Ref: GYG/162/H24

September 14, 2012

Comments on the Basel Committee on Banking Supervision's Consultative Document: Monitoring indicators for intraday liquidity management

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for this opportunity to comment on the consultative document: *Monitoring indicators for intraday liquidity management*, released on July 2, 2012 by the Basel Committee on Banking Supervision (the "Committee").

We hope that our comments below will be of assistance and perhaps offer an additional point of reference as you work towards finalizing the rules proposed by the Committee.

[General comments]

This consultative document proposes eight indicators as well as stress tests to be monitored. We respectfully request the Committee to fully ensure that the proposed indicators are used for monitoring purposes only and do not prompt the introduction of new standards around intraday liquidity management.

Further, considering the monitoring and supervision of the intraday liquidity management by individual banks, the significance of the monitoring items would vary among banks because their management style differs depending on their business model. Taking this into account, the reporting of monitoring indicators should not impose excessive operational workload by unduly focusing on the reporting itself, and consider differences in each bank's business model.

Further, banks are subject to other regulatory reporting regimes including the liquidity requirements under Basel III which are expected to be introduced at the same time as these requirements. Given this, we respectfully request the Committee to give consideration to avoid excessive reporting frequency and granularity.

- **Stress test**

The Committee’s proposal expects banks to report the monitoring indicators and stress test results on a monthly basis in line with proposed LCR reporting requirements. However, we are of the opinion that the stress test needs not be subject to the monthly reporting requirement.

While it is meaningful to carry out stress testing at higher frequency in crisis times, the stress testing in normal times only increases banks’ operational workload and cost. Therefore, such stress testing should be either based on individual banks’ scenarios, or its reporting is limited to cases where underlying scenarios are changed.

The consultative document particularly identifies a “market-wide credit or liquidity stress” as one of stress scenarios. Given that the purpose of such stress scenario is to address systemic risk being realized, it is important that a common set of stressed conditions are shared with all banks. Therefore, specific scenarios for systemic risk should be developed in consultation with the supervisors.

Further, those indicators related to timing of settlements should not be included in the proposed indicators applied to stress testing because, as discussed below, such indicators are considered to lack significance for monitoring purposes.

- **Treatment of monitoring indicators (Paragraph 6 etc.)**

It should be fully ensured that the proposed indicators are used for monitoring purposes only and do not prompt the introduction of new standards around intraday liquidity management. If these proposed indicators become constraining factors - for example the “daily maximum liquidity requirement” or other indicators may hamper further business development in the domestic fund transfers, there may be a risk that some event, such as procrastinated payments, may occur.

Further, since, while banks receive intraday liquidity supply (mainly from central banks), they also serve as an intraday liquidity provider (mainly for its customer financial institutions), it is requested to clarify the scope of reporting so as to avoid overlapping reporting as liquidity providers and recipients.

- **<u>Unified/efficient data collection (Establishment of an infrastructure to allow access to indicators using a central bank's settlement system)</u>**

Direct participants to a central bank's settlement system execute most of their settlements via its system. Therefore, an infrastructure should be equipped to the central bank's settlement system to enable unified and efficient data collection.

- **<u>Effective date (including early clarification of requirements allowing sufficient time for system developments)</u>**

It is expected that a significant-scale of system development and construction of in-house structure are entailed for collecting and reporting underlying figures for the monitoring indicators. Therefore, it is considered necessary to finalize monitoring indicator requirements at an early point, and ensure a sufficient preparation period. To address this, clear definitions of monitoring indicators should be provided at an earlier stage. Given the budgeting process, size of system development and other factors, it is requested that an outline of the requirements and detailed requirements be finalized 24 months and 18 months prior to the effective date, respectively.

Further, following the Liquidity Coverage Ratio (LCR) requirements expected to be effective from 2015 and other requirements in Basel III, a sufficient preparation period should be set.

Also, the Committee's consideration on limiting the scope of currencies to a home currency during early period or several years would be appreciated.

[Specific comments]

- **<u>Intraday liquidity sources (Paragraph 12)</u>**

Since uncommitted credit lines may be reduced without a prior notice, and in such cases, credit lines may not be available as own liquidity sources, it is considered not appropriate to treat them as such.

- **<u>The set of monitoring indicators (Paragraph 14)</u>**

○ **(i) Daily maximum liquidity requirement (actual settlement times) (Paragraph 17, etc.)**

The settlement of foreign currencies relies on Society for Worldwide Interbank Financial Telecommunication (SWIFT). Therefore, we request the Committee to encourage the SWIFT vendors to modify their system database to be consistent with the proposed reporting formats, if necessary, on a global basis.

The consultative document states that “intraday liquidity positions should be calculated on actual settlement times, rather than on submission times of payments to the system or to a correspondent bank, as appropriate”. However, this is not practicable, since, under the current practice, no means are available to confirm the time when each payment order was actually settled in foreign currency through a nostro account.

In order to capture actual settlement times, it is considered necessary to improve infrastructure. The example of improvement includes requiring each settlement time for each receipt and payment to be shown in the statements issued by correspondent banks such as SWIFT MT950.

Also, even if the above mentioned improvement (the requirement to include settlement times in the statement) is introduced, it should be noted that the customer banks need to rely on the correspondent banks in terms of settlement times recorded on the statements, and the customer banks have no way to fully ensure the accuracy and appropriateness of the statements.

○ **(v) Time-specific and other critical obligations (Paragraph 25)**

Payment of fail charges at the time of delay in settlement and other events is an established market practice, as seen in the fail practice for bonds transactions.

Therefore, some fail charges are recognized as costs, rather than financial penalty, with an effective measure to reduce delay in settlement.

It is understood that this indicator is intended to identify settlement obligations which may cause a significant adverse impact such as financial penalty, damage from bad reputation and loss of future business opportunities. However, it is not considered appropriate to uniformly apply this requirement to all transactions including those with a market practice such as fail practice stated above. Accordingly, we request the Committee to further clarify the definition of this indicator by excluding transactions with fail practice from this indicator, or by making clear how such transactions are treated for this indicator.

○ **Selection of the largest five financial institution customers (Paragraphs 26 and 27)**

The criteria for selecting the largest five financial institution customers by transaction value should be clearly defined in order to identify the scope of measurement and assess feasibility. (e.g. the largest five customers by value as at the end of the previous month.)

○ **(vi) Intraday credit lines extended to financial institution customers (Paragraph 27)**

The Committee's consideration to clarify that, in cases where intraday incoming and outgoing payments are executed using over-night credit lines, the amount of intraday liquidity extended from over-night credit lines is not subject to the reporting of "Intraday credit lines extended to financial institution customers" would be appreciated. Because over-night credit lines, such as general current account overdraft line, are not monitored regularly, it is considered impossible to measure the historical amount of intraday credit lines including the one extended from over-night credit lines.

○ **(vii) Timing of intraday payments and (viii) Intraday throughput (Paragraphs 28 to 30)**

Reporting of the average time of a bank's daily payment settlements and the

proportion of a bank's outgoing payments that settle by specific times by individual banks is not considered necessary. This is because these reporting items would vary depending on the mechanism and practice of each settlement system as well as seasonality, and, if the purpose of this requirement is to monitor the overall status of the entire settlement system, such information can be captured through the indicators (i) to (vi). It is requested that monitoring of the timing of intraday settlements, if considered necessary, be covered by reporting the indicator (viii) Intraday throughput only.

Particularly, given that, for intraday liquidity monitoring purposes, it is preferable to constantly monitor cash positions to ensure no net cash shortage (i.e. cash squeeze) to occur, doubt is raised as to requiring the calculation of the average time for the indicator (vii) which focus only on the payment amount.

○ **Indicators monitoring for indirect participants**

The scope of monitoring for indirect participants should be limited to key accounts which are used primarily for cash position management/settlement since it is difficult for indirect participants to identify all accounts that are attributable to settlement agencies.

(1) "(i) Daily maximum liquidity requirement", "(ii) Available intraday liquidity", and "(iv) Time-specific and other critical obligations"

The timing of settlement by indirect participants is dependent on a correspondent bank, and therefore it may be impracticable to identify balances on a time-series basis. On the other hand, even if the balance identification is practicable, it would be difficult for indirect participants to measure "(i) Daily maximum liquidity requirement", "(ii) Available intraday liquidity", and "(iv) Time-specific and other critical obligations", unless the correspondent banks disclose information to indirect participants.

(2) "(viii) Intraday throughput"

As commented above, our request is to eliminate the reporting of the monitoring indicator "(viii) Intraday throughput". Further clarification is requested to confirm

whether this consultative document requires indirect participants to report this item like "(vii) Timing of intraday payments". At all events, we are of the opinion that indirect participants cannot meet this reporting requirement, because it is difficult to measure this item due to a correspondent bank if they do not disclose such information to indirect participants.

- **<u>Intraday liquidity stress scenarios (Paragraphs 31 and 32)</u>**

The primary assumptions used for intraday liquidity stress scenarios are expected to be funding risk and counterparty fund settlement risks in the inter-bank market as well as volatility in market value of qualified collaterals. We would like to confirm whether such scenarios should consider potential outflows of deposits as well.

Further, we would like to recommend an approach where each bank identifies where risks exist, and prepares specific stress scenarios based on this, and then reaches an agreement with a supervisor. The ground of our recommendation is that the stress scenarios assumed for each bank depend on the bank-specific situation and business model.

○ **Counterparty stress: A major financial institution counterparty suffers an intraday stress event which prevents it from making payments (Paragraph 35)**

This consultative paper does not clearly specify the definition of "counterparty stress". If such definition could not be clarified, we respectfully request that this indicator be included in Paragraph 37 "Market-wide credit or liquidity stress", or an alternative approach be considered where the scope is limited to financial institutions which are highly dependent on other financial institutions for liquidity source (or payment settlement).

Also, the Committee's consideration for this paragraph would be appreciated to ensure that the liquidity risk management framework based on the current practice between reporting banks and correspondence banks (overdraft interest collection, processing completed by having a counterparty which delayed in payment assume a burden, and a credit line management through providing collateral) does not significantly deviate from the monitoring approaches proposed in this consultative document. This is because, if the current practice undergoes extensive review to align

with the monitoring approaches expected to be introduced, such extensive review may have an adverse impact on intraday cash settlement.

➢ **<u>Scope of application</u>**

The consultative document requires banks to report significant currencies and significant subsidiaries' account. However, it is proposed that the following should be considered so that the introduction of such reporting is limited to the extent it is considered to be operationally practicable.

○ **Reporting exemption associated with particular currency (Paragraph 54)**

With respect to particular currencies, we respectfully propose to set the scope of and criteria for monitoring indicator reporting. For example, it is recommended that the following exemptions be established:

(1) Criteria commonly applied to home currencies and foreign currencies on a account basis (including Due from other banks):

Set "the minimum criteria for the number of fund transfer activities for the month or transfer amount" and "the minimum criteria for month-end balances", and exempt the reporting in cases where values are below these thresholds.

(2) Criteria on currencies:

From materiality perspectives, set "balance sheet criteria, including a ratio of foreign currencies to liabilities", and exempt the reporting in cases where values are below the set threshold.

Also, in establishing the above (2), we request that the criteria on currencies exempted from the reporting should be applied to "cases where the total of liabilities associated with the currency accounts for less than 5% of the total of bank-wide liabilities". Monitoring indicators for intraday liquidity management needs to be consistent with the treatment of LCR by currency since these indicators function as complementary items to LCR.

In addition, if individual reporting requirement is exempted from the standpoint of

materiality, we respectfully request to consider exempting such currencies from the total amount in consideration of reporting burden.

○ **Organizational structure (Paragraph 55)**

This paragraph states that "The appropriate organisational level for each bank's reporting of its intraday liquidity indicators should ultimately be determined by the home supervisor." In terms of monitoring at significant individual legal entity level, settlement agents as well as risk management practice vary depending on the types of financial institutions, such as banks and securities firms. Therefore, this indicator should not be applied uniformly across all types of financial institutions, and reporting requirements should be considered factoring in the type of each entity, including subsidiaries.

○ **Responsibilities of the home and host supervisor (Paragraph 57)**

The scope of application of this requirement should consider the materiality. Sufficient supervision could be achieved by reviewing a management/operation structure, without requiring home supervisors to monitor all payments/settlements of all locations.

On the other hand, this consultative document sets forth that for a branch operation, "the home supervisor should receive a full set of intraday liquidity indicators for its banking groups covering both domestic payment and settlement obligations and obligations in nondomestic payment and settlement systems", but some banks may need to take actions to reorganize multiple settlement location system to one location system on a currency-by-currency basis and concentrate settlements to one correspondence bank, and establish a centralized data monitoring structure, hence giving rise to a new system investment and operational burden. We therefore request the Committee to make careful reconsiderations on this requirement.

➢ **<u>Reporting frequency and granularity (Paragraphs 58 and 59)</u>**

Banks should be granted some latitude in relation to reporting frequency/items, instead of applying uniform reporting requirements. Since the intraday liquidity framework differs across jurisdictions due to differences in the settlement mechanisms,

nature of settlement business and financial practice, it is not considered necessary to require all banks to report all the proposed items. For example, regional financial institutions have less volume of dealing foreign currency transactions and therefore should be given consideration in respect of reporting granularity and scope, such as permitting exemptions from reporting the foreign currency related items.

As to reporting frequency, the consultative document proposes monthly reporting. However, given remaining uncertainties such as workload required for data collection, sufficient time needs to be reserved after clarification and before introducing monthly reporting.

For those indicators with a nominal daily volatility such as “value of intraday credit lines extended to financial institution customers” set forth in the paragraph 59, since daily track record is difficult to be reflected in the bank’s own system timely and accurately (that is, it is difficult to determine the date of setting credit line and other items), it is requested that banks be allowed to report only the month-end value, instead of reporting the monthly average and maximum and minimum value.

- **Practical example of the monitoring indicators (Annex 1)**

While the consultative document states in page 7 that banks should report the total value of their daily payments made and received, the example in Annex 1 (iii) illustrates the total payments made only. The explanation of the reason why total payments received is not included in this illustration would be appreciated.

- **Sample intraday liquidity monitoring return (Annex 2)**

With regard to the indicator “3h. Lowest amount of available intraday liquidity during the business day (3a+3b+3d+3f)” set out in the chart of Annex 2, since the timing (date and time) of being the lowest amount differ among items, using a figure which is derived by simply aggregating lowest amounts as this indicator is considered to provide limited useful data. Therefore, the consideration of excluding this item from the reporting requirement would be appreciated.