Addendum 1

Operational notice pertaining to the committed liquidity facility

August 2013

Contents

1. Background

1.1 During 2012, the South African Reserve Bank (Bank) approved the provision of a committed liquidity facility (CLF) in order to assist banks in meeting the requirements of the liquidity coverage ratio (LCR). Guidance Note 5/2012 was issued containing details regarding acceptable collateral for the CLF. Guidance Note 6/2013 replaced Guidance Note 5/2012 and contains updated specifications on the acceptable collateral for the CLF, while this Addendum to the Operational Notice (Addendum 1) provides details on the operational requirements thereof.

1.2 On 7 January 2013, the Basel Committee on Banking Supervision (the Basel Committee) published a document detailing changes to the definition of the LCR, including an expansion in the range of assets eligible as high-quality liquid assets (HQLA) and some refinements to the assumed inflow and outflow rates to better reflect actual experience in times of stress. The LCR will be introduced on 1 January 2015, but the minimum requirement will be set at 60 per cent and rise in equal annual increments of 10 per cent to reach 100 per cent on 1 January 2019

1.3 Addendum 1 clarifies the eligible collateral for CLF as well as the operational arrangements pertaining to a draw-down on the CLF by a bank. The Bank may from time to time amend Addendum 1. The Bank will, however, endeavour to give reasonable notice of any amendments, but reserves the right to introduce any amendment with immediate effect, if necessary. A legal contract will be negotiated between the Bank and any individual bank applying for the CLF and will be finalised and signed by the respective parties prior to the commencement of the year when the CLF will be required for LCR. The contract will be effective for a year.

1.4 The CLF is only available to the extent that it will cover an individual bank's shortfall for the LCR requirement, provided that such shortfall is attributable to a general shortage of HQLA in the South African financial system.

2 Application process for the provision of the committed liquidity facility

2.1 The facility is negotiated for a calendar year and is renewable on an annual basis.

2.2 Banks that apply for the CLF for the first time should apply to the Registrar of Banks before the end of August of the year preceding the year for which they require the CLF to provide sufficient time to negotiate a contract and ensure adherence to the collateral requirements.

2.3 Applications to make use of the CLF should be directed in writing to the Registrar of Banks. Draw-down of the facility will be for a period of 31 days. BSD will inform the Financial Markets Department (FMD) whether a bank qualifies for the CLF and the maximum amount.

2.4 Applications to make use of the CLF have to be approved by each bank's board of directors.

2.5 Detailed information on all collateral should be kept in the Collateral Management System as maintained by FMD or in any collateral management system approved by the Bank.

2.6 Banks that intend rolling over an existing CLF the following year can apply to do so by the end of October of the preceding year for which they require the CLF.

2.7 The Bank reserves the right to adjust the amount of acceptable collateral required, the commitment fees and the draw-down fees when a facility is renewed.

3. Characteristics of the committed liquidity facility

3.1 **Size of the facility**

3.1.1 Each individual bank will be required to meet the level 1 requirement of the LCR on its own. The CLF may be utilised as a substitute for level 2 assets. The CLF will be capped at 40 per cent of the total amount of HQLA any particular bank is required to hold in rand and will be based on the estimated requirement as from 2019. The Registrar of Banks will review this cap annually and reserves the right to reduce it if the supply of HQLA in the market increases.

3.1.2 For the purpose of entering into a facility agreement with the Bank during the phase-in period of the LCR (that is, for the years2013 to 2018) the size of the CLF will be capped at 40 per cent of the full HQLA requirement as projected for the year for which the application is made. For example, banks applying for the CLF in 2013, for implementation in 2014, should project their maximum full HQLA requirement for 2014, and the CLF would be capped at 40 per cent of the projected amount.

