BNY MELLON

September 21, 2012

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Monitoring indicators for intraday liquidity management

Ladies and Gentlemen:

The Bank of New York Mellon Corporation ("**BNY Mellon**") is pleased to have the opportunity to comment on the Basel Committee on Banking Supervision's (the "**Basel Committee**" or the "**Committee**") July 2, 2012 consultative document, *Monitoring indicators for intraday liquidity management* (the "**Consultative Document**"). BNY Mellon supports the intraday liquidity management principles embodied in the Consultative Document and its fundamental precept that banks should actively manage intraday liquidity positions and risks to meet payment and settlement obligations under normal and stressed conditions. We already do just that for U.S. dollar ("**USD**") clearing mechanisms. BNY Mellon monitors and measures our intraday liquidity flows according to many of the proposed new requirements, as well as those the Committee set forth in its 2008 *Principles for Sound Liquidity Risk Management*.[1]

Our significant payment, clearing and settlement activities provide a unique window into inter-bank payment flows and the potentially material impacts of disruptions within and between payments systems. While we believe there is much merit in the Consultative Document's general framework, we also believe that certain components require a fundamental reevaluation. In several key areas the proposal diverges from industry best practices and may lead to unintended negative consequences. Likewise, it is unclear that the proposed indicators are the best or most accurate measurements of salient liquidity flows, intraday liquidity risk, or the interconnectivity between global financial institutions.

Executive Summary

BNY Mellon believes that any intraday liquidity monitoring framework, when finalized, should reflect a balanced approach: providing supervisors with transparent data concerning

[1] Basel Committee, *Principles for Sound Liquidity Risk Management* (September 2008).

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intraday liquidity, while also accurately measuring payment flows and, to the extent possible, avoiding unnecessary, duplicative and burdensome requirements that may impede payment and settlement operations.

The Consultative Document requires refinement in two principal areas. First, while the Committee's proposal would apply all of the indicators to the broad cohort of all internationally active banks, BNY Mellon believes that a quantitative materiality threshold should be adopted as part of the final framework. The indicator-based monitoring and measuring requirements should only be applied to banks processing 5% or more of transaction values within an individual currency or market. The desire of supervisors to review and analyze data across geographies, payment systems and currencies is understandable; however, this goal should be balanced against the operational burdens that would be placed on firms that are minor participants in most payment systems. Nevertheless, should supervisors believe it necessary to require granular data reporting across payment systems participants; we would remind the Committee that banks will be most able to provide useful and meaningful data if given sufficient time to build and develop the necessary monitoring and reporting systems.

Second, it is possible that implementing the indicator-based framework as proposed will increase, rather than decrease, idiosyncratic operational risks and broader systemic risk. As the Committee itself notes in paragraph 5 of Annex 3, the framework may unintentionally promote bank behavior that could be destabilizing: delaying payments to improve measurements could create payment systems gridlock and difficult to manage bottlenecks.

Beyond these primary concerns, BNY Mellon believes the Consultative Document:

- Relies on inexact indicators;

- Creates a monitoring system without any acknowledgment of existing bank governance and control processes; and

- May lead to inappropriate disclosures of confidential information;

Apart from these specific technical flaws with the Consultative Document's approach, we are unsure how the Basel Committee and domestic supervisors intend to use the data. Without greater specificity around what risks and data problems the reporting requirements are attempting to remediate – and which remedies are under consideration – it is difficult to determine how helpful the data will be to supervisors. BNY Mellon strongly believes that further clarity around supervisory objectives is needed, especially in light of the complex and intensive reporting that may be required.

This commentary is divided into four parts. Part I provides a brief overview of BNY Mellon's payment operations and intraday liquidity practices. Part II addresses the scope of the Consultative Document's applicability. Part III focuses on potential negative unintended consequences. Part IV provides our specific feedback on certain indicators and related data concerns. Where appropriate, feedback on implementation challenges and policy recommendations are provided.

Part I: BNY Mellon is a leading participant in payment systems and already manages intraday liquidity in accordance with industry best practices.

