



The Governance of Macprudential Policy in South Africa

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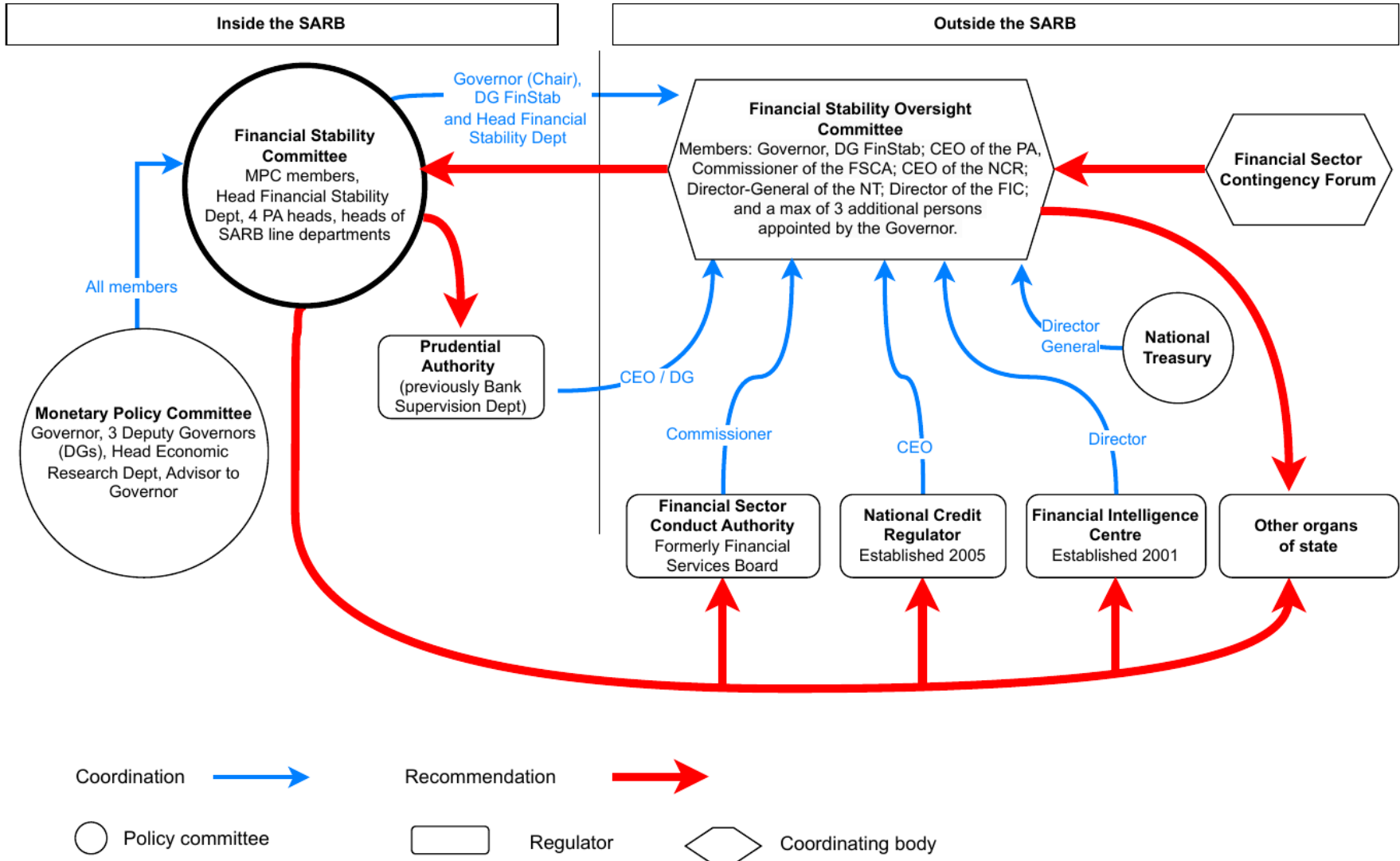
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- See full paper: <https://www.inet.ox.ac.uk/publications/the-governance-of-macroprudential-policy-in-south-africa>
- *Post-GFC*: overhaul of governance for prudential and conduct regulation of bank and non-bank financial sectors.
- *Financial Sector Regulation Act 2017* (eff. Apr-2018): extended monetary policy mandate explicitly to financial stability (previously implicit).
- *Context*: ‘**Twin-Peaks-plus macroprudential**’ *hybrid model*. First Emerging Market country to adopt Twin-peaks (others: AU, BE, NE, NZ, UK).
 - **Prudential authority** (previously, Banking Supervision Dept) – *housed within the SARB as an independent organization with its own objectives and powers.*
 - **Financial Sector Conduct Authority** (similar)+ **National Credit Regulator** (pre-existing with own Act) – *bifurcated, historical.*
 - **Financial Stability Committee**, internal committee of SARB, non-statutory – *not itself mentioned in the FSR Act.*
- *Financial Stability Review (FSR)*: the **Act requires** policy transparency and accountability to be tracked and transmitted through the *FSR*.

New Regulatory Structure for Financial Stability: Twin Peaks and the Financial Stability Committee



Opaque Financial Stability Committee with inadequate powers to act



- **2017 Act provides for** N. Treasury and SARB to agree a policy framework for execution of the financial stability mandate.
- **No framework published** by National Treasury, transparently setting up the FSC as the executive committee for macroprudential policy.
 - Financial Stability Committee (FSC) vs. the statutory coordinating committee, the Financial Stability Oversight Committee (FSOC).
 - Confusion: Edge & Liang (2022); lawyers; early drafts of the Act.
- **Willingness to act vs. ability to act:**
 - **Willingness to act** is supported by a clear mandate for macroprudential policy and well-defined policy objectives (though there are weaknesses in transparency and accountability mechanisms, see below).
 - **Ability to act** is constrained by inadequate powers.

Strengths of policy powers for FSC/Governor for direct control of macroprudential tools

Institution	Macroprudential tools			Has any SIFI status been published?	
	'Hard' powers	'Comply or explain'	'Soft' powers		
FINANCIAL SECTOR (bank and non-bank)	In 'ordinary' times:				
	SIFI	Yes	None		Yes, 6 banks. No non-banks.
	Non-SIFI		None	Yes	
	A systemic event (or preamble to) is declared:				
	ALL	Yes			

SIFI: Systemically important Financial Institution - designated

Table: Policy powers re bank and non-bank sectors, crisis vs. ordinary times

- **Ordinary times:** the SARB's macro-prudential powers are 'soft'.
 - Result: SARB must rely on regulators to carry out *non-binding recommendations* to act and **MOUs**.
- **Crisis times:** Governor acquires **sweeping 'hard' powers** only during declared crises. *Exception: designated Systemically Important Financial Institutions.*
- 'GFC mindset' when drafting the Act: **imbalance of powers** to direct macroprudential policy in **crisis times vs. 'ordinary' times**.
 - Result: **limited ability to act pre-emptively on the credit-cycle** and limit impact of damaging credit cycles on vulnerable households/firms.

- SA Reserve Bank Act (90, 1989): provides rights to governance to **the set of** the Governor and 3 Deputy-Governors.
- Under 2017 Act: emergency decision-making structure appears to override the Bank Act:
 - The **Governor gains sole sweeping authority in crises** (SDM).
 - (Governor's powers override regulators, who must obey directives under the FSR Act, subject to fiscal/other provisos.)
 - **The SDM in NZ**, present until 2019, has been strongly criticised by Dervan & Jensen (2021).
- We consider an SDM, and most especially in a crisis, to be risky.
 - The **governance structure should 'future-proof' policy** against inaction bias or over-action-bias by too powerful a Governor.

- Institutional Design
 - Formally-designate the FSC - preferably as a **statutory committee** (quorum, majority vote, casting vote for Governor).
 - Reduce **committee size** (>15 members, one third from PA) while keeping SARB majority. (No need for Minister of Finance – well provided for in Act.)
 - Add 2–3 **external members** to FSC for independent oversight.
 - Will reduce inaction bias, ‘group think’, and too great a focus/bias on micro-prudential policy (as currently). Should address the SDM.
- Process Design
 - Strengthen macroprudential policy in ‘ordinary’ times, **by adopting ‘comply or explain’ recommendations**, through legislative amendment to the Act.
 - Accountability: regulators must then act or provide written justification, then subject to ministerial arbitration.
 - Will help remove lags and inaction.
 - Integral to the successful functioning of the system, if policy making is to be more forward-looking, taking countercyclical steps ahead of crises.

Some recommendations: transparency and accountability of policy



- **Act requires** policy transparency and accountability to be transmitted through the *Financial Stability Review* (FSR).
- Publish **set of well-constructed core risk indicators** to help make policy systematic and more predictable.
 - But with limited info on **historical risk trends**: difficult to assess stance and outcome of policy, hence accountability.
 - **Gaps** in tracking risk: e.g. for lending conditions and loan performance for mortgages; other secured loans and unsecured loans; data for business loans, (SMEs); and lending to commercial real estate.
 - Address the gaps, **release historical quarterly raw data** behind the heat-map.
- Financial Stability Committee (FSC).
 - No account of quarterly meetings, **deficit in transparency and communication**. Recommend publishing a **short Summary & Record** after each FSC meeting.
 - **Are not tracking accountability**: require **dedicated Annex in the FSR** to track policy actions, implementation status, outcomes, and ‘no-change’ decisions.
 - Accountability also requires **connection between FSC and FSR**: list FSC members and roles on the preamble of the FSR.

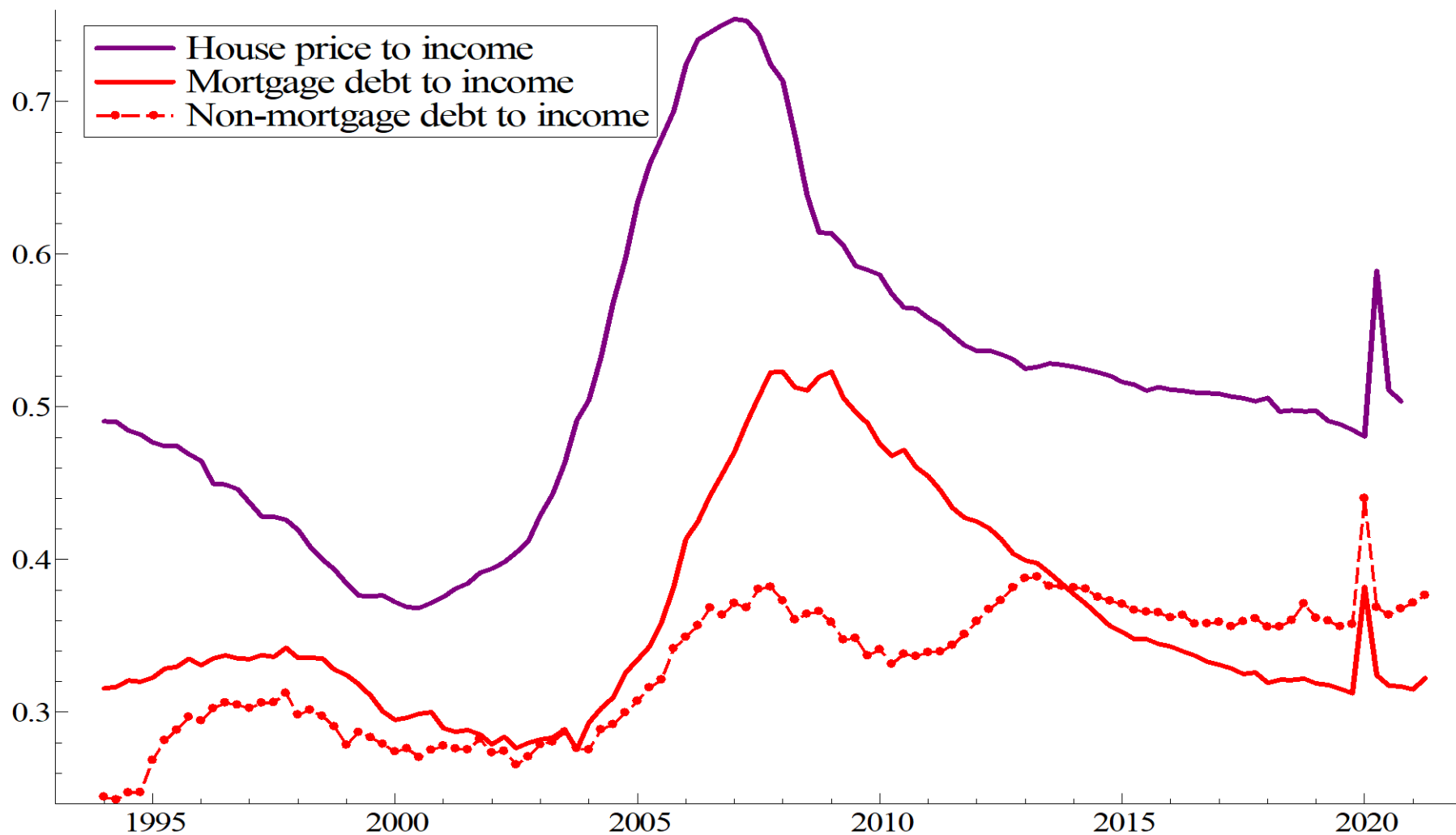
Governance features behind limited toolkit and limited policy actions



- IMF FSAP (2022) noted:
 - **Narrower, more bank-centric** toolkit (based on Basel III) than EM peers.
 - **Fewer and later** macropru policy actions vs EM peers since the GFC.
 - **No borrower-based tools** (used by EM peers), no sectoral capital buffers or sectoral risk weights, limited measures for *non-bank* financial institutions.
- Governance reasons?
 - FSC is a ‘**mass meeting**’ dominated by PA. Few decisions.
 - Financial Sector conduct Authority **bifurcated**: NCR + FSCA
 - Combination: ‘Soft’ powers in ‘ordinary’ times/NCR resource constraints - **created inefficiencies, data gaps, problems in data collection and sharing.**
- Options:
 - Absorb NCR into FSCA for economies of scale? Or strengthen NCR funding, training, and data-sharing mandates?
 - **Much attention devoted to BBMs in our paper**: recommend the *PA extends BA200 forms and collects data itself* for the lenders it covers (*not rely on NCR*) to be able to calibrate/implement BBM tools (see our Appendix).

- Legacy of Apartheid.
- *Highly unequal* income and wealth distribution, *large informal sector*.
- The *20th most capitalised stock market* globally. First amongst EM.
- *High degree of financial development*. But growth challenges.
- Financial sector is *well-regulated and robust, but oligopolistic*
- Mainly *floating rate debt*. Many *very indebted HHs*.
- *Low national saving rate* – dependence on capital inflows.
- Respected judiciary but faces numerous challenges. *Pervasive corruption* in state institutions – but SARB's reputation is generally sound.
- *Central Bank independence*: Public Protector ordered Parliament to amend Constitution to change the mandate of SARB and end inflation targeting. High Court struck down in 2018, upholding SARB's autonomy.

Household debt in South Africa: ratios to income



- **Build databases** for distributions of debt-to-income, debt-service-to-income and (better-measured) loan-to-value ratios.
- **Enable calibration** of borrower-based measures and **impact assessment** of other macropru policies.
- **Extend bank-style reporting** to *all* lenders (PA and NCR).
- **Capture granular arrears and foreclosure** and distressed sale data across banks, non-banks and smaller lenders.
- **Monitor private credit bureaux data** on SME loans and their performance.

- **Continuously track LTV, DTI and DSTI** distributions, especially the **tails** that signal emerging vulnerabilities.
 - DTIs and DSTIs relevant for non-mortgage debt (> 50 % of household debt).
- CGFS (2023) recommends **tools with automatic stabilising properties** to overcome decision and implementation lags, and inaction bias.
- Hence, **use DTI caps and limits on high-DTI-shares** of lenders - that tighten as house-price-to-income and debt/income ratios rise.
- DTIs (or DSTI+) also **protect against** risk of rising interest rate.
- Develop **early-warning indicators** from **NPL** and **arrears**-by-days data- with **3-year** horizon, not 1-year.

- Price Stability vs. Financial Stability:
 - *High inflation* → *higher rates* → *rising NPLs*.
In **floating rate markets** pre-emptive macro-prudential guidance mitigates trade-off. **Micro-regulation is not enough!**
- Competition vs. Stability:
 - **Oligopolistic** SIFI banks are well-capitalised, but **over-emphasis on their protection** may increase monopoly power.
- Big-Bank Protection vs. Vulnerable Households/SMEs:
 - *Liberal credit standards + high rates* → *high household debt service burdens*.
- An alternative equilibrium:
 - *Greater transparency on lending terms and compulsory SME credit reporting* → *greater competition and lower interest rates on lending*.
 - More **sophisticated macropru** with larger toolkit.
 - **Better balance** between bank profits and HH welfare and growth.
- **Embeds** the central bank's **vulnerable-population focus** in public discourse to **reinforce independence**.

- Importance of **floating (vs. fixed)** rates: HHs vulnerable when floating rates rise; but protected by lower interest rates in other crises.
- Currently **8.6%** of outstanding mortgages in default!
- In **floating rate markets** and where **non-mortgage debt is high**: DTIs (or DSTI+) **more relevant** than LTVs.
- **High unsecured debt levels** can also pose stability risks.
- **HH vulnerability vs. banking sector vulnerability**:
 - SA's classic credit and house price boom-bust in 2004-2009 raised subsequent NPLs but not enough for banking crisis (prevented by rate cuts).
 - Then, long period of credit contraction, damaging SMEs and HHs, and growth.
 - SARB sees **slow and unequal growth** as increasing stability risk.
 - Paradoxically, concern for **HHs** should support safe financial system.