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CANADIAN BANKERS ASSOCIATION

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October 11, 2013

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

Dear Basel Committee members:

Re: CBA[1] Comments on consultative document:
"*Liquidity coverage ratio disclosure standards*"

We appreciate the opportunity to review the consultative document, *Liquidity coverage ratio disclosure standards*, dated July 19, 2013. We understand that the goal of this paper is to help market participants consistently assess the liquidity risk position of banks through the use of a common LCR disclosure template for internationally-active banks.

As proposed in the consultative document, these disclosure requirements will come into effect by the first reporting cycle after January 2015, on a quarterly basis at the consolidated level. To explain the LCR results, banks are also expected to release supporting qualitative (e.g. risk tolerance and management approach to liquidity risk management) and quantitative (e.g. monitoring tools such as contractual maturity mismatch and concentration of funding) information.

Overall, we support providing stakeholders with meaningful liquidity disclosure. Notwithstanding this we remain concerned that LCR disclosure has the potential to precipitate a liquidity crisis should a bank(s) report an LCR below 100%. We also support a liquidity disclosure regime that is applied consistently in each jurisdiction; however, we are concerned that misinterpretation may result due to national discretion or accounting treatment differences.

A summary of our comments on the consultative document is provided below. Detailed comments are included in the attached appendix.

[1] The Canadian Bankers Association works on behalf of 57 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 275,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. www.cba.ca.

Use of Daily Averages

While we acknowledge that banks have to be able to provide supervisors with daily LCR data if requested, we believe that public disclosure using daily averages may not provide information that is incrementally meaningful, and could be misleading. Daily results at the level proposed in the disclosure standards may involve estimates that will not be subject to the same level of rigour typically required of public disclosures. Some examples include:

- Particular data elements may only be available on a lag basis, or may not be available on a daily basis, for some institutions.
- Some loans, deposit, and commitment feeds are only updated weekly or monthly as they are less volatile.
- Certain daily data elements may not be subject to elimination that occurs for accounting reporting purposes at the month-end (e.g., reverse repo and repo netting with the same counterparty and internal trade netting), which could lead to higher reported cash outflows and inflows (without impacting the final LCR) than would be reported using month-end data.

Month-end data is subject to a robust and stringent reconciliation process that is required to produce a bank's financial statements (i.e. reconciled to general ledger, designed to meet external audit, and Sarbanes-Oxley requirements, etc.), and it would be impractical to apply these standards on a daily basis. We would emphasize the issue is not that banks lack the ability to track daily positions and cash flows, but rather that the quality of the data may not be adequate to meet the required disclosure standards.

As required in paragraph 162 of the LCR text, we recognize the need to have the "*operational capacity to increase the frequency to weekly or even daily in stressed situations*." In a stressed situation, the prudent approach will be to focus on the most volatile and dynamic components to ensure adequate monitoring. A reported daily average would make it an operational requirement across all systems on a permanent basis.

We are also aware that some supervisors may want to use daily data to address the possibility that banks could manipulate LCR drivers to ensure optimal point-in-time LCR results. It is our opinion that this concern would be best addressed on a non-public bilateral basis through ongoing dialogue with the national supervisor as part of the supervisory liquidity monitoring process. Canadian banks have been providing monthly LCR since January 2012 as well as other supervisory reports and frequent updates on banks' own intra-month metrics.

Therefore, we request that the Basel Committee reconsider this requirement, considering the concerns highlighted above and existing practices that mitigate against undue intra-month fluctuations in liquidity metrics.

We recommend that LCR disclosures be based on monthly averages using data from the previous four or six month-end periods, supported by appropriate discussion. This would be sufficient for monitoring/disclosure purposes, and adequately represents positions and aids trend analysis. We believe that the potential for regulators to ask for 'spot' LCR data, especially during a crisis, should not drive broad-based LCR disclosure requirements. These ad hoc requests should be handled by each bank bearing in mind circumstances, laws, and their disclosure practices.

Level of Understanding Required for Transparency

The LCR common disclosure template outlined on page 4 of the consultative document will require extensive qualitative information to explain a bank's LCR results relative to how banks explain their enhanced liquidity risk disclosures. A key factor is the one-size-fits-all assumptions and factors used in the LCR stress test compared to individual management views expressed in the Management Discussion & Analysis (MD&A).

For example, we expect that banks will need to explain the differences between liquid assets disclosed in the new Enhanced Disclosure Task Force (EDTF) table and the LCR view of High Quality Liquid Assets (HQLA). One example is that financial institution (FI) equities attract no value and non-FI equities are discounted by 50%. Most banks will also likely have to explain that their non-operational relationship deposits are far more stable, that the EUR 1MM threshold for small and medium enterprises (SME) is not consistent with experience in their home country, and that assumed draw experience on some liquidity lines is many times worse than ever experienced, even during the crisis.

We are concerned that a reader will be overwhelmed with the detailed LCR explanations that will be required, and simply focus on the quantitative LCR results without proper consideration on how banks view and otherwise manage the risk. This may lead to interpreting results out of context and suboptimal clarity, especially when comparing LCR results across banks with different business models and organizational structures. This is particularly apparent in the instructions for completing the LCR template in Annex 2, where it states that "*not all reported figures will sum exactly, particularly in the denominator of the LCR.*" This suggests that the data provided is incomplete, which will potentially contribute to misinterpretation and confusion to the intended audience.

We anticipate that the more granular the LCR data disclosures are, the more extensive the explanations required will be, and the more likely that users will be distracted by spending a majority of their time reconciling the differences among various liquidity measurement regimes. In light of these considerations, we recommend that the disclosure be limited to the basic components of the LCR metrics, such as HQLA and high-level outflow/inflow categories, supported by additional quantitative and qualitative information, as appropriate, to ensure that disclosure stays meaningful and is used for its intended purpose.

We would like to highlight that the LCR is just one element of a bank's liquidity risk management process. Significant progress has been made by banks in explaining approaches used to determine liquidity risk positions and measures through the EDTF recommendations. We believe the LCR complements this disclosure, and too much granularity and resulting explanations of variances to internal liquidity disclosures will place more emphasis on to LCR. Therefore, we believe concise disclosures demonstrating compliance to the LCR requirement within the overall Liquidity Risk disclosure would be sufficient.

Market Disclosure

The industry would like to highlight that market participants are highly sensitive of market reactions to the interpretation of the disclosed liquidity results, compared to other risk disclosures, and thus we strongly recommend that the LCR disclosure standards be developed with this consideration in mind. Disclosing non-compliance with the LCR minimum (100%), even during a period of stress, has the potential to be destabilizing and may precipitate a liquidity crisis

(idiosyncratic or systemic). This could be exacerbated by providing detailed disclosure of current LCR components that are not clearly understood by market participants.

As the standards are finalized, we suggest that the Basel Committee consider providing enhanced outreach communication/education to market participants that clearly highlight the intention and features of the LCR metric. In particular, it would be helpful if the Basel Committee could emphasize that the LCR is a stress metric, not a measure of normal cycle liquidity risk management, and a measure below the threshold (100%) may be appropriate during a stress event. We note that the LCR is not the sole measure of liquidity employed by banks, and relying only on it to measure a bank's liquidity position can be misleading. It would be helpful if the Basel Committee would encourage national host and home supervisors to discuss among themselves (e.g. College of Supervisors) how they will act if banks disclose a LCR <100% and share any insight they can with banks to help them better prepare in the event of a foreseen breach.

Alignment with Other Liquidity Disclosure Requirements

We welcome the flexibility afforded banks in paragraph 16 to provide sufficient qualitative discussion to promote a greater understanding of the results and data provided where significant to their LCR. We view the list of examples of discussion issues in this paragraph as suggestions, not requirements, and as such, we believe that banks have the flexibility to provide appropriate qualitative discussion to reflect the unique liquidity characteristics of the most material off- and on-balance sheet exposures.

As highlighted above, LCR is just one element of our liquidity risk management. Significant progress has been made to explaining our approach to and current liquidity risk position through the EDTF recommendations. We are concerned that the proposed LCR disclosure standards will differ from the EDTF recommendations, and thus may lead to misinterpretation. One notable example is the difference in the definition of high-quality liquid assets (HQLA) between the LCR and EDTF's Table 5. Other examples are outlined in our attached detailed comments. While we recognize that the LCR is a stress measure, and EDTF liquidity disclosures have a different purpose developed by market participants, we hope that harmonization of the disclosure requirements will occur over time in order to avoid the need for extensive explanations and reconciliations.

In addition, we are concerned with the implications of paragraph 10 ("*national supervisors may apply disclosure requirements to other banks and to any subset of entities of internationally active banks…*"). This paragraph could be interpreted to mean that a host supervisor could compel disclosure of cross-border subsidiary (under the supervision of the local regulator) information in a parent bank's consolidated reports, which may pose jurisdictional issues. Therefore, we recommend that this paragraph be reworded to indicate that host supervisors should only have the authority to impose disclosure requirements for regulated entities that already provide public disclosure in their jurisdiction. One suggestion is to add the underscored introductory phrase to the second sentence of paragraph 10 as follows: "<u>*For regulated entities within their jurisdiction*</u>*, national supervisors may apply […]*".

As it relates to the positioning of the proposed disclosure within financial statements, and to ensure consistency with other disclosure regimes, we recommend that the LCR disclosures be included in the liquidity section of banks' management discussion and analysis.

We thank you for taking our comments into consideration and look forward to future discussions on these issues.

Sincerely,

Attachment: Detailed comments
CC:

- Carolyn Wilkins, Executive Advisor, Bank of Canada
- Brad D. Shinn, Acting Managing Director, Bank Capital, OSFI
- Silvano Tittonel, Director, Capital Definition and Precedents, OSFI
- Brian Rumas, Senior Analyst, Capital Division, OSFI

CBA comments on Basel Committee consultative document: *Liquidity coverage ratio disclosure standards*

CBA Members' Comments and Requests for Clarification
INTRODUCTION *(pages 1 - 2)*
[Para 7]: It is not clear that disclosure of LCR and its key components will, on a stand-alone basis, allow market participants to "*consistently assess the liquidity risk position of banks*". Some of the HQLA eligibility criteria and outflow/inflow factors are very severe relative to observed market liquidity and historical/prospective conditions, while other factors are more aligned with expected outcomes. This has been well documented in advocacy documents prepared by the industry. Such disclosure will likely result in banks needing (wanting) to highlight key instances where LCR factors are materially different than those they deem reasonable given respective and, at times, materially different circumstances and experiences. Banks may even choose to disclose an LCR based on their own risk-based LCR assumptions. For example, two banks with the exact same liability composition and LCR % would not be equally liquid if one mostly held liquid assets not given liquidity value in the LCR numerator (e.g. financial equities), while the other one mostly held illiquid loans. Other examples include comments related to severe outflow factors for some undrawn commitments and certain types of wholesale deposits.
SECTION 1: SCOPE OF APPLICATION, IMPLEMENTATION DATE AND FREQUENCY OF REPORTING *(pages 2 – 3)*
An over-riding question is how LCR disclosure standards will be coordinated with Enhanced Disclosure Task Force (EDTF) recommendations given the treatment differences in the reported data. The presence of both will invariably result in viewer confusion, and banks could potentially spend a considerable amount of resources explaining/reconciling the regime differences. One option would be to have the LCR disclosure standard supersede EDTF and continue EDTF in areas that LCR disclosure standards do not cover. Also, it would be beneficial to have some regulatory direction on the format of future management discussion and analysis (MD&A) sections considering the volume of recommendations and different data requirements from the Basel Committee, from the Office of the Superintendent of Financial Institutions' (OSFI)'s Liquidity Adequacy Requirements (LAR Guideline), and from the EDTF.

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Below is a brief comparison of recommended EDTF vs. LCR disclosures:

#	EDTF	LCR
#18	Quantitative analysis of liquid reserve components	HQLA disclosure addresses LCR quantitative components
#19	Liquid assets including encumbered/unencumbered	HQLA disclosure addresses LCR qualitative components
#20	Contractual maturity table (on/off balance sheet)	On/off-balance sheet liquidity gap analysis by legal entity/branch/sub and mismatch by currency
#21	Funding strategy, including concentrations	Funding strategy, including concentrations

[Para 10]:

- As suggested in the cover letter, we recommend that the underscored phrase be added to the second sentence, "For regulated entities within their jurisdiction, national supervisors may apply […]".
- "*The disclosure requirements set out in this document should be applied to all internationally active banks on a consolidated basis"*. It may not be appropriate to apply these requirements to non-internationally active banks and/or for banks not deemed as systemically important banks by a regulator in the same fashion as they operate based on a relatively simple business model. This would place an additional strain on the limited resources of these institutions. Will the Basel Committee assume that the concept of proportionality will apply in these circumstances?

[Para 11]:

- Current reporting standards require the inclusion of prior-period data for comparative purposes. Will this be applicable under this standard considering that the LCR standard would not be binding for periods prior to January 1, 2015?

  Given that the standard requires data based on 90-day averages, we believe that the implementation date should be set to the reporting period that follows the first 90-days (i.e. Q2 2015 for Canadian banks) after the LCR standard becomes binding.

