CREDIT SUISSE

Credit Suisse responses to BCBS Paper Principles for Sound Liquidity Risk Management and Supervision. June 2008 Draft for consultation

General Remarks

We appreciate and support the proposals made to achieve a more harmonized and coordinated framework within the Supervisory area globally.

While we recognise the need for the regulation of liquidity we are concerned with the heterogeneity of regulatory approaches of individual countries. A concerted approach by regulators to establish a supervisory framework is fundamental to efficient liquidity risk management and international capital markets.

Of utmost importance is a clear co-ordination and cooperation between Home and Host regulator to avoid inefficiencies, duplications or areas that do not receive adequate supervisory attention.

We expect reduced regulatory duplication, a reduction of trapped pockets of liquidity in cross-border funding. We fully support the proportional approach to supervision allowing for recognition of internal methodologies on a case-by-case basis and calling for an international framework to coordinate supervisory requirements and actions.

We support the work that is being undertaken by CEBS, through its June 2008 draft paper which sets common standards for liquidity risk management and how these should be applied in Europe to prevent future liquidity shortfalls at individual institutions potentially resulting in industry wide systemic shocks.

Specific Recommendations and Points

Point 11 – Senior Management responsibility - last sentence
Processes and controls which are vital apart from effective systems should be included. We would therefore enhance the last sentence as follows.
(…) senior management and appropriate personnel have the necessary expertise, **processes** and systems to measure**, control** and monitor all sources of liquidity risk.

Point 12 – Liquidity strategy
Due to the importance of country risk it would be worthwhile mentioning country risk in addition to jurisdictions in which a bank operates.

Point 16 – Independent internal controls
In order to ensure that personnel in independent control functions have the skills and authority to challenge information and modelling assumptions we would recommend that in large banks there be an independent committee comprised of senior risk functions covering liquidity risk, market risk and credit risk. This would ensure professionalism, consistency and continuity of risk measurement methodologies applied.

Commercially sensitive and not to be considered available under Freedom of Information Act.

Principle 4 – Incorporation of liquidity costs – Funds Transfer Pricing
We recommend defining this process as an important element of banks' funds transfer pricing (FTP) as typically also used to transfer interest rate risk from and allocate the cost of capital to the businesses.
For the avoidance of doubt liquidity costs, benefits and risks should be incorporated in the **internal** product pricing. Whether or not a bank can or is willing to adjust external product pricing (i.e. vs. its customers) depends on the competitive environment, the integration of client relationship vs. product management and organizational aspects.

Point 30 – Contingent cash flows
We recommend not just looking at individual credit worthiness of the counterparty but also looking at the aggregate exposures to major business lines as a number of counterparties operating in the same businesses could be affected in some stress scenarios.

Point 43 – Liquidity back-stop facilities
We assume that back-stop facilities are not suitable for large banks namely due to the potential stigma if they are used. Hence, the recommendation should be made to smaller banks only. We note that the FSA is currently consulting on the possibility of entities in receipt of such funding being allowed to delay disclosure to the markets. In such circumstances back-stop facilities may become more suitable for larger banks.

Point 49 – Limits across lines of business and legal entities
The application of limits across lines of business and legal entities within the bank should be done where appropriate only. As an example we view it important to apply limits for legal entities where funding constraints may be imposed by the host regulator or significant country risk is anticipated. A reason for implementing limits across businesses may be to control the overall liquidity risk exposure in addition to the FTP framework. We recognise that the implementation of such limits strongly depends on the nature of the business and organization of the bank.

Point 59 – Cross-entity funding limits
This point sounds counter-intuitive to banks with a centralized funding and liquidity management framework where the primary driver is the overall size of the risk and the ability to move liquidity within the bank.
An implicit limitation could be the measure of trapped liquidity at entity level whereby the intercompany support of moving liquidity within the bank could be limited.

Point 63 – Funding diversification and funding plan
The funding plan should also consider capacity constraints to ensure further diversification. The funding plan should also be tested with regards to appropriate tenors to make the liquidity position resilient to a sudden loss of funding capacity.

Point 74 – Asset securitisation
Another efficient mitigating possibility is to reduce or stop the asset origination activity if the re-distribution channels are not working anymore as planned.

Point 78 – Intraday liquidity management – Information from key customers/banks
In our view the last recommendation to ask key customers including customer banks to forecast their (intraday) liquidity flows is not realistic. As such information from customers is not legally binding and can be reserved at any time by them it might lead to wrong decisions at the bank and ultimately additional costs or missed opportunities. Where customer banks are involved it is their own responsibility to manage liquidity in a way not putting unnecessary

Commercially sensitive and not to be considered available under Freedom of Information Act.

stress to the clearing/custodian bank. Key customers with occasional need for very high value timed payments (outgoing and incoming) should be educated about the impact of such payments on the intraday liquidity situation at the bank and the underlying payment system and specific arrangements with such customers should be established.
The clearing banks should be able to immediately respond to unusual intraday-balances and contact the customers without delay.

Point 85 – Reliance on correspondents
The recommendation to have alternative arrangements in place in the event that a correspondent or custodian suffers disruptions is from an operational process view almost impossible to arrange. In practice this would mean that in each market either a second provider (correspondent or custodian) would be needed to step in on very short notice or on a permanent basis positions and transactions would be split among two selected providers per market. Instead, banks acting as correspondents or custodians should be forced to have adequate BCP and alternative processing arrangements in place at all times. Such arrangements and back-up procedures should be assessed regularly by independent bodies and if possible certified publicly.

Principle 9 – Collateral management
This principle states that the bank should also monitor the physical location where collateral is held. This is often not possible as banks often use custodians (such as Euroclear, Clearstream, etc.) who in turn use sub-custodians. Points 86 to 91 detailing this principle do not further clarify the need and benefit for the monitoring of physical location apart from the implications of timely mobilisation of the collateral.

Point 101 – Stress testing assumptions
We would also include assumptions about market shocks that can impact liquidity via reduced asset prices, FX cash flow impact etc.

Principle 17 – Supervisor communication and cooperation
In addition to cooperation this principle should also include **co-ordination** between Regulators and other supervisory stakeholders.
Implicitly this is addressed in point 143 but it is important to explain the benefits of good co-ordination between regulators, namely between home and host regulators. For large internationally operating banks it is important that reporting duties are not unnecessarily duplicated by requesting different formats and scope of information. A close co-ordination between regulators and exchange of information can help to keep the reporting efficiently and consistent. Information requested by a host regulator should also be made available to the home regulator.

Commercially sensitive and not to be considered available under Freedom of Information Act.