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SOUTH AFRICAN RESERVE BANK
Prudential Authority

Ref.:

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

Internal Liquidity Adequacy Assessment Process.

Executive summary

This proposed directive outlines the Prudential Authority's (PA) requirements for the Internal Liquidity Adequacy Assessment Process (ILAAP), applicable to banks, controlling companies, and branches of foreign institutions (hereinafter collectively referred to as 'banks').

Guided by the Basel Committee on Banking Supervision's Principles for Sound Liquidity Risk Management and Supervision, the ILAAP aims to ensure robust liquidity risk management through a dual framework, integrating the bank's own risk assessment with regulatory liquidity requirements.

These perspectives mutually reinforce liquidity adequacy evaluation, supported by robust governance, rigorous stress testing, comprehensive documentation, and integration with the Internal Capital Adequacy Assessment Process and recovery planning. This forms a critical input into the PA's supervisory processes.

Banks must submit their ILAAP, including the signed Liquidity Adequacy Statement (LAS), to the PA annually, demonstrating compliance.

1. Introduction

- 1.1. The ILAAP is based on established principles that underpin effective liquidity risk management, encompassing robust governance, precise measurement and management of liquidity risks, contingency funding planning, rigorous stress testing, and transparent disclosures. It employs a dual framework, integrating the bank's own risk assessment with regulatory liquidity requirements, to ensure a comprehensive evaluation of liquidity adequacy, with these perspectives mutually informing each other. The ILAAP integrates with the Internal Capital Adequacy Assessment Process (ICAAP), the Risk Appetite Statement, and recovery plans, serving as a critical input to the PA's supervisory processes.
- 1.2. In terms of Regulation 39 of the Regulations relating to Banks (the Regulations), the board of directors holds ultimate accountability for establishing effective corporate governance, including robust liquidity risk and capital management, necessitating comprehensive risk management processes and board-approved policies. Regulation 39(5)(i) of the Regulations requires that banks address liquidity risk through detailed cash flow forecasting, defined funding source mix and concentration limits, thorough scenario-based stress testing, diverse contingency funding plans, and a sufficient liquid asset buffer to meet unexpected needs.
- 1.3. The ILAAP enhances liquidity risk management by establishing a comprehensive framework to assess and mitigate risks, integrating with strategic and risk management processes, including the ICAAP and recovery plans. This ensures a cohesive approach to financial resilience. Within the supervisory process, the ILAAP facilitates robust oversight, enabling the PA to evaluate liquidity risk management.

2. Objective and Processes

2.1. The ILAAP encompasses processes to identify, measure, manage, and monitor liquidity and funding risks across diverse time horizons, including intraday, under business-as-usual and stressed conditions. It integrates qualitative and quantitative elements that support the bank's risk appetite, as determined by the board. The objective is to establish a robust, transparent, and forward-looking framework that ensures:

- Adequate liquidity resources to meet internal and regulatory demands;
- A prudent funding profile to sustain operational and strategic continuity;
- Effective control of liquidity and funding risks across all scenarios.

The ILAAP, through the bank's own risk assessment and regulatory liquidity requirements, contributes to operational resilience and informs strategic decision-making.

3. ILAAP Governance

3.1. The board of directors is accountable for the ILAAP. Key responsibilities include:

- Approving the ILAAP annually, ensuring alignment with the bank's risk appetite;
- Producing and signing a Liquidity Adequacy Statement (LAS) each year, encapsulating the bank's liquidity position, material risks, and key supporting analyses;
- Embedding the ILAAP within risk management and strategic decision-making frameworks;
- Conducting an annual review of the ILAAP's effectiveness against board-determined objectives, with a board-approved report documenting findings and assessing whether implemented processes achieve these objectives, provided to the PA upon request.

3.2. The LAS strengthens accountability, mandating that the board demonstrates a comprehensive understanding of liquidity adequacy, informed by the bank's own risk assessment and regulatory liquidity requirements. Governance

necessitates a structured framework with clearly segregated roles for development, validation, and review, adhering to the three lines of defence model, comprising business operations, risk management, and internal audit.

4. Strategic and Liquidity Planning

- 4.1. The ILAAP must underpin strategic decision-making, embedding liquidity and funding considerations within the bank's management culture. All stress testing methods and processes for liquidity and funding, integral to strategic and operational planning, shall be approved by the board, rigorously reviewed, and documented within the ILAAP, ensuring consistency between qualitative and quantitative aspects, the bank's own risk assessment, regulatory liquidity requirements, and the bank's business strategy and risk appetite.
- 4.2. Whilst the ILAAP ensures operational continuity under business-as-usual conditions, recovery plans delineate measures to restore the banks' financial stability during significant stress. Banks must maintain alignment between these frameworks to effectively mitigate financial risks.

5. Risk Identification and risk quantification.

- 5.1. The ILAAP must document, among others, a robust process for identifying and addressing all material liquidity risks, encompassing the bank's own risk assessment and regulatory liquidity requirements. This process must extend to forward-looking assessments, capturing potential risks and their correlations, both within and between risk categories, across all ILAAP components.
- 5.2. The ILAAP must ensure that the liquidity impact of current and prospective risks is quantified, with all methodologies subject to independent validation to uphold their integrity and reliability.

