

FLAC UPDATE

Health Funders Association

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WHY WE'RE HERE TODAY

A regulatory change in banking is creating an unintended problem for medical scheme investments



Banks must change how they borrow

New regulations require SA's six largest banks to issue debt from their holding companies, not the bank itself. This is called FLAC.



Medical scheme rules haven't kept up

FLAC is excluded from Cat(1)(a)(i)&(ii) in Annexure B. Schemes must hold at least 20% in Cat (1)(a)(i)&(ii), but FLAC does not count towards the 20%.



This will cost schemes money

As traditional bank paper matures and isn't replaced, schemes will be forced into lower-yielding alternatives. Estimated impact: approx. R2m per R1bn per year.

WHAT IS FLAC?

Key facts

Designated banks:

Absa, Capitec, FirstRand, Investec, Nedbank, Standard Bank

Phase-in:

1 Jan 2026 to 31 Dec 2031 (6 years)

Rate-type:

Mostly floating rate (ZARONIA-linked)

Maturities:

2 to 11 years observed thus far

Financial Loss Absorbing Capacity

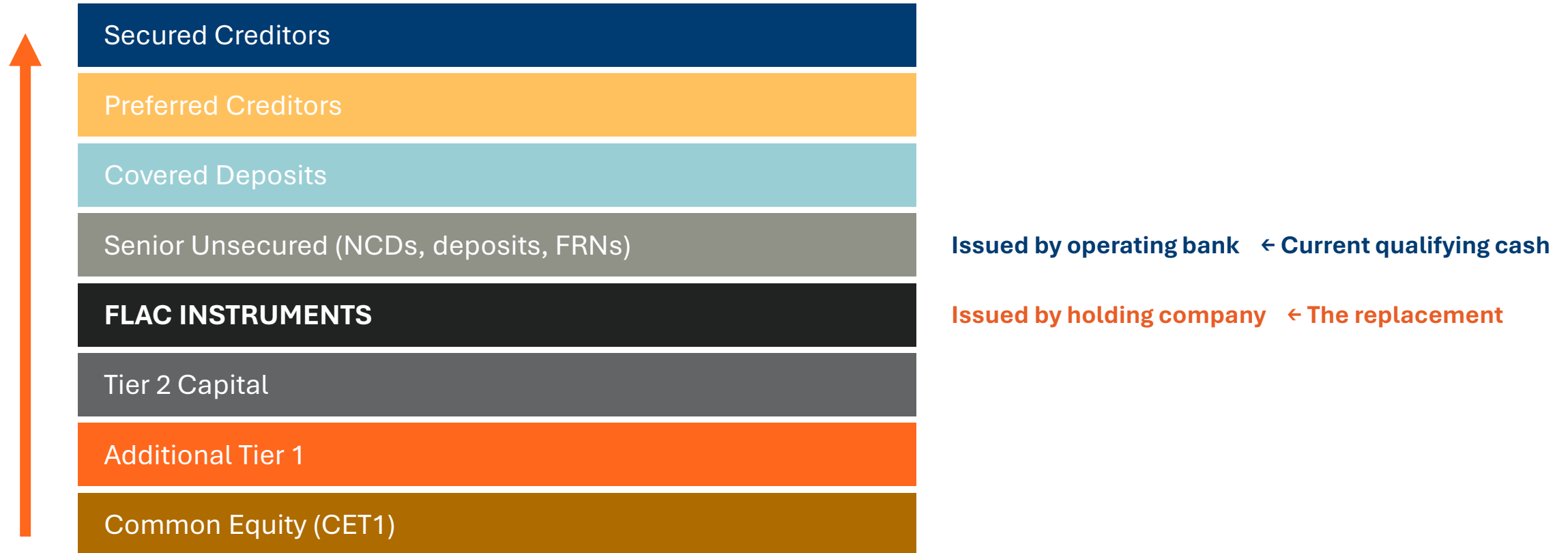
After the 2008 financial crisis, regulators worldwide decided that taxpayers should never again have to bail out failing banks.

South Africa adopted this principle. Under the new Resolution Framework, the country's six largest banks must now issue special debt that can absorb losses in a crisis. These instruments are called FLAC notes.

FLAC notes are essentially the replacement for the senior unsecured bonds that banks have been issuing for decades. The key difference: they are issued by the bank's holding company, not the bank itself. This is a regulatory requirement, not a choice.

WHERE FLAC SITS IN THE CREDIT HIERARCHY

In a crisis, losses flow from the bottom up. FLACs will replace Senior Unsecured.



IT'S ALREADY HAPPENING

The first FLAC auctions took place in February 2026 and were significantly oversubscribed, demonstrating strong institutional investor appetite.

Standard Bank | 19 February 2026

R2 billion raised across 4 tranches

R10+ billion in bids from 30+ investors

Africa's first FLAC issuance. ZARONIA-linked.

Absa | 20 February 2026

R3.2 billion across 4, 6, 8, 11-year tenors

R8.41 billion in bids. 2.65x oversubscribed.

Group Treasurer: "Most senior bank paper will transition to FLAC."

Market scale: Current senior unsecured bank bonds outstanding: approx. R206 bn. Total FLAC issuance required: R288 - R360 bn. Over the six-year phase-in, existing senior paper will mature and not be replaced.

