee thereof on any matter, knowing such evidence to be false or not believing it to be true.

Table 3.3: Detail of offences in Companies Act, 1973 (continued)

<b>Section</b>	<b>Detail of offences</b>
440F	Dealing in a security on the basis of unpublished price-sensitive information in respect of that security if such information has been obtained by virtue of a relationship of trust or any other contractual relationship; or through espionage, theft, bribery, fraud, misrepresentation or any other wrongful method, irrespective of the nature thereof.
440I	Disclosure of information acquired by a person in the exercise of powers or the performance of duties in terms of this Act and relating to the business or affairs of any person.

Source: Author (2008)

### 3.2.4 Competition Act, 1998

The following table details offences because of non-compliance with the different sections of the Competition Act, 1998.

Table 3.4: Detail of offences in Competition Act, 1998

<b>Section</b>	<b>Detail of offences</b>
69	Disclosing any confidential information concerning the affairs of any person or firm obtained in carrying out any function in terms of this Act; or as a result of initiating a complaint or participating in any proceedings in terms of this Act.
70	Hindering, opposing, obstructing or unduly influencing any person who is exercising a power or performing a duty delegated, conferred or imposed on that person by this Act.
71	Failure to attend when summoned.
72	Failure to answer fully or truthfully.
73(1)	Contravening or failing to comply with an interim or final order of the Competition Tribunal or the Competition Appeal Court.
73(2)	Improperly influencing, anticipating any findings, knowingly providing false information, wilfully interrupting the proceedings or misbehaving, and defaming the Competition Tribunal or Competition Commission.

Source: Author (2008)

### 3.2.5 Consumer Act (Unfair Business Practices), 1988

The following table details offences because of non-compliance with the different sections of the Consumer Act, 1988.

Table 3.5: Detail of offences in Consumer Act, 1988

<b>Section</b>	<b>Detail of offences</b>
6(3)	Failure to adhere to a notice given by the committee to furnish the committee, within a period specified in the notice, or from time to time at the times or within the periods so specified, with a written return showing in detail such information in respect of the business or activities of that person as may be specified in the notice.
12(7)	Failure to adhere to a notice in the <i>Gazette</i> stating that the unfair business practice to be unlawful, and direct any person who in the opinion of the Minister is concerned in the unfair business practice to take such action, including steps for the dissolution of any body, corporate or unincorporated, or the severance of any connection or form of association between two or more persons, including any such bodies as the Minister may consider necessary to ensure the discontinuance or prevention of the unfair business practice.
11(3)	Failure to adhere to a notice of such an arrangement or modified arrangement, together with the conditions, if any, subject to which it has been confirmed, as published by the Minister in the <i>Gazette</i> .

Source: Author (2008)

### 3.2.6 Electronic Communications and Transactions Act, 2002

The following table details offences because of non-compliance with the different sections of Electronic Communications and Transactions Act, 2002

Table 3.6: Detail of offences in the Electronic Communications and Transactions Act, 2002

<b>Section</b>	<b>Detail of offences</b>
37(3)	Falsely holding out products or services to be accredited by the Accreditation Authority.
40(2)	Falsely holding out its products or services to have been duly recognised by the Minister.

Table 3.6: Detail of offences in the Electronic Communications and Transactions Act, 2002 (continued)

<b>Section</b>	<b>Detail of offences</b>
58(2)	Failing to take remedial action within the period stated in the notice which incorporates the finding of the audit report, the action required to remedy the non-compliance, and the period within which the remedial action must be performed.
80(5)	Falsely pretending to be a cyber inspector.
82(2)	Refusing to co-operate or hindering a person who is conducting a lawful search and seizure in terms of this section.
86(1)	Intentional access or interception of any data without authority or permission to do so.
86(2)	Intentional and without the allocated authority, interfering with data in a way which causes such data to be modified, destroyed or otherwise rendered ineffective.
86(3)	Unlawfully producing, selling, offering to sell, procuring for use, designing, adapting for use, distributing or possessing any device, including a computer program or a component, which is designed primarily to overcome security measures for the protection of data, or performing any of those acts with regard to a password, access code or any other similar kind of data with the intent to unlawfully utilise such item to contravene this section.
86(4)	Utilising any device or computer program mentioned in subsection (3) in order to unlawfully overcome security measures designed to protect such data or access thereto.
86(5)	Committing any act described in this section with the intent to interfere with access to an information system so as to constitute a denial, including a partial denial, of service to legitimate.
87(1)	Performing or threatening to perform any of the acts described in Section 86, for the purpose of obtaining any unlawful proprietary advantage by undertaking to cease or desist from such action, or by undertaking to restore any damage caused as a result of those actions.
87(2)	Performing any of the acts described in Section 86 for the purpose of obtaining any unlawful advantage by causing fake data to be produced with the intent that it be considered or acted upon as if it were authentic.

Source: Author (2008)

### **3.2.7 Employment Equity Act, 1998**

The following table details offences because of non-compliance with the different sections of the Employment Equity Act, 1998

Table 3.7: Detail of offences in the Employment Equity Act, 1998

<b>Section</b>	<b>Detail of offences</b>
59	Disclosing any confidential information acquired in the performance of a function in terms of this Act.
61	Obstructing or attempting to improperly influence any person who is exercising a power or performing a function in terms of this Act; or knowingly giving false information in any document or information provided to the Director-General or a labour inspector in terms of this Act.

Source: Author (2008)

### 3.2.8 Financial Advisory and Intermediary Services Act, 2002

The following table details offences because of non-compliance with the different sections of the Financial Advisory and Intermediary Services Act, 2002.

Table 3.8: Detail of offences in the Financial Advisory and Intermediary Services Act, 2002

<b>Section</b>	<b>Detail of offences</b>
7(1)	Acting or offering to act as a financial services provider without having been issued with a licence.
8(8)	<ul style="list-style-type: none"> <li>- Failing to display a certified copy of the licence in a prominent and durable manner within every business premises of the licensee;</li> <li>- Failing to ensure that a reference to the fact that such a licence is held is contained in all business documentation, advertisements and other promotional material ;</li> <li>- Failing to ensure that the licence is at all times immediately or within a reasonable time available for production to any person requesting proof of licensed status under authority of a law or for the purpose of entering into a business relationship with the licensee.</li> </ul>
13(1)	Rendering financial services to clients for, or on behalf of any person who is not authorised as a financial services provider; and is not exempted from the application of this Act relating to the rendering of a financial service.

Table 3.8: Detail of offences in the Financial Advisory and Intermediary Services Act, 2002 (continued)

<b>Section</b>	<b>Detail of offences</b>
14(1)	Failure by an authorised financial services provider to ensure that any representative of the provider who no longer complies with the requirements referred to in Section 13(2)(a), is prohibited by such provider from rendering any new financial service by withdrawing any authority to act on behalf of the provider, and that the representative's name, and the names of the key individuals of the representative, are removed from the register.
18	Failing to maintain records for a minimum period of five years regarding known premature cancellations of transactions or financial products by clients of the provider, complaints received together with an indication whether or not any such complaint has been resolved, the continued compliance with the requirements referred to in Section 8, cases of non-compliance with this Act, and the reasons for such non-compliance; and the continued compliance by representatives with the requirements referred to in Section 13(1) and (2).
19(2)	Failing to let the financial statements be audited and reported on by an external auditor approved by the Registrar and not submitting the statements and reports to the Registrar within six months after the end of the financial year or such longer period as may be allowed by the Registrar.
34(4)	Carrying on the business practice on or after the date of the publication of a notice regarding the termination of the practice.
34(6)	Failing to rectify or reinstate to the satisfaction of the Registrar any loss or damage which was caused by or arose out of the carrying on of the business practice concerned in contravention of a notice.
36	Deliberately making a misleading, false or deceptive statement, or concealing any material fact in any application in terms of this Act.

Source: Author (2008)

### 3.2.9 Financial Intelligence Act, 2001

The following table details offences because of non-compliance with the different sections of the Financial Intelligence Act, 2001.

Table 3.9: Detail of offences in the Financial Intelligence Act, 2001

<b>Section</b>	<b>Detail of offences</b>
46	Performing any act to give effect to a business relationship or single transaction and failing to identify persons involved.
47	Failure to keep records on a business relationship or single transaction.
48	Wilfully destroying or tampering with records.
49	Failure to give assistance to a representative of the Centre.
50	Failure to advise the Centre of client.
51	Failure to report cash transactions within the prescribed period to the Centre, in respect of such a cash transaction.
52	Failure to report within the prescribed period to the Centre the prescribed information in respect of a suspicious or unusual transaction or series of transactions.
53	Unauthorised disclosure of information as described in this Act.
54	Wilful failure to report conveyance of cash into or out of the Republic.
55	Failure to send to the Centre a report regarding the conveyance of cash.
56	Failure to report to the Centre on electronic transfer of money.
57	Failure to comply with a request from the Centre or investigating authority acting under the authority of an authorised officer.
58	Failure to comply with a direction by the Centre.
59	Failure to comply with monitoring order by a judge.
60	Disclosure of confidential information obtained from the Centre or wilful destroying of, and/or tampering with information obtained from the Centre.
61	Failure to formulate and implement internal rules.
62	Failure to provide training to or appoint a compliance officer.
63	Obstructing, hindering or threatening an official or representative of the Centre in the performance of duties or the exercise of their powers in terms of this Act.
64	Conducting or causing to be conducted, two or more transactions with the purpose, in whole or in part, of avoiding giving rise to a reporting duty under this Act.
65	Wilfully accessing or causing any other person to access any computer system that belongs to, or is under the control of, the Centre, or any application or data held in such a computer.
66	Unauthorised modification of contents of computer system that belongs to, or is under the control of, the Centre.

Source: Author (2008)

### 3.2.10 Income Tax, 1962

The following table details offences because of non-compliance with the different sections of the Income Tax Act, 1962 including all amendments up to 2005.

Table 3.10: Detail of offences in the Income Tax Act, 1962

Section	Detail of offences
4	Not preserving secrecy whilst employed or engaged by the Commissioner in carrying out the provisions of this Act.
12G	Every employee of the Department of Trade and Industry and every member of the adjudication committee not preserving secrecy or using their position or any information entrusted to them, to enrich themselves or improperly benefit any other person.
30	Any person who is in a fiduciary capacity responsible for the management or control of the income and assets of any approved public benefit organisation who intentionally fails to comply with any provision of this section or of the constitution, will or other written instrument under which such organisation is established to the extent that it relates to the provisions of this section.
37H	Members and employees of the board not preserving secrecy with regard to all matters that may come to their knowledge in the performance of their functions in terms of this section, and communicating any such matter to any person.
66	Using an electronic or digital signature of any other person in any electronic communication to the Commissioner for any purpose, without the consent and authority of such person.
75	Failure to furnish any return, information or reply, within any period deemed by the Commissioner to be reasonable and of which notice has been given by the Commissioner, to furnish the return, information or reply in respect of which the offence was committed.
104	Intention to evade or to assist any other person in evading assessment or taxation, making any false statement or entry in any return rendered in terms of this Act, or signs any statement or return so rendered without reasonable grounds for believing the same to be true.

Table 3.10: Detail of offences in the Income Tax Act, 1962 (continued)

<b>Section</b>	<b>Detail of offences</b>
Fourth schedule: 30	<ul style="list-style-type: none"> <li>- Making any payment of remuneration and failing to deduct or withhold any amount of employees' tax or to pay such amount to the Commissioner;</li> <li>- Using or applying any amount deducted or withheld by way of employees' tax for purposes other than the payment of such amount to the Commissioner;</li> <li>- Making or issuing any employees' tax certificate which is false,</li> <li>- Giving any false information or misleading an employer in relation to any matter affecting the amount of employees' tax to be deducted;</li> <li>- Failing or neglecting to deliver to any employee or former employee an employees' tax certificate;</li> <li>- Failing to comply with any condition prescribed in terms of the manner in which employees' tax certificates may be used or as to the surrender of unused stocks of such certificates, or to account for used, unused or spoiled employees' tax;</li> <li>- Failing or neglecting to maintain any record as required or to retain such record for a period of five years from the date of the last entry therein or to furnish to the Commissioner any declaration as required by that paragraph;</li> <li>- Failing or neglecting to apply to the Commissioner for registration as an employer as required or having so applied failing or neglecting to notify the Commissioner of any change of address or the fact of it having ceased to be an employer;</li> <li>- Altering any employees' tax certificate made or issued by any other person or falsely pretending to be the employee named in any employees' tax certificate or for his own advantage or benefit obtaining credit with respect to or payment of the whole or any part of any amount of employees' tax deducted or withheld from remuneration received by another person;</li> <li>- Not being an employer and without being duly authorised by any person who is an employer, issuing or causing to be issued any document purporting to be an employees' tax certificate;</li> <li>- Failing to submit to the Commissioner any estimate of taxable income as required.</li> </ul>
Seventh schedule: 17	Issuing any certificate which is false.

Source: Author (2008)

### 3.2.11 Labour Relations Act, 1995

The following table details offences because of non-compliance with the different sections of the Labour Relations Act, 1995

Table 3.11: Detail of offences in the Labour Relations Act, 1995

<b>Section</b>	<b>Detail of offences</b>
201	Disclosure of any information relating to the financial or business affairs of any other person or any business, trade or undertaking if the information was acquired by the first-mentioned person in the performance of any function or exercise of any power in terms of this Act.

Source: Author (2008)

### 3.2.12 Medical Schemes Act, 1998

The following table details offences because of non-compliance with the different sections of the Medical Schemes Act, 1998

Table 3.12: Detail of offences in the Medical Schemes Act, 1998

<b>Section</b>	<b>Detail of offences</b>
21A (1)	Marketing, advertising or in any other way promoting the business of any person in a manner likely to create the impression that such person conducts, will conduct, or is entitled to conduct, the business of a medical scheme unless that person is registered as a medical scheme in terms of this Act.
21A(3)	Marketing, advertising or in any other way promoting a medical scheme in a manner likely to create the impression that membership of such medical scheme is conditional upon an applicant purchasing or participating in any product, benefit or service provided by a person other than the medical scheme in terms of its rules.
35	Failure to comply with any provision pertaining to the financial arrangements of a medical aid.
50(21)	Wilfully interrupting the proceedings of the Appeals Board or wilfully hindering or obstructing the Appeals Board in the performance of its functions.
50(22)	Failure to attend and give evidence or to produce any book, document or object before the Appeal.

Table 3.12: Detail of offences in the Medical Schemes Act, 1998 (continued)

Section	Detail of offences
50(23)	Giving false evidence under oath or confirmation before the Appeals Board on any matter knowing that such evidence is false or not knowing or believing it to be true.
55	Failure to comply with the requirements with regards to the information for agreeing to a compromise.
64	Failure to comply with the requirements regarding a medical scheme's voluntary or automatic dissolution.
66	<ul style="list-style-type: none"> <li>- Contravening any provision of this Act;</li> <li>- Making or causing any claim for the payment of any benefit allegedly due in terms of the rules of a medical scheme, knowing such claim to be false;</li> <li>- Knowingly making or causing a false representation of any material fact to a medical scheme, for use in determining any right to any benefit allegedly due in terms of the rules of the medical scheme;</li> <li>- Having knowledge of any fact or the occurrence of any event affecting the right to receive any benefit in terms of the rules of a medical scheme, and failing to disclose such fact or event to the medical scheme with the intent to obtain from the medical scheme a benefit;</li> <li>- Rendering a statement, account or invoice to a member or any other person, knowing that such statement, account or invoice is false and which may be used by such member or other person to claim from a medical scheme any benefit or a benefit greater than the benefit to which he or she is entitled in terms of the rules of the medical scheme.</li> </ul>

Source: Author (2008)

### 3.2.13 National Credit Act, 2006

The following table details offences because of non-compliance with the different sections of the National Credit Act, 2006.

Table 3.13: Detail of offences in the National Credit Act, 2006

Section	Detail of offences
156	Disclosure of any confidential information concerning the affairs of any person or juristic person obtained in carrying out any function in terms of this Act.
157	Hindering, opposing, obstructing or unduly influencing any person who is exercising a power or performing a duty delegated, conferred or imposed on that person by this Act.
158	Failure without sufficient cause to appear at a hearing at the time and place specified, or to attend as required, but refusing to be sworn in or to make an affidavit; or failing to produce a book, document or other item as ordered, if it is in the possession of, or under the control of, that person.
159	Failure to answer any question or giving false evidence, knowing or believing it to be false.
160(1)	Failure to comply with an order of the Tribunal.
160(2)	<ul style="list-style-type: none"> <li>- Improperly influencing the Tribunal or a regulator concerning any matter connected with an investigation;</li> <li>- Anticipating any findings of the Tribunal or a regulator concerning an investigation in a way that is calculated to influence the proceedings or findings;</li> <li>- Doing anything in connection with an investigation that would have been contempt of court if the proceedings had occurred in a court of law;</li> <li>- Knowingly providing false information to a regulator;</li> <li>- Defaming the Tribunal or a member of the Tribunal, in their respective official;</li> <li>- Wilfully interrupting the proceedings of a hearing or misbehaving in the place where a hearing is being conducted;</li> <li>- Acting contrary to a warrant to enter and search;</li> <li>- Without authority, but claiming to have authority in terms of section;</li> <li>- Entering or searching premises;</li> <li>- Attaching or removing an article or document.</li> </ul>

Source: Author (2008)

### 3.2.14 Occupational Health and Safety Act, 1993

The following table details offences because of non-compliance with the different sections of the Occupational Health and Safety Act, 1993.

Table 3.14: Detail of offences in the Occupational Health and Safety Act,  
1993

<b>Section</b>	<b>Detail of offences</b>
7	Failure to formulate and display a Health and Safety Policy.
8	Failure to provide and maintain, as far as is reasonably practicable, a working environment that is safe and without risk to the health of employees.
9	Failure to conduct an undertaking in such a manner as to ensure, as far as is reasonably practicable, that persons other than those in its employment who may be directly affected by its activities are not thereby exposed to hazards to their health or safety.
10(1)	Designing, manufacturing, importing, selling or supplying any article for use at work that is not safe and without risks to health when properly used.
10(2)	Erecting or installing any article for use at work on or in any premises in such a manner that makes it unsafe or creates a risk to health when properly used.
10(3)	Designing, manufacturing, importing, selling or supplying any substance for use at work shall that is not safe and without risks to health when properly used, and not taking such steps as may be necessary to ensure that information is available with regard to the use of the substance at work, the risks to health and safety associated with such substance, the conditions necessary to ensure that the substance will be safe and without risks to health when properly used and the procedures to be followed in the case of an accident involving such substance.
12	Failure to comply with the requirements of listed work.
13	Failure to inform every employee about the hazards to his health and safety attached to any work which he has to perform.
14	Failure by employees in their general duties concerning health and safety at work.
15	Intentionally or recklessly interfering with, damaging or misusing anything which is provided in the interest of health or safety.
16(1)	Chief Executive Officer not performing certain duties.
16(2)	Chief Executive Officer delegating responsibility or liability in terms of subsection (1), by assigning any duty contemplated in the said subsection to any person under his control.
17(1)	Failure to appoint Health and Safety Representatives where the employer has more than 20 employees in his employment at any workplace.
17(2)	Failure to consult in good faith regarding the arrangements and procedures for the nomination or election, period of office and subsequent designation of health and safety.

Table 3.14: Detail of offences in the Occupational Health and Safety Act, 1993 (continued)

Section	Detail of offences
17(5)	Failure to comply with the number of health and safety representatives for a workplace or section thereof.
17(6)	Inadequate number of safety representatives.
18(3)	Not providing such facilities, assistance and training as a health and safety representative may reasonably require and as have been agreed upon for the carrying out of his functions.
19(1)	Not establishing a health and safety committee.
19(4)	A health and safety committee not holding meetings.
19(7)	Not adhering to an inspector's written directive directing the employer to establish for such workplace such number of health and safety committees as the inspector may determine.
20(2)	Not keeping a record of each recommendation made to an employer and of any report made to an inspector.
20(4)	Failure to take the prescribed steps to ensure that a health and safety committee complies with the provisions relating to meetings held and performing the duties assigned to it.
21(1)	Failing to adhere to a notice by the Minister prohibiting an activity which threatens or is likely to threaten the health or safety of an employee belonging to that category of employees, or that no employer shall require or permit any such employee to perform any work on or in such premises.
22	Selling or marketing in any manner whatsoever any article, substance, plant, machinery or health and safety equipment unless it complies with the requirements of any health and safety standard.
23	Deducting from any employee's remuneration or requiring or permitting any employee to make any payment to the employer or any other person in respect of anything which the employer is required to provide or to do in the interest of the health or safety of an employee.
24(1)	Failure to report to inspectors certain information regarding incidents at work.
24(2)	Disturbing the site at which the incident occurred or removing any article or substance involved in the incident, in the event of an incident in which a person died, or was injured to such an extent that he is likely to die, or suffered the loss of a limb or part of a limb, without the consent of an inspector.
25	Failure to report within the prescribed period and in the prescribed manner the case in terms of the Workmen's Compensation Act, 1941 (Act No. 30 of 1941).

Table 3.14: Detail of offences in the Occupational Health and Safety Act,  
1993 (continued)

<b>Section</b>	<b>Detail of offences</b>
26	Dismissing an employee, or reducing the rate of remuneration, or altering the terms or conditions of employment to terms or conditions less favourable to the employee, or altering the employee's position relative to other employees employed by that employer to the employee's disadvantage.
29(3)	Not providing facilities as are reasonably required by an inspector to enable him and his assistant (if any) to perform effectively and safely his or their functions under this Act.
30(2)	Interfering with or removing a blocking, bar, barricade or fence imposed by an inspector in the workplace or plant.
30(3)	Not adhering to an inspector's direction whenever an inspector is of the opinion that the health or safety of any person at a workplace or in the course of his employment or in connection with the use of plant or machinery is threatened on account of the refusal or failure of an employer or a user, as the case may be, to take reasonable steps in the interest of such person's health or safety.
30(4)	Not adhering to an inspector's direction issued whenever an inspector is of the opinion that an employer or a user has failed to comply with an applicable provision of a regulation.
30(6)	Not bringing the contents of a prohibition, direction or notice under this section to the attention of the health and safety representatives and employees concerned.
34	Obstructing an investigation or inquiry or presiding inspector or failure to render assistance.
36	Disclosing information concerning the affairs of any other person obtained in terms of this Act.

Table 3.14: Detail of offences in the Occupational Health and Safety Act, 1993 (continued)

<b>Section</b>	<b>Detail of offences</b>
38(1) d-p	<ul style="list-style-type: none"> <li>- Wilfully furnishing information or making a statement which is false in any material respect;</li> <li>- Hindering or obstructing an inspector in the performance of his functions;</li> <li>- Refusing or failing to comply to the best of his ability with any requirement or request made by an inspector in the performance of his functions;</li> <li>- Refusing or failing to answer to the best of his ability any question which an inspector in the performance of his functions has put to him;</li> <li>- Wilfully furnishing to an inspector information which is false or misleading;</li> <li>- Giving himself out as an inspector;</li> <li>- Failing to attend on the day and at the place specified in the subpoena, or failing to remain in attendance until the inspector has excused him from further attendance;</li> <li>- Refusing to appear before the inspector; refusing to be sworn in or to make affirmation as a witness after he has been directed to do so; refusing to answer, or failing to answer to the best of his knowledge and belief, any question put to him; or refusing to comply with a requirement to produce a book, document or thing specified in the subpoena or which he has with him;</li> <li>- Tampering with or discouraging, threatening, deceiving or in any way unduly influencing any person with regard to evidence to be given or with regard to a book, document or thing to be produced by such a person before an inspector under Section 32;</li> <li>- Prejudices, influences or anticipates the proceedings or findings of an inquiry under Section 32 or Section 33;</li> <li>- Tampering with or misusing any safety equipment installed or provided to any person by an employer or user;</li> <li>- Failing to use any safety equipment at a workplace or in the course of his employment or in connection with the use of plant or machinery, which was provided to him by an employer or such a user;</li> <li>- Wilfully or recklessly doing anything at a workplace or in connection with the use of plant or machinery which threatens the health or safety of any person.</li> </ul>
38(2)	<p>Doing or omitting to do an act, causing any person to be injured at a workplace, or, in the case of a person employed by him, to be injured at any place in the course of his employment, or any user doing or omitting to do an act in connection with the use of plant or machinery, thereby causing any person to be injured.</p>

Source: Author (2008)

### 3.2.15 Promotion of Access to Information Act, 2000

The following table details offences because of non-compliance with the different sections of the Promotion of Access to Information Act, 2000.

Table 3.15: Detail of offences in the Promotion of Access to Information Act, 2000

<b>Section</b>	<b>Detail of offences</b>
90	<ul style="list-style-type: none"> <li>- Destroying, damaging or altering a record;</li> <li>- Concealing a record; or</li> <li>- Falsifying a record or making a false record.</li> </ul>

Source: Author (2008)

### 3.2.16 Skills Development Act, 1998

The following table details offences because of non-compliance with the different sections of the Skills Development Act, 1998.

Table 3.16: Detail of offences in the Skills Development Act, 1998

<b>Section</b>	<b>Detail of offences</b>
33	<ul style="list-style-type: none"> <li>- Obstructing or attempting to improperly influence a person who is performing a function in terms of this Act;</li> <li>- Obtaining or attempting to obtain any prescribed document by means of fraud, false pretences or by submitting a false or forged prescribed document;</li> <li>- Furnishing false information in any prescribed document knowing that information to be false;</li> <li>- Providing employment services for gain without being registered;</li> <li>- Conducting the business of a private employment services agency in contravention of this Act or any other prescribed requirement.</li> </ul>

Source: Author (2008)

### 3.2 17 Tobacco Products Control Act, 1993

The following table details offences because of non-compliance with the different sections of the Tobacco Products Control Act, 1993.

Table 3.17: Detail of offences in the Tobacco Products Control Act, 1993

Section	Detail of offences
2(1)	Failure to comply with any notice issued prohibiting the smoking of tobacco products in any public place.
3	<ul style="list-style-type: none"> <li>- Advertising, including the use of tobacco trade marks, logos, brand names or company names used on tobacco products;</li> <li>- Using tobacco trade marks, logos, brand names or company names used on tobacco products for the purposes of advertising any organisation, service activity or event;</li> <li>- A manufacturer, importer, distributor or retailer of tobacco products organising or promoting any organised activity that is to take place, making any financial contribution to any organised activity that is to take place, making any financial contribution to any person in respect of the organisation or promotion of any organised activity, or participation, by that person, in any organised activity that is to take place, or is taking place in whole or in part, in the Republic;</li> <li>- Selling or importing for subsequent sale any prescribed tobacco product without the product being packaged, the package in which the tobacco product is sold bearing the prescribed warning concerning the health hazards incidental to the smoking of tobacco products, and the quantities of the constituents present in the tobacco product concerned being stated on the package.</li> </ul>
3A	Failure to comply with the provisions regarding the declaration of the maximum permissible levels of tar, nicotine and other constituents which tobacco products may contain and the maximum yield of any such substance that may be obtained there from.
4A	<ul style="list-style-type: none"> <li>- A manufacturer, distributor, importer or retailer of a tobacco product giving for free or distributing at a reduced price any tobacco product or supplying any tobacco product to any person for subsequent distribution.</li> <li>- Offering any gift, cash rebate or right to participate in any contest, lottery or game, to any person in consideration of the purchase of a tobacco product, or the furnishing of evidence of such a purchase.</li> </ul>
4(1)	Selling or supplying any tobacco product to any person under the age of 16 years, whether for his personal use or not.
5	Selling tobacco products from vending machines which are accessible to persons under the age of sixteen years.

Source: Author (2008)

### 3.2.18 Unemployment Insurance Act, 2001

The following table details offences because of non-compliance with the different sections of the Unemployment Insurance Act, 2001.

Table 3.18: Detail of offences in the Unemployment Insurance Act, 2001

<b>Section</b>	<b>Detail of offences</b>
61	Causing any loss or damage to the Fund.
63	Disclosing information obtained in the performance of functions contained in this Act.
64	<ul style="list-style-type: none"> <li>- Knowingly making a statement or causing a statement to be made which is materially false or which results in an incorrect payment of benefits in an application for benefits in terms of this Act;</li> <li>- Wilfully making any false entry on a contributor's record card or any other book, record or document relating to either a contributor's employment history or to a contributor's claim for benefits;</li> <li>- Contravening, or refusing or failing to fully comply with any provision of this Act or of any regulation or notice of this Act.</li> </ul>

Source: Author (2008)

### 3.2.19 Unemployment Insurance Contributions Act, 2002

The following table details offences because of non-compliance with the different sections of the Unemployment Insurance Contributions Act, 2002.

Table 3.19: Detail of offences in the Unemployment Insurance Contributions Act, 2002

<b>Section</b>	<b>Detail of offences</b>
17	<ul style="list-style-type: none"> <li>- Failure to pay any amount due in terms of this Act on the day determined for payment thereof;</li> <li>- Failure to submit or deliver any statement or other document or thing required to be submitted or delivered by or under this Act;</li> <li>- Failure to disclose any information required by or to answer any question under this Act;</li> <li>- Failure to attend and give evidence at an enquiry under this Act where duly required to do so;</li> </ul>

Source: Author (2008)

### 3.2.20 Value-Added Tax Act, 1991

The following table details offences because of non-compliance with the different sections of the Value-Added Tax Act, 1991.

Table 3.20: Detail of offences in the Value-Added Tax Act, 1991

<b>Section</b>	<b>Detail of offences</b>
14	Failure to comply with the requirements for the collection of value-added tax on imported services.
20(1)	Failure to issue a tax invoice within 21 days of supply.
23	Failure to register as a person making supplies in the course of business.
24(3)	Failure to notify the Commissioner of the ceasing of business.
25	Failure by vendor to notify change of status.
28(1), (2)	Failure to submit returns and calculate the payments of tax.
29, 30	Failure to submit special or any other returns.
48(7)	Failure to notify the Commissioner of the fact that he/she has become a representative vendor of that other person.
54(3), (5)	Failing to comply with the requirements for being an agent or auctioneer.
55	Failing to keep proper records.
58	<ul style="list-style-type: none"> <li>- Pretending to be an officer engaged in carrying out the provisions of this Act;</li> <li>- Pretending to be an officer authorised by the Commissioner or a judge for the purposes of the obtaining of information, documents or things, an inquiry or entry;</li> <li>- Refusing to produce or make available any information, documents or things, reply to or answer truly and fully, any questions, attend and give evidence, hindering or obstructing or assaulting any officer engaged in carrying out duties;</li> <li>-Failing to provide a recipient with a tax invoice, credit note or debit note as required by this Act;</li> <li>- Issuing a document purporting to be a tax invoice, or bearing the words 'tax invoice', if that document does not meet the requirements;</li> <li>- Using an electronic or digital signature of any other person in any electronic communication to the Commissioner for any purpose, without the consent and authority of such person.</li> </ul>

Table 3.20: Detail of offences in the Value-Added Tax Act, 1991  
(continued)

Section	Detail of offences
59	<ul style="list-style-type: none"> <li>- Intention to evade the payment of tax levied under this Act or to obtain any refund of tax under this act to which such person is not;</li> <li>- Making or causing or allowing any false statement or entry in any return rendered in terms of this Act, or signing any statement or return so rendered without reasonable grounds for believing the same to be true;</li> <li>- Giving any false answer, whether verbally or in writing, to any request for information made under this Act by the Commissioner or any person duly authorised by the Commissioner or any officer;</li> <li>- Preparing or maintaining or authorising the preparation or maintenance of any false books of account or other records or authorising the falsifications of any books of account or other records;</li> <li>- Making use of any fraud, art or contrivance whatsoever, or authorising the use of such fraud, art or contrivance;</li> <li>- Making any false statement for the purposes of obtaining any refund of or exemption from tax;</li> <li>- Receiving, acquiring possessing of or dealing with any goods or accepting the supply of any service, knowing or having reason to believe that the tax on the supply of the goods or services has been or will be evaded;</li> <li>- Knowingly issuing any tax invoice, credit note or debit note required under this Act which is in any material respect erroneous or incomplete;</li> <li>- Knowingly issuing any tax invoice showing an amount charged as tax where the supply in respect of which the tax is charged will not take place;</li> <li>- Fabricating, producing, furnishing or making use of any tax invoice, debit note, credit note, bill of entry or other document contemplated in that section knowing the same to be false.</li> </ul>
65	Prices advertised or quoted do not include tax.

Source: Author (2008)

### 3.2.21 Penalties imposed for non-compliance with the different acts

The following table summarises the penalties, as identified in the different acts, imposed for non-compliance with the different acts.

Table 3.21: Penalties imposed for non-compliance with the different acts

<b>Acts</b>	<b>Number of instances versus number of sections where non-compliance is an offence</b>	<b>Penalties</b>
Banks Act, 1990	54 out of 96	Fines determined in court and imprisonment of up to ten years.
Basic Conditions of Employment Act, 1997	7 out of 96	Fines determined in court and imprisonment of up to three years.
Companies Act, 1973 as amended	114 out of 443	Fines determined in court and imprisonment of up to ten years.
Competition Act, 1998	6 out of 84	Fines determined in court up to a maximum amount of R500 000 and/or imprisonment of up to ten years.
Consumer Act, 1988	3 out of 21	Fines determined in court and imprisonment of up to five years.
Electronic Communications and Transactions Act, 2002	10 out of 95	Fines determined in court and imprisonment of up to five years.
Employment Equity Act, 1998	2 out of 65	Fines determined in court up to a maximum amount of R10 000.
Financial Advisory and Intermediary Services Act, 2002	9 out of 46	Fines determined in court up to a maximum amount of R1 000 000 and/or imprisonment of up to ten years.
Financial Intelligence Act, 2001	21 out of 82	Fines determined in court up to a maximum amount of R10 000 000 and/or imprisonment of up to fifteen years.
Income Tax Act, 1962	19 out of 112	Fines determined in court and imprisonment.
Labour Relations Act, 1995	1 out of 201	Fines up to R10 000.

Table 3.21: Penalties imposed for non-compliance with the different acts

(continued)

<b>Acts</b>	<b>Number of instances</b>	<b>Penalties</b>
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	<b>versus number of sections where non-compliance is an offence</b>	
Medical Schemes Act, 1998	13 out of 69	Fines determined in court and imprisonment of up to five years.
National Credit Act, 2006	15 out of 173	Fines determined in court and imprisonment of up to ten years.
Occupational Health and Safety Act, 1993	49 out of 50	Fines determined in court up to a maximum amount of R100 000 and/or imprisonment of up to two years.
Promotion of Access to Information Act, 2000	3 out of 93	Fines determined in court and imprisonment of up to two years.
Skills Development Act, 1998	5 out of 39	Fines determined in court and imprisonment of up to one year.
Tobacco Products Control Act, 1993	6 out of 8	Fines determined in court up to a maximum amount of R200 000 and/or imprisonment determined in court.
Unemployment Insurance Act, 2001	5 out of 69	Fines and/or imprisonment determined in court.
Unemployment Insurance Contributions Act, 2002	5 out of 19	Fines determined in court and imprisonment of up to one year.
Value-Added Tax Act, 1991	27 out of 87	Fines determined in court and imprisonment of up to five years.

Source: Author (2008)

It must be emphasised that the results contained in the tables above indicate that the direct cost of non-compliance with these acts is severe by looking at the number of instances where non-compliance is an offence. It must also be mentioned that the costs mentioned above exclude any other legal or settlement costs. Important here is the fact that the fines imposed can be as high as R10 000 000 and the prison sentences can be up to 15 years per incident.

It was also calculated that the ratio between the number of instances where non-compliance is an offence and the number of sections in the acts is significant. The table shows that when looking at all the mentioned acts together, offences can be the result of non-compliance in 374 instances out of a possible 1 948 sections of the different acts. This specific ratio expressed as a percentage is an average of 20 per cent.

It was noted that it is not just the company or bank that can be taken to court in cases of non-compliance. Comply-online (2006:1) states, for instance, that in the case of non-compliance with the Occupational Health and Safety Act, the Chief Executive Officer of every business is personally accountable to ensure compliance or may face criminal prosecution.

The conclusion drawn from this section is that compliance with the acts identified in Chapter Two needs to be carefully managed as the direct cost of non-compliance is severe. Fisher (2004) concurs with this finding and states that businesses should align all decisions and actions strictly in accordance with existing legislation as the financial cost of non-compliance in any form is severe.

### **3.3 INDIRECT COST OF NON-COMPLIANCE**

Perry (2005:4) defines reputational risk as the potential that negative publicity regarding the institution's business practices will cause a decline in the customer base, costly litigation or loss of revenue. The true indirect cost of non-compliance is, however, difficult to quantify (Deffree, 2005:2). It can thus be said that every single bank in South Africa is exposed to reputational risk.

Some cases were found in South African banking history where a damaged reputation caused a bank to fail. An example of this is the case of Saambou Bank, which will be discussed next.

#### **3.3.1 Saambou Bank: A South African case of indirect non-compliance**

It was found that before its collapse, Saambou Bank ("Saambou") was South Africa's seventh-largest bank providing general banking services, as stated in the previous chapter, to the general public.

Saambou's reputation as a solid well-managed bank was tarnished when it became known that the senior management of the bank allegedly prevented information on the failing financial status of Saambou Bank and Saambou Bank Holdings from being disclosed to its shareholders, depositors and investors. Sources further revealed that the senior management also allegedly sold their personal holdings of Saambou shares. The total amount involved was estimated at R640 million.

Saambou was brought to its knees and collapsed in 2002 after investors lost confidence in Saambou's ability to repay their deposits. Investors furthermore lost confidence in Saambou's management and withdrew more than R1 billion of their savings, leaving Saambou in a serious crisis. The Insider Trading Act and the regulatory mechanism, however, have shown their mettle with the arrest and prosecution of senior Saambou officials.

