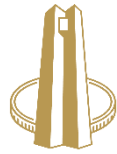


—
P O Box 427 Pretoria 0001 South Africa

370 Helen Joseph Street Pretoria 0002

+27 12 313 3911 / 0861 12 7272

www.resbank.co.za



SOUTH AFRICAN RESERVE BANK
Prudential Authority

Ref.: 15/8/1/3

To: All banks, branches of foreign institutions, controlling companies, 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

Scope of application and related disclosure issues for the liquidity coverage ratio

Executive summary

The purpose of this proposed Directive is to provide clarity and to direct all banks, branches of foreign institutions and controlling companies (hereinafter collectively referred to as ‘banks’) and to also inform eligible institutions and auditors of banks or controlling companies on the scope of application and related calculation issues regarding the liquidity coverage ratio (LCR).

1. Introduction

- 1.1 On 10 April 2015, the amended Regulations relating to Banks (Regulations) regarding the implementation of the LCR were published in *Government Gazette* No. 35950.
- 1.2 The LCR promotes short-term resilience of banks’ liquidity risk profile by ensuring that they have sufficient unencumbered high-quality liquid assets (HQLA) that can be easily and immediately converted into cash in private markets to meet their liquidity needs for a 30 calendar-day liquidity stress scenario.

2. Scope of application

- 2.1. The LCR requirements state that: “The requirements set out in this document should be applied to all internationally active banks on a consolidated basis, but may be used for other banks and on any subset of entities of internationally active banks as well, to ensure greater consistency and a level playing field between domestic and cross-border banks.”
- 2.2 Consolidation within this context should be read in conjunction with the objective of the LCR, which is to ensure that every bank maintains an adequate stock of HQLA to meet its liquidity needs for a 30 calendar-day liquidity stress scenario.
- 2.3 The LCR framework also makes provision for banks operating in jurisdictions that are not assigned a 0% risk weight under the Basel II standardised approach for credit risk to include, in their Level 1 HQLA, sovereign or central bank debt securities issued in domestic currencies by the sovereign or central bank of the country in which the liquidity risk is incurred.

- 2.4 The LCR framework requires that the liquidity parameters adopted by the home jurisdiction be applied to all legal entities being consolidated, except for retail and small business deposits, which should follow the host jurisdiction parameters. However, should the host jurisdiction not have these parameters in place, the parameters of the home jurisdiction must be followed.
- 2.5 The LCR framework requires banks, in accordance with regulation 26(12)(a)(iii) of the Regulations, to take into account any liquidity transfer restrictions that would inhibit the transfer of HQLA and funding flows within the relevant banking group and to include eligible HQLA that are held by a legal entity being consolidated to meet its local LCR requirements in the consolidated LCR, to the extent that such HQLA is used to cover the total net cash outflows of that entity.

3. LCR requirements

- 3.1. In terms of the provisions of regulation 26(12)(a)(ix) of the Regulations, while the bank has to report its LCR in South Africa in Rand on a solo and consolidated basis, the bank also has to ensure that it continuously meets its liquidity needs in each relevant currency.
- 3.2. The LCR disclosure requirements state that the LCR data must be presented as simple averages of daily observations over the previous quarter, that is, the average shall be calculated over a period of, typically, 90 days.

4. Directive


- 4.1. Based on the aforesaid, and in accordance with the provisions of section 6(6) of the Banks Act 94 of 1990 (Banks Act) banks are hereby directed:
- 4.1.1. to comply with the relevant LCR disclosure requirements as set out in Directive 1/2019.
- 4.1.2. to calculate the consolidated LCR in accordance with the requirements specified below:
- 4.1.2.1. only banking and/or deposit-taking entities shall be included;
- 4.1.2.2. branches shall be consolidated in accordance with the requirements specified in paragraph 2.4 above;
- 4.1.2.3. all banking and/or deposit-taking entities that operate in a jurisdiction where compliance with the LCR is a regulatory requirement shall be included;
- 4.1.2.4. all banking and/ or deposit-taking entities that operate in jurisdictions where the LCR is not a regulatory requirement shall be included in accordance with the provisions of regulation 36 of the Regulations;
- 4.1.2.5. an aggregation of the relevant individual net cash outflows and the HQLA portfolios of all the relevant entities shall be performed in order to calculate the relevant required consolidated LCR. In this regard, the HQLA of the relevant entities shall be capped at the lower of the specified minimum LCR requirement in each relevant jurisdiction or the home jurisdiction in the aggregation process. Any excess HQLA of a particular entity shall only be included in the consolidated

