



Financial Sector Regulation Act, 2017 (Act No. 9 of 2017)

Prudential Communication 11 of 2023

Revised market risk and credit valuation adjustment frameworks-minimum guidelines for model validation and independent assurance providers related to model validation submissions

Objective of this prudential communication

This prudential communication provides minimum guidelines for model validation, and independent assurance assessments to be conducted for model validation submissions related to the revised market risk and credit valuation adjustment frameworks.

The Basel Committee on Banking Supervision's (BCBS) Revised Minimum Capital Requirements for Market Risk, also referred to as the Fundamental Review of the Trading Book (FRTB), and the Credit Valuation Adjustment (CVA) framework due for implementation in South Africa on 1 July 2025¹ bear reference.

The Prudential Authority (PA) published an implementation roadmap² and an FRTB application suite^{3,4} to guide project planning initiatives within the PA and across supervised banks in preparation for the FRTB and CVA implementation date.

The implementation roadmap sets out submission milestones for model validations, and associated independent assurance assessments, together with associated governance approvals. In this regard, the PA developed a set of minimum guidelines contained in Appendices A to E (the summary of which is provided in Table 1 below) of this prudential communication for the attention of banks and their independent assurance providers (IAPs) relating to the FRTB and CVA model validation submissions. In addition to this prudential communication, banks should also refer to Prudential Communication 7 of 2022⁵ for additional guidelines on the use of IAPs for model validation assurance engagements.

¹ As per the schedule reflected in Guidance Note 3 of 2023

² Prudential Communication 10 of 2023

³ <https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-public-awareness/Communication/2022/Prudential-Communication-1-of-2022-Revised-Market-Risk-Framework-Application-Suite>

⁴ A draft CVA application suite has been released to the Banking Association South Africa and bilaterally to banks. A final application suite will be published on the PA website in due course

⁵ <https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-public-awareness/Communication/2022/Prudential-Communication-7-of-2022-FRTB-and-CVA-Independent-assurance-guidelines>

Table 1: Appendices structure

Appendix	Description
A	Minimum guidelines for model validation submissions
B	Minimum guidelines for independent assurance providers related to model validation submissions
C	Approval process requirements
D	Minimum guidelines for the executive summary report
E	Operational guidelines for final submissions

As part of their final submissions, which may include multiple models such as the FRTB-Standardised Approach (SA) and the SA-CVA, banks must construct and submit an executive summary report (as further expanded upon in Appendix D) that reflects key findings across the model validation, assurance and governance outcomes. In addition, the executive summary report should contain confirmation that all requisite processes stipulated in this prudential communication have been completed.

As noted in Prudential Communication 9 of 2022⁶, the PA is currently engaged in the development of prudential standards related to the BCBS FRTB and CVA frameworks. Consequently, following the embedment of the respective prudential standard into South Africa's legislative framework, the reference base of this prudential communication will be updated from the BCBS FRTB and CVA frameworks to the respective prudential standard in order to reflect ongoing model validation requirements.

Banks and their IAPs are strongly encouraged to employ the full extent of their resources, capability, and governance to ensure that the requirements stipulated in this prudential communication are comprehensively addressed. Notwithstanding the minimum prescribed requirements contained in this prudential communication, banks and their IAPs should apply themselves rigorously, interrogate the complete BCBS FRTB and CVA frameworks, and submit any additional applications or information as may be deemed relevant.

Should banks and their IAPs foresee any challenges in meeting the requirements set out in this prudential communication, it remains incumbent upon such banks and their IAPs to engage with the PA thereon in an expeditious manner.

All requests for further information related to this prudential communication may be submitted via email to the PA's Market Risk Division⁷, with the relevant PA front-line division copied, where applicable.

⁶ <https://www.resbank.co.za/en/home/publications/publication-detail-pages/prudential-authority/pa-public-awareness/Communication/2022/Prudential-Communication-9-of-2022-FRTB-and-CVA-Draft-Prudential-Standards>

⁷ PA_RSD-MarketRisk@resbank.co.za

Yours sincerely

Fundi Tshazibana
Chief Executive Officer

Date:

APPENDIX A: MINIMUM GUIDELINES FOR MODEL VALIDATION SUBMISSIONS

Table 2: Minimum guidelines for model validation submissions

Index	Guidelines
1.	A model validation unit, that is separate and has independent reporting lines from the units (including an external vendor) that designs, implements, manages, and/or owns the models, must conduct the initial (and ongoing) validation of all FRTB and CVA models.
2.	The model validation unit should carry out comprehensive testing of the models across lifecycle considerations, including, but not limited to, model inputs, calibrations, functional operators, and model performance.
3.	Should a bank deem that it has insufficient capacity, capability, or competence to conduct such model validations, it may appoint a suitably qualified external model validation service provider. Whenever external resources are used, the bank must clearly define and agree upon the scope of work for the validation activities to be conducted. Notwithstanding that some validation activities are outsourced to external parties; the bank's internal validation or respective risk management unit and senior management should maintain complete and ultimate responsibility for both the validation activities and the corresponding results. The bank should also have a contingency plan in the event of delivery or quality risks posed by the external model validation service providers.
4.	All model validations must be conducted by suitably qualified individuals with relevant quantitative analysis backgrounds and qualifications. The executive summary report must document such backgrounds and qualifications. This requirement applies to both internal and external resources of the bank.
5.	The work of the model validation unit must be underpinned by relevant approved policies and frameworks to ensure consistency and adherence to regulatory requirements. These policies and frameworks should have been reviewed and approved in the last two financial years for the purpose of this prudential communication.
6.	Where issues have been identified by the model validation unit, banks must confirm that necessary remedial steps were taken or that appropriate mitigating controls have been planned for implementation (ahead of the commencement of the regulatory reporting milestones stipulated in the implementation roadmap mentioned earlier) or have been implemented.
7.	The validation must be tabled for approval at the applicable committees noted in Appendix C ahead of submission to the PA.

APPENDIX B: MINIMUM GUIDELINES FOR INDEPENDENT ASSURANCE PROVIDERS RELATED TO MODEL VALIDATION SUBMISSIONS

Table 3: Minimum guidelines for independent assurance providers related to model validation submissions

Index	Guidelines
1.	For the purposes of this prudential communication, a limited assurance engagement must be conducted.
2.	IAPs must ensure that there are approved model validation policies and frameworks in place at the bank and that the specific model validations related to this prudential communication have been conducted in accordance with such bank-approved model validation policies and frameworks.
3.	Independent model validation assurance must be conducted by suitably qualified individuals with relevant quantitative analysis backgrounds and qualifications. As such, the executive summary report must document such backgrounds and qualifications. This requirement applies to both internal and external resources of the bank.
4.	IAPs must confirm and document in the final assurance report that the models have been subjected to rigorous challenge by the model validation unit and that the results were tabled for approval at the applicable committees stated in this prudential communication prior to submission to the PA.
5.	Where issues have been identified by the model validation unit, IAPs must confirm and document in the final assurance report that the necessary remedial steps or mitigating controls have been planned for implementation (ahead of the commencement of the regulatory reporting milestones stipulated in the implementation roadmap mentioned earlier) or have been implemented.
6.	IAPs must present the final assurance report, inclusive of findings and recommendations, at a bank's highest assurance/audit committee for approval and thereafter, to the bank's board of directors in order to facilitate a comparison against the relevant submissions received from the bank's highest committees responsible for risk (and capital) or model governance, as applicable.
7.	IAPs must report the final outcome of the assurance assessment to the PA using a mapping of its own internal conventions of assurance outcomes to the following categories: <ul style="list-style-type: none"> 1. Satisfactory 2. Satisfactory with room for improvement 3. Unsatisfactory with significant room for improvement 4. Unsatisfactory

APPENDIX C: APPROVAL PROCESS REQUIREMENTS

This appendix describes the approval process for the final submission to the PA. In this regard, the PA may request purpose-specific engagements with a bank's board of directors, senior management, model validation unit, and independent assurance/audit function when assessing the relevant submissions.

The bank should ensure appropriately assigned senior management as a submission agent(s) to ensure that the various requirements and prescribed or consequential dependencies set out in this prudential communication are comprehensively addressed and managed.

