Basel Committee on Banking Supervision

Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel large exposures regulations – South Africa

April 2023

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Contents

Glossary ................................................................................................................................................................................................. 1
Preface ................................................................................................................................................................................................... 2
Executive summary ........................................................................................................................................................................... 3
Response from the South African authorities ........................................................................................................................................ 4
1 Assessment context ................................................................................................................................................................. 5
  1.1 Regulatory system .......................................................................................................................................................... 5
  1.2 Status of implementation of the large exposures framework ...................................................................... 5
  1.3 Scope of the assessment ............................................................................................................................................. 6
2 Assessment findings ............................................................................................................................................................... 6
  2.1 Assessment grades and summary of findings ..................................................................................................... 6
  2.2 Detailed assessment findings ..................................................................................................................................... 8
  2.3 Observations ..................................................................................................................................................................... 8
Annexes ............................................................................................................................................................................................... 10
Annex 1: RCAP Assessment Team and Review Team ....................................................................................................... 10
Annex 2: List of Basel standards and implementing regulations issued by the South African authorities 11
Annex 3: Materiality assessment ............................................................................................................................................... 12
Annex 4: Areas where South African rules are stricter than the Basel standards .......................................................... 13
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BCBS</td>
<td>Basel Committee on Banking Supervision</td>
</tr>
<tr>
<td>BIS</td>
<td>Bank for International Settlements</td>
</tr>
<tr>
<td>C</td>
<td>Compliant (grade)</td>
</tr>
<tr>
<td>CRM</td>
<td>Credit risk mitigation</td>
</tr>
<tr>
<td>D-SIB</td>
<td>Domestic systemically important bank</td>
</tr>
<tr>
<td>D-SIFI</td>
<td>Domestic systemically important financial institution</td>
</tr>
<tr>
<td>G-SIB</td>
<td>Global systemically important bank</td>
</tr>
<tr>
<td>LC</td>
<td>Largely compliant (grade)</td>
</tr>
<tr>
<td>LEX</td>
<td>Large exposures</td>
</tr>
<tr>
<td>MDB</td>
<td>Multilateral development bank</td>
</tr>
<tr>
<td>MNC</td>
<td>Materially non-compliant (grade)</td>
</tr>
<tr>
<td>NC</td>
<td>Non-compliant (grade)</td>
</tr>
<tr>
<td>NDB</td>
<td>National development bank</td>
</tr>
<tr>
<td>NSFR</td>
<td>Net Stable Funding Ratio</td>
</tr>
<tr>
<td>PA</td>
<td>Prudential Authority</td>
</tr>
<tr>
<td>PSE</td>
<td>Public sector entity</td>
</tr>
<tr>
<td>RCAP</td>
<td>Regulatory Consistency Assessment Programme</td>
</tr>
<tr>
<td>SARB</td>
<td>South African Reserve Bank</td>
</tr>
<tr>
<td>ZAR</td>
<td>South African rand</td>
</tr>
</tbody>
</table>
Preface

The Basel Committee on Banking Supervision (Basel Committee) places a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only fully accrue if these are implemented in a full, timely and consistent manner by all member jurisdictions. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members’ implementation of the Basel III framework.¹

This report presents the findings of an RCAP Assessment Team (Assessment Team) on the adoption of the Basel large exposures (LEX) framework in South Africa. The assessment focused on the completeness and consistency of the South African LEX regulations with the Basel LEX framework and relied on the information provided by the Prudential Authority (PA) within the South African Reserve Bank (SARB).²

The Assessment Team was led by Mr Jean Hilgers, Executive Director of the National Bank of Belgium (NBB), and comprised four technical experts, from the Canadian Office of the Superintendent of Financial Institutions (OSFI), the Central Bank of Brazil (BCB), the Central Bank of Sweden (Riksbank) and the Bank of Spain (see Annex 1). The main counterpart for the assessment was the PA. The work was coordinated by the Basel Committee Secretariat with support from NBB staff.