3.2 Commitment fees

3.2.1 Banks electing to make use of the CLF will pay a commitment fee to the Bank. In order for the fee charged by the Bank to provide an incentive for banks to reduce their liquidity risk exposure, and therefore their dependence on the CLF, a scaled commitment fee will be applied. Banks with a higher dependence on the CLF will be charged a higher weighted average commitment fee, as set out in Table 1, which applies from 2014. The commitment fee, which will be the same for all banks, will be set on an annual basis, based on market conditions prevailing when a bank applies for the facility or if the facility is renewed. The fees will be payable on the last day of the month. Furthermore, the facility will lapse if the fee is not paid on the tenth business day after month-end.

Table 1: Commitment fee structure of the CLF

CLF as percentage of HQLA	***Proposed fee per tranche (basis points per year)***	***Weighted average fee* (basis points per year)***
<10 per cent	15	15
10 – 20 per cent	25	20
20 – 30 per cent	35	25
30 – 40 per cent (maximum = 40 per cent)	45	30

*If full tranche is used in the calculation.

3.3 Draw-down procedures

3.3.1 In the event that banks draw funds from the CLF, they will be charged an interest rate equal to the Bank's repo rate plus 100 basis points (equal to the Bank's normal standing facilities). Any draw-down of funds will be for a period of 31 days.

3.3.2 Any bank requiring a draw-down on the CLF, should notify the Registrar of Banks. The FMD will have all arrangements in place to effect the draw-down one day after being informed by the Registrar of Banks.

3.4 Eligible collateral

3.4.1 The collateral should be in security format with the exception of other loans and advances that remain on the bank's balance sheet. Assets selected as collateral should provide adequate credit risk protection acceptable to the Bank, while also limiting any distorting effects on the securities market. Acceptable collateral that will be considered for the CLF comprises the following:

3.4.1.1 Listed debt securities with a minimum credit rating of A- on a domestic rating scale (equivalent to BBB- on an international scale) by an eligible External Credit Assessment Institution (ECAI).

3.4.1.2 Equities that are listed on the Johannesburg Stock Exchange's (JSE) main board and included in the Top 40 Index.

3.4.1.3 Notes of self-securitised pools of high-quality residential mortgage loans

a) Notes of self-securitised pools of high quality residential mortgage loans, which are ring-fenced in an insolvency-remote structure or special-purpose institution (SPI), shall qualify as collateral for the CLF. Such self-securitised assets should be managed and controlled in a similar way as a normal securitisation. As required by the provisions of Government Notice No. 2 published in Government Gazette No. 30628 dated 1 January 2008 (the Securitisation Notice), the SPI created has to be insolvency remote.

b) The commercial paper created in this manner would be given an International Securities Identification Number (ISIN) and would be recorded in the collateral management system of the Bank as available for the CLF only. Once a bank needs to draw down on the CLF, a repurchase transaction will give effect to the true sale condition as required by the Securitisation Notice since the Bank will then become the owner of the commercial paper.

c) A bank will be allowed to create more than one SPI that could issue commercial paper to qualify as collateral for the CLF, provided that the criteria and conditions set by the Bank in its approval of the securitisation are complied with. The composition of the underlying portfolio of assets should be specified in the securitisation application. The collateral has to be lodged with the Bank when the application is approved. The chosen composition needs to be maintained throughout the approved period to use the CLF.

d) For the residential mortgage-backed securitisation structures only, an external credit rating will not be required if the underlying residential mortgages adhere to the criteria set out in Guidance Note 6/2013. The Bank, however, retains the option to require a rating.

e) In the event of draw-down, the Bank will agree to invest in the senior tranche of the securitisation structure and will provide liquidity equal to the face value of the notes (no haircut will be applied).

f) To ensure all requirements are in place before the event of drawdown, a bank applying for use of the CLF should also apply for the approval of the securitisation structure as done under its normal course of business. The securitisation structure will have to comply with the provisions of the Securitisation Notice. A pre-sale report produced by the rating agency (if externally rated) or by the bank itself (if internally rated) should form part of the application.

