

FLAC update

Health Funders Association

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More information?

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1 Introduction

1.1 About RisCura

RisCura is a purpose-driven global investment firm that offers investors unique insights and guidance to help shape the future world we all want to live in whilst still achieving and exceeding financial goals for its clients.

RisCura is known for its leading focus on liability-driven investing, responsible investment practices, investment transparency, reliable valuations, independent risk assessments, world-class performance standards and excellent returns, which has brought about a major systemic shift in the African investment landscape.

Today RisCura provides advisory and reporting to clients with combined assets of more than R3.2 trillion, including some of the country's largest medical schemes. The company strives to steer global capital towards investments that benefit society and the planet in the long run.

1.2 Executive summary

South Africa's systemically important banks, through their respective holding companies, have begun issuing a new class of debt instrument called FLAC (Financial Loss Absorbing Capacity) notes, as required by the South African Reserve Bank's banking regulation arm ("the Prudential Authority") under Prudential Standard RA03. These instruments are being phased in over six years from 1 January 2026 and are expected to progressively replace existing senior unsecured bank debt as it matures.

A regulatory classification matter arises for medical schemes because Annexure B of the Medical Schemes Act requires schemes to hold a minimum of 20% in Category 1(a)(i) and 1(a)(ii) instruments in which a bank is the issuer ("qualifying cash"). FLAC instruments are issued by bank holding companies rather than operating bank entities. Because a holding company is not a registered bank under the Banks Act, FLAC instruments do not currently fit this definition of qualifying cash.

In practical terms, FLAC instruments replace senior unsecured bank paper previously issued by operating banks. The underlying banking groups remain the same, but the issuing entity has shifted from the operating bank to the holding company under the Prudential Authority's framework. Unless there is a regulatory or interpretive change, medical schemes may need to allocate more assets to lower-yielding bank deposits - i.e. instruments that clearly meet the current qualifying cash definition, in order to maintain compliance with the 20% minimum.

The exclusion of FLACs from the qualifying cash would have a significant impact on the returns generated on their assets. The return impact of not being able to access FLAC instruments is estimated to be a reduction in annual investment returns of R2m for every R1bn held in cash-like instruments and R100m in investment returns lost per year across the industry.

From a principle perspective, a broad and diversified opportunity set is the cornerstone of a healthy investment strategy. Annexure B of the Medical Schemes Act already reduces the available opportunity set of medical schemes significantly (e.g. not allowing offshore equities), which results in a less robust and lower return outcome over time. Any further reduction in the opportunity set is of concern.

As advisors to several medical schemes, RisCura considers this a matter that may warrant attention from medical schemes and other industry stakeholders given its potential implications for compliance and portfolio construction.

2 Background to FLAC instruments

2.1 Why FLAC exists

Following the 2008 Global Financial Crisis, regulators globally determined that systemically important banks should hold sufficient loss-absorbing debt to enable recapitalisation without the use of taxpayer funds. The Financial Stability Board developed the Total Loss-Absorbing Capacity (TLAC) framework to support this objective.

South Africa adopted this framework through Chapter 12A of the Financial Sector Regulation Act (FSRA), which came into effect on 1 June 2023. The Prudential Authority subsequently published the final Prudential Standard RA03 on 11 December 2024, setting out the specific FLAC (Financial Loss-Absorbing Capacity) instrument requirements. The standard took effect on 1 January 2026.

The six banks designated as Systemically Important Financial Institutions (SIFIs) and required to issue FLACs are: Absa, Capitec, FirstRand, Investec, Nedbank, and Standard Bank.