The assessment comprised: (i) a self-assessment by the PA; (ii) an assessment phase; and (iii) a review phase including a technical review of the Assessment Team’s findings by a separate RCAP Review Team. The assessment report ultimately reflects the view of the Basel Committee.

The Assessment Team acknowledges the cooperation received from the PA throughout the assessment process.

¹  www.bis.org/bcbs/implementation.htm.
²  The PA is a juristic person operating within the administration of the SARB.
Executive summary

The Basel LEX framework was implemented by the PA via amended Regulations relating to Banks and the issuance of Directive 3/2022. The LEX framework applies to all banks in South Africa, effective as of 1 April 2022.

As of 31 January 2023, the large exposures regulations in South Africa are assessed as compliant with the Basel LEX framework. All three components of the framework (scope and definitions; minimum requirements and transitional arrangements; and value of exposures) are also assessed as compliant.

The Assessment Team identified one non-material deviation relating to the scope and definitions. The report also contains some observations relating to each of the components of the framework.
Response from the South African authorities

The PA and SARB wish to thank Mr Jean Hilgers and the Assessment Team for their work on the RCAP. We would like to commend the professionalism and rigour that was demonstrated by the Assessment Team throughout the RCAP, to ensure constructive and thorough discussions on the implementation of the Basel LEX framework in the South African context. We also extend our appreciation to the Basel Committee Secretariat for coordinating an efficient and constructive RCAP engagement. We welcome and share the view of the assessment that the implementation of the LEX framework in South Africa is compliant with the Basel standard.
1 Assessment context

1.1 Regulatory system

With the publication of the Financial Sector Regulation Act in 2017, South Africa has implemented a “Twin Peaks” model of regulation and supervision. The PA is a separate juristic person operating within the SARB, and is responsible for the prudential regulation and supervision of financial institutions, while the Financial Sector Conduct Authority (FSCA) regulates and supervises the conduct of financial institutions.

South Africa has implemented the Basel Framework using the following three-tier regulatory structure:

(i) Tier 1: The Tier 1 legislation consists of a parliamentary Act, the “Banks Act, 1990”, which contains the enduring principles and constitutes the overarching enabling framework. Only the South African Parliament is empowered to amend this primary legislation.

(ii) Tier 2: The Tier 2 legislation contains the operational details that transpose the bulk of the Basel Framework into domestic regulations, the “Regulations relating to Banks” (the Regulations). The Regulations are issued by the Minister of Finance and constitute enforceable secondary legislation. They are published in the “Government Gazette”. The Banks Act and the Regulations framed thereunder are administered by the PA. The Banks Act provides enabling legislation that allows the PA to prescribe the minimum requirements and selected supervisory review and evaluation process (SREP) in the Regulations and Directives, Circulars and Guidance Notes issued under the Banks Act. The Regulations specify the internationally agreed minimum prudential and other requirements necessary to implement and comply with the Basel Framework.

(iii) Tier 3: Other major regulatory instruments used to implement the Basel standards in South Africa include Directives, Circulars and Guidance Notes issued by the PA. These are generally referred to as Tier 3 legislation and their purpose is to provide further direction, interpretation, guidance or clarification, and information on best practices. The Directives and Circulars are binding in nature, while Guidance Notes do not constitute enforceable legislation.

Being an Act passed by the Parliament, the Banks Act is the primary binding Act, along with the Regulations framed under this Act. The Directives and Circulars are issued by the PA under the powers available under the Banks Act and are therefore binding in nature. The objective of the Guidance Notes is to provide detailed guidance on more technical matters to facilitate and ensure accurate and consistent implementation of the Regulations across all banks in the country. Though the Guidance Notes do not constitute enforceable legislation, the PA and banking associations confirmed that these are normally adhered to by banks. Annex 2 lists the relevant regulatory instruments implementing the Basel standards in South Africa. All these instruments are henceforth collectively referred to as “South African regulations”.

1.2 Status of implementation of the large exposures framework

South Africa implemented the Basel LEX framework via amended Regulations and the issuance of Directive 3/2022, all effective as of 1 April 2022. The latter addresses in particular:

- treatment of and limits imposed on interbank exposures;
- application of the LEX requirements to other banking entities within a banking group, where a bank within the group has been designated as a D-SIB/D-SIFI or G-SIB;
- application of the LEX requirements to intragroup exposures;
- application of the LEX requirements to a foreign subsidiary of a controlling company required to report on a solo basis; and
1.3 Scope of the assessment

The Assessment Team considered the large exposures requirements applicable to internationally active banks in South Africa as of 31 January 2023. The assessment had two dimensions:

- a comparison of South African regulations with the Basel LEX framework to ascertain that all the required provisions have been adopted (completeness of the regulations); and
- whether there are any differences in substance between the South African regulations and the Basel LEX framework and, if so, their significance (consistency of the regulations).

In its assessment, the Assessment Team considered all binding documents that effectively implement the Basel LEX framework in South Africa. Annex 2 lists the Basel standards used as the basis for the assessment. The assessment did not evaluate the resilience of the banking system in South Africa or the supervisory effectiveness of the PA.

The Assessment Team evaluated the materiality and potential materiality of identified deviations between the Basel LEX framework and the South African regulations. The evaluation was conducted using a sample of six South African banks, of which five are the internationally active banks. Together, these banks comprise about 94% of assets in the banking sector in South Africa. In addition, the Assessment Team reviewed the non-quantifiable impact of identified deviations and applied expert judgment as to whether the South African regulations meet the Basel LEX framework in letter and in spirit. The materiality assessment is summarised in Annex 3, which also lists the sample of banks.

The Assessment Team noted that, in some areas, the South African rules go beyond the minimum Basel standards. Although these elements (listed in Annex 4) provide for a more rigorous implementation of the Basel Framework, they have not been taken into account for the assessment of compliance.

The outcome of the assessment is summarised using a four-grade scale, both for each of the three key components of the Basel LEX framework and for the overall assessment of compliance. The four grades are compliant (C), largely compliant (LC), materially non-compliant (MNC) and non-compliant (NC).

2 Assessment findings

2.1 Assessment grades and summary of findings

Overall, the Assessment Team finds the implementation of the LEX framework in South Africa to be compliant with the Basel standard. This grade is based on the materiality assessment as summarised in Annex 3.
## Assessment grades

<table>
<thead>
<tr>
<th>Component of the Basel large exposures framework</th>
<th>Grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall grade</td>
<td>C</td>
</tr>
<tr>
<td>Scope and definitions</td>
<td>C</td>
</tr>
<tr>
<td>Minimum requirements and transitional arrangements</td>
<td>C</td>
</tr>
<tr>
<td>Value of exposures</td>
<td>C</td>
</tr>
</tbody>
</table>

Assessment scale: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

### 2.1.1 Scope and definitions

This component is assessed as compliant with the Basel LEX framework.

The Assessment Team identified one finding under the South African regulations with respect to exemptions of exposures from the large exposures limit. In addition to the allowed exemptions in the Basel LEX framework (sovereigns, central banks, public sector entities treated as sovereigns and exposures to qualifying central counterparties), the South African regulations include a general clause that allows exclusion of any other exposure specified in writing by the PA. This finding is assessed as not material because such provision has never been exercised and is designed to provide the PA legal authority to exempt certain exposures in accordance with the Basel LEX framework (for example interbank exposures during periods of stress). Use of such provision will be publicly communicated by the PA.

There is one observation relating to the definition of a large exposure. Although South African regulations do not contain a definition of large exposures, they are considered to contain all material aspects of the essential components of the definition of a large exposure. As such, a separate definition of a large exposure is deemed unnecessary.

### 2.1.2 Minimum requirements and transitional arrangements

This component is assessed as compliant with the Basel LEX framework. No findings were identified.

There is one observation relating to the implementation date in South Africa being 1 April 2022 with a transitional period until January 2025 (for interbank exposures). The Basel Committee’s agreed implementation date was January 2019.

### 2.1.3 Value of exposures

This component is assessed as compliant with the Basel LEX framework. No findings were identified.

