South African Reserve Bank
From the Office of
the Registrar of Banks

G5/2012

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To: All banks, controlling companies, branches of foreign institutions, eligible institutions and auditors of banks or controlling companies

Guidance Note 5/2012 issued in terms of section 6(5) of the Banks Act, 1990

Provision of a committed liquidity facility and utilisation of statutory cash reserves in terms of the Basel III liquidity framework

Executive summary

The South African Reserve Bank (SARB) has approved the provision of a committed liquidity facility available to banks to assist banks to meet the liquidity coverage ratio (LCR) in terms of the Basel III liquidity framework. The SARB has also approved that statutory cash reserves could be included in banks' high quality liquid assets for purposes of calculating the LCR.

1. Introduction

1.1 The Basel III liquidity framework[1] requires banks to adhere to a new LCR to ensure that they have sufficient high-quality liquid assets (HQLA) to survive a month-long significant stress scenario. The LCR aims to ensure that banks maintain an adequate level of unencumbered, HQLA that can be converted into cash to cover net outflows during periods of stress.

1.2 Characteristics of assets that qualify as unencumbered HQLA are described in the Basel III liquidity framework. It distinguishes between Level 1 assets, which shall comprise at least 60 per cent of total HQLA, and Level 2 assets, which shall constitute no more than the remaining 40 per cent. The qualification criteria of HQLA are based on prescribed fundamental and market-related characteristics.

1.3 During the past several months, the Bank for International Settlements (BIS) has conducted quantitative impact studies (QISs) based on December 2010, June 2011 and December 2011 data. Seven South African banking groups participated in the QIS, and the results revealed shortfalls among some of the participant banking groups in meeting the LCR. These shortfalls resulted from a dependence on wholesale, short-term funding, and the limited availability of HQLA as defined in the Basel III liquidity framework. South Africa has a limited pool of the above-mentioned Level 1 assets, and virtually no Level 2 assets that satisfy the prescribed criteria.

[1] Basel Committee on Banking Supervision, "Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring" (issued December 2010).

1.4 One of the discretionary options available to national supervisors in jurisdictions with inadequate HQLA is to make available to banks a committed liquidity facility (CLF) at a fee. In view of the difficulty that banks experience in acquiring adequate holdings of liquid assets in an environment of limited supply, the associated increases in the cost of funding and the possible distortionary effects on the domestic financial markets, the South African Reserve Bank (SARB) considered making such a facility available to the domestic operations of South African banks. The minimum characteristics of such a facility are described in paragraph 47 of the Basel III liquidity framework.

1.5 The Basel III liquidity framework also requires supervisors to confirm the extent to which statutory cash reserves could be drawn down during periods of stress, and therefore qualify as HQLA.

1.6 This Office wishes to confirm that the SARB has approved the provision of a CLF and the utilisation of statutory cash reserves as part of HQLA.

2. Characteristics of the committed liquidity facility

2.1 Size of the facility

The CLF will be provided for an amount up to 40 per cent of any particular bank's net cash outflows under stressed scenarios (the denominator in the LCR calculation). Although this implies that the CLF will become a substitute for Level 2 assets, banks will be required to meet the Level 1 requirement on their own.

2.2 Collateral

Assets selected as collateral should provide adequate credit risk protection for the SARB, while also limiting any distorting effects on the securities market.

Acceptable collateral for the CLF would comprise the following:

i Marketable 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 rating institution (ECAI).
ii Equities that are listed on the JSE's main exchange and included in the Top 40 Index.
iii Notes of self-securitised pools of high-quality loans, which are ringfenced in an appropriate structure and carry a minimum rating of A- by an ECAI on a domestic rating scale. Such self-securitised assets should be managed and controlled in a similar way as a normal securitisation. The securitisation notes would serve as collateral in the event of a draw-down.

The haircuts applied to the collateral will be the same as prescribed in the credit risk standardised approach as contained in regulation 23 (9)(b)(xi) of the Regulations relating to Banks, as these are universal for specific credit ratings. These haircuts will be based on the domestic credit rating on securities, bonds or self-securitised loans.

Collateral for the CLF should have the following additional characteristics:

i it should be unencumbered;
ii self-securitised assets should be clearly ringfenced, rated by an ECAI and audited on an annual basis; and
iii collateral should have a maturity of more than one year.

2.3 Pricing

Banks electing to make use of the facility will pay a commitment fee to the SARB, even if they don't draw funds from the facility. In order for the fee charged by the SARB to provide an incentive to banks to reduce their liquidity risk exposure, and therefore their dependence on the CLF, a scaled commitment fee will be applied and banks with a higher dependence on the CLF will be charged a higher weighted average commitment fee, as set out in the table below. The commitment fee will be set on an annual basis when the facility is renewed, and will be payable even when a facility is not drawn.

CLF as percentage of net cash outflow	Proposed fee per tranche (bps per year)	Weighted average fee*
<10%	15	15
10-20%	25	20
20-30%	35	25
30-40% (to a maximum of 40%)	45	30

* If full tranche is used in the calculation.

In the event that banks draw funds from the facility, they will pay a draw-down rate equal to the SARB's repo rate plus 100 basis points (equal to the SARB's normal standing facilities). Any draw down of funds will be for a 30 calendar-day period.

2.4 Implementation and administrative processes

The CLF will be made available to all banks from 1 January 2013. The facility will be negotiated for a calendar year and will be renewed on an annual basis. The SARB reserves the right to adjust the amount of acceptable collateral required, the commitment fees or the draw-down fees when a facility is renewed. Banks wishing to secure a committed facility for the 2013 calendar year should indicate this in writing to the Registrar of Banks by no later than 28 September 2012 to allow sufficient time to put in place the necessary legal, collateral and operational requirements between your bank and the SARB.

Should you have any questions in the above regard, please contact Dr Nicola Brink, Head: Resolution Planning, at 012 313 3614, or Mr Wessel Mostert, Risk Specialist: Asset and Liability Management, at 012 313 4652.

3. Acknowledgement of receipt

3.1 Two additional copies of this guidance note are enclosed for use by your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the chief executive officer of the institution and the said auditors, should be returned to this Office at the earliest convenience of the aforementioned signatories.

René Van Wyk
Registrar of Banks

The previous guidance note issued was Guidance Note 4/2012, dated 8 May 2012.