LCR once it has been evaluated for transferability across jurisdictions and convertibility across currencies, and if it is freely available to the consolidated (parent) entity in times of stress;

- 4.1.2.6. for all entities included in the consolidated LCR, the requirements of paragraphs 2.3 and 2.4 shall apply;
- 4.1.2.7. for the purpose of consolidation, all intragroup transactions should be eliminated;
- 4.1.2.8. for the purpose of consolidation, inflows from all relevant banking and/or deposit taking entities must be capped at 75% on a group consolidated basis and not at an entity level;
- 4.1.2.9. cash reserves may only be included, to the extent to which central bank reserves are allowed to count towards the stock of liquid assets, that is, the extent to which reserves can be drawn down in times of stress, with the permission of the relevant local supervisors in accordance with the BCBS framework and the section 1 of the Banks Act;
- 4.1.2.10. all the respective components required for the calculation of the LCR shall be converted into rand;
- 4.1.2.11. consolidated LCR shall be calculated on a monthly basis to form the base of the public disclosure requirements, and shall be made available to the PA on request; and
- 4.1.2.12. the aggregated LCR shall be reported in line with the form BA 600 requirements.
- 4.1.3. Liquidity transfer restrictions in the calculation and disclosure of the relevant LCR should be taken into account.
- 4.1.4. The LCR disclosures shall be made available to the public on a quarterly basis in line with D1/2019.
- 4.1.5. The PA reserves the right to change the inflow factor for any country or currency if it deems the country or currency risky and funds not transferable or fungible when calculating the LCR on a consolidated basis.
- 4.1.6. Should a bank be unable to comply with any of the relevant directives specified in this Directive, the bank shall, in accordance with the provisions of regulation 5 of the Regulations, report its inability to comply in writing to the Prudential Authority, stating the reasons for such failure or inability to comply.

5. Invitation for comment

- 5.1. Banks and other interested persons are hereby invited to submit their comments with respect to the proposed Directive and the Statement of expected impact to SARB-PA@resbank.co.za and Cristel.Bakker@resbank.co.za for the attention of Ms Cristel Bakker by no later than 8 October 2021.



Kuben Naidoo
Deputy Governor and CEO: Prudential Authority

Date: 2021-09-01

Encl. 1



South African Reserve Bank

Prudential Authority

Statement of the need for, expected impact and intended operation of the proposed Directive: Scope of application and related disclosure requirements regarding the liquidity coverage ratio

August 2021

(DRAFT – FOR CONSULTATION)

Contents

1. Introduction	2
2. Statement of the need — Context and definition of policy problem	3
3. The objective of the proposed Directive	3
4. Statement of expected impact — costs, benefits of the proposed Directive	3
5. Statement of intended operation — implementation and evaluation	5
6. Conclusion	5

1. Introduction

- 1.1 In January 2013, the Basel Committee on Banking Supervision (BCBS) issued a framework relating to the liquidity coverage ratio (LCR)¹, which was subsequently implemented by the Prudential Authority² (PA).
- 1.2 The BCBS developed the LCR to promote short-term resilience of the liquidity risk profile of banks by ensuring that banks have sufficient high-quality liquid assets (HQLA) to survive a significant stress scenario lasting 30 calendar days.
- 1.3 In January 2014, the BCBS issued a framework relating to the LCR disclosure standards³. This was subsequently implemented by the PA through Directive 11 of 2014⁴ and Directive 1 of 2019⁵.
- 1.4 Principle 6 of Principles for Sound Liquidity Risk Management and Supervision⁶ states the following “A bank should actively monitor and control liquidity risk exposures and funding needs within and across legal entities, business lines and currencies, taking into account legal, regulatory and operational limitations to the transferability of liquidity.”
- 1.5 Banks must adopt a common public disclosure framework to help market participants consistently assess their liquidity risk position.
- 1.6 The PA continues to enhance the consolidation requirements relating to the LCR and has issued a proposed Directive (for consultation) that seeks to replace Directive 11 of 2014.
- 1.7 In order to ascertain the impact of the respective requirements specified in the proposed Directive, the PA solicited industry inputs through a questionnaire to

¹ See BCBS.2013. *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* January 2013 <https://www.bis.org/publ/bcbs238.pdf>