There are two observations. The first relates to the recognition of exposures to credit risk mitigation (CRM) providers. Under the South African regulations, banks may choose not to recognise the eligible CRM technique in the calculation of an exposure value to the original counterparty (ie gross value approach) when assessing compliance with large exposure limits. While there is no explicit provision that requires banks to assign an exposure to the CRM providers should they apply the gross value approach, the PA confirmed that banks are required to recognise exposures to CRM providers under this scenario. This was also the interpretation of several banks.

The second observation is related to the look-through approach (LTA) for structured vehicles. Where the relevant exposure value to a structure is equal to or higher than 0.25% of the eligible capital base and the underlying assets of the structure cannot be identified, the Basel LEX framework requires banks to assign the exposure to the unknown client. On the other hand, the South African regulations require banks to inform the PA of their inability to look through. Once notified, the PA will assess the situation and act accordingly. Actions may include requiring banks to assign the total exposure amount to an unknown client for a specified period.
2.2 Detailed assessment findings

2.2.1 Scope and definitions

This component is assessed as compliant with the Basel LEX framework. One finding was identified and assessed as not material.

<table>
<thead>
<tr>
<th>Section grade</th>
<th>Compliant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basel paragraph number</td>
<td>13: Scope of counterparties and exemptions</td>
</tr>
<tr>
<td>Reference in the domestic regulation</td>
<td>Regulation 24(8)(a)</td>
</tr>
</tbody>
</table>

Finding

The Basel LEX framework exempts exposures to sovereigns and their central banks. This exemption also applies to public sector entities treated as sovereigns according to the risk-based capital framework.

In addition to the Basel LEX exemptions, the South African regulations include a provision that allows the exclusion of any other exposure specified in writing by the PA. As indicated by the PA, this enabling provision is necessary for the authority to have the power to exempt, for example, interbank exposures during periods of stress (which is compliant with the Basel LEX framework). The provision has not been exercised to date and in the event that a new exemption is applied based on this provision, it will be publicly communicated (probably in the form of a Directive) and could be applied to all banks, a set of banks, or a particular bank.

Materiality Not material

2.2.2 Minimum requirements and transitional arrangements

This component is assessed as compliant with the Basel standard. No findings were identified.

2.2.3 Value of exposures

This component is assessed as compliant with the Basel standard. No findings were identified.

2.3 Observations

The following observations highlight certain special features of the regulatory implementation of the Basel LEX framework in South Africa. These are presented to provide additional context and information. Observations are considered compliant with the Basel LEX framework and do not have a bearing on the assessment outcome.

2.3.1 Scope and definitions

<table>
<thead>
<tr>
<th>Basel paragraph number</th>
<th>14: Definition of a large exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reference in the domestic regulation</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Observation

The Basel LEX framework defines a large exposure as the sum of all exposure values of a bank to a counterparty or to a group of connected counterparties that is equal to or above 10% of the bank's eligible capital base.

The South African regulations do not contain a definition of a large exposure. However, South African Regulation 24(7)(a) together with Regulation 24(6)(f) are considered to be equivalent in all material respects to the essential components of the definition of a large exposure set out in the Basel LEX framework. As such, a separate definition of a large exposure is deemed unnecessary.
### 2.3.2 Minimum requirements and transitional arrangements

<table>
<thead>
<tr>
<th>Basel paragraph number</th>
<th>93: Implementation date and transitional arrangements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reference in the domestic regulation</td>
<td>Government Gazette No 46159 of 31 March 2022</td>
</tr>
<tr>
<td>Observation</td>
<td>The Basel LEX framework states that all aspects of the large exposures requirements must be implemented in full by January 2019. The PA implemented the amended Regulations with effect from 1 April 2022 considering industry comments and requests, quantitative impact studies, implementation progress by other Committee member jurisdictions, regulatory responses to the outbreak of Covid-19, and other matters related to implementation. Additionally, the PA approved a transitional period until January 2025 for all banks (not only internationally active banks) to comply with the LEX limits relating to interbank exposures only.</td>
</tr>
</tbody>
</table>

### 2.3.3 Value of exposures

<table>
<thead>
<tr>
<th>Basel paragraph number</th>
<th>43: Recognition of exposures to CRM providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reference in the domestic regulation</td>
<td>Regulation 24(6)(d)(v)</td>
</tr>
<tr>
<td>Observation</td>
<td>The Basel LEX framework specifies that whenever a bank is required to recognise a reduction of the exposure to the original counterparty due to an eligible CRM technique, it must also recognise an exposure to the CRM provider. The South African regulations provide banks an option not to reduce the exposure to the original counterparty by an eligible CRM technique (ie gross value approach) when assessing compliance with large exposure limits. In this instance, there is no explicit provision to state that banks should assign related exposure to the provider of the eligible CRM. The PA confirmed that under the regulations, banks are required to recognise an exposure to the CRM provider even if they choose to apply a gross value approach to the calculation of exposure to the original counterparty for LEX purposes. This was also the interpretation of several banks. Furthermore, the PA plans to assess practices across the sector and take appropriate steps (from a supervisory and/or regulatory perspective) to ensure the intended treatment of the LEX regulations at affected banks.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Basel paragraph number</th>
<th>75: Collective investment undertakings, securitisation vehicles and other structures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reference in the domestic regulation</td>
<td>Regulation 24(6)(c)(iii)</td>
</tr>
<tr>
<td>Observation</td>
<td>The Basel LEX framework requires a bank to look through structures to identify the underlying assets and add exposures, subject to a 0.25% threshold. If a bank is unable to identify the underlying assets of a structure and the total amount of its exposure exceeds 0.25% of its eligible capital base, the bank must assign this total exposure amount to the unknown client. The PA generally expects banks to be able to look through structures. In the event that banks cannot identify underlying assets and the relevant exposure value to a structure is equal to or higher than 0.25% of the eligible capital base, banks must inform the PA of their inability to look through the structure. The PA will assess the situation and may require the bank to assign the total exposure amount to the unknown client for a specified period (which is compliant with the LEX framework).</td>
</tr>
</tbody>
</table>
Annexes

Annex 1: RCAP Assessment Team and Review Team

Assessment Team Leader

Mr Jean Hilgers  
National Bank of Belgium

Assessment Team members

Ms Lindsay Cheung  
Office of the Superintendent of Financial Institutions, Canada

Mr Fabiano Ruiz Dutra  
Central Bank of Brazil

Mr Tobias Lindqvist  
Sveriges Riksbank

Ms Covadonga Martínez Gómez-Galarza  
Bank of Spain

Supporting members

Ms Sabina Bernardo  
National Bank of Belgium

Mr Sietse Bracke  
National Bank of Belgium

Mr Saif Chaibi  
National Bank of Belgium

Mr Gaëtan Doucet  
National Bank of Belgium

Ms Irina Barakova  
Basel Committee Secretariat

Mr Carsten Folkertsma  
Basel Committee Secretariat

Mr Olivier Prato  
Basel Committee Secretariat

Review Team members

Mr Saurav Sinha  
Reserve Bank of India

Ms Sandra Wesseling  
De Nederlandsche Bank

Ms Joanne Marsden  
Basel Committee Secretariat
Annex 2: List of Basel standards and implementing regulations issued by the South African authorities

The following Basel standards were used as the basis of this RCAP assessment:

- *Supervisory framework for measuring and controlling large exposures*, April 2014
- *Frequently asked questions on the supervisory framework for measuring and controlling large exposures*, September 2016

Table A.1 lists the regulations issued by the PA to implement the LEX framework in South Africa. Previous RCAP assessments of South African implementation of the Basel standards considered the binding nature of regulatory documents in South Africa. This RCAP Assessment Team did not repeat that assessment, but instead relied on the previous assessments’ findings, which concluded that the types of instruments described in Table A.1 could be considered as binding on banks and supervisors for the purposes of an RCAP assessment.

