HSBC

To Secretariat

September 14, 2012

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel, SWITZERLAND
Sent by email to: baselcommittee@bis.org

Re: Request for comment on consultative document – monitoring indicators for intraday liquidity management

Dear Secretariat

HSBC Banking Group appreciates this opportunity to respond to the Basel Committee on Banking Supervision ("BCBS") consultative document on "Monitoring indicators for intraday liquidity management".

HSBC understands the objective of the monitoring indicators for intraday liquidity management and supports the increased requirements for transparency, management, control and governance around intraday liquidity. This is encompassed in our support for principle 8 of the "Principles for Sound Liquidity Risk Management and Supervision" (Sound principles).

A. General Comments

Whilst we appreciate and support the BCBS' goal is to better manage intraday liquidity risk, there are some areas where HSBC would seek clarifications regarding the proposed framework.

Quantitative Metric

We would be interested to know if the BCBS intends to recommend a *quantitative metric* around intraday liquidity management. It should be noted that some jurisdictions already have such frameworks or metrics in place to monitor intraday liquidity movement. We would support BCBS recommending a similar approach, as this would help to ensure a more consistent treatment for globally active financial institutions. It makes sense to emphasize that the encumbrance of prudential liquidity during the course of the day for operational purposes would not be appropriate as the experience of the last few years has shown.

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Rules around throughput targets

If a quantitative framework is used, then we believe this will have an effect on those with responsibility for the smooth running of payment systems who will also have to tighten their *rules around throughput targets* and increase the granularity of those throughput timings. This will ensure that the appropriate throughput is made and will not encourage payment delay and large late spikes in payments.

Eligible collateral for RTGS framework

In addition, we would encourage the BCBS to recommend to Central Banks that *non-Liquid Asset Buffer collateral* be deemed eligible within the RTGS framework (with an appropriate haircut and considering wrong way risks). Basel III, as well as the large number of regulatory reform initiatives currently being negotiated, will introduce significant pressure on financial markets to post high volumes of collateral. This runs the risk of 'collateral famine' if a certain degree of flexibility is not permitted to encourage diversity and reduce the strain on financial markets.

Best Practice and Governance of intraday Liquidity

More broadly, we would suggest that BCBS consider a wider discussion of best practice around the governance of intraday liquidity. An example of this would be establishing an acceptable intraday risk appetite, and reporting this to the appropriate management or oversight group, taking into account the capacity and controls within an institution. This might be the Asset and Liability Management Committee or another firm-specific equivalent.

Enable local regulators to work with regulated entities

We also believe that greater emphasis should be placed on allowing local regulators to work with their regulated entities to determine the most effective indicators of that institution's intraday management. In fact it is *the combination of the most appropriate indicators for different jurisdictions which is likely to provide and allow for the most robust risk management.* Enabling local regulators to work with their entities will also help to ensure that specific details and particularities of the regulated entities' payment systems are taken into account.

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Indirect vs. direct clearing member compliance

In order to manage intraday liquidity as an indirect user, predict the end of day balance, understand the current exposure and record its trend, we believe that the *correspondent banks will need to provide greater information and perhaps a wider array of message types*. There seems little point in indirect members building complicated systems to understand their intraday position, if it is not possible to source complete information from their correspondents.

To help reduce systemic risk it may also be worth considering if direct clearers should have systems in place and be able to enter into agreements to encumber non-Liquid Asset Buffer collateral when the indirect members have an intraday overdraft. Although this will not cover the direct members "double duty" position, it would reduce the clearer's unsecured risk exposure and loss given default, and could help ensure a more timely delivery of payments.

For an entity using indirect services with an internal group member that is a direct clearer, the scope of application of some of the rules is not clear. *Is full compliance necessary from an indirect clearing member?* It seems unlikely that a direct member of the same group would reduce their intraday overdraft - so should the direct clearer just treat the internal member as an external counterparty for stress testing?

A *de minimis* level of reporting and monitoring should be considered for secondary Nostros in currencies where the overall capacity of the entity is large and the transfer of liquidity is timely between Nostros. Normally, most of these Nostros are in place due to reciprocal behavior, and the flow of payments is very small.

B. Response to Questions Posed by the BCBS

1. Do the proposed indicators adequately capture the intraday liquidity risk run by banks?

We agree that the proposed indicators are helpful in trying to identify intraday liquidity risk, but given materiality and efficiency considerations, a smaller and more focused number of metrics should be designed. This will better fit the entity's and regulator's requirements and the risk they pose.

We think that operational "outages" of the system should also be included as an indicator.

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2. Are the stress scenarios identified in the paper comprehensive?

The stress scenarios address both idiosyncratic and systemic stress scenarios. However it is arguably more important that an institution conduct stress testing that is firm-specific given its specific payment and settlement business, and the importance of ensuring that the whole payments system continues to operate smoothly. Contingency plans and operational outage plans should form part of this, while reverse stress testing should also be considered.

3. Is the proposed scope of application of indicators clear?

The scope of application is not totally transparent, and in particular needs to go further in considering how this would apply to complex group structures. We agree in principle that direct participants should apply a "bottom up" approach on a system by system basis but, as mentioned above, consideration needs to be given to indirect clearing with group members who are direct clearers alongside multiple nostros in the same currencies for indirect clearers. In addition, the nature of the legal entity (branch versus subsidiary model) needs to be addressed to understand which regulator has responsibility for enforcing any intraday prudential liquidity requirements. Any level of consolidated reporting where there is no technical bridge for RTGS systems would make the exercise pointless, especially when considering the Daily maximum liquidity requirement across different systems, as the timing of the worst case daily position would be different.

4. What, if any, implementation challenges would the proposed reporting requirements present to banks?

Such a wide range of metrics, unless better focused, would require significant one-off and recurrent costs. This is worthwhile if the outcome is better control and management, rather than just reporting.

Implementation challenges are driven by the historical position of providers in different jurisdictions: differences between countries can be considerable. With national, regional and international implementation of Basel III reporting and its specific formats in national law, the availability of resources to undertake this analysis is limited. In addition, 3rd party providers of software solutions may need time to scale up their operations, should they suddenly experience high demand for a product. We therefore recommend a longer timeline for implementation of these indicators that is distinct from the timetable for Basel III implementation. In the short-term,

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regulators may be able to obtain the same data on a semi-annual or annual basis and capture the material elements of intraday risk.

We would question whether monthly reporting to the regulators on the full range of indicators is necessary. Some metrics are better suited to some jurisdictions than others and, in our view, a combination of certain indicators is generally more useful. In addition, in some jurisdictions, the regulator responsible for the oversight of payments systems already has most of the data; *it may also be better for other regulators to build databases in order to obtain their own independent view of the data*. In many respects, only a small sub-section of the metrics requires monitoring on a daily basis, while others can be adequately monitored on a semi-annual or annual basis. Most correspondent providers do not change their risk in payment systems over the short term and therefore a longer-term trend analysis is more relevant to ensure no slippage or loosening of controls, or changes to business models.

5. Are the different monitoring and reporting requirements for direct and indirect payment and settlement system participants clear?

Yes, although we have specific concerns on the aggregation of indirect clearing reporting obligations and data production by clearing members to indirect members, as alluded to above.

HSBC Group appreciates the opportunity to share feedback and is happy to engage with regulators to further consider the issues around the intraday risk drivers.

Sincerely,

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