

The public consultation to the BCBS proposal for an international framework for liquidity risk

Money Market Contact Group
Frankfurt, 18 May 2010

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I. Background

- BCBS issued a consultative document on International framework for liquidity risk management, standards and monitoring in December 2010, putting forward:
 - A liquidity risk coverage ratio (LCR), to ensure that banks hold sufficient high quality liquid assets to withstand an acute stress scenario lasting one month
 - A net stable funding ratio (NSFR), to incentivise banks to fund themselves using more stable sources on a structural basis
 - A set of tools for ongoing monitoring of liquidity risk exposures and information exchange among supervisors
- The consultation period ended on 16 April. At the same time, public consultation was held for CRD IV at the EU, including a section on liquidity risk.

II. General comments

- Respondents welcomed the introduction of a harmonised liquidity framework and supported the two complementary measures for the short and long term;
- However respondents highlighted problems in the design of the two ratios that could affect the real economy, financial system and the business models of certain banks;
- Particular emphasis was given to the NSFR, as it was considered that it does not allow the level of maturity mismatch necessary for banks to perform their role in the economy.

III. Impact on the real economy and the interbank market

- Different RF under the NSFR for loans with maturity more and less than a year provides incentives to decrease average maturity, possibly reducing the stability of funding to the real economy;
- The NSFR would result in banks issuing more covered bonds and unsecured long-term debt putting stress on their price and affecting the cost of funding for the economy;
- Favourable treatment of marketable securities vs. loans could disadvantage SMEs over large corporates;
- Treatment of unsecured wholesale funding and undrawn liquidity lines under the LCR could hamper the interbank market and increase reliance on central banks.

IV. Impact on the financial system

- Banks will have incentives to be involved in more risky transactions to cover additional liquidity costs;
- Uniformity in business models, possibly resulting from the application of the standards, is likely to increase systemic risk;
- Limiting maturity transformation by banks may encourage the development of the shadow banking sector;
- Retail deposits will become less stable due to increased competition to meet the standards;
- Narrow definition of the liquid assets would draw a significant amount of liquidity out of the system.

V. Impact on specific business models and jurisdictions

- Under the NSFR, capital market instruments receive better treatment than retail deposits, penalising universal banking model and possibly favouring broker dealers;
- The asymmetric weighting of assets and liabilities under the NSFR would pose difficulties for traditional retail banks to meet the 100% limit, not taking into account their resilience in the crisis;
- Banks' credit ratings should be taken into account in the calibration of the ratios;
- National specificities need to be taken into account including the size of government bond issuance, liquidity of covered bond market, preference on short-term vs. long-term deposits.

VI. Technical comments on the liquidity standards

- On high quality liquid assets, the narrow definition implies concentration risk, high cost for the assets that are not included, difficulties to fund through bank bonds and lack of consistency with the stress scenario;
- The proposed framework lacks mechanism for releasing liquid assets;
- Certain run-off rates should be revisited also taking into account specific business models e.g. custodian banks, bank networks;
- More granularity is required in the NSFR, in particular with regard to the assets requiring 100% stable funding. Certain types of assets, e.g. state-regulated deposits and covered bonds (in specific markets) were considered stable.

VII. Suggestions to address the comments received

- Reviewing the calibration of high quality liquid assets and various parameters of the LCR and NSFR. For the former proposals include considering as high quality liquid assets all central bank eligible assets, assets that are highly liquid but not-central bank eligible (with regard to jurisdictions and currencies), collateral for repos eligible for CCP clearing;
- Establishing the NSFR as a Pillar 2 monitoring tool;
- Allowing the use of internal data, subject to quality requirements and backtesting;
- Appropriate phasing-in the liquidity standards to allow banks to adjust their business models.

VIII. Way forward

- Impact assessment by **mid-2010**
- Fully calibrated standards by **end-2010** (to inter alia include further guidance on possible application of standard at the solo level and treatment of intra-group flows; currencies; disclosure)
- Implementation envisaged by **end-2012**. Appropriate phase-in measures and grandfathering arrangements will be put in place for a sufficiently long period to ensure smooth transition to the new standards.