### Overview of relevant large exposure regulations in South Africa

<table>
<thead>
<tr>
<th>Domestic regulations</th>
<th>Type, version and date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulations relating to Banks, issued pursuant to Section 90 of the Banks Act, 1990 Amended by Government Notice No 943, published in Government Gazette No 46159 of 31 March 2022 to incorporate the BCBS LEX framework. Primarily regulations 24(6) to 24(8) of the Regulations relating to Banks, read with regulations 23(8), 23(9) and 23(18) of the Regulations.</td>
<td>The requirements in the Regulations that incorporate the BCBS LEX framework were published in Government Gazette No 46159 on 31 March 2022 and implemented with effect from 1 April 2022. The Regulations constitute secondary enforceable legislation.</td>
</tr>
<tr>
<td>Directive 3 of 2022 – Large exposure requirements</td>
<td>Directives constitute tertiary enforceable legislative instruments.</td>
</tr>
<tr>
<td>Guidance Note 3 of 2011 – Covered bonds</td>
<td>Guidance Notes are issued to furnish banks, controlling companies, representative offices, eligible institutions and auditors of banks or controlling companies with information related to market practices or market or industry developments within or outside the Republic, and do not constitute enforceable legislation.</td>
</tr>
</tbody>
</table>

Source: PA.

---

Annex 3: Materiality assessment

The outcome of the RCAP assessment is based on the materiality of the findings described in Section 2.2 and summarised in Table A.2. Assessment Teams evaluate the materiality of findings quantitatively where possible, or using expert judgment when the impact cannot be quantified.

The materiality assessment for quantifiable gaps is based on the cumulative impact of the identified deviations on the reported large exposures of banks in the RCAP sample. These banks are listed in Table A.3.

<table>
<thead>
<tr>
<th>Number of deviations by component</th>
<th>Table A.2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Component</td>
<td>Not material</td>
</tr>
<tr>
<td>Scope and definitions</td>
<td>1</td>
</tr>
<tr>
<td>Minimum requirements and transitional arrangements</td>
<td>0</td>
</tr>
<tr>
<td>Value of exposures</td>
<td>0</td>
</tr>
</tbody>
</table>

RCAP sample banks

<table>
<thead>
<tr>
<th>Banking group</th>
<th>Share of banks’ assets in the total assets of active banks in the South African banking system as of June 2022 (in per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absa Group Limited</td>
<td>19.1</td>
</tr>
<tr>
<td>Standard Bank Group Limited</td>
<td>30.8</td>
</tr>
<tr>
<td>Nedbank Group Limited</td>
<td>13.7</td>
</tr>
<tr>
<td>Investec Limited</td>
<td>6.2</td>
</tr>
<tr>
<td>Capitec Holdings</td>
<td>2.1</td>
</tr>
<tr>
<td>FirstRand Limited</td>
<td>21.9</td>
</tr>
<tr>
<td>Total</td>
<td>93.8</td>
</tr>
</tbody>
</table>

For this purpose, banking assets are based on the measure of total exposures used in the leverage ratio, which includes both on- and off-balance sheet exposures.

Source: PA.

RCAP sample banks based on the six designated South African D-SIBs, five of which are the internationally active banks.
Annex 4: Areas where South African rules are stricter than the Basel standards

In some areas, the PA has adopted a stricter approach than the minimum standards prescribed by the Basel Committee. These are listed below for information. The stricter rules have not been taken into account as mitigants for the overall or component-level assessment of compliance.

- The PA allows banks not to recognise an eligible CRM in the calculation of an exposure to an obligor for the purpose of large exposures limits. This “gross value approach”, if applied by banks, is considered stricter than the LEX framework, which is net of CRM.
- The Basel LEX framework is applicable to internationally active banks. The South African LEX regulation, however, is applicable to all banking entities incorporated in South Africa. The Banks Act and the Regulations apply uniformly to all 31 banks and/or banking groups in South Africa.
- The PA imposes tighter limits for exposures of D-SIBs to:
  - Other D-SIBs: an average daily balance for the month cannot exceed 15% of eligible capital base, with a daily maximum of 18%.
  - Other G-SIBs: an average daily balance for the month cannot exceed 15% of eligible capital base, with a daily maximum of 18%.