### **3.3.2 Methods used for calculating the cost of indirect non-compliance**

The study has found a number of methods used by the different banks around the world to calculate the indirect cost of non-compliance, namely:

#### **3.3.2.1 Changes in certain indicators**

Some banks use changes in certain indicators to estimate and/or to calculate the indirect cost of non-compliance (Perry, 2005:5). These indicators include:

- Loss of current and future customers;
- Loss of employees;
- Reduction in current or future business partners;
- Increased costs of financial funding; and

- Increased costs due to tighter supervision by the Regulator.

Some banks have also developed statistical and other models to predict how changes in the indicators, such as those mentioned above, will influence amongst other the bank's revenue streams, deposits on hand and profitability.

### **3.3.2.2 Share price analysis**

The study has found that a number of banks around the world measure reputational losses by examining the reaction of their share prices to an announcement of a major loss event. If the bank's market value declines by more than the announced loss amount, it is interpreted as a reputational loss. Research undertaken by some of the banks has shown that the market value of shares fall one-for-one with losses caused by external events, but fall by more than twice the loss percentage in cases involving internal fraud (Perry 2005:1).

### **3.3.2.3 Impact analysis**

Another method identified and used by banks to calculate the impact of indirect non-compliance, is to rate the reputational damage into risk categories of high, medium and low impact on the bank. This damage can be caused by negative publicity and comments on business governance, compliance, integrity, performance or customer relationships.

- High impact

Reputational damage will be high when there is widespread comment on and widely held perceptions of negative views pertaining to business governance, compliance, integrity, performance or customer relationships published in national newspapers, business newspapers,

television news and radio news, radio talk shows, public web comment, specific queries from a wide variety of clients, suppliers or media.

- **Medium impact**

Reputational damage will be of medium impact when there is limited comment on and perceptions of negative view pertaining to business governance, compliance, integrity, performance or customer relationships published nationally and locally but in limited volumes, specific queries from local clients, suppliers or media.

- **Low impact**

Reputational damage will be low when there are isolated comments on and perceptions of negative view of business governance, compliance, integrity, performance or customer relationships, published in the lesser-known publications; only briefly mentioned in news/publications no client or supplier queries and/or a few media queries, largely from small publications.

#### **3.3.2.4 Market share**

The impact of the effect of non-compliance on the company's market share can also be categorised as being of high, medium or low impact. The impact will be high if there is a loss of a major client or group of clients or when the bank is not achieving desired outcomes relative to competitors by a large margin. The impact will be of medium impact if there is a loss of any clients or if the bank is not achieving desired outcomes relative to competitors. The impact will be low if there is a possible loss of some clients.

The conclusion drawn from this section is that calculating the indirect cost of non-compliance is difficult but there are, nonetheless, statistical methods available to predict this cost. There is, however, no doubt that if a bank is

deliberately non-compliant it will almost certainly be forced from the market (Deffree, 2005:2).

### **3.4 SUMMARY**

In the previous chapter, a number of acts have been identified that govern the activities of a bank. The acts identified were those that have the most severe impact on bank's activities and that should be managed centrally in a bank.

In this chapter, these acts were reviewed to ascertain the direct cost of non-compliance where direct cost is defined as fines, settlement cost and legal fees. All the sections of the different acts were reviewed to identify instances of non-compliance resulting in an offence. The review has shown that non-compliance resulting in an offence can occur in each an every single act. The number of possible instances of non-compliance varies from act to act with the Banks Act, Companies Act and the Occupational Health and Safety Act at the top of the list. Penalties imposed on instances of non-compliance were identified and listed. These penalties take the form of imprisonment and fines where fines of up to R10 000 000 and imprisonment of up to 15 years can be imposed by a court of law. The conclusion reached in this section is that there is a multitude of instances where non-compliance can occur and that the penalties are severe, not only for banks, but for individual staff members.

The indirect cost of non-compliance was also reviewed, where this cost can be defined as losses due to damaged reputation and brands. Calculating this cost can be difficult. There are models available to predict this cost, but the more popular method established by the author is to categorise the possible instances of non-compliance into risk categories of high, medium and low with no mathematical calculations. Different methods of managing the risks are then applied.

History has shown that the cost of non-compliance is high. Some companies and banks such as Saambou, Riggs Bank and Arthur Anderson have paid severe penalties and had to eventually cease their activities at a terrible cost.

The findings in this chapter are used in Chapter Six as one of the inputs towards the creation of the proposed compliance framework. In the next chapter, the financial cost of being compliant is calculated.

## CHAPTER FOUR

### COST OF COMPLIANCE

#### 4.1 INTRODUCTION

The opinion is often expressed that regulatory compliance extends beyond the compliance department, and that it affects each employee of a bank. Carlson and Fernandez (2006:3) hold the same view and states that depending on the structure of a bank, the compliance functions could reside in several areas within the bank in addition to the compliance department. Such areas could include the risk management department, treasury department, internal audit department, the branch network and the human resources department.

In keeping with this view, the Financial Services Authority (FSA, 2006a) states that banks should not underestimate the continuing challenge of keeping up with the implementation of new legislation. Compliance with new legislation places great demands on banks and failure to do so could result in significant compliance cost. The Financial Services Authority (FSA, 2006a) urges banks to make timely changes to their compliance structures in order to avoid these unnecessary costs.

Carlson and Fernandez (2006:4) state that in the United States of America, these costs have risen substantially in the recent past and that it is important to understand that the overwhelming bulk of the total compliance cost is staff-related. A further important aspect mentioned is that a substantial portion of the costs is avoidable, reflecting not only deficiencies in the way that regulated entities manage compliance but also in the operations of regulators.

It was found that although the cost of non-compliance as discussed in the previous chapter is difficult to calculate, the calculation of the organisational cost of compliance could be equally difficult. Carlson and Fernandez (2006:3) define organisational cost as costs incurred relating to a bank's efforts to achieve compliance with laws, regulations and supervisory requirements.

The purpose of this chapter is to arrive at an understanding of the situation with regard to the cost of compliance in banks in South Africa. In order to reach this goal, a questionnaire has been designed and used towards conducting a survey amongst banks regulated by the SARB. The survey was extended to include audit firms that perform regulatory audits at the banks in South Africa.

In this chapter, the types of organisational costs incurred are reviewed, the scope of the survey is defined, the questionnaires used are discussed, and analyses of the information obtained are presented.

## **4.2 TYPES OF COST**

In order to understand the cost of compliance, it is necessary to identify the different types of costs involved. Elliehausen (1998:3) identifies two types of compliance costs, namely start-up costs and ongoing costs. Start-up costs are those one-time costs of implementing changes necessary to fulfil the requirements of the regulations. These include legal costs, training costs, systems costs and designing new internal audit programmes. Ongoing costs refer to the recurring costs of performing the activities required by regulations.

The distinction between start-up and ongoing costs is not clear as regulations change frequently, thus causing banks to incur both types of costs on an ongoing basis. Carlson and Fernandez (2006:7) therefore categorise compliance cost differently to avoid this problem. Compliance cost can be divided into the following types of costs:

### **4.2.1 Staff-related cost**

Staff-related costs encompass fixed and variable compensation, including salaries, bonuses, medical aid contributions, and leave pay. Carlson and Fernandez (2006:7) mention that these costs are easily quantifiable for certain functions in banks such as the compliance and legal department. It could,

however, be more difficult to calculate in the business areas where staff only spend some of their working days performing compliance duties.

Carlson and Fernandez (2006:7) further mentions that experienced compliance staff are in short supply and that higher salaries have to be paid in order to attract such staff. Another contributing factor mentioned is that the pace of regulatory change has necessitated a premium to be paid in terms of higher compensation.

#### **4.2.2 Out-of-pocket expenses**

Out-of-pocket expenses refer to costs associated with the direct purchase of legal, auditing, accounting and other services for compliance-related activities. Carlson and Fernandez (2006:7) note that there has been a worldwide tendency to spend more on these types of services and furnishes the following possible reasons:

- The banks are experiencing difficulty in expanding internal compliance support rapidly enough to meet the sharply increased regulatory and supervisory demand; and
- Internal resources have become so overloaded that the use of external sources is the only way to meet the deadlines.

#### **4.2.3 Capital spending**

Carlson and Fernandez (2006:8) propound that the rapid pace of regulatory change and the numerous new requirements have forced banks to turn to outside vendors that provide specialised computer software geared to meet the new requirements. Banks purchase multiple software and hardware systems to meet all the regulatory demands that contribute to the bank's increased capital spending.

The initial benefits of this type of capital spending are, however, reduced by the relatively rapid obsolescence of hardware and software systems,

advances in information technology and strong growth in financial transactions. System maintenance cost is relatively smaller.

#### **4.2.4 Opportunity costs**

Opportunity costs are incurred whenever an employee spends additional time on compliance-related activities instead of developing business for the bank (Carlson & Fernandez, 2006:8). In addition, when multiple regulators request the same information, the time spent on this duplication represents an opportunity cost.

Carlson and Fernandez (2006:9) identify the following types of opportunity costs:

- Loss of time and benefits foregone;
- Limitations to entry and expansion into new markets and products;
- Effects on employment; and
- Impact on price and range of services offered.

#### **4.2.5 Other costs**

Clients are also impacted, as banks tend to spend more and more money on compliance-related activities. Clients are therefore limited regarding the choice of products on offer or in the selection of a financial advisor. Clients also see increased compliance obligations such as greater reporting and disclosure of client information as a cost and a reduction in benefits (Carlson & Fernandez, 2006:9).

### **4.3 INFORMATION OBTAINED FROM THE BANKS AND AUDIT FIRMS IN SOUTH AFRICA**

#### **4.3.1 Introduction**

A survey was conducted amongst banks and audit firms in South Africa with the purpose of obtaining information on regulatory compliance costs and other information on compliance in South African banks as well as the branches of foreign-owned banks. The data reported in the survey is confidential and participation was voluntarily. Information obtained in this survey was used, amongst other, in the formulation of the framework in Chapter Five.

The target population included a number of the banks in South Africa licensed by the SARB as well as the “big four” audit firms. The survey was conducted by means of a questionnaire which was completed during interviews with the relevant staff from the different banks and the audit firms.

#### 4.3.2 Registered banks in South Africa

SARB lists the following registered banks that are locally controlled (SARB, 2006):

Table 4.1: Registered Banks – Locally controlled

<b>Name of Bank</b>	<b>Web Address</b>
ABSA Bank Limited	<a href="http://www.absa.co.za">http://www.absa.co.za</a>
African Bank Limited	<a href="http://www.africanbank.co.za">http://www.africanbank.co.za</a>
Capitec Bank Limited	<a href="http://www.capitecbank.co.za">http://www.capitecbank.co.za</a>
FirstRand Bank Limited	<a href="http://www.firstrand.co.za">http://www.firstrand.co.za</a>
Imperial Bank Limited	<a href="http://www.imperialbank.co.za">http://www.imperialbank.co.za</a>
Investec Bank Limited	<a href="http://www.investec.com">http://www.investec.com</a>
Meeg Bank Limited	<a href="http://www.meegbank.co.za">http://www.meegbank.co.za</a>
Nedbank Limited	<a href="http://www.nedbank.co.za">http://www.nedbank.co.za</a>
Rennies Bank	<a href="http://www.renniesbank.co.za">http://www.renniesbank.co.za</a>
Sasfin Bank Limited	<a href="http://www.sasfin.co.za">http://www.sasfin.co.za</a>
Teba Bank Limited	<a href="http://www.tebabank.co.za">http://www.tebabank.co.za</a>
The Standard Bank of South Africa	<a href="http://www.standardbank.co.za">http://www.standardbank.co.za</a>

Source: SARB (2006)

SARB lists the following registered banks that are foreign controlled (SARB, 2006):

Table 4.2: Registered Banks – Foreign Controlled

<b>Name of Bank</b>	<b>Web Address</b>
Albaraka Bank Limited	<a href="http://www.albaraka.co.za">http://www.albaraka.co.za</a>
Habib Overseas Bank Limited	<a href="http://habiboverseas.co.za">http://habiboverseas.co.za</a>
HBZ Bank Limited	<a href="http://www.hbzbank.co.za">http://www.hbzbank.co.za</a>
Mercantile Bank Limited	<a href="http://www.mercantile.co.za">http://www.mercantile.co.za</a>
South African Bank of Athens Limited	<a href="http://www.bankofathens.co.za">http://www.bankofathens.co.za</a>

Source: SARB (2006)

SARB lists the following registered mutual banks (SARB, 2006):

Table 4.3: Registered Mutual Banks

<b>Name of Bank</b>	<b>Web Address</b>
GBS Mutual Bank	<a href="http://www.gbsbank.co.za">http://www.gbsbank.co.za</a>
VBS Mutual Bank	<a href="http://www.vbsmutualbank.co.za">http://www.vbsmutualbank.co.za</a>

Source: SARB (2006)

SARB lists the following registered branches of foreign banks, locally controlled (SARB, 2006):

Table 4.4: Registered Branches

<b>Name of Branch</b>	<b>Web Address</b>
Bank of Taiwan	<a href="http://www.bot.com.tw">http://www.bot.com.tw</a>
Calyon Corporate and Investment Bank	<a href="http://www.calyon.com">http://www.calyon.com</a>
China Construction Bank	<a href="http://www.ccbjhb.com">http://www.ccbjhb.com</a>
Citibank N.A.	<a href="http://www.citibank.co.za">http://www.citibank.co.za</a>
Commerzbank Aktiengesellschaft	<a href="http://www.commerzbank.co.za">http://www.commerzbank.co.za</a>

Table 4.4: Registered Branches (Continued)

Deutsche Bank AG	<a href="http://www.db.com">http://www.db.com</a>
HSBC Bank plc	<a href="http://www.hsbc.co.za">http://www.hsbc.co.za</a>
JPMorgan Chase Bank N.A	<a href="http://www.jpmorgan.com">http://www.jpmorgan.com</a>
Societe General	<a href="http://www.socgen.com">http://www.socgen.com</a>
Standard Chartered Bank	<a href="http://www.standardchartered.com">http://www.standardchartered.com</a>
State Bank of India	<a href="http://www.statebank.co.za">http://www.statebank.co.za</a>

Source: SARB (2006)

### 4.3.3 The bank questionnaire

The questionnaire was designed to obtain specific information pertaining to compliance and the cost of compliance. The questionnaire was also designed with a view of obtaining information regarding the different types of costs as mentioned above. Importantly, it also tested the participants' views on specific aspects of regulation in South Africa.

The questionnaire consists of questions divided into the following segments:

- Bank demographics;
- Compliance structure;
- Compliance responsibilities;
- Cost of compliance;
- Regular submissions;
- Other submissions;
- Outsource agreements; and
- Supplementary information.

The following table details the reasons why these questions, in the stated segments, were posed to the participants.

Table 4.5: Questions to bank participants

Topic	Rationale
Bank demographics	<ul style="list-style-type: none"> <li>- To ascertain the South African regulated banks' geographical presence;</li> <li>- To identify the business sectors in which the banks operate;</li> <li>- To identify the banks' business models;</li> <li>- To establish the banks' compliance staff complement;</li> <li>- To categorise the banks in terms of annual revenue; and</li> <li>- To identify the different regulators.</li> </ul>
Compliance structure	<ul style="list-style-type: none"> <li>- To identify the compliance structures in each bank;</li> <li>- To identify the interaction between the role-players.</li> </ul>
Compliance responsibilities	<ul style="list-style-type: none"> <li>- To identify the compliance responsibilities in each bank.</li> </ul>
Cost of compliance	<ul style="list-style-type: none"> <li>- To establish the cost of compliance in each bank in terms of staff-related costs, legal costs and out-of-pocket expenses'; and</li> <li>- To establish the total compliance budgets of the banks.</li> </ul>
Regular submissions	<ul style="list-style-type: none"> <li>- To establish to extent of regular submissions.</li> </ul>
Other submissions	<ul style="list-style-type: none"> <li>- To establish to extent of other submissions.</li> </ul>
Outsource agreements	<ul style="list-style-type: none"> <li>- To establish to extent of outsource agreements.</li> </ul>
Supplementary information	<ul style="list-style-type: none"> <li>- To obtain other relevant supplementary information.</li> </ul>

Source: Author (2008)

The following is the actual bank questionnaire used in the survey.

## COMPLIANCE QUESTIONNAIRE

### 1. Bank demographics

#### 1.1 Geographical distribution

Please indicate where your bank has branches, subsidiaries or other business ventures.

- Republic of South Africa \_\_\_\_\_
- Europe \_\_\_\_\_
- Asia \_\_\_\_\_
- Australasia \_\_\_\_\_
- Africa \_\_\_\_\_
- Other \_\_\_\_\_

#### 1.2 Business sectors

Please indicate in which business sectors your bank is active.

- Retail banking \_\_\_\_\_
- Commercial banking \_\_\_\_\_
- Investment banking \_\_\_\_\_
- Treasury trading \_\_\_\_\_
- Merchant banking \_\_\_\_\_
- Other \_\_\_\_\_

#### 1.3 Business model

Please indicate your bank's business model, where centralised means that head office is dictating activities and decentralised means that business units manage their own activities.

- Centralised \_\_\_\_\_
- Decentralised \_\_\_\_\_
- Combination \_\_\_\_\_
- Other \_\_\_\_\_

## COMPLIANCE QUESTIONNAIRE (Continued)

### 1.4 Compliance staff complement

Please indicate the number of permanent compliance staff in your bank.

- Total number of staff \_\_\_\_\_
- Total in compliance \_\_\_\_\_
- Centralised \_\_\_\_\_
- Decentralised \_\_\_\_\_
- Other \_\_\_\_\_

### 1.5 Annual revenue

Please indicate your bank's average annual revenue over the past three years.

- Under R100 million \_\_\_\_\_
- R 100 to R 500 million \_\_\_\_\_
- R 500 to R 1 billion \_\_\_\_\_
- R 1 to R 100 billion \_\_\_\_\_
- R 100 billion + \_\_\_\_\_

### 1.6 South African regulators

Please indicate the South African regulators that your bank reports to.

- South African Reserve Bank \_\_\_\_\_
- Financial Services Board \_\_\_\_\_
- \_\_\_\_\_

### 1.7 Foreign regulators

Please indicate the foreign regulators that your bank reports to.

- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

**COMPLIANCE QUESTIONNAIRE (Continued)**

**2. Compliance structure**

Please indicate your bank's compliance structure, where centralised means that head office is dictating activities and decentralised means that business units manage their own activities. Also indicate where each of the acts is managed.

- Centralised compliance function \_\_\_\_\_
- Banks Act \_\_\_\_\_
- Anti-money laundering \_\_\_\_\_
- FAIS \_\_\_\_\_
- FICA \_\_\_\_\_
- Occupational health and safety \_\_\_\_\_
- \_\_\_\_\_
- Decentralised compliance function \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

**3. Compliance responsibilities**

Please indicate which of the following compliance responsibilities are applicable to your bank's compliance function.

- Advisory role \_\_\_\_\_
- Develop policies and procedures \_\_\_\_\_
- Education and training \_\_\_\_\_
- Monitoring \_\_\_\_\_
- Compliance reviews \_\_\_\_\_
- Investigations \_\_\_\_\_
- Regulatory liaison \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

**COMPLIANCE QUESTIONNAIRE (Continued)****4. Cost of compliance**

Please furnish the following detail. (Only if the numbers are publicly available)

- Staff complement
  - Current year \_\_\_\_\_
  - Previous year \_\_\_\_\_
  - Year before \_\_\_\_\_
- Total budget (R '000)
  - Current year \_\_\_\_\_
  - Previous year \_\_\_\_\_
  - Year before \_\_\_\_\_
- Staff-related cost (R '000)
  - Current year \_\_\_\_\_
  - Previous year \_\_\_\_\_
  - Year before \_\_\_\_\_
- Out-of-pocket expenses (R '000)
 

	<u>Legal</u>	<u>Audit</u>	<u>Other</u>
- Current year	_____	_____	_____
- Previous year	_____	_____	_____
- Year before	_____	_____	_____
- Capital spending
  - Current year \_\_\_\_\_
  - Previous year \_\_\_\_\_
  - Year before \_\_\_\_\_

## COMPLIANCE QUESTIONNAIRE (Continued)

### 5. Regular submissions

Please indicate the number of submissions made to the Regulator on an annual basis. (Please include all submissions with regard to DI's, Section 52 applications or any other official submissions)

#### South African regulators

- South African Reserve Bank \_\_\_\_\_
- Financial Services Board \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

#### Foreign regulators

- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

### 6. Other submissions

- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

### 7. Outsource agreements

Please indicate the number of outsource agreements that your bank has entered into with regard to compliance.

- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

**COMPLIANCE QUESTIONNAIRE (Continued)****8. Supplementary information**

8.1 Has the overall cost of compliance, over the last three years:

- Increased;
- Decreased; or
- Remained the same?

8.2 In the event of it having increased, what is the reason?

- Increased complexity in the compliance universe;
- Larger volume of submissions;
- Increased number of acts and regulations;
- Increased regulatory focus; or
- Other.

8.3 What is the average time period given to respond to regulatory queries?

8.4 What is the average time waiting for responses from the regulators?

8.5 Do you think the current regulatory regime in South Africa is too onerous?

8.6 If so, what could be the possible reasons for this?

8.7 Does the current regulatory regime influence competition in the banking sector?

8.8 Are there too many regulators in South Africa?

8.9 Any thoughts on self-regulation?

8.10 Any suggestions on how to improve the situation?

8.11 What is the cost of implementing Basel II?

8.11.1 Rand value?

8.11.2 Is there any benefit?

8.11.3 What are the main cost components: people, systems or other?

8.11.4 Do you anticipate any further costs after the 2008 implementation?

#### **4.3.4 Information obtained and analysis**

Not all the banks in South Africa were invited to participate as the focus was on obtaining information from the banks with the largest balance sheets (DI 900's) in terms of assets as published by the SARB on their website and those banks with diversified business activities as discussed in Chapter Two. The target audience included locally controlled banks, foreign controlled banks as well as the branches of foreign banks.

A total number of eight banks were invited to participate in the survey, including the largest banks in South Africa. Of the number of banks that have responded, five were South African controlled banks, one was a foreign controlled bank and two were branches of foreign banks. All of the invited banks responded positively and indicated up front, without exception, that the cost of compliance was of importance to them. The information obtained from the banks is presented below in the same sequential order as the questions in the questionnaire.

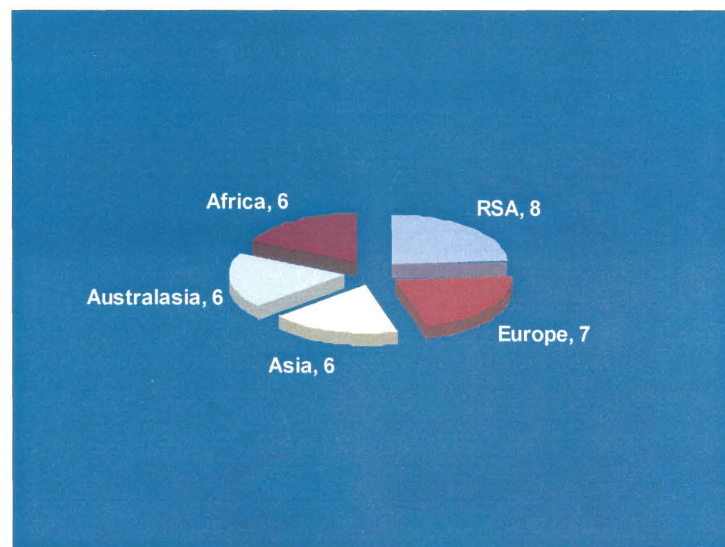
#### **Question 1: Bank demographics**

The following information was obtained from the banks pertaining to demographics. The information is presented under the headings geographical distribution, business sectors, business models, number of permanent compliance staff, annual revenue, South African regulators and foreign regulators.

#### **Question 1.1: Geographical distribution**

The following figure represents the information obtained from the banks with regard to the banks' presence in the jurisdictions as stipulated in the questionnaire.

Figure 4.1: Graphical distribution



Source: Author (2008)

The figure shows that the banks surveyed practise banking activities in jurisdictions such as South Africa, Europe, Africa, Asia and Australasia. The figure also indicates the number of banks that are active in each specific jurisdiction.

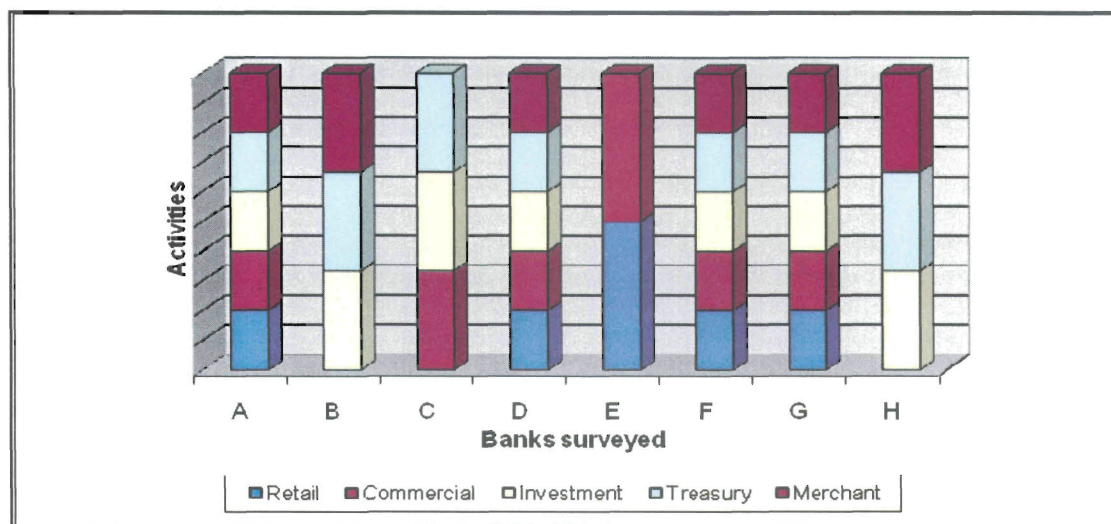
All the banks surveyed, with the exception of one, are active in Europe. The banks' presence is furthermore evenly spread between Africa, Asia and Australasia.

It was noted that the banks are well represented across the world, and this could have additional compliance cost implications to these banks. The fact that the banks have to comply with different regulatory requirements in the different countries could place an additional burden on compliance and, in the process, escalate the cost of compliance.

#### **Question 1.2: Business sectors in which the banks are active**

The following figure represents information obtained from the banks with regard to the business sectors in which the banks are active in, as stipulated in the questionnaire.

Figure 4.2: Business sectors



Source: Author (2008)

The figure shows that the banks surveyed are active in business sectors such as retail, commercial, investments, treasury and merchant banking; but not to the same degree.

The following was specifically noted:

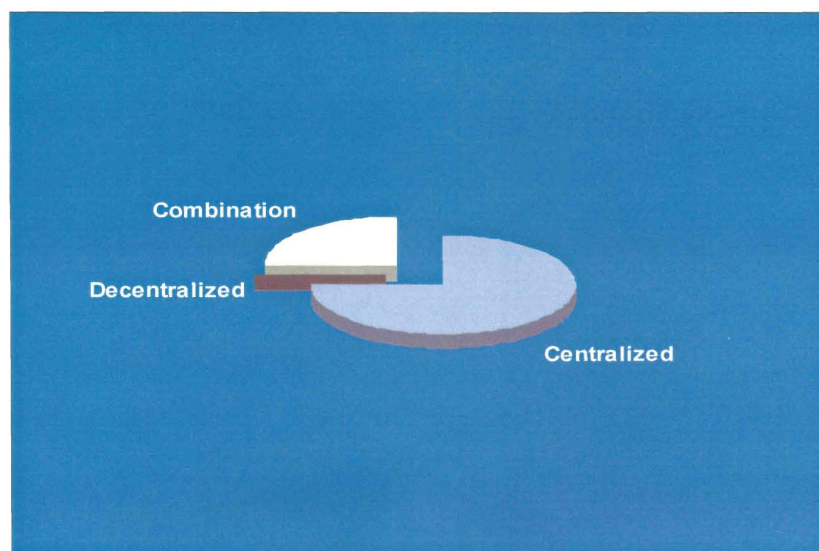
- Four of the banks surveyed are active in all the business sectors;
- Two banks are active in investment, treasury and merchant;
- One bank is active in commercial, investment and treasury;
- One bank is active in retail and commercial; and
- The business sectors with the most banking participants are investment and treasury.

The fact these banks have to comply with different regulatory requirements and acts, as stated in Chapter Two and required by the different business sectors, could place an additional burden on compliance and in the process escalate the cost of compliance.

### Question 1.3: Business model employed by the banks

The following figure presents information obtained from the banks with regard to the business model employed by the banks where a centralised model means that all compliance activities in the bank are dictated from the centre. The banks surveyed had to categorise their business model in terms of centralised, decentralised or a combination of the two models.

Figure 4.3: Business model



Source: Author (2008)

It was noted that six of the banks have indicated that their business model is a centralised one where business is conducted and controlled from the centre or so-called “head office”. Two banks indicated that their business model is a combination of a centralised and a decentralised model where business is conducted and controlled from the centre as well as from the different business units or divisions, and none of the banks has a totally decentralised business model.

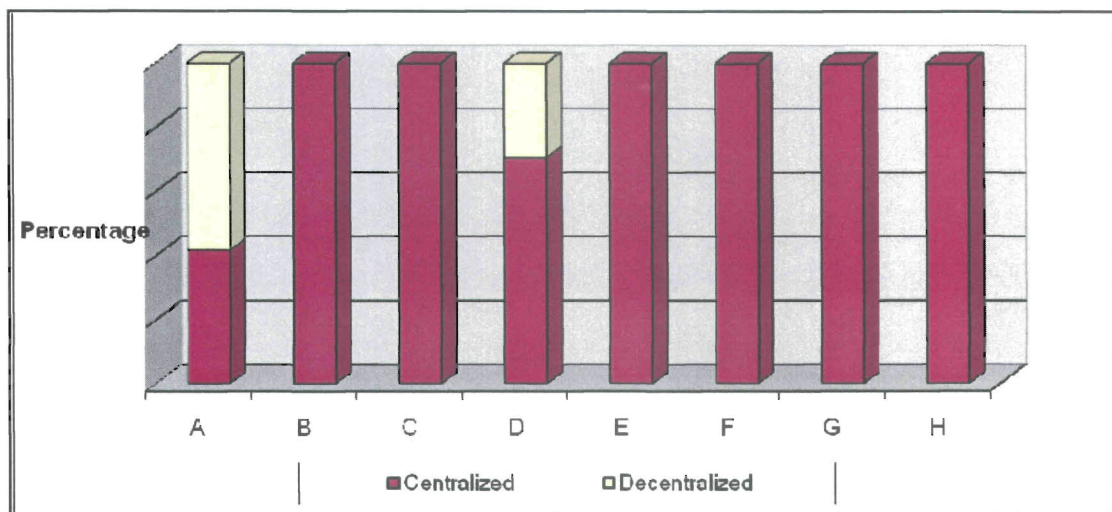
It was also determined that there is no consensus amongst banks regarding the best model. It was also found that banks using the combination model are

not even sure which activities should be centralised, and which should be decentralised.

#### Question 1.4: Number of compliance staff employed in the banks

The following figure represents information obtained from the banks with regard to the actual number of permanent compliance staff, expressed as a percentage, employed by the banks. The banks had to indicate the total number of compliance staff, compliance staff deployed at a central level as well as the compliance staff deployed at a decentralised level.

Figure 4.4: Permanent compliance staff



Source: Author (2008)

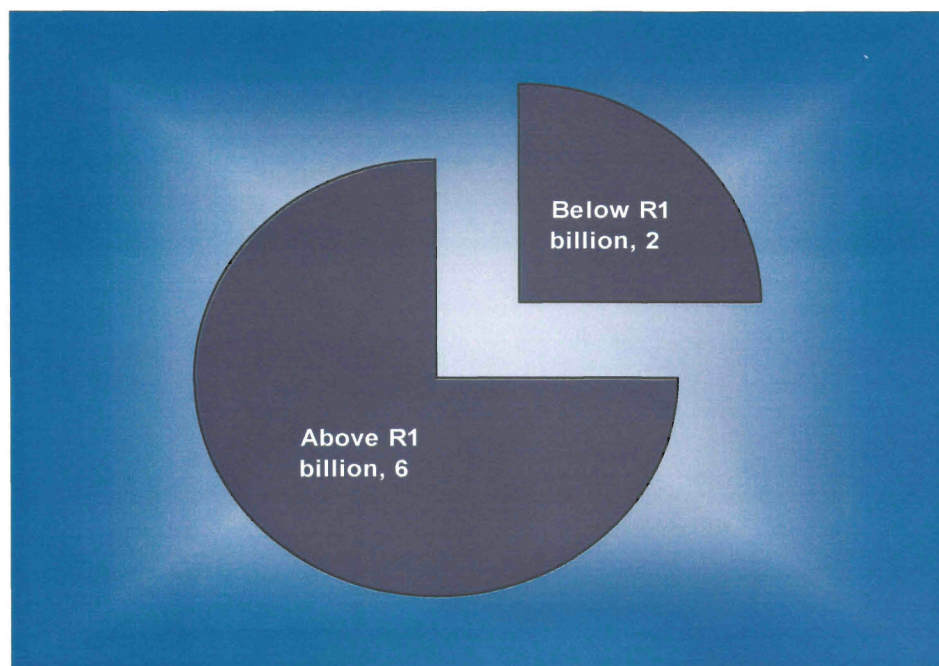
The information obtained indicates that only two banks have compliance staff deployed at both a central and a decentralised level. A further analysis of the information on a bank-by-bank basis revealed that the number of compliance staff in relation to the total number of staff in the banks is on average less than 0.3 percent. This low percentage, indicating the total number of permanent compliance staff employed, could be indicative of the fact that all banks are complaining about the high cost of compliance.

This ratio is also low given the number of punishable offences as result of non-compliance with the onerous requirements of the diverse South African regulatory universe and its regulators indicated in the previous chapter.

### Question 1.5: Annual revenue of the banks

The following figure represents information obtained from the banks with regard to the annual revenue generated by them. The banks had to indicate whether their annual revenue was more of less than R1 billion per annum.

Figure 4.5: Annual revenue



Source: Author (2008)

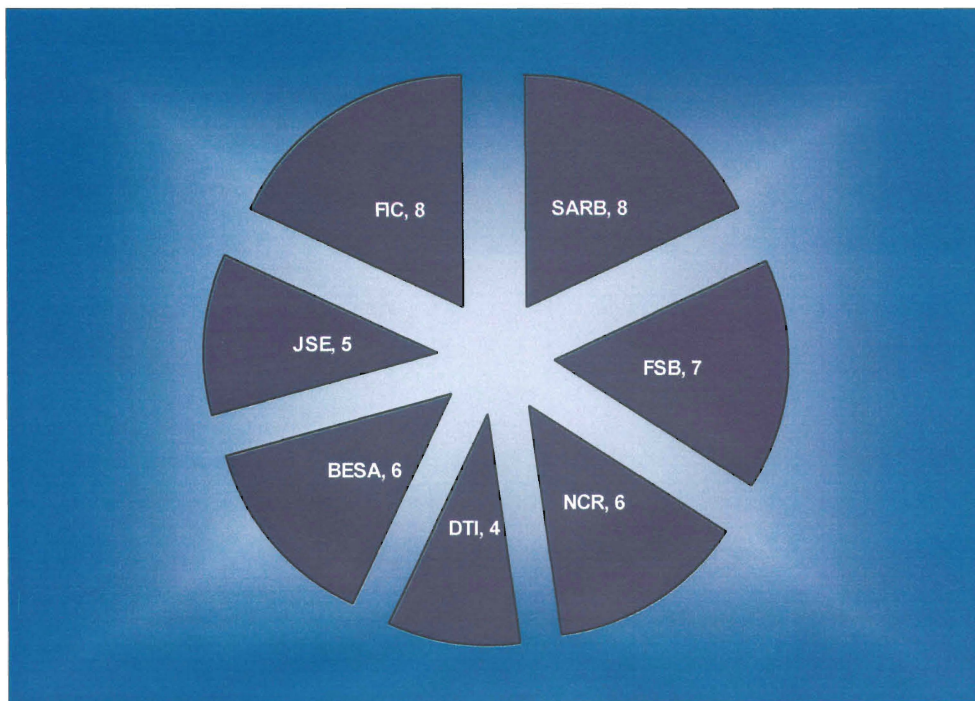
It was observed that six out of the eight banks investigated have an annual revenue of more than R1 billion. The information on the banks' annual revenue in conjunction with the findings on the sectors in which the banks are active indicates that the banks are exposing themselves to a variety of regulatory requirements from the different regulators. The result is that banks

could be exposing themselves to an ever-increasing level of compliance risk as well as a possible higher cost of compliance.

### Question 1.6: South African regulators

The following figure represents information obtained from the banks with regard to the different regulators in South Africa regulating and supervising the banks.

Figure 4.6: South African regulators



Source: Author (2008)

The abbreviations used in the figure are as follows:

- SARB : South African Reserve Bank;
- FSB : Financial Services Board;
- NCR : National Credit Regulator;
- DTI : Department of Trade and Industry;
- BESA : Bond Exchange of South Africa;

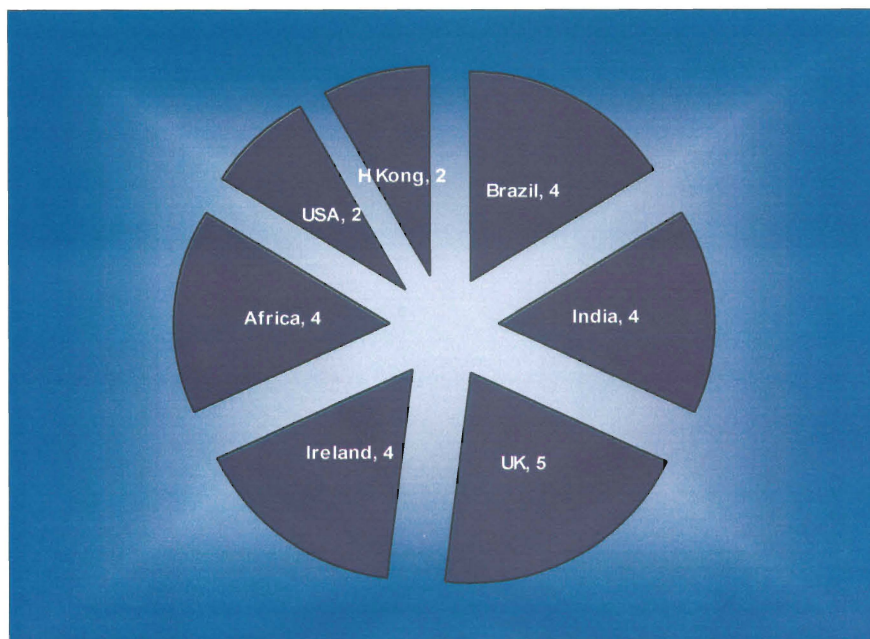
- JSE : Johannesburg Stock Exchange; and
- FIC : Financial Intelligence Centre.

It was found that all the banks have to comply with the requirements of the SARB and the FIC, while it was also determined that only seven banks have to comply with requirements of the FSB. The number of banks decreases to six with regard to the requirements of the NCR and BESA. With regard to the JSE, the number of banks is five and only four banks have to comply with the requirements of the DTI. It was further noted that the information obtained corroborates the information obtained with regard the business sectors in which the banks are active. The information obtained confirms that the banks have diverse activities and that this places an additional burden on the banks as far as compliance is concerned.

#### **Question 1.7: Foreign regulators**

The following figure represents information obtained from banks in South Africa with regard to the foreign regulators regulating and supervising these banks in offshore jurisdictions.

Figure 4.7: Foreign regulators



Source: Author (2008)

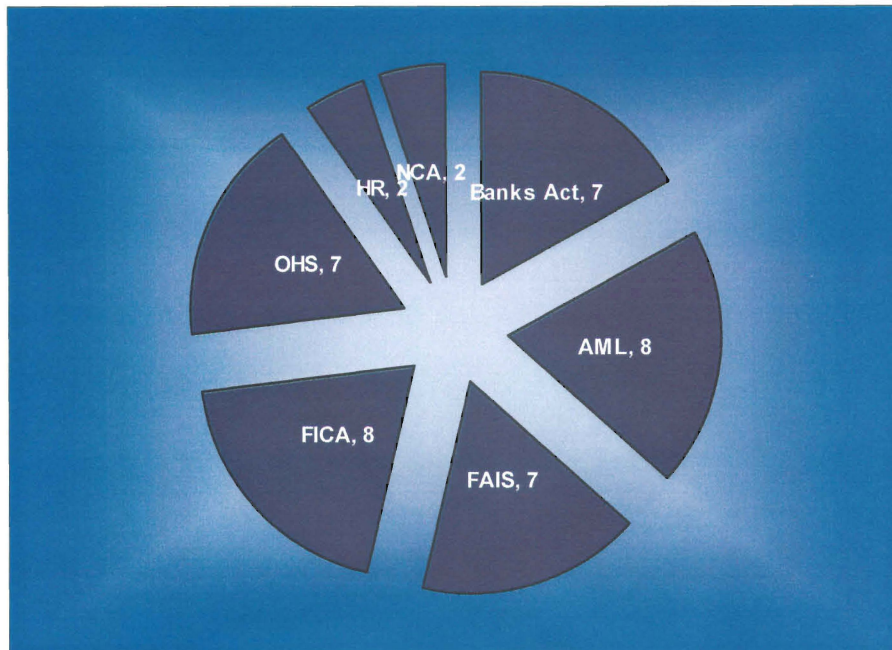
Based on the information obtained from the banks, it was found that they have to comply with the requirements of foreign regulators in Brazil, India, the United Kingdom, Ireland, Africa, the United States of America and Hong Kong. It was also found that the majority of banks are active in the United Kingdom followed by India, Brazil, Ireland, Africa, Hong Kong and the United States of America.

The information obtained also confirms that this geographical distribution of the banks constitutes an additional burden on all the banks insofar as compliance is concerned.

### Question 2: Compliance structures

The following figure presents information obtained from the banks in South Africa with regard to the different acts managed under a centralised and decentralised compliance structure in the banks.

Figure 4.8: Compliance structures



Source: Author (2008)

The abbreviations used in the figure above are as follows:

- Banks Act : South African Banks Act;
- AML : Anti-money Laundering;
- FAIS : Financial and Intermediary Services Act;
- FICA : Financial Intelligence Centre Act;
- OHS : Occupational Health and Safety Act;
- HR : Industrial relations, human resources acts; and
- NCA : National Credit Act.

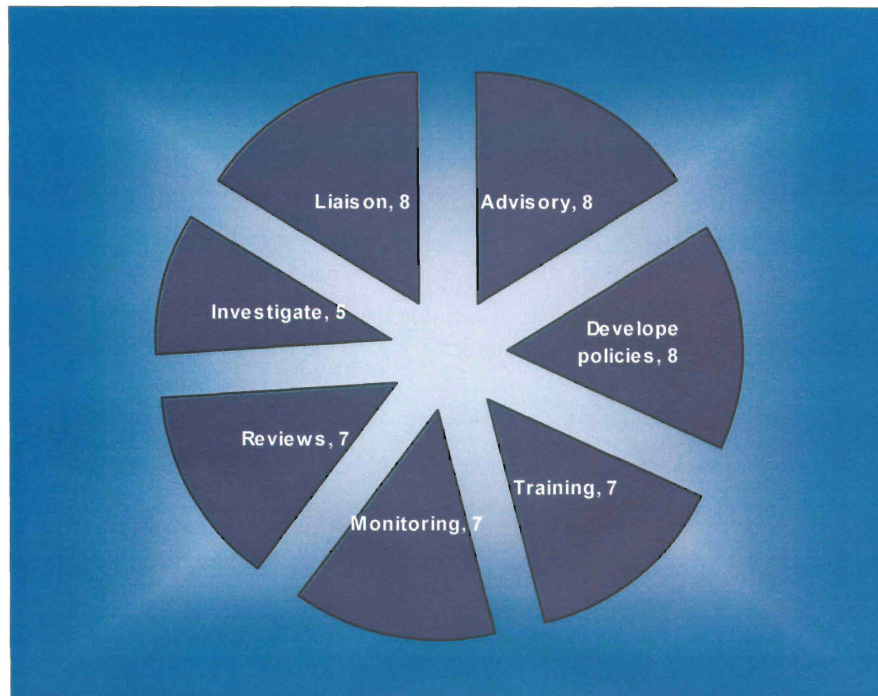
It was noted that the majority of the banks regarded Banks Act, AML, FAIS, FICA and OHS as high-risk acts and are managing these from a central position in the banks. HR and NCA are, with the exception of two banks, left to the divisions to manage.

Another trend noted was that the majority of banks were managing the NCA at a divisional level. One of a bank's main functions is to grant credit to clients and consistency in granting credit should be priority in the banks. The banks should therefore recognise this Act as one of the most important acts to a bank. This opinion is strengthened by the fact the NCA is being managed and supervised by its own regulator called the National Credit Regulator. This opinion is further strengthened by the fact that banks not only have to comply with the NCA, but also with a set of NCA regulations including frequent and onerous external reporting requirements.

### **Question 3: Compliance responsibilities**

The following figure represents information obtained from the banks in South Africa with regard to the compliance responsibilities in the different banks.

Figure 4.9: Compliance responsibilities



Source: Author (2008)

It was found that the majority of banks perform the basic compliance responsibilities, namely:

- Advisory services;
- Developing compliance policies;
- Training staff on compliance;
- Monitoring compliance with the different acts;
- Performing compliance reviews; and
- Liaison with the regulators.

However, not all the banks delegate compliance-related investigations to their compliance divisions. The banks indicated that other divisions perform such investigations.

**Question 4: Compliance cost**

None of the banks was able to furnish exact information pertaining to the actual cost of compliance.

The reasons stated by the banks included the following:

- Banks have no specific methodology for the calculation of the cost of compliance;
- Management in general are not particularly interested in the exact cost but rather in the consequences and cost of non-compliance;
- Compliance costs are not a separate cost item in the financials of the banks;
- It is difficult to calculate the cost of compliance as the requirements differ from jurisdiction to jurisdiction;
- Compliance officers also perform other duties;
- Systems are not designed to capture compliance costs; and
- The majority of the banks have no specific budget for compliance but incorporates the cost into other budgets.

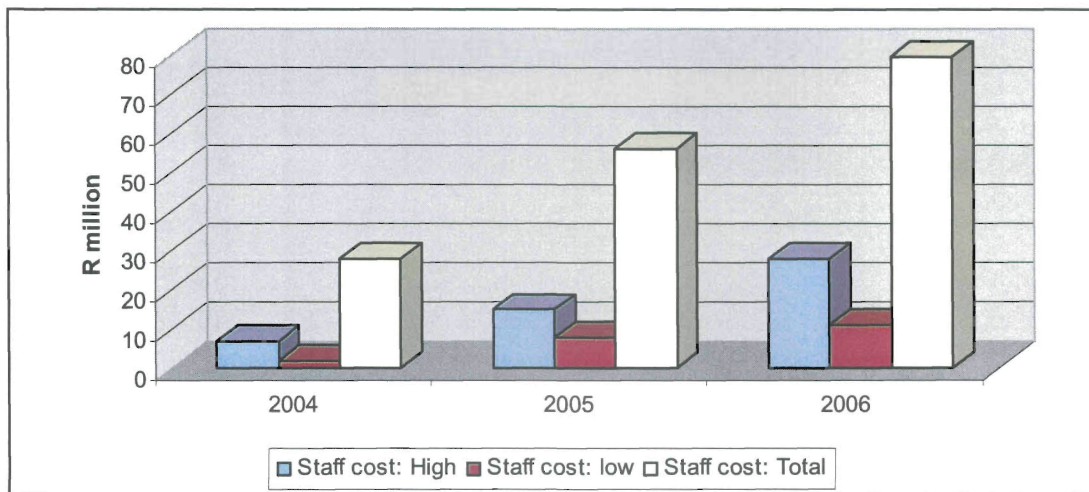
These results are regarded as disappointing since financial institutions and banks have been vocal in the past about the cost of compliance, as indicated in the previous chapters. The banks were, however, not able to substantiate these claims with hard figures. Interestingly enough, the majority of banks expressed an interest in the possibility to calculate the cost of compliance accurately.

The majority of the banks - five out of the eight - were, however, prepared and able to furnish only estimated compliance costs. Although these are only estimates, it still provides sufficient evidence to detect trends in the cost of compliance over a number of years.

### Staff-related cost

Figure 4.10 (a) below provides the estimated staff-related costs as furnished by the five banks. The figure provides information on the combined total staff cost of the banks, the highest as well as the lowest staff cost in the banks. It must be noted that these estimates only pertain to those banks that were able to estimate costs and not the banking industry as a whole. The researcher is also of the opinion that any trends detected could nonetheless point to a trend in the banking industry.

Figure 4.10 (a): Staff costs



Source: Author (2008)

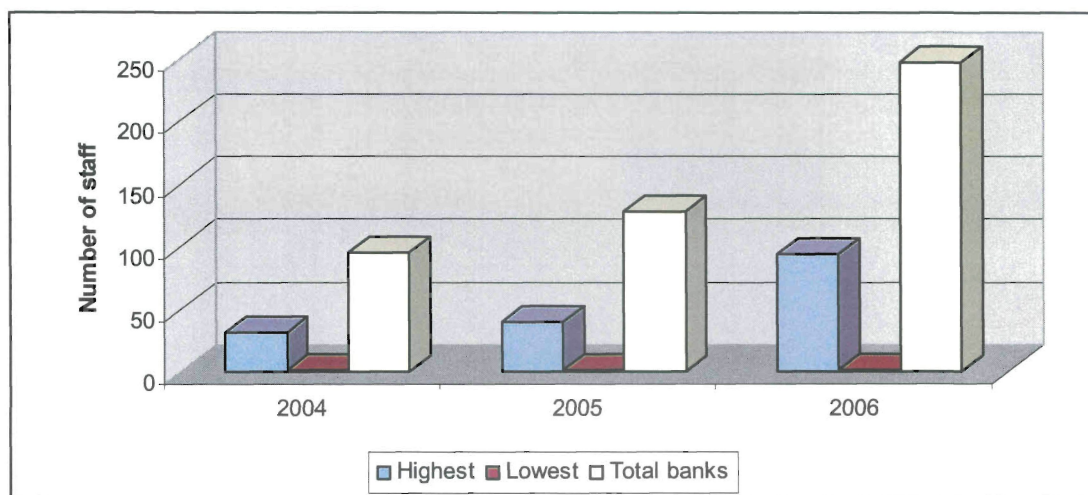
In analysing the information, the following are pertinent:

- The total staff cost to the banks has risen by nearly 300 per cent from 2004 to 2006;
- The total staff cost has risen from an estimated R 28 million in 2004 to R 80 million in 2006; and
- The same trend can be observed in the highest and the lowest staff costs provided by the banks.

### Number of compliance staff

Figure 4.10 (b) below provides the number of compliance staff as furnished by the six banks. The figure provides information on the total number of staff, the highest number of staff in the banks as well as the lowest number of staff in the banks. It must be noted that these numbers only pertain to those banks that were able to provide information and not the banking industry in total. Any trends detected, however, could point to a trend in the banking industry.

Figure 4.10 (b): Number of compliance staff



Source: Author (2008)

In analysing the information, the following is significant:

- The total number of compliance staff in the banks has risen from 96 in 2004 to 248 in 2006;
- The same rising trend is present regarding the highest number of staff provided by the banks; and
- Some of the banks have not increased the number of compliance staff at all during the period 2004 to 2006.

The cost per staff member was calculated as follows by using the information in figure 4.10 (a) and figure 4.10 (b) above.

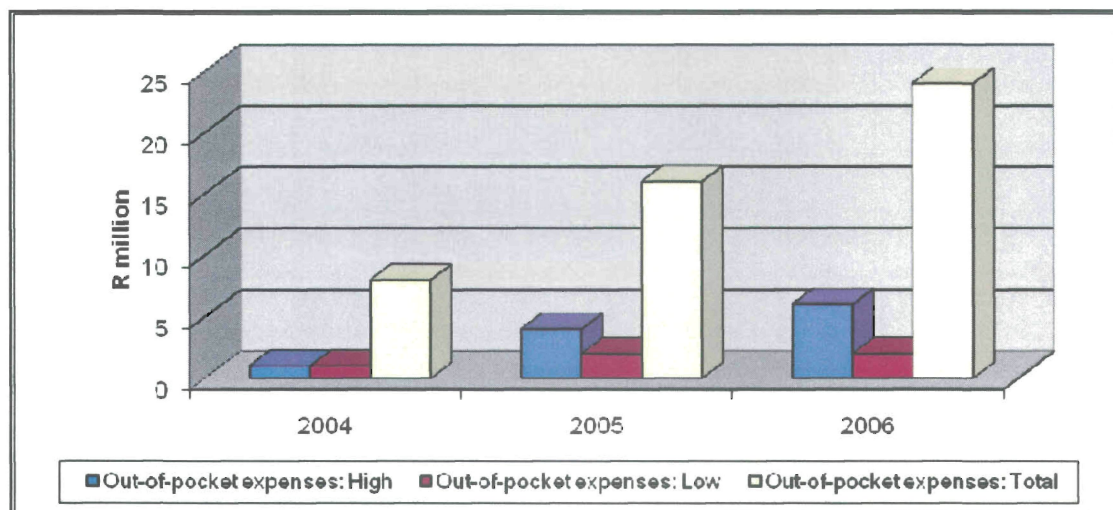
Staff cost per staff member in 2004	: R 290 000-00
Staff cost per staff member in 2005	: R 440 000-00
Staff cost per staff member in 2006	: R 320 000-00

It was observed that there was a rise in the staff cost per staff member from 2004 to 2006. An interesting feature is that there was a sharp rise in the cost from 2004 to 2005 but that the cost declined from 2005 to 2006. The banks were questioned about these trends and responded that they established and in some instances enhanced compliance functions in their banks during that period. The banks further responded that they streamlined their compliance activities during 2006 and could therefore reduce the cost of compliance per staff member.

### Out-of-pocket expenses

Figure 4.10 (c) below provides the estimated out-of-pocket expenses as furnished by the six banks. The figure provides information on the estimated total out-of-pocket expenses, the highest out-of-pocket expenses in the banks as well as the lowest out-of-pocket expenses in the banks.

Figure 4.10 (c): Out-of-pocket expenses



Source: Author (2008)

In analysing the information, note can be taken of the following:

- The out-of-pocket expenses to the banks has risen by 300 per cent from 2004 to 2006;
- The out-of-pocket expenses has risen from an estimated R 8 million in 2004 to R 24 million in 2006; and
- The same trend can be observed in the highest and the lowest out-of-pocket expenses provided by the banks.

The banks are correct in that out-of-pocket expenses have increased substantially over the past number of years.

The out-of-pocket expenses per staff member were calculated as follows by using the information in figure 4.10 (b) and figure 4.10 (c) above.

Out-of-pocket expenses per staff member in 2004	: R 80 000-00
Out-of-pocket expenses per staff member in 2005	: R 130 000-00
Out-of-pocket expenses per staff member in 2006	: R 100 000-00

It was observed that there was a rise in the out-of-pocket expenses per staff member from 2004 to 2006. An interesting feature is that there was a sharp rise in the cost from 2004 to 2005 but that the cost declined from 2005 to 2006. The banks were questioned about these trends and they responded that they established and in some instances enhanced compliance functions in their banks during that period. The banks further responded that they streamlined their compliance activities during 2006 and could therefore reduce the out-of-pocket per staff member.

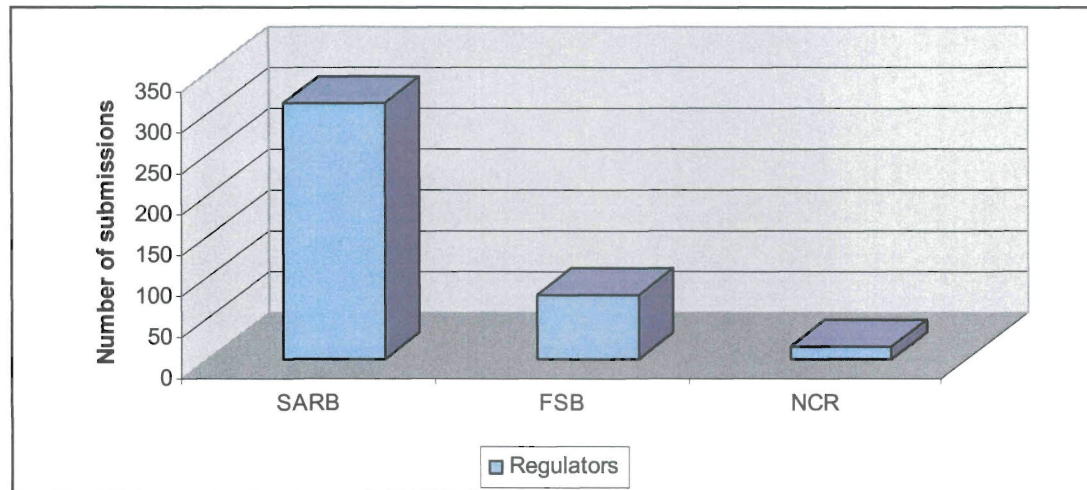
### **Question 5 and 6: Regular submissions**

#### **Submissions to South African regulators**

The following figure presents information obtained from the banks in South Africa with regard to the number of regular submissions made to the

regulators identified by the study as being the major regulators in South Africa.

Figure 4.11: Regular submissions



Source: Author (2008)

The figure indicates that the majority of regular submissions are made to the SARB (313) followed by submissions to the FSB (79) and to the NCR (16).

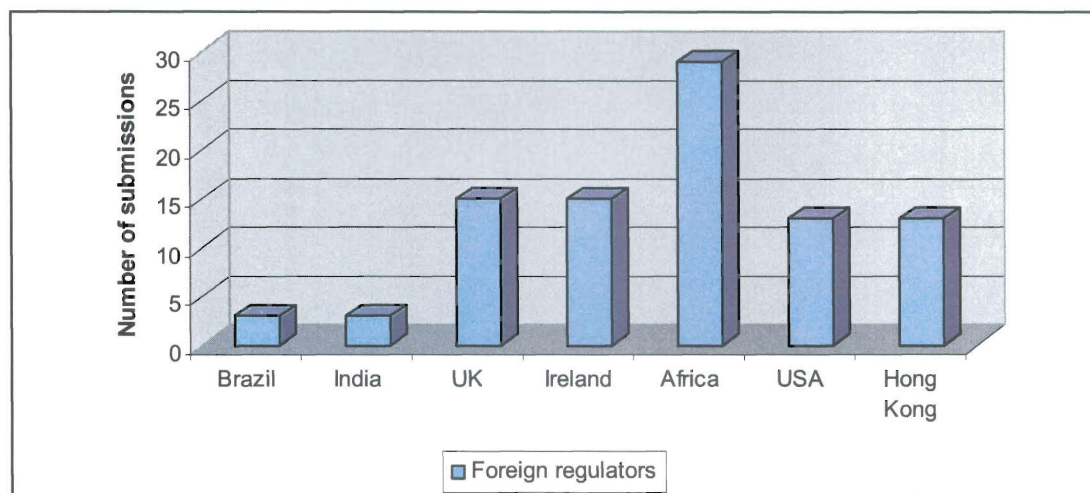
The banks were questioned on these statistics and they responded as follow:

- SARB requires monthly, quarterly, half yearly and annual submissions pertaining to various topics;
- FSB requires mainly quarterly and annual submissions pertaining to various topics;
- NCA requires mainly quarterly and annual submissions pertaining to two topics;
- SARB has more onerous reporting requirements and other supervisory activities than FSB and NCA;
- SARB has more onerous approval requirements than FSB and NCA; and
- SARB has a rigorous annual regulatory and supervisory programme.

## Submissions to foreign regulators

The following figure presents information obtained from the banks in South Africa with regard to the number of regular submissions made to foreign regulators.

Figure 4.12: Submissions to foreign regulators



Source: Author (2008)

The information obtained from the banks indicates the number of submissions made to foreign regulators by the eight banks surveyed:

- Brazil : 3 submissions
- India : 3 submissions
- UK : 15 submissions
- Ireland : 15 submissions
- Africa : 29 submissions
- USA : 13 submissions
- Hong Kong : 13 submissions

The information obtained confirms the place of the SARB as the lead regulator of South African banks. The information also confirms the banks' expansion into Africa and shows that new countries such as Brazil and India are now targeted.

**Question 7: Outsourcing agreements**

The banks were asked to indicate the number of outsourcing agreements that they have entered into with regard to compliance. All the banks, without exception, stated that they have no outsourcing agreements in place with regard to compliance whether it is external or internal agreements. The reason given was that the SARB is not in favour of such agreements as stated in Banks Act Circular 14/2004 (SARB, 2004b).

Some of the banks however indicated that they would possibly consider outsourcing agreements with regard to compliance if they were permitted to enter into such agreements. The reasons given were that the cost of compliance could then be accurately calculated and managed and that such agreements could ensure that compliance activities are totally independently performed. Some banks however expressed the view that they would prefer internal compliance outsourcing agreements instead of external outsourcing agreements.

**Question 8: Supplementary information**

The following supplementary information was obtained from the banks:

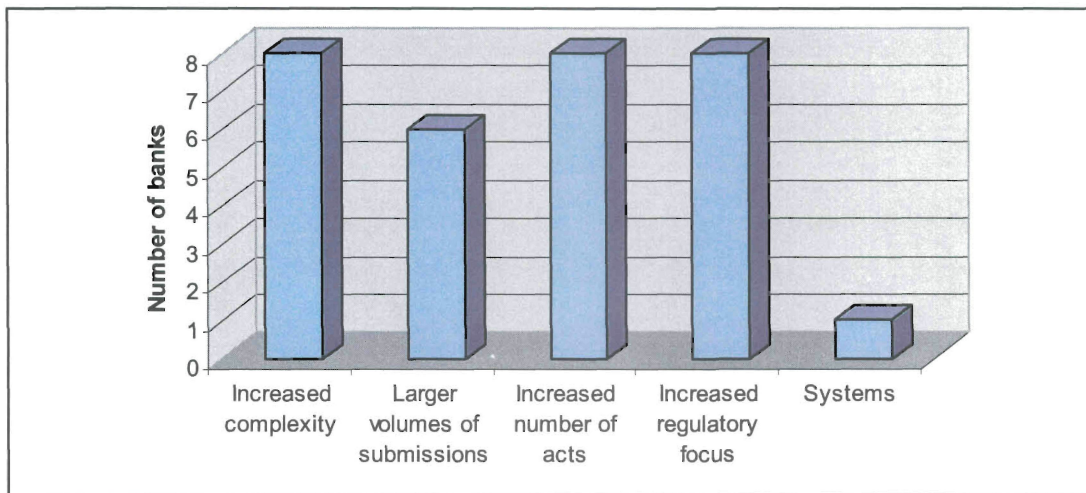
**Question 8.1: Has the overall cost of compliance, over the last three years increased, decreased or stayed the same?**

All the banks, without exception, were of the opinion that the overall cost of compliance have increased over the last three years. It is however interesting to note that none of the banks were in a position to accurately calculate their cost of compliance (see question 4 above).

**Question 8.2: In the event of it having increased, what is the reason?**

The following figure presents information obtained from the banks in South Africa with regard to the possible reasons for the increase in the cost of compliance.

Figure 4.13: Possible reasons for the increase in compliance cost



Source: Author (2008)

The information obtained from the banks indicates the following:

- The banks were unanimous in their view that the cost of compliance has increased because of increased complexity of the regulatory environment, increased number of acts and increased regulatory focus.
- Some banks (six) also blamed the increase in the cost of compliance on the larger volume of submissions.
- Only one of the banks blamed the introduction of new systems as an additional cause for the increase in compliance cost.

**Question 8.3: What is the average time period given to respond to regulatory queries?**

The banks responded that they are given between 7 and 30 days to respond to regulatory queries depending on the nature of the query and the

Regulator's instructions. The average time given, based on the information furnished by the banks, is 14 days. Some banks responded that regulators sometimes do not give them enough time to respond, as it is not always easy to gather the relevant information.

**Question 8.4: What is the average time waiting for responses from the regulators?**

The banks responded that they have to wait between 21 and 60 days on responses from the regulators. The average time given, based on the information furnished by the banks, is 40 days.

**Question 8.5: Is the current regulatory regime in South Africa is too onerous?**

The response from the banks to this question indicates that they are divided on the answer to this question. Exactly 50 per cent of the banks responded "Yes" to this question.

**Question 8.6: What could be the possible reasons for the answer in 8.5?**

The banks answering "Yes" to this question stated the following reasons for their answers:

- There are too many acts and regulations to comply with;
- There are too many regulators with diverse requirements; and
- The current regime is too onerous but necessary to be on par with the rest of the world.

The banks answering "No" to this question stated the following reasons for their answers:

- The current regime is not too onerous but as South Africa had to play catch-up the last number years, it put undue pressure on the banks;

- The current regime is not too onerous but it is not necessarily effective; and
- The regulators should have gone for a more phased approach in implementing compliance.

**Question 8.7: Does the current regulatory regime influence competition in the bank sector?**

The majority of the banks (six) agreed that the current regulatory regime does influence competition in the bank sector. The banks were however divided whether this influence was positive or negative to the bank sector.

The following reasons were stated for the current regulatory regime having a positive influence on competition:

- It ensures that banks and other financial institutions are more efficient with regard to internal controls;
- It ensures equal treatment for all banks in the country; and
- It ensures a stable bank sector.

The following reasons were stated for the current regulatory regime having a negative influence on competition:

- Too many acts, regulations and requirements;
- It hampers the way a bank can do business; and
- It is a barrier to entry in the bank sector.

**Question 8.8: Are there too many regulators in South Africa? (One regulator for South Africa?)**

The response from the banks to this question indicates that they are divided on the answer to this question. Exactly 50 per cent of the banks responded “Yes” to this question and would like to see only one regulator supervising banks. No specific reasons were given for the answers provided.

**Question 8.9: Any thoughts on self-regulation?**

The response from the banks to this question indicates that they are also divided on the answer to this question with the majority of the banks not favouring self-regulation. Those banks favouring self-regulation argued that it would create healthy competition in the market. Those banks not favouring self-regulation argued that history has shown that banks are not able to do it and should be supervised by an independent regulator.

**Question 8.10: Any suggestions to improve the current regulatory situation in South Africa?**

The banks provided a variety of suggestions on how to improve the current regulatory situation in South Africa. These were condensed into three themes and are as follows:

- The boards of banks and also senior management should be made accountable for compliance;
- Regulators should involve financial institutions more in the process of creating new acts and regulations; and
- Regulators should co-ordinate the promulgation of new legislation to allow for smoother implementation.

**Question 8.11: What is the cost of implementing Basel II?****Question 8.11.1: What is the rand value?**

The banks were unanimous in their response to this question. They all stated that it is difficult to calculate the exact cost, as there are too many aspects involved. At best, they could make an estimate but also declined on doing so.

**Question 8.11.2: Is there any benefit in implementing Basel?**

The banks provided a variety of benefits, and these were condensed into common themes, and they are as follows:

- Increased focus on operational risk and corporate governance;
- Improved risk management practices; and
- Capital benefit in the sense of reduced capital requirements.

**Question 8.11.3: What are the cost components: people or systems?**

The banks provided the following information on the cost components involved in the implementation of Basel II:

- Staff cost  
(Attracting staff with Basel II knowledge)
- Systems  
(System implementation and training)
- Opportunity cost  
(Management's attention is drawn away from growing the business)
- External consulting fees  
(Payment of fees to consultants with regard to implementation, training, assurance services and model validation)

The banks ranked staff cost and systems as the main cost items.

**Question 8.11.4: Do you anticipate incurring any further costs after the 2008 implementation?**

The banks were unanimous in their response to this question. They all stated that they would be incurring additional cost after the 2008 implementation. They stated that these costs would be mainly system driven and in particular automating the regulatory returns.

#### 4.3.5 The audit questionnaire

An audit questionnaire was designed to obtain information pertaining to compliance and the cost of compliance from the audit firms that perform regulatory audits as required by the South African Reserve Bank. Importantly, it was also designed to test the auditors' view on specific aspects of regulation in South Africa and open ended questions were used.

The questionnaire is divided into the following segments:

- Bank demographics;
- Regulatory services; and
- Supplementary information.

The following table details the reasons why these questions were posed to the participants.

Table 4.6: Questions to audit firms

Topic	Rationale
Bank demographics	<ul style="list-style-type: none"> <li>- To ascertain the South African audit firms geographical presence; identify the firms business models; establish the firms regulatory audit staff compliment; categorise the firms in terms of annual revenue; and identify the different regulators.</li> </ul>
Regulatory services	<ul style="list-style-type: none"> <li>- To identify the regulatory services provided by each firm.</li> </ul>
Supplementary information	<ul style="list-style-type: none"> <li>- To obtain supplementary information on specific aspects of regulation in South Africa.</li> </ul>

Source: Author (2008)

The following is the questionnaire used in the survey amongst the audit firms in South Africa.

## COMPLIANCE QUESTIONNAIRE: AUDITORS

### 1. Bank demographics

#### 1.1 Geographical distribution

Please indicate in which jurisdictions your firm performs regulatory audits, as required by the South African Banks Act, on South African owned banks.

- |    |                          |       |
|----|--------------------------|-------|
| a. | Republic of South Africa | _____ |
| b. | Europe                   | _____ |
| c. | Asia                     | _____ |
| d. | Australasia              | _____ |
| e. | Africa                   | _____ |
| f. | Other                    | _____ |

#### 1.2 Business model

Please indicate how many regulatory audits in these offshore jurisdictions are performed by your local South African audit teams or by offshore audit teams.

- |   |                     |       |
|---|---------------------|-------|
| • | South African teams | _____ |
| • | Offshore teams      | _____ |
| • | Combined teams      | _____ |

#### 1.3 Regulatory audit staff

Please indicate the following on the regulatory audit staff in your South African firm.

- |   |  |       |
|---|--|-------|
| • | Number of audit staff in the firm                      | _____ |
| • | Number of permanent regulatory audit staff in the firm | _____ |
| • | Number of part-time regulatory audit staff in the firm | _____ |

**COMPLIANCE QUESTIONNAIRE: AUDITORS  
(CONTINUED)**

**1.4 Annual revenue**

Please indicate your firm's average annual regulatory audit revenue over the past three years as a percentage of total annual audit income.

- Under 10 per cent \_\_\_\_\_
- Between 10 and 20 per cent \_\_\_\_\_
- Between 20 and 30 per cent \_\_\_\_\_
- More than 30 per cent \_\_\_\_\_

**1.5 South African Regulators**

Please indicate the South African regulators to whom your firm furnishes reports.

- South African Reserve Bank \_\_\_\_\_
- Financial Services Board \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

**2. Regulatory services**

Please indicate which of the following regulatory services are provided by your firm.

- Advisory services \_\_\_\_\_
- Regulatory return audits \_\_\_\_\_
- Education and training \_\_\_\_\_
- Regulatory and compliance reviews \_\_\_\_\_
- Investigations \_\_\_\_\_
- Regulatory liaison \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

**COMPLIANCE QUESTIONNAIRE: AUDITORS  
(CONTINUED)**

**3. Supplementary information on the banking sector in South Africa**

3.1 In your opinion, has the cost of regulatory compliance, over the last three years:

- Increased;
- Decreased; or
- Remained the same?

3.2 In the event of it having increased, what are the reasons?

- Increased complexity in the compliance universe;
- Larger volume of submissions;
- Increased number of acts and regulations;
- Increased regulatory focus; or
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

3.3 Do you think the current regulatory regime in South Africa is too onerous?

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3.4 If so, what could be the possible reasons for this?

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**COMPLIANCE QUESTIONNAIRE: AUDITORS  
(CONTINUED)**

3.5 Does the current regulatory regime influence competition in the banking sector?

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3.6 Are there too many regulators in South Africa? (Single regulator possibly?)

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3.7 Any thoughts on self-regulation?

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3.8 Any suggestions to improve the current regulatory situation in South Africa?

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**COMPLIANCE QUESTIONNAIRE: AUDITORS  
(CONTINUED)**

3.9 What do you think is the cost (rand value) of implementing Basel II in the banking sector in South Africa?

3.9.1 Rand Value?

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3.9.2 What are the main cost components: people, systems or other?

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3.9.3 Do you anticipate banks incurring any further costs after the 2008 implementation?

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**4.3.6 Information obtained and analysis**

The auditors' questionnaire was sent to a number of audit firms that are involved in regulatory audits as required by the South African Banks Act (SARB, 1990a). The following information was obtained through the survey and the information obtained is presented following the same sequential order as the questions in the questionnaire.

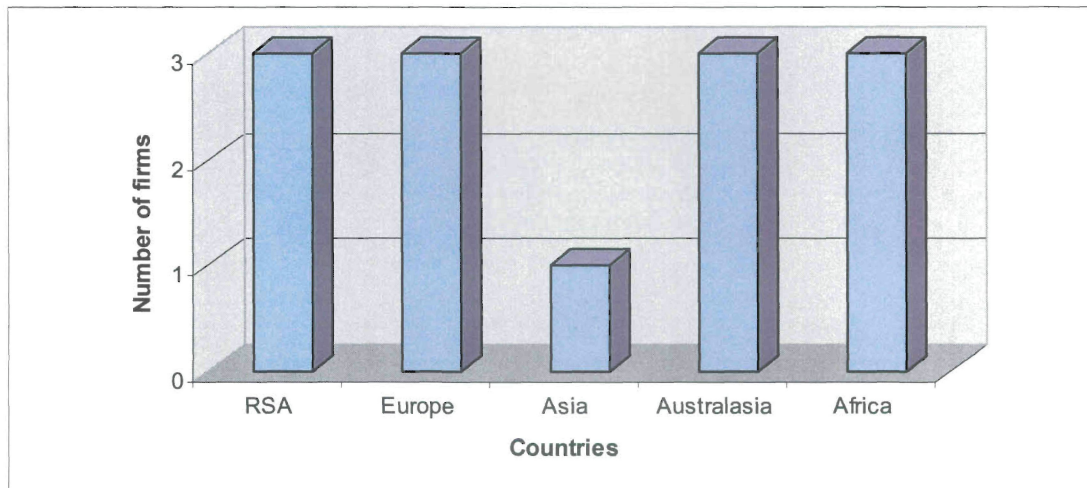
A total number of four audit firms, which are the largest audit firms in South Africa, were invited to participate in the survey. All but one of the audit firms responded positively and indicated upfront that the cost of compliance was also of importance to them. The information obtained from the three audit firms is presented below in the same sequential order as the questions in the questionnaire.

### Question 1: Audit firm demographics

**Question 1.1: Indicate in which jurisdictions your firm performs regulatory audits, as required by the South African Banks Act, on South African owned banks.**

The following figure details the information obtained from the audit firms on jurisdictions in which regulatory audits as required by the South African Banks Act (SARB, 1990a) are performed.

