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Appendix 1

BCBS 165- Consultative Document

International Framework for liquidity risk measurement, standards and monitoring – December 2009

(References are made to the relevant paragraphs of the CD where applicable.)

Liquidity Coverage Ratio (LCR)

1. Para 21 - It is unclear from the proposal whether a bank can utilise the liquid assets within the buffer during a period of either idiosyncratic or market-wide liquidity stress. The requirement to maintain the LCR of at least a 100% at all times suggests a bank cannot utilise the liquid assets contained in the buffer to meet cash outflow obligations during a time of stress, which is clearly at odds with the purpose of maintaining the liquid asset buffer.

2. Para 26, footnote 5 – The CD includes assets that are "held as a hedge for any other exposure" as encumbered assets. We do not believe assets that are used as a hedge should necessarily be considered to be "encumbered". Contractually, a bank may still be able to use assets that serve as a hedge to generate liquidity, the restriction in footnote 5 should therefore be removed.

3. Para 34 and 58 – We feel the definition of securities qualifying as liquid assets should be expanded. While we agree that a conservative stance is warranted, we nevertheless feel that additional asset classes demonstrate sufficient liquidity characteristics to justify including them as "liquid". Consideration should therefore be given to: securities issued by supra-nationals, high quality covered bonds and corporate debt, mortgage backed securities issued by government-sponsored entities and certain privately issued securities. Appropriate haircuts and concentration caps should be applied.

   Consideration should also be given to including equities, again after applying appropriate haircuts, which are listed on recognised exchange markets and which display the relevant characteristics of a high quality liquid asset (for example, high trading volumes and market depth).

   Widening the scope of the liquid asset definition will also ensure there is sufficient portfolio diversification which would lead to lower concentration risks.

4. Para 34 – We suggest that certain precious metals, such as gold and silver, be given a liquidity value in the definition of "liquid assets". While a conservative haircut should be applied, for example 25 percent, it is unreasonable to ascribe zero liquidity value to all precious metals positions for LCR purposes.

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5. Para 34 (c) (iii) – We concur that bank securities should be excluded from liquid assets, however, we believe that government guaranteed bank issued securities should be included.

6. Para 36 and 37 – As mentioned above, we are supportive of the inclusion of high quality corporate bonds as liquid assets where a deep and liquid market exists. However, we believe the requirements set out in the last two bullet points at paragraphs 36 and 37 are very onerous, too restrictive and impractical to apply - especially the requirement to observe bid-ask yield spreads and market value movements over a 10 year time period. While bid-ask yield spreads and valuation movements may be indicative of the quality and liquidity value of a security, we feel observations over a 2 year time horizon is much more reasonable.

7. Para 41–77 - In general, the proposed stress assumptions reflect what would be a very severe scenario for all asset, liability and contingent liability types occurring simultaneously. We feel this is unrealistic and will have overly penal consequences for the liquidity positions of many banks.

8. Para 41 – We agree with the BCBS's initiative to differentiate between stable ("core") and unstable ("non-core") deposits. It would also be useful for banks to understand how the BCBS determines that customers with transactional accounts or other accounts/services held with the bank would lead to a lower deposit run-off rate.

9. Banks already have defined internal policies for customer segmentation. Furthermore these banks have already developed, or should be required to develop, internal behavioural assumptions for these existing segmentations based on such things as the peculiarities of their customer base, their market-place and their product mix. The segmentation policies and applicable behavioural assumptions would of course need to be justifiable to the supervisors. Internal assumptions would serve the industry better than a one-size-fits-all framework.

10. Para 55 – The treatment of funds received from financial institution customers with whom a bank has operational relationships is unclear. The majority of funds received for Custodian and Corporate Trust Services come from what would be classed as "financial institution" customers, and would therefore appear to be subject to a 100 percent outflow assumption per paragraph 55. We believe a 100 percent outflow factor for operational activities of financial institution customers is not appropriate – on average, a run-off factor of 50 percent is closer to our internal assumptions.

    Such customers would generally only have the ability to withdraw funds from Corporate Trust services following a credit rating downgrade. There is considerable lead time needed to move the service to another institution due to a number of factors such as negotiation, legal agreement drafting, account set up and transfer of monies.

Custody funds are held for purposes of FX settlements, to provide liquidity to prime the securities settlement cycle (ie. working capital), and for cash on deposit until asset allocation decisions are completed. Although we would expect a certain level of run-off over a one month period, it would be unlikely that the entire portfolio balance would be withdrawn.

11. Para 58 – To the extent the BCBS agrees to a widening in the definition of liquid assets, and providing the bank has the ability to transact, those assets should be allowed for secured funding purposes.

12. Para 66 (c) – The assumption that 100 percent of committed liquidity facilities provided to non-financial corporate customers will be drawn within a 30 day time frame is too aggressive and is materially at odds with experiences of the industry in the last 2-3 years. We would urge the BCBS to reconsider this severe assumption and propose a draw down assumption of 33 percent to be more appropriate.