CBA Members' Comments and Requests for Clarification

- The consultative document has recommended publication of this disclosure with the same frequency as financial statements. Some banks' financial statements are only published annually (i.e. not published quarterly). In the absence of quarterly financial statements, would the LCR disclosure be attached to the Pillar 3 disclosure, or would it be a stand-alone document posted on the public website? Would this be required to be posted on a quarterly or semi-annually basis?

SECTION 2: DISCLOSURE REQUIREMENTS *(page 4 – LCR Common disclosure template)*

[Para 14]:

- *Average of daily observations over the previous quarter:* The calculation frequency used in the disclosure document seems at odds with the LCR final rules published in January 2013. In fact, the LCR rule book states that LCR should be reported to supervisors at least monthly, with the capacity to increase the frequency to weekly or even daily in stressed situations at the discretion of the supervisor. We believe that the disclosure requirements should be aligned with the LCR rule book's month-end reporting requirement. Also, financial statements are only produced once a month, and any attempt to produce intra-month financial statements would have to be based on assumptions. One option is that the disclosure could be based on the average of the past four or six monthly LCRs.
- The LCR is not currently measured daily by many firms even if capabilities are being built to meet this Basel Committee requirement; therefore, there is little experience with daily intra-month fluctuations in LCR figures. They could possibly end up being more volatile than month-end figures for the wrong reasons (i.e. operational challenges to produce figures not fundamental changes in liquidity profiles). Starting with monthly observation points, at least at the outset, would be preferable until more experience is gained with daily numbers. The potential supervisory concern with 'real' material fluctuations in intra-month LCR and balance sheet manipulation by banks would be best handled in a non-public manner through bilateral discussions and data exchanges between supervisors and banks.
- In daily LCR calculations, some feeds with more stable data will likely be updated less frequently (e.g. weekly or monthly) by some banks (i.e. data kept constant). There will also be no intra-month reconciliation to GL by all banks. Thus, there would be a need to confirm that this less rigorous approach will not cause disclosure standard issues with regulators or other stakeholders.

CBA Members' Comments and Requests for Clarification
▪ Disclosing LCR averages for the most recent quarter could have the potential of unduly accelerating a name-specific or systemic crisis. For example, if material negative news hits many banks at the same time and their LCR goes down noticeably during that quarter, even if still well over 100% and the two events are not related, this may create unwanted chatter and pro-cyclicality. Fear of such reaction could force banks to access funding markets faster than desirable, sending out further negative signals, as they would be reluctant to disclose an LCR < 100%, even if permitted. A longer time horizon (e.g. four or six months) using monthly observation points would be preferable. The Basel III Liquidity Coverage Ratio and Liquidity Monitoring Rules of January 2013 indicate that "*the LCR should be reported to supervisors at least monthly, with the operational capacity to increase the frequency to weekly or even daily in stressed situations at the discretion of the supervisor (LCRLMR Section 162)".* Under the Basel III consultative document "*Liquidity coverage ratio disclosure standards"* dated July 2013 "*data must be presented as simple averages of daily observations over the previous quarter i.e. the average is calculated over a period, typically, 90 days*" (paragraph 14). The calculation of the LCR measure is very labour intensive. It requires data feeds from many different arms of the organization, and then needs to be reconciled and manipulated to generate accurate reporting. Large organizations have teams of individuals who are dedicated to the production of regulatory reporting. Small financial institutions need to devote a higher percentage of their budget to produce the equivalent number of reports. It would take considerable resources to be able to produce these numbers daily on a continuous basis. Will the principle of proportionality be applied for smaller institutions? Non-internationally active financial institutions and non-domestically systemically important banks should be required to report LCR at a maximum on a monthly basis with no daily averaging. In the worst case scenario, non-internationally active financial institutions and non-domestically systemically important banks should be given a longer phase-in time to be able to comply with the "continuous" reporting standard. **Overall comments related to [Para 16 – 20]:** We welcome the LCR language that disclosure standards are principles based, and items identified are for banks consideration and not binding requirements. This gives banks flexibility to adjust the level of disclosure that suits their business models, while adhering to the principle of transparency. We caution that, without relevant expertise to understand them, some types of additional qualitative/quantitative information may cause confusion/misinterpretation. This includes currency mismatch, liquidity exposure at legal entity-level, and derivative exposure.

