

Basel Committee on Banking
Supervision
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Finance Norway (FNO) was established in 2010 by the Norwegian Savings Banks Association and the Norwegian Financial Services Association and represents some 180 financial institutions operating in the Norwegian market.

Finance Norway's response to the Basel Committee's consultation on International Framework for Liquidity Risk Measurement, Standards and Monitoring

FNO welcomes the opportunity to comment the consultative document of December 2009 on International framework for liquidity risk measurement, standards and monitoring.

The recent financial crisis has documented the need to improve liquidity risk management and regulatory liquidity risk standards. FNO supports the introduction of a quantitative standard as a supplement to the existing qualitative approach; consisting of a short term ratio that focuses on the adequacy of a financial institution's liquidity buffer and a long term ratio that focuses on the structure of its funding.

However, we caution the Committee against the introduction of an overly tight and prescriptive one-size-fits-all framework which do not take account of institutional-, market- or country specific conditions. We are deeply concerned by the proposed calibration and definitions, which we find far too conservative based on national experience, and the likely negative consequences for the traditional relationship driven banking model. Moreover we fear that the proposal will have a negative impact both on the financial system and the broader economy.

FNO back the responses from ESBG and EBF. Our feedback focuses on the key issues for Norwegian banks.

1. Composition of the liquidity buffer

Extraordinary fiscal stimulus has led to large amounts of outstanding government debt in many countries. That is not the case in Norway. In Norway the government bond market is small due to the fact that the government runs a budget surplus and has a net public wealth of 140% of GDP. The main reason for the government to nevertheless issue a limited amount of government bonds is to maintain a risk free yield curve in Norway.

On the demand side, we have witnessed an increasing demand for Norwegian government bonds from foreign investors whom now hold about 64 percent of total outstanding volume. Life insurance companies and pension funds own about 20 per cent. A considerable part of issued government debt is thus held by long term investors which lead to reduced liquidity in the securities.

The proposed narrow definition of what is being considered as liquid assets implies that the demand for the limited number of Norwegian government bonds will increase even more. As a result large parts of these bonds will be stuck in the balance sheet of banks due to regulatory herd behaviour. The liquidity will be reduced even further or even "locked in", and with possible adverse price movements as a consequence. Clearly there is also a danger that selling of government bonds, in such a regime, will be perceived as an indication of a liquidity problem in the selling bank. We therefore urge the Committee to expand the definition to include assets that historically have been liquid even in periods of stress subject to appropriate haircuts.

According to the proposal, "high quality liquid assets" must both be traded in an "active and sizable" market and be central bank eligible. This combination of requirements will unnecessarily limit the range of LCR-eligible assets. Central banks generally demand high quality assets as collateral for lending, and set their requirements based on a judgement of the relevant assets available in both domestic and international markets. We believe the proposal will represent competitive disadvantages for institutions located in the smaller non-euro markets because these markets are generally less "active and sizable". "And" should therefore be replaced with "or".

We fully agree that the central banks should not be considered as lenders of first resort. However, there are market differences that have to be taken into consideration. As for Norway, the money market has for the last 20-25 years been highly dependent on the central bank's lending facilities. This reflects the government's choice to hold its liquidity

with the central bank. Macro liquidity in Norway fluctuates significantly on a daily basis and withdrawn liquidity (taxes etc.) from the money market has to be sterilized by either a reduction in central bank reserves or with borrowing from the central bank. This has resulted in structural central bank lending over longer periods of time. Therefore, borrowing in the central bank can not automatically be regarded as unfortunate behaviour from banks, as it can be a result of public choices/decisions, and reserves in the central banks should be considered as highly liquid, regardless of being in the form of deposits or available credit lines.

Central banks, for their part, should be urged to make their criteria for lending clear and disclosed, to avoid uncertainty of possible withdrawal in times of stress.

2. Treatment of deposits/Net Stable Funding Ratio (NSFR)

In Norway deposits have proved to be a very stable source of funding even in periods of stress. The proposed significant haircuts in deposits do not correspond with Norwegian experience neither from the financial crises in 2008 nor the banking crises in the early 1990's.

Norway is dominated by traditional relationship driven banking models with a large SME sector not able to approach the bond market themselves. A part of the picture is also that time deposits only account for a minor part of the overall deposit structure. Our experience is that in periods of stress depositors, who typically also are borrowers, will act cautiously and not move deposits out of the bank. We caution against being overly prescriptive in setting behavioural overlays that should apply to outflows and inflows given the difficulty in defining stable vs non-stable sources of funding. We also believe that a key explanation can be found in the existence of a well funded deposit insurance scheme with a high coverage. The choice of correct hair cut will inter alia depend on the government measures chosen in each individual country. For example, in Norway the government decided not to, contrary to some other countries, grant state guarantees for deposits during the recent financial crises. Still we did not experience outflows of any significance from well established banks. FNO ask the Committee to give national supervisors flexibility in making adjustments to haircuts to take account of country specific conditions.

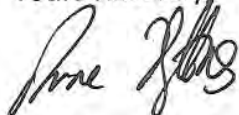
FNO also believe that banks should be given the possibility to tailor the assumptions to their particular circumstances and experience. This will be in line with the principles behind the Basel II framework which encourage banks to improve risk measurement and management based on their specific business model and experience. This will also reduce the risk of regulatory failure due to herd behaviour.

Moreover FNO believe that the 100 per cent floor on the NSFR will weaken supervised banks in the role of maturity transformation – a task that is of vital importance to the economy – and is a bank's core business. As a result, the role of banks would merely be limited to distribute liquidity. It would be a paradox if this regulation in consequence will introduce new unregulated players to take the role of maturity transformation.

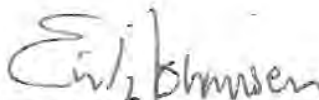
The proposal will also have a negative impact on banks capacity to lend, and thus the economy as a whole, because the funding used to meet the ratios can not be used for lending to consumers and businesses. This comes at a time when banks lending capacity is already hit by market and regulatory requirements for increased capital ratios.

Finance Norway believes that the proposal should be reconsidered in light of the negative consequences it will have on the banking industry and the economy as a whole. We thus welcome the statement made in the document that the final calibration of the factors of the outflows and inflows as well as the composition of the stock of liquid assets will be determined with a view to minimising the negative impact on the financial system and the broader economy.

Yours sincerely,



Arne Hyttnes
Managing director



Erik Johansen
Director