

Amendments to the Basel Committee liquidity risk framework

Money Market Contact Group
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I. The December consultative document on the liquidity risk framework - recap

- Basel Committee develops an international liquidity risk framework:
 - Purpose: (1) increase banks' resilience to liquidity shocks and (2) increase the market confidence in the liquidity position of banks.
- Framework mainly consists of:
 - A liquidity risk coverage ratio (LCR), to establish a minimum level of high-quality liquid assets to withstand an acute stress scenario lasting one month.
 - A net stable funding ratio (NSFR), to ensure a closer alignment of the funding of longer-term assets or activities by more stable medium or longer-term liability and equity financing.
 - A set of tools for ongoing monitoring of liquidity risk exposures and information exchange among supervisors

II. Industry reactions

- Generally industry participants voiced support for the objectives and the overall structure of the liquidity risk framework;
- However the industry also clearly voiced concerns that the liquidity proposal could create severe economic consequences for the financial industry and the global economy;
 - Particularly the NSFR measure was criticised as it would not allow to perform the essential maturity transformation of banks within the economy.
 - The NSFR measure raised questions regarding the impact on particular business models and the incentives it might provide.
 - As for the LCR, the proposed narrow definition of liquid assets was heavily criticised as it could lead to severe concentration risk and would be too restrictive.

III. Quantitative Impact Study results

- As the reform package puts forward for the first time a liquidity risk framework for banks, it had as implication that banks did not collect or dispose of the data as required by the standards.
 - Despite the guidance provided a variance in assumptions and in reported internal liquidity data was observed.
- E.g. different treatment of cash inflows and the assumptions of the ongoing business, which were left to the discretion of the bank.
 - Some banks assumed that 100% of maturing loans should be counted as inflows others assumed 0%.
 - Made that in some cases the inflows were estimated to be of the order that banks did not require a stock of liquid assets.
- This has affected the outcome of the Quantitative Impact Study (QIS) and the comparability across banks and jurisdictions.

III. Quantitative Impact Study results

- Therefore, the QIS results for liquidity are more useful as a directional tool to view the calibration changes, rather than a tool that shows the actual numerical impact of the standards.
- The QIS does show that alternative scenarios – that go into the direction of the agreement reached by the Governors and Heads of Supervision – are more favourable than the December consulted proposals.
- Finally the QIS importantly revealed elements in the framework that need clarification and tightening up of definitions and explanations.

IV. a) The GHOS agreement on the Liquidity Coverage Ratio

- Provided the QIS results, the industry comments and the further assessment of the liquidity risk framework, the Basel Committee proposed a series of changes.
- Under the agreement reached by the Governors and Heads of Supervision (GHOS), changes to the LCR are primarily related to recalibration:
 - Recalibration of the stress scenario “a conservative bank level and plausible system wide shock”, translated into
 - Run-off rate floors lowered to 5% for stable and 10% for less stable retail deposits
 - 25% outflow bucket for custody, clearing, settlement as well as selected cash management activities.

IV. a) The GHOS agreement on the Liquidity Coverage Ratio

- Recalibration of LCR continued
 - Run-off rates for deposits of Sovereigns, Central Banks and PSEs were lowered from 100% to:
 - 75% run-off rate for unsecured funding of all sovereigns, central banks and PSEs;
 - Secured funding backed by assets not included in the stock of liquid assets are assumed to run-off at a 25% rate;
 - Secured funding backed by buffer eligible assets are recognised to be rolled-over.

IV. a) The GHOS agreement on the Liquidity Coverage Ratio

- Recalibration of LCR continued
 - Definition of liquid assets.
 - Level I liquid assets:
 - Cash and Central bank reserves – if can be drawn in times of stress;
 - Government bonds assigned a 0% risk weighting;
 - Domestic sovereign debt for non-0% risk weighted sovereigns issued in foreign currency (to the extent currency matches currency needs in that jurisdiction);
 - Level II liquid assets:
 - Apply 15% haircut and cap that allows 40% of the stock to be made up of;
 - Government securities qualifying for the 20% risk weighting;
 - High-quality non-financial corporate and covered bonds (not own-issued);
 - Still determination of eligibility criteria (outside of ratings);

IV. b) The GHOS agreement on the Net Stable Funding Ratio

- As for the NSFR measure, the Basel Committee remains committed to the introduction of the NSFR as a longer-term structural complement;
 - Besides recalibration changes, modifications could be necessary to better address differences in the business models;
 - Observation ratio to guard the smooth introduction of the measure.

V. Next steps

- Finalise LCR by end 2010;
- Phase in LCR by 2015;
- Develop by end 2010 a revised NSFR proposal;
- Introduce the NSFR as a minimum standard by January 2018.

Thank you for your attention