POSITION PAPER

WSBI-ESBG common response to the Basel Committee consultation on "Monitoring indicators for intraday liquidity management".

WSBI-ESBG (World Institute of Savings Banks - European Savings Banks Group)
Rue Marie-Thérèse, 11 - B-1000 Brussels
WSBI-ESBG Register ID 8765978796-80

September 2012

I. General observations

The WSBI-ESBG welcomes the opportunity to share its views and opinions on the Basel Committee's proposal for a framework on Monitoring indicators for intraday liquidity management. The WSBI-ESBG agrees with the Basel Committee view that transparency and management of intraday liquidity risk is an important component of the overall liquidity risk management. However, the WSBI-ESBG does not believe that the introduction of quantitative indicators – which the Basel Committee proposes - is the most efficient way of conducting supervision of these risks.

First of all, the WSBI-ESBG would like to stress that monitoring of intraday liquidity risk is addressed by financial institutions by different means, from keeping control on intraday flows and having sufficient liquidity available in real time, to arrangements/rules governing the payment and settlement systems, both on the timing of the exchange of transactions and the handling of technical and financial disruptions. The WSBI-ESBG is of the opinion that the Basel Committee should have focused on the qualitative aspects of the intraday risk management. This would have been a more efficient and natural first step of controlling and monitoring a bank's intraday liquidity risks than directly introducing quantitative indicators. This would also allow the supervisors to obtain improved understanding and knowledge about the intraday liquidity risks which would have helped to better define and interpret quantitative indicators.

This framework, suggested by the Basel Committee, would introduce a set of indicators for monitoring intraday liquidity that financial institutions should include in their operation management. According to the proposal, banks would have to report for each payment and settlement system and every (material) currency would have different manifestations both at the level of individual banks and also at a consolidated level.

Costs of setting up the suggested reporting requirements

The indicators suggested by the Basel Committee would provide a detailed picture of each individual bank's intraday liquidity situation. However, it must be considered that in order to comply with these reporting requirements financial institutions would have to invest in new systems that would involve huge additional costs in terms of the implementation and maintenance of the systems. The probable size of costs must be estimated and compared to the benefits that these new reporting requirements would mean for the banking system and for economic activity. Furthermore, the Basel Committee should be aware of the huge workload that banks would have to face as a result of all the new financial regulation that would enter into force in the short term. Banks are now preparing for the new Basel III requirements that already includes two quantitative liquidity indicators.

These additional requirements would probably add pressure on the institutions and especially on the IT-resources. Financial institutions would need to undertake rather extensive developments of their IT systems to retrieve the requested data in the prescribed manner. The amount of underlying data needed to compile the requested indicators would be huge and the complexity high. Furthermore, the WSBI-ESBG is of the opinion that a significant share of the data needed to calculate the proposed monitoring indicators is already available by the providers of the payment systems themselves (often central banks). Thus, the WSBI-ESBG believes that it would be more efficient and less costly to retrieve the required data directly from the payment system providers rather than from each bank individually. All this should be considered when deciding on the timeframe for the implementation of these new requirements. The Basel Committee does not include any assessment of how the setting up of these new requirements could impact financial institutions. Regulators should be aware of these circumstances and refrain from bringing in additional requirements beyond what is absolutely necessary and well argued for.

The huge reporting burden that this framework would involve bears no relation to the actual intraday liquidity risk. In practice, intraday liquidity risks are managed by institutions by payments of damages as well as higher interest rates or fees charged to institutions that incur in delayed payments. These are monitored and controlled by operational risk management tools; a failure to pay falls under the remit of credit risk management.

Furthermore, the mentioned costs would even mean a greater burden for small institutions that due to their business model do not engage in high intraday liquidity risks. The Basel Committee does not include any guidance on how the indicators can be implemented and do not refer to an alternative approach on the setting up of indicators according to the scale and complexity of businesses. Given the differences in inherent intraday liquidity risk, regulators should include some provisions in the framework in order to grant the principle of proportionality which is present in the rest of initiatives put forward by the Basel Committee.

Additionally, the WSBI-ESBG considers that intra-group transactions should be treated more favourably according to the latest Danish Presidency compromise.

The reporting requirement on monitoring indicators may create wrong incentives

The WSBI-ESBG would like to stress that two of the suggested indicators may even have some adverse effects compared to the aim of the reporting. Both indicators "(vii) Timing of intraday payments" and "(viii) Intraday throughout" seems to imply that late outflows is a positive sign - of low intraday liquidity need and risk - and thus giving incentives for delaying outgoing payments . The ratios proposed in the consultative document would benefit those institutions that hold back their payments throughout the day for as long as possible (for instance by maximum consumption of intraday liquidity). However, as delaying inflows must go together with counterparties' delayed

inflows, such behaviour could jeopardise the well-functioning of payments and settlement systems, both nationally and cross-border. As a result, the reporting of the ratios could create incentives for mismanagement of intraday liquidity. Delaying settlements closer to the end of the day also gives less time for money market activity - necessary to adjust overnight liquidity - giving rise to the risk of banks not having enough overnight funds. 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. These wrong incentives could, in a worst–case scenario, increase the systemic risks in the intraday payment systems by creating delays and gridlocks.

Moreover, 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.

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 that presented in Annex 1.

Another problem with the suggested indicators is that they will be affected by factors not controlled by the "reporting bank". For example failures to execute payments in time and/or other deficiencies at a correspondent bank would have negative impacts on the reporting bank's indicators, while the correspondent bank actually benefits from its failure. This of course gives wrong signals and further guidance and clarifications are needed on how to consider such issues.

No industry standard for intraday payments

One important prerequisite to calculate and report the suggested monitoring indicators for intraday liquidity risks is an existence of a common industry format standard on the information exchanged on each intraday transaction. Today, the information exchanged on many types of intraday transactions does not comply with the requirements stipulated in the Basel Committee's consultative paper, e.g. time stamps are missing on several types of payments and accounts statements which make it impossible to e.g. measure many of the proposed indicators.

In order to implement a new information standard for intraday payments, cooperation and agreements across the banking industry, including central banks, are necessary. This has also to be considered in the time needed to introduce these requirements. Currently, newer standards are developed by S.W.I.F.T. which may fulfil the reporting requirements, but those are not commonly used yet.

II. Specific comments

The concepts of Direct and Indirect participants

Some members of the WSBI-ESBG are not familiar with the concept of direct and indirect participants that are used throughout the consultative paper that determines on which indicators individual banks are obliged to report. In the consultative paper the direct participants are defined as "a participant in a transfer system that can settle transactions without using an intermediary" while an indirect participation means "a participant with a tiering arrangement that uses the services of a direct participant (a correspondent bank) to perform particular settlements on its behalf".

First of all, the WSBI-ESBG thinks that it is somewhat unclear whether an indirect participant is equivalent to using a correspondent bank for executing intraday payments. In that case this should be clarified in the paper. Moreover, given that almost every bank, at least internationally active banks, is acting as both a direct and indirect participant to the payment systems, this classification will not add any valuable information.

Paragraph 7 scope of application of the framework

Regarding the paragraph No. 7 of the consultative document, it 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.

The WSBI-ESBG is of the opinion that at this stage, 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. The principle of proportionality should be considered and integrated in the framework.

Paragraph 11 Definition of business day

In the Basel Committee consultative paper "Business day" is defined as the opening hours of the payment and settlement system during which it is possible for a bank to receive and make payments.

The WSBI-ESBG is of the opinion that the definition of "Business day" needs to be clarified especially for banks that have operations and performs intraday settlements in several time zones e.g. in Europe and in the US. Would the Business day for that bank be defined as the opening time in Europe to the closing time in US?

Paragraph 15: cumulative intraday liquidity inflows and outflows

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 to include a corresponding clarification in the consultative document.

Paragraphs 24 - 25 on Time-specific and critical obligations

According to the monitoring indicator "Time-specific and critical obligation", banks are required to report "the volume and value of their time specific and other critical obligations" respective to "the total number and value of failed time- specific and critical obligation that were failed during the reporting period". Time-specific and other critical payments are defined as payment "obligations which must be settled at a specific time within the day or have an expected intraday settlement deadline".

In this sense the WSBI-ESBG agrees with the Basel Committee on this categorisation approach. To monitor "time-specific and critical obligations" separately makes sense and is an appropriate method to monitor intraday liquidity. However, in order to categorise intraday payments properly, more guidance and an elaborated definition of a "time-specific and critical obligation" are needed.

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 at any time, also in future.

About WSBI-ESBG (European Savings Banks Group)

WSBI-ESBG – The European Voice of Savings and Retail Banking

WSBI-ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of over €7,470 billion, non-bank deposits of €3,400 billion and non-bank loans of €4,000 billion (31 December 2010). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

WSBI-ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. WSBI-ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.

WSBI-ESBG - Association internationale sans but lucratif/Internationale vereniging zonder instoogmerk/
International not-for-profit association

Rue Marie-Thérèse, 11 ■ B-1000 Brussels ■ Tel: +32 2 211 11 11 ■ Fax: +32 2 211 11 99
info@savings-banks.eu ■ www.savings-banks.eu

Published by the WSBI-ESBG, August 2012