# SARB'S EXTERNALLY FACILITATED **LIQUIDITY STRESS SIMULATIONS**

**On the 14th of April 2021, the Prudential Authority (PA) of the South Africa Reserve Bank released its latest directive (D4/2021) regarding the requirements and frequency of externally facilitated liquidity stress simulations for both domestic systemically important banks (D-SIBs) and non-D-SIBS. These simulation exercises will require mandatory consultation with and participation of the PA.**

Stress-testing is a critical tool for risk management as it helps banks to gauge if they can withstand significant economic and financial shocks. It also provides an opportunity to review and refine existing risk frameworks to detect, manage and mitigate future stress events.

## DSIB REQUIREMENTS OF D4/2021

These banks will be required to perform a liquidity stress simulation at a bank solo level at least once every four years. In line with our paper **Stress Testing: Agile Risk Management During Covid-19**, the PA has set out the **objectives** together with the **implementation** and **governance** requirements of the exercise.

### OBJECTIVES

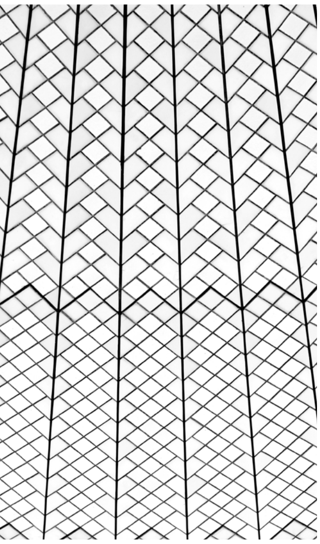
This exercise will be performed for banks to balance the benefits, costs, planning and preparation of these simulations and highlight gaps in the bank's liquidity risk management framework. These stress simulations will at a minimum need to address the following items:

- Early detection of liquidity stress events and timely responses through monitoring and mitigation of risk exposures
- Sufficient funding sources to withstand unexpected market disruptions
- Contingency funding plans and/or recovery plans
- Effective risk governance processes
- Assessing the interrelationships between idiosyncratic and system stability factors

### IMPLEMENTATION

The Directive highlights the use of **reserve stress testing** as a starting point for the **development of stress scenarios** that would be considered severe enough to bring the bank to failure without corrective action, such as a contingency funding plan and recovery plan.

These banks will need to include **dynamic projections** in their simulations to consider the collective behaviour of market institutions as they would realistically respond to the proposed stress event to avoid system-wide distress and the resulting economic costs. The Directive is clear in setting one of its objectives as the assessment of the micro-prudential and macroprudential interrelationships that unfold as market stakeholders react to the developed liquidity shock.



## GOVERNANCE

The Directive calls for relevant representation from the PA and SARB to be consulted when organising the externally facility liquidity stress simulation to assess the effectiveness of banks' overall liquidity risk management frameworks. However, it will be the banks who will be responsible for the implementation of the exercise.

The simulation exercise should be **performed at least once every four years**, unless an exercise has not been performed in the previous four years since the effective date of the directive, in which case one must be performed within twelve months.

## NON-DSIB REQUIREMENTS OF D4/2021

The PA may request a respective non-DSIB to conduct a liquidity simulation exercise based on additional parameters proportional to its nature, scale and complexity.

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**Directive 4/2021:**
https://www.resbank.co.za/content/dam/sarb/publications/prudential-authority/pa-deposit-takers/banks-directives/2021/D4%20-%202021%20-%20Externally-facilitated%20liquidity%20stress%20simulation.pdf


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