

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

Reporting requirements in terms of regulation 30 of the Regulations relating to Banks

Executive summary

The amendments to regulation 30 of the Regulations relating to Banks (Regulations) were published in the Government Gazette on 23 December 2022 and came into effect on 1 January 2023

This Directive sets out, amongst others, instructions for monitoring credit spread risk in the banking book, which is related to interest rate risk in the banking book and matters related thereto

1. Introduction

- 1.1 The amendments to regulation 30 of the Regulations were gazetted on 23 December 2022 and came into effect from 1 January 2023.
- 1.2 The amended Regulations make provision for the Authority to issue directives for the completion of the form BA 330. As such, this Directive includes, among others, instructions for the completion of credit spread risk in the banking book (CSRBB).
- 1.3 As per regulations 30 and 67 of the Regulations, CSRBB is a risk related to interest rate risk in the banking book (IRRBB) that includes any asset/liability spread risk of instruments with inherent credit risk-related characteristics that is not fully explained by IRRBB or by relevant expected credit/jump to default risk.

2. Directive

- 2.1 Based on the aforesaid and in accordance with the provisions of section 6(6) of the Banks Act 94 of 1990, banks, branches of foreign institutions and controlling companies (hereinafter collectively referred to as “banks”) are hereby directed to identify, monitor, measure, manage and report CSRBB as follows:

2.2 Identification and Assessment of CSRBB

2.2.1 CSRBB captures a combination of two elements:

- (a) The changes of the “market credit spread” or “market price of credit risk” representing the credit risk premium required by market participants for a given credit quality (the credit spread is the yield difference of a bond compared to a risk-free interest rate); and
- (b) The changes in the “market liquidity spread” represent the liquidity premium that sparks market appetite for investments and the presence of willing buyers and sellers.

2.2.2 CSRBB does not include the effect of credit quality changes during the observation period of a 12-month rolling period (rating category downgrade/upgrade of a specific counterparty or instrument). In particular, the deterioration of a bank’s credit quality must not positively impact the credit spread risk measure. Banks must avoid any overlap with the credit valuation adjustment risk management framework as well as the counterparty credit risk management framework when assessing the CSRBB.

2.2.3 When assessing changes in the credit risk premium and liquidity premium movements, banks shall consider currency-specific dimensions (i.e. ZAR, EUR, USD, etc.) as relevant dimensions for market credit spread and market liquidity spread.

2.2.4 Banks must not exclude any instrument in the banking book from the perimeter of CSRBB, including assets, liabilities, derivatives, and other off-balance sheet items, such as loan commitments, irrespective of their accounting treatment. Any potential exclusion of instruments from the relevant perimeter must be done in the case of the absence of sensitivity to credit spread risk and must be appropriately documented and justified.

2.2.5 Furthermore, banks must not exclude assets accounted at fair value.

2.3 CSRBB Governance and Strategy

2.3.1 The CSRBB strategy of banks, including its risk appetite for CSRBB, must be aligned with the bank’s overall strategy, strategic objectives, and risk objectives, as approved by the relevant committees.

2.3.2 A bank’s risk appetite for CSRBB must be expressed in terms of the impact of fluctuating credit spreads on the different CSRBB measures.

2.3.3 Banks must ensure that procedures to identify, measure and monitor CSRBB have been established when proposing new products or activities. CSRBB characteristics of new products and activities must be well understood.

2.3.4 Group reporting for CSRBB must ensure that internal governance arrangements and processes are consistent and well-integrated on a consolidated and solo basis.

2.4 CSRBB risk assessment framework and responsibilities

- 2.4.1 The board of directors is ultimately responsible for overseeing the CSRBB management framework and the bank's risk appetite framework to cover CSRBB management adequately. The monitoring and management of CSRBB can be delegated to senior management, expert individuals, or the asset and liability management committee (ALCO).
- 2.4.2 The CSRBB risk management framework must establish clear lines of responsibilities that consist of policies, processes, and internal controls, including regular independent reviews and evaluations of the effectiveness of the framework.
- 2.4.3 The board of directors or respective committee or delegates must ensure that the validation of CSRBB measurement methods and assessment of the corresponding model used is included in a formal document that must be reviewed and approved by the respective committee or delegates.
- 2.4.4 Banks must understand the implications of CSRBB strategies and their potential linkages with market, liquidity, credit, and operational risk without requiring all the management body members to be experts in the area. Some committee members must have sufficient technical knowledge to question and challenge the reports made to the respective committees.