2.2 What FLAC instruments are

FLAC instruments are senior unsecured debt instruments issued by the ultimate holding company of a designated bank. They sit in the creditor hierarchy below the operating bank's existing senior unsecured instruments but above Tier 2 and Additional Tier 1 regulatory capital. Key characteristics, as set out in Prudential Standard RA03 and confirmed by the SARB, include:

Issuer: The ultimate bank holding company (not the operating bank entity)

Collateral: Unsecured

Maturity: Minimum initial maturity of 24 months; minimum remaining maturity of 12 months

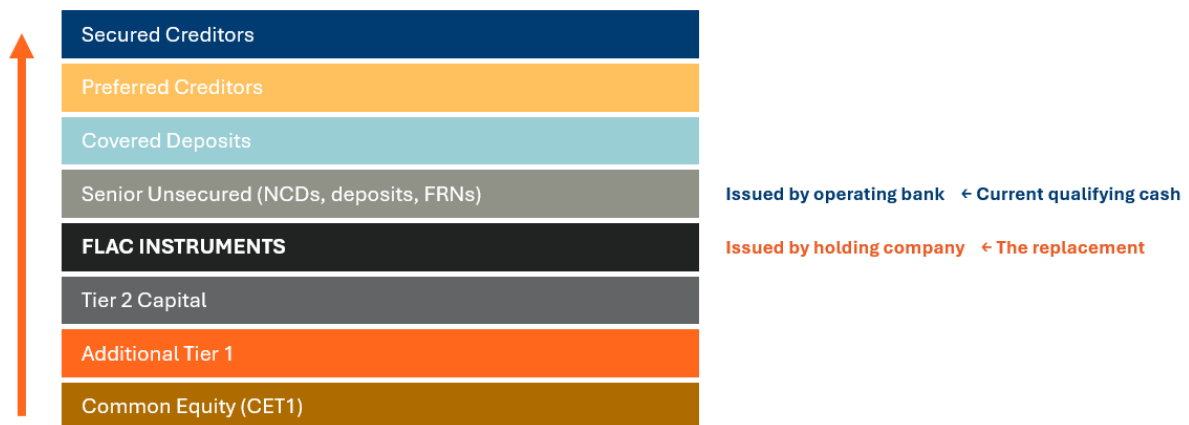
Rate structure: Predominantly floating rate, linked to ZARONIA

Tenors observed: To date, from 2 to 11 years

The chart below shows the credit hierarchy. FLAC instruments sit below current senior unsecured debt. This senior unsecured debt layer will be replaced by FLAC between now and the end of 2031, as banks stop issuing these instruments and replace them with FLAC issuance.

Where FLAC sits in the credit hierarchy

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



2.3 Phase-in timeline and early market activity

The first FLAC issuances took place in February 2026. Standard Bank raised R2 billion in four tranches on 19 February 2026, attracting bids exceeding R10 billion from more than 30 institutional investors. Absa raised R3.2 billion on 20 February 2026 across 4-, 6-, 8-, and 11-year maturities, with the auction 2.65 times oversubscribed at R8.41 billion in bids. Both issuances were linked to ZARONIA.

As of August 2025, JSE-listed vanilla senior unsecured bank bonds outstanding totalled approximately R206 billion. The total FLAC issuance requirement is estimated at R288 to R360 billion. The expectation is that most senior bank paper will transition to FLAC over time, with existing senior instruments maturing and rolling off without replacement.

3 The Medical Scheme Investment Framework

3.1 Regulation 30 and Annexure B

The Medical Schemes Act (No. 131 of 1998), through Regulation 30 and Annexure B, prescribes the categories and limits within which medical schemes must invest their assets.

The category relevant to this discussion is Category 1(a), which is 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, as well as margin deposits with SAFEX, and collateralised deposits."

This is further divided into:

- **Category 1(a)(i):** Instruments per bank with net qualifying capital and reserve funds (per SARB DI900 return) greater than R5 billion.
- **Category 1(a)(ii):** Instruments per bank with net qualifying capital and reserve funds greater than R100 million.

Explanatory Note 2 to Annexure B further requires that at least 20% of a scheme's Regulation 30 assets must be invested in these assets.

3.2 Medical scheme money market mandate structure

Medical schemes would generally make use of money market type mandates for a portion of their assets, as part of a diversified investment strategy. These allocations are usually at least 25% but can be significantly larger. These mandates would need to ensure compliance with Annexure B and therefore require a substantial portion of the assets to be invested in instruments qualifying as Category 1(a)(i) and 1(a)(ii) assets.

These instruments are generally a combination of bank-issued wholesale deposits, as well as senior unsecured floating rate notes (FRNs) issued by the operating bank entities of South Africa's major banking groups.

A typical mandate might invest approximately 30% in wholesale deposits and 60% to 70% in FRNs.

4 The Issue: FLAC and the qualifying cash definition

4.1 A technical misalignment

The issue is one of legal entity classification. Annexure B requires Category 1(a) instruments to be those "in terms of which such a bank or mutual bank is liable". FLAC instruments are

issued by the bank's holding company, which is a separate legal entity and is not registered as a bank under the Banks Act, 1990.

According to RisCura's analysis, the current Annexure B wording may not fully accommodate the post-RA03 issuance structure. The Annexure B definitions predate this new prudential framework by many years and were drafted when all material bank debt was issued at the operating company level. The shift to holding company issuance is not a market-driven choice, but a regulatory requirement. The Prudential Authority specifically requires that FLAC be issued by the ultimate holding company.

Several factors suggest that the treatment of FLAC instruments under the current qualifying cash definition may warrant consideration:

- The issuing holding companies are designated by the SARB as SIFIs and are subject to comprehensive regulatory oversight.
- Although the issuer differs, FLAC instruments are issued within the same broader banking groups that historically issued senior unsecured bank paper. This implies that the probability of default of FLAC instruments may be the same as that of the operating bank's senior debt.
- FLAC issuance has replaced traditional senior unsecured bank bond issuance for designated banks under the current prudential framework, whereas those instruments previously formed a core component of qualifying cash portfolios.

4.2 What remains as qualifying cash?

If FLAC instruments are not included in the qualifying cash definition, the remaining universe would be limited to:

- **Negotiable Certificates of Deposit (NCDs):** Issued by the operating bank. Banks are expected to continue issuing these for liquidity management, although volumes and spreads may decrease as FLAC absorbs term funding requirements.
- **Wholesale bank deposits:** Call and fixed deposits placed directly with banks. These typically offer lower yields than tradeable instruments.

Traditional senior unsecured FRNs, which have historically formed a substantial portion of qualifying cash holdings, are expected to decline over time as they mature and are not replaced.

5 Estimated return impact

The estimates below are based on information provided by a large South African cash manager in South Africa, based on observed market rates. These figures are indicative only

and should be understood as approximate. Actual outcomes will depend on market conditions, the pace of transition, and the supply-demand dynamics for qualifying instruments over time.

5.1 Estimated return impact

If FLAC instruments are not available as qualifying cash, the affected portion of the money market portfolio would need to be substituted into lower-yielding NCDs and wholesale deposits.

- The difference in return between wholesale bank funding and senior unsecured FRNs, is approximately 0.3% per annum.
- Assuming that money market mandates hold 60% to 70% in FRNs, the estimated impact on the overall return of those mandates would be 0.18% to 0.21% per annum.
- A base case reduction in returns could therefore be estimated at 0.2%, or R2m annually for every R1bn in reserves held in cash investments.

According to the CMS 2024 Industry Report (published December 2025, covering the year ended 31 December 2024), net investable assets across the industry increased to R142.99 billion, with approximately 31% allocated to cash across the industry.

Medical Scheme Industry: Asset Allocation

Total investable assets: R142.99 billion | As at 31 December 2024

	ALLOCATION	%	VALUE
Bonds	40.6%	40.6%	R58.1bn
Cash and cash equivalents	31.0%	31.0%	R44.3bn
Equities	21.8%	21.8%	R31.2bn
Property	4.2%	4.2%	R6.0bn
Other	1.8%	1.8%	R2.5bn
Debentures	0.5%	0.5%	R0.7bn

Source: Council for Medical Schemes, Industry Report 2024 (Figures 42 & 43). Weighted average of open and restricted scheme allocations.

Using these asset allocations and the returns earned across asset classes during 2025, a reasonable assumption is that net investable assets at the end of 2025 increased by 20% to approximately R 170 billion. This implies R50 billion allocated to cash-like assets, and an expected reduction in investment returns for the industry of R100 million per year.