The approval process described in this appendix is illustrated in Figure 1 below. Each stage and set of constituent steps (where applicable) must be completed sequentially. An adverse outcome in one stage may influence the decision to proceed to the next stage.

The final submission to the PA should include the minutes from each committee sitting, including the board of directors, noted in this appendix.

STAGE 1: DUAL MODEL GOVERNANCE

With respect to model governance, the bank must submit a comprehensive model validation assessment, an independent assurance assessment of the model validation, and associated approvals from its highest committees responsible for model governance and assurance/audit, respectively, against the minimum guidelines set out in this prudential communication (collectively referred to as dual model governance). The model governance and assurance/audit committees may convene simultaneously, yet independently (joint sittings will not be permitted). This dual model governance stage must be completed before entry into the second stage of application governance noted below.

STAGE 2: DUAL APPLICATION GOVERNANCE

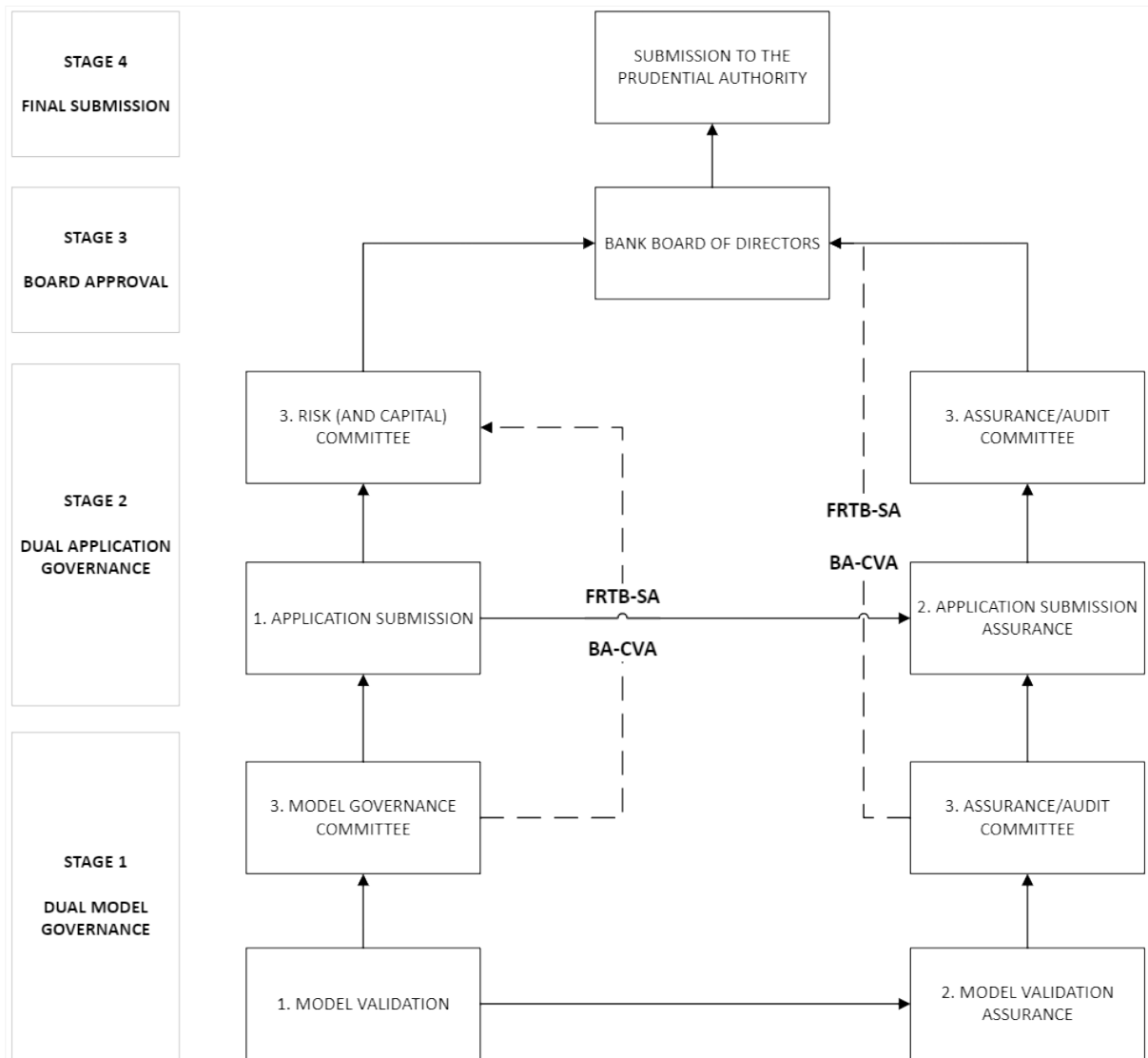
All applications for the use of models (such as the FRTB internal models approach (IMA) or the SA-CVA) or specific model components (as in the case of the Basic Approach (BA)-CVA) requiring regulatory approval, must be accompanied by an associated independent assurance/audit assessment (against the minimum guidelines set out in this prudential communication) and approval from a bank's highest committees responsible for the oversight of risk (and capital), and assurance/audit (hereafter, collectively referred to as dual application governance), respectively. The submissions to the relevant committees in the dual application governance stage must include the outcome of the preceding dual model governance stage. The risk (and capital) and assurance/audit committees may convene simultaneously, yet independently (joint sittings will not be permitted). This dual application governance stage must be completed before entry into the board approval stage noted below.