MEDICAL SCHEME INVESTMENT CONSTRAINTS

Annexure B LIMITATION ON ASSETS

[Annexure B substituted by GNR.1360 of 2002 wef 1 January 2003.]

<i>Item</i>	<i>Categories or kinds of assets</i>	<i>Maximum percentage of aggregate fair value of liabilities and the minimum accumulated funds to be maintained in terms of Regulation 29</i>
1.	(a) Inside the Republic—	
	Deposits and balances in current and savings accounts with a bank, including negotiable deposits, money market instruments and structured bank notes in terms of which such a bank or mutual bank is liable, as well as margin deposits with SAFEX, and collateralised deposits:	100%
	(i) Per bank with net qualifying 35% capital and reserve funds per Reserve Bank DI900 return greater than R5 billion.	35%
	(ii) Per bank with net qualifying 10% capital and reserve funds per Reserve Bank DI900 return greater than R 100 million.....	10%

Explanatory notes and conditions for Annexure B

- In respect of items 1 (a) (i) and 1 (a) (ii), for banks that are subsidiaries of foreign banks, the foreign parent's capital may not be taken into account.
- The sum of deposits in categories 1 (a) (i) and 1 (a) (ii) shall not be less than 20%.

MEDICAL SCHEME QUALIFYING CASH RULES

Annexure B of the Medical Schemes Act

- Regulation 30 and Annexure B prescribe how medical schemes must invest their assets.
- At least 20% must be held in "qualifying cash" (Category 1(a)), defined as:

"Deposits and balances in current and savings accounts with a bank, including negotiable deposits, money market instruments and structured bank notes in terms of which such a bank or mutual bank is liable..."

- **The key words:** "in terms of which such a **bank** ... is liable"
- This means the instrument must be issued by a registered bank. A holding company is not a registered bank.

Typical money market mandate used by medical schemes:

30% wholesale deposits + 70% senior unsecured FRNs (issued by bank)

THE PROBLEM

The Annexure B definitions were written before the new bank resolution framework existed. They don't account for the shift to holding company issuance.



Operating Bank

Issues: NCDs, deposits, FRNs

Registered under Banks Act



Qualifies as Category 1(a)



replaced by



Bank Holding Company

Issues: FLAC notes

Not registered as a bank



Does not qualify under current rules

Same banking group. Same credit quality. Same regulator. Only the issuing legal entity has changed.

WHAT HAPPENS IF FLAC IS EXCLUDED?

Still qualifying

- Negotiable Certificates of Deposit (NCDs)
- Wholesale bank deposits (call and fixed)

Disappearing from the universe

- Senior unsecured FRNs (70% of mandates)
- Will mature over 6 years without replacement
- Banks will issue FLAC instead

Consequences

- **Shrinking universe:** Fewer qualifying instruments means less diversification and more concentration risk.
- **Forced into lower yields:** Deposits pay less than tradeable instruments. Schemes will earn less on their cash.
- **Spread compression:** More demand chasing fewer qualifying instruments will push yields down further.
- **Lost term exposure:** FLAC spans different tenors. Without it, managers lose the longer end of the curve.

ESTIMATED FINANCIAL IMPACT

R100 million

lost across the industry per year, or R2m per R1 billion in qualifying cash

Based on 0.2% p.a. reduction in mandate returns

Scaling by scheme size:

Reserves in Cash	Estimated Annual Loss
R1 billion	R2 million
R5 billion	R10 million
R10 billion	R20 million

Methodology: Senior unsecured FRNs yield approximately 0.3% p.a. more than wholesale deposits. Money market mandates hold 60-70% in these instruments. Overall mandate impact: 0.18% - 0.21% p.a. Base case: 0.2% reduction.

These are conservative estimates. As the qualifying universe shrinks and demand concentrates, the differential is likely to widen over time. Source: Large South African cash manager, based on observed market rates.

WHY THIS IS A STRAIGHTFORWARD UPDATE

FLAC instruments are the functional replacement for the very instruments that medical schemes have relied on.

The case for including FLACS rests on four simple points:

Same credit quality

FLAC carries the same probability of default as the operating bank's senior debt. The holding company's main asset is the operating bank.

Same regulatory oversight

Issuing entities are SARB-designated SIFIs, subject to Prudential Standard RA03 and comprehensive supervision.

Direct replacement

FLAC is the mandated successor to senior unsecured bank bonds. Only the legal entity changed; the risk profile did not.

No change in prudential intent

Updating Annexure B preserves its purpose: ensuring liquidity and safety. It simply reflects how banks are now required to operate.

SUMMARY

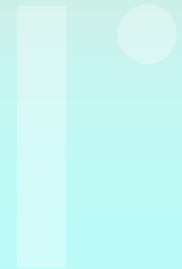
1. FLAC instruments are the regulatory-mandated future of bank funding in South Africa.
2. Current Annexure B definitions create an unintended exclusion, because they predate the resolution framework.
3. The financial impact on medical schemes is material: approximately R2m per R1bn in qualifying cash, annually.
4. This affects every medical scheme with money market mandates, not just one scheme.
5. The fix can be a simple definitional update. Same institutions. Same credit quality. Same regulator.

Proposed next step: HFA to coordinate formal engagement with CMS on an Annexure B update.



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