

South African Reserve Bank

From the Office of
the Registrar of Banks

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

Guidance Note 8/2014 issued in terms of section 6(5) of the Banks Act, 1990

Provision of a committed liquidity facility by the South African Reserve Bank

Executive summary

The South African Reserve Bank (SARB) has approved the provision of a committed liquidity facility (CLF) available to banks to assist banks to meet the liquidity coverage ratio (LCR). This facility was first announced in Guidance Note 5/2012, with further guidance provided in Guidance Note 6/2013. This proposed guidance note will replace Guidance Note 6/2013 and contains revised guidelines in terms of the acceptable collateral and other requirements for the CLF and other related conditions.

1. Introduction

- 1.1 On 7 January 2013 the Basel Committee on Banking Supervision (the Basel Committee) published a document detailing changes to the definition of the LCR¹, 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.
- 1.2 During 2012 the SARB approved the provision of a CLF in order to assist banks in meeting the requirements of the LCR. Guidance Notes 5/2012 and 6/2013 were issued to inform banks about the details regarding acceptable collateral for the CLF. This guidance note addresses some areas of uncertainty that have subsequently been identified and updated specifications on the acceptable collateral and other requirements for the CLF.

¹ Basel Committee on Banking Supervision, "Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools" (issued January 2013).

2. Size of the facility

- 1.3 Each individual bank will be required to meet the level 1 HQLA requirement of the LCR on its own. The CLF is only available to banks with a LCR shortfall that may be attributed to an inadequate supply of level 1 HQLA. The CLF will be capped at 40 per cent of the total amount of HQLA any particular bank is required to hold in rand.
- 1.4 For the purpose of entering into a facility agreement with the SARB during the phase-in period of the LCR (that is, for the years 2015 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.
- 1.5 It has come to the attention of this Office that some applicant banks will not be in a position to have the full amount of required collateral for their CLF undertaking in place by 1 January 2015. The amount of the CLF that can be recognised for purposes of regulatory reporting of the bank's LCR, and that is available to be drawn down during a period of stress, will at all times be limited to the amount of collateral that is available, after haircuts, irrespective of the size of the facility that has been applied for and the payment made in respect of the commitment fee. In the case of securitised collateral, availability of collateral will be based on the value of assets that are fully ceded to the special purpose institution (SPI).

3. Acceptable collateral

- 3.1 Assets selected as collateral should provide adequate credit risk protection for the SARB, while also limiting any potential distorting effects on the securities market. Paragraphs 3.3 to 3.5 set out the general criteria of collateral that the SARB will consider acceptable for the CLF. Specific criteria may be agreed with individual banks on a case-by-case basis.
- 3.2 The SARB will accept as collateral listed domestic debt securities with a minimum credit rating of A- issued by an eligible external credit assessment institution (ECAI) on a South African domestic rating scale. For foreign listed debt securities an international scale rating of BBB- or better will be accepted as collateral.
- 3.3 High-quality residential mortgage loans
 - 3.3.1 The SARB will accept pools of high-quality residential mortgage loans as collateral for the CLF. Such loans should be transferred in the Deeds Office to a dedicated SPI and the quality of the loans should be maintained. The transfer of deeds to the SPI is necessary to facilitate a sale of securities (notes) referencing the underlying fully-ceded pool of mortgage loans in the event of default on any credit extended to a bank against the commitment to the bank by the SARB, as envisaged by the CLF.
 - 3.3.2 Currently, some of the SARB's requirements relating to the maintenance of securitised notes as envisaged collateral for the CLF are not accommodated by the provisions of Government Notice No. 2 published in Government Gazette No. 30628 dated 1 January 2008 (the Securitisation Exemption

Notice). Until such time as the Securitisation Exemption Notice and the CLF collateral requirements have been aligned, any self-securitisation applications should be submitted in terms of the provisions of Section 54 of the Banks Act, 1990, requesting the Registrar's approval for the transfer of 25 per cent or less of the assets of a bank. One of the conditions for such a transfer would be that the terms of transfer of assets from the bank should be that the SPI could issue commercial paper to the originating bank, which in turn may transfer the commercial paper only to the SARB for purposes of serving as collateral for any utilisation in terms of the CLF.

