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SOUTH AFRICAN RESERVE BANK
Prudential Authority

Ref.: 15/8/1/3

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

Proposed directive issued in terms of section 6(6) of the Banks Act 94 of 1990

Matters relating to liquidity risk

Executive summary

The Prudential Authority (PA) has become aware that there is some ambiguity in the interpretation and application of various matters related to banks', controlling companies' and branches of foreign institutions' (hereinafter collectively referred to as banks) respective exposures to liquidity risk.

The purpose of this proposed directive is to provide clarity in specified cases and to direct banks in respect of the formula to be applied in respect of early withdrawal penalty fees relating to retail deposits, the liquidity coverage ratio and net stable funding ratio requirements of foreign entities as well as requirements related to "liquid assets month to date average held" to be reported on the form BA 325.

1. Introduction

1.1. The liquidity coverage ratio (LCR) was introduced as a minimum liquidity requirement, effective from 1 January 2015. The LCR promotes the short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient unencumbered high-quality liquid assets (HQLA) that can be converted into cash easily and immediately in private markets to meet its liquidity needs for a 30-calendar day liquidity stress scenario.

1.2. The net stable funding ratio (NSFR) requires banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities by ensuring a sustainable funding structure to reduce the likelihood that disruptions to a bank's regular sources of funding could erode its liquidity position.

1.3. Since the implementation of the LCR and NSFR requirements, a number of interpretive-related matters appear to have arisen related to the liquidity risk returns. Clarification and specified requirements in respect of these matters are set out below.

2. Proposed Directive

Based on the aforesaid and in accordance with the provisions of section 6(6) of the Banks Act 94 of 1990, banks are hereby directed, as follows:

2.1. Regulation 26(12)(d)(ii) of the Regulations relating to Banks (Regulations) states the following:

> "(ii) fixed or term retail deposits with a residual maturity or withdrawal notice period of more than 30 days may be excluded from the bank's calculation of total expected cash outflow for LCR, provided that-
> (A) the depositor shall have no legal right to withdraw the deposit within the said 30-day horizon of the LCR;
> (B) subject to such conditions as may be specified in writing by the Authority, and the bank's sole discretion, the bank may allow a depositor to early withdraw the deposit, provided that-
> (i) the withdrawal shall be subject to a penalty substantially higher than the loss of interest;"

In this regard, banks must apply the formula specified below when calculating the penalty value, and impose a penalty higher than or equal to:

Penalty value = balance withdrawn x penalty interest rate x number of days left to maturity / 365.

Should a bank elect not to impose a penalty or to impose a penalty not substantially higher than its loss of interest, the bank will be required to treat those deposits as demand deposits and apply a 10% outflow factor to those deposits, when calculating its LCR. The PA will continuously monitor banks' methodology for determining early withdrawal penalty fees on retail term deposits to ensure adequate penalties are applied.

2.2. Regulation 37(3) of the Regulations states that "Unless specifically otherwise provided in this regulation 37 or specified in writing by the Authority, all the relevant directives and interpretations (a) relating to the completion on a solo basis of the respective risk-based returns by a bank in the Republic shall mutatis mutandis apply to the return to be completed in respect of any foreign operation of the said bank in the Republic". In this regard, banks are hereby directed to hold sufficient liquidity buffers at a group level to appropriately compensate for cases where the bank's foreign entity is not able to meet the minimum LCR and NSFR requirements at a jurisdictional level, in to ensure overall Group LCR and NSFR compliance and to account for any shortfalls in banks' foreign entities.

2.3. Regulation 29 of the Regulations contains, among others, directives for the completion of the daily return form BA 325. Line item 13 of the BA 325 relates to the liquid assets month to date average held. Banks are hereby directed to ensure that the amount of liquid assets disclosed in line item 13 of the form BA 325 must be the average calculated from the 15th business day of the current reporting month to the 14th business day of the month following the reporting month, to align to the holding period.

3. Invitation for comment

3.1. Banks are hereby invited to submit their comments with respect to the proposed Directive directly to SARB-PA@resbank.co.za and Cristel.Bakker@resbank.co.za for the attention of Ms Cristel Bakker by no later than 14 January 2022.

3.2. All comments received from banks may be published on the website of the PA, unless a respondent bank specifically requests confidential treatment.

Kuben Naidoo
Deputy Governor and CEO: Prudential Authority

Date: 2021-12-02