BNY Mellon provides a comprehensive array of essential payment and clearing services that enable institutions and individuals to manage and service their financial assets in more than one hundred markets worldwide. These services enhance transparency, facilitate liquidity, improve risk management and increase operational efficiency. As a global leader in asset servicing, investment and wealth management, issuer services, broker-dealer and advisory services, and global payment processing services, BNY Mellon is active in several market segments that necessitate sound to intraday liquidity management.

BNY Mellon is the world's largest custodian and asset servicer with $27.1 trillion in assets under custody and administration and the most significant corporate trust provider, administering $11.5 trillion in outstanding debt from 61 locations in 20 countries around the globe. We are also a global leader in securities clearance and collateral management administering over $1.8 trillion in tri-party repurchase balances daily and providing services to 17 of the 21 primary dealers of U.S. government securities. Finally, we are a top-five participant in both the Clearing House Interbank Payments System ("**CHIPS**") and overall funds transfer markets, processing more than $1.4 trillion in payments transactions daily.

Our roles in these global market segments are supported by an infrastructure of direct and indirect clearing relationships in more than one hundred currencies. We actively manage our own intraday liquidity to ensure steady payment flows and constantly review the operational needs of our clients, considering specific counterparty credit worthiness. BNY Mellon has also developed formal review and escalation processes to manage intraday liquidity peaks, market stress and specific counterparty stress.[2]

Part II: The Consultative Document is overly broad in its application and should be narrowed to focus on critical payment and liquidity activity.

It is axiomatic that proper intraday liquidity management by banks is necessary to ensure constant payment flows and to manage systemic risk. But the ambitious approach the Committee has taken requires refinement and refocusing. Many global banking organizations, including BNY Mellon, process varying volumes of transactions across legal entity structures and markets. Not every component of our direct and indirect participation in payment systems is important, but the Consultative Document does not distinguish between activities that are relevant to intraday liquidity monitoring and systemic risk and those that are not.

We commend the Committee for acknowledging the need for local supervisor flexibility in Paragraph 58, but believe that providing a bright-line standard would increase clarity for reporting banks. Establishing a threshold that triggers the reporting requirements would permit supervisors to receive the most useful intraday liquidity data, while reducing burdens associated with building monitoring systems to capture data regarding *de minimis* intraday liquidity and

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[2] BNY Mellon's intraday liquidity management practices are discussed in greater detail in Part IV.

payments activity. BNY Mellon believes that banks processing 5% or more of transaction values within an individual currency or market should provide reports to the appropriate home or host country supervisor.[3] Absent a materiality standard, many banks will be forced to expend resources to developing unnecessary MIS enhancements.

In our USD operations, BNY Mellon already measures and collects much of the data contemplated in the Consultative Document. Some of this information is shared with the Federal Reserve on a daily basis. The current intraday liquidity monitoring paradigm is symbiotic: we report data to the Federal Reserve Bank of New York ("**FRBNY**") in fifteen minute intervals and the FRBNY – like all reserve banks – provides minute-by-minute data to BNY Mellon through the Daylight Overdraft Reporting and Pricing System ("**DORPS**").[4]

BNY Mellon believes that in most markets, central banks and payment systems operators may already collect the intraday liquidity data that the Committee is seeking. It may be more practical for the Committee to leverage the significant data archives of central banks and operators or to encourage those entities to augment their existing reporting infrastructures to capture relevant data. For instance, it is likely that the Trans-European Automated Real-time Gross Express Transfer system and the Federal Reserve's Intraday Position Report already include – or could capture – the granular intraday liquidity data the Committee is seeking. As a fundamental matter, any finalized framework should begin by using existing reporting structures, rather than creating new and potentially duplicative ones.

Should the Committee believe that intraday liquidity reporting will only be useful if all data emanates from banks, BNY Mellon recommends that the rigid reporting framework be replaced with a principles-based approach. Individual supervisors are best positioned to determine what intraday liquidity risk data and which banks are most relevant to their work. Since the financial crisis of 2008-09, supervisors have used bilateral supervisory processes to evaluate the liquidity risk management of firms, with new, more quantitative standards being proposed to regulate post-day one liquidity risk. Currently, regulators are using more flexible methods to oversee the intraday liquidity management of banks. BNY Mellon believes this is the best approach: implement general principles for managing intraday liquidity risk and allow regulators to use flexible supervision and examination processes to demand relevant intraday liquidity data from individual banks.