- 3.3.3 Once a bank needs to draw down on the CLF, a repurchase transaction between the SARB and the relevant bank would be entered into.
- 3.3.4 A bank will be allowed to establish more than one SPI that could issue commercial paper for ultimate transfer to the SARB as collateral in terms of the provisions of the CLF. The composition of the underlying portfolio of assets should be specified in the Section 54 application and needs to be maintained throughout the approved period of the CLF.
- 3.3.5 For the residential mortgage loan SPI structure in terms of Section 54 of the Banks Act only, an external credit rating will not be required if the underlying residential mortgages adhere to the following criteria. The SARB, however, retains the option to require a rating.
- (a) The residential mortgages shall comply with the definition as specified in regulation 23(6)(c) of the Regulations relating to Banks (the Regulations).
 - (b) The property against which a mortgage is granted shall be located in the Republic of South Africa. At the inception of the mortgage loan, the borrower should also be domiciled in South Africa.
 - (c) Residential mortgages shall be denominated in rand.
 - (d) The residential mortgages shall be governed by the laws of the Republic of South Africa.
 - (e) The residential mortgages shall be originated during the issuer's normal course of business under the applicable lending criteria.
 - (f) The residential mortgage loan repayments shall not be in arrears for more than 90 days.
 - (g) Mortgages over vacant land may not be included.
 - (h) The capital amount outstanding shall not exceed 80 per cent of the current market value of the property. The property has to be revalued at least once a year using the methodology approved for the normal course of business of the bank for residential mortgages.
 - (i) The residential mortgages should have been on the bank's balance sheet for at least one year prior to being transferred to the SPI.
 - (j) On a quarterly basis, the collateral pool has to be reassessed to ensure compliance with all the relevant specified requirements. If a loan does not comply with all the relevant specified requirements, it has to be replaced immediately.
- 3.3.6 In order to ensure that concentration in the portfolio is within acceptable limits and also to cater for bank-specific conditions, concentration limits (amount and percentage based) may be determined by the SARB once a bank applies to use the CLF.

- 3.3.7 In the event of drawdown, the SARB will apply a 10 per cent haircut on the collateral value.
- 3.3.8 To ensure all requirements are in place before the event of drawdown, a bank applying for the use of the CLF should also apply for the approval of the transfer of assets in terms of Section 54 of the Banks Act, as done in its normal course of business.
- 3.4 Commercial mortgages
- 3.4.1 In view of (i) the inherently higher credit risk attached to commercial mortgages, (ii) the complexity associated with the specification of 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 SARB is in principle not in favour of accepting commercial mortgages as collateral for the CLF. However, should a particular bank wish to pledge commercial mortgages as collateral, such applications 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 with the particular bank.
- 3.5 Loans other than mortgages
- 3.5.1 The SARB will accept other loans and advances, for example, vehicle and asset finance, as an eligible form of collateral for the CLF. However, the SARB will not accept any unsecured loans or any loans to other regulated financial institutions as collateral.
- 3.5.2 Banks will have a choice of keeping loans other than mortgages on balance sheet in a ring-fenced pool until the CLF is accessed, or transferring them to an SPI. 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.
- 3.5.3 For a ring-fenced on-balance sheet asset pool, the SARB will provide minimum asset quality criteria based on the underlying assets. 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 SARB will provide a loan against the agreed collateral, at an agreed haircut.
- 3.5.4 In the event of drawdown against the CLF with a ring-fenced asset pool transferred to an SPI serving as collateral, the SARB will invest in the senior tranche of the 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.

3.5.5 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.

3.5.6 The haircuts applied to externally rated acceptable collateral for the CLF, will be the same as prescribed in the credit risk standardised approach as specified in regulation 23(9)(b)(xi) of the Regulations. These haircuts will be based on the domestic credit rating of the particular securities, bonds or self-securitised loans.

