The voice of banking
& financial services

20 August 2012

baselcommittee@bis.org
c/o the Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sirs,

Consultative document – Monitoring indicators for intraday liquidity management

The BBA is pleased to respond to the consultation.

Key messages

Banks are going through a series of changes aimed at strengthening capital and, for the first time, liquidity standards. It would be helpful for them to digest Basel III before moving on to the next phase.

However, we recognise that BCBS 188 did not include provision for intraday liquidity and the "LCR stress does not cover expected or unexpected intraday liquidity needs that occur during the day and disappear by the end of the day". As set out in paragraph 137, additional work is required to produce a set of indicators although we would prefer to see a discussion of the control and governance process surrounding the management of intraday liquidity before the implementation of any monitoring indicators. Until such time as the way in which banks undertake intraday liquidity management is understood, we believe that it will be difficult to define the parameters to be included in the indicators. In particular

1. The relationship between assets used for collateral to ensure the smooth working of payment systems and those held in the liquidity buffer need to be understood as they will influence the sources of intraday liquidity. Banks need to have a minimum level of payment system eligible assets available to them at the beginning of the day to ensure their payments can be made. Such assets cannot then be regarded as also available in the LCR liquidity buffer – so-called "double-duty" – as, if they are used to meet obligations at the end of the day, they will not then be available for the payments systems at the start of the next day. Please note that there may be domestic payment systems outside the UK where members of the BBA operate where this practice may to some extent still be appropriate.

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2. The ability of direct participants to control intraday positions of non direct participants is important to recognise when looking at how throughput can be managed in a crisis and at the levels of intraday liquidity a direct participant needs. At the same time non-direct participants need to recognise that their intra overdrafts (put another way, their use of their clearing member's intraday liquidity) may not always be relied upon.

3. Any introduction of new indicators on their own may have an impact the way in which banks look at the management of intra day liquidity. We are concerned that additional operational risk may result from concentration of payments at the end of the day if the indicators are used to attempt to reduce intra day liquidity risk.

4. Not all jurisdictions work in the same way. In some countries, central bank reserves are usable as intraday liquidity and in others they are not. In the US, the existence of the Fed unsecured overdraft facility influences the level of intraday liquidity banks need.

We would also suggest that the Committee examines where the information required might come from. In many cases it might be better for systems providers to supply the information to the banks (rather than the banks build their individual data gathering systems) as this will result in economies of scale. Since central banks are often the managers/suppliers of payment systems, we strongly encourage dialogue with them in the design of the indicators and any discussion about how best to build the information infrastructure to support them.

Regulators should ensure that whatever emerges from this consultation does so in a way that ensures a level playing field. There are competing regulatory objectives, and different payment and settlement systems that need alignment.

The BCBS should be made aware that the granularity and frequency of this proposed data collection may necessitate significant resource and systems developments at firms. Therefore, flexibility with regards to reporting timeframes would be welcomed.

As per Annex 2, the BBA's members operate across different jurisdictions, and payment systems. As such, we would be delighted to discuss our reply with the authorities.

Conclusion

Annex 1 to our letter contains our formal response to the consultation, and further specific observations and questions arising from the proposals.

We hope that you will find our comment useful. Please contact me by way of e-mail (irving.henry@bba.org.uk) or telephone on (00 44) 20 7216 8862 should you require further information.

Yours faithfully,

Irving Henry
Director, Prudential Capital and Risk

Annex 1

Additional comments

The BBA supports the aim of the Consultative Document to provide more transparency around intraday liquidity. However, we feel that the document does not address some important aspects which should also be incorporated:

1. Focus on Monitoring: The document almost exclusively focuses on monitoring intraday liquidity, but fails to address other aspects such as governance and control. These aspects are as important as the monitoring and should be elaborated upon. We would in particular recommend that a control framework be developed around the indicators and that the roles of the local supervisors are clarified.

   Supervisors need to fully understand the governance and framework around a firm's intraday liquidity management in order to provide context to the quantitative indicators. This could be by way of supporting documentation to completed templates (updated annually) or closer interaction with those responsible for the day-to-day management of intra-day liquidity risk at the firms.

2. Available Intraday Liquidity: Available intraday liquidity is not clearly defined, especially as the document also refers to stress scenarios. All forms of liquidity buffers and reserves will, when used, become intraday liquidity. Thus, the document should elaborate on what forms of liquidity are considered as intraday liquidity and to what extent "Double Duty" is considered acceptable. We consider it exaggerated to impose additional liquidity requirements on banks to cover for normal as well as stressed intraday liquidity scenarios. Additionally, the sources for available intraday liquidity should be enhanced by sources such as unencumbered, non central bank eligible collateral.

3. Liquidity Requirement: The document rightfully focuses on required intraday liquidity and timing of payments. However, we find that some important aspects are missing: The "required liquidity" as defined in the document is actually the liquidity a bank uses, but not necessarily requires to timely fulfil their payments obligations. Examples for differences in used liquidity and required liquidity are payments released to the market earlier than the market rules require or payments on the back of the funding of market accounts. Especially payments released early are essential for avoiding gridlock situations and, thus, for the functioning of the payment markets. The definition of an indicator describing required liquidity should take these aspects into consideration.

4. Indicator Relevance: The relevance of the proposed indicators should be clarified. While the document explains what should be measured, we miss explanations on what risk is to be measured and ultimately mitigated with these indicators. Especially, the indicators for indirect participants should be further developed.

5. Reporting Scope: The reporting as stipulated in the document requires a bank to report on direct and indirect market participation. This would lead to a host of new reports and significant investments into the MIS infrastructure. Since some of the required data would need to be sourced from the payment and settlement systems (e.g. timing of automated liquidity transfers) as well as from correspondents (timing of outgoing and incoming payments), a vast reporting framework not only within the banks but also across the industry would be required. Thus, a cost/benefit analysis should be undertaken and the results taken into account when defining the scope of the reporting. However, in order to do so, the aspects as described in point (1) need to be clarified first. Also, this additional initiative should take into consideration, all other additional reporting duties currently being imposed upon the banks, including those linked to the FSA data template.

6. Data Secrecy: The proposed monitoring requires highly sensitive data. The document should be enhanced by a section about data confidentiality and disclosure. Our preference would be to keep all data within the Financial Institutions and share them with the supervisors when requested.

7. Under "correspondent banking indicators", firms are asked to provide exposure details for their "Top 5 Financial Institution Customers". The BCBS should be made aware that this universe is dynamic and effectively requires monitoring of exposures to a much wider range of customers.

8. Daily Maximum Liquidity Requirements Indicator

   What will be the minimum time stamp frequency?

   In payment systems where net paid/received payments made by banks in a direct clearing role do not necessarily have to be collateralised on a one for one basis (for example LVTS Tranche 2 in Canada), what will need to be tracked, maximum collateral exposure or maximum net payment exposure?

   If regulatory expectations were to be eventually set on this metric, accepting that payment flows between commercial banks are a zero-sum game, there is a risk that attempts to improve individual bank net exposure levels will lead to increased systemic risk, ie encourage banks to delay payment outflows, which could cause payment gridlock. Messaging around the usage of this metric by regulators will be key.

   Current practice in many countries is for direct clearers to provide unadvised intraday credit facilities to indirect participants they clear for. Pushing banks to have documented committed facilities from their nostro providers to increase their "available intraday liquidity" and thus mitigate the risk outlined in this metric could lead to unintended consequences. For example, costs would be much higher for the providers of the facilities in light of related LCR rules and no credit would be given to the banks obtaining the lines in the LCR metric. Further discussion is recommended to ensure potential impacts are better understood.

   High dependence on third party providers to provide access to information

8. Materiality: Will banks be allowed to use their own definition of materiality in defining what systems, currencies and legal entities to focus on in their Group? The data acquisition and MIS challenges for these indicators are likely to be material for most banks for their key related risk areas, so keeping the scope to key areas only will be key in light of competing MIS requests for other regulatory metrics.

Answers to the questionnaire

(i) Do the proposed indicators adequately capture the intraday liquidity risk run by banks?

We believe that the indicators reflect the risks, sources and needs associated with intraday liquidity although they do not set out how to distinguish between liquid assets needed to run the payment systems and those required for the LCR.

The intra-day buffer should be aligned with the normal buffer.

There is no mention of the governance process associated with managing assets and liabilities.

The flexibility proposed with regard to collateral (22) is welcome.

With regard to timing, flexibility should be provided as banks may have operations and/or relationships spanning the globe, ie from the Far East and Australasia to the west coast of the Americas. This is linked to the definition of a “business day”, especially in the EU’s iteration of Basel III, CRD IV.

(ii) Are the stress scenarios identified in the paper comprehensive?

This is a realistic set of scenarios for firms to use.

The ability of firms to agree stress scenarios with their supervisors is welcome.

There is no mechanical number that can be calculated. Figures are put together differently around the world, reflecting payment systems. Our concern is that returns focus on legal entities, which are not always material and do not reflect how business is transacted.

The definition of the firm for the purposes of this exercise should be aligned with the definition of the firm for existing liquidity reporting.

It’s not clear what a critical payment is. This varies e.g. daily and by jurisdiction. The term “critical obligations” needs to be defined. For example:

- CLS settlements
- LCH concentration payments
- Margin/exchange settlements within ‘x’ minutes of calls
- Clearing system settlements, e.g. deferred netting systems

NB critical obligations are not restricted to earlier in the day.

There is a read across between intra- and end of day, double duty and behaviour (normal, exceptional and stress).

Some payment systems require participants to share losses. This is linked to “living wills”.

(iii) Is the proposed scope of application of the indicators clear?

Recognition that practice (46) differs across firms is welcome.

We welcome the statement that “separate monitoring indicators will not be necessary for such ancillary systems”.

An element of materiality should be agreed between firms and their supervisors with regard to the monitoring of currencies and entities.

Aggregation does not mean much as payment systems are different and one can’t transfer excess liquidity across them. When determining the scope of this exercise (the level of aggregation), the BCBS should recognise qualitative controls as much, or perhaps more so, than quantitative measurement. Treasury-driven activity (e.g. switching a buffer cash balance into buffer liquid assets) takes place through the same payment channels as customer-driven activity and those firms that can identify and segregate this activity should be recognised.

An alignment of systems would be helpful as, amongst others, it would assist pre-payment positioning.

Also, the management/mitigation of risks is as important as measuring them.

(iv) What, if any, implementation challenges would the proposed reporting requirements present to banks?

The level of and timeframe for application will be challenges.

Another challenge will be to resolve the competing interests of home and host supervisors, and what obligations are put on the firm. In any case, central banks and systems providers have the information that regulators are looking for.

It's not clear whether systems providers or individual banks develop the systems to monitor intra-day liquidity.

Alignment with the Liquidity Coverage Ratio (LCR) is helpful, but as the LCR is being finalised as at the time of writing, it is essential that flexibility be in-built, so that firms can adjust for whatever emerges from this consultation.

Where one group entity is a direct participant of a particular payment system and it provides correspondent banking services for another group entity, only the direct participant entity should be required to report its exposures to that system.

(v) Are the different monitoring and reporting requirements for direct and indirect payment and settlement system participants clear?

How will aggregation work? Will it be by currency, payment systems or legal entities? As stated above, when determining the scope of this exercise (the level of aggregation), the BCBS should recognise qualitative controls as much, or perhaps more so, than quantitative measurement. Treasury-driven activity (e.g. switching a buffer cash balance into buffer liquid assets) takes place through the same payment channels as customer-driven activity and those firms that can identify and segregate this activity should be recognised.

These will be complicated by notified and unnotified uncommitted credit lines, netting, systems controls, being a provider or taker of liquidity, the definition of critical payment and whether pre-positioning can be effected.

Regulatory returns are based on estimates, not actuals, and, therefore, not that useful. The concerns are that such reports are not comparable, transparent and auditable, and one can't drill down into the inputs.

Comments on Annex 3

The following comments relate to Annex 3 of the consultation paper – "Combining the Indicators":

1. We agree. We need to understand from the supervisor to what extent net received liquidity from customer inflows or deferral of non-urgent payments can be considered in a calculation of intraday requirements for time specific obligations for typical non-stressed days.

2. We agree. A firm's liquidity adequacy should be sized to cover this impact.

3. We agree. The supervisor should investigate and understand the reasons behind such failures to meet obligations.

4. We agree. In addition, the supervisor should recognise firms that actively seek to mitigate the size of intraday liquidity requirements through analysis of customer activity and that of potential customers.

5. We agree.

Annex 2

The British Bankers' Association ("BBA") is the leading trade association for the UK banking and financial services sector. We represent over 230 banking members, which are headquartered in 60 countries and have operations in 180 countries worldwide. These member banks collectively provide the full range of banking and financial services, and make up the world's largest international banking centre.