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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland
baselcommittee@bis.org

Dear Sir/Madam:

Re: ***Response to the BCBS consultation on monitoring indicators for intraday liquidity management***

The IBFed welcomes the opportunity to share with the Basel Committee (BCBS) its views on the proposal for a framework on monitoring indicators for intraday liquidity management. We would like to offer several general observations and responses to the specific questions posed:

General Observations

- Before finalising intraday indicators, the IBFed strongly encourages the Basel Committee to consider the extent to which banks manage and control their intraday exposures. Where there is good governance, banks are able to manage their intraday liquidity risk within defined parameters, and minimise in turn impacts on the amount of intraday liquidity they need. The controls include the ability to redirect liquidity to address exceptional circumstances (either because of payment systems problems or because of a stress). Good governance will, therefore impact, the indicators set out in this consultation; for example, determining the appropriate amount of collateral needed in payment systems.

- We welcome the statement “that the proposed indicators are for monitoring purposes only and do not represent the introduction of new standards around intraday liquidity management”. We note, however, that while paragraph 6 outlines that 'the proposed indicators.... do not represent the introduction of new standards', paragraph 58 indicates that 'Banks are expected to report the monitoring indicators to their supervisor on a monthly basis in line with the proposed LCR reporting requirements'. Therefore, we wonder why this paper is labelled as an Indicator rather than as a Requirement. Use of the wording “Monitoring framework” might better reflect its status.

- As outlined, the reporting requirements will be costly to implement, and we urge policy makers to avoid establishing a regime that is excessively burdensome. Given that these reports will be prepared and sent to supervisors on a monthly basis on past intraday (hour by hour) information on several different variables and at the legal entity (possibly branch) level , we question:
    - The amount of the information required;
    - The ability and use supervisors will give it;
    - Its relevance in terms of intraday liquidity monitoring.

  In our view, the reporting requirements, should be limited to a few core variables, and reflect the scale and complexity of the activities in the individual institution.

- 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. This will further allow policy makers to fully understand the impacts of the new regulatory standards (that were being created from scratch for the first time ever). A time frame for implementation of the proposals, and one that recognises other measures in progress should be proposed. Furthermore a level playing field must be ensured in final monitoring framework.

- Even if institutions have the systems to monitor the intended indicators, institutions will still have to develop their IT and systems to capture data in the prescribed manner. It will be important that the Basel Committee gives an appropriate lead in time to ensure that the necessary reporting infrastructure can be put in place for such data capture, before determining when they expect the first returns to be available to supervisors.

- Much of the data for the indicators will pass through the payment systems themselves. It may be more efficient for the payment systems providers (often central banks) to develop their IT to produce the reports rather than each bank having to develop their own reports which may, anyway, require downloads from the payment systems providers. We note, however, that with regard to establishing the link to payment systems, it needs to be acknowledged that there are differences in payment systems in how they operate and the way liquidity is managed.

- However, the report should also take into consideration payments in ancillary systems, which are supported by inflows of customers that occur in the previous day, or in the same day. This point is not clear in the current consultation. Hence, there should be a clear difference of the following groups of payments: interbank, ancillary and payment orders of customers.

- Additionally, reports should also consider problems occurring in the payments systems themselves which disturb the correct flow of payments and influence intraday statistics.

- Finally, we think that a definition of intraday liquidity risk should be clearly articulated in the text, which is currently not the case. We think that a proper definition could be:

  Intraday liquidity risk is the risk that the intraday liquidity needs of an institution exceeds its intraday liquidity as defined in §11 of BCBS consultative document "monitoring indicators for intraday liquidity management". Furthermore, the IBFed notes the following clarifications as helpful:

- Intra-day liquidity risk is the risk that materialises, between the opening and the closing hour of the value date, when the amount of guaranteeing collateral is not sufficient, or not at the right location, or can only be secured at excessive cost to allow normal continuation of payments.

- Intraday liquidity risk management is the management of the payment capacity of a bank, a process that ensures that an eventual shortage of funds, visible during the settlement period, is covered within the agreed intraday time-frame of the value day, during normal and stressed circumstances, at reasonable cost.

Further specific points

- Indicator (vii): The formula may require consideration of the fixed settlement times for certain payments systems, such as CLS, IRECC etc, where bulk numbers are exchanged at the same time every day, masking smaller irregular payment events.

- Paragraph 52: The paper should acknowledge that certain currencies are squared on a Spot Next and Tom Next basis and therefore would not be suitable for intraday 'Indicator analysis', since they are settled a few days later.

- There is a need to distinguish between collateral (and cash) pledged (or placed) with the central banks for intraday payments purposes and those placed to raise term funding and/or as part of the end of day buffer. Put another way, banks need a minimum amount of collateral to ensure they can make their payments each day. This should not be confused with liquid assets held for contingency or other purposes. Whilst the collateral needed for payment purposes cannot be used for stress reserves (i.e. it cannot perform “double duty”), the liquidity buffer can be called upon to meet intraday needs in the event a bank is under stress.

- Intraday Liquidity Sources - Paragraph 11 lists the type of potential intraday liquidity sources, one of it being 'eligible collateral pledged with the central bank'. Since for the purpose of managing intraday risk for a direct participant the main purpose is to provide collateral direct to the central bank itself, we therefore assume that 'central bank eligibility' is a sufficient criteria and no further qualitative requirements need to be fulfilled by holding such collateral other than recognising an appropriate haircut (e.g. marketable securities representing claims on specified counterparts, traded in large, deep and active repo or cash markets, proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions).

  We understand paragraph 37 pointing in this direction: "A market-wide credit or liquidity stress may have adverse implications for the value of liquid assets that a bank holds to meet its intraday liquidity needs. A widespread fall in the market value and/or credit rating of a bank’s unencumbered liquid assets may constrain its ability to raise intraday liquidity from the central bank. In a worst case scenario, a material credit downgrade of these assets may result in the assets no longer meeting the eligibility criteria for the central bank’s intraday liquidity facilities."

  This in effect means that banks may use additional liquidity sources which are not currently considered eligible for use under the liquidity buffer as required for Basel III / CRD IV.

- Furthermore, the IBFed would seek further clarification on the following:
  - The definition of 'financial institution customers' is unclear (indicators 5 and 6). What is meant here? Would this include pension funds and investment funds? Correspondent banking (nostro or loro) clients or all financial institution customers?
  - The definitions of critical and time-specific payments are unclear (indicator iv).

Response to questions posed

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

We believe that the indicators broadly capture the elements of intraday liquidity risk. However, there is some duplication in the indicators, e.g. indicators (vii) and viii) overlap. In indicator iv), we feel that the need to identify failed transactions is unnecessary, as payment systems themselves already record such failures and this is a good example of where the payment system provider can more efficiently produce the required reports. Indicators vi) and vii) for incoming payments should be included as well.

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, i.e. from the Far East and Australasia to the west coast of the Americas. This is linked to the definition of a "business day" in Basel III.

When it comes to indicator vii) and viii), there is the possibility that late outflows could be regarded as a sign of lower intraday liquidity risk for the institution in question. However, as the consequence for the receiving party is by necessity the opposite, we question whether such indicators could tend to bring in negative incentives, potentially hindering the smooth functioning of payment and settlement systems. We also question the value of the information that the indicators will provide.

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

Care needs to be taken to split stress scenarios which impact intraday liquidity specifically from more general stress events. Stresses (ii) and (iii), plus an additional stress where a bank sees its correspondent bank experiencing difficulties are examples of intraday stresses where collateral requirements need to be considered to support intraday payment needs. Stresses (i) and (iv), however, are stress events of a more general nature and for which the liquidity buffers are held. In these types of stress, the intraday risk is a manifestation of the more general event and not intraday specific.

Some IBFed Members think that further work is needed on the Basel Committee side to specify the stress scenarios in more detail. These hypotheses should be elaborated bearing in mind that the reporting should at the end be automated.

Some IBFed Members would also welcome homogenisation of stress scenarios across banks as necessary so as to obtain meaningful indicators both for the firms and the regulators.

However, other IBFed members maintain that it would be difficult for regulators to devise a uniform stress test that would be applied to banks consistently and would therefore welcome the flexibility in determining appropriate stress scenarios provided in paragraph 32 of the consultative document.

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

No. The report application is not clear when it refers to:

- The treatment of branches, subsidiaries and intra-group transactions;
- A bank which is both a direct and an indirect participant: which transactions should be reported (for example: transactions on behalf of customers, transactions on nostro accounts);
- Which type of payment systems should be considered (e.g. CLS, Euroclear)? How should they be considered (i.e. should transactions be reported netted).

We are concerned that the requirement to provide indicators which include balances on all the nostro accounts will be extremely burdensome and may even be misleading. We therefore suggest that the reporting be limited to the most significant nostro accounts at most.

The percentile proposed is based on 30 days observations (22 working days) which leave us with 5% of 22 results, meaning one day observation. This results in an insignificant dataset and therefore more volatility and less comparability. If the Committee wishes to examine maximum and minimum levels of intraday liquidity needs (and appropriate confidence levels) then we suggest that this be based on at least one year's worth of data. Having at least one year's worth of data would allow banks and regulators to see the effect of seasonal factors, for example.

Additionally, since the scope of the application may differ between banking groups, and the scope will depend on conversations/negotiations between each group and the supervisory authorities, the proposed application cannot be clear in terms of scope.

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

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

An element of materiality should be agreed upon between firms and their supervisors with regard to the monitoring of currencies and entities. It is necessary to rule on the minimum volume of payments for a currency to be reported.

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

These will be significant for most, where IT, system changes and reporting enhancements will be required. The proposed implementation would result in new procedures, new reporting and certainly huge investments in IT. New data warehousing may be necessary in order to store the amount of information needed to compute the intraday liquidity indicators and the required reports.

A further challenge will be to resolve the competing interests of home and host supervisors, and what obligations are placed on the firm.

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

Regulators should also be aware that increased emphasis on the use of intraday liquidity **could** lead to charging for intraday liquidity. This, in turn, may lead to banks delaying their payments to later in the day, leading to increased operational risk.

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

As mentioned in (iii) above, monitoring and reporting rules for banks that are both direct and indirect participants is not clear. More detail could be added to some requirements, such as the type of payments reported for correspondent banking services (payments systems included, correspondent relationships, etc) and the parameters to identify the five largest financial institution customers.

It is also not clear what is meant by 'intra-day credit (offered) as part of providing payment services to customers'. This should be explicitly limited to arrangements that are functionally equivalent to a correspondent banking relationship and should not include, for instance, routine extensions of credit made by banks in support of day to day clearing and settlement activities.

The IBFed urges the Basel Committee to recognise that small and medium sized banks (SBs) may have more straightforward indicators than more sophisticated banks that provide direct access to payment systems. Furthermore IBFed would like to point out that SBs often outsource their data development and/or systems. Therefore the time for implementation and the degree of freedom in extraction of data are different from those of banks with proprietary systems. Of course both types of institution already have significant IT developments being undertaken to meet the existing regulatory changes.

In these situations new prudential requirements or monitoring tools are difficult to implement, and with respect to other items on the agenda, seem to be too complex and not indispensable for sound liquidity risk management at SBs.

Yours faithfully,

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