3.5.7 The collateral requirements set out in this Guidance Note represent general guidelines on the SARB's preferences. The SARB may enter into bilateral contractual agreements with banks that apply for the CLF that could stipulate further specific collateral requirements.

4. Capital and reporting requirements for SPI structures for CLF purposes

4.1 The look-through approach should be applied for the transferred assets, that is, for the calculation of minimum required capital relating to credit risk, the amount of capital that banks would be required to maintain shall be equal to the capital had the assets not been transferred. Banks should report the assets that form part of the structure in the original asset class (for example, residential mortgage advances) on the form BA200. In addition, for monitoring purposes, banks will be required to complete the form BA200 on a quarterly basis based on the underlying assets in the SPI. This form BA200 should be signed off by the bank's internal audit function.

5. Pricing

5.1 Banks electing to make use of the CLF will pay a commitment fee to the SARB, even if they do not draw funds from the CLF. In order for the fee charged by the SARB 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 the table below, which applies for 2015. The commitment fee will be set on an annual basis when the facility is renewed. The annual fee is payable in advance by the fifth working day of January of each year.

Table 1 CLF fee structure for 2015

CLF as percentage of required HQLA	Proposed fee per tranche (basis points per year)	Weighted average fee* (basis points per year, excluding VAT)
≤10%	15	15
>10 to 20%	25	20
>20 to ≤30%	35	25
>30 to ≤40% (to a maximum of 40%)	45	30

* If full tranche is used in the calculation.

- 5.2 In the event that banks draw funds from the CLF, they will pay a drawdown rate equal to the SARB's repo rate plus 100 basis points (equal to the SARB's normal standing facilities). Any drawdown of funds will be for a 31 calendar-day period.

6. Operational arrangements

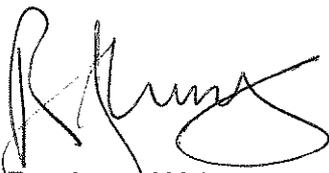
- 6.1 A complete list of the operational arrangements is contained in the Operational Notice of the Financial Markets Department of the SARB, which will be available on the SARB's website. The high-level requirements at this stage are the following:

- (a) Cash reserves utilised for square-off operations in SAMOS cannot be used to comply with the LCR.
- (b) The board of directors of a bank has to ensure that the collateral requirements are continuously met.
- (c) The facility is negotiated for a calendar year and is renewed on an annual basis.
- (d) Banks that apply for the CLF for the first time should apply 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.
- (e) Banks that intend rolling over an existing CLF the following year should apply before the end of October of the year preceding the year for which they require the CLF.
- (f) The SARB reserves the right to adjust the available level of the CLF, the amount and types of acceptable collateral required, the commitment fees and the drawdown rate when a facility is renewed. Any revisions to these conditions for the CLF will be communicated to banks before the end of July of each year.
- (g) The CLF is only available to the extent that it is required to cover an individual bank's shortfall in HQLA to meet the LCR requirement provided that such shortfall can be attributed to a general shortage of HQLA in the South African financial system.
- (h) Reporting on the CLF and the qualifying collateral should be done in terms of banks' monthly BA returns.
- (i) Applications to make use of the CLF should be directed to the Registrar of Banks.
- (j) Applications to make use of the CLF have to be approved by each bank's board of directors.
- (k) Accounting standards require the SARB and banks to disclose the availability of the CLF. More details regarding specific disclosure requirements are described in the Operational Notice of the Financial Markets Department of the SARB.
- (l) Banks that draw down on the CLF in a period that runs over the financial year end of the SARB (i.e. over the end of March of each year), will be required to have the value of their collateral verified by their external auditors.

6.2 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 Manager: Asset and Liability Management, at 012 313 4652.

7. Acknowledgement of receipt

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.



pp René van Wyk
Registrar of Banks

The previous guidance note issued was Guidance Note 7/2014, 23 July 2014.