The Singapore Foreign Exchange Market Committee

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Secretariat
Basel Committee on Banking Supervision
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CH-4002 Basel, Switzerland

Comments on International Framework for Liquidity Risk Measurement, Standards and Monitoring

The Basel Committee on Banking Supervision (BCBS) issued a consultative document on the liquidity framework on 17 Dec 2009. Two measures of liquidity risk exposure were introduced i.e. Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR), with the intent to be adopted as standards for internationally active banking organisations. The Singapore Foreign Exchange Markets Committee (SFEMC) has sought the banking industry's feedback on the proposed liquidity framework, which is set out in this document.

2 Singapore is one of the leading global banking and financial services centres with a strong presence of regional and global headquarters of over 100 international banks. The SFEMC comprises senior representatives of local and foreign banks operating in Singapore and welcomes this opportunity to provide feedback. Our feedback takes into account the BCBS' other proposals on capital and risk management in the "Strengthening the resilience of the banking sector" consultative document.

3 Our overall assessment is that the proposed liquidity framework relies heavily on one-size-fits-all assumptions that do not give sufficient consideration to factors such as central bank facilities. These assumptions could lead to outcomes that have far reaching consequences for financial stability, such as vis-a-vis unregulated financial intermediaries. The concern is that a uniform blanket rule could lead to distortionary behaviour by banks in different jurisdictions. We consider that in well-regulated jurisdictions, such as Singapore, incentivising deposit-taking could lead to unhealthy competition for deposits and market share – which could result in even higher risks as a result. Moreover, we expect the interactions between the liquidity framework and other proposed measures abovementioned to compound the impact on banks. To strengthen banks' resilience, we would propose that refinements be made to the existing Basel II capital framework, and for liquidity requirements to be supervised by regulators that can take into account the domestic environment. Notwithstanding, we have provided feedback below on specific standards under the proposed liquidity framework.

a. **Availability of Government Bonds**. The proposed liquidity framework presumes that there is a correlation between the size of the banking sector and the size of the government bond market. This is not so: well-rated governments like Singapore run balanced budgets and do not rely on debt to fund deficits. By limiting liquid assets to government bonds, the proposed framework unfairly penalises austere governments and appears to support deficit governments' debt-raising effort. Additionally, adopting such tight criteria for liquid assets could result in an unhealthy squeeze in government bond markets and concentration risk in bank portfolios of government bonds. This could have negative consequences for liquidity in government bond markets and for financial stability. In recognition of these risks, we propose to adjust the criteria to allow banks to hold high-quality and liquid non-government bonds, subject to central bank eligibility (see below).

b. **Central Banks as Ultimate Providers of Local Currency Liquidity**. We recognise the Basel Committee's concern that even active repo markets could cease to function under market stresses. On these occasions, only the central bank's liquidity window can be relied upon with any certainty by banks. The proposed liquidity framework ought to give greater recognition to the role of central banks as ultimate providers of liquidity under all market conditions. We propose that, in addition to the existence of active repo markets, any asset that is accepted as eligible collateral at the central bank's discount window should be eligible as a liquid asset. Additionally, the valuation of the assets should be based on the amount of liquidity that the bank can obtain for the asset from the central bank. In other words, the discount factors should be varied to be based on the respective central banks' stipulated haircuts for acceptable collateral.

c. **Central Banks as Alternative Providers of Foreign Currency Liquidity**. In addition to local currency liquidity, several central banks also provided foreign currency liquidity during the recent crisis. This was intended to stabilise foreign currency money markets operating in their jurisdictions, so as to avoid spill-over effects into local money markets. Central banks can provide foreign currency liquidity either from their own reserves or through fx swap arrangements with home central banks of the foreign currency (i.e. Federal Reserve for US dollars, European Central Bank for Euros, etc.). Given the high quality of central bank liquidity, we propose that the liquidity framework take into account such facilities by allowing the Liquidity Coverage Ratio (LCR) to be calculated on an aggregate basis (across applicable currencies) of the jurisdiction for banks where such foreign currency liquidity facilities are available.

d. **One-Size-Fits-All Assumptions for Run-Off Factors**. The proposed liquidity framework prescribes one-size-fits-all run-off factors for deposits and liquidity/credit facilities to be used by all banks. This ignores differences in local environments and customer characteristics that would result in different behavioural profiles for deposits and facilities. This could result in unhealthy competition for retail deposits, which could distort bank behaviour by

inadvertently encouraging them to take even more risk on the asset side. We propose that the run-off factors take into account historical behavioural profiles, subject to review by the host regulator.

e. **Central Counterparties**. Given the global move toward Central Counterparty (CCP) clearing, the criteria for OTC derivatives (viz. run-off factors) should take into account the availability of collateralized positions with the CCP. This would be consistent with the capital relief given for CCPs. Correspondingly, the run-off factors for OTC derivatives should be in accordance with the respective CCPs' guidelines for collateral management of the derivatives.

f. **Fundamental Strength of Jurisdiction**. Lastly, the proposed liquidity framework does not differentiate according to the strength and resilience of different banking systems. A banking system supported by a prudential regulator and operating in a jurisdiction with a stronger fiscal and balance of payments position and credit standing is fundamentally more stable in a crisis. This is consistent with the reality that market confidence in banking systems varies depending on the strength of the governments that back the respective banking systems. To be consistent with the credit rating differentiation for liquid assets, we propose that the run-off factors and availability funding factors be differentiated by the credit ratings of the respective sovereigns in which the banks operate.

4 In conclusion, we hope the BCBS would consider our recommendations above to enhance the liquidity framework to allow for incorporation of jurisdiction-specific realities and market safeguards (such as central bank facilities) that would reasonably remain functional under all market conditions. Given the far-reaching impact of the framework on banks' liquidity management, the implementation of the framework should be carried out in phases to allow sufficient time for banks to adjust and adapt to the framework.

Yours sincerely

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