13. Para 73 – The description for contractual cash flow receipts from retail counterparties does not clearly identify the treatment for revolving loan facilities such as overdrafts and credit cards. We presume that in a stressed environment no cash inflows would be appropriate, but we suggest this should be articulated. Also, the term 'fully performing' we assume refers to the performance compared with current agreed terms rather than originally contracted terms.

14. Para 76 - We believe it is reasonable for a bank to assume it will be able to draw down on a committed liquidity facility provided by an affiliated banking entity, as long as the group and the relevant regulators are satisfied that the provider of the facility is forced to hold sufficient liquid funds to honour its obligations. In these circumstances, the recipient should be able to assume full draw down.

    Furthermore, in the absence of such provision, paras 66(d) and 76 lead to an asymmetric treatment of committed liquidity facilities between entities within the same banking group. Assuming that fellow group counterparties will behave in the same manner as third parties is unreasonable, affords no recognition to the strength of a banking group's existing internal liquidity risk management framework and does not allow for the efficient use of liquidity across a large banking organisation.

Net Stable Funding Ratio (NSFR)

15. Para 89, table 2 - We encourage the introduction of a 'Tier 2' liquid asset concept for those assets which contribute to liquidity after the initial 30 day period of the LCR and which should therefore be reflected in the numerator for NSFR purposes. The inclusion of a definition for 'Tier 2' liquid assets will allow recognition that some assets can still easily be liquidated over a time horizon of between 1 and 12 months and hence should be reported as an inflow in those periods. Again, appropriate haircuts should be applied.

16. Para 89, table 2 – We believe the haircut for Gold is too conservative and suggest that a haircut of 25 percent is more reasonable. We also feel other precious metals should be considered as having some liquidity value.

17. Para 89, table 2 – Weighting “all other assets” at 100 percent but fully excluding “all other liabilities” is unreasonable and may unfairly penalise some banking entities. We recommend that the guidelines allow scope for regulators to form a better understanding of the components of “other assets” and “other liabilities” before concluding whether or not such a binary approach is justified. For example, requiring 100 percent funding for positive mark-to-market valuations of derivative portfolios but giving no funding credit at all for negative mark-to-market valuations of derivative portfolios is too conservative and we suggest that a more balanced approach is warranted.

Scope and Application

18. There are significant inconsistencies in regulatory liquidity reporting requirements across the international arena and we urge the committee to continue advocating and working towards a harmonised and consistent reporting framework. We understand there will be instances where a certain market may require supplementary information reported due to regulatory, accounting or operational nuances, and in such instances, this should be an exception rather than the norm.

19. Para 133 - The aim of the proposed standards is to introduce a consistent supervisory approach to liquidity risk frameworks at banking organisations, including cross-border institutions. This paragraph seems to indicate that “the proposed standards….should be applied to all internationally active banks …”. The scope should be more clearly articulated. For example, if banking institutions operating only in domestic markets are to be excluded, then internationally active banks may be put at a competitive disadvantage unless similarly stringent requirements are also applied to these domestic banks. Another important consideration is the differentiation between systemically risky institutions versus those that are comparatively smaller or present less risk to the local/international economy.

20. Para 133 - The proposal to apply the metrics to all internationally active banks “on a consolidated basis” seems to ignore possible restrictions on the transferability of liquidity across a group. In reality there could be many constraints on the transferability of liquidity across a large group; for example, regulatory restrictions, tax constraints and currency issues. Consolidated measures will mask these restrictions and could create a false sense of comfort for any underlying entities that may have weak liquidity positions. We support the concept of the LCR and NSFR measures but suggest they should be calculated at the legal entity level in the first instance. We also believe this legal entity level approach reflects best practice for the management of liquidity risk.

21. Para 135 - Disclosing “one size fits all” liquidity metrics which follow a very prescriptive format raises the serious risk of misinterpretation of a banks true

liquidity position. Standard metrics will also undoubtedly lead to comparisons between banks which may not be justified. Banks should be encouraged, even required, to disclose quantified measures that best reflect their liquidity positions but the disclosure of the LCR and NSFR (at least as set out in the CD and without giving a bank the ability to use internal behaviour assumptions) should not be required and may have dangerous, but unfounded, consequences for the industry. This would also allow a bank to temporarily dip below 100 percent for valid liquidity reasons, assuming it did so with the full blessing of its regulator, without causing undue alarm.

22. While we support the BCBS's initiative to assess the impact of introducing the liquidity standards on banking institutions, the unintended consequences on the macro-economic environment, combined with the tougher capital standards and local regulatory reforms, is likely to be significant. This compounding effect should be considered further and approximately quantified if possible. This effect will be felt well beyond the banking industry itself. High quality corporate customers may find it increasingly difficult to issue debt in future if no liquidity value is given to their paper. Any increase in liquidity costs incurred by banks will be largely passed onto the borrower in the form of increased credit costs.