October 11, 2013

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Liquidity Coverage Ratio Disclosure Standards

Ladies and Gentlemen:

The Clearing House Association L.L.C. ("**The Clearing House**")[1] appreciates the opportunity to comment on the Basel Committee on Banking Supervision's (the "**Basel Committee**") July 19, 2013 consultative document entitled *Liquidity coverage ratio disclosure standards* (the "**Consultative Document**") and its proposed Liquidity Coverage Ratio ("**LCR**") disclosure requirements (the "**Disclosure Proposals**").

The Clearing House fully shares the Basel Committee's view that "the LCR is an essential component of the set of reforms introduced by Basel III and, when implemented, will help deliver a more robust and resilient banking system."[2] However, while it is an important supervisory metric to be monitored and evaluated by regulators, we remain concerned that the LCR and its quantitative data components are less useful and less appropriate as disclosure metrics for depositors, creditors and market participants. Moreover, in certain circumstances public disclosure of the LCR and its components may pose the very types of risks to banks and systemic stability that the LCR is purposely designed to mitigate—that is, the risk of depositor and creditor runs.[3]

1 Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively employ over 2 million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing – through regulatory comment letters, amicus briefs and white papers – the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated clearing-house, funds transfer, and check-image payments made in the U.S. *See* The Clearing House's web page at www.theclearinghouse.org.

2 The Basel Committee, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools* (January 2013), ¶ 8, at 2 (the "**LCR Framework**").

3 *See* The Clearing House comment letter, dated April 16, 2010, to the Basel Committee regarding the Committee's liquidity reform proposals, at 8. "The risks associated with disclosure of LCR… are both apparent and significant. Public disclosure may expose banks to market penalties for marginal differences

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In summary, our principal concerns regarding the Disclosure Proposals are as follows:

- The Clearing House believes there remains an unresolved public policy tension between, on the one hand, the Basel Committee's recognition that "during periods of stress, it would be entirely appropriate for banks to use their stock of [high quality liquid assets] thereby falling below the minimum requirement, as maintaining the LCR at 100% percent under such circumstances could produce negative effects on the bank and other market participants"[4] and, on the other hand, the public disclosure of banks' LCR data, especially in times of stress. We welcome an open and constructive dialogue among the regulatory community, the banking industry and other interested parties to address the tension between LCR disclosure and contagion and systemic risk.

- Allowing a delay of LCR public disclosure beyond January 1, 2015 would be a constructive way to provide supervisors and the banking industry with a greater opportunity to evaluate the practical implication of required industry-wide LCR disclosures, effective data comparability and the reporting methodologies.

- The perceived benefits of publicly reporting LCR data on the basis of average daily observations are not necessarily commensurate with the associated operational challenges.

In forming the substantive shape of the LCR itself, the Basel Committee has previously re-evaluated the systemic risk implications of certain aspects of the LCR Framework and, upon further reflection, made important improvements in this regard. In particular, one of the most important revisions made was the Basel Committee's explicit acknowledgement that a bank can and should be able to use its stock of high quality liquid assets ("**HQLA**") and thereby allow its LCR to fall below the otherwise required 100% minimum during times of stress, subject to supervisory guidance.[5] In dealing with departures from the 100% LCR minimum, the LCR Framework states that supervisors "should allow for differentiated responses to a reported LCR minimum below 100%" and "should assess a number of firm- and market-specific factors…" including "[t]he potential for contagion to the financial system and additional restricted credit flow or reduced market liquidity…."[6] This clarification to the LCR Framework correctly recognizes that rigid insistence on maintaining the 100% LCR minimum in fact can actually increase the risk of contagion and therefore systemic risk.

The Clearing House emphatically agrees with the Consultative Document that "[t]here are… some challenges with disclosure of liquidity positions under certain circumstances, including the

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in their ratios as compared to peers, even where the differences do not reflect meaningful differences in the banks' respective liquidity strength."

4 Consultative Document ¶ 6, at 1. *See also*, LCR Framework, ¶ 11, at 2.

5 *See* Group of Governors and Heads of Supervision of the Basel Committee, *Basel III liquidity standard and strategy for assessing implementation of standards endorsed by Group of Governors and Heads of Supervision* (January 8, 2012); LCR Framework, ¶ 17, at 4.

6 LCR Framework, ¶ 18, at 5.

potential for undesirable dynamics during stress."[7] More specifically, we believe that disclosure to the general public of the LCR and component quantitative information may actually precipitate or accelerate a liquidity event at a bank, which in turn may expand into an industry-wide destabilizing event due to the Disclosure Proposals' undeniable effect of providing to the market an effective ranking of all subject banks by LCR. It is conceivable that, in times of financial stress particularly, rational market participants would begin acting on the signals implied by those rankings by withholding funding from the seemingly most vulnerable. This dynamic could be particularly acute if and when one more bank's LCR drops below 100% as stocks of HQLA are used in precisely the manner contemplated by the LCR Framework to reduce systemic risk. As a result, the Disclosure Proposals may be counterproductive and actually <u>heighten</u> systemic risk at exactly the time when supervisors are attempting to lessen the risk of contagion during a stress event.

We note that this type of public policy concern is not unique to the Consultative Document and has historically been present and addressed in other bank regulatory contexts. In the United States, for example, the results of supervisory examinations and the related Uniform Financial Institutions Supervisory Rating System – or "CAMELS" rating – are not made public and the improper disclosure thereof can constitute a Federal crime.[8] Despite the fact that public disclosure of CAMELS ratings would likely "improve transparency, reduce uncertainty in the markets and strengthen market discipline,"[9] the prohibition on disclosure of supervisory ratings reflects the policy judgment that the general benefits of disclosure can be outweighed by the potential risk of, in fact, fostering negative system effects such as potential bank runs.[10]

The Consultative Document indicates that the Basel Committee has considered this tension and trade-off between disclosure and stability in formulating the Disclosure Proposals.[11] The Clearing House respectfully urges the Basel Committee to publicly disclose a more fulsome explanation of the rationale with respect to reconciling this tension in order for supervisors, the banking industry and other interested observers to have an opportunity to engage in a more meaningful dialogue regarding how to, at minimum, ameliorate the potential negative consequences of LCR disclosure in stress situations.

As such, we recommend that the introduction of any mandatory LCR public disclosure regime be delayed past January 1, 2015 in order to give supervisors and the banking industry ample opportunity to effectively evaluate the practical implications of the implementation of the LCR and potential impact of disclosure. For example, it is possible that the additional qualitative disclosures described in paragraphs 16-20 of the Consultative Document, as well as the requirements for disclosure of both "weighted" and

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7 Consultative Document, ¶ 7, at 2.

8 *See* 12 C.F.R. §§ 4.36, 4.37(b), and 18.9; 12 C.F.R. § 309.6; 12 C.F.R. §§ 261.20(g) and 261.22; 18 U.S.C. § 641; 18 U.S.C. § 1906.

9 Consultative Document, ¶ 7, at 2.

10 *See* Michael E. Collins, *Supervisory Insights on Transparency in Bank Supervision*, SRC Insights, Federal Reserve Bank of Philadelphia (1st Q 2011), at 2.

11 Consultative Document, ¶ 7, at 2.

"unweighted"[12] LCR quantitative component factors, are meant to provide banks with a limited opportunity to provide additional information that might, in theory at least, soften the market perception of a relatively low LCR. These provisions would presumably allow banks to describe aspects of their actual economic liquidity position that is not readily captured within the rigid confines of the LCR construct and its underlying highly stressed assumptions. If this was the intention, we are uncertain that such additional disclosures, even after the passage of time to give market participants the ability to properly evaluate the types of information being disclosed, would sufficiently counteract the "undesirable dynamics" during periods of economic stress. For better or worse, the LCR and its components are exactly the type of appealingly simple information that market participants can easily seize upon during a crisis.

Finally, we are concerned that requiring public disclosure of LCR data based on "averages of daily observations"[13] is likely to itself create significant operational challenges and burdens, the benefits of which may not necessarily be commensurate. The financial reporting systems that most banks use to generate data for public disclosure purposes utilize rigorous period-end – *e.g.*, monthly and quarterly – reconciliation and closing procedures to help ensure data of a quality suitable for financial statements, external audits and statutory requirements. While banks have the capability to track and report to supervisors daily asset and cash flow positions as needed, it may be difficult to apply the same types of demanding standards typically applied in the period-end context to the daily data required by the Disclosure Proposals without considerable effort and substantial expense. The Consultative Document is also largely silent as to exactly why public disclosure of LCR data should be based on averages of daily observation, as opposed to other time horizons more in line with normal financial reporting. There is little reason to believe that the purported market discipline benefits of public disclosure cited by the Consultative Document[14] could not be achieved through a less burdensome and expensive methodology than averages of daily data.[15]

The Clearing House and its members recognize that resolving this tension is inherently challenging. Nevertheless, we sincerely believe that an open, constructive and deliberative process among the regulatory community, the banking industry and other interested parties can result in the formulation of a more optimal answer to these potentially significant public policy issues.

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12 *See* ¶ 15 of the Consultative Document requiring disclosure of HQLA and inflows/outflows both with and without applicable haircuts and in-flow/out-flow assumptions.

13 Consultative Document, ¶ 14, at 3.

14 *See* Consultative Document, ¶ 7, at 2.

15 While it is possible that the Basel Committee has proposed daily averages as a way to avoid the hypothetical risk of banks "manipulating" a more point-in-time measurement, we believe that supervisory scrutiny would readily guard against such potential issues.

If you have any questions or need further information, please contact me at (212) 612-9211 (email: brett.waxman@theclearinghouse.org).

Respectfully Submitted,

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