² Regulation 26 of the Amendment of Regulations,

³ See BCBS.2014. *Liquidity coverage ratio disclosure standards* January 2014 (rev. March 2014) <https://www.bis.org/publ/bcbs272.pdf>

⁴ See Directive 11 of 2014: LCR: Scope of application and related disclosure requirements

⁵ See Directive 1 of 2019: Matters related to Pillar 3 disclosure requirements

⁶ See Principles for Sound Liquidity Risk Management and Supervision <https://www.bis.org/publ/bcbs144.pdf>

all the domestically systemically important banks (D-SIBs). The responses from the industry were analysed and are incorporated into this report.

2. Statement of the need — Context and definition of policy problem

2.1 The requirements set out in Directive 11 of 2014 requires banks to disclose their LCR on a consolidated basis by aggregating their LCR components.

2.2 The existing Directive is not specific on how intra-group transactions, cash reserves of foreign entities, or the 75% inflow cap on foreign entities should be treated when calculating the LCR on a consolidated basis.

2.3 By addressing the respective items, banks will disclose comparable numbers.

2.4 The proposed Directive stipulates that banks have to

2.4.1 exclude intra-group transactions;

2.4.2 apply a 75% inflow cap on a group consolidated basis and

2.4.3 exclude cash reserves of foreign entities except in the cases where foreign supervisors allow banks to include cash reserves in their consolidated LCR.

3. The objective of the proposed Directive

3.1 The overall purpose of the proposed Directive is to enhance consistency in the computation, regulatory reporting and public disclosure of the consolidated LCR to ensure that the LCR numbers amongst the banking industry are comparable.

4. Statement of expected impact — costs, benefits of the proposed Directive

4.1 The outcome of the QIS was as follows:

4.1.1 In cases where cash reserves of foreign entities were included in the consolidated LCR without approval from the relevant jurisdictions, there was

a slight decrease in the consolidated LCR when the cash reserves of foreign entities were excluded.

- 4.1.2 Where banks excluded the intra-group transactions and applied the 75% cap on a group consolidated basis, the increases in banks LCR ranged from marginal to moderate. No bank's LCR was impacted negatively.
- 4.2 All banks remained well above the minimum required LCR ratio when the enhancements mentioned in 2.4 are applied to the calculation of the consolidated LCR.

Costs of eliminating intragroup transactions (Consolidated approach)

- 4.3 A concern was raised that the exclusion of intragroup transactions when calculating the consolidated LCR will create a significant reporting burden to reflect the required disclosure net of intragroup transactions correctly.
- 4.4 Another concern was raised regarding system implications when excluding intra-group transactions. In order to implement a consolidated approach, business rules, system code, and data will require some enhancement to cater for automated intercompany eliminations in the correct maturity buckets. It was further stated that the issues outlined can be resolved but that a period of time would be required to engage all impacted persons and design.

Benefits of eliminating intragroup transactions

- 4.5 Since intragroup transactions receive a 100% outflow factor and 100% inflow factor in the LCR, banks will be unduly penalised if a 75% inflow factor is applied at entity level prior to aggregation when intragroup transactions are included in the LCR calculation (should banks reach their inflow cap). Eliminating intragroup transactions will eliminate asymmetric treatment of intragroup flows.
- 4.6 The majority of the banks LCR ratios will increase.
- 4.7 Audit implications are reduced since all banking entity inflows will not be capped at 75% per entity.
- 4.8 According to regulation 36 of the Regulations relating to Bank's, banks are required to eliminate intragroup transactions.

- 4.9 According to the International Financial Reporting Standards (IFRS) related to Consolidated Financial Statements, banks are required to eliminate intragroup transactions.
- 4.10 Other central banks consulted during this process also indicated that they require banks to calculate their LCR on a consolidated basis, excluding intragroup transactions and placing the 75% inflow cap on a group basis.
- 4.11 No concerns were raised regarding excluding foreign entity cash reserves when calculating the consolidated LCR without the relevant country supervisory approval.

5. Statement of intended operation — implementation and evaluation

- 5.1 The proposed Directive applies to all banks.

6. Conclusion

The proposed Directive is issued in terms of section 6(6) of the Banks Act No. 94 of 1990 for a six week public consultation period. Following the consultation process, the PA will publish the final Directive and a revised version of this statement, taking into account all the submissions received during the consultation process.