4 September 2012

Group Treasury
5th Floor
280 Bishopsgate
London
EC2M 4RB

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 BASEL, SWITZERLAND

John.Cummins2@rbs.com

BCBS 225 - Monitoring indicators for intraday liquidity management

The Royal Bank of Scotland Group is pleased to have the opportunity to comment on the proposals for the introduction of monitoring indicators in respect of intra day liquidity.

Our response has been broken down into four parts. The first part sets out our key messages, the second is our response to the questions raised, the third part provides additional comment on some of the paragraphs in the paper and the fourth part sets out our proposals for a qualitative approach.

Part 1: Key messages

- We are concerned the consultative document has outlined a series of quantitative monitoring indicators when intra day liquidity is better managed via qualitative measures. As we found with the UK FSA ILAA regime (and as highlighted in the Basel Paper 2008 paper paragraphs 77-79), the key issue for intra day liquidity is the overall control and wider governance of intraday liquidity. We believe there is a real danger that the introduction of a series of metrics or indicators across the market could lead to dysfunctional behaviour by providing incentives to banks to delay payments simply to improve the metrics. This would distort existing market operations and increase operational and liquidity risk. Qualitative measures would also allow for the fact that banks may be direct, indirect participants or (in many cases) both across a number of currencies and payment systems. Quantitative measures, on the other hand, are not appropriate across all models. In Part 4 we set out our suggested qualitative measures for discussion.

- This paper does not clearly articulate what is expected of banks in respect of the provision of intra day liquidity. In particular the question of “double duty” i.e. where the **minimum** level of assets needed for intra day settlement are also included as part of the liquidity buffer. One way of looking at this is to break the need for intra liquidity into three distinct parts:
    1. Collateral to support normal intra day payments taking account of the normal cashflows a bank experiences in its payment systems (including cash in tills). Such collateral is required by the bank to open its doors each morning and should be separated from any liquidity buffer held for contingency arrangements.
    2. Collateral required for peaks and troughs in payment flows. Again this is part of non stressed activity and is separate from any liquidity buffer held for contingency purposes.
    3. BCBS 188 has stated that the calculation of the LCR does not include collateral for intra day liquidity in stress situations. Therefore there is a need for banks to consider what additional liquidity is required in the buffer - if a stress occurs - to support intra day payments e.g. where payments systems demand additional margin, increased haircuts and/or direct participants withdraw intra day overdraft lines.
    - The **minimum** level of liquid assets needed to manage a bank’s intra day obligations for the first two cases cannot be regarded as available in the LCR liquidity buffer to meet obligations at the end of the day because they must be available for the payment systems, at the start of the next day.

- However, where a bank encounters a liquidity stress, the liquidity buffer **is** available to support **additional** intra day liquidity needs arising from that stress

- Given the scope of the application set out in para 57, the volume of data generated by these proposals will be substantial and could impact on the key messages and actions being identified by regulators when analysing the intraday liquidity data. Our view is that a level of 'materiality' should be encompassed within the guidelines to ensure that they focus on the flows and clients that drive the key movements in intraday liquidity.

    - In order to keep costs down we suggest the Basel Committee work with payment system providers (often central banks) to develop IT solutions where possible. We believe that, rather than each individual direct participant developing the same report, the payment provider could develop a single formatted report to the relevant bank for inclusion in that bank's risk management and monitoring.

Conclusion

Four themes emerge:

- Before requiring banks to develop IT reporting systems to produce a set of quantitative indicators, we need to explore whether the regulation of intra day liquidity risk would not be better served using a qualitative approach.
- If quantitative measures are to be used: need to be aware that one size will not fit all, be clear what the indicators are measuring, to what standards banks are expected to manage and then consider whether behaviour will change, particularly if there is any intention of publishing the measures, bearing in mind market pressure for more disclosure.
- Any indicators need to be developed taking into account the controls a bank has over its intra day payments
- A distinction needs to be made between collateral needed to manage normal intra day liquidity flows and that needed in stress situations and which therefore need to be added to the LCR buffer.
- A proportionate approach needs to be adopted.