We believe this process has been working in the United States. In March 2010, the U.S. banking agencies released supervisory guidance addressing funding and liquidity risk

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3 Adopting an applicability threshold of 5% of transaction volumes within an individual currency or market would create congruency with existing supervisory requirements for payments market participants. The Federal Reserve and other U.S. regulators use the same 5% standard for designating payment and clearing operations as "critical" and subjecting them to enhanced supervisory requirements – including monitoring and reporting. *See* Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System and Supervision and Regulation Letter SR 03-9 (April 7, 2003). *Available at*: http://www.newyorkfed.org/banking/circulars/11522.pdf.

4 DORPS reports capture all debits and credits from an institution's payment activity and provide end-of-minute account balances using the daylight overdraft posting rules. Like many other institutions, BNY Mellon uses DORPS reports provided at the end of each day and at the end of each two-week reserve maintenance period to enhance our internal monitoring operations.

management that included principles for intraday liquidity position management.[5] The principles directed senior management to focus on:

- Monitoring and measuring expected daily gross liquidity inflows and outflows;
- Managing and mobilizing collateral when necessary to obtain intraday credit;
- Identifying and prioritizing time-specific and other critical obligations in order to meet them when expected;
- Settling other less critical obligations as soon as possible;
- Controlling credit to customers when necessary; and
- Ensuring that liquidity planners understand the amounts of collateral and liquidity needed to perform payment-system obligations when assessing the organization's overall liquidity needs.

The agencies have buttressed these principles through additional reporting requirements for certain banks.

BNY Mellon considers this is to be the best model for regulating intraday liquidity risk and would encourage the Committee to refrain from requiring quantitative, one-size-fits-all reports from all institutions. A more flexible program will allow supervisors to discuss and analyze idiosyncratic and payment system concerns with relevant banks; and allow supervisors to seek measurement and monitoring reports that are directly related to their supervisory concerns.

Part III: The Consultative Document may negatively affect intraday liquidity management and, in practice, increase rather than decrease systemic risk.

The Consultative Document states that the proposed indicators would be used "for monitoring purposes only and do not represent the introduction of new standards around intraday liquidity management."[6] BNY Mellon appreciates this sentiment, but fears it is only precatory. Because the Committee has not stated why this data is being sought and what risks are to be remediated, many firms are likely to treat the reporting requirements as new, binding requirements. This is especially true because the framework implies that data demonstrating insufficient liquidity over specific time intervals would lead to supervisory scrutiny. Paragraph 58, for example, indicates that "[b]anks are expected to report the monitoring indicators to their supervisor on a monthly basis in line with the proposed [liquidity coverage ratio]."[7]

BNY Mellon worries that absent greater clarification in the final release that the indicators are for informational purposes only, banks will slow the pace of scheduled payments so that their results appear stronger on both absolute and relative bases. If banks decide to

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5 *See* Interagency Policy Statement on Funding and Liquidity Risk Management, p. 8 (March 17, 2010).

6 Paragraph 6, Basel Committee, *Monitoring indicators for intraday liquidity management* (July 2012)

7 *Id*.

withhold scheduled payments, gridlock across and between multiple payments systems may ensue. This scenario would be worsened during periods of systemic stress, when many correspondent banks increase prefunding requirements. We concerned, for the same reason, that the framework may introduce unexpected procyclicality.

We would also note that, as addressed in several industry association commentaries, including The Clearing House Association's September 14 letter, failure by supervisors to harmonize reporting requirements across jurisdictions could lead to payment system arbitrage, whereby liquidity flees one system only to overwhelm another.

Part IV: The relevance of certain indicators is unclear and, in general, the information provided using the indicators will not accurately explain how banks monitor and manage intraday liquidity.