6. Managing Liquid and Marketable Assets composition

- 6.1. Within the ILAAP, banks must demonstrate that the quantum and composition of their liquid assets, as informed by the bank's own risk assessment and regulatory liquidity requirements, are appropriate to their liquidity risk profile.

This shall be achieved through a risk appetite framework that governs the monitoring and management of the liquid asset portfolio.

- 6.2. Banks must establish robust internal controls and limits to maintain a diversified portfolio of liquid assets, ensuring their convertibility into cash in the short term without undue constraint.

7. Stress testing

- 7.1. Regulation 39(5)(i)(iii) of the Regulations requires banks to conduct robust stress testing. Banks must embed their stress testing within the ILAAP to evaluate liquidity adequacy under the bank's own risk assessment and regulatory liquidity requirements. These tests must encompass severe yet plausible forward-looking scenarios, tailored to the bank's operational characteristics, assessing impacts on cash flows, liquidity resources, profitability, asset encumbrance, and funding profile. Stress testing must appropriately integrate with the bank's ICAAP, capturing liquidity-capital interactions, such as losses from forced asset sales or funding constraints, to ensure a comprehensive risk perspective.
- 7.2. Banks must undertake annual reverse stress testing, commencing with scenarios like business model failure, calibrated to their scale, complexity, and risks. These tests must challenge ILAAP assumptions, necessitating practical mitigation measures if vulnerabilities emerge, with the dual approach reinforcing resilience across internal and regulatory dimensions.

8. Intraday liquidity risk management

- 8.1. Intraday liquidity risk, arising from cash flow timing mismatches within daily settlement obligations, including payment and securities systems, must be robustly managed within the ILAAP. The PA mandates that banks establish appropriate assumptions, informed by the bank's own risk assessment and regulatory liquidity requirements, ensuring sufficient liquidity to sustain normal payment activities under both business-as-usual and stressed conditions.

8.2. Banks must demonstrate a comprehensive analysis of intraday liquidity risk, delineating its origins within their operations and articulating a defined risk appetite and management approach integrated with broader stress testing frameworks.

9. Funds transfer pricing

9.1. Banks must ensure that funding costs, benefits, and risks, as assessed through the bank's own risk assessment and regulatory liquidity requirements, are embedded within product pricing, new product approvals, and business unit performance. The ILAAP must document, among others, a funds transfer pricing (FTP) framework, detailing its methodology, including liquidity cost allocation under stressed scenarios, as well as the board-approved processes for monitoring and periodic review. This framework must demonstrate its alignment with the bank's business strategy and its role in aligning business incentives with liquidity risk management.

10. Independent review and validation

10.1. The ILAAP must undergo independent review at least annually, conducted by internal or external auditors or an equivalent external party. This review must ensure that the ILAAP, encompassing the bank's own risk assessment and regulatory liquidity requirements, remains comprehensive, proportionate to the bank's nature, scale, and complexity, and accurately reflects material risks impacting available liquid assets.

11. Integration with ICAAP and Recovery Plans

11.1. The ILAAP must appropriately integrate with the ICAAP, reflecting the bidirectional relationship between liquidity and capital. Liquidity stress, assessed via the bank's own risk assessment, may precipitate asset fire sales, eroding capital, while capital constraints may restrict funding access, exacerbating liquidity risk. Stress testing must capture these interactions to ensure robust buffers.

11.2. The ILAAP must align with the Recovery Plan, harmonising liquidity measures, such as asset disposals or funding strategies, with recovery actions while reassessing material measures to avoid overlaps or conflicts and ensuring cohesive crisis management.

12. Documentation

12.1. Banks must maintain a robust ILAAP framework, documenting the interplay of its elements, including the bank's own risk assessment and regulatory liquidity requirements, and their integration into the bank's governance and risk management framework. This documentation must encompass, among others:

- An outline of how elements (e.g., risk appetite, stress testing, funds transfer pricing) interlink and support decision-making;
- The annual Liquidity Adequacy Statement;
- Risk taxonomy, inventory, stress testing scenarios, and outcomes;
- Funds transfer pricing and intraday liquidity risk management frameworks, including methodologies and assumptions;
- Evidence of independent validation of risk quantification methodologies;
- Alignment with the Recovery Plan, detailing harmonised management actions.

13. Proposed Directive

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

13.1.1. To submit the bank's ILAAP, including the signed LAS, to the PA annually. The bank's submission must demonstrate compliance with the respective requirements set out in paragraphs 3 to 12 of this proposed directive, including, among others:

- the adequacy of the bank's governance arrangements, including matters related to board oversight and board-approved policies.
- the use of the ILAAP for strategic and liquidity planning;
- matters related to the robustness of the bank's internal risk assessment and quantification;
- matters related to the bank's compliance with regulatory liquidity requirements as an integral component of the bank's ILAAP framework;
- the adequacy of the bank's intraday liquidity risk management;
- the adequacy of measures related to independent review and validation;
- the robustness of the bank's FTP; and
- matters related to the integration of the bank's ILAAP with ICAAP and recovery plans.

14. Invitation for comment

14.1. Banks, controlling companies, branches of foreign institutions, and other interested persons are invited to submit comments on this proposed directive to SARB-PA@resbank.co.za and Wessel.Mostert@resbank.co.za, for the attention of Mr Wessel Mostert, by no later than 30 April 2026.

Fundi Tshazibana
Chief Executive Officer

Date: