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Comments by the German Banking Industry Committee on the Basel Committee's consultative document published in July 2012

"Monitoring indicators for intraday liquidity management"

13-09-12

Dear Ladies and Gentlemen,

On 2 July 2012, the Basel Committee for Banking Supervision submitted its consultative document "Monitoring indicators for intraday liquidity management". This covers reporting of certain indicators to the supervisors and shall complement the qualitative requirements for the management of the intraday liquidity risk in the „Principles for Sound Liquidity Risk Management and Supervision" which the Basel Committee published in 2008. We appreciate the present opportunity to share our respective comments below.

General Comments

In this paper, the BCBS proposes a host of indicators for monitoring intraday liquidity. Regarding these indicators, banks should report for each payment and settlement system and every (material) currency different manifestations both at the level of individual banks and also on a consolidated level. Furthermore, for most indicators banks will also be required to report figures that would materialise in the event of certain stress scenarios. In this way, approximately 270 data points result per payment and settlement system. For all of these data points, the underlying data will have to be collected, calculated and reported to supervisors on a monthly basis. In our view, these requirements would fail to live up to a cost benefit analysis. The costs incurred for banks would not be sufficiently justified by the benefits for supervisors.

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For banks which are direct participants in a payment and settlement system the required data (in euro) is already readily available in these payment and settlement systems. All that needs to be done is prepare this data accordingly. These data should therefore be gathered directly by the central banks.

First, the huge reporting burden described above bears no relation to the actual intraday liquidity risk. We are not aware of any single bank which ran into critical payment difficulties due to *intraday* liquidity problems. In practice, intraday liquidity risks translate above all into payments of damages as well as punitive interest rates or fees charged on the grounds of delayed payments. These are monitored and controlled by operational risk management; a *de facto* failure to pay falls under the remit of credit risk management.

Furthermore, intraday liquidity risk is already mitigated by the economic liquidity risk management under the "Principles for Sound Liquidity Management and Supervision" which the Basel Committee published in 2008. Based on these principles, banks need to prepare liquidity overviews. The respective time horizons of these liquidity overviews also offer a true and fair view of the short-term liquidity trends. In practice, to this end, daily maturity buckets are selected for at least the first 30 days. The liquidity shortfalls predicted in the liquidity overviews have to be covered by a sufficiently high liquidity buffer (e.g. highly liquid, unencumbered assets). The free liquidity reserves necessary for this regularly exceed the intraday liquidity need several times over. They can be used as an interim answer for any potential intraday liquidity need that may occur. Furthermore, banks can generally also cover their intraday liquidity need by drawing upon credit lines.

For the purposes of mitigating intraday liquidity risk, in practice, banks also draw upon clearing systems with central counterparties comprising the provision of collateral. The consultative document fails to take account of the risk mitigating effect that results from this. The gross reporting requirement, which is partly what is called for under the consultative document's current proposals (cf. No. 23) fails to provide a true and fair view of the actual risk.

Furthermore, the ratios proposed in the consultative document would reward banks that hold back their payments throughout the day for as long as possible (for instance by maximum consumption of intraday liquidity). As a result, the reporting of the ratios could create incentives for mismanagement of intraday liquidity. This would undermine the target of stable and balanced intraday payment transactions and promotes disequilibria at various points which might jeopardise payment transactions in general. High volume deals would probably only be feasible if carried out in several tranches so that payments can be made at different hours of the day.

Last but not least, we would like to point out that the consultative document requires banks to report data which regulators already receive through other reports.

Obviously, in order to ensure that it will be able to carry out payments at any point during the day, every bank should have an active management of intraday liquidity. At this juncture, the ratios proposed in the consultative document can support the internal control of intraday liquidity. Yet, this largely depends on the respective bank's individual situation. Hence, it should be left to the banks' discretion which ratios or combinations of ratios they wish to monitor in their internal liquidity risk management. In our view, it would be more constructive if - depending on the specific business orientation as well as on the respective business volume - every bank was given the right to define an individual ceiling for its intraday liquidity needs and if, to this end, it kept a liquidity reserve in place in order to ensure a holistic liquidity

management. This ceiling approach would also allow extrapolating bank specific ratios that are monitored accordingly.

However, the compulsory requirement to report all intraday liquidity risk indicators suggested in the consultative document should be dropped. Given that liquidity risk management falls under the supervisory review process (Pillar 2), supervisors would have the right to impose certain compulsory reporting obligations upon the respective banks if Pillar 2 saw any material shortcomings in the field of monitoring and control of intraday liquidity.

Notwithstanding our fundamental rejection of a regulatory reporting requirement on intraday liquidity, in the following paragraphs we would like to address the Basel Committee's individual proposals more specifically.

First of all, due to the high implementation effort required for introducing the new ratios, there needs to be a sufficiently long implementation period. Particularly for indirect participants or for banks offering payment transactions as a service for other market participants, the data collection in general presents a particular challenge. At this juncture, an illustration of the Basel Committee's expectation would be helpful. This might come in the form of an example similar to the one presented in Annex 1.

Furthermore, we hold the view that separate reports at the level of individual banks and at the level of the group are redundant. If intraday liquidity is ensured at the level of individual banks, this automatically also translates into sufficient liquidity at the level of the group. However, bank groups featuring a central liquidity (risk) management should similarly be granted the right to limit their reporting to a consolidated view of the entire group. Furthermore, it is also worth considering ways in which the cooperative banking networks' specific liquidity system could be reflected in an adequate manner.

Besides, the provisions proposed by the Basel Committee should be consistent with the objectives under No. 4 (monitoring of intraday liquidity risk (i.e. the bank's capacity to meet its payment obligations on time)). Based on the foregoing, the rationale behind individual indicators proposed as well as behind the reporting of these indicators is not immediately obvious. No. 28, for instance states that an average time must be given for intraday payment settlements over a single day. It is unclear in how far this indicator will enable national supervisors to gain a better understanding (apart from perhaps the fact that such an exercise is basically feasible). Furthermore, it is debatable whether information on 95% quantiles (No. 59) is technically validated and whether such data allow any conclusions that can be operationalised. After all, there is a lack of statistically validated payment distributions and time stamps. Based on the foregoing, we suggest a review of the figures which banks are required to report with a view to a potential simplification.
We last but not least feel it would be a good idea to list further differentiated examples for several periods of time in which the particular calculation steps and properties are listed for the ratios. Furthermore, for these examples we also suggest the publication of a reporting template which is already populated with the respective data.

As regards the stress test assessment, we see that essentially the the same market and bank specific scenarios are used as for the LCR. Hence, at this juncture a clarification would be helpful concerning the Basel Committee's expectations as regards the interplay between the intraday liquidity buffer that needs to be kept in place and the liquidity buffer required under the LCR stress. Also, it would be helpful to know if and how the Basel Committee permits using the latter. In the final analysis, also the LCR buffer

serves the purposes of securing the banks' payment capacity. And in their press release of 08 January 2012, the Group of Governors and Heads of Supervision (GHOS) announced a presentation on the ways in which the buffer can be tapped during stress scenarios.

Specific comments

No. 7: The consultative document states that the indicators have been designed to apply to all banks including those that access payment and settlement systems indirectly via the services of a correspondent bank. At this juncture, it should be made clear that whilst the Basel regulatory framework's scope of application is geared towards large, internationally active banks, national regulators shall have sufficient discretion under the provisions of No. 58. Furthermore, please see also the comments on No. 52ff.

No. 12: With regard to the liquidity sources there should be a focus on assets which can be pledged. This is due to the systems technology which will often also allow utilising eligible securities at very short notice for intraday management purposes that were initially not yet earmarked for this purpose. For direct participants the focus is on eligible collateral pledged directly with the central bank (if and when the central bank requires such a provision of collateral and unless it does not permit an overdraft on the basis of other instruments such as, for instance, credit lines). We therefore assume that the criterion "central bank eligibility" is a sufficient precondition for recognition of such collateral as a source of liquidity. It is also our understanding that said collateral shall not have to meet any further quality requirements that also our understanding that said collateral shall not have to meet any further quality requirements that would go beyond the consideration of the applicable haircut.

No. 15: The cumulative intraday liquidity inflows and outflows should be captured "at any point in the day". In our view, this is neither constructive nor is it feasible in practice. There should be a clarification that positive positions or negative positions will only have to be established for those points in time which also saw intraday payments. Alternatively, it should be possible to use at least hourly time buckets for cumulating the payments (cf. also the assumption underlying the example under Annex 1 and the proposal concerning the "intraday throughput" under No. 30). We propose including a corresponding clarification in the consultative document. This comment also applies to the establishment of other ratios which refer to intraday payments received and payments made (e.g. No. 23: total payments or No. 28: timing of intraday payments).

No. 18: Most likely, the requirement of calculating the "largest net cumulative outflow" on a daily basis will have a clear impact on banks' intraday payment behaviour. Banks will endeavour to keep this figure as low as possible. Hence, this provision would create incentives to hold back own payments as far as possible. This cannot be in line with the underlying rationale. For instance, a bank expecting to receive a payment in the near future would not suffer any disadvantages if it were to make a payment prior to receipt of this payment. Otherwise, this will create a problem: Nobody would want to be the first to make a payment meaning that the liquidity cycle would fail to kick into motion or, moreover, that the cycle will grind to a halt on a regular basis. For ancillary systems, e.g. aimed at securities settlement, the unwanted side-effects of such incentives can be seen already today. These would be boosted further by introducing the "largest net cumulative outflow". In our understanding No. 17 means that this problem is supposed to be taken into account by – if need be – focussing on "settlement times". Yet, also the provision under No. 17 is not capable of defusing the danger of wrong incentives entirely.

No. 21: The available own sources of liquidity (especially securities) should be broken down further on the basis of the time required for turning them into liquidity. For instance securities which are already deposited at the central bank can be converted into liquidity faster than securities which may be ECB eligible and available but which, for instance, are kept in a custody account abroad.

There should be a clarification that (for the purposes of measuring liquidity available to banks at the start of a business day) it will be possible to also use the values as at the end of the previous day. For internationally active banks we suggest a concept clarification as regards "the start of a business day" in cases where an aggregation through the payment system would be possible under the provisions of indent 48.

No. 24: The term "time critical payment obligation" should be defined more precisely. Due to the fact that there will generally be a so-called cut-off-time for payments which will always have to be respected, generally speaking, all payments tend to be "time critical". Depending on the interpretation, the definition given may refer to either each and any or not a single one of the intraday payment obligations. Generally speaking, in our view the special risk which results from time critical payment obligations is covered by monitoring operational risk.

No. 26 and 27: A correspondent bank will be, *inter alia,* required to report the total value of payments settled on behalf of its five largest customers. At this juncture, "internalised payments"(i.e. internal payments that are settled across a bank's books) should be shown separately. It remains completely obscure in which way such "internalised payments" can possibly incur an intraday liquidity risk. This extension of the regulatory scope would create wrong management incentives and it would trigger results that would lack comparability. The latter is due to the fact that the criteria which inform the inception of banks' internal accounts are heterogeneous.

Furthermore, in order to ensure that it will be construed in a consistent manner amongst banks themselves, also the term "correspondent bank" should be defined in greater detail.

No. 28: Banks which are direct participants in a payment and settlement system are required to disclose the average time of a bank's daily payment settlements as the value-weighted average time of settlement. In our view, this ratio makes no sense if the formula is supposed to include both liquidity inflows and – also - outflows. Furthermore, the reporting period should be specified in greater detail.

In our preliminary understanding, only those time points shall be taken into account where payments were *de facto* made or received. Furthermore, it should also be possible to aggregate the payments to full hours (cf. comment on No. 18). To this end, we would appreciate a specification in greater detail as to how an aggregation should be carried out (for instance all payments between 8.00 a.m. and 9.00 a.m. aggregated to 9.00 a.m. or all payments between 8.30 to 9.30 aggregated to 9.00).

No. 29: No. 29 refers to payment inflows and outflows. No. 28 and the example under (vi) in Annex 1, however, only focus on outflows. We would appreciate a clarification or, moreover, specification in greater detail as to what is meant exactly at this juncture.

No. 52ff.: In our view, a requirement for banks to provide data on cleared currencies i.e. on currencies where the respective bank handles the payments through a correspondent bank, is hardly feasible in

practice. At present, there is no or only limited scope for prioritisation. Even seeing that an account has been charged by accessing an online bank statement which is partly accessible is no guarantee for the actual execution of the payment at that very point in time. Furthermore, the aspect of the time zones needs to be taken into account. In today's environment, for foreign currencies, control or monitoring within the meaning of the requirement appears impossible or possible only to a very limited extent. The benefit of such an approach should be double-checked by the Basel Committee.

Furthermore, incoming payments on clearer accounts (nostro accounts) will only be finalised at a later point in time. Frequently this will only take place upon receipt of the bank account statements (without stating the time). In terms of fixing the value date, there is a juxtaposition of incoming payments on the one hand and outgoing payments on the other hand. However, the exact execution times of incoming and outgoing payments within the meaning of intraday liquidity monitoring are unknown whenever a clearer bank is asked to become involved (which is a common market practice particularly in the field of foreign currency).

No. 54: The item envisages a potential exemption from monitoring and reporting by currency subject to the agreement by the national supervisor. This exemption clause should receive a less restrictive wording. One possibility would be, for instance, only monitoring and reporting intraday liquidity separately for those currencies which account for at least 5% or 10% of the daily liquidity need. Realistic solutions would then have to be stipulated for establishing this threshold level.

Annex 1, table: For clarification purposes, we would appreciate a confirmation that the figures listed in the table should be understood as hourly aggregated figures and, as such, ought to be viewed as an overhang.

Furthermore, we feel that a data provision which is based on an hourly analysis is excessively onerous. In our experience, a two hour interval yields good results. We hold the view that this is capable of providing appropriate information anytime also in future.

Annex 2, template reporting form: Banks shall report to regulators the liquidity which they have available at the start of a business day in order to cover their intraday liquidity need (2 h). However, the reporting form only asks for the"[l]owest amount of available intraday liquidity at the start of the business day …". We assume that this, however, is merely an editing error.

Furthermore, it remains unclear how the lowest intraday liquidity available shall be calculated. No. 21 gives rise to the impression that the available intraday liquidity will be established throughout the entire day and that the respectively lowest amount of available intraday liquidity shall be reported. On the other hand, the reporting template suggests a different calculation method: Pursuant to this, the lowest available intraday liquidity results from adding the lowest amount of the aforementioned intraday liquidity items (3a, 3b, 3d, and 3f). More often than not, this calculation method will lead to a situation where the lowest available liquidity will be lower than that which would result from a calculation pursuant to No. 21.

Furthermore, it is unclear which items can be included in the calculation of the lowest amount of available intraday liquidity. More specifically, apart from the items mentioned in the "Sample intraday liquidity monitoring return", pursuant to No. 21 in conjunction with No. 12(a), further eligible items would be balances with other banks that can be used for settlement on the same day (b) payments received from

other payment system participants or (c) payments received from ancillary systems. However, these cannot be entered into the “Sample intraday liquidity monitoring return”.

Said reporting template should therefore be adjusted in order to accommodate the requirements set out under No. 21 in conjunction with No. 12. The only amount that should still require reporting is the lowest amount of available liquidity. In line with the presentations under Annex 1, this could be calculated simply by deducting the highest cumulative liquidity shortfall from the amount of liquidity available at the start of the day (cf. item B. I.). There should be no reporting of sub items 3(a)-3(g).

Also, it is not quite clear which figures have to be reported in the reporting template under 6(a) and 6(b). Pursuant to No. 25, banks are required to report the volume or total volume of "time critical" payment obligations. The wording in the reporting template could also be interpreted as meaning that banks will only have to report the number and the volume of payments settled on time. At this juncture, there should be a clarification.

Yours sincerely,
on behalf of the German Banking Industry Committee
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