John Cummins
Group Treasurer

Direct Dial: +44 20 7672 3342
Email: John.Cummins2@rbs.com

Part 2: Five questions

1) Do the proposed indicators adequately capture the intraday liquidity risk run by banks?
Response:

- Without any further context the indicators in themselves do not explain the liquidity risk run by banks. The relationship between the figures, the business behind and the controls are very important to consider before assessing the liquidity risk - such as a bank's ability to manage, monitor and influence payment flows and liquidity levels in times of stress. There is a direct relationship between a bank's ability to manage its intra day flows and its need for intra day collateral.
- We believe there may be duplication and more efficient ways of monitoring the risks. For example,
  - Under Indicator 4 (time-specific payments) the need to include reporting of 'missed' payments is unnecessary as the clearing and settlement systems themselves normally monitor this information and could be made available to regulators, if not already supplied.
  - We accept banks should monitor, report and manage time critical payments. However, it is unclear why indicator 7 (timing of payments) is required when Intraday throughput is captured under indicator 8.
- In addition, feedback is required in relation to overnight settlement, or <u>night time settlement windows</u> which are available in some payment and settlement systems. These windows allow banks to receive and make payments although their ability to influence the process may be limited (for example the EBA SCT night time settlement window – or Euroclear night time settlement).
- We are concerned that indicator 6 could be misinterpreted.
  - Firstly the sum of the intra day credit lines (settlement limits) is not a good indicator of the intra day liquidity risk. Each intra day line is specific for each counterparty and reflects the credit assessment of the counterparty. Not all counterparties will need the full line at the same time. We assume it is the purpose of indicator 1 to assess the maximum level of intra day collateral i.e. pick up the portfolio impact of the many indirect clients as well as the direct participants own flows.

  - Secondly intra day credit lines are uncommitted and unadvised. This means withdrawal of those limits will not lead to a reputational issues particularly where it is the counterparty's credit standing that is the issue. Where the direct participant itself is under stress we do recognise that one way of limiting exposure is to reduce intra day credit offered but a) good control processes help smooth the effects and b) the liquidity buffer is there to support the intra day flows.

  - Thirdly, credit limits may change if the direct participant's credit risk department sees the standing of a particular counterparty declining. The speed at which such limits can be changed, advised to the payments team and acted upon is, of course, a reflection of the controls and governance of the direct participant.

- Paragraph 60 sets out the 5^{th} and 95^{th} percentile requirements. We suggest these are required only annually (or at least based on 1 year's worth of data) as the information needed to estimate intra day liquidity needs to be based on a complete year's worth of data to take account of such things as seasonal factors and statistical significance,

2) Are the stress scenarios identified in the paper comprehensive?
Response:

- As set out in our key points we believe there is a need to separate out liquidity required for intra day liquidity management under normal times for the bank concerned from those where the bank is under stress.
- To that end stresses set out in B i) 33/34 and B(iv) 37-39 are stress events for which additions to the LCR buffer may be required whilst the stresses set out in B (ii) 35 and B(iii) 36 are intra day liquidity risks for which intra day collateral is required. The collateral required for (ii) and (iii) should not be seen as part of the LCR buffer, but part of the internal control process to limit intra day exposure.

- A further intra liquidity stress event is one considering the possibility of a client bank's clearing agent suffering a stress and the client bank then being unable to make payments through its Nostro accounts. In this case additional collateral may not be the only solution:
  - Industry is already discussing with SWIFT the possibility of re-routing the non direct participants' payments to an alternative direct participant in such an event.
- We welcome the recognition that information from the stress scenarios should inform the discussion between a bank and its supervisor(s) as we believe a one size fits all approach will be difficult to achieve. Having said that it is vital that there is alignment between supervisors in order to avoid differences/unlevel playing fields.
- The way a stress scenario has an impact on the indicators is largely determined by banks specific situations and capabilities around monitoring and controls. For that reason there should be clarity on how supervisors can include this additional information in their assessment. In Annex 3 these elements are not included.

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

Response

- We welcome recognition that a bank can agree with its local regulator which legal entities are significant (paragraph 55) but believe that this also needs to apply to which payment system, currency, nostro account etc are also significant. Failure to set de minimis levels across these variables will lead to large volumes of data being produced for relatively small intra day liquidity risk. Definition of an appropriate de minimis reporting level would be helpful.
- Clarification on some of the definitions - e.g. financial institution, critical payments - will be key to ensure the right level of IT programming and data capture is undertaken to ensure consistent and meaningful aggregated data.

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

Response

- Large banking groups like RBS hold substantial numbers of nostro accounts, and hence indirect participants, the majority of which will process only relatively low values. Unless there is an appropriate de minimis reporting threshold, this will create a significant reporting challenge for no benefit.
- Whilst our internal systems have the ability to meet a number of these indicators, the detailed definitions need to clearly articulate what is expected to be reported, as mentioned in response to Question 3. Another concern is the competing interests of home and host supervisors (and the obligations put on firms).
- The interaction of risk and credit systems with payments systems to automatically produce the data will be critical to address certain indicators and will require clear breakout of data requirements to ensure reporting is undertaken on a consistent basis.
- Some of this challenge might be alleviated by asking payment systems owners to develop reports for the intra day payments crossing their systems.

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

Response

- No, it is not entirely clear which indicators apply to both direct and indirect participants and which to direct only, for example Indicator 8. If both are required it would make sense to differentiate between direct and indirect when reporting. Aggregation of these data sets will hide the differences that should be considered in relation to each type of business, monitoring and control capabilities – which are different between direct and indirect.

Part 3: - Comments on specific paragraphs

Paragraph 11

- The definition in paragraph 11 for Intraday is rather understating the subject. We feel it should be more specific referring to FI and customer flows, managing critical payments and complementing wider control and management techniques

Paragraph 15 & 16

- This section refers to payments received and made at 'any point in the day'. Is there an expectation that this data is captured in time buckets (say 10 minutes intervals) or tracked on a second by second basis? The latter will require substantial amount of data to be collated throughout the day. Current intraday liquidity reporting systems such as the Bank of England's new RTBI database reports data at 5 or 10 minute intervals.
- The maximum observed daily 'net cumulative liquidity position' is not necessarily an accurate measure of a bank's true maximum liquidity requirement, as that amount of liquidity may have been utilised simply because it happened to be available at the time. It is perfectly possible that the bank could have managed its payment flow adequately within a significantly lower maximum net position had it chosen to do so. There is a risk that introducing metrics like this will encourage banks to slow down their payment flows so as to reduce their reported liquidity requirements, with a detrimental impact on the market as a whole. We believe the key aim to be the ability of organisation to manage and control the peaks and understand which clients are driving these peaks. Additionally, if this data is made available to the client, this could well influence their behaviour and timing of payments being undertaken intraday.
- Re footnote 13, we assume that the purpose of excluding the ability to raise intra day collateral, in this indicator, from central banks is for this measure to determine the level of facilities required at the central bank. If we are not able to include the funds obtained through central bank intraday facilities, we would expect that the collateral used for these operations could be included in sources of liquidity. Otherwise all our intraday operations to raise liquidity intraday with and via the central bank facilities would be 'lost' and potentially result in double collateral requirements.

Paragraph 17, 20, & 27

Basing intraday liquidity positions on actual settlement times is appropriate where a bank is a direct participant in a payment system. For indirect participants the situation is less straightforward - in principle an indirect participant's intraday liquidity usage is determined by the timing of debits / credits to its nostro account rather than the time when payment instructions are actually sent to the correspondent bank. However in practice correspondent banks may take different approaches to debiting their indirect participants and releasing payments depending on the local payment environment. Some debit and release in bulk, allowing payments to queue either internally or in the RTGS system, so the balance of the nostro account is no longer a proper reflection of liquidity requirements. There will also be challenges for indirect participant banks in obtaining data on the movement of their intraday nostro account flows from correspondents in a consistent manner suitable for reporting to regulators.

Due to time-zone differences it could well be that indirect participants send the majority of their payments to their nostro providers before the clearing opens, whereas the payments received will only arrive during clearing hours. Obviously this will have an impact on the banks position with the nostro agent (depending on the procedures and practices of the nostro provider)

In terms of intraday credit lines extended by correspondent banks to their indirect participant customers, we agree that the value of these credit lines determines the amount of the correspondent bank's liquidity that can be consumed by its indirect participants under normal conditions although we would point out that these are not legally committed nor even advised. Extending the reporting to include the maximum daily usage of that credit for the top 5 customers does not add any obvious value since

- The direct participant can reduce the limits without reputational damage if they themselves are under stress or if they perceive that their client is under stress
- The indirect participant does not know the limit they have and must, anyway, plan to run their nostro in credit for times when they are under stress.

Paragraphs 24-25

- All banks will have different time specific/critical payments, and many will be of differing order of magnitude. Some may relate to exceptional items such as corporate transactions, so critical for one day only. Many of these industry wide critical payments are already covered by processes and rules, e.g. CLS, LCH monitor this information and could make it available to regulators, if they do not already do so. Therefore, we are not sure the need for this indicator except in so far as regulators confirm that banks are using the information in their intra day liquidity management and control processes.

Paragraph 26

- Clear definition of Financial Institutions is required as there are a number currently in circulation with the Basel III and European CRR 4 texts.
- In addition, are we referring to a system by system basis e.g. gross value of CHAPS payments made on behalf of FI clients or all payments to include the likes of BACS, which are settled on a net basis.
- How are payments which are addressed in our own books (to other clients or to ourselves) to be treated?

Paragraphs 28 to 30

- This will be onerous to calculate and report, and which is of little obvious benefit over Indicator 8 (intraday throughput) when it is in place. Both 7 and 8 seem to have the same objective, namely detecting changes to a bank's payment flow profile over time.
- Whilst we are not looking for additional indicators, the difference between submission timing of the flows and the actual settlement timing would give valuable information e.g. it would help analyse why, for example, settlement timing overall is delayed. It makes a huge difference if the delay is caused by late sending or due to lack of liquidity in the system (which could be caused by delayed received payments).

Paragraphs 40 to 45

- We welcome the recognition of a need to discuss the output from the stress scenarios with regulators rather than imposing additional regulatory imposed metric limits.

Paragraphs 47 to 51

- It is not sufficiently clear which indicators are supposed to apply to indirect participants.
- Paragraph 48, second bullet point. It does not appear to make sense to consolidate as the controls within the system and on the bank side differ. Therefore, the indicators, and the way stress scenarios apply to these, need to be assessed separately.

Paragraphs 52 to 56

- We believe there is a need to consider appropriate de minimis thresholds to enable both banks and regulators to focus on relevant data, and to ensure a consistent application across jurisdictions.

Paragraph 57

- Here again there is a need to recognise a proportional approach.

Paragraphs 58 to 60

- As mentioned elsewhere we believe that, in the interests of keeping costs down, payment system providers should be encouraged to develop reports that could be provided to their direct participants to save each bank having to develop its own reporting on e.g. payment throughput

Part 4: Proposals for a Qualitative Approach

To help the discussion of how regulation of intra liquidity risk might work we set out below a quantitative approach. Where appropriate we refer to the 6 operational elements (e.g. P(i) set out in principle 8 of the Basel Committee's *Principles for Sound Management of Liquidity Risk* published in 2008.

A) Direct Participants

1. Does the bank know through which payments systems its significant payments are made? P(i)
2. How good is the bank at controlling its flows to other direct participants throughout the day e.g. using schedulers? P(v)
3. Does the bank have visibility of its central bank balances during the day? P(ii)
4. What processes does the bank have to identify and mange high priority payments? P(i)
5. What processes does the bank have to identify and mange unusual and significant flows? P(vi)
6. What processes does the bank have to monitor and manage its customer's (indirect participant's) positions against intra day credit limits and historic flows? P(ii)
7. P(vi) How good are the communications between:
    a. Bank and its significant intra day customers
    b. Intra day position mangers and other parts of the bank
    c. Payment system managers e.g. central banks
    d. Regulators
8. How does the bank control its collateral for the payments systems in which it is a direct participant? P(iv)
9. What processes and governance surround the use of that collateral? P(iii)
10. In the event of an idiosyncratic stress event what is the process for informing the intra day management team of a problem? P(vi)
11. Given that idiosyncratic stress will show up very quickly in the intra day cashflows, what are the lines of escalation that the intra day management team have where they are experiencing other direct counterparties delaying payments to them? P(vi)
12. How quickly can contingency arrangements be communicated and put into practice? P(vi)

B) Indirect participants

1. Does the bank know through which direct participants its significant payments are made? P(i)
2. How good is the bank at controlling its flows through its main nostro accounts? P(v)
3. Does the bank have visibility of its main nostro flows during the day? P(ii)
4. What processes does the bank have to negotiate the priority of its payments through its nostro accounts? P(i)
5. P(vi) How good is the communication between:
    a. Bank and its correspondent banks
    b. Intra day position mangers and other parts of the bank
    c. Payment system managers e.g. central banks
    d. Regulators
6. What processes and governance surround the use of those nostro accounts? P(iii)
7. In the event of an idiosyncratic stress event what is the process for informing the intra day management team of a problem? P(vi)
8. Given that idiosyncratic stress will show up very quickly in withdrawal of intra day overdraft facilities, what are the lines of escalation that the intra day management team (or nostro managers) have where they are experiencing other direct counterparties delaying payments to them? P(vi)
9. How quickly can contingency arrangements be communicated and put into practice? P(vi)