For our USD operations, BNY Mellon already collects much of the data sought through the indicators. We believe that much of the desired data is material to robust supervisory oversight of intraday liquidity risk – so long as a bank's activities within a jurisdiction are material – but would fail to present a complete picture. Missing from the indicators is any acknowledgment of governance and control practices and a complete conception of all available intraday liquidity sources. Concerning the latter, the proposed framework does not fully capture liquidity savings mechanisms (*i.e.*, the unique algorithms) associated with certain systems not run by central banks, such as CHIPS.

Failing to consider the dynamic governance and control processes employed by many banks, especially larger banks, reduces the value of the data provided. BNY Mellon has a robust governance process around our management of USD intraday liquidity. We have an established intraday liquidity committee that focuses on daily operations and monitoring. This committee reports to our larger intraday liquidity steering committee, which includes senior management participants. Our governance process is reinforced through our front-end controls process, which consists of granular intraday liquidity monitoring – at the transaction and counterparty levels – that allows management to remediate potential risks early in the process.

Regarding the individual indicators, BNY Mellon would note the following:

Daily maximum liquidity requirement. The relevant metric for peak liquidity need is not what is actually used by a bank, but what is required to fulfill payment obligations. As the Federal Reserve Bank of New York's Payments Risk Committee analysis found, only $9 trillion is needed to cover $14 trillion of settlement responsibilities.[8] In several systems, payments are released earlier than required to ensure smooth flows. Measuring actual use instead of necessary payments will discourage such beneficial timing decisions by direct participants and encourage payments hoarding. Doing so would not only be bad policy, it would be contrary to the joint-work of central banks and payment systems participants.

The amount of intraday liquidity a particular institution – and a payments system – requires is driven by structural considerations. As the Payments Risk Committee noted in its September 14 commentary to the Committee, "Real Time Gross Settlement systems typically require greater intraday liquidity demands than net settlement systems" due to the fact that they

8 *See* "Intraday Liquidity Flows" Report of the Payments Risk Committee, March 30, 2012.

settle transactions sequentially and in real-time. The intraday liquidity data of banks participating in such systems will be directly impacted by the efficiency of these systems.

Available Intraday Liquidity. This indicator focuses exclusively on central bank payment systems and does not consider systems that involve only banks or private market participants. Because many firms, including BNY Mellon, manage intraday liquidity risk through systems like CHIPS they should be included in the indicator framework.

Beyond the substantive components of the indicators, we would note that data constraints may affect indirect participants. Like many institutions, in some jurisdictions we participate in payment systems directly, while in others we rely on a correspondent relationship. Juxtaposed, we offer correspondent banking services to many clients. Generally, indirect participants lose control of their payments once they submit instructions to the correspondent bank – payments are made at the correspondent bank's discretion. This inability to control when payments are made could adversely affect the reporting of indirect participants. Similarly, in most cases, intraday liquidity data is not provided by direct participants to indirect participants. It will be difficult for the Committee to formulate a methodology for measuring indirect participant intraday liquidity that accounts for the divergent and opaque practices of correspondent banks. For these reasons, BNY Mellon believes the Committee should initially limit the monitoring framework to direct participants.

Finally, the data the Committee would require banks to provide to local supervisors is highly-sensitive. Due to the many outstanding legal issues surrounding the sharing of such sensitive data between and among supervisors, BNY Mellon recommends that the Committee develop clear data security and disclosure policies. We believe the best course, at least initially, is to keep data at covered banks and to allow supervisors to review it when necessary.

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BNY Mellon appreciates your consideration of these comments and stands ready to meet with the Basel Committee to discuss their substance. We look forward to being a constructive partner as the Committee finalizes a framework for monitoring intraday liquidity management.

Should you have any questions, please feel free to contact Frank Behlmer, Executive Vice President and Chief Operations Officer for Global Operations at 315-765-4700 (e-mail: francis.behlmer@bnymellon.com) or Eli Peterson, Managing Director and Senior Managing Counsel at 202-624-7925 (e-mail: eli.peterson@bnymellon.com).

Respectfully,

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