CBA Members' Comments and Requests for Clarification
We believe that this information is best suited for ad-hoc requests than for publication. **[Para 16]:** ▪ We believe that the qualitative discussion should be limited to the intra-period changes and the changes over time. Many of the remaining items of paragraph 16 will be covered in Q4 by the EDTF requirements. ▪ The disclosure of weighted and un-weighted numbers seems excessive. A qualitative discussion around make up of LCR and other existing disclosure should nullify the need for both sets of numbers. ▪ Links to the relevant supervisors' rules or guidance on national implementation of the LCR should not only include factors left to national discretion but also deviations, if any, from the Basel Committee rules. ▪ Some items, such as operational deposits, in the LCR common disclosure template could be subjectively defined by the institutions and might not be directly comparable among them. ▪ Could the suggested qualitative discussion items around LCR such as "*concentration of funding sources*" be defined more clearly? **[Para 16 a]** *the main drivers of their LCR results and the evolution of the contribution of inputs to the LCR's calculation over time***:** Further clarification required. We believe that a level of significance/materiality should be applied. **[Para 16 e]** *derivatives exposures and potential collateral calls*: Currently, banks are required to provide the collateral downgrade impact for up to a three notch credit downgrade. We believe that this is adequate for the purposes of this standard. **[Para 16 h]**: Could some examples be provided for the "*other inflows and outflows in the LCR calculation that are not captured in the LCR common template but which the institution considers to be relevant for its liquidity profile*"?
SECTION 3: GUIDANCE ON ADDITIONAL DISCLOSURES *(pages 5 – 6)*
This area lacks specifics, and we will need national discretion guidance to fully opine. However, additional elements of liquidity disclosure should be standardized as much as possible across jurisdictions.

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[Para 17]: Even though the Basel Committee recognises that the LCR is only one measure of a bank's liquidity risk position, by requiring banks to disclose it and by emphasising that the LCR is a standardized metric across all banks, the Basel Committee will by default make the LCR the only measure used to compare liquidity from bank to bank. Hence, we believe it will make all other measures computed by individual banks far less relevant. We believe that this section should be aligned to EDTF disclosure guidelines, which stipulate a comprehensive list of disclosure requirements that address the majority of the recommendations outlined in Para. 19 and 20. **[Para 19]:** Disclosing more detailed information by individual legal entities, foreign branches and subsidiaries will raise a number of challenges from a management and measurement perspective: ▪ The additional volume of information may detract users from focusing on more pertinent summary information. ▪ Legal and regulatory limitations that restrict the transferability of liquidity evolve over time and may make comparability more difficult or less meaningful, within and across institutions. ▪ It is not possible to predict ad hoc restrictions that may be added or relaxed during a crisis. ▪ The operational and other limitations that may restrict transferability can be very scenario-dependent. o For example, in a more severe crisis, management may be more willing to incur costs and take certain actions to achieve transferability that it would not have been willing to take in normal course of business. **[Para 20]:** Quarterly Pillar 3 disclosures are robust and currently provide adequate disclosure of governance structure, responsibilities, liquidity risk management policies and procedures, risk monitoring and mitigation techniques, liquidity risk tolerance, funding structure, etc. We believe that this is sufficient to address the suggested qualitative disclosures outlined in paragraph 20. **[Para 20 b]** (*intraday liquidity needs*): Providing disclosures for intraday liquidity needs may be premature for Jan 2015 considering recent proposals to extend implementation timeline to 2017.

CBA Members' Comments and Requests for Clarification
ANNEX 1: EXPLANATION OF THE LCR COMMON DISCLOSURE TEMPLATE *(page 7 – 8)*
We believe that the information presented in annex 1 is too granular. This high level of granularity will probably confuse the reader. In fact, the HQLA as shown in the LCR (as an average of daily positions) will differ from the ones presented in table 5 required by the EDTF. Moreover, in the contractual maturity table, the reader will probably try to reconcile the 1-month bucket of the contractual maturity table with the LCR disclosure template. Because these two tables have different purposes, the reader will be unable to reconcile the numbers. Disclosing so much detailed information will create more confusion than clarity. Instead, we recommend that the average of month-end LCR observations over a four-month period should be disclosed.
ANNEX 2: INSTRUCTIONS FOR COMPLETION OF THE LCR COMMON DISCLOSURE TEMPLATE *(page 9 – 10)*
The fact that figures must be presented as averages of the daily observations of individual line items will create more confusion than clarity because, as stated in the paper's last paragraph, not all reported figures will sum exactly. This unnecessary confusion could be corrected if month-end un-weighted and weighted HQLA, net cash outflows, and LCR were disclosed and the average of month-end LCR was computed. The average could be based on a four or six month-end period, as previously suggested.