Whilst this stage deals with the construction, assurance, and governance of applications to the PA, it simplifies for default model implementations, such as and in particular for the FRTB-SA or the BA-CVA without any election for the use of specific components requiring regulatory approval. In this regard, a submission must be made to the highest committee responsible for risk (and capital) depicted as part of Stage 2 below, following the completion of the preceding dual model governance stage. This submission must indicate the outcome of the dual model governance stage. For the assurance engagement, a submission may be made directly to the bank's board of directors following the completion of stage 1 (dual model governance stage) and the sitting of the highest committee responsible for risk (and capital) depicted as part of Stage 2 below.

STAGE 3: BOARD APPROVAL

The results of the dual model governance stage and dual application governance stage (including for default model implementations) must be submitted to a bank's board of directors to facilitate the final approval process for submission to the PA. If any of the preceding stages presents concerns, the bank's board of directors must exercise its judgement in terms of withholding the final submission to the PA to ensure the remediation of any material deficiencies. A joint sitting of the board and other committees noted in this prudential communication will not be permitted.

Figure 1: Approval process



APPENDIX D: MINIMUM GUIDELINES FOR THE EXECUTIVE SUMMARY REPORT

Table 4: Minimum guidelines for the executive summary report

Index	Guideline
1. Introductory details	
1.	Bank name
2.	Submission date
3.	Contact person's(s') name(s) (submission agent(s))
4.	Email address(es) of contact person(s)
5.	Name of the model(s) forming part of the submission
2. Summary of model validation submissions	
1.	Stipulate the make-up of the model validation resources (internal and/or external)
2.	Qualifications and experience of the resources involved in the applicable validations
3.	Respective reporting structures of the model validation unit, and model developers through to the end users
4.	List of applicable bank-approved policies and frameworks (including approval dates)
5.	Key model validation findings (including any remedial steps taken, or appropriate mitigating controls)
6.	Model Governance: Date of meeting and key outcomes of the model governance committee and the risk (and capital) committee, respectively.
3. Summary of model validation submissions assurance/audit	
1.	Stipulate the make-up of the IAP resources (internal and/or external)
2.	Qualifications and experience of IAP resources involved in the applicable assurance
3.	Key assurance/audit findings (including confirmation of the implementation of any remedial steps taken, or appropriate mitigating controls by management)
4.	Assurance/audit governance: Date of meeting and key outcomes of the assurance/audit committee
4. Summary of the outcomes of the submission to the bank's board of directors	
1.	Name of chair of the bank's board of the directors
2.	List of the board members in attendance
3.	Date of meeting and key outcomes from the meeting
5. List of accompanying submissions	
1.	Provide a register and a corresponding account of the accompanying submissions (including the resolution passed by the bank's board of directors)

APPENDIX E: OPERATIONAL GUIDELINES FOR FINAL SUBMISSIONS

Banks should contact their respective PA front-line divisions prior to the submission process to establish the preferred submission protocol to be leveraged.