Figure 4.14: Countries



Source: Author (2008)

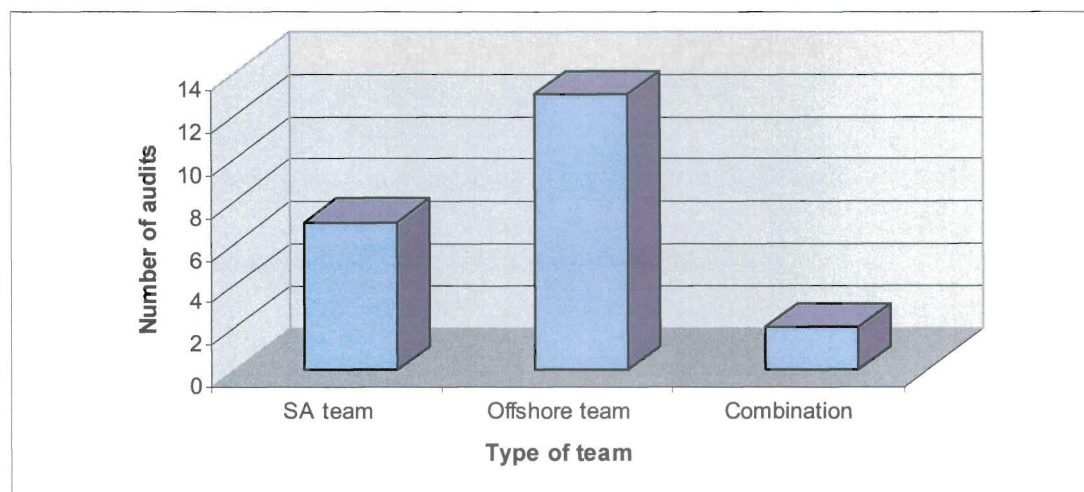
The figure indicates that all the firms interviewed perform regulatory audits as required by the SARB in Europe, Australasia and Africa. Some of the firms are not involved with banks in Asia.

The information obtained also indicates that the audit firms in South Africa are global firms active in all the major financial centres of the world. It further indicates that these firms have to be familiar with all the requirements from the different regulators. This could mean that the firms could incur costs in training their staff with regard to the different regulatory requirements.

**Question 1.2: Please indicate how many regulatory audits in these offshore jurisdictions are performed by your local South African audit teams or by offshore audit teams.**

The following figure details the information obtained from the audit firms on how many regulatory audits in these offshore jurisdictions are performed by local South African audit teams or by the firms' offshore regulatory audit teams or a combined team.

Figure 4.15: Types of teams



Source: Author (2008)

The information obtained indicates that the majority of SARB regulatory audits (14) in offshore jurisdictions are performed by the audit firms' offshore teams. Only six audits are performed by South African audit teams in the foreign countries. Only one audit is performed by a combined audit team.

The information obtained confirms that the audit firms in South Africa are global firms active in all the major financial centres of the world. It further confirms that these firms have to be familiar with all the requirements from the different regulators. This also confirms that the firms could incur additional costs in training their foreign staff with regard to the South African regulatory requirements.

**Question 1.3: Please indicate the number of regulatory audit staff in your South African firm.**

The firms indicated that they mainly utilise part-time regulatory audit staff to perform regulatory audits in South Africa and abroad. The information also indicates that the audit firms only have a small number of full-time dedicated specialist regulatory audit staff which is only used to manage the regulatory audits.

**Question 1.4: Please indicate your firm's average annual regulatory audit revenue over the past three years as a percentage of total annual audit income.**

All the firms reported that their annual income derived from regulatory audits are less than ten per cent of the firms' total annual income. The audit firms do not regard regulatory audits as a major part of their business. They rather see it as a service rendered as required by acts and regulations.

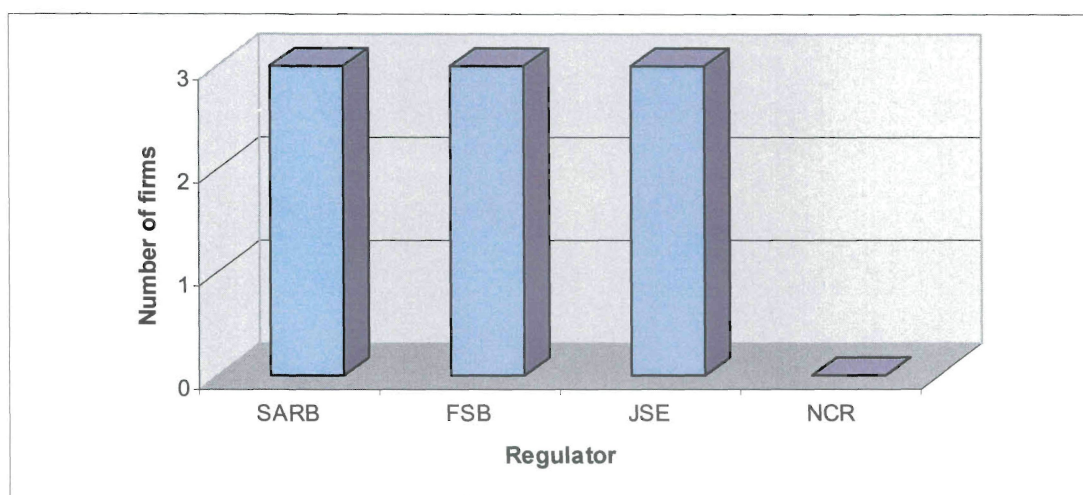
The majority of the firms agree that these audits are necessary but see it as a normal extension of financial year-end audits. It could also be seen as a platform to generate advisory work.

All the firms emphasised the importance of a sound working relationship with the different regulators, both locally and abroad.

**Question 1.5: Please indicate the South African regulators to whom your firm furnish reports.**

The following figure details the information obtained from the audit firms regarding the main South African regulators to whom they are issuing reports.

Figure 4.16: Reports to regulators



Source: Author (2008)

The audit firms all issue reports to the following regulators:

- SARB : South African Reserve Bank
- FSB : Financial Services Board
- JSE : Johannesburg Stock Exchange

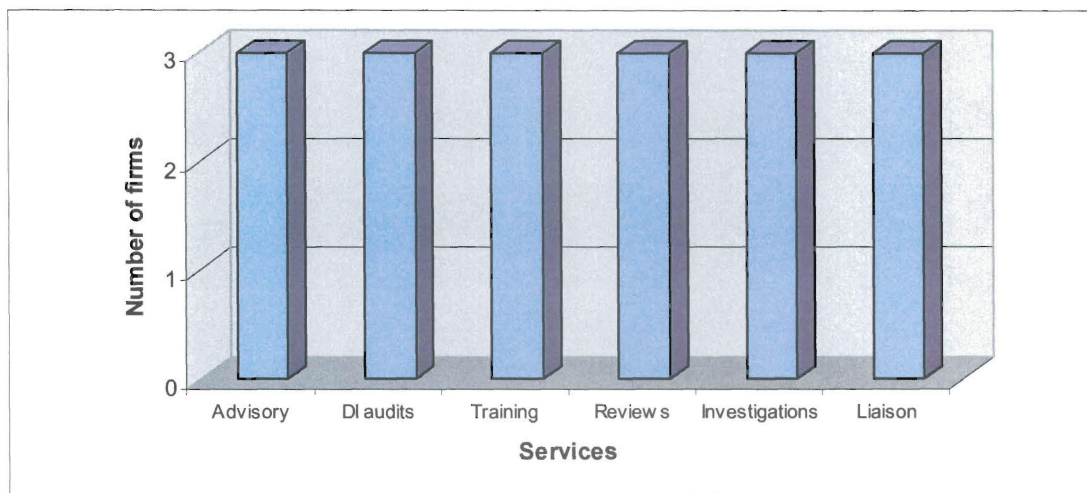
The audit firms mentioned that no specific regulatory reports are furnished to the NCR, as the regulator is apparently not involved in prudential supervision. This could not be confirmed with any of the participants in the credit market.

The information obtained also confirms the information furnished by the banks on the business sectors in which they are active.

**Question 2: Regulatory services - Please indicate which of the following regulatory services are provided by the firm.**

The following figure details the information obtained from the audit firms on the regulatory services provided to the banks by the audit firms.

Figure 4.17: Regulatory services provided



Source: Author (2008)

The information obtained from the audit firms indicates that the firms provide a range of regulatory services to the banks and includes:

- Advisory services on the different acts and regulations;
- Performing statutory returns audits;
- Training on the different acts and regulations;
- Assurance services such as reviews;
- Special investigations either requested by the banks or regulators; and
- Liaison services on behalf of the banks.

This information confirms that the audit firms view regulatory audits as one of many regulatory services that are provided to the banks.

### Question 3: Supplementary information

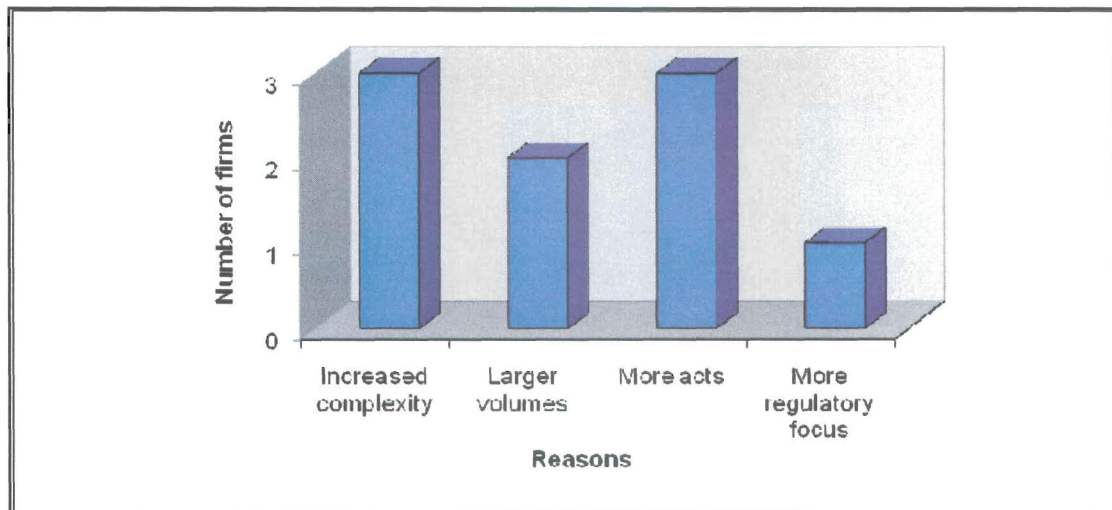
#### Question 3.1: Has the cost of regulatory compliance increased or not over the last three years?

The auditors are unanimous that the cost of compliance has increased over the past three years.

#### Question 3.2: In the event of it having increased, what are the reasons?

The following figure details the information obtained from the audit firms on the reasons why the audit firms are of the opinion that the cost of compliance has increased over the past three years.

Figure 4.18: Reasons for cost increase



Source: Author (2008)

The audit firms agree on two possible reasons for the increase in the cost of compliance, namely increased complexity of the regulatory environment and the fact that there are an increasing number of acts to comply with. The firms are divided on the issues of larger volumes of submissions to the regulators and increased regulatory focus.

It was noted that all of these reasons are contributing to the increase in the cost of compliance to both the banks and the audit firms.

**Question 3.3 and 3.4: Do you think the current regulatory regime in South Africa is too onerous? If so, what could be the possible reasons for this?**

The audit firms agree that the current regulatory regime in South Africa is not too onerous on the banks.

**Question 3.5: Does the current regulatory regime influence competition in the bank sector?**

The firms are divided on the issue of whether the current regulatory regime influences competition in the bank sector. None of the firms could furnish any clear motivation in this regard.

**Question 3.6: Are there too many regulators in South Africa?**

The audit firms agree that there are not too many regulators in South Africa. They are of the opinion that the current regulatory model is appropriate for the South African financial sector.

**Question 3.7: Any thoughts on self-regulation?**

None of the firms interviewed favoured self-regulation by the banks. They are of the opinion that self-regulation is inappropriate in view of South Africa's current state of development.

**Question 3.8: Suggestions to improve the current regulatory situation in South Africa?**

The firms interviewed were silent on how to improve the current regulatory situation in South Africa and could offer no suggestions.

**Question 3.9: What do you think is the cost (rand value) of implementing Basel II in the bank sector in South Africa?**

**Question 3.9.1: Rand Value?**

None of the firms interviewed have any idea of what the cost of implementing the Basel II requirements would be to the bank sector in South Africa.

**Question 3.9.2: What are the main cost components: people, systems or other?**

The audit firms agree that the main cost components are systems and people with the main cost factor being the use of consultants by the banks.

**Question 3.9.3 Do you anticipate banks incurring any further costs after the 2008 implementation?**

The audit firms agree that there will be additional cost after the 2008 Basel II implementation.

**4.3.7 Possible future cost implications**

It should be noted that the findings of both the surveys indicated the current situation with regard to compliance in the banks in South Africa. This situation could however have possible future cost of compliance implications to these banks and the audit firms. Table 4.7 and table 4.8 below provide the detail on these possible future cost implications.

Table 4.7: Possible future cost implications: Banks

Survey finding	Possible future cost implication
The majority of the banks in South Africa have a presence in Europe and Africa, whilst fewer banks also have a presence in Asia and in Australasia.	Increased compliance cost because of compliance with the requirements of a wide variety of different local and foreign regulators.
The majority of the banks in South Africa are active in the commercial, investment and treasury sectors, whilst fewer banks are active in the retail and merchant banking sectors.	Increased compliance cost because of compliance with a wide variety of different local and foreign regulations and acts.
The banks have either a centralised or a combination of a centralised and a decentralised business model for compliance. None of the banks in South Africa has a completely decentralised business model.	The majority of the cost of compliance is incurred at a centralised level and not at a decentralised or business unit level. Higher cost due to hiring more experienced staff.
Annual revenue of the majority of the banks exceed R1 billion.	Banks are taking more risks to generate income thereby increasing the cost of compliance.
Lead regulators for banks in South Africa are the SARB and FIC.	Increased compliance cost because of compliance with the supervisory programmes of the SARB and FIC.
Lead foreign regulator for South African banks is based in the UK with other regulators in Africa, USA, Hong Kong, Brazil and India.	Increased compliance cost because of compliance with the requirements of a wide variety of different local and foreign regulators.
Compliance with the requirements of AML and FICA is managed by the banks on a centralised basis whilst 80 per cent of the banks manage the Banks Act, FAIS and OHS also on a centralised basis. The majority of the banks manage HR and NCA on a decentralised basis.	The majority of the cost of compliance is incurred at a centralised level and not at a decentralised or business unit level. Higher cost due to hiring more experienced staff.
All the banks perform the basic compliance responsibilities, namely advisory services, developing compliance policies, providing training on compliance, monitoring compliance with the different acts, performing compliance reviews and liaise with the regulators.	Increased compliance cost because of specific compliance responsibilities that could be outsourced to internal or external parties.

Table 4.7: Possible future cost implications: Banks (Continued)

Survey finding	Possible future cost implication
None of the banks was able to furnish information on the actual cost of compliance to these banks.	Actual cost of compliance is not known to the banks leading to some undetected hidden cost.
The majority of regular submissions to local regulators are made to SARB followed by submissions to FSB and NCR.	Increased compliance cost because of compliance with the submission requirements of the SARB, FSB and NCR.
The majority of regular submissions to foreign regulators are made to regulators in Africa followed by the UK, USA and Hong Kong.	Increased compliance cost because of compliance with the submission requirements of foreign regulators.
None of the banks has outsourcing agreements in place pertaining to compliance activities.	Increased compliance cost because of specific compliance responsibilities that could be outsourced to internal or external parties.
The banks are unanimous that the cost of compliance has definitely increased over the past three years but not to what extent.	The actual cost of compliance is not known to the banks leading to some undetected hidden cost.
Banks are given between 7 and 30 days to respond to regulatory queries depending on the nature of the query and the Regulator's instructions. The average time given, based on the information furnished by the banks, is 14 days.	Increased compliance cost because of compliance with the submission requirements of the regulators as it puts a strain on available staff.
The banks have to wait between 21 and 60 days on responses from the regulators. The average time, based on the information furnished by the banks, is 40 days.	Increased compliance cost as banks might miss business opportunities.
Banks in South Africa are divided on the question whether the current regulatory regime in South Africa is too onerous or not.	Increased compliance cost because of compliance with requirements of a variety of different local regulators.
The banks were also divided whether the current regulatory regime influenced competition between the banks positively or negatively.	Increased compliance cost as banks might miss business opportunities.
The banks are furthermore divided on the question whether there are too many regulators in South Africa or not.	Increased compliance cost because of compliance with requirements of a variety of different local regulators.

Table 4.7: Possible future cost implications: Banks (Continued)

<b>Survey finding</b>	<b>Possible future cost implication</b>
Some banks favoured self-regulation and others were totally opposed to it.	Increased compliance cost because of compliance with requirements of a variety of different local regulators.
None of the banks could accurately calculate the cost to them of implementing Basel II.	The actual cost of compliance is not known to the banks leading to some undetected hidden cost.
The banks are unanimous in that they all believe that there are definite benefits in implementing Basel II principles.	The banks believe that implementing Basel II principles is worth the cost but there could be some undetected hidden cost.
Staff cost and implementing systems are identified by the banks as the main cost components in the Basel II implementation.	Increased compliance cost because of compliance with requirements of a Basel II.
The banks see that further costs to be incurred after the January 2008 implementation of Basel II would also be system-driven.	Increased compliance cost because of compliance with requirements of a Basel II.

Source: Author (2008)

Table 4.8: Possible future cost implications: Audit firms

<b>Survey finding</b>	<b>Possible future cost implication</b>
Audit firms active in South Africa are global firms with a presence in all the major financial centres of the world.	Increased compliance cost because of compliance with the requirements of a wide variety of different local and foreign regulators.
Majority of SARB regulatory audits in offshore jurisdictions are performed by the audit firms' offshore teams.	Increased compliance cost as a result additional training provided to the offshore teams.
Audit firms only have a small number of full-time specialist regulatory audit staff. Firms utilise part-time regulatory audit staff to perform regulatory audits in South Africa and abroad.	Increased compliance cost as a result additional training provided to the part-time teams.
Audit firms' annual income derived from regulatory audits are less than ten per cent of the firms' total annual income.	Annual income as result of regulatory audits is not seen as a major source of income.
Audit firms report to all the major regulators in South Africa.	Increased compliance cost because of compliance with requirements of a variety of different local regulators.
Audit firms provide a full range of regulatory services to the banks.	Increased compliance cost because of compliance responsibilities.

Table 4.8: Cost of compliance implications: Audit firms (Continued)

Survey finding	Possible future cost implication
Audit firms agree on two possible reasons for the increase in the cost of compliance, namely increased complexity of the regulatory environment and more and more acts to comply with.	Increased compliance cost because of compliance with the requirements of a wide variety of different local and foreign regulators.
Audit firms are divided on the issue as to whether the current regulatory regime influences competition in the bank sector.	Increased compliance cost as banks might miss business opportunities.
None of the audit firms interviewed favoured self-regulation by the banks as they are of the opinion that self-regulation is inappropriate in view of South Africa's current state of development.	Increased compliance cost because of compliance with requirements of a variety of different local regulators.
None of the audit firms have any idea of what the cost of implementing the Basel II requirements would be in the bank sector in South Africa.	Actual cost of compliance could not be known to the banks.
Audit firms agree that the main cost components are systems and people with the main cost factor being the use of consultants by the banks.	Increased compliance cost because of compliance with the requirements of a wide variety of different local and foreign regulators.
Audit firms agree that there will be additional cost after the 2008 Basel II implementation.	Increased compliance cost because of compliance with requirements of a Basel II.

Source: Author (2008)

#### 4.4 SUMMARY

Banks should not underestimate the continuing challenge of keeping pace with the implementation of legislation. Compliance with new legislation places great demands on banks and failure to keep pace could result in significant compliance cost. The cost of compliance can be defined as the costs related to a bank's efforts to achieve compliance with all applicable laws, rules, regulations and supervisory requirements. An important aspect that needs to be mentioned is that substantial portions of compliance costs are avoidable, reflecting deficiencies in the way that banks currently manage compliance.

In a review of relevant literature it was found that experts agree that the cost of compliance can be divided into staff-related costs (that encompass fixed and variable compensation and include salaries, bonuses, medical aid contributions and leave pay), out-of-pocket expenses (that refer to the cost associated with the direct purchase of legal, auditing, accounting and other services for compliance-related activities), capital spending (that refers to the purchase of specialised computer hardware and software geared to meet new requirements), opportunity costs that are incurred whenever an employee spends additional time on compliance-related activities instead of developing business for the bank, and other costs.

In order to understand the cost of compliance to banks in South Africa, a survey was conducted amongst the banks regulated by the South African Reserve Bank as well as audit firms involved in regulatory audits. The target population included all the banks in South Africa licensed by the South African Reserve Bank as well as the “big four” audit firms. The survey was conducted by using questionnaires which was completed by relevant staff from the different banks and the audit firms.

The results obtained from the survey revealed some interesting facts about the cost of compliance in South Africa. The results are summarised as follow:

- The majority of the banks in South Africa have a presence in Europe, Africa and Australasia;
- The majority of the banks in South Africa are active in the commercial, investment, treasury, retail and merchant bank sectors;
- All the banks have either a centralised or a combination of a centralised and decentralised business model for compliance. None of the banks in South Africa has a completely decentralised business model.
- The majority of permanent compliance staff is deployed on a decentralised basis by the banks.
- The lead regulators for banks in South Africa are the SARB and FIC.

- The lead foreign regulator for South African banks is based in the UK with other regulators in Africa, USA, Hong Kong, Brazil and India.
- Compliance with the requirements of AML and FICA is managed by all the banks on a centralised basis whilst fewer banks manage the Banks Act, FAIS and OHS also on a centralised basis. The majority of the banks manage HR and NCA on a decentralised basis.
- All the banks perform the basic compliance responsibilities.
- None of the banks was able to furnish information on the actual cost of compliance to these banks.
- The majority of regular submissions to local regulators are made to SARB followed by submissions to FSB and NCR.
- The majority of regular submissions to foreign regulators are made to regulators in Africa followed by the UK, USA and Hong Kong.
- None of the banks has outsourcing agreements in place pertaining to compliance activities.
- The banks are unanimous that the cost of compliance has definitely increased over the past three years.
- Banks are given between 7 and 30 days to respond to regulatory queries depending on the nature of the query and the Regulator's instructions.
- The banks have to wait between 21 and 60 days on responses from the regulators.
- Banks in South Africa are divided on the question whether the current regulatory regime in South Africa is too onerous or not.
- The banks were also divided whether the current regulatory regime influenced competition between the banks positively or negatively.
- The banks are furthermore divided on the question as to whether there are too many regulators in South Africa or not.
- Some banks favoured self-regulation while others were totally opposed to it.
- None of the banks could accurately calculate the cost of implementing Basel II.
- The banks are unanimous in that they all believe that there are definite benefits in implementing Basel II principles.

- Staff cost and systems implementation are the main cost components in the Basel II implementation.
- The banks foresee that further cost to be incurred after the January 2008 implementation of Basel II would also be system-driven.

The mentioned results were in the main confirmed by the results obtained from the survey conducted amongst the audit firms.

In the next chapter, a review is conducted in order to identify international trends in regulatory activities, which could possibly be used in South Africa.

## **CHAPTER FIVE**

### **REGULATORY FRAMEWORKS AND COMPLIANCE: AN INTERNATIONAL PERSPECTIVE**

#### **5.1 INTRODUCTION**

Internationally, regulatory activities and the regulatory environment in which the banking industry operates have undergone tremendous changes during recent years (Carlson & Fernandez, 2006:5). It was established that regulatory activities could be divided into two broad functions, namely regulation and supervision. Regulation involves providing input into developing and interpreting legislation, regulations, issuing guidelines, and approving requests from regulated financial institutions as required. Supervision, however, involves assessing the safety and soundness of regulated financial institutions, providing feedback to institutions, and using supervisory powers to intervene in a timely manner when necessary.

There are currently 149 bank regulators around the world responsible for the regulation and supervision of financial institutions and banks (Bankers of the World, 2007). A number of these regulators are active in countries called the Group of Ten countries ("G10"). The G10 countries consist of eleven industrial countries and include Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States. These countries consult and cooperate on economic, monetary and financial matters. The Ministers of Finance and Central Bank Governors of the G10 usually meet once a year. The Governors of the G10 normally meet bi-monthly at the Bank for International Settlements and the Deputies of the G10 Governors usually meet as needed, but usually between two and four times per year .

The G10 countries have sophisticated financial systems and can be regarded as leaders in the field of banking and banking regulations. A review of the regulatory regimes in these countries could be useful in the context of this study to ascertain

whether any of their structures could be applied in a South African context to reduce the cost of compliance.

The purpose of this chapter is to identify international trends in regulatory activities and structures, which could possibly be used in South Africa to reduce the cost of compliance to banks.

## **5.2 THE G10 COUNTRIES: SUPERVISORY FRAMEWORKS**

The regulatory activities of the G10 countries have been reviewed in order to identify those measures that can be undertaken by the relevant South African authorities to possibly reduce the burden of regulation on the banks.

The following was observed in the G10 countries' supervisory and regulatory frameworks:

### **5.2.1 Belgium**

The National Bank of Belgium ("NBB") has the task of ensuring the stability of the financial system in Belgium (NBB, 2005). The NBB has created an International Cooperation and Financial Stability Department in March 2001 in the bank to perform this task. This task covers the supervision of individual institutions, constituting the "macro-prudential supervision" which is concerned with the smooth operation of the financial system as a whole and the avoidance of major financial disasters. The NBB therefore focuses on systemic risks and concentrates on macro-prudential analysis and examination of the resilience of the large infrastructures enabling the financial markets to operate (NBB, 2005:18).

The Banking, Finance and Insurance Commission ("BFIC") in Belgium is charged with the "micro-prudential supervision" of financial institutions, which is concerned with supervising crises occurring in individual financial institutions.

The BFIC supervises financial services groups, credit institutions, investment firms, listed companies, financial markets, insurance companies and financial intermediaries (BFIC, 2005).

### **5.2.2 Canada**

The Bank of Canada was established in 1935 to oversee banking and monetary governance. The five largest banks in Canada are the Royal Bank of Canada, the Toronto Dominion Bank, the Bank of Montreal, the Bank of Nova Scotia, and the Canadian Imperial Bank of Commerce. Canada's federal government has sole jurisdiction over banks and credit unions, and securities dealers and mutual funds are largely regulated by provincial governments. The bank regulator is the "Office of the Superintendent of Financial Institutions" under authority of the Canadian Banks Act.

### **5.2.3 France**

Banque De France (BDF, 2006) is in the position where the regulation of the banking and financial sector is devoted to the Minister of Finance, assisted by the Advisory Committee on Financial Legislation and Regulation. This committee covers all regulation and legislation applying to the financial sector, which includes banks, insurance companies and investment firms.

The Banking Commission ("SGCB") is a supervisory body consisting of seven members and chaired by the Governor of the French Central Bank. The Commission's mission is to protect depositors as well as to act as watchdog over the French banking and financial system to ensure its profitability and financial stability. The General Secretariat, and its staff, carry out the Commission's decisions and conduct the day-to-day work of supervising credit institutions and investment firms both on and off-site to ensure that they are operating in a safe and sound manner. The SGCB is also in charge of enforcing the French anti-money laundering and anti-terrorism rules.

#### **5.2.4 Germany**

The German Federal Institution for Supervision of Financial Service ("BaFin") is the national supervisory body in Germany supervising the activities of banks, other credit institutions, institutes for financial service, insurance companies and securities trading enterprises. BaFin reports to the German Minister of Finance and its main goal is to ensure the operability, integrity and stability of the German financial system. In the process, the BaFin has to guarantee the solvency of banks, insurance and institutes for financial service and must also protect and maintain the confidence of investors and banking customers.

Although the BaFin leads bank examinations, the German Federal Bank also conducts examinations from time to time, which include the evaluation of the banks' returns and the end-of-year reports.

#### **5.2.5 Italy**

During 1998 the Banca D'Italia ("BDI"), the Central Bank of Italy, shifted its responsibility for monetary and exchange rate policies to the European Central Bank. Within the European institutional framework, BDI implements the decisions, issues Euro banknotes, withdraws and destroys worn pieces.

The main function of the BDI has thus become banking and financial supervision. The objective is now to ensure the stability and efficiency of the system in Italy together with compliance with rules and regulations. In performing its supervisory duties, BDI uses analytical methods, prudential analyses and - if needed - direct or indirect supervisory action (BDI, 2006).

Other functions of BDI include market supervision, oversight of the payment system and provision of settlement services, the State Treasury Service, maintaining the Central Credit Register, economic analyses and institutional consultancy.

### **5.2.6 Japan**

The Bank of Japan (“BOJ”) was established under the Bank of Japan Act, which was promulgated in June 1882 and began operating on 10 October 1882 as the nation's central bank (BOJ, 2007). In the BOJ the regulation and supervision is conducted by BOJ’s Financial and Bank Examination Department.

BOJ conducts both on-site examinations and daily off-site monitoring of the banks in Japan. These activities entail monitoring the business conditions and asset quality of individual correspondent financial institutions, continuous monitoring of potential risks in the overall financial system and applying the above information to contribute to the overall activities of the Bank.

The BOJ therefore endeavours to obtain an accurate picture of conditions at individual financial institutions and banks by aggregating and analysing the information acquired and to understand the overall risk in the financial system.

### **5.2.7 Netherlands**

The Dutch Central Bank (“DCB”) has as its most important objectives to maintain the external stability of the Netherlands Antillean guilder (NAf.) and to promote the efficient functioning of the financial system in the Netherlands (BNA, 2007).

In order to fulfil its objectives, the DCB supervises banking and credit institutions to guarantee depositors and other creditors funds at banking and credit institutions in particular, and the soundness of the financial sector in general.

The prudential supervision of banking and credit institutions is aimed at controlling the soundness of the financial system in the Netherlands Antilles and at safeguarding the deposits of creditors at commercial banks. This supervision is pursued mainly through the Bank’s analyses of the solvency and liquidity of banks.

### **5.2.8 Sweden**

The Sveriges Riksbank or Swedish National Bank is the central bank of Sweden and it is known to be the world's oldest central bank. The supervision of banks is, however, the responsibility of the Swedish Financial Supervisory Authority ("SFSA").

The role of the SFSA is to promote stability and efficiency in the financial system and to ensure effective consumer protection. It authorises, supervises and monitors all companies, including banks operating in the Swedish financial markets (SFSA, 2006).

The SFSA also monitors and analyses trends in the financial market. It assesses the financial health of individual companies, the various sectors and the financial market as a whole. It examines the risks, control systems in banks and financial companies, and supervises compliance with statutes, ordinances and other regulations.

Reporting by financial institutions is important to the SFSA and it monitors financial institutions to disclose complete and clear information. Its responsibility is also to prepare rules for financial reporting by financial institutions.

### **5.2.9 Switzerland**

The Swiss Federal Banking Commission ("SFBC") regulates and supervises banks in Switzerland. These activities take place under Section. 98 of the Federal Constitution of April 18, 1999, which was instituted on January 1, 2000 (FBC, 2005). The SFBC together with the Federal Finance Administration and the Federal Office of Private Insurance has drawn up guidelines for effective financial market regulation, which it incorporates in the regulatory process in Switzerland.

The SFBC monitors compliance with legal prescriptions, issues rulings that are necessary to implement the law and in this respect, has an all-embracing right to obtain information. In addition to audit reports, its sources of information are various approval and notification requirements, newsletters and reports of other authorities, customers or third parties as well as the reporting of the media.

Anti-money laundering activities are among the supervisory functions performed by the SFBC. In this regard, the SFBC monitors whether the banks and other financial intermediaries under its supervision comply with the provisions of the Swiss Anti-Money Laundering Act.

#### **5.2.10 United Kingdom**

In the United Kingdom (“UK”), the supervision and regulation of banks and other financial services companies and firms are the responsibility of the Financial Services Authority (“FSA”) which is an independent non-governmental body, given specific statutory powers by the Financial Services and Markets Act of 2000 in the UK.

The regulation of the financial services industry includes a wide range of rule-making, investigating and enforcement powers to meet the FSA’s statutory objectives. The FSA also sets the standards that the financial services industry must meet and can take action against firms if they fail to meet the required standards (FSA, 2006).

#### **5.2.11 United States of America**

The United States of America (“US”) has one of the most highly regulated and supervised banking environments in the world. Many of the regulations are not safety and soundness related, but is instead focused on privacy, disclosure, fraud prevention, anti-money laundering, anti-terrorism, anti-usury lending, and promoting lending to lower-income segments. Even individual cities enact their own financial regulation laws.

A bank's primary federal regulator could be the Federal Deposit Insurance Corporation, the Federal Reserve Board, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. Furthermore, within the Federal Reserve Board, there are 12 districts centred on 12 regional Federal Reserve Banks, each of which carries out the Federal Reserve Board's bank regulatory responsibilities in its respective district. In addition, there are 50 state regulatory bodies, which regulate and supervise banks chartered by the laws of their respective states.

Melbourne Centre (2002:1) states that achieving and maintaining an optimal regulatory structure for the financial sector is an ongoing challenge because of the continuous changes in and evolution of the financial sector around the world. All regulation involves winners and losers; therefore, there are significant political challenges to ensure that the regulatory evolution reflects social cost-benefit considerations, rather than the self-interest of affected parties. Compliance costs will increase, but the development of new solutions will encourage financial institutions to enhance existing risk and compliance management strategies, processes and systems.

### **5.3 REGULATORY FRAMEWORKS: NEW TRENDS IN THE G10 COUNTRIES**

In analysing the G10 regulatory frameworks, it was found that there are currently some interesting trends developing in regulatory frameworks around the world.

The trends observed are the following:

#### **5.3.1 Allocation of supervisory responsibilities**

It was found that in a number of G10 countries, the responsibility for banking supervision rests with the central bank, while supervision over other financial institutions is typically vested with other agencies. There are, however, several examples of countries moving away from this model such as the United Kingdom and Japan where the model of a single financial regulator has been adopted.

This single regulator is outside of the central bank and independent from direct political influence. The reason for adopting this kind of model is that, since the boundaries between the different types of financial institutions are becoming more and more blurred, it makes sense to integrate the supervision of all financial institutions into a single agency.

South Africa has a different regulatory framework, and supervisory and regulatory duties are mainly shared between the SARB and the FSB.

### **5.3.2 Quest for greater risk-sensitivity**

It was found that the management of risk in G10 banks and other financial institutions consists of three elements, namely accurate measurement and monitoring of risk, controlling and pricing exposures and holding of adequate capital and reserves to meet unexpected losses.

G10 supervisors have recently been focusing increasingly on these aspects. The 1988 Basel Accord was a major step forward and the Basel II Accord is a further important step in this direction. The G10 bank supervisors and other supervisors around the world are introducing the new Basel II rules and banks are now compelled to abide by the new rules and in the process focusing attention on compliance risk and other types of risks and the management thereof.

It was noted that the new Basel II Accord became effective from 1 January 2008 in South Africa. Banks in South Africa have to comply with a new Banks Act as well as a new set of Banks Act Regulations from that date.

### **5.3.3 Increased use of supervisory oversight and market discipline**

The most important trend that was observed in the financial markets is the move by regulators away from regulation towards supervision. This move is aimed at the assessment of whether the overall management of a financial institution's business is prudently conducted.

It was noted that supervisors have to understand all aspects of a financial institution's business. Supervision is becoming a demanding profession, especially under the requirements of Pillar Two of the new Basel II accord, and the skills required of supervisors are becoming greater and more diverse. Supervisors have to seek staff with backgrounds in economics and business management, who, in the process, are becoming consultants whose task is to understand the bank's business and draw management's attention to under-appreciated sources of risk.

#### **5.3.4 Importance of the financial infrastructure**

Any financial sector's efficiency and stability depend on the robustness of the financial infrastructure, which consists of the legal framework, accounting standards used to value financial assets, availability of relevant statistics, payment and settlement system and principles of corporate governance. Weaknesses in the financial infrastructure can severely damage the most careful supervisory oversight. The necessary legislation therefore needs to be in place and must be enforced.

It was found that supervisors are paying increasingly more attention to the financial sector's efficiency and stability in their respective countries. Supervisors also expect the banks to comply with all relevant legislation and regulations.

#### **5.3.5 Need for a level playing field**

The globalisation of financial activities makes a global approach to financial supervision essential. In the absence of such a global approach, there would be the danger of regulatory arbitrage where banks would endeavour to operate in jurisdictions in which the burden of regulation is the lightest.

It was found that a number of different approaches are available to supervisors to counter regulatory arbitrage. The most promising approach is the one adopted by the Basel Committee on Banking Supervision. The Basel Committee drew up a set of standards and guidelines that was agreed upon by supervisors in most

jurisdictions. There is a growing tendency around the world to follow the Basel Accord and, in the process, creating a more level playing field.

### **5.3.6 Marrying micro- and macro-perspectives in regulation and supervision**

Supervisors are becoming aware of the fact that financial sector instability usually has its roots in macroeconomic factors. Banks do not often find themselves in serious trouble only of their own doing. Crises typically occur because banks are jointly exposed to a common macroeconomic shock, related to the current position in the financial cycle.

Supervisors are searching for techniques that will make banking systems more resilient to financial cycles. Banks are encouraged to build up capital cushions in good times to protect lending when the cycle turns down. Among such techniques are stress-testing, pre-provisioning and cyclically variable loan to value ratios. The strengthening of the supervisory review process under Pillar Two of the new Basel Capital Accord could provide a more sound basis for promoting these practices.

## **5.4 REGULATORY COMPLIANCE: NEW TRENDS IN THE G10 COUNTRIES**

In analysing the G10 regulatory frameworks, the following new trends in regulatory compliance in the G10 countries were identified:

### **5.4.1. Basel Committee guidelines**

The Basel Committee on Banking Supervision (BIS, 2005) issued a high-level paper on compliance risk and the compliance function in banks. All the G10 countries are members of the Basel Committee and therefore have to comply with the principles in the mentioned paper. This paper has set a new trend in regulatory compliance and could ensure much more level playing fields in all the

member countries. These guidelines are regarded as *the* major trend currently in regulatory compliance.

It was established that the banks have to comply with the following principles:

- The bank's board of directors is responsible for overseeing the management of the bank's compliance risk.
- The bank's senior management are responsible for the effective management of the bank's compliance risk.
- The bank's senior management are responsible for establishing and communicating a compliance policy, for ensuring that it is observed, and for reporting to the board of directors on the management of the bank's compliance risk.
- The bank's senior management are responsible for establishing a permanent and effective compliance function within the bank as part of the bank's compliance policy.
- The bank's compliance function should be independent.
- The bank's compliance function should have the resources to carry out its responsibilities effectively.
- The responsibilities of the bank's compliance function should be to assist senior management in managing the compliance risks faced by the bank effectively. Its specific responsibilities are set out below. If staff in different departments carry some of these responsibilities, the allocation of responsibilities to each department should be clear.
- The scope and breadth of the activities of the compliance function should be subject to periodic review by the internal audit function.
- Banks should comply with applicable laws and regulations in all jurisdictions in which they conduct business, and the organisation and structure of the compliance function and its responsibilities should be consistent with local legal and regulatory requirements.

- Compliance should be regarded as a core risk-management activity within the bank. Specific tasks of the compliance function may be outsourced, but these must remain subject to appropriate supervision by the head of compliance.

#### **5.4.2. Alignment of compliance with business objectives and strategies**

A multiplicity of government regulations, growing pressure from financial markets, and increasing demands from stakeholders has increased the significance of the corporate-wide focus on compliance. As a result, leading organisations no longer see compliance as a discrete activity managed as a separate function. Rather, they are adopting a compliance strategy that guides people, standardises processes, and integrates technology at every organisational level.

This approach to compliance promotes business viability by unifying corporate strategy, control initiatives, opportunity discovery, and loss mitigation across the extended enterprise. Managing compliance across the financial institution allows for processes and strategies to be evaluated within the institution and extended to partners, suppliers, and customers.

Regulatory compliance and reporting are viewed as a natural extension of the governance duties of the top management and the boards of directors. Good governance can ensure that compliance is aligned with the company's business objectives and risk management strategies and thereby adds value and not just cost to the bank (PWC, 2007). It was observed that regulatory compliance is now regarded as a part of doing business and not a stand-alone activity.

#### **5.4.3. New methods to prepare for on-site examinations**

In the era of class action lawsuits and intense scrutiny from regulatory agencies, Deloitte (Financial Advisory Services, 2007) poses the following question: What to do when regulators come knocking? It was found that financial institutions are currently taking steps to position themselves better to respond to a large variety of detailed, formal, regulatory investigations.

Below is an example of the scope of an extremely detailed on-site examination to ascertain the safety and soundness of a bank (Federal Reserve, 1994) as well as how banks prepare for such an on-site examination.

- Capital adequacy
  - Assessment of the amount and adequacy of capital as expressed by various capital measurement indices including the appropriate ratios under the prompt corrective action framework;
  - Bank growth experience, plans and future prospects; quality and strength of earnings and earnings retention and capital maintenance policy;
  - The volume of risk-weighted assets;
  - Management strength, including the ability to monitor and control risk;
  - Financial strength of subsidiaries, parent, affiliates, and other potential sources of additional capital;
  - The risk exposure represented in off-balance sheet items;
  - Interest rate risk, concentration of credit risk and risks associated with non-traditional activities;
  - Asset quality and growth; and
  - Adequacy of loan loss reserve.
  
- Asset quality
  - The level, distribution, and severity of classified assets including an analysis of classified assets to total assets and capital including compliance with the maximum classified assets to capital ratio and other appropriate ratios;
  - The adequacy of internal controls, credit underwriting standards and practices, and the quality of loan documentation;
  - The level, composition, and trend of past due, non-accrual and reduced-rate assets;
  - Bank's loan loss valuation methodology and charge-off policies including past charge-off and reserve experience;

- Ability to identify, administer and collect problem credits;
  - Concentration of on- and off-balance sheet credits or investments, including the magnitude and severity of the concentrations;
  - Nature and volume of special mention assets;
  - Comprehensiveness of and adherence to lending, investment, and trading policies;
  - Adequacy of credit administration, including real estate owned, problem assets and real estate appraisal practices;
  - Quality and control of off-balance sheet items, including assets sold with recourse, derivative products and netting policies and practices; and
  - Exposure to insiders.
- Evaluation of management/administration
    - Technical competence, leadership and administrative ability;
    - Compliance with relevant banking regulations and statutes;
    - Effectiveness of internal controls, management information systems and the strength and integrity of the internal and external audit programmes;
    - Sufficiency of and adherence to the bank's policies and procedures;
    - Ability to identify, measure and control financial<sup>1</sup> and operating risks, including the adequacy of formal risk management systems;
    - Use of the payments system and effectiveness of controls to prevent misuse;
    - Ability to effectively plan and respond to changing circumstances, including strategic planning and the adequacy of management information systems;
    - Management depth and succession planning;
    - Tendencies toward self dealing and transactions with related organisations;
    - Compensation standards, including safeguards to prevent against the payment of excessive compensation;
    - Management's philosophy with respect to dividends;
    - The accuracy of regulatory reports;
    - The board of directors' discharge of its responsibilities;

- Compliance with outstanding supervisory improvement programmes (formal and informal); and
- The overall condition of the institution.
  
- Earnings
  - Quality and future prospects for core income;
  - The ability to cover losses and maintain adequate capital including compliance with the minimum earnings standard;
  - Earnings levels and trends;
  - The composition of earnings and sustainability of the various earnings components;
  - Peer group comparisons;
  - Vulnerability to interest rate and other market or price risks;
  - The reliability of the bank's income and expense accounts, including applicable accounting practices, internal controls, and audit methods;
  - Compliance with laws and regulations relating to earnings and dividends; and
  - The effectiveness of management's budgeting process.
  
- Liquidity
  - The volatility and structure of deposits;
  - Reliance on interest-sensitive funds and frequency and level of borrowings;
  - Technical competence of management with respect to the structure of liabilities;
  - Access to money markets or other ready sources of cash;
  - Availability of assets readily convertible into cash at a reasonable cost;
  - The bank's reputation and image in market;
  - Outstanding commitments to provide funds;
  - Funds management programme to determine the adequacy of contingency planning and the reasonableness of established parameters;

- Internal reports to determine whether management is provided with the necessary information for informed funds management decisions and whether risks are appropriately monitored; and
- Implications of the overall financial condition or suitability of the funding sources.

The scope of an on-site examination, as given above, has compelled financial institutions to develop new strategies to cope with such examinations. The author has found that banks are developing new strategies on the following issues:

- Assessing allegations;
- Preparing for an investigation by the Regulator;
- Developing an investigation team and plan;
- Strategies for dealing with special examinations;
- Planning for potential resolution strategies; and
- Taking the initiative with remedial actions.

#### **5.4.4. Records management**

Gable (2007) states that a quite a number of financial institutions are in a process of transition from paper records to electronic records and that the pace of transition is picking up. Financial institutions now realise that records management constitutes a significant part of compliance. Records management is in the first place concerned with information, how it is managed, and what kind of response is given to a regulator or an inspector. Records managers not only have to be experts in storing and managing and collecting the content, but also the procedures, and the laws that govern the job.

It was observed that the following new trends in records management have emerged (South Texas College, 2007):

- Electronic record management is now part of the risk management plan

- Many financial institutions now have risk management programmes that contain an electronic record management module;
  - The majority of financial institutions have already started applying risk management principles to electronic information systems and procedures;
  - Records are managed by content and by not by media;
  - Financial institutions have realised that there is a significant loss of functionality with the “print & file” concept; and
  - There are already some tools available in the marketplace to assist with records management.
- Radical decentralisation of information management
- Financial institutions are devolving the responsibility for information and records management to the users of such information. This responsibility has therefore been moved from a central point in the institution to subject matter experts; and
  - The sheer volume of information has necessitated users to even deploy their own information management capabilities.

However, financial institutions are made aware of the danger that the radical decentralisation of information management can cause issues for the institution and it should be carefully considered before implementation.

- Instituting a pragmatic records management process
- Financial institutions have different internal requirements, but similar external requirements as far as records management are concerned. They are therefore faced with a decision between retention of records or full-bore records management;

- Financial institutions are simplifying records management and records management processes;
- Financial institutions are incorporating risk management processes into existing information technology tools and applications; and
- Some financial institutions are using automatic classification tools.

#### **5.4.5 Outsourcing**

Compliance costs are on the increase, but banks are investigating possibilities to outsource some of the compliance functions related to data management and reporting without compromising quality or abdicating management responsibility (Capgemini, 2007). The responsibility for compliance cannot be outsourced to external or internal independent third parties, but some compliance duties may well be outsourced to such third parties.

It was found that the FSA in the United Kingdom has recently adopted specific guidelines on the application of outsourcing that are effective from 1 November 2007 (MiFid, 2007). These guidelines are as follows:

- Outsourcing is defined as an arrangement of any form between a financial institution and a service provider by which that service provider performs a process, a service or an activity, which would otherwise be undertaken by the financial institution itself.
- The financial institution relying on a third party for the performance of operational functions which are critical for the performance of regulated activities on a continuous basis, must ensure that it takes reasonable steps to avoid undue additional operational risk. It must also have effective processes and internal control mechanisms in place to identify, manage, monitor and report risks.

- The mentioned operational functions are regarded as critical or important if a defect or failure in their performance would materially impair the continuing compliance of the financial institution with the conditions and obligations of its authorisation or its other obligations under the regulatory system, or its financial performance, or the soundness or the continuity of its relevant services and activities.
  
- The following is not considered to be critical or important services:
  - Provision of advisory services;
  - Appointment of sub-custodians;
  - Participation in securities settlement systems and payment systems;
  - Provision of one-off, expert assistance with compliance, internal audit, accounting or risk management issues;
  - Provision of logistical support, such as cleaning, catering and procurement of basic services/products;
  - Provision of human resources support, for example sourcing of temporary employees and processing of payroll;
  - Buying standard software "off-the-shelf" or engaging a software designer to develop bespoke software; and
  - Reliance on software providers for ad-hoc operational assistance in relation to off-the-shelf systems.
  
- The following are deemed to be outsourcing agreements:
  - Provision of regular or constant compliance, internal audit, accounting or risk management support;
  - Provision of credit risk control and credit risk analysis;
  - Portfolio administration or portfolio management by a third party;
  - Provision of data storage;
  - Provision of ongoing, day-to-day systems maintenance/support; and

- Provision of ongoing, day-to-day software/systems management (for example, where a third party carries out day-to-day functionality and/or runs software or processes on its own systems).
- The financial institution that outsources critical or important operational functions remains fully responsible for discharging all of its obligations under the regulatory system and must comply, in particular, with the following conditions:
  - The outsourcing must not result in the delegation by *senior personnel* of their responsibility;
  - The relationship and obligations of the financial institution towards its clients under the regulatory system must not be altered;
  - The conditions with which the financial institution must comply with in order to be authorised must not be undermined; and
  - None of the other conditions under which the financial institution's authorisation was granted, must be removed or modified.
- A financial institution must exercise due care and diligence when entering into, managing or terminating any arrangement with a service provider for the outsourcing of critical or important operational functions. These include:
  - The service provider must have the ability, capacity, and any authorisation required by law to perform the outsourced functions, services or activities reliably and professionally;
  - The service provider must carry out the outsourced services effectively, and to this end, the financial institution must establish methods for assessing the standard of performance of the service provider;
  - The service provider must properly supervise the carrying out of the outsourced functions, and adequately manage the risks associated with the outsourcing;

- Appropriate action must be taken if it appears that the service provider may not be carrying out the functions effectively and in compliance with applicable laws and regulatory requirements;
  - The financial institution must retain the necessary expertise to supervise the outsourced functions effectively and manage the risks associated with the outsourcing, and must manage those risks and must supervise those functions;
  - The service provider must disclose to the financial institution any development that may have a material impact on its ability to carry out the outsourced functions effectively and in compliance with applicable laws and regulatory requirements;
  - The financial institution must be able to terminate the arrangement for the outsourcing where necessary without detriment to the continuity and quality of its provision of services to clients;
  - The service provider must cooperate with the appropriate regulators in connection with the outsourced activities;
  - The financial institution and its auditors must have effective access to data related to the outsourced activities, as well as to the business premises of the service provider;
  - The service provider must protect any confidential information relating to the financial institution and its clients; and
  - The financial institution and the service provider must establish, implement and maintain a contingency plan for disaster recovery and periodic testing of backup facilities with regard to the function, service or activity that has been outsourced.
- 
- The financial institution should have dedicated persons with the responsibility of supervising and monitoring the outsourced function on an ongoing basis, and the financial institution should have sufficient competence at a senior level in-house to enable them to resume control over the outsourced function if necessary.

- The financial institution must:
  - Establish methods for assessing the standard of performance of the service provider;
  - Take appropriate action if it appears that the service provider may not be carrying out the functions effectively and in compliance with applicable laws and regulatory requirements;
  - Retain the necessary expertise to supervise the outsourced functions effectively and manage the risks associated with the outsourcing, and supervise and manage those risks;
  - Ensure that the arrangement for outsourcing may be terminated where necessary without detriment to the continuity and quality of its provision of services to clients;
  - Ensure access for the financial institution, its auditors and the relevant competent authorities to data related to the outsourced activities, as well as to the business premises of the service provider, and the competent authorities must be able to exercise those rights of access; and
  - Establish, implement and maintain a contingency plan for disaster recovery and periodic testing of back-up facilities, with regard to the function, service or activity that has been outsourced.
  
- The financial institution must ensure that the service provider:
  - Has the ability, capacity and authorisation required by law to perform the outsourced functions, services or activities reliably and professionally;
  - Carries out the outsourced services effectively;
  - Properly supervises the carrying out of the outsourced functions and adequately manages the risks associated with outsourcing;
  - Discloses to it any development that may have a material impact on its ability to carry out the outsourced functions effectively and in compliance with applicable laws and regulatory requirements;

- Cooperates with the competent authorities of the financial institution in connection with the outsourced activities;
  - Protects any confidential information relating to the financial institution and its clients; and
  - Establishes, implements and maintains a contingency plan for disaster recovery and periodic testing of back-up facilities, with regard to the function, service or activity that has been outsourced.
- 
- A financial institution must ensure that the respective obligations and rights of the financial institution and of the service provider are clearly allocated and set out in a written agreement.
  
  - In the case where a financial institution and the specific service provider are members of the same group, the financial institution must take into account the extent to which the financial institution controls the service provider or has the power to influence its actions.
  
  - Financial institutions are required to ensure that they have the ability to terminate the arrangement for outsourcing where necessary without detriment to the continuity and quality of its provision of services to clients.

The banking regulator in South Africa opposes this view and states that it is not in favour of banks in South Africa outsourcing its compliance duties (SARB, 2004b). The circular, however, fails to provide further detail as to what exactly is meant by "Compliance Duties".

#### **5.4.6 e-Compliance Solutions**

Adams (2005) states that regulatory requirements need to be addressed during the development stage of any new product or service offered by a bank. The main driver behind software development has always been functionality.

Software is meant to provide new or expanded access to data and services, and the requirements for software are typically set down with these needs in mind.

Data privacy and integrity, which are often neglected in specifications, have become non-negotiable business requirements. Regulations now require that software behave differently, specifically in the way that it identifies users, stores sensitive data and records access to system resources.

A number of companies around the world have developed automated systems that can complement the compliance process. These automated systems can track, reference and record events, and prompt user actions throughout the entire compliance process. In tracking, managing and recording completed compliance tasks, these systems assist the financial institution in meeting and exceeding legal obligations and remaining abreast of regulatory restrictions. It is, however, stressed that these systems cannot replace compliance activities but should rather be seen as complementing the compliance process.

The vendors for these systems are of the opinion that there are numerous advantages to the financial institution for using them. These advantages include the following (Wonderware, 2007):

- The software is affordable and can reduce the cost of compliance;
- Information is secure;
- It guarantees a paperless environment ;
- The software is easy to integrate with existing business and/or operations systems; and
- The software is user-friendly and easy to use.

It was found that some of the banks are in favour of e-Compliance solutions, but are of the opinion that there is not a one-fit-all solution available and that

consequently, each system should be tailor-made to suit the individual bank's requirements.

## **5.5 SUMMARY**

The study has found that regulatory compliance is a new science that concerns itself with compliance laws, rules and standards. These laws, standards and rules cover issues such as observing proper standards of market conduct, managing conflicts of interest, treating customers fairly, and ensuring the suitability of customer advice. Also included are areas such as the prevention of money laundering and terrorist financing. Any bank participating in transactions could be exposed to a compliance risk.

The review of the G10 countries' regulatory frameworks has revealed that not only are there significant differences between banks regarding regulatory compliance, but a range of differences could also be discerned also amongst the regulators in the different countries investigated for this review. The G10 countries are regarded by many industry experts as the leaders in the financial world and yet it was found that the way compliance is managed differs from country to country.

An example of this where banking regulation in the US is fragmented compared to that of the other G10 countries. Some of the G10 countries have only one or two bank regulators, but in the U.S., banking is regulated at both the federal and the state level. Depending on a banking organisation's charter type and organisational structure, it may be subject to numerous federal and state banking regulators. Unlike Japan and the United Kingdom, where regulatory authority over the banking, securities and insurance industries is combined into one single financial services agency, the U.S. maintains separate securities, commodities, and insurance regulatory agencies. These agencies are separate from the bank regulatory agencies at the federal and state levels.

The current review of new trends in regulatory compliance has also revealed some interesting new developments. These include developments such as the new Basel II requirements, aligning compliance with the bank's business objectives and strategies, regulatory compliance and software, preparation and readiness for on-site examinations, outsourcing of compliance functions and the use of e-Compliance solutions.

The information obtained in this chapter will be used in the analysis of the regulatory frameworks and new trends in regulatory compliance in the next chapter where a compliance framework is developed.

## CHAPTER SIX

### COMPLIANCE FRAMEWORK

#### 6.1 INTRODUCTION

In Chapter Four, a survey was conducted amongst banks in South Africa to ascertain the impact of the cost of compliance on these banks. The results of the survey indicated that the cost of compliance has increased substantially over the past number of years. It would therefore be beneficial to find methods of possibly minimising this cost. Two distinct areas were identified where the cost of compliance can be managed, namely the areas where compliance duties are actually performed and the monitoring of compliance by dedicated compliance personnel.

Tamus (2007) is of the opinion that performing compliance in a bank is the responsibility of each of the bank's employees. It is the duty of the compliance division to only monitor and report on the level of compliance in a bank. In order to save costs, CCH (2006) further states that banks need to create a compliance culture by making the compliance programme part of the business and part of the mindset and responsibility of each and every employee. By communicating constantly, visibility of the compliance programme could be enhanced.

From an employee perspective, the inclusion of certain compliance-related key performance indicators into each employee's remuneration package will increase accountability. The inclusion of compliance in business cases for budgets and strategic initiatives and making compliance an agenda item at board meetings will increase visibility at a more strategic level. Setting up management information systems that provide relevant information to the board and executive management about the bank's compliance and clear, transparent reporting procedures could all contribute towards an effective compliance programme.

Deloitte (2006:1) is of the opinion that there is no single compliance division structure for all banks and that there is considerable variability in structures. While some banks have created positions such as vice-president: compliance or director of regulatory compliance, others are adding the compliance activities responsibility to existing positions within financial reporting. Regardless of the structure, the goal is to make compliance a regular part of doing business, not an “add-on” to an existing job function.

This chapter therefore focuses on the compliance divisions of banks with the purpose of constructing a compliance framework for. To achieve this goal, the current chapter defines the compliance universe, the responsibilities of the compliance officers, constructs a compliance organogram; defines the reporting structures, compliance cost calculation models, provides a risk-effectiveness matrix, and discusses the outsourcing of compliance duties by the compliance division.

In order to ascertain whether the compliance framework meets all regulatory requirements, a self-assessment of the framework is performed by measuring it against the requirements of Regulation 47 of the Regulations relating to Banks as well as the Basel principles relating to compliance.

## **6.2 COMPLIANCE FRAMEWORK**

The compliance framework incorporates the following elements:

- A specific regulatory universe for banks in South Africa;
- Specific responsibilities for compliance officers;
- A functional compliance structure (organogram);
- Details on reporting matters;
- A simplified model for measuring actual compliance cost;
- A risk-effectiveness matrix to risk weight matters of non-compliance;
- Principles on the outsourcing of compliance duties by the compliance division.

### 6.2.1 Regulatory universe in South Africa

The regulatory universe in the framework is based on the activities of a bank as identified by ABSA (Absa, 2005:112 – p113):

- Personal banking that includes personal financial services, retail banking services, micro loans, home loans and credit card services.
- Commercial banking that includes business banking, vehicle and asset finance.
- Wholesale banking that includes corporate and merchant banking activities, trading, investment solutions, and international operations.
- Financial services that include life insurance, short-term insurance, advisory services, fund management, trust services and investment management services.
- Other services that include real estate management.

The acts identified in Chapter Two are those that have the most severe impact on the activities of a bank, as mentioned above, and that have to be managed centrally in a bank and not by the different divisions in the bank. The following reasons are stated:

- Different regulators administer these acts and banks are the subjects of an applicable regulator's supervisory process. This supervisory process necessitates frequent contact between the bank and the regulator and the banks should manage and nurture this relationship.
- Non-compliance with these acts can be a criminal offence and may carry hefty penalties for both the bank and bank employees.
- These acts are applicable across all the divisions or departments of the bank and consistency in application of the law is critical.

It should be noted that there could be other acts in existence that were not included in the final list of acts. These acts cannot be discarded or ignored and compliance with these acts should be ensured at a divisional level in a bank as it could apply to the specific activities of that division in a bank.

Acts listed below, in alphabetical order, are the acts that have been identified in the South African legislative universe that can be managed at a central level in a bank.

- Banks Act, 1990;
- Basic Conditions of Employment Act, 1997;
- Companies Act, 1973;
- Competition Act, 1998;
- Consumer Act (Unfair Business Practices), 1988;
- Electronic Communications and Transactions Act, 2002;
- Employment Equity Act, 1998;
- Financial Advisory and Intermediary Services Act, 2002;
- Financial Intelligence Act, 2001;
- Income Tax, 1962;
- Labour Relations Act, 1995;
- Medical Schemes Act, 1998;
- National Credit Act, 2006;
- Occupational Health and Safety Act, 1993;
- Promotion of Access to Information Act, 2000;
- Skills Development Act, 1998;
- Tobacco Products Control Act, 1993;
- Unemployment Insurance Act, 2001;
- Unemployment Insurance Contributions Act, 2002; and
- Value-Added Tax Act, 1991

The acts mentioned above are among the most important cornerstones in the construction of the compliance structure in 6.2.3 below.

## 6.2.2 Compliance responsibilities

Compliance officers often struggle to understand the full extent of what their job entails and the role played by their department in the bank's overall risk management programme. Compliance responsibilities rest with the compliance officers at a central level in a bank and also with the compliance officers at a business unit level. The compliance officers at the central level are called subject-matter experts ("SMEs") as they are the experts in specific pieces of legislation.

The SMEs at a central level are responsible for the establishment of uniform risk management standards, policies, procedures and methodologies in conjunction with the business entities, audit and risk committees, management boards and boards of directors of a bank. These SMEs are also responsible for the communication to the business units of risk management strategies and general risk management requirements, creating risk awareness, monitoring the implementation and effectiveness of the risk management processes and assisting with the improvement of risk management processes as required.

The general and specific compliance responsibilities for SMEs at a central level are defined as:

- General responsibilities:
  - Overseeing the distribution of policies and regulations;
  - Developing and distributing the specific rules governing the implementation of policies and regulations;
  - Interpreting or answering questions about policies, regulations and rules; and
  - Communicating information concerning policies, regulations and rules.
  
- Specific responsibilities:
  - Reviewing all new or revised policies and regulations;

- Determining if new rules or the modifications of current rules are applicable;
- Distributing policies and regulations to all applicable divisions of the bank;
- Overseeing the development or implementation of rules;
- Overseeing the distribution of rules to appropriate bank personnel;
- Publishing rules through bank distribution channels and appropriate web sites;
- Providing training to present, interpret or explain the rules;
- Ensuring that the names of all the bank's compliance officers are available to employees in order to respond to questions/comments on policies, regulations, or rules;
- Reporting to the appropriate forums on a regular basis on progress in developing and distributing policies, regulations and rules ; and
- Making recommendations to the bank's management concerning policy compliance.

The following task list for SMEs managing, for example, the South African Banks Act at a central level in a bank can be set out as follows:

- Reviewing the Banks Act, circulars and guidance notes and ensure that all compliance officers are informed about applicable legislation;
- Receiving and replying to all enquiries relating to interpretational matters;
- Reviewing the SARB website regularly to ensure that all publications relating to legislative and procedural changes are considered and that all relevant parties are notified;
- Reviewing all SARB correspondence and ensuring that appropriate action is taken;
- Updating all internal guidelines based on the Banks Act, circulars and other guidance notes published by the SARB;
- Drafting and updating risk management plans for the Banks Act;
- Communicating with the Regulator and acting as the primary liaison officer with the regulator;

- Reviewing SARB communication and informing all applicable employees accordingly;
- Ensuring that action is taken as required by SARB correspondence;
- Communicating with the industry;
- Considering industry communication and informing all relevant employees;
- Coordinating Banks Act Section 52 applications for approval by the SARB;
- Managing and updating the banking group organogram;
- Reviewing and submitting the bank's Banks Act DI 800 to the Regulator;
- Ensuring that the Banks Act Regulation 38, 39 and 45 audit reports are submitted to the Regulator;
- Submitting compliance reports to the bank's boards;
- Submitting compliance reports to the regulators;
- Reporting to the Regulators in the event of non-compliance;
- Amending training material in line with legislative changes;
- Ensuring that required training development takes place and signing off as subject matter expert on the developed material;
- Providing training on ad hoc basis as requested;
- Attending applicable Banking Association meetings;
- Attending meetings on ad hoc industry issues;
- Acting as chairperson for internal Banks Act meetings; and
- Attending various ad hoc meetings relating to the Banks Act.

The responsibilities of compliance officers at a divisional or business unit level can be divided into general and specific responsibilities. These are:

- General responsibilities:
  - Ensuring that all applicable policies and regulations have been received;
  - Adhering to rules regarding the implementation of policies and regulations;
  - Obtaining answers to questions about policies, regulations and rules from subject-matter experts; and

- Communicating information concerning policies, regulations and rules.
- Specific responsibilities:
  - Reviewing all new or revised division-specific policies and regulations;
  - Distributing policies and regulations through all applicable channels to all affected areas of the division;
  - Implementation of rules;
  - Overseeing distribution of approved rules to appropriate divisional personnel;
  - Publishing rules through the division's distribution channels;
  - Providing training, as appropriate, to present, interpret or explain the rules;
  - Providing the names of the division's compliance officers to all employees in order to respond to questions/comments on policies, regulations, or rules;
  - Reporting to the head of the division on a regular basis on progress regarding developing and distributing policies, regulations and rules ; and
  - Making recommendations to the subject-matter experts concerning policy compliance.

The task list for a compliance officer managing, for example, the South African Banks Act at a divisional level in a bank can set out as follows:

- Ensuring that all employees are informed about applicable legislation;
- Replying to all enquiries relating to interpretational matters;
- Ensuring that appropriate action is taken with regards to all SARB communications;
- Updating all divisional guidelines based on the Banks Act, circulars and other guidance notes published by the SARB;
- Ensuring that divisional risk management plans for the Banks Act are updated;
- Communicating with the subject-matter expert and acting as the primary liaison officer with the subject-matter expert;

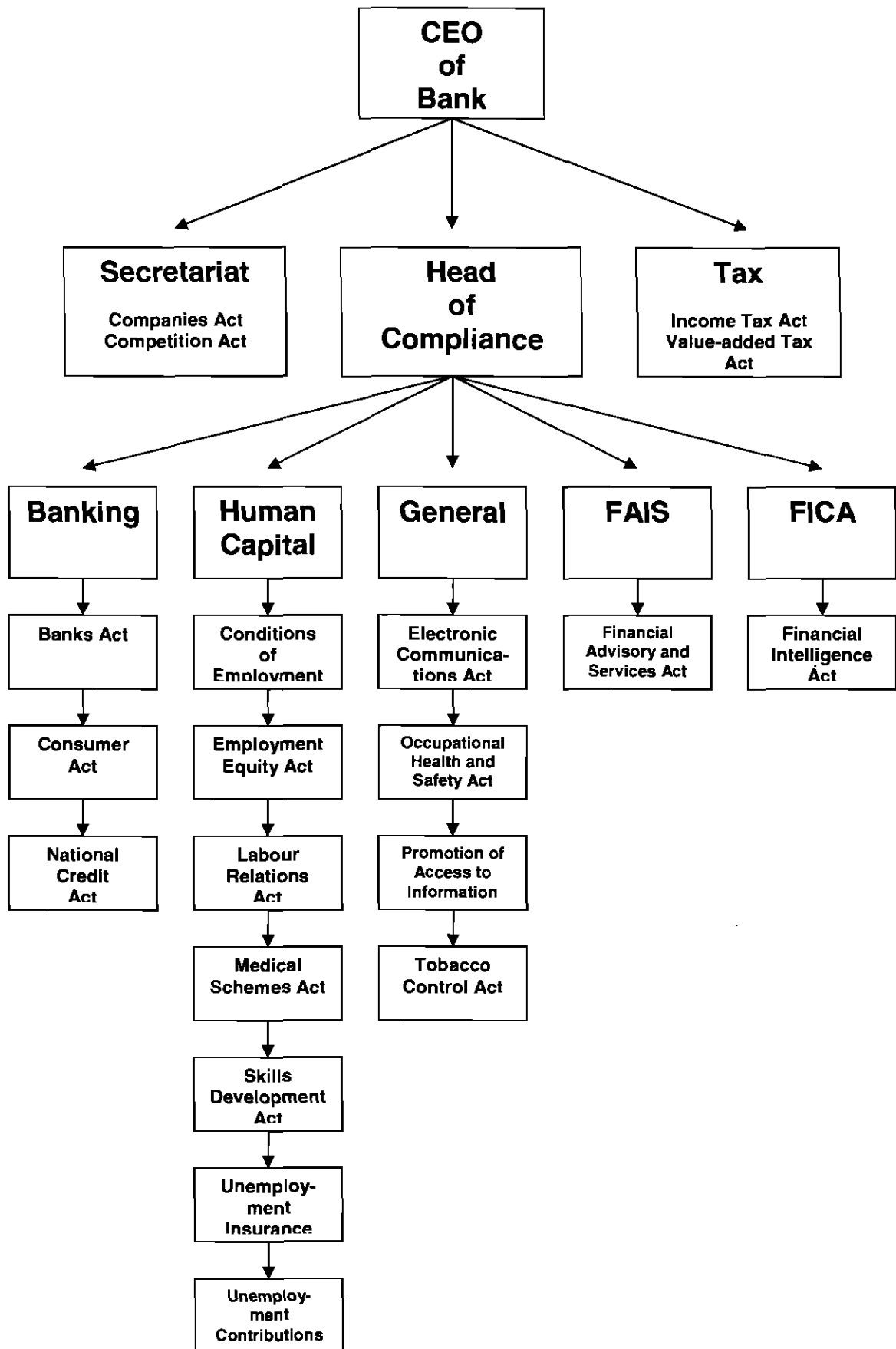
- Reviewing subject-matter expert communication and informing all relevant employees accordingly;
- Ensuring that action is taken as required by the subject-matter expert;
- Preparing divisional Banks Act Section 52 applications for approval by the SARB;
- Reviewing and submitting the division's Banks Act DI 800 to the subject-matter expert;
- Submitting divisional compliance reports to the subject-matter expert;
- Reporting to the subject-matter expert in the event of non-compliance;
- Ensuring that divisional training development required takes place;
- Providing divisional training on ad hoc basis as requested;
- Attending applicable bank's compliance meetings;
- Acting as chairperson for internal divisional Banks Act meetings; and
- Attending various ad hoc meetings relating to the Banks Act.

The above-mentioned responsibilities and task lists can be used to describe the responsibilities and tasks of SMEs or divisional compliance officers involved in any of the acts mentioned above. These are the basics needed to perform the compliance functions. It should, however, be tailored to meet any particular requirements of a specific act.

### **6.2.3 Compliance structure at a central level**

The compliance structure for the framework below is a functional structure based on the legislative universe as described above.

Figure 6.1: Compliance structure



Source: Author (2008)

There are four different levels in the structure, namely:

- Level one: Executive management

The bank's board of directors is ultimately responsible for compliance in a bank. The Chief Executive Officer ("CEO"), who reports to the board, is responsible for the management of compliance risk. In banks, active board and CEO oversight is critical. It is also important to have the right culture at the top, ensuring that compliance is a bank-wide priority and that business units are responsible for performing compliance in the respective units.

The board, in conjunction with the CEO, shall also review the bank's compliance policy at least once a year and assess the extent to which the bank is managing compliance risk effectively.

- Level two: Senior management

Senior management are responsible for the establishment and maintenance of appropriate compliance risk policies, procedures, and internal controls. Senior management are furthermore responsible to report any material breaches of acts, regulations or any other rules to the board and CEO.

The senior management level incorporates the Head of Compliance ("HOC"), Head of Secretariat ("HOS") and the Head of Tax ("HOT"), each of whom reports directly to the CEO. Senior management are divided into these three groups based on the acts identified in Chapter Two as well as applicable regulatory requirements.

The HOS is responsible for managing compliance with the Companies Act and Competition Act. The HOC, in turn, is responsible for managing compliance with a wide spectrum of acts that can be divided into banking acts, human capital acts, financial acts and some other applicable acts.

The HOT is responsible for managing compliance with the Income Tax Act and Value-added Tax Act.

- **Level three: Management**

The group compliance division, headed up by the HOC, is divided into sections as described above. A manager responsible for each set of acts heads each section. There are therefore dedicated managers for banking, human capital, general, FAIS and FICA sections.

The manager's primary responsibility is to co-ordinate activities in the particular section and to ensure that subject matter experts (SME's) adequately manage compliance risk for all the applicable acts. The manager also acts as the liaison person between the SMEs and the rest of the business.

- **Level four: Subject matter experts**

Subject matter experts may each manage a particular act or more than one related act. They are regarded as "the experts" in those specific acts. The SME's duties were discussed in detail under 6.2.2 above.

#### **6.2.4 Compliance risk rating**

The bank's board of directors should decide on the bank's overall compliance risk appetite and determine how much compliance risk the bank is willing to accept. This determination of risk tolerance should be done with reference to potential impact on the strategy and the achievement of business objectives. The establishment of appropriate materiality levels by the bank will assist management in discharging their responsibility for the ongoing and effective management of compliance risk by providing a mechanism for the identification of matters requiring priority focus and attention.

In the regulatory framework, compliance risk appetite is defined as “... *the risk of legal or regulatory sanctions, material financial loss or reputational damage a bank may suffer as a result of its failure to comply with all applicable laws, regulations and supervisory requirements*”.

Non-compliance with any rule, whether intentional or accidental, could have severe consequences for a bank - leading to possible criminal prosecution, penalties, and the loss of any licence as required in terms of the applicable legislation. The compliance framework therefore recognises the presence of compliance risks and promotes the rating of these risks.

In order to rate these compliance risks, the following scale is presented to establish the level of seriousness of the non-compliance event:

<b>High Risk</b>	1	2	3
<b>Medium Risk</b>	4	5	6
<b>Low Risk</b>	7	8	9
	<b>Compliant</b>	<b>Non-Compliant (Room for improvement)</b>	<b>Non-Compliant (Unacceptable)</b>

Source: Author (2008)

The terms on the different axes used can be defined as follows:

- High risk

High risk refers to events of non-compliance that are specifically classified in the legislation as criminal offences resulting in substantial fines and or jail terms.

- Medium risk

Medium risk refers to events of non-compliance that are not classified in the legislation as criminal offences but that could result in regulatory sanctions.

- Low risk

Low risk refers to events of non-compliance that are not classified in the legislation as criminal offences but that could result in regulatory penalties or increased regulatory supervision.

- Compliant

Compliant means that every single requirement in a particular section or regulation has been met.

- Non-compliant (Room for improvement)

Non-compliant (Room for improvement) means that some of the requirements in a particular section or regulation have not been met.

- Non-compliant (Unacceptable)

Non-compliant (Unacceptable) means that the majority or all of the requirements in a particular section or regulation have not been met.

The colour-coding used in the above-mentioned matrix is as follows:

- Red

Events of non-compliance marked as red are serious in nature and require immediate attention from the bank's board and management. Red also indicates that there should be immediate communication and engagement with the relevant authority in order to resolve the matter.

- Yellow

Events of non-compliance marked as yellow are not as serious as the red events in nature, but still requires attention from the bank's board and management. Yellow also indicates that there should be communication and engagement with the relevant authority in order to resolve the matter.

- Green

Actions marked as green require no additional attention from the bank's board and management. Green also indicates that there is no need for additional communication and engagement with the relevant authority other than that required by the authority.

Using the South African Banks Act as the underlying legislation, the different squares in the graphical example of the rating scale above can be explained as follows:

- Square 1: Green

This square represents a bank's actions that are of a high-risk nature but with which the bank are fully compliant and no action needs to be taken. A typical action would occur when a new entity bought by the bank is not opened for dealings with the public until such time that all the necessary approvals have been obtained from the Registrar of Banks.

- Square 2: Red

Events of non-compliance placed in this square are serious in nature, require immediate action, and could, for example, represent events where a bank is continuously submitting its regulatory returns to the Registrar of Banks after the due date.

- Square 3: Red

Events of non-compliance placed in this square are serious in nature, require immediate action, and could, for example, represent an event where a company conducts the business of a bank without the written consent of the Registrar of Banks.

- Square 4: Green

This square represents the bank's actions that are of a medium-risk nature, but with which the bank is fully compliant and no action needs to be taken. A typical action would occur when a new internal division is created by the bank but not opened until all the necessary approvals have been obtained from the Registrar of Banks.

- Square 5: Yellow

This square represents the bank's actions that are of a medium-risk nature with which the bank is only partially compliant and action needs to be taken. A typical action would occur when a new product is launched by the bank and the accounting is done manually with the existence of compensating controls.

- Square 6: Red

This square represents the bank's actions that are of a medium-risk nature with which the bank are only partially compliant and action needs to be taken. A typical action would occur when a new product is

launched by the bank and the accounting is done manually with no compensating controls to mitigate risk.

- Square 7: Green

This square represents the bank's actions that are of a low-risk nature with which the bank are fully compliant and no action needs to be taken. These actions should, however, still be monitored to ensure continued compliance.

- Square 8: Green

This square represents the bank's actions that are of a low-risk nature with which the bank are only partially compliant and action needs to be taken. A typical action would occur where the bank is non-compliant with a regulation, but has obtained a condonation from the relevant regulator to be non-complaint.

- Square 9: Red

This square represents the bank's actions that are of a low-risk nature with which the bank are non-compliant and action needs to be taken. A typical action would occur when a new non-executive director has been appointed by the bank and the necessary documentation has not been forwarded to the Registrar of Banks.

This method of rating compliance risk is one of the cornerstones in the following sections, which deal with monitoring of and reporting on compliance risk.

### **6.2.5 Compliance monitoring**

Compliance monitoring is one of the key tools that a bank can use to protect itself, shareholders and depositors by ensuring that the bank and adheres to

laws and regulations. The Compliance Institute of South Africa (CISA, 2002) defines compliance monitoring as “*An examination of business activities to assist management and the board of directors to understand whether business is conducted in compliance with the relevant regulatory requirements*”.

In the compliance framework, a risk-based approach is promoted for compliance monitoring. The divisional compliance officers as well as the compliance officers at a central level furthermore perform compliance monitoring.

The role of the compliance officer at the centre or SME can be defined as identifying the acts that govern the activities of a bank, identifying the inherent risks, assessing the risks and rating the risks. The objective of the process is to provide direction in terms of which requirements could be regarded as high regulatory risks for the bank. High risk and core regulatory requirements identified are those that warrant monitoring on a continuous basis.

The role of the divisional compliance officer is to monitor compliance with all applicable laws and regulations that are relevant to that particular division. The monitoring of divisional compliance is firstly, based on the guidance provided by the different SMEs. Secondly, the divisional compliance officer should monitor all applicable acts and regulations not managed by the SMEs and that are only applicable to that division.

There are a number of methods available to compliance officers for monitoring compliance. The study aligns itself with these methods which are relevant to this compliance framework:

- Meeting attendance

It is the duty of the compliance officer to attend all meetings in the bank or division in order to remain informed of business activities. These meetings include audit, risk and compliance committee meetings, new

product/business meetings and meetings with senior management. The ideal is that the compliance officer should be a non-executive member of the committees. The advantage is that any non-compliance can be identified at an early stage and that guidance can be provided to the division.

- Research

The SME needs to constantly research the regulatory universe to identify applicable acts and regulations that need to be managed at a central level in a bank. The divisional compliance officer should also constantly search the regulatory universe to ensure that all applicable acts and regulations not managed by the SMEs are identified.

- Risk-management plans

The SME formulates a risk-management plan ("RMP") that will guide the monitoring process. Some of the monitoring will be conducted by the SME and some by the divisional compliance officer. The SME must ensure implementation of the RMP throughout the entire bank. Communication can take many forms and should outline the objectives and expectations of the RMPs. Directions given by the SME should be consistent with existing decision-making processes and structures, and establish and communicate implementation goals and timelines, where appropriate. The monitoring of compliance with a certain act, as managed by an SME, can also be divided into two sections: firstly, the sections monitored by the SME and secondly, the sections monitored by the divisional compliance officer. The reason for this is that "experts" in the division can better perform the monitoring of certain sections of an act.

The divisional compliance officer will use the RMPs created by the SMEs. The nature of the business unit's activities will dictate which acts are applicable and which RMPs will be used. The divisional compliance

officer will therefore, in contrast to the SME, have to monitor a number of acts. In cases where there are no RMPs available from the central level, the divisional compliance officer will have to develop its own RMP for that particular act. An example of this is when the compliance officer for the treasury division in a bank will develop an RMP for the Stock Exchange Act. This act only applies to the activities of the Treasury Division and will not be managed by an SME.

Below, an example is provided of an SME's RMP for the South African Banks Act, 1990. The RMP is divided into different tables to differentiate between the different tasks of the SME, the general divisional compliance officer and the specialist divisional compliance officer.

In the tables, the different sections of the Banks Act, 1990, are also grouped together if a common theme is shared. The tables consist of six columns, and comprise:

- Section of the act to be monitored;
- Task to be performed by the compliance officer;
- Yes, if there was compliance with that particular section;
- No, if there was non-compliance with that particular section;
- Not applicable ("N/A") if the relevant section is not applicable to the activities of the division; and
- Risk, where non-compliance is risk rated using the matrix above.

The answers to the questions in the tables are one of the cornerstones for reporting on non-compliance as explained in the section on reporting below. These answers also act as a permanent record of the compliance work performed and can be used in cases where remedial action is required.

The following table presents details on the compliance monitoring tasks for an SME monitoring the South African Banks Act, 1990.

Table 6.1: SME – Compliance monitoring tasks for the Banks Act, 1990

Section of the Act (S)	Task	Yes	No	N/A	Risk
S6	- Were new Banks Act circulars adequately implemented and actioned? - Were the RMPs updated, where necessary? - Were all acknowledgements of receipts signed by the CEO and auditors?				Yellow
S7	Was the SARB timeously furnished with information or reports, as requested in SARB notices or other correspondence?				Red
S12, S15, S16 and S58	Were SARB requests to furnish them with information, documents or reports, with regards to an application for authorisation to establish a new bank, adequately actioned?				Yellow
S26	Were restrictions by the SARB of activities of the Bank, adequately implemented and actioned?				Yellow
S35 and R57	Has the bank paid its annual licence fee as prescribed?				Red
S43	Were SARB requests to furnish them with additional particulars with regards to an application for registration of a new controlling company, adequately actioned?				Yellow
S60	Were the SARB's decisions to terminate (or not) any appointments, adequately actioned?				Yellow
S61	Was an SARB refusal to an application for appointment or an SARB withdrawal of an approval previously granted adequately actioned and was another auditor appointed?				Yellow
S21, S29, S30 and S73	- Did the bank implement an effective process to ensure that whenever it makes investments, or grant loans, advances or other credit to any person, to an aggregate amount exceeding 10 per cent of such an amount of the bank's capital and reserves, permission was obtained from the board of directors, or of a committee appointed for such purpose (for the composition of which committee the prior written approval of the Registrar has to be obtained), as required by Section 73(1) of the Act? - Did the bank/controlling company adhere to the additional capital requirements in respect of large exposures, as prescribed by Sections 73(1)(b) & 73(2) of the Act? - Was approval (with reference to the capital of the bank/controlling company and not credit risk) obtained from the Registrar in respect of any transaction in the form of an investment with, or a loan, advance or other direct or indirect credit facility, to a private-sector non-bank person, as prescribed by Section 73(2) of the Act?				Red

Table 6.1: SME – Compliance monitoring tasks for the Banks Act, 1990  
(continued)

Section of the Act (S)	Task	Yes	No	N/A	Risk
S78	Did the bank implement an effective process to ensure compliance with the provisions of Section 78 of the Act relating to undesirable practices?				
R47	- Does the bank have an independent compliance function as required by Regulation 47 of the Regulations? - Was a report on the bank's level of compliance with laws and regulations or supervisory requirements submitted to the Registrar?				

Source: Author (2008)

The following table presents details on the compliance monitoring tasks for an SME managing the bank's official organogram as required by the Banks Act, 1990.

Table 6.2: SME – Compliance monitoring tasks of the bank's official organogram in terms of the Banks Act, 1990

Section of the Act (S)	Task	Yes	No	N/A	Risk
S37 and R50	- Does the bank comply with the provisions of Section 37 of the Act regarding the acquisition of shares in the bank or controlling company? - Does the controlling company comply with the provisions of Section 37 of the Act regarding the acquisition of shares in the bank or controlling company?				
S52 and R53	- Was the Registrar's approval obtained for the following in terms of Section 52 of the Act? - Were SARB requests to furnish them with additional information with regards to new subsidiaries, branch offices, other interests and representative offices, adequately actioned? - Was the SARB notified of: (a) substitution of its chief representative officer; (b) change of address; or (c) close down?				
S53	Has an updated organogram, reflecting all interests under the bank controlling company, been furnished to the Registrar of Banks?				

Table 6.2: SME – Compliance monitoring tasks of the bank's official organogram in terms of the Banks Act, 1990 (continued)

Section of the Act (S)	Task	Yes	No	N/A	Risk
S54	Does the bank comply with Section 54 of the Act?				Yellow
S55	Was the SARB's approval obtained prior to any reconstruction within group of companies?				Yellow
S80	Was the SARB's prior written approval obtained to acquire or hold shares in a registered insurer that exceeds 49 per cent of the issued shares of such insurer?				Red

Source: Author (2008)

The following table presents details on the general compliance monitoring tasks for a divisional compliance officer as required by the Banks Act, 1990.

Table 6.3: Divisional compliance officer: General compliance monitoring tasks in terms of the Banks Act, 1990

Section of the Act (S)	Task	Yes	No	N/A	Risk
S6	Were new Banks Act circulars adequately implemented and actioned?				Yellow
S7	- Was the SARB timeously furnished with information or reports, as requested in SARB notices or other correspondence? - Is or was any due diligence audit (of a South African bank) adequately conducted as prescribed?				Red
S22	Was there proper use of the bank's and the BU's name and logo?				Yellow
S52	- Was the SARB's approval obtained for the establishment of a subsidiary or a division? - Was the SARB's approval obtained for the investment in a joint venture [within or outside RSA + exposure > 5% of capital and reserves]? - Was the SARB's approval obtained for the opening of a branch office? - Was the SARB's approval obtained for the acquirement of an interest in any undertaking? - Was the SARB's approval obtained for the creation of a trust?				Red
S54	Does the bank comply with Section 54 of the Act?				Yellow
S60A	Are regular training courses provided on compliance officers' functions, including as prescribed in the Regulations?				Yellow

Source: Author (2008)

The following table presents details on the specialist compliance monitoring tasks for the secretariat compliance officer as required by the Banks Act, 1990.

Table 6.4: Secretariat compliance officer: Compliance monitoring tasks in terms of the Banks Act, 1990

Section of the Act (S)	Task	Yes	No	N/A	Risk
S11	- Are they all public companies with registered certificates of incorporation (form CM1)? - Do they all have SARB-approved banking licences?				Yellow
S12, S15, S16 and S58	Was the SARB's approval obtained for all new entities established to conduct the business of a bank?				Yellow
S38	Do the bank and the controlling company comply with the provisions of Section 38 of the Act regarding the registration of shares in the name of nominees?				Red
S42	- Are they all public companies with registered certificates of incorporation (form CM1)? - Do they all have certificates of registration as controlling companies (DI005)?				Red
S43	Was the SARB's approval obtained for the registration of any new bank controlling company?				Yellow
S51	Were new GG notices with Companies Act declarations, affecting the bank, adequately implemented and actioned?				Yellow
S55	Was the SARB's approval obtained prior to any affected reconstruction within the banking group?				Yellow
S56	- Was the SARB's written approval obtained prior to the registration of the following by the Registrar of Companies: (a) An alteration of the memorandum of association; (b) An alteration of the articles of association; or (c) Change of name. - Was the application to the SARB, before the proposed special resolution by the general meeting, accompanied by - (a) two copies of the proposed special resolution; and (b) an explanation of the reasons for the resolution? - Was the certificate of the alteration and/or DI008: "Certificate of change of name", received from the SARB?				Yellow

Table 6.4: Secretariat compliance officer: Compliance monitoring tasks  
in terms of the Banks Act, 1990 (continued)

Section of the Act (S)	Task	Yes	No	N/A	Risk
S60, R41 and R50	<ul style="list-style-type: none"> <li>- Did the directors, CEO and executive officers receive training on their fiduciary duties and their duties of care and skill?</li> <li>- Are the majority of the directors of the controlling company non-executive directors? (In terms of Section 60(3) of the Act, a non-executive director of a controlling company shall not be an employee of that controlling company or of any bank in respect of which that company is registered as a controlling company).</li> <li>- Are the majority of the directors of the bank non-executive directors? (In terms of Section 60(3) of the Act, a non-executive director shall not be an employee of a bank or any of its subsidiaries, or of such bank's controlling company or of any of such controlling company's subsidiaries).</li> <li>- Has a duly completed statement and declaration in the form of a form DI 020 (and curriculum vitae – refer to question 5 on the form DI 020) been submitted to the Registrar by the chairperson of the board, or the chairperson's duly appointed representative, or, in the case of a new bank, by the auditor, in respect of the following: Every person who for the first time accepts an appointment as a director of a bank or a controlling company, at least 30 days prior to the appointment becoming effective?</li> <li>- Has a duly completed statement and declaration in the form of a form DI 020 (and curriculum vitae – refer to question 5 on the form DI 020) been submitted to the Registrar by the chairperson of the board, or the chairperson's duly appointed representative, or, in the case of a new bank, by the auditor, in respect of the following: Every person who for the first time accepts an appointment as an executive officer of a bank or a controlling company, at least 30 day prior to the appointment becoming effective?</li> <li>- Has a duly completed statement and declaration in the form of a form DI 020 (and curriculum vitae - refer to question 5 on the form DI 020) been submitted to the Registrar by the chairperson of the board, or the chairperson's duly appointed representative?</li> </ul>				

Table 6.4: Secretariat compliance officer: Compliance monitoring tasks  
in terms of the Banks Act, 1990 (continued)

Section of the Act (S)	Task	Yes	No	N/A	Risk
S60B	<p>Did the bank's process of corporate governance meet the bank's strategic and business objectives to ensure:</p> <p>(a) compliance with the strategic framework and guidelines;</p> <p>(b) commitment by the executive officers to adhere to corporate behaviour that is correct and proper;</p> <p>(c) a balance of interests of the shareholders and other interested persons</p> <p>(d) that mechanisms and procedures minimise or avoid conflicts of interests between the business and the directors or executive officers;</p> <p>(e) responsible conduct by the directors and executive officers;</p> <p>(f) the achievement of the maximum level of efficiency and profitability;</p> <p>(g) the timely, accurate and meaningful disclosure of matters that are material;</p> <p>(h) that the board retains control over the direction, whilst enabling executives to manage operations and the achievement of objectives?</p>				
S61	<ul style="list-style-type: none"> <li>- Was the SARB's approval obtained for the appointment of new auditors?</li> <li>- Was the appointment per SARB's prescribed period and conditions?</li> <li>- Was a form DI 006 submitted to the Registrar when a new auditor was appointed?</li> <li>- Were the questionnaires in respect of the audit firm and the lead partner submitted to the Registrar, together with the form DI 006?</li> <li>- Was an SARB refusal to an application for appointment or a SARB withdrawal of an approval previously granted adequately actioned and was another auditor appointed?</li> </ul>				
S64	<ul style="list-style-type: none"> <li>- Have at least three directors been appointed to the audit committee?</li> <li>- Does the audit committees have updated, documented charters and mandates covering their Banks Act responsibilities?</li> <li>- Are the majority of these directors non-executive directors? (The majority of the members of the audit committee shall be persons who are not employees of the bank or any of its subsidiaries.)</li> </ul>				

Table 6.4: Secretariat compliance officer: Compliance monitoring tasks  
in terms of the Banks Act, 1990 (continued)

Section of the Act (S)	Task	Yes	No	N/A	Risk
S64A	Does the risk committee have updated, documented charters and mandates covering their Banks Act responsibilities?				
S64B	Does the director's affairs committee have updated, documented charters and mandates covering their Banks Act responsibilities?				
S65	<ul style="list-style-type: none"> <li>- Did the bank forward the information to the Registrar whenever (at the same time as) it was submitted to the Registrar of Companies?</li> <li>- Did the bank forward the following information to the Registrar whenever (at the same time as) it was submitted to the Registrar of Companies: Declaration of dividend?</li> <li>- Did the bank forward the following information to the Registrar whenever (at the same time as) it was submitted to the Registrar of Companies: A report on its activities during a financial year or part of such year forwarded to its shareholders?</li> <li>- Did the bank forward the following information to the Registrar whenever (at the same time as) it was submitted to the Registrar of Companies: A notice of any intended change in the situation of its registered office or of its postal address?</li> <li>- Did the bank forward the following information to the Registrar whenever (at the same time as) it was submitted to the Registrar of Companies: Any other information submitted to the Registrar of Companies in terms of Sections 216 and 302 of the Companies Act?</li> <li>- Were copies of the minutes of the general meetings of shareholders of the bank forwarded to the Registrar of Banks within 30 days after the said meeting?</li> <li>- Were copies of the minutes of the general meetings of shareholders of the controlling company forwarded to the Registrar of Banks within 30 days after the said meeting?</li> </ul>				

Table 6.4: Secretariat compliance officer: Compliance monitoring tasks in terms of the Banks Act, 1990 (continued)

Section of the Act (S)	Task	Yes	No	N/A	Risk
S79	- Did the bank adhere to not: (a) issuing shares of no par value; or (b) converting any of its shares into shares of no par value? - Was the SARB's approval obtained to: (a) issue any preference shares or debt instruments; (b) convert any of its shares into preference shares or debt instruments; or (c) convert any of its preference shares of a particular class into preference shares of any other class?				
S91	Did the bank implement an effective process to ensure that the Registrar's approval has been obtained to sell immovable property to directors/employees of the bank/controlling company, as prescribed by Regulation 54 of the Regulations?				

Source: Author (2008)

The following table presents details on the specialist compliance monitoring tasks for the Group Finance compliance officer as required by the Banks Act, 1990.

Table 6.5: Group finance compliance officer: Compliance monitoring tasks in terms of the Banks Act, 1990

Section of the Act (S)	Task	Yes	No	N/A	Risk
S50	Does the controlling company comply with Section 50 of the Act in that its investments in undertakings other than banks which conduct business similar to the business of a bank in a country other than the Republic of South Africa does not at any time exceed 40 per cent of the sum of its share capital and reserve funds?				
S67	When an individual shareholder holds more than 25 per cent of all the issued shares of the bank (to which shares voting rights are attached) and the sum of the bank's investments with, or loans and advances or other exposures to, the individual shareholder/s referred to is more than the nominal values of the shares held by such shareholder, the bank shall disclose this in its financial statements.				

Source: Author (2008)

The following table presents details on the specialist compliance monitoring tasks for the Regulatory Reporting compliance officer as required by the Banks Act, 1990.

Table 6.6: Regulatory reporting compliance officer: Compliance monitoring tasks in terms of the Banks Act, 1990

Section of the Act (S)	Task	Yes	No	N/A	Risk
S59	As part of the bank's compliance with Section 59 of the Act, was a form DI 703 submitted to the Registrar?				
S70	<ul style="list-style-type: none"> <li>- Does the bank comply with the minimum amount of allocated qualifying primary and secondary capital and reserve funds relating to banking activities, as prescribed by Regulation 21(6) of the Regulations?</li> <li>- Does the bank comply with the requirements of regulation 21(6) relating to the maintenance of the prescribed minimum amounts of allocated qualifying primary and secondary capital and reserve funds relating to banking activities?</li> <li>- In calculating the bank's allocated qualifying primary and secondary capital and reserve funds relating to banking activities in terms of Regulation 21 (form DI 400) of the Regulations, were deductions made in respect of impairments, as prescribed by Regulation 21(14) - table of risk weightings?</li> <li>- Does the bank comply with the requirements of Regulation 21(6)(d)(ii) relating to the maintenance of the prescribed minimum amount of allocated qualifying primary and secondary capital and reserve funds and tertiary capital relating to trading activities?</li> <li>- In calculating the bank's allocated qualifying primary and secondary capital and reserve funds and tertiary capital relating to trading activities in terms of Regulation 21 (form DI 400) of the Regulations, were deductions made in respect of impairments, as prescribed by Regulation 21(9) - table of risk weightings?</li> </ul>				
S70A	Was a form DI 401 submitted to the Registrar in respect of the bank controlling company?				

Table 6.6: Regulatory reporting compliance officer: Compliance monitoring tasks in terms of the Banks Act, 1990 (continued)

Section of the Act (S)	Task	Yes	No	N/A	Risk
S74	<ul style="list-style-type: none"> <li>- If the bank does/did not comply with Regulation 21(6), was condonation requested from the Registrar?</li> <li>- Was condonation granted by the Registrar?</li> <li>- If condonation was granted, did the bank adhere to the conditions of condonation?</li> <li>- If the bank failed to comply with the requirements, was the form DI 099 (declaration) qualified?</li> <li>- If the bank does/did not comply with Regulation 21(6)(d)(ii), was condonation requested from the Registrar?</li> <li>- Was condonation granted by the Registrar?</li> <li>- If condonation was granted, did the bank adhere to the conditions of condonation?</li> <li>- If the bank failed to comply with the requirements, was the form DI 099 (declaration) qualified?</li> </ul>				
S75	Has the bank submitted all the risk returns required to be submitted in terms of Regulation 6 of the Regulations?				
S76 and S77	As part of the bank's compliance with Sections 76 and 77 of the Act, was a form DI 700 submitted to the Registrar?				
S85	<ul style="list-style-type: none"> <li>- Has the bank submitted the required form DI 099 in respect of the current DI reporting month to the Registrar?</li> <li>- Was the form DI 099 duly completed and signed by all the parties, as required by Regulation 4 and 6 of the Regulations relating to Banks? (Note: The hash totals to be completed in the table in section B of the form DI 099 have to reconcile with the hash totals of the DI returns submitted.)</li> </ul>				

Source: Author (2008)

The following table furnishes details on the specialist compliance monitoring tasks for the regulatory reporting compliance officer as required by the Banks Act, 1990.

Table 6.7: Balance sheet management compliance officer: Compliance monitoring tasks in terms of the Banks Act, 1990

Section of the Act (S)	Task	Yes	No	N/A	Risk
S72	<ul style="list-style-type: none"> <li>- Does the bank comply with the average daily minimum amount of liquid assets, as provided for in Section 72 of the Act?</li> <li>- Did the bank, in its compliance with Section 72 of the Act, comply with the requirements of Regulation 20(3)(i), in that the minimum amount of liquid assets held by the bank at the close of business on any day during the holding period did not decrease to an amount less than an amount equal to 75 per cent of the average daily amount of liquid assets required to be held?</li> <li>- Did the bank, in its compliance with Section 72 of the Act, comply with the requirements of Regulation 20(3)(ii), in that the minimum amount of liquid assets held by the bank at any time during the day did not decrease to an amount less than an amount equal to 50 per cent of the average daily amount of liquid assets required to be held?</li> <li>- Did the bank, in its compliance with Section 72 of the Act, comply with the requirements of Regulation 20(3)(iii), in that at least 95 per cent of the liquid assets required to be held were liquid assets that the bank owned outright; that is, liquid assets that are not subject to any further commitment?</li> <li>- Does the bank comply with Regulation 20(3)(b) in that no foreign-currency assets, except gold coin and bullion, and no instruments acquired in terms of a securities-lending transaction shall qualify as liquid assets?</li> <li>- Does the bank comply with Section 72(3) of the Act in that none of the liquid assets have been pledged or otherwise been encumbered?</li> <li>- Have the securities being held as liquid assets been valued in accordance with the provisions of Section 72(4) of the Act?</li> </ul>				
S74	<ul style="list-style-type: none"> <li>- If the bank does/did not comply with the liquid-asset requirement, was condonation requested from the Registrar?</li> <li>- If the bank does/did not comply with the liquid-asset requirement, was condonation requested from the Registrar?</li> <li>- If the bank failed to comply with the above-mentioned requirements, was the form DI 099 (declaration) qualified?</li> </ul>				

Table 6.7: Balance sheet management compliance officer: Compliance monitoring tasks in terms of the Banks Act, 1990 (continued)

Section of the Act (S)	Task	Yes	No	N/A	Risk
S10A Reserve Bank Act	<ul style="list-style-type: none"> <li>- Does the bank comply with the requirements of section 10(A) of the SARB Act relating to the average daily minimum reserve balance (reserve and contra account) required to be held by banks?</li> <li>- Did the bank maintain the prescribed minimum reserve balance (reserve account) on a daily basis during the holding period?</li> <li>- If the bank did not maintain the said balance, was condonation requested in terms of the SARB Act?</li> <li>- Was condonation granted in terms of the SARB Act?</li> <li>- If condonation was granted, did the bank adhere to the conditions of condonation?</li> <li>- If the bank failed to comply with the reserve-balance, was the form DI 099 (declaration) qualified?</li> </ul>				

Source: Author (2008)

The following table presents details on the specialist compliance monitoring tasks for the treasury trading compliance officer as required by the Banks Act, 1990.

Table 6.8: Treasury trading compliance officer: Compliance monitoring tasks in terms of the Banks Act, 1990

Section of the Act (S)	Task	Yes	No	N/A	Risk
S79	<ul style="list-style-type: none"> <li>- Does the bank comply with the requirements of Regulation 19(4) relating to the issuing of negotiable certificates of deposit?</li> <li>- Does the bank comply with the requirements of Regulation 19(4) relating to the issuing of negotiable certificates of deposit, in that: The total number of negotiable certificates of deposit issued by a bank for a period not exceeding 12 months and not yet repaid, did not exceed 20 per cent of the total amount of liabilities to the public?</li> </ul>				

Source: Author (2008)

### 6.2.6 Reporting

Regulation 47 (RSA, 2000: 189) states that a bank shall establish mechanisms for reporting and resolving non-compliance with laws and regulations or supervisory requirements. Compliance officers are required to provide information on each identified area of non-compliance with a focus on strategies taken or proposed to manage or eliminate the risk. In addition, compliance officers should provide updates on the status of actions to manage risks associated with identified non-compliance as well as advise on any new areas of potential non-compliance.

The reporting process in this framework starts after the monitoring process as described above has been completed for each of the applicable acts. The reporting process can be divided into two sections, namely the reporting responsibilities of divisional compliance officers and reporting responsibilities of SMEs.

The following reporting process is prescribed to be followed by the divisional compliance officers:

- Step one: Identifying all new instances of non-compliance by actively monitoring the activities of the division;
- Step two: Categorising new instances of non-compliance identified during the monitoring period into high, medium and low-risk categories;
- Step three: Reporting detail of all the new instances of non-compliance;
- Step four: Reviewing instances of non-compliance previously identified in terms of progress made to resolve these instances of non-compliance;
- Step five: Compiling the compliance report and submitting this to the division's senior management and/or committee structure; and
- Submitting the same report to the SMEs at the group level.

No specific format for reports was found when the survey was conducted on the different banks. This framework, however, uses the "heat map" format as

explained below. The same format is used for the reports to the division's senior management as well as to the SMEs.

The following table is an example of a compliance report on the South African Banks Act as compiled by a divisional compliance officer:

Table 6.9: South African Banks Act: Compliance report for the period  
June 2006

<b>South African Banks Act, 1990</b>			
<b>Section of the Act (S)</b>	<b>Non-compliance</b>	<b>Risk</b>	<b>Comments</b>
S22	An advertisement was placed in a local newspaper without properly displaying the bank's logo.		The advertisement was withdrawn and applicable controls instituted to prevent recurrence.
S52	No instances of non-compliance.		
S60A	No instances of non-compliance.		

Source: Author (2008)

The following reporting responsibilities of the SMEs are prescribed:

- Monitoring the appropriateness and integrity of reporting performed by the divisional compliance officers;
- Facilitating prompt resolution and reporting of non-compliance with laws and regulations or supervisory requirements;
- Considering the impact of non-compliance from a bank perspective and indicating whether the matter should be reported to the board of directors; and
- Consolidating issues of non-compliance, whether new or unresolved, from the divisional compliance reports and including other matters as deemed appropriate, and submitting the report to the board of directors.

The format of the consolidated compliance report compiled by the SMEs in the framework is the same as that given for the divisional compliance report in table 6.9 above.

### 6.2.7 Measuring the actual cost of compliance

Hopkins (2005) states that:

*Challenges facing research into regulatory costs are substantial, but the scale and scope of such costs are sufficient to justify increasing the priority accorded them by policy makers and researchers. Notwithstanding the substantial burdens created by regulation, no comprehensive system exists for a regular, annual accounting of such costs. The decidedly primitive allocation assumptions underlying the measuring of cost represent, regrettably, the state of the art.*

The research, as presented in Chapter Four, also underlines Hopkins's point of view. The proposed framework, on the other hand, uses a simple method for measuring actual cost of compliance to a bank. It distinguishes, however, between measuring the cost of compliance pertaining to full-time compliance staff and part-time compliance staff.

The following cost elements are identified:

- **Staff-related costs**  
This cost element includes staff-related expenses such as salaries, medical aid contributions, pension fund contributions, bonuses, leave pay, training costs, teambuilding events and annual conferences.
- **Out-of-pocket expenses**  
This cost element includes compliance expenses such as legal costs, auditing costs, accounting costs, cost of advisory services and staff travelling costs.
- **Capital spending**  
This cost element includes compliance capital spending such as office and other equipment, furniture, computer hardware and software.
- **Other direct costs**  
This cost element includes other direct costs pertaining to compliance such as license fees, office rental and telephone/fax costs.

- Outsourcing agreements

The compliance department could outsource some of its activities to other departments in the bank. This cost element therefore includes expenses such as human resources costs and financial accounting.

The cost elements, as mentioned above, can be used to measure the actual cost of compliance pertaining to full time compliance staff. Table 6.10 details such a calculation.

It must be noted that the methodology applied in the framework measuring compliance cost for part-time compliance staff would be different to the method described above for full-time compliance staff. The same cost elements can be used but the actual cost should be reduced on a pro-rata basis according to the time spent on actual compliance. It is further suggested that proper timesheets are used to record the actual time spent on duties relating to compliance. The pro-rata rule can be applied to all of the cost elements except out-of-pocket expenses.

Although the methodology detailed above is a simple method, it can be tailored according to the needs of the different banks but should always at least include as a minimum the cost elements.

The table below details the method for measuring compliance cost for full-time compliance staff that can be adjusted on a pro-rata basis to measure part-time compliance costs.

Table 6.10: Calculating actual compliance costs – full-time compliance staff

<b>Cost element</b>	<b>Amount</b>
<b>Staff-related costs:</b> <ul style="list-style-type: none"> <li>- Salaries</li> <li>- Medical aid contributions</li> <li>- Pension fund contributions</li> <li>- Bonuses</li> <li>- Leave pay</li> <li>- Training</li> <li>- Team-building events</li> <li>- Annual conferences</li> <li>- Parking</li> </ul>	
<b>Out-of-pocket expenses:</b> <ul style="list-style-type: none"> <li>- Legal costs</li> <li>- Auditing costs</li> <li>- Accounting costs</li> <li>- Advisory services</li> <li>- Travelling</li> </ul>	
<b>Capital spending:</b> <ul style="list-style-type: none"> <li>- Equipment</li> <li>- Furniture</li> <li>- Computer hardware</li> <li>- Computer software</li> </ul>	
<b>Other direct financial costs:</b> <ul style="list-style-type: none"> <li>- License fees</li> <li>- Office rental</li> <li>- Telephone and fax costs</li> </ul>	
<b>Outsourcing agreements:</b> <ul style="list-style-type: none"> <li>- Human resources</li> <li>- Financial accounting</li> </ul>	

Source: Author (2008)

### **6.2.8 Outsourcing by the compliance department**

Circular 14/2004 (SARB, 2004b) strictly forbids any bank in South Africa to outsource its compliance responsibilities to independent third parties. There is nothing, other than this requirement, that prevents the outsourcing of compliance activities by a bank. The consequence of the proposed outsourcing is that the compliance division of a bank can now become an income earner and not merely a cost to the bank. The most important condition is that the bank should never jeopardise its own compliance responsibilities in the process of outsourcing.

The outsourcing of compliance by a bank can entail one or both of the following actions:

- Performing compliance duties on behalf of non-banking entities in the same group of companies of which the bank is a part.

Regulation 47 (SARB, 2000:188) requires that each bank shall have an independent compliance function responsible for all compliance activities in that particular bank. All the banks surveyed in Chapter Four have such functions and are part of a larger group of companies. The bank's compliance department can therefore render compliance services to the other companies in the group at a fee. The only restriction is whether that particular company's regulator, if any, would allow such outsourcing.

- Performing compliance duties on behalf of non-banking entities outside the group of companies of which the bank is part.

The same rationale as described above could be followed when rendering compliance duties on behalf of non-banking entities outside the bank's group of companies.

The conclusion is therefore that it is, in theory, possible for a bank's compliance department to become a profit centre instead of merely a cost centre.

### **6.2.9 New trends in regulatory compliance risk management**

A number of new trends have been observed in regulatory compliance risk management. These new trends may, at the particular bank's own discretion, be incorporated into the compliance framework to enhance compliance risk management even further.

- **New Basel II requirements**

The regulatory environment in which financial institutions operate has been one of constant change and evolution in recent years; an example of such a change is the move to more principles-based regulation as promoted by the Basel Committee. The objective of the committees with the new Basel II Accord has been to develop a framework that would further enhance the soundness and stability of the international banking system. It is believed that the new Basel II framework will promote improved risk management practices by the banking industry (BIS, 2005:1). The Basel requirements also specifically require an internal audit function to review the activities of the compliance department.

- **Aligning compliance with the bank's business objectives and strategies**

Banks are urged to organise their compliance functions and to set priorities for the management of their compliance risks in a way that is consistent with the banks' own risk management strategy and structures (BIS, 2005:3). For instance, some banks may wish to organise compliance functions within their operational risk function, as there is a close relationship between compliance risk and certain aspects of operational risk. Others may prefer to have separate compliance and operational risk functions, but may wish to establish mechanisms

requiring close cooperation between the two functions on compliance matters. Banks are further encouraged to make compliance part of doing business and to make it a part of the bank's decision-making process.

- Regulatory compliance and software

Software vendors are of the opinion that they have a solution for companies facing the issue of regulatory compliance. There is no lack of vendor hype with each claiming to offer the "silver bullet" for solving compliance woes. Although no single tool can ensure compliance, technologies such as system management, database auditing and monitoring provide a mix of preventive and detective capabilities that can lay a firm foundation for compliance risk management. Compliance software is therefore defined as software that performs compliance recordkeeping and reporting (BitPipe, 2004:1)

Compliance software has distinctive features, namely:

- Integrated central repository for assessment of items such as risks, compliance and controls;
- Specific architecture allowing use across LANs, WANs, Internet and ASP;
- Flexibility to model processes and parameters according to the bank's needs;
- Powerful reporting features with slice-and-dice and perform-trend analyses;
- Full audit trails; and
- Performance monitoring.

- Preparation and readiness for on-site examinations

Regulators conduct on-site examinations with a view to sufficiently fulfilling the following functions (BOJ, 2000):

- Monitoring the business conditions and asset quality of individual correspondent financial institutions;
- Identifying risks in the overall financial system and analysing the mechanisms through which such risks materialise; and
- Applying the above information to the overall activities of the bank.

Regulators also employ specific methodologies during these on-site examinations (IRS, 2005):

- Initial interview with the relevant bank staff;
- Tour of the bank's facilities by the regulator's staff;
- Examination of relevant books and records, including minutes of meetings and returns;
- Corporate governance structures and mandates;
- Details of transactions with related parties;
- Review of bank publications such as websites, newsletters, pamphlets, brochures, magazines and annual reports.
- Review of correspondence files with the Regulator;
- Review of the bank's financial information containing important information about the bank's activities;
- Balance sheet analyses; and
- Compliance reports.

Preparing and being ready for an on-site examination is essential and it makes compliance risk management more efficient. It can also contribute to maintaining a healthy relationship between the Regulator and the bank.

### **6.3 EVALUATION OF THE FRAMEWORK AGAINST REGULATORY REQUIREMENTS**

The compliance framework discussed above pertains to a bank. However, this framework needs to be evaluated in order to ensure that it complies with all the regulatory requirements and that can be used by banks in South Africa. In South Africa, banks compliance frameworks should meet the requirements of Regulation 47 of the Regulations pertaining to banks.

The Cambridge Dictionary (2007) defines the word evaluation as *“to judge or calculate the quality, importance, amount or value of something”*. The framework is evaluated to ascertain whether it complies with all the requirements of Regulation 47.

The framework will also be evaluated against the specific Basel Committee’s principles contained in their publication: *“Compliance and the compliance functions in banks”*.

Details of the mentioned evaluations are presented in table format below.

This table details the evaluation of the framework in terms of Regulation 47 of the Regulations pertaining to banks (SARB, 2000).

Table 6.11: Evaluation of the framework – Regulation 47

Criteria	Does the framework comply?
<i>(1) A bank shall establish an independent compliance function as part of its risk management framework, in order to ensure that the bank continuously manages its regulatory risk; that is, the risk that the bank does not comply with applicable laws and regulations or supervisory requirements.</i>	Yes, see 6.2.3
<i>(2) The compliance function shall be headed by a compliance officer of the bank, who shall perform the compliance officer's functions with diligence and care and with such a degree of competence as can reasonably be expected from a person responsible for such a function.</i>	Yes, see 6.2.3
<i>(3) The compliance function shall have adequate resources and stature in order to ensure that non-compliance with laws and regulations or supervisory requirements by the bank can be addressed adequately.</i>	Yes, see 6.2.3
<i>(4) As a minimum, the compliance officer of a bank shall -</i>	
<i>(a) have senior executive status in the bank;</i>	Yes, see 6.2.3
<i>(b) have direct access to and demonstrable support from the chief executive officer of the bank;</i>	Yes, see 6.2.3
<i>(c) function independently from functions such as internal audit and shall be demonstrably independent;</i>	Yes, see 6.2.3

Table 6.11: Evaluation of the framework – Regulation 47 (continued)

Criteria	Does the framework comply?
<i>(d) report non-compliance with laws and regulations or supervisory requirements to the chief executive officer, the board of directors and the audit committee of the bank in a timely manner;</i>	Yes, see 6.2.6
<i>(e) submit a report on the level of compliance with laws and regulations or supervisory requirements by the bank at every meeting of the board of directors or the audit committee of the bank and provide the Registrar with a copy of such a report;</i>	Yes, see 6.2.6
<i>(f) ensure, as far as possible, that no conflict of interest with/between other internal control functions exists;</i>	Yes, see 6.2.3
<i>(g) be responsible for establishing a compliance culture in the bank that contributes to the overall objective of prudent risk management by the bank;</i>	Yes, see 6.2.2
<i>(h) establish a line of communication to line management, in order to monitor continuously compliance with laws and regulations or supervisory requirements by the bank;</i>	Yes, see 6.2.2
<i>(i) require line management to monitor compliance with laws and regulations or supervisory requirements as part of their normal operational duties;</i>	Yes, see 6.2.2

Table 6.11: Evaluation of the framework – Regulation 47 (continued)

Criteria	Does the framework comply?
<i>(j) require regulatory requirements to be incorporated into operational procedure manuals when appropriate;</i>	Yes, see 6.2.2
<i>(k) make recommendations whenever necessary in order to ensure that there is compliance with laws and regulations or supervisory requirements;</i>	Yes, see 6.2.2
<i>(l) establish prompt mechanisms for reporting and resolving non-compliance with laws and regulations or supervisory requirements;</i>	Yes, see 6.2.6
<i>(m) ensure that resolutions are signed off;</i>	Yes, see 6.2.3
<i>(n) document the compliance officer's findings, including any remedial action, as part of the compliance-monitoring programme;</i>	Yes, see 6.2.6
<i>(o) recruit sufficient staff of the correct quality in order to monitor and test the bank's compliance with laws and regulations or supervisory requirements continuously;</i>	Yes, see 6.2.6
<i>(p) ensure that compliance staff are trained on a continuous basis in order to ensure that they have adequate technical knowledge in order to understand the regulatory framework that applies to the bank, as well as the risks to which the bank is exposed;</i>	Yes, see 6.2.6

Table 6.11: Evaluation of the framework – Regulation 47 (continued)

Criteria	Does the framework comply?
<p><i>(q) compile and maintain a compliance manual that -</i></p> <p><i>(i) adequately addresses all material risks to which the bank is exposed;</i></p> <p><i>(ii) adequately addresses all material objectives and aspects of applicable legislation;</i></p> <p><i>(iii) refers to specific legislation, rules and regulations when appropriate;</i></p> <p><i>(iv) is readily available to all relevant staff;</i></p> <p><i>(v) is reviewed and updated at least once a year.</i></p>	Yes, see 6.2 et al
<p><i>(5) The provisions contained in this regulation shall not be construed as derogating from the general provisions contained in the Act that place the primary responsibility of compliance with the provisions of the Act and the Regulations on directors and executive officers.</i></p>	Yes, see 6.2.3

Source: Author (2008)

The table above indicates that the framework complies with the requirements of Regulation 47 of the Regulations relating to banks.

The following table details the evaluation of the framework in terms of the Basel Committee's principles contained in the publication: "Compliance and the compliance functions in banks" (BIS, 2005).

Table 6.12: Evaluation of the framework – Basel principles

Principle	Does the framework comply?
<i>(1) The bank's board of directors is responsible for overseeing the management of the bank's compliance risk. The board should approve the bank's compliance policy, including a formal document establishing a permanent and effective compliance function. At least once a year, the board or a committee of the board should assess the extent to which the bank is managing its compliance risk effectively.</i>	Yes, see 6.2.3
<i>(2) The bank's senior management is responsible for the effective management of the bank's compliance risk.</i>	Yes, see 6.2.3
<i>(3) The bank's senior management is responsible for establishing and communicating a compliance policy, for ensuring that it is observed, and for reporting to the board of directors on the management of the bank's compliance risk.</i>	Yes, see 6.2.3
<i>(4) The bank's senior management is responsible for establishing a permanent and effective compliance function within the bank as part of the bank's compliance policy.</i>	Yes, see 6.2.3
<i>(5) The bank's compliance function should be independent.</i>	Yes, see 6.2.3

Table 6.12: Evaluation of the framework – Basel principles (continued)

<b>Principle</b>	<b>Does the framework comply?</b>
<i>(6) The bank's compliance function should have the resources to carry out its responsibilities effectively.</i>	Yes, see 6.2.3
<i>(7) The responsibilities of the bank's compliance function should be to assist senior management in managing the compliance risks faced by the bank effectively. If some of these responsibilities are carried out by staff in different departments, the allocation of responsibilities to each department should be clear.</i>	Yes, see 6.2.3
<i>(8) The scope and breadth of the activities of the compliance function should be subject to periodic review by the internal audit function.</i>	Yes, see 6.2.9
<i>(9) Banks should comply with applicable laws and regulations in all jurisdictions in which they conduct business, and the organisation and structure of the compliance function and its responsibilities should be consistent with local legal and regulatory requirements.</i>	Yes, see 6.2.3
<i>(10) Compliance should be regarded as a core risk management activity within the bank. Specific tasks of the compliance function may be outsourced, but they must remain subject to appropriate oversight by the head of compliance.</i>	Yes, see 6.2.3

Source: Author (2008)

The table above indicates that the framework complies with the requirements of the Basel Committee's principles contained in the publication: "Compliance and the compliance functions in banks" (BIS, 2005).

## **6.4 MEASURING THE COST OF IMPLEMENTATION**

It was established in 6.3 above that the proposed framework does comply with the regulatory requirements as stated in Regulation 47 of the Regulations relating to banks as well as the specific Basel requirements pertaining to the compliance functions in banks. It is furthermore important that the costs of implementing the framework have to be measurable. A cost-benefit analysis of implementing the framework will thus be performed in order to ascertain the value that the implementation of such a framework would have for a bank.

A cost-benefit analysis is a term that refers to a formal process used to help appraise, or assess, the case for a project or proposal and an informal approach to making decisions of any kind. The process involves, whether explicitly or implicitly, weighing the total expected costs against the total expected benefit. The aim is to gauge the cost of the framework relative to the status quo that was found in the banks in South Africa. A cost analysis will be performed of the framework based on the organogram in 6.2.3 above and the cost compared to the cost of compliance as estimated and provided by the banks in Chapter Four. The benefits of implementing the framework will be assessed, again by comparing it to the information obtained from the banks in the survey.

### **6.4.1 Cost analysis of the framework**

In order to perform an accurate costing of the framework, the organogram in 6.2.3 above was used as the basis for the staff needs. A total compliance staff complement of 85 was assumed, in line with the number indicated by the banks. This number was decided upon because that would facilitate a comparison between the calculated cost of the framework and the cost of compliance indicated by the banks. Based on this assumption, the different

components were assessed using current market data to ascertain the value of these components.

The table below indicates the actual cost of the different components obtained from the market.

Table 6.13: Calculating the cost of compliance of the framework

<b>Cost element</b>	<b>Assumptions</b>	<b>Amount</b>
<b>Staff-related cost:</b>		<b><u>R29 845 000</u></b>
- Salaries	- Senior managers X3 @ R700 000 per annum; - Managers X5 @ R520 000 per annum; - SMEs X16 @ R400 000 per annum; and - 61 Divisional compliance officers @ R400 000.	R29 400 000
- Medical aid contributions	- Included in salaries	
- Pension fund contributions	- Included in salaries	
- Bonuses	- Included in salaries	
- Leave pay	- Included in salaries	
- Training	- One external training session @ R5000	R 305 000
- Team-building events	- One annual event @ R40 000	R 40 000
- Annual conferences	- One annual event @ R100 000	R 100 000
- Parking	- Included in salaries	
<b>Out-of-pocket expenses:</b>		<b><u>R3 100 000</u></b>
- Legal costs	- Legal opinions for National Credit Act	R 100 000
- Auditing costs	- Annual regulatory audit	R1 000 000
- Accounting costs	- Internal accounting cost	R 500 000
- Advisory services	- External opinions	R 500 000
- Travelling		R1 000 000
<b>Capital spending:</b>		<b><u>R 850 000</u></b>
- Equipment	- All components included	
- Furniture		
- Computer hardware		
- Computer software		
<b>Other direct financial costs:</b>		<b><u>R 3 250 000</u></b>
- License fees	- Banks Act and NCA annual fees	R 2 000 000
- Office rental	- For 85 staff members per annum	R 1 000 000
- Telephone and fax costs	- For 85 staff members per annum	R 250 000
<b>Outsourcing agreements:</b>		<b><u>Nil</u></b>
- Human resources	- No outsourcing agreements	
- Financial accounting		
<b>TOTAL COST PER ANNUM</b>		<b><u>R37 045 000</u></b>

Source: Author (2008)

In the next step of the cost-benefit analysis, the cost of implementing the framework is compared to the cost of compliance indicated by the banks in the survey. The banks furnished their compliance costs for 2004, 2005 and 2006. In order to compare the compliance costs as calculated, which are the current 2008 cost, the banks' costs were adjusted with inflation at 10 per cent per annum.

In the following table, the cost of implementing the framework is compared to the cost of compliance indicated by the banks as adjusted for inflation.

Table 6.14: Comparing the cost of implementing the framework to the bank's cost of compliance

<b>Cost element</b>	<b>Proposed framework</b>	<b>Banks' cost estimates</b>
Staff-related costs	R29 845 000	R33 880 000
Out-of-pocket expenses	R 3 100 000	R 6 000 000
Capital spending	R 850 000	Unavailable
Other direct financial costs	R 3 250 000	Unavailable
Outsourcing agreements	Nil	Nil
<b>Total cost</b>	<b>R37 045 000</b>	<b>R39 880 000</b>

Source: Authorm(2008)

The following conclusions are drawn from this comparison:

- The cost of implementing the framework is very similar to the cost of compliance indicated by the banks, but is more detailed;
- Implementing the framework has the advantage that each cost element can be identified and a accurate budget can be developed;
- The framework also facilitates the measurement of costs and in the process enhances the management of expenses; and
- The bank's management can make informed decisions with regard to compliance activities in general, including the management of the actual cost of compliance.

The implementation of the framework is thus advantageous to a bank as the cost of implementing the framework can be measured.

#### 6.4.2 Benefit analysis of implementing the framework

In order to perform a benefit analysis of the framework, the components of the framework were used as defined above and the possible benefits assessed of implementing this framework.

In the table below, the possible benefits of implementing the framework are indicated.

Table 6.15: Benefit analysis of implementing the framework

Framework component	Benefit
<p><b><u>Regulatory universe:</u></b>            Defining the bank's regulatory universe in accordance with activities undertaken resulting in a list of acts to be managed at a central level in a bank.</p>	<ul style="list-style-type: none"> <li>• The bank can establish exactly which acts and regulations pertain to its own activities.</li> <li>• The bank will also be able to identify the high-risk legislation that needs to be managed from a central point in the bank and accordingly construct its compliance division and activities.</li> <li>• The list of high-risk acts provided should be sufficient for a bank to manage its compliance risk.</li> </ul>

Table 6.15: Benefit analysis of implementing the framework (continued)

Framework component	Benefits
<p><b><u>Compliance responsibilities:</u></b></p> <p>Defining general and specific compliance responsibilities of SMEs and divisional compliance officers, resulting in a list of such responsibilities.</p>	<ul style="list-style-type: none"> <li>• The bank can establish the exact responsibilities of the SMEs and divisional compliance officers.</li> <li>• The list of responsibilities provided should be sufficient for a bank to manage its specific compliance risk.</li> </ul>
<p><b><u>Compliance structure:</u></b></p> <p>Defining a compliance structure based on the defined legislative universe.</p>	<ul style="list-style-type: none"> <li>• Implementing such a compliance structure could ensure that all the high-risk acts are managed by experts (SMEs).</li> <li>• The structure can be tailor-made to suit the individual needs of a bank.</li> <li>• The structure ensures the establishment of suitable levels of responsibility.</li> <li>• Implementing the structure will ensure that no duplication of activities takes place.</li> </ul>
<p><b><u>Compliance risk rating:</u></b></p> <p>Defining the bank's risk appetite, rating the risks and determining the level of compliance risk a bank is prepared to accept using the risk-rating methodology.</p>	<ul style="list-style-type: none"> <li>• The board accepts responsibility for compliance risk in a bank and determines the level of risk they want to take.</li> <li>• The compliance risk-rating methodology can help in this process.</li> <li>• Enhances the management of risk.</li> </ul>

Table 6.15: Benefit analysis of implementing the framework (continued)

Framework component	Benefits
<p><b><u>Compliance monitoring:</u></b> Defining methods of monitoring compliance.</p>	<ul style="list-style-type: none"> <li>• Implementing the methods will ensure that all areas in the bank are monitored.</li> <li>• The methodology defines the SMEs' and the divisional compliance officer's responsibilities with regard to monitoring as possible duplication are avoided.</li> <li>• The compliance monitoring tasks dedicated to the SMEs and divisional compliance officers ensures a systematic approach to the monitoring of compliance.</li> </ul>
<p><b><u>Reporting:</u></b> Defining mechanisms and specific methodologies for reporting on the level of compliance in a bank.</p>	<ul style="list-style-type: none"> <li>• Implementing the methods will ensure that the information reported is consistent throughout the bank.</li> <li>• Implementing the reporting mechanisms will ensure that the information is reported.</li> </ul>
<p><b><u>Measuring the cost of compliance:</u></b> Defining a specific methodology to measure the cost of compliance.</p>	<ul style="list-style-type: none"> <li>• Implementing the methodology will ensure that each cost element can be identified.</li> <li>• Management can make informed decisions with regard to compliance activities and cost of compliance.</li> </ul>

Source: Author (2008)

The implementation of the framework will not only enhance compliance risk management in banks, but it is also effective.

## **6.5 POSSIBLE LEGISLATIVE CHANGES**

In addition to the formulation of the framework described above, five possible legislative changes have been formulated that could result in a more efficient and effective compliance regime in South Africa. These will be discussed below and it will be indicated, where applicable, what the cost savings could be to the banks upon implementation of these changes by the authorities.

### **6.5.1 Single Financial Services Regulator**

In Chapter Two, the current regulators and the regulatory structure in South Africa were discussed. This structure is not operating efficiently as it has not kept up with the evolution of the financial services industry. The South African Reserve Bank and Financial Services Board operate independently. This arrangement often leads to customer confusion, regulatory overlap and high costs. It could also possibly hamper compliance because the two bodies could have different requirements pertaining to the same issues.

Only one financial service regulator is needed; similar to the approach found in the United Kingdom and Australia. This regulator should be responsible for the prudential supervision of all financial institutions including banks and non-banks. The benefits that such a single regulator will bring are the necessary consistency and uniformity to the current fragmented South African regulatory structure and is justified by the continuing blurring of institutional and product boundaries, as well as growth in financial conglomerates.

The cost benefit of a single regulator is also important. For example, the number of submissions to the regulator could reduce resulting in lower costs. It was established that a Section 52 application under the South African Banks Act carries a cost of R6 840. Minimising such applications could have a significant cost-saving effect for a bank. A further advantage, over and above

the direct cost, would be a cost saving because staff would spend less time in preparing the documentation.

It is therefore suggested that the issue of a single financial services regulator for South Africa be thoroughly investigated by the authorities and the financial services industry.

### **6.5.2 Tax deductions**

There should be compliance-related tax incentives for banks and banking groups in South Africa. Currently all compliance-related costs are reflected on the banks' income statements as a cost deductible from income for purpose of calculating net profit before tax. The compliance cost, as discussed in Chapter Four, should still be deductible but not on the income statement but as a tax rebate. A bank should therefore calculate the exact cost of performing compliance once a year, have it audited by the external auditors and then be allowed to deduct such cost from the tax payable by the bank.

With reference to the calculation of the cost of compliance (R37 045 000 - in 6.4.1 above) it must be noted that this would be a major incentive to banks to manage compliance risk properly.

The cost of non-compliance, as discussed in Chapter Three, should not be tax-deductible as an expense on the bank's income statement. The bank shall therefore carry the "full" cost, penalties and fines, of its non-compliance and this cost could be as high as R10 000 000 per incident.

### **6.5.3 Capital reduction**

The new Basel II capital accord has been effective in South Africa from 1 January 2008. Under the new Basel rules, a bank is rewarded for its appropriate management of credit, market and operational risk in terms of a capital reduction. However, no mention is made in the accord for rewarding a bank for effective compliance risk management.

Compliance risk and the management thereof should be assessed as part of the operational risk assessment under pillar two of the new Basel Accord. The external auditors should then also audit a bank's compliance function once a year and report their findings to both the bank's board as well as to the Registrar of Banks.

The result of this will be that the capital charge for operational risk can be reduced or increased according to the findings of the assessments and the external audit.

With a view to illustrating a capital reduction, the information in the table below is used as an example:

Table 6.16: Benefit analysis of a reduction in the capital charge

Type of charge	Charge (%)	Bank's capital ('000)	Capital requirement ('000)	Capital reduction	New capital requirement ('000)
Base	9.00%	R1 000 000	R90 000		R90 000
<u>add-on</u>	<u>0.75%</u>		<u>R 7 500</u>	0.50%	<u>R 5 000</u>
Total	9.75%		R97 500		R95 000

Source: Author (2008)

The table indicates that if the bank has a balance sheet of R1 000 000 000, a reduction of 0.50% in the charge would result in a total capital saving to the bank of R2 500 000. It was also calculated that if the bank has a balance sheet of R500 000 000 000, the corresponding saving to the bank would be an amount of R1 250 000 000.

A reduction or increase in the capital charge of banks because of appropriate or defective compliance practices requires a change in legislation that regulators should seriously consider.

#### **6.5.4 Outsourcing of the compliance function**

In 6.2.8 above it is mentioned that Circular 14/2004 (SARB, 2004) strictly forbids any bank in South Africa to outsource its compliance responsibilities to independent third parties. It is argued in the current research that the outsourcing of a bank's compliance activities should be allowed, subject to strict conditions and oversight by the Registrar of Banks and auditors. The choice whether to outsource compliance activities to independent third parties should be left to the bank in question.

Should the bank choose to outsource its compliance activities, it is suggested that the regulations be amended to include the following conditions to allow outsourcing:

- The existence of a legally binding agreement between the bank and the compliance services provider ("CSP") detailing the exact terms of the agreement;
- The CSP is only responsible for the monitoring and not for performing compliance in the bank;
- The CSP shall be totally independent from the bank and appointed on an annual basis;
- The appointment of the CSP shall also be subject to the Registrar of Bank's approval based on specific criteria set by the Registrar;
- There shall be regular, formal meetings between the Registrar of Banks and the CSP;
- The work of the CSP shall be subject to an audit by the bank's external auditors on at least an annual basis;
- The CSP shall report its findings to the bank's board of directors and make all the reports available to the Registrar of Banks; and
- The CSP shall also be responsible for the training of bank staff with regard to compliance.

The possibility of outsourcing the monitoring of compliance to an independent CSP was researched and the related costs were calculated. As a basis, the cost of compliance as calculated in table 6.13 above was used.

The following scenario was used to determine the possible cost savings of outsourcing the monitoring of compliance to an independent third party:

- The number of permanent compliance officers is reduced from 61 to 30 and these compliance officers are totally dedicated to the business with no monitoring responsibilities;
- Monitoring is conducted by four independent monitors;
- The CSP uses its own hardware and software in the monitoring process;
- Monitoring takes place each month for 12 months of the year;
- Each independent monitor monitors compliance for 40 hours a month;
- The rate per hour is set at R2 500 per hour, which was found to be the rate charged by audit firms for work performed;
- Monitoring thus takes place for two weeks of the month;
- A total number of 40 hours for report writing and meetings was set aside; and
- Report writing and attending meetings are also charged at R2 500 per hour.

The following table details the calculation of:

- The cost saving to the banks making use of outsourcing;
- The cost of the outsourcing; and
- The total cost saving to the bank.

Table 6.17: Cost analysis of outsourcing arrangement

<b>Description</b>	<b>Amount</b>
<b><u>Cost saving:</u></b>	
• Salaries	• R 9 150 000
• Out-of-pocket expenses	• R 750 000
• Office rental	• R 500 000
• Telephone costs	• R 125 000
• Computers	• R 425 000
• Training	• R 150 000
• Teambuilding	• R 20 000
• Conferences	• <u>R 50 000</u>
Total cost saving	<b>R11 170 000</b>
New total cost (R37 045 000 – R11 170 000)	<b>R25 875 000</b>
<b><u>Cost of outsourcing:</u></b>	
Total hours	1 960
Rate per hour	R2 500
Total cost	<b>R 4 900 000</b>
Total cost of compliance (outsourcing included)	<b><u>R30 775 000</u></b>
Cost of compliance as calculated in table 6.13	<b>R37 045 000</b>
Total cost saving as a result of outsourcing	<b>R 6 270 000</b>

Source: Author (2008)

The conclusion is that a bank can derive a definite cost benefit from outsourcing the monitoring of its compliance function to independent third parties.

Apart from the financial benefits, other possible benefits of outsourcing the monitoring of compliance to an independent CSP were researched. The following are the benefits identified.

The bank can:

- reduce overheads;
- minimise capital expenditure and investment in fixed infrastructure;
- focus scarce resources on compliance;
- access specialised skills;
- save on manpower and training costs;
- control operating costs;
- eliminate peak staffing problems such as financial year-end;
- provide value-added services;
- establish long-term, strategic relationships with service providers to gain a competitive edge;
- benefit from the provider's expertise in solving problems for a variety of clients with similar requirements;
- acquire access to best practices and proven methodologies;
- leverage off the service provider's extensive investments in technology, methodologies and people;
- increase efficiency by consolidating and centralising functions; and
- remain abreast with, and minimise the impact of rapid changes in technology without changing its infrastructure.

#### **6.5.5 Ensure independence in the bank**

In 6.4.4 above it is mentioned that banks should be given the choice as to whether or not to outsource compliance activities. To cater for the eventuality where a bank chooses to conduct its own compliance activities, Section 60A of the South African Banks Act should also be amended. Additions are in **bold** and underlined while omissions are in **(brackets, bold and underlined)**.

Currently, Section 60A of the South African Banks Act (SARB, 1990: 57) states:

*(1) Notwithstanding anything to the contrary in any law, a bank shall establish an independent compliance function as part of the risk management framework of the bank **or outsource this function to an independent, approved services provider.***

*(2) The compliance function shall be headed by a compliance officer **(of the bank)**, who shall perform his or her functions with such care and skill as can reasonably be expected from a person responsible for such a function in a similar institution.*

*(3) The appointed compliance officer shall perform his or her functions subject to such requirements and conditions as may be prescribed in the Regulations relating to Banks.*

The requirements mentioned above are described in detail in Regulation 47 (SARB, 2000: 188).

Regulation 47 should also be amended to ensure a more effective compliance function in a bank. The following changes to Regulation 47 are thus proposed:

#### 47. Compliance function

(1) A **banking group** shall establish an independent compliance function **at a group level** as part of its risk management framework, in order to ensure that the bank **and the banking group** continuously manage its regulatory risk, that is, the risk that the bank **or the banking group** does not comply with applicable laws and regulations or supervisory requirements.

(2) The compliance function shall be headed by a **banking group** compliance officer **(of the bank)**, who shall **(perform the) ensure that the** compliance **(officer's) functions are performed** with diligence and care **(and with such a degree of competence as can reasonably be expected from a person responsible for such a function).**

(3) The **board of the banking group shall ensure that the** compliance function **(shall)** have adequate resources and stature in **the banking group** **in** order to ensure that non-compliance with laws and regulations or supervisory requirements by the bank **and the banking group** can be addressed adequately.

(4) As a minimum, the **banking group** compliance officer **and compliance function** of a **banking group** shall -

#### Effectiveness

- (a) have senior **(executive)** status in the **banking group**;
- (b) have direct access, **reporting lines** to and demonstrable support from the **both the** chief executive officers of the bank **and banking group**;
- (c) function independently from **any other** functions **in the banking group** such as internal audit **(and shall be demonstrably independent)**;
- (d) report non-compliance with laws **(and)**, regulations, **directives** or **other** supervisory requirements to the chief executive officers, the board of directors and the audit committees of the bank **and banking group in line with the banking group's reporting policy (a timely manner)**;
- (e) submit **(a)** reports on the level of compliance with laws **(and)**, regulations, **directives** or **other** supervisory requirements to the chief executive officers, the board of directors and the audit committees of the bank **and banking group** and provide the Registrar with **(a)** copies of such **(a)** reports **in line with the banking group's reporting policy**;
- (f) ensure **(, as far as possible,)** that no conflict of interest with/between other internal control functions **within the banking group** exists;

#### Monitoring

- (g) be responsible for establishing a compliance culture in the bank **and banking group** that contributes to the overall objective of prudent risk management by the bank **and banking group**;
- (h) establish a line of communication to line management, in order to monitor continuous**(ly)** compliance with laws and regulations or **other** supervisory requirements by the bank **and banking group**;
- i) **(require) ensure that** line management **(to)** monitor compliance with laws, **directives** and regulations or supervisory requirements as part of their normal **(operational)** duties;

j) **(require) ensure that all** regulatory requirements **(to) are (be)** incorporated into operational procedure manuals when appropriate;

(k) make recommendations whenever necessary in order to ensure that there is compliance with laws, **directives** and regulations or **other** supervisory requirements;

#### Reporting

(l) establish **procedures (prompt mechanisms)** for reporting and resolving non-compliance with laws, **directives** and regulations or **other** supervisory requirements;

(m) ensure that resolutions are **recorded and** signed off;

(n) document **(the)** compliance officers' findings, including any remedial action, as part of the compliance-monitoring **procedures and** programme;

#### Resources

(o) **ensure the recruitment and retention of** sufficient **compliance** staff of the correct quality in order to monitor and test continuously the bank(**'s**) and **banking group's** compliance with laws, **directives** and regulations or **other** supervisory requirements:

(p) ensure that **all** compliance staff are trained on a continuous basis in order to ensure that they have adequate technical knowledge in order to understand the regulatory framework that applies to the bank **and the banking group**, as well as the risks to which the bank **and the banking group** is exposed;

#### Manual

(q) compile and maintain a compliance manual that -

(r) adequately addresses all material risks to which the bank **and the banking group** are exposed;

(s) adequately addresses all material objectives and aspects of applicable legislation;

(t) refers to specific legislation, rules, **directives** and regulations when appropriate;

(u) is readily available to all (**relevant**) staff;

(v) is **frequently** reviewed and updated at least once a year.

### **Outsourcing**

**(w) Outsourcing of the compliance function shall be subject to the following conditions:**

- **A legally binding agreement between the bank and the Compliance Service Provider (“CSP”) detailing the exact terms of the agreement;**
- **CSP is only responsible for the monitoring and not for performing compliance in the bank;**
- **CSP shall be totally independent from the bank and appointed on an annual basis;**
- **Appointment of the CSP shall also be subject to the Registrar of Banks approval based on specific criteria set by the Registrar;**
- **Regular meetings between the Registrar of Banks and the CSP;**
- **The CSP’s activities shall be subject to an audit by the bank’s external auditors on at least an annual basis;**
- **The CSP shall report its findings to the bank’s board of directors and make all the reports available to the Registrar of banks; and**
- **The CSP shall also be responsible for the training of bank staff with regard to compliance.**

(5) The provisions contained in this regulation shall not be construed as derogating from the general provisions contained in the Act that place the primary responsibility of compliance with the provisions of the Act and the Regulations on **the board of** directors and executive officers **of both the bank and the banking group.**

## 6.6 SUMMARY

The compliance problem in South Africa is that the cost of compliance is escalating, as the participants in this study have indicated. In order to address this problem, the main objective of this study was to develop a regulatory compliance framework for use by South African banks.

The focus of this chapter was on the compliance divisions of banks with the purpose of constructing a compliance framework for a bank.

The structure of the compliance framework encompasses all compliance professionals and resources within the bank, including compliance specialists outside the compliance department and other personnel responsible for performing compliance. Some banks have a traditional compliance department that solely focuses on compliance activities. In other banks, the compliance function may be more dispersed, with compliance responsibilities handled by the legal department or individual business managers. A compliance function that is disjointed can be a drain on the bank's resources. In addition, poorly defined structures may lead to finger pointing in the bank when compliance issues arise.

The compliance universe for banks in South Africa was defined, the responsibilities of the compliance officers detailed, a compliance organogram constructed; specific reporting structures defined, a simplified compliance cost calculation method developed, a risk-effectiveness matrix provided, and outsourcing of compliance duties by the compliance division defined. The framework was also evaluated using the requirements of Regulation 47 of the Regulations relating to banks as well as the Basel II principles on compliance.

A benefit analysis of the implementation of the framework was performed. The analysis has shown that the implementation of the framework should enhance compliance risk management in banks. It is furthermore important that the costs of implementing the framework have to be measurable. A cost analysis of implementing the framework was performed as well as a cost-benefit analysis in order to ascertain the value that the implementation of such a framework would have for a bank.

Some new trends were discussed that have been observed in the banking world that are not essential to the regulatory framework but could possibly further enhance compliance *per se*. These trends included the Basel II requirements, aligning compliance with a bank's business objectives and strategies, regulatory compliance and software and preparation for on-site examinations. In addition, some changes to the legislation were proposed that could result in a more efficient compliance regime in South Africa. These included recommendations on a single financial regulator in South Africa, compliance related tax deductions, compliance-related capital reductions, outsourcing and changes to the South African Banks Act.

In the next chapter, the entire current study is summarised with an emphasis on the findings as well as the conclusions drawn from the results obtained, including some specific recommendations that can possibly be instituted by banks in order to enhance compliance activities at acceptable costs in these banks.

## CHAPTER SEVEN

### SUMMARY AND RECOMMENDATIONS

#### 7.1 SUMMARY

In the section below, a summary of the study is provided, after which certain recommendations are presented with a view to address and possibly resolve the issues under investigation in this research.

##### 7.1.1 Introduction

In April 2005, after lengthy discussions and much debate with banks around the world, the Basel Committee issued its paper entitled “Compliance and the compliance function in banks” (BIS, 2005). This paper provides detailed compliance principles to which banks should adhere. The Committee’s paper stipulates that compliance in banks begins at the top with the board of directors and senior management of a bank. It further stipulates that compliance should be part of the culture of a bank and that the compliance function should be adequately resourced. The same principles set by the Basel Committee are applicable to banks in South Africa and is supervised by the SARB as part of its supervisory programme.

Regulation 47(1) of the Regulations relating to the Banks Act (SARB, 2000) states that:

A bank shall establish an independent compliance function as part of its risk-management framework, in order to ensure that the bank continuously manages its regulatory risk, that is, the risk that the bank does not comply with applicable laws and regulations or supervisory requirements.

The regulations further require that a compliance officer of the bank shall head an independent compliance function and that the compliance function shall have adequate resources. The SARB has expressed its dissatisfaction in the

past with the level of compliance among banks in South Africa and has ordered the different boards of directors to rectify the situation as a matter of urgency. This requirement compelled banks to spend more and more money on compliance, resulting in complaints from the banks about the cost of compliance. Media reports focussing on the increase in the cost of compliance have aggravated the situation even further. The cost of compliance is divided into two broad categories, namely the cost associated with performing compliance, and the cost of non-compliance.

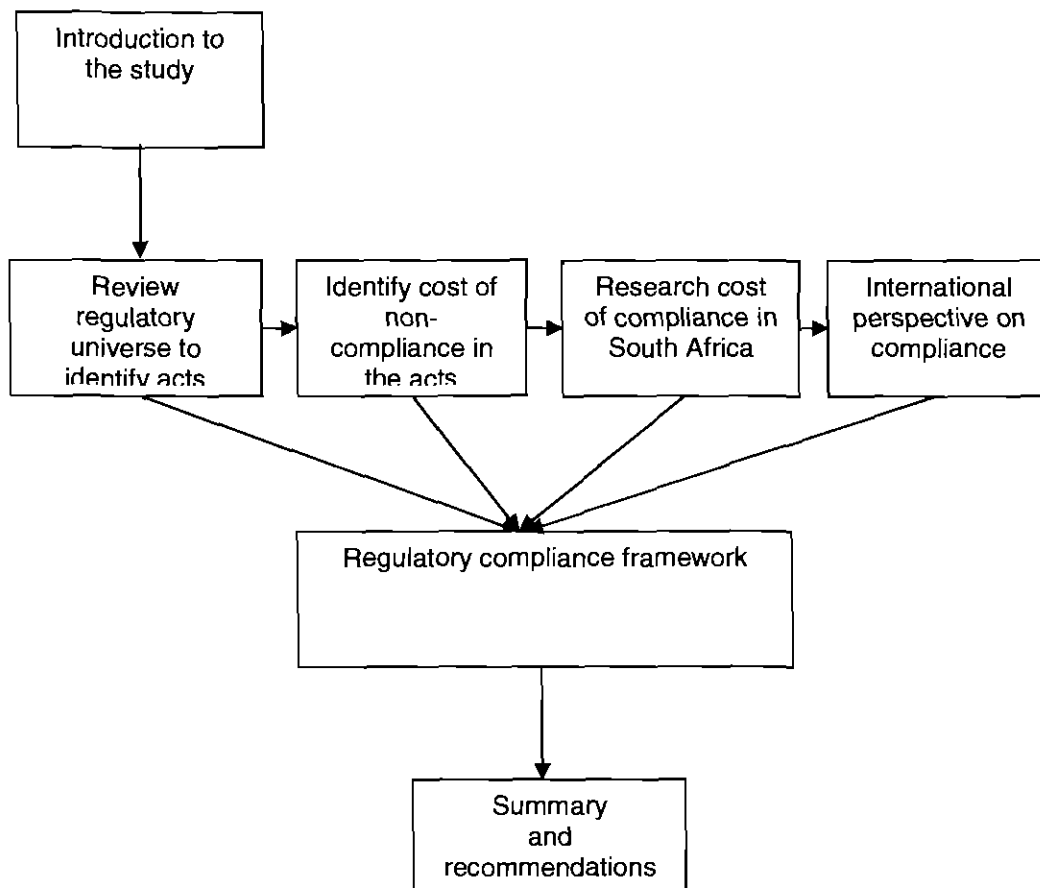
The problem that this study addresses is how to ensure that the compliance function in banks becomes compliant with all applicable acts and regulations at a measurable cost. The main objective of this study was thus to provide a regulatory compliance framework for implementation by banks in South Africa. In order to achieve the stated objective, a specific methodology was thus formulated, namely:

- The regulatory universe in South Africa was reviewed in order to identify all the acts that govern the activities of banks.
- The direct cost of non-compliance was identified by reviewing the specific sections of the different acts in the regulatory universe where non-compliance is an offence. Included in this investigation was research into the possible indirect cost of non-compliance such as loss of revenue due to reputational damage caused by a bank's non-compliance.
- Compliance officers of banks in South African were interviewed in order to ascertain the cost of compliance to these banks. Questions aimed at obtaining specific information pertaining to personnel cost, infrastructure cost, direct regulatory cost and operational cost were included.
- A review of the international perspective on regulatory compliance was performed and attention was paid to supervisory structures and current trends in regulatory compliance in the G10 countries.
- A regulatory compliance framework was developed by incorporating the information obtained in the research. This framework was measured

- against Regulation 47 of the Regulations relating to banks as well as the Basel principles on compliance to ascertain whether it met the specific regulatory standards.
- Legislative changes and other incentives were proposed in order to enhance the management of compliance risk.

The methodology mentioned above was divided into steps and each step was dealt with in a separate chapter, as detailed in the figure below.

Figure 7.1: Structure of the study



Source: Author (2008)

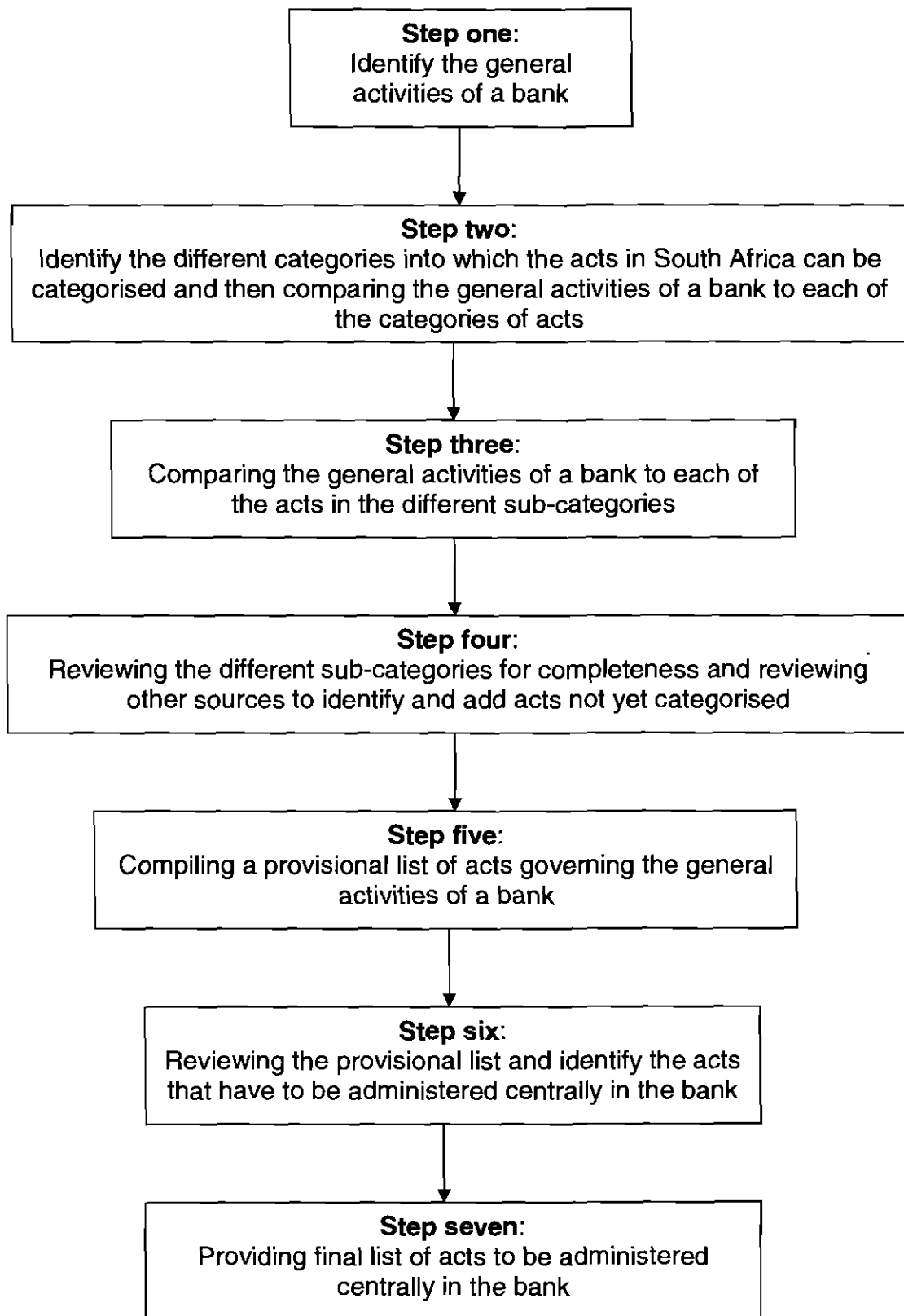
### 7.1.2 Regulatory universe

Following the introduction to the study in Chapter One, Chapter Two commenced with the review of the different regulators in South Africa and then focused on the main purpose of this chapter, namely an investigation into the current South African regulatory universe as at **30 June 2006** in order to identify and list the acts that govern the general activities of banks in South Africa. The acts identified were those that had the most severe impact on the activities of a bank and that had to be administered centrally in the bank and not by the different divisions in the bank. It was noted that there could be acts in existence that were not included in the final list of acts. These acts cannot be discarded and compliance with these acts should take place at a divisional level in a bank as these could only apply to the specific activities of such a division.

A specific methodology was formulated to identify these specific acts. The methodology consisted of a number of steps, namely:

- Step one: Identifying the general activities of a bank;
- Step two: Identifying the different categories into which the acts in South Africa can be categorised and then comparing the general activities of a bank to each of the categories of acts;
- Step three: Comparing the general activities of a bank to each of the acts in the different sub-categories;
- Step four: Reviewing the different sub-categories for completeness and review other sources to identify and add acts not yet categorised;
- Step five: Compiling a provisional list of acts governing the general activities of a bank;
- Step six: Reviewing the provisional list and identifying the acts that have to be administered centrally in the bank; and
- Step seven: Providing final list of acts to be administered centrally in the bank.

Figure 7.2: Identifying the regulatory universe



Source: Author (2008)

By following the steps above, a number of acts have been identified that can be administered centrally in a bank, namely:

1. Banks Act, 1990
2. Basic Conditions of Employment Act, 1997
3. Companies Act, 1973
4. Competition Act, 1998
5. Consumer Act (Unfair Business Practices), 1988
6. Electronic Communications and Transactions Act, 2002
7. Employment Equity Act, 1998
8. Financial Advisory and Intermediary Services Act, 2002
9. Financial Intelligence Act, 2001
10. Income Tax, 1962
11. Labour Relations Act, 1995
12. Medical Schemes Act, 1998
13. National Credit Act, 2006
14. Occupational Health and Safety Act, 1993
15. Promotion of Access to Information Act, 2000
16. Skills Development Act, 1998
17. Tobacco Products Control Act, 1993
18. Unemployment Insurance Act, 2001
19. Unemployment Insurance Contributions Act, 2002
20. Value-Added Tax Act, 1991

### **7.1.3 Cost of non-compliance**

In Chapter Three, the cost of non-compliance was reviewed and it was indicated that the financial history of the world is riddled with examples of financial institutions, including banks, making newspaper headlines because of non-compliance with laws and related regulations. The largest civil penalty against a United States financial institution was registered when Riggs Bank was fined for violations under the United States Banks Secrecy Act. Riggs Bank was fined US\$ 25 million for numerous violations of this act as well as their failure to report suspicious transactions. Apart from the direct cost of the

fine, Riggs suffered extensive damage to its reputation, resulting in the loss of clients and consequently, also a loss of income.

It was found that internationally one of the primary reasons that cause financial institutions to violate laws is the unwillingness of these institutions to spend the money necessary to comply with laws and regulations. Another reason found was that many acts and requirements are quite complex or overly burdensome, resulting in the financial institutions not complying with every detail.

The current study focussed on the situation in South Africa and the purpose of Chapter Three was therefore to ascertain the direct cost of non-compliance in South Africa. As a first step, all the acts that have been identified in Chapter Two were reviewed in order to identify the sections in the different acts where non-compliance is a criminal offence. Details on the nature of the non-compliance classified as criminal offences were provided for each of the acts. The penalties attached to these offences were identified, whether prison sentences, fines, or a combination thereof.

It was found that the ratio between the number of instances where non-compliance is an offence and the number of sections in the acts is significant. In looking at all the identified acts together, offences can be the result of non-compliance in 374 instances out of a possible 1 948 sections of the different acts. This ratio expressed as a percentage is an average of 20 per cent. It was further found that the executives of banks carry the responsibility for non-compliance and can face jail terms or individual fines because of non-compliance. The direct cost of non-compliance with the identified acts was found to be severe, with fines as high as R10 000 000 imposed on banks and prison sentences of up to 10 years per incident.

Research on the indirect cost of compliance was also conducted, where this type of cost can be defined as costs relating to a damaged reputation and/or brand. The indirect cost of non-compliance was found to be a serious threat to

any company and it was found that in some extreme cases, such as Arthur Anderson, non-compliance led to the demise of the company.

Research conducted in this study found that banks use changes in certain indicators to estimate the indirect cost of non-compliance. These indicators include loss of current and future customers, loss of employees, reduction in current or future business partners, increased costs of financial funding, and increased costs due to increased supervision by the Regulator.

Some banks have developed statistical models to measure the indirect cost of non-compliance. The most popular method found was the examination of a bank's share price reaction to an announcement of a major loss event. Arriving at an accurate estimation or calculation of the indirect cost of non-compliance is difficult, but there is, however, no doubt that if a bank is deliberately non-compliant it will almost certainly be forced to exit the market.

#### **7.1.4 Cost of compliance**

In order to understand the cost of compliance to banks in South Africa, a survey was conducted amongst the banks regulated by the South African Reserve bank as well as audit firms involved in regulatory audits. Below follows the summarised results of the bank survey:

- The majority of the banks in South Africa also have a presence in Europe and Africa, whilst a small number of banks also have a presence in Asia and in Australasia.
- The majority of the banks in South Africa are active in the commercial, investment and treasury sectors, whilst some banks are also active in the retail and merchant bank sectors.
- All the banks have either a centralised or a combination of a centralised and decentralised business model for compliance. None of the banks in South Africa has a completely decentralised business model.

- The majority of compliance staff is deployed on a decentralised basis by the banks.
- Annual revenue of the majority of the banks exceed R1 billion.
- The main regulators for banks in South Africa are the SARB and FIC.
- The main foreign regulator for South African banks is based in the UK with other regulators in Africa, the USA, Hong Kong, Brazil and India.
- Compliance with the requirements of AML and FICA is managed by the banks on a centralised basis whilst a small number of banks manage compliance with the Banks Act, FAIS and OHS on a centralised basis. The majority of the banks manage HR and NCA on a decentralised basis.
- All the banks perform the basic compliance responsibilities, namely advisory services, developing compliance policies, providing training on compliance, monitoring compliance with the different acts, performing compliance reviews and liaising with the regulators.
- None of the banks was able to furnish accurate information on the actual cost of compliance to these banks. Only estimates were provided.
- The majority of regular submissions to local regulators are made to the SARB, followed by submissions to FSB and NCR.
- The majority of regular submissions to foreign regulators are made to regulators in Africa followed by the UK, the USA and Hong Kong.
- None of the banks has entered into outsourcing agreements that pertain to compliance activities.
- The banks are unanimous in that they agree that the cost of compliance has definitely increased over the past three years.
- Banks are given between 7 and 30 days to respond to regulatory queries depending on the nature of the query and the regulator's instructions. The average time given to respond, based on the information furnished by the banks, is 14 days.
- The banks have to wait between 21 and 60 days for responses from the regulators. The average time, based on the information furnished by the banks, is 40 days.

- Banks in South Africa are divided on the question as to whether the current regulatory regime in South Africa is too onerous.
- The banks are also divided on whether the current regulatory regime influenced competition between the banks positively or negatively.
- The banks are furthermore divided on the question as to whether there are too many regulators in South Africa.
- Some banks favoured self-regulation and others were totally opposed to this notion.
- None of the banks could accurately calculate the cost of implementing Basel II.
- The banks are unanimous in that they all believe that there are definite benefits in implementing Basel II principles.
- Staff cost and systems implementation costs are deemed to be the main cost components in the Basel II implementation.
- The banks foresee that further costs will be incurred after the January 2008 implementation of Basel II and believe that this implementation would also be system-driven.

The following are the results of the audit survey:

- Audit firms active in South Africa are global firms with a presence in the all the major financial centres of the world.
- The majority of SARB regulatory audits in offshore jurisdictions are performed by the audit firms' offshore teams.
- Audit firms only have a small number of full-time specialist regulatory audit staff. Firms utilise part-time regulatory audit staff to perform the regulatory audits in South Africa and abroad.
- Audit firms' annual income derived from regulatory audits is less than ten per cent of the firms' total annual income.
- Audit firms report to all the major regulators in South Africa.
- Audit firms provide a full range of regulatory services to the banks.

- Audit firms agree on two possible reasons for the increase in the cost of compliance, namely increased complexity of the regulatory environment and a growing number of acts to comply with.
- Audit firms are divided on the issue as to whether the current regulatory regime influences competition in the banking sector.
- None of the audit firms interviewed favoured self-regulation by the banks as they are of the opinion that self-regulation is inappropriate in view of South Africa's current state of development.
- None of the audit firms have any idea of what the cost of implementing the Basel II requirements would be in the banking sector in South Africa.
- Audit firms agree that the main cost components are systems and people with the main cost factor being the use of consultants by the banks.

In view of the above results, it can be noted that there is a definite need for improvement in the banks in South Africa as far as compliance risk management is concerned, especially with regard to the allocation of responsibilities and calculating of the cost of compliance. The information provided by the banks was in the main confirmed by the information obtained from the audit firms.

#### **7.1.5 International perspective**

In Chapter Five, an international perspective on regulatory compliance was presented with the purpose of identifying international trends in regulatory activities and structures, which could possibly be used in South Africa. In order to achieve this goal, a high-level review of the supervisory and regulatory frameworks was conducted in each of the G10 countries as well as a review of trends in the regulatory compliance in the said countries.

Internationally, it was found that regulation involves providing input into developing and interpreting legislation and regulations, issuing guidelines, and approving requests from regulated financial institutions as required.

Supervision, on the other hand, involves assessing the safety and soundness of regulated financial institutions, providing feedback to institutions, and using supervisory powers to intervene in a timely manner when necessary.

The following trends in the international regulatory frameworks were identified:

- Single financial regulator

Internationally, the responsibility for banking supervision rests with the central bank; while supervision over all other financial institutions is typically vested with other regulatory agencies. There are, however, several countries that are departing from this model, rather adopting the model of a single financial regulator. The reason for favouring this kind of model is that, since the boundaries between different kinds of financial institutions are becoming more blurred, it makes sense to integrate the supervision of all financial institutions into a single agency.

- Quest for greater risk sensitivity

The management of risk in the majority of international banks consists of three elements, namely accurate measurement and monitoring of risk, controlling and pricing exposures, and holding of adequate capital and reserves to meet unexpected losses. Instead of reviewing regulatory returns, supervisors have been focusing more on these risk aspects lately.

- Increased supervisory oversight

The most important trend observed in the financial markets is that regulators are departing from traditional regulations regarding supervision. This constitutes a move aimed at the assessment of whether the overall management of a financial institution's business is being prudently conducted. There is a strong tendency towards the introduction of action plans and additional supervisory activities by supervisors to

review and fully understand all the aspects of a financial institution's business.

- Financial infrastructure

Supervisors are paying greater attention to their country's own financial sector's efficiency and stability as it was found that any financial sector's efficiency and stability depend on the robustness of the financial infrastructure which consists of the legal framework, accounting standards used to value financial assets, availability of relevant statistics; payment and settlement system and principles of corporate governance.

- Level playing fields

Internationally there is a growing tendency amongst regulators to create a more level playing field. The globalisation of financial activities made this global approach to financial supervision essential. The absence of such a global approach would create the danger of regulatory arbitrage where banks would endeavour to operate in jurisdictions in which the burden of regulation is the lightest. The introduction of the Basel II principles is regarded as a positive step towards more level playing fields.

- Micro- and macro-perspectives in regulation and supervision

Supervisors are becoming aware that financial sector instability usually has its roots in macroeconomic factors. Supervisors are therefore now introducing techniques that will make banking systems more resilient to the financial cycle. Banks are also encouraged by supervisors to build up capital cushions in good times to protect lending when the cycle turns down.

The following trends in the international regulatory compliance were identified:

- Basel II

The Basel Committee's paper on compliance risk and compliance function in banks has set a new trend in regulatory compliance and could ensure level playing fields in all the member countries. These guidelines can be regarded as the major trend in regulatory compliance as regulators around the world have adopted these principles and expect the banks under their supervision to follow suit.

- Alignment of compliance with business objectives and strategies

Regulatory compliance and reporting are now internationally viewed as a natural extension of the governance duties of top management and boards of directors. Compliance is aligned with the company's business objectives and risk management strategies and is thereby adding value, not simply adding another cost to the bank. Regulatory compliance is also regarded as a part of doing business and not as a stand-alone activity.

- On-site examinations

It was found that financial institutions and banks are currently taking steps to position themselves better to respond to a variety of formal, regulatory investigations. These investigations include reviews on capital adequacy, asset quality, management/administration of the bank, earnings and liquidity. Banks are therefore developing strategies for assessing allegations, preparing for an investigation by the Regulator, putting together an investigation team/plan, establishing resolution strategies and taking the initiative with remedial actions.

- Records management

A number of financial institutions find themselves in a transition from paper records to electronic records. They also experience that the pace of transition is picking up which requires of these institutions to incorporate

records management and related procedures as part of compliance. Records management is concerned with information, how it is managed, and what kind of response is given to a regulator or an inspector. Records managers not only have to be experts in storing, managing and collecting the content, but must also be well informed regarding the procedures and the laws that govern the job.

- Outsourcing

Compliance costs are on the increase, something that may well force banks to investigate the possibility of outsourcing some of the compliance functions related to data management and reporting, without impacting quality or abdicating management responsibility. A number of experts are of the opinion that the responsibility for compliance cannot be outsourced to independent third parties, although they indicate that some duties may well be outsourced to internal third parties.

The FSA in the United Kingdom has a different opinion and recently adopted guidelines on outsourcing, effective from 1 November 2007.

- E-Compliance Solutions

A number of companies around the world have developed automated systems that can complement the already existing compliance process. These automated systems can track, reference and record events, and prompt user actions throughout the entire compliance process. In tracking, managing and recording completed compliance tasks, these systems assist the financial institution to meet and exceed legal obligations and keep abreast of regulatory restrictions. It is, however, stressed that these systems cannot replace compliance activities but should rather be seen as complementing the compliance process.

### 7.1.6 Compliance framework

In view of the above, a compliance framework was developed in Chapter Six for banks in South Africa. The framework defined the compliance universe for banks in South Africa, the responsibilities of compliance officers, constructed a compliance department organogram; defined reporting structures, proposed compliance cost calculation models, provided a risk-rating matrix, and defined outsourcing of compliance duties by the compliance division.

The compliance framework consists of the following components:

- Compliance universe

The compliance framework is based on a specific compliance universe consisting of the 20 acts mentioned above that were identified in the review of the legislation in South Africa as at 30 June 2006. The acts identified were those that had the most severe impact on the activities of a bank and that had to be administered centrally in the bank and not by the different divisions in the by specially appointed subject matter experts.

It must be noted that there are acts in existence that were not included in the final list to be administered centrally in a bank. These acts cannot be discarded and compliance with these acts should take place at a divisional level in a bank as these could apply to the specific activities of that division in a bank.

- Compliance department structure

The centralised compliance department structure, as shown in figure 7.3 below, for the compliance framework is a functional structure based on the compliance universe as described above.

Four different levels can be distinguished in the structure, namely:

- Executive management

The bank's board of directors is ultimately responsible for compliance in a bank. The Chief Executive Officer ("CEO"), which reports to the board, is responsible for the management of compliance risk. In banks, active board and CEO oversight is of the utmost importance.

- Senior management

Senior management are responsible for the establishment and maintenance of appropriate compliance risk policies, procedures, and internal controls. Senior management are, furthermore, also responsible to report to the CEO any material breaches of all acts, regulations or any other rules. The senior management level incorporates the Head of Compliance, Head of Secretariat and the Head of Tax, each of whom reports directly to the CEO. Senior management are divided into these three groups based on the acts identified in Chapter Two as well as applicable regulatory requirements.

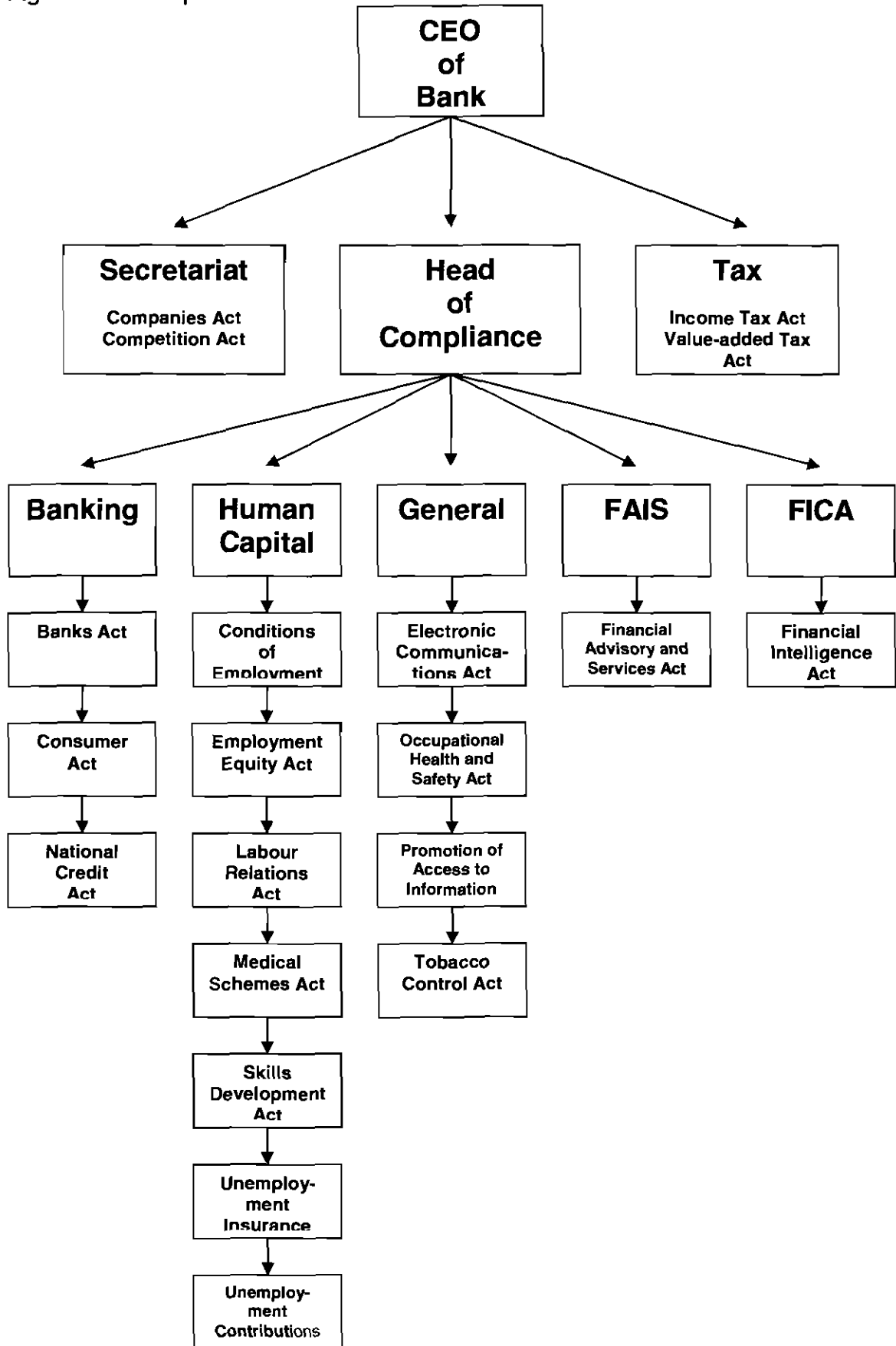
- Management

The manager's primary responsibility is to coordinate activities in the particular section and to ensure that subject matter experts ("SMEs") adequately manage compliance risk for all the applicable acts. The manager also acts as the liaison person between the SMEs and the rest of the business.

- Subject matter experts.

Subject matter experts are each managing a particular act.

Figure 7.3: Compliance structure



Source: Author (2008)

- Compliance responsibilities

Compliance responsibilities rest with the SMEs at a central level in a bank and also with the compliance officers at a business unit level. The SMEs at a central level are responsible for the establishment of uniform risk management standards, policies, procedures and methodologies in conjunction with the business entities, audit and risk committees, management boards and boards of directors of a bank. These SMEs are also responsible for the communication to the business units of risk management strategies and general risk management requirements, creating risk awareness, monitoring of the implementation and effectiveness of the risk management processes and for assisting with the improvement of risk management processes as required.

- Compliance risk rating

A bank's board of directors should decide on the bank's overall compliance risk appetite and should determine how much compliance risk the bank is willing to accept. This decision regarding risk tolerance should be taken with reference to potential impact on the strategy and the achievement of business objectives.

Non-compliance with any rule, whether intentional or accidental, could have severe consequences for a bank leading to possible criminal prosecution, penalties, and the loss of any licence as required in terms of applicable legislation. In the compliance framework there is zero tolerance for intentional non-compliance with any section of any applicable act, regulation or circular issued by any authorised authority.

In order to rate the compliance risks, the following scale is proposed to establish the level of seriousness of the non-compliance event:

<b>High Risk</b>	1	2	3
<b>Medium Risk</b>	4	5	6
<b>Low Risk</b>	7	8	9
	<b>Compliant</b>	<b>Non-Compliant (Room for improvement)</b>	<b>Non-Compliant (Unacceptable)</b>

Source: Author (2008)

This specific method of rating compliance risk is regarded as one of the cornerstones pertaining to monitoring of and reporting on compliance risk.

- Compliance monitoring

Compliance monitoring is regarded as one of the key tools a bank can use to protect itself, its shareholders and depositors by ensuring that the bank adheres to laws and regulations. In the compliance framework, a risk-based approach to compliance is also promoted.

The role of the compliance officer at the centre or SME can be defined as identifying the acts that governs the activities of a bank, identifying the inherent risks, assessing the risks and rating the risks. The objective of the process is to provide direction in terms of the requirements that could be regarded as high regulatory risks for the bank. High risk and core regulatory requirements identified are those that warrant monitoring on a

continuous basis. The role of the divisional compliance officer is to monitor compliance with all applicable laws and regulations that are relevant to that particular division. The monitoring of divisional compliance is firstly based on the guidance provide by the different SMEs. Secondly, the divisional compliance officer should monitor all applicable acts and regulations not managed by the SMEs and that are only applicable to that division.

Monitoring is performed through attending meetings, research and the use of risk-management plans.

- Reporting

The reporting process in this framework starts after the monitoring process has been completed for each of the applicable acts. The reporting process can be divided into two sections, namely the reporting responsibilities of divisional compliance officers and reporting responsibilities of SMEs.

The following reporting process is proposed for the divisional compliance officers:

- Identify all new instances of non-compliance by actively monitoring the activities of the division;
- Categorise new instances of non-compliance identified during the monitoring period into high, medium and low risk categories;
- Report detail of all the new instances of non-compliance;
- Review instances of non-compliance previously identified in terms of progress made to resolve these instances of non-compliance;
- Compile the compliance report and submit it to the division's senior management and/or committee structure; and
- Submit the same report to the SMEs at the group level.

The following reporting responsibilities for the SMEs are proposed:

- Monitor the appropriateness and integrity of reporting performed by the divisional compliance officers;
- Facilitate prompt resolution and reporting of non-compliance with laws and regulations or supervisory requirements;
- Consider the impact of non-compliance from a bank perspective and indicate whether the matter should be reported to the board of directors; and
- Consolidate issues of non-compliance, whether new or unresolved, from the divisional compliance reports, include other matters as deemed appropriate, and submit the report to the board of directors.

A specific compliance report has been developed for use when reporting on instances of non-compliance. The table below is an example of such a report.

Table 7.1: An example of a compliance report

<b>South African Banks Act, 1990</b>			
<b>Section of the Act (S)</b>	<b>Non-compliance</b>	<b>Risk</b>	<b>Comments</b>
S22	An advertisement was placed in a local newspaper without properly displaying the bank's logo.		The advertisement was withdrawn and applicable controls instituted to prevent reoccurrence.
S52	No instances of non-compliance.		
S60A	No instances of non-compliance.		

Source: Author (2008)

- Measuring the actual cost of compliance

The framework uses a simple method of measuring the actual cost of compliance to a bank. It adds up all the different costs to calculate the total compliance cost, but it also distinguishes between calculating the cost of compliance pertaining to full-time compliance staff and part-time compliance staff.

The method of calculation for the cost pertaining to full-time compliance staff comprises the following cost elements:

- Staff-related costs which include salaries, medical aid contributions, pension fund contributions, bonuses, leave pay, training, team-building events, annual conferences and parking, out-of-pocket expenses which include legal costs, auditing costs, accounting costs, advisory services, and travelling costs;
- Capital spending, which includes amongst other equipment, furniture, computer hardware and computer software.
- Other direct financial costs which include license fees, office rental, telephone and fax costs;
- Outsourcing agreements that include human resources costs and financial accounting.

In calculating the compliance cost pertaining to part-time compliance staff, it is recommended that the same cost elements be used but that the actual cost should be reduced on a pro-rata basis according to the time spent on actual compliance. Furthermore, the use of proper timesheets is proposed to record the actual time spent on duties relating to compliance. The pro-rata rule can be applied to all of the cost elements except out-of-pocket expenses.

The following table is an example of the calculation of the cost of compliance to a bank. The actual individual costs were researched in the market and this calculation is thus based on actual figures and costs in the market.

Table 7.2: Calculating the cost of compliance

<b>Cost element</b>	<b>Assumptions</b>	<b>Amount</b>
<b>Staff-related cost:</b>		<b><u>R29 845 000</u></b>
- Salaries	- Senior managers X3 @ R700 000 per annum; - Managers X5 @ R520 000 per annum; - SMEs X16 @ R400 000 per annum; and - 61 Divisional compliance officers @ R400 000.	R29 400 000
- Medical aid contributions	- Included in salaries	
- Pension fund contributions	- Included in salaries	
- Bonuses	- Included in salaries	
- Leave pay	- Included in salaries	
- Training	- One external training session @ R5000	R 305 000
- Team-building events	- One annual event @ R40 000	R 40 000
- Annual conferences	- One annual event @ R100 000	R 100 000
- Parking	- Included in salaries	
<b>Out-of-pocket expenses:</b>		<b><u>R3 100 000</u></b>
- Legal costs	- Legal opinions for National Credit Act	R 100 000
- Auditing costs	- Annual regulatory audit	R1 000 000
- Accounting costs	- Internal accounting costs	R 500 000
- Advisory services	- External opinions	R 500 000
- Travelling		R1 000 000
<b>Capital spending:</b>		<b><u>R 850 000</u></b>
- Equipment	- All components included	
- Furniture		
- Computer hardware		
- Computer software		
<b>Other direct financial costs:</b>		<b><u>R 3 250 000</u></b>
- License fees	- Banks Act and NCA annual fees	R 2 000 000
- Office rental	- For 85 staff members per annum	R 1 000 000
- Telephone and fax costs	- For 85 staff members per annum	R 250 000
<b>Outsourcing agreements:</b>		<b><u>Nil</u></b>
- Human resources	- No outsourcing agreements	
- Financial accounting		
<b>TOTAL COST PER ANNUM</b>		<b><u>R37 045 000</u></b>

Source: Author (2008)

The cost of compliance as calculated above can be compared to the cost of compliance as indicated by the banks in South Africa in the survey.

The following table details this comparison.

Table 7.3: Comparing the cost of compliance

<b>Cost element</b>	<b>Proposed framework costing</b>	<b>Banks' cost estimates</b>
Staff-related costs	R29 845 000	R33 880 000
Out-of-pocket expenses	R 3 100 000	R 6 000 000
Capital spending	R 850 000	Unavailable
Other direct financial costs	R 3 250 000	Unavailable
Outsourcing agreements	Nil	Nil
<b>Total cost</b>	<b>R37 045 000</b>	<b>R39 880 000</b>

Source: Author (2008)

The following are the conclusions drawn from this comparison:

- The cost of implementing the framework is very similar to the cost of compliance indicated by the banks, but is more detailed;
  - Implementing the framework has the advantage that each cost element can be identified and a accurate budget can be developed;
  - The framework also facilitates the measurement of costs and in the process enhances the management of expenses; and
  - The banks' management can make informed decisions with regard to compliance activities in general including the management of the actual cost of compliance.
- Outsourcing

Should the bank choose to outsource its compliance activities, the following conditions are suggested to allow outsourcing:

- The existence of a legally binding agreement between the bank and the compliance services provider ("CSP") detailing the exact terms of the agreement;

- The CSP is only responsible for the monitoring and not for performing compliance in the bank;
- The CSP shall be totally independent from the bank and will be appointed on an annual basis;
- The appointment of the CSP shall also be subject to the Registrar of Banks approval based on specific criteria set by the Registrar;
- There shall be regular, formal meetings between the Registrar of Banks and the CSP;
- The work of the CSP shall be subject to an audit by the bank's external auditors on at least an annual basis;
- The CSP shall report its findings to the bank's board of directors and make all the reports available to the Registrar of banks; and
- The CSP shall also be responsible for the training of bank staff with regard to compliance.

It was calculated that there could be a substantial cost saving when a bank outsources its compliance monitoring activities. A calculation based on actual market data was performed and it was found that the saving could be as high as 20 per cent.

A bank should be allowed to outsource the services of its compliance department to other divisions in the banking group, thus making the compliance department a profit centre and not only a cost centre. It is recommended that pricing of such a service should be based on the method as described in table 6.17 in Chapter Six.

## **7.2 RECOMMENDATIONS**

In order to enable banks to implement the compliance framework, an approach that consists of three components is recommended, namely:

- Changes to current South African legislation;
- Compliance framework principles; and

- Implementation of the compliance framework.

### **7.2.1 Changes to current South African legislation**

The following changes to the current legislation in South Africa are recommended:

- Single financial services regulator

Only one financial service regulator is needed, similar to the situation in the United Kingdom and Australia. This regulator should be responsible for the prudential supervision of all financial institutions including banks and non-banks. Such a single regulator will bring the necessary consistency and uniformity to the current fragmented South African regulatory structure and is justified by the continued blurring of institutional and product boundaries, as well as growth in financial conglomerates.

- Tax deductions

The compliance cost should be a deductible item not on the income statement, but as a tax rebate. A bank should therefore calculate the exact cost of compliance once a year, have it audited by the external auditors and then be allowed to deduct such cost from the tax payable by the bank.

The cost of non-compliance, as discussed in Chapter Three, should not be tax-deductible as an expense on the bank's income statement. The bank shall therefore carry the "full" cost, penalties and fines, of its non-compliance.

- Capital reductions

A bank should be rewarded for effective compliance risk management. It is thus suggested that compliance risk and the management thereof be

assessed as part of the operational risk assessment under pillar two of the new Basel Accord. The external auditors should also audit a bank's compliance function once a year and report the findings to both the bank's board as well as to the Registrar of Banks. The result of this will be that the capital charge for operational risk can be reduced or increased according to the findings of the assessments and the external audit.

- Outsourcing of the compliance function

The Registrar of Banks and auditors should allow the outsourcing of a bank's compliance activities subject to strict conditions and oversight. The decision as to whether to outsource compliance activities to independent third parties should be left to the bank in question.

- Changes to Section 60A of the Banks Act

It is recommended that Section 60A of the Banks Act be changed to enable banks to implement the compliance framework. The detailed changes are discussed under 6.3.5 in Chapter Six. In the main, the changes pertain to permission for outsourcing, to monitor compliance at a banking group level and to enhance reporting.

### **7.2.2 Compliance framework principles**

The following general principles have been formulated that a bank should adopt when implementing the compliance framework:

- Principle 1: The board of directors and chief executive officer of a bank have the ultimate responsibility for the management of the bank's compliance risk.
- Principle 2: All the staff in a bank is responsible for the day-to-day management of the bank's compliance risk with the head of each division being responsible for compliance in that specific division.

- Principle 3: The centralised compliance divisions in the banks are responsible for managing compliance with all the acts identified as part of the bank's compliance universe whilst decentralised compliance officers are responsible for managing compliance with acts pertaining to them specifically.
- Principle 4: The bank's compliance division, both centralised and decentralised, is responsible for ensuring that the bank's compliance risk is monitored and the level of compliance in the bank is reported.
- Principle 5: The bank's compliance divisions, both centralised and decentralised, should be independent business units reporting to the chief executive officer.
- Principle 6: The compliance function in a bank may be outsourced subject to specific conditions and oversight. In addition, the compliance division may outsource compliance activities to other divisions in the bank.
- Principle 7: The centralised compliance division is responsible for, and manages the relationship with the regulators, and also acts as conduit between the bank and the regulators.
- Principle 8: All instances of non-compliance shall be reported at once to all the relevant internal authorities, including line management and the board of directors. External compliance reporting to regulators is the responsibility of the centralised compliance division.
- Principle 9: Compliance should be managed on a consolidated basis in line with the Basel principles on compliance.

- Principle 10: The centralised compliance division is responsible for, and manages the relationship with the external as well as internal auditors, and acts as conduit between the bank and the mentioned auditors.

The current shortcomings in the banks' compliance frameworks, as identified in the survey, can be addressed successfully by recommending that banks adopt the compliance framework as described above.

### **7.2.3 Implementation of the compliance framework**

The implementation of the compliance framework is a phased approach and a bank should follow the following steps:

- Step one: Define the compliance universe

The banks should define their own compliance universe by using the list of acts as described above and then customising it according to the bank's activities and needs. This is the specific task of the centralised compliance function.

- Step two: Establish the compliance department structure

The compliance structure at a central level in the bank should be based on the acts managed at a central level in a bank, also taking into account the responsibility for managing the outsourcing of the monitoring activities.

- Step three: Outsource compliance monitoring activities

The banks should outsource their compliance monitoring activities at a divisional level to independent third parties without relinquishing control over such outsourcing arrangements.

- Step four: Other compliance responsibilities

The centralised compliance function is still responsible for the other compliance activities such as advisory services, developing compliance policies, training staff on compliance, monitoring compliance at a centralised level, performing compliance reviews, liaising with the regulators and measuring the actual cost of compliance.

### **7.3 FURTHER RESEARCH**

This study has developed a regulatory compliance framework that can be implemented by banks in South Africa to ensure compliance with all relevant acts and regulations. There were however, particular issues identified that warrant further research.

The first of these issues pertains to the use of software in compliance. The framework is mostly reliant on people and their related responsibilities with regard to compliance. In addition, banks are complaining about the rising cost of compliance and as a result, more and more people are looking into the possibility of using software to fulfil the duties of a compliance officer. Software vendors are of the opinion that they have a solution for companies facing the issue of regulatory compliance. Although no single tool can ensure compliance, technologies such as system management, database auditing and monitoring provide a mix of preventive and detective capabilities that can lay a firm foundation for compliance risk management.

The second of these issues pertains to the calculation of the probability and severity of penalties for non-compliance in an expected loss type framework as found under the Basel II AMA approach. Further detailed research and development in this regard can make the idea of cost-effective compliance a reality.

The last of these issues pertains to changing the law worldwide to enforce strict compliance requirements on all companies and not just on banks and

financial institutions. A Basel-type regime, with specific requirements, should be investigated for these companies to ensure that business is conducted in an orderly and lawful fashion.

#### **7.4 CONCLUSION**

It was shown that the regulatory compliance problem in South Africa and elsewhere in the world is that the cost of compliance is ever-growing due to a variety of reasons. In order to address this problem, the primary objective of this study was to develop a regulatory compliance framework for use by South African Banks and of which the cost of implementation can be measured.

This chapter summarised the process by means of which this objective was achieved. It provided a summary of the compliance universe for banks in South Africa, responsibilities of centralised and decentralised compliance officers, a centralised compliance organogram based on the defined compliance universe, reporting structures, a simplistic direct compliance cost calculation method, a risk-effectiveness matrix, and outsourcing of compliance duties by the compliance division.

Finally, this chapter presented a summary of new trends observed in the international banking arena. In addition, it provided a short summary of the proposed changes to South African legislation that, when instituted, could result in a more efficient compliance regime in South Africa.

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