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July 31, 2008

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: *Principles for Sound Liquidity Risk Management and Supervision*

Dear Sirs:

The Clearing House Association L.L.C. ("The Clearing House") and its member banks[1] are please to comment on the Basel Committee on Banking Supervision's consultative paper *Principles for Sound Liquidity Risk Management and Supervision* ("Principles"). The Principles represent an update of the Committee's 2000 paper, *Sound Practices for Managing Liquidity in Banking Organizations* based in part on lessons that the Committee gained from the market turmoil that began in mid-2007, during which, the Committee notes, "many banks had failed to take account of a number of basic principles when liquidity was plentiful."[2]

While these findings do indicate serious shortcomings at some banks, it is also clear that a large number of globally significant banks (including Clearing House members) fully understood that changes in market conditions and industry practices in recent years necessitated a reconsideration of practices for sound liquidity-risk management. In early 2007, the Institute of International Finance ("IIF") issued the report of its Special Committee on Liquidity Risk.[3] The IIF report proposed a number of practices regarding managing and measuring liquidity risk, and contained a number of recommendations regarding stress testing and contingency planning. Many of the recommendations in the IIF report anticipate the BIS Principles.

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1 The members of The Clearing House are ABN AMRO Bank, N.V.; Bank of America, National Association; The Bank of New York Mellon; Citibank, National Association; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; UBS AG; U.S. Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association.

2 Basel Committee on Banking Supervision, Bank for International Settlements, *Sound Practices for Managing Liquidity in Banking Organizations* at 1 (2008).

3 Institute of International Finance, *Principles of Liquidity Risk Management* (Mar. 2007).

In general, The Clearing House strongly supports the BIS Principles and commends the Committee for its emphasis on each bank's responsibility for measuring its own liquidity risk based on a comprehensive review of its operations and assets and developing a risk-based plan to monitor and control its risks, and the Principles' avoidance of mandatory quantitative standards. While we do take issue with certain particulars of the Committee's work, these should be read in the context of our overall support for the Principles.

Public Disclosure.

Principle 13 provides that "[a] bank should publicly disclose information on a regular basis that enables market participants to make an informed judgement about the soundness of its liquidity risk management framework and liquidity position." This statement is in itself unexceptional. In expanding on this, however, the Committee states that each bank should, "[a]s part of its periodic financial disclosure . . . provide quantitative information about its liquidity risk management framework . . . ," giving as examples "the size and composition of the bank's liquidity cushion, as well as the values of key metrics that management monitors . . . and limits placed on the value of those metrics."[4]

The Clearing House believes that these specific quantitative measures may be misleading. If the Committee's goal is for each bank to publish a few simple statistics about the size of its liquidity cushion and the metrics it relies on so that market participants will be able to compare liquidity-risk position with those of its peers, we do not believe that such a goal is achievable.

As the Committee recognizes, each bank has a liquidity-risk profile based on the particularities of its own business, and each bank has developed a unique set of policies and procedures to measure, manage, and control those risks and deal with any contingencies that may arise. Reports of quantitative data that the Committee appears to contemplate will therefore be unlikely to provide other market participants with meaningful information without extensive analysis and explanations to provide the context that will be necessary to properly understand the quantitative data. Such an analysis could run to dozens of pages, defeating any attempt at simple comparisons, which, as noted, would in any case be meaningless.

We urge the Committee to adopt the position set out in the IIF report,[5] and not require mandatory quantitative disclosures.

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4 Principles ¶ 128 at 30.

5 "Mandatory quantitative disclosure would not be meaningful or comparable across firms given that firms' liquidity practices vary significantly, as do their internal and external environments." IIF Report at 25.

Other Issues.

Liquidity Cushion. The Principles discuss extensively the issue of the liquidity cushion that banks ought to maintain. Nevertheless, we believe that these sections could be strengthened by adding language to encourage central banks to expand the kinds of collateral that they will accept at their discount windows, harmonize these collateral requirements across jurisdictions, and remove barriers to the free transfers of collateral. As more banks operate globally and in a variety of currencies, it is important that they have access to sources of liquidity in all markets and currencies in which they operate. Harmonization of collateral requirements, the expansion of eligible collateral, and the ability of banks to move collateral to where they need it will significantly aid banks in establishing necessary liquidity cushions.

We believe that the Principles should explicitly state that liquidity cushions should be developed during benign market conditions. Banks should develop liquidity sources when they are not needed, rather than searching for untapped sources when the markets are stressed.

Contingency Funding Plan. Principle 11 states that each bank needs to have "a formal contingency funding plan (CPF) that clearly sets out strategies for addressing liquidity shortfalls in emergency situations," and the discussion of this point states that "[t]o facilitate the timely response needed to manage disruptions, the plan should set out a clear decision-making process on what actions to take at what time, who can take them, and what issues need to be escalated to more senior levels at the bank."[6]

Although we agree with designating clear roles in decision making related to liquidity disruptions and identifying a range of alternatives through the liquidity planning process, we disagree with any suggestion that there can be prescriptive actions designated ahead of a crisis. A response will need to be tailor made based on the facts and circumstances existing at the time of the disruption.

Role of Supervisors. Here we wish to make two points: First, as a general matter, we believe that there is a strong need for more consistent regulation of liquidity across the globe, and we believe that supervisors should work toward the adoption of consistent regulations along the lines of the Principles. In this regard, and as we noted earlier, we believe that it is important to harmonize collateral requirements for discount-window advances.

Second, Principle 16 states that supervisors should intervene to require remedial action by a bank that shows certain weaknesses or excessive liquidity risk, including requiring higher capital levels. The Committee notes, that "[a]lthough capital is not itself a solution for inadequate liquidity or a long-term solution to ineffective risk management processes, a bank's capital position can affect its ability to obtain liquidity . . . ."[7] We believe that the Committee needs to emphasize that capital levels should not be associated with liquidity risk. Although a

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[6] Principles ¶ 113 at 27.
[7] Principles ¶ 140 at 33.

bank's capital position may help its liquidity position through the confidence of knowing that there is a strong financial position, capital itself is not a substitute for adequate liquidity.

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We hope these comments are useful. If you have any questions about this comment letter, please contact Joseph R. Alexander, Senior Counsel, at joe.alexander@theclearinghouse.org or 212-612-9234.

Very truly yours,

cc: Board of Governors of the Federal Reserve System
Office of Comptroller of the Currency