3.4.1.4 Commercial mortgages

a) In view of (i) the inherently higher credit risk attached to commercial mortgages, (ii) the complexity of defining credit risk criteria for commercial mortgages, and (iii) the fact that most banks have more than adequate collateral for the CLF even if commercial mortgages are excluded, the Bank is in principle not in favour of accepting commercial mortgages as collateral for the CLF. However, should a particular bank have an exceptional need to offer commercial mortgages as collateral, these will be considered on a case-by-case basis. An external credit rating will be required and haircuts will be applied based on this rating, as agreed on with the particular bank.

3.4.1.5 Loans other than mortgages

a) The Bank will accept other loans and advances, for example, vehicle and asset finance, as an eligible form of collateral for the CLF. Banks will have a choice of keeping the assets on balance sheet in a ring-fenced pool until the CLF is accessed, or transferring them to a SPI. In the case of the former, a draw-down of the CLF will be dealt with in a way similar to emergency liquidity assistance (ELA) and will be formalised in an agreement between the Bank and the individual bank. The agreement will contain the detail of the assets and haircuts. If the assets are transferred to a SPI, the collateral will be treated as securitised notes with ISIN numbers. The ring-fenced asset pool must at all times exceed the amount approved under the CLF. Banks with approval to use the internal ratings-based approach for credit risk will be allowed to rate the proposed structure internally. Banks on the standardised approach for credit risk will be required to have their asset pools externally rated by an eligible ECAI.

b) For a ring-fenced on-balance sheet asset pool (that is, no notes with ISIN numbers are issued against the loans), the Bank will provide minimum asset quality criteria. On a quarterly basis, the asset pool should be reassessed to ensure compliance with the requirements. If a loan does not comply with all requirements, the loan has to be replaced. In the event of drawdown, the Bank will provide a loan against the collateral, at an agreed haircut.

c) In the event of drawdown of a ring-fenced asset pool transferred to an SPI, the Bank will invest in the senior tranche of a securitisation structure, and will provide a liquidity amount less than the face value of the notes, that is, a haircut will be applied. Such haircuts will be agreed bilaterally with banks, based on the type, liquidity and credit quality of the underlying assets.

3.4.1.6 In general, all collateral for the CLF should have the following additional characteristics:

a) it has to be unencumbered;
b) securitised asset pools have to be audited on an annual basis; and
c) collateral shall have an outstanding maturity of more than one year.

3.4.2 The collateral requirements set out in this Addendum represent general guidelines on the Bank’s preferences. The Bank may enter into bilateral contractual agreements with banks that apply for the CLF that could stipulate more specific collateral requirements.

3.4.3 The Board of Directors of a bank has to ensure that the collateral requirements have been met. The application pack for the CLF should include a signed letter from the bank’s independent auditors confirming that the collateral requirements would be met.

3.5 Market-value adjustments (haircuts)

3.5.1 Market-value adjustments as set out in Table 2 will apply. These haircuts may be changed at any time at the discretion of the Bank when facilities are renewed.

Table 2: Market-value adjustments (haircuts)

International rating scale	National rating scale	Residual maturity	Sovereigns (percentage points)	Other issuers (percentage points)
AAA to AA-	n/a.	< 1yr	0,5	1
		> 1 yr < 5 yrs	2	4
		> 5 yrs	4	8
A+ to BBB-	AAA (zaf) to A- (zaf)	< 1yr	1	2
		> 1 yr < 5 yrs	3	6
		> 5 yrs	6	12
Main index equities, including convertible bonds and gold				15

4 Disclosure requirements

4.1 Reporting on the CLF and the qualifying collateral should be done in terms of banks' BA200 and BA300 returns.

4.2 For annual financial reporting, the commercial banks should disclose that a CLF has been secured from the Bank. The Bank will reflect in its Annual Report the total CLF approved.

5 Legal implications and considerations

5.1 The collateral requirements represent general guidelines on the Bank's preferences. The Bank will enter into bilateral contractual agreements with banks that apply for the CLF which could stipulate more specific collateral requirements.

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