5.2 Additional considerations

Beyond the direct yield differential, several secondary effects may also arise:

- **Universe contraction:** A smaller pool of qualifying instruments could concentrate exposure across fewer issuers and maturities, with possible diversification implications.
- **Spread dynamics:** If institutional demand is funnelled into a smaller pool of NCDs and deposits, competition for these instruments could compress yields further over time.
- **Term exposure:** FLAC issuance spans tenors out to 5 years and beyond. Without access to these instruments, managers may find it more difficult to capture yield at the longer end of the money market curve, where spread differentials are often wider.

These effects are difficult to quantify precisely at this stage, but they may be relevant when assessing qualifying cash definitions to ensure these remain aligned with developments in the banking system.

6 Industry context

This issue is likely to affect medical schemes in South Africa that invest in cash or money market mandates of this type. The aggregate effect across the industry (and therefore on medical scheme members) is likely to be material.

The timing is relevant. The FLAC phase-in commenced on 1 January 2026, and the first auctions have already been completed. As existing senior unsecured bank paper matures over the next six years without replacement, the supply of qualifying instruments will narrow progressively. Raising the issue at an early stage may provide time for the regulator and industry participants to consider whether any clarification or amendment is required.

7 Proposed way forward

Further engagement with the industry and the regulator may be appropriate.

Given that FLAC instruments are replacing traditional senior unsecured bank debt, under the current prudential framework, stakeholders may wish to consider whether Annexure B should be clarified or updated. The shift in issuance from operating bank to holding company is not a market innovation or a change in risk profile, but rather a structural requirement of the new framework.

Any such consideration would need to assess whether recognising FLAC instruments would remain consistent with the prudential intent of Annexure B. FLAC instruments are issued by SARB-designated institutions, are subject to Prudential Standard RA03, and serve a similar market function to instruments that have historically been used in qualifying cash portfolios.

Annexure A - Disclosures

The RisCura Group has four operating subsidiary companies:

- **RisCura Analytics (Pty) Ltd** provides investment analysis, including risk and performance reporting, mandate compliance monitoring and index calculations to investment managers and hedge funds.
- **RisCura Fundamentals (Pty) Ltd** provides independent valuation, risk and performance analysis services to private equity funds and other investors in unlisted instruments.
- **RisCura Invest (Pty) Ltd** provides discretionary cashflow management, asset rebalancing and investment management services, investment administration and transition services to institutional and corporate investors.
- **RisCura Solutions (Pty) Ltd** provides investment strategy and advice, as well as investment manager research and selection to institutional investors.

The following points summarise RisCura's relationship with 3rd party investment managers, custodians, brokers and other 3rd party financial service providers ("3rd parties") and explain how we ensure our independent position.

- RisCura's shares are owned by directors, management and staff of RisCura.
- RisCura's staff, management and directors are required to disclose to RisCura any material interest in any 3rd parties.
- None of RisCura's directors, management or staff have a material interest in any 3rd parties.
- RisCura has no ownership interest in any 3rd parties.
- RisCura has no debt provided by any 3rd parties.
- RisCura does not make any loans to any 3rd parties and is not a registered provider of credit.
- RisCura does not receive direct or indirect commissions or rebates.
- RisCura has two companies, RisCura Analytics (Pty) Ltd and RisCura Fundamentals (Pty) Ltd, that provide a range of services to a number of different financial service providers including hedge funds, private equity funds, investment managers, stock brokers and banks. These companies operate independently from the remainder of the RisCura Group companies, and any conflicts of interest that may arise are carefully managed in line with RisCura's Conflicts of Interest Management Policy.
- RisCura Invest (Pty) Ltd's transition management service follows the standard industry practice of recovering its fee from the third parties that facilitate the provision of the transition services (such as security brokers, investment managers and banks). All such

fee arrangements are expressly recorded in the relevant agreements with clients and their third party service providers, and are strictly in line with the consent given by the clients.

- RisCura has a full Gift Disclosure Policy with stringent guidelines. All gifts of any amount are declined.
- RisCura has a comprehensive Conflicts of Interest Management Policy, which is available on request.