2.5 CSRBB risk policies, processes, and controls

- 2.5.1 Risk policies and processes:
- 2.5.1.1 The responsible committee must, based on its overall CSRBB strategy, adopt robust risk policies, processes and systems which must ensure that:
- a) Procedures for updating scenarios for the assessment and monitoring of CSRBB are set up;
 - b) The measurement approach and the corresponding assumptions for assessing and monitoring CSRBB risks are appropriate and proportional.
 - c) The assumptions of the models used are regularly reviewed and, if necessary, amended;
 - d) Standards for the evaluation of positions and the measuring of performance are defined; and
 - e) The lines of authority and responsibility for managing CSRBB exposures are defined.

2.6 Risk processes

- 2.6.1 The board of directors or relevant committee must be responsible for the following:
- a) Understanding the nature and the level of CSRBB exposure. Ensure that there is clear guidance regarding the risk appetite for CSRBB in respect of the banks business strategies;
 - b) Establishing that the appropriate actions are taken to assess and monitor CSRBB, consistent with the approved strategies and policies;
 - c) Setting systems and standards for monitoring CSRBB, valuing positions and assessing performance, including procedures for updating the shock in

place, parameters and stress scenarios and key underlying assumptions driving the Banks' CSRBB analysis;

- d) A comprehensive CSRBB reporting and review process;
- e) Effective internal controls and management information systems (MIS);
- f) Carrying out the oversight of the approval, implementation and review of CSRBB management policies and procedures; and
- g) Have adequate oversight of CSRBB exposure.

2.7 Internal controls

2.7.1 Regarding CSRBB control policies and procedures, banks must have appropriate approval processes, reviews and other mechanisms designed to ensure that risk management objectives are being achieved reasonably.

2.7.2 Banks must have their CSRBB identification, measurement, monitoring, and control processes reviewed by an independent auditing function, which may be an internal or external auditor regularly. Reports written by internal or external auditors must be made available to the PA upon request.

2.8 Model governance

2.8.1 Banks must ensure that the validation of CSRBB measurement methods, which must be reviewed and validated independently of their development and the assessment of corresponding model risk, are included in a formal policy process that must be reviewed and approved by the management body or its delegates. The policy must be integrated within the governance processes for model risk management and must specify:

- a) The management roles and designate who is responsible for the development, validation, documentation, implementation and use of models; and
- b) The model oversight responsibilities as well as policies, including the development of initial and ongoing validation procedures, evaluation of results, approval, version control, exception, escalation, modification and decommissioning processes.

2.9 CSRBB monitoring assumptions

2.9.1 When measuring CSRBB, banks must fully understand and document key modelling assumptions. These assumptions must be aligned with business strategies and be regularly reviewed.

2.9.2 Banks must consider the implications of accounting practices for the measurement of CSRBB, in particular for net interest income measures plus market value changes.

2.9.3 Banks are required to appropriately validate and document the reliability and stability of diversification assumptions, diversification between CSRBB and IRRBB is possible. The diversification effects must be estimated conservatively enough to be assumed to be sufficiently stable even in economic downturns and under market conditions unfavourable for a bank's business and risk structure. Banks must have separate assessments of CSRBB.

2.9.4 For CSRBB, banks must set up prudent documentation supporting their policies, assumptions and procedures, and include a process for keeping them under review. Banks must understand, for the purpose of CSRBB, the impact of their chosen CSRBB-related investment strategies.

2.10 CSRBB measurement

2.10.1 CSRBB is driven by changes in market perception about the credit quality of groups of different credit-risky instruments, either because of changes to expected default levels or market liquidity changes.

2.10.2 To capture “credit spread” risk, the PA is adopting a sensitivity measure “credit spread per basis point” delta, denoted by “CS01”.

2.10.3 Banks with CSRBB exposure must calculate the CS01 sensitivity measure per exposure to enable a calculation of change in a value for a 1bps parallel upward/downward shift of the credit spread curve.

2.11 CSRBB reporting template

2.11.1 The PA will monitor the attached Annexure A (CSRBB reporting template) through manual submissions. Accordingly, the frequency of required submissions may vary depending on materiality.

2.11.2 As an interim solution, submissions must be submitted monthly to pa-informationrequests@resbank.co.za.

2.11.3 Automated CSRBB reporting will be phased into the PA’s final system solution as soon as and when the PA migrates to the future system solution.

Banks must ensure ongoing compliance with the requirements specified in:

2.12 Regulation 39 of the Regulations relating to:

- a) Delegation arrangements and procedures for any assessment and monitoring of CSRBB;
- b) CSRBB IT system and data quality; and
- c) CSRBB internal reporting requirements.

3. Invitation for comment

3.1 Banks are invited to submit their comments concerning the proposed directive to SARB-PA@resbank.co.za and katleho.makoko@resbank.co.za for the attention of Ms Katleho Makoko by no later than 31 January 2024.

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

Fundi Tshazibana
Chief Executive Officer

Date: