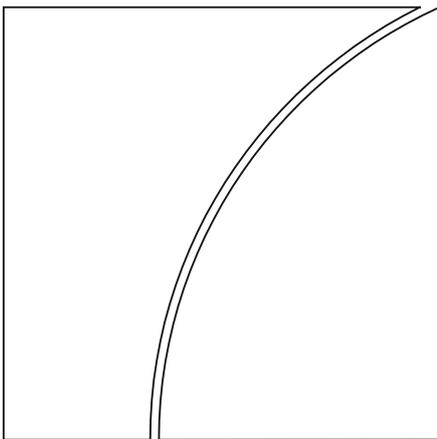


# Basel Committee on Banking Supervision



## Basel III – The Liquidity Coverage Ratio framework: frequently asked questions

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## Contents

The Liquidity Coverage Ratio: frequently asked questions.....	iii
Introduction.....	iii
1. Secured transactions collateralised by a pool of assets.....	iii
2. <i>Periodic monetisation of HQLA (paragraph 30)</i> .....	iv
3. HQLA eligibility of lower-rated sovereign debt ( <i>Paragraph 54</i> ).....	iv
4. HQLA-eligible RMBS ( <i>Paragraph 54(a)</i> ).....	v
5. <i>Level 2B eligible debt securities (paragraph 54(b))</i> .....	v
6. HQLA-eligible equities ( <i>Paragraph 54(c)</i> ).....	vi
7. Deposit run-off ( <i>Paragraphs 73 and following</i> ).....	vi
8. Central counterparties ( <i>Paragraphs 107, 109</i> ).....	vii
9. <i>Secured funding – scope of application (paragraph 112)</i> .....	vii
10. <i>Secured funding – preferential run-off rate (paragraph 114)</i> .....	vii
11. Treatment of longs and shorts ( <i>Paragraphs 113–115, 140, 145–146</i> ).....	viii
12. Derivatives ( <i>Paragraphs 116–117, 158</i> ).....	viii
13. Collateral treatment ( <i>Paragraphs 118–123</i> ).....	ix
14. Historical look-back approach for market valuation changes ( <i>Paragraph 123</i> ).....	x
15. <i>Excess collateral (paragraph 120)</i> .....	xi
16. Loss of funding on ABS, covered bonds and other structured finance ( <i>Paragraph 124</i> ).....	xi
17. <i>Liquidity facilities (paragraph 128)</i> .....	xi
18. Special purpose entities (SPEs) and conduits ( <i>Paragraphs 129–131</i> ).....	xi
19. <i>Other contractual/contingent obligations (paragraph 130)</i> .....	xii
20. <i>Other contractual/contingent obligations (paragraphs 132 and 133)</i> .....	xii
21. <i>Secured lending transactions – reuse of the collateral to cover a customer’s short position (paragraphs 140 and 145–6)</i> .....	xii
22. Maturity of margin loans ( <i>Paragraph 145</i> ).....	xii
23. Operational deposit inflows ( <i>Paragraph 156</i> ).....	xiii
24. <i>Other cash flows (Paragraphs 141, and 160)</i> .....	xiii
25. <i>Unsecured securities borrowings/lending (Paragraphs 141, and 160)</i> .....	xiv
26. <i>Central bank facilities (paragraph 142)</i> .....	xiv
27. <i>Secured lending transactions – reuse of the collateral in a repo transaction with collateral substitution right (paragraphs 145–6)</i> .....	xv
28. Loans with fixed interest rate periods ( <i>Paragraphs 142, 152</i> ).....	xv
29. <i>Received collateral used to cover short positions (Paragraph 146)</i> .....	xv
30. <i>Ability to return collateral (paragraph 148)</i> .....	xvi

31. <i>Other wholesale cash inflows (paragraphs 150–4)</i> .....	xvi
32. <i>Maturing Level 1 and Level 2 assets (Paragraph 155)</i> .....	xvi
33. <i>Inflows on nostro accounts (paragraph 156)</i> .....	xvi
34. <i>Adjustment of HQLA – relevance of rehypothecated collateral for the unwind mechanism (Annex 1, paragraph 4)</i> .....	xvii

# The Liquidity Coverage Ratio: frequently asked questions and responses

## Introduction

The Basel Committee on Banking Supervision has received a number of interpretation questions related to its Liquidity Coverage Ratio standard. To help ensure consistent global implementation of the LCR standard, the Committee has agreed to periodically review frequently asked questions (FAQs) and publish answers along with any technical elaboration of the rules text and interpretative guidance that may be necessary.

This document has been updated to include a second set of frequently asked questions that relate to the Basel III Liquidity Coverage Ratio framework, inclusive of the FAQs previously published in April 2014. The questions and responses are grouped according to the paragraph number of the related issue within the LCR framework.

New FAQs and updates to existing FAQs published in April 2014 are denoted in *italics* and consist of 1 (b, d and e), 2, 5, 6 (d and e), 9, 10, 13 (i), 15, 17, 19, 20, 21, 24 (b), 25 (b), 26, 27, 29, 30, 31, 33 and 34.

## 1. Secured transactions collateralised by a pool of assets

(a) A bank has a reverse repurchase agreement, receiving collateral that consists of a pool of assets including non-HQLA. Can the whole portion of Level 1 and Level 2 assets of the collateral basket be counted towards HQLA (subject to the other requirements on HQLA-eligible assets)?

**Response** – An HQLA-eligible asset received as a component of a pool of collateral for a secured transaction (eg reverse repo) can be included in the stock of HQLA (with associated haircuts) to the extent that it can be monetised separately.

(b) If a bank pledges a pool of HQLA and non-HQLA collateral with a clearing entity such as a central counterparty (CCP) against secured funding transactions, may it count any HQLA-eligible securities that are held as part of the collateral pool, but remain unused at end-of-day as part of the stock of HQLA? *Does this requirement apply to derivatives as well?*

**Response** – The bank may count the unused portion of HQLA-eligible collateral pledged towards its stock of HQLA (with associated haircuts). If the bank cannot determine which specific assets remain unused, it may assume that assets are encumbered in order of increasing liquidity value, consistent with the methodology set out in footnote 9 of the LCR framework. *Assets in a pool that is intended to (exclusively or additionally) collateralise derivatives transactions are not readily available within the meaning of the operational requirements.*

(c) Which cash flow assumptions are applied if a bank pledges a pool of HQLA and non-HQLA collateral to secured funding transactions and a portion of the secured funding transactions has a residual maturity greater than 30 days?

**Response** – All secured transactions maturing within 30 days should be reported according to the collateral actually pledged as of close of business on the LCR measurement date applying the outflow assumptions in paragraph 115. If the bank cannot determine which specific assets in the collateral pool are used to collateralise the transactions with a residual maturity greater than 30 days, it may assume that assets are encumbered to these transactions in order of increasing liquidity value, consistent with the methodology set out in footnote 9 of the LCR framework in such a way that assets with the lowest liquidity value in the LCR are assigned to the transactions with the longest residual maturities first.

(d) Which cash flow assumptions are applied for secured transactions where assets are received on the basis of a collateral pool that is subject to potential collateral substitution? *And, does the concept of collateral substitution also apply to inflows for secured borrowing transactions, ie can a bank take an inflow where it has the contractual right to receive HQLA if it was able to pledge available non-HQLA collateral to a secured lender?*

**Response** – The risks associated with collateral substitution on secured lending transactions with a residual maturity greater than 30 days should be considered as a contingent outflow in accordance with paragraph 122 of the LCR framework. *The contractual right to substitute HQLA collateral for lower -quality or non-HQLA collateral would be a contingent inflow. As such, it is not considered in the LCR in line with paragraph 142.*

(e) *At what time is the “unused” assessment performed? Is it at the end of day in the respective jurisdiction?*

**Response** – *The assessment is at the end of the day of the reporting date in the respective jurisdiction.*

## 2. *Periodic monetisation of HQLA (paragraph 30)*

*Paragraph 30 requires that banks “periodically monetise a representative proportion of the assets in the stock through repo or outright sale...”*

(a) *What is “a representative proportion of the assets in the stock” banks are supposed to “periodically monetise... through repo or outright sale” according to paragraph 30?*

**Response** – *The extent, subject and frequency of HQLA monetisation necessary to comply with paragraph 30 should be assessed on a case by case basis. It is generally the responsibility of banks to incorporate the intent of paragraph 30 in their management of liquid assets and be able to demonstrate to supervisors an approach which is appropriate rather than ex ante stipulations.*

(b) *Do banks need to monetise HQLA specifically for test purposes? Or can the requirement of paragraph 30 be met through transactions in the course of the bank’s normal business?*

**Response** – *The requirement in paragraph 30 can be met by operations in the course of the bank’s normal business.*

## 3. *HQLA eligibility of lower-rated sovereign debt (Paragraph 54)*

(a) While corporate debt securities rated BBB+ to BBB– may be included in Level 2B according to paragraph 54(b), there is no explicit assignment of sovereign debt securities with such a rating. How should those securities be treated?

**Response** – Sovereign and central bank debt securities rated BBB+ to BBB– that are not included in the definition of Level 1 assets according to paragraph 50(d) or (e) may be included in the definition of Level 2B assets with a 50% haircut within the 15% cap for all Level 2B assets.

(b) Does “the sovereign” in paragraphs 50(d) and (e) refer to the bank’s home country, host country, the country in which the bank does not have any presence but has liquidity risk exposure denominated in that currency, or all of them?

**Response** – Sovereign and central bank debt securities, even with a rating below AA–, should be considered eligible as Level 1 assets only when these assets are issued by the sovereign or central bank in the bank’s home country or in host countries where the bank has a presence via a subsidiary or

branch. Therefore, paragraphs 50(d) and (e) do not apply to a country in which the bank's only presence is liquidity risk exposures denominated in the currency of that country.

(c) In paragraph 50(e), could a bank use non-0% risk-weighted sovereign or central bank debt securities issued in foreign currencies to offset the amount of that specific foreign currency exposure in a country other than the issuing sovereign's or central bank's home country?

**Response** – In paragraph 50(e), the amount of non-0% risk-weighted sovereign/central bank debt issued in foreign currencies included in Level 1 is strictly limited to the foreign currency exposure in the jurisdiction of the issuing sovereign/central bank.

#### 4. HQLA-eligible RMBS (*Paragraph 54(a)*)

(a) Does the maximum LTV criterion of 80% mean that the average pool LTV is to be less than 80% or that each loan has to have less than 80% LTV?

**Response** – The LTV requirement in paragraph 54(a) refers to the weighted average (by loan balance) LTV of the portfolio of underlying mortgages, not to any individual mortgage, ie mortgages that have an LTV greater than 80% are not excluded per se.

(b) Does "at issuance" in paragraph 54(a) refer to the issuance of the RMBS or of the underlying mortgages?

**Response** – "At issuance" refers to the time when the RMBS is issued, ie the average LTV of the underlying mortgages at the time of the issuance of the RMBS must not be higher than 80%.

#### 5. *Level 2B eligible debt securities (paragraph 54(b))*

(a) *While corporate debt securities with a rating between A+ and BBB– whose maximum decline of price does not exceed 20% may be included in Level 2B according to paragraph 54(b), and corporate debt securities with a rating of at least AA– whose maximum decline of price does not exceed 10% may be included in Level 2A according to paragraph 52(b), But is it the case that there is no explicit assignment of corporate debt securities with a rating of at least AA– whose maximum decline of price is between 10 and 20%?*

**Response** – *Corporate debt securities with a rating of at least AA– whose maximum decline of price or increase in haircuts over a 30-day period during a relevant period of significant liquidity stress is between 10 and 20% may count towards Level 2B assets provided that they meet all other requirements stated in paragraph 54(b).*

(b) *Securities representing claims on public sector entities (PSEs) are not part of the definition of Level 2B assets in paragraph 54. Can such securities from PSEs whose risk weight under the Basel II standardised approach for credit risk is higher than 20%, but which have a rating of at least BBB– and whose maximum price decline does not exceed 20% still be classified as Level 2B?*

**Response** – *Yes, PSE debt securities with a rating of at least BBB– whose maximum decline of price or increase in haircuts over a 30-day period during a relevant period of significant liquidity stress does not exceed 20% may count towards Level 2B assets provided that they meet all other requirements stated in paragraph 54(b).*

## 6. HQLA-eligible equities (*Paragraph 54(c)*)

(a) Some jurisdictions have more than one index that could reasonably claim to be a “major” one. Can “the primary index” be construed to mean “a primary index” where there is more than one relevant index (to be defined, as already specified, by the supervisor in each jurisdiction concerned)?

**Response** – Home jurisdiction supervisors may determine what constitutes a major stock index in their jurisdiction, which in some cases may permit inclusion of more than one index.

(b) Paragraph 54(c), third bullet refers to “the major stock index in the home jurisdiction or where the liquidity risk is taken, as decided by the supervisor in the jurisdiction where the index is located”. It is not clear what is meant by “taking a risk”.

**Response** – Equities that are a constituent of a major stock index can only be assigned to the stock of HQLA if the stock index is located within the home jurisdiction of the bank or if the bank has liquidity risk exposure through a branch or other legal entity in that jurisdiction.

(c) In paragraph 54(c), when considering which common equity shares might satisfy the criteria for Level 2B assets of a maximum decline of share price not exceeding 40% over a “relevant period of significant liquidity stress”, we assume that this criterion does not need to be applied for time periods prior to the shares’ inclusion in the major index. Indicators of volatility prior to the shares’ inclusion in the index will not be representative of current or future pricing.

**Response** – The criterion must be satisfied by all equity shares that enter the stock of HQLA. A consistent stressed period should be used for justification and whether the share was part of the index during that timeframe is not relevant.

(d) *Paragraph 54(c) only allows equity securities that have not experienced a 40% drop in price during a 30-day period. Most stocks with a long history have dropped more than 40% (eg via crashes in 1999, 2002, 2009 etc). In our study we saw that only young companies with a short history on the market qualify for this requirement. Hence, young risky stocks can be included but not the more stable companies/stocks. Was this really the intention?*

**Response** – *Determining the appropriate stress period for meeting market performance requirements is a matter of national discretion. However, it is not the intention of the Basel Committee to exclude all established companies and include only young companies.*

(e) *According to paragraph 54(c) of the LCR framework, equities eligible as Level 2B HQLA must be a constituent of a major stock index as decided by the supervisor in the jurisdiction where the index is located. Could confirmation be given on a centralised basis by the Basel Committee as to which indices are deemed to be “major” ones?*

**Response** – *The issue is the responsibility of national authorities. The Basel Committee will not provide such a list.*

## 7. Deposit run-off (*Paragraphs 73 and following*)

If a deposit is contractually pledged to a bank as collateral to secure a credit facility or loan granted by the bank that will not mature or be settled in the next 30 days, should the pledged deposit be excluded from the calculation of the total expected cash outflows under the LCR?

**Response** – The pledged deposit may be excluded from the LCR calculation only if the following conditions are met:

- the loan will not mature or be settled in the next 30 days;

- the pledge arrangement is subject to a legally enforceable contract disallowing withdrawal of the deposit before the loan is fully settled or repaid; and
- the amount of deposit to be excluded cannot exceed the outstanding balance of the loan (which may be the drawn portion of a credit facility).

The above treatment does not apply to a deposit which is pledged against an undrawn facility, in which case the higher of the outflow rate applicable to the undrawn facility or the pledged deposit applies.

## 8. Central counterparties (*Paragraphs 107, 109*)

How should central counterparties (CCPs) be treated in the context of the LCR? Specifically,

- (a) Should deposits from a CCP be regarded as operational deposits, noting that such deposits are usually associated with clearing activities?

**Response** – As for any other qualifying operational deposits, the conditions set out in paragraphs 93–104 must be fulfilled.

- (b) There may be various cash inflows and outflows between a CCP and its member banks. Can a bank net off such cash flows with respect to trades cleared with a CCP when calculating the LCR?

**Response** – There is no specific treatment of cash flows between CCPs and its member banks, ie netting is restricted to cases where it is permitted in the LCR framework (eg derivative cash flows that are subject to the same master netting agreement in paragraph 116).

## 9. Secured funding – scope of application (*paragraph 112*)

*Paragraph 112 states that “For the purposes of this standard, ‘secured funding’ is defined as those liabilities and general obligations that are collateralised by legal rights to specifically designated assets owned by the borrowing institution in the case of bankruptcy, insolvency, liquidation or resolution.” On the other hand, we saw that secured funding solely refers to “repurchase, reverse repurchase and other securities financing transactions”. Could we interpret paragraph 112 in a broader approach, namely that “secured funding” or “secured lending” refers not only securities financing transactions but also other secured borrowing or lending transactions?*

**Response** – Paragraphs 112 to 115 on secured funding transactions and paragraphs 145 to 148 on secured lending transactions refer only to the types of transactions explicitly mentioned therein, and, unless the counterparty is a central bank, do not cover, for example, lending that is secured by non-tradable assets, such as property, plant and equipment.

## 10. Secured funding – preferential run-off rate (*paragraph 114*)

*Paragraph 114 of the LCR text provides preferential treatments for banks’ secured funding transactions with the domestic central bank (ie subject to a 0% outflow rate), the domestic sovereign, multilateral development banks or domestic public sector entities that have a 20% or lower risk weight (ie subject to an outflow rate of no more than 25%, depending on the type of the collateral). Footnote 46 provides that “domestic” can be defined as a jurisdiction where a bank is legally incorporated.*

*Should “domestic” also refer to a jurisdiction where a bank’s branch or consolidated subsidiary is operating? (Note: it is not uncommon for a bank’s overseas branch to conduct repo transactions with the central bank of the host jurisdiction, which is not the place of “incorporation” of the bank but the place in which the bank’s overseas branch operates.)*

**Response** – The application of the reduced outflow assumptions for secured funding transactions with “domestic” public counterparties should be principally limited to counterparties from the jurisdiction where a bank is legally incorporated. It may be expanded to other public counterparties where the reduced outflow rates in paragraph 115 can be expected to reflect the behaviour of the other public counterparties. For example, in terms of central banks, this might be assumed when the overseas branch has equal access to central bank funding as domestic banks and where it seems reasonable that this equal treatment will remain in the context of central bank measures in times of severe idiosyncratic or market-wide stress.

## 11. Treatment of longs and shorts (Paragraphs 113–115, 140, 145–146)

Are client shorts covered by external securities borrowings subject to paragraph 146 (under “secured lending, including reverse repos and external securities borrowings”) or paragraph 113 (“secured funding run-off”)? Firm shorts covered by external securities borrowings are clearly covered by paragraph 146, and it seems more logical that client shorts covered by external securities borrowings should be as well. However, paragraph 113 makes references to customer shorts and the treatment is different.

**Response** – The treatments of customer shorts versus firm shorts are separate and distinct and for this reason are addressed in two separate paragraphs. Customer shorts are considered equivalent to other secured financing transactions, as the proceeds from the customer’s short sale may be re-used by the facilitating bank to finance the purchase or borrowing of the shorted security. Contrary to firm short positions, customer short positions are initiated and maintained at the discretion of the customer, and therefore the availability of this financing may be uncertain during a period of stress. These characteristics explain why customer shorts are treated in accordance with the roll-off assumption in paragraph 115.

## 12. Derivatives (Paragraphs 116–117, 158)

The language of paragraph 158, which directly references paragraph 116 (the sum of all net cash inflows should receive a 100% inflow factor, but calculated as per paragraph 116) seems at odds with paragraph 142 (contractual inflows that are fully performing and for which the bank has no reason to expect a default within 30 days can be counted but contingent inflows cannot):

(a) Would it be correct to assume that expected contractual derivatives cash inflows from “in the money” options for which the bank is the option holder can be included without contravening the high-level principle in paragraph 142 that contingent inflows are not to be recognised?

**Response** – Yes, paragraph 116 states that “options should be assumed to be exercised when they are in the money to the option buyer”, eg cash inflows from contractual derivatives that are “in the money” count towards derivatives cash inflows in the LCR. This is an exception to both paragraph 142, which excludes contingent inflows, and paragraph 152, which excludes inflows with no specific date from the LCR.

(b) Can it also be assumed that “in the money” options are exercised on expiry, for consistency across different option types and market practice?

**Response** – No, any option that expires or can be exercised within the next 30 days and that is “in the money” to the option buyer should be considered. The cash flow shall reflect the state of the transaction as of the reporting date.

(c) Could you confirm that options with delivery settlement during the relevant period could be considered as cash flows to the extent of the liquidity value of the delivered assets? Or whether all options are assumed to be cash-settled?

**Response** – Options with delivery settlement shall be considered according to the liquidity value of the delivered assets, ie the assets are subject to the haircuts that would be applied if these assets were collateral in secured transactions or collateral swaps. If contractual arrangements allow for both physical delivery and cash settlement, cash settlement may be assumed.

(d) What is the assumed behaviour in case of options with delivery settlement where the delivery obligation can be fulfilled with a variety of asset classes, ie the party liable has the choice between different securities?

**Response** – If the delivery obligation can be fulfilled with different security classes, delivery of the least valuable security possible (“cheapest to deliver”) can be assumed. This applies symmetrically to both the inflow and outflow perspective, such that the obligor is assumed to deliver the security with the lowest liquidity value.

(e) What is the required treatment of FX derivatives in the LCR, ie where the gross amount for currency X is exchanged for the gross amount of currency Y? Does it depend on whether the cash flows are subject to a valid master netting agreement as indicated in paragraph 116?

**Response** – Cash flows arising from FX derivative transactions that involve a full exchange of principal amounts on a simultaneous basis (or within the same day) may be reflected in the LCR as a net cash flow figure, even where those deals are not covered by a master netting agreement.

### 13. Collateral treatment (*Paragraphs 118–123*)

(a) Do the bank’s normal procedures apply to determine the notional amount pursuant to the penultimate sentence of paragraph 119?

**Response** – The notional amount to be collateralised in paragraph 119 is based on contractual terms (eg collateral agreements) that regularly include the methodology of calculating the amount to be covered (“notional amount”).

(b) Do paragraphs 118–122 apply in the same way to all derivative instruments, whether OTC or on-exchange, whether cleared or not? In particular, can confirmation be given that margin posted for clearance through a CCP and held for the benefit of the bank in accordance with the rules of such CCP should be recognised under the logic of these paragraphs, although the point is not addressed explicitly?

**Response** – Unless expressly specified otherwise, the provisions apply generally. Any Level 1 assets in segregated accounts held in a bank’s name by the CCP will be treated in accordance with paragraph 119.

(c) Paragraph 119 requires that an additional stock of HQLA be maintained for outflows where the bank is posting non-Level 1 collateral securing its derivatives. Can this be interpreted as applying on a net basis to the extent the bank uses non-Level 1 collateral received from one counterparty to secure derivative liability to another counterparty, if any decrease in the value of this collateral would affect both collateral posting to and by the bank?

**Response** – No. Netting of collateral inflows and outflows across counterparties is not provided for in paragraph 119 as the impacts of valuation changes (even of identical collateral) may be asymmetric across different counterparties.

(d) Assuming that a bank is a net poster of non-Level 1 collateral, can the net outflows under paragraph 119 be calculated taking into account any additional eligible non-Level 1 collateral that is unencumbered as of the date of the LCR or that would become unencumbered as a result of the stresses?

**Response** – No. The LCR framework provides no basis for separate sub-pools of (non-Level 1) HQLA dedicated to specific liquidity needs or for considering contingent inflows of collateral.

(e) Can it be assumed that a bank will post collateral in the most efficient manner practicable? For example, if a bank is currently a net poster of non-Level 1 collateral (with higher haircuts), it seems appropriate to assume that the bank would use its cash or lower-haircut Level 1 securities first, and not use that cash to purchase additional non-Level 1 collateral that would have a higher haircut.

**Response** – As with any other outflow captured in the LCR, the outflows addressed in paragraph 119 add to the bank's net cash outflow that must be met by Level 1 and/or Level 2 assets according to Section II.A of the LCR framework. No further assumptions have to be made in terms of what the bank actually "will post".

(f) Paragraph 122 sets a 100% HQLA requirement for the amount of received HQLA collateral that can be substituted for non-HQLA assets without the bank's consent. Does the outflow factor of 100% refer to the amount of HQLA collateral before or after the application of potential valuation haircuts (eg in the case of Level 2A collateral)?

**Response** – Paragraph 122 does not require an outflow for potential collateral substitution that is greater than the liquidity value of the received HQLA collateral in the LCR. The 100% outflow factor refers to the market value of the received collateral that is subject to potential substitution after applying the respective haircut in the LCR.

(g) Paragraph 122 refers only to the substitution of HQLA for non-HQLA collateral. Can it also be applied to potential collateral substitution of HQLA for other HQLA collateral of a lower liquidity value?

**Response** – Yes, if HQLA collateral (eg Level 1 assets) may be substituted for other HQLA collateral (eg Level 2A assets), an outflow amounting to the market value of the received collateral multiplied by the difference between the haircuts of the received collateral and the potential substitute collateral should be applied. If the substituted collateral can be of different liquidity value in the LCR, the bank should assume that the potential substitute collateral with the lowest liquidity value will be posted.

(h) Can you confirm that potential collateral substitution to non-HQLA assets according to paragraph 122 counts toward cash outflows only if the HQLA actually counts toward the bank's stock of HQLA in the LCR?

**Response** – Yes, outflows of HQLA that are excluded from the bank's stock of HQLA due to operational requirements are not considered in paragraph 122.

(i) *Paragraph 119 of the LCR text requires that if a bank has posted a non-Level 1 asset as collateral to secure its mark-to-market exposure under derivatives contracts or other transactions, the bank must hold additional stock of HQLA to cater for a potential reduction in the value of the collateral to the extent of 20% of the collateral value. Similar references to "other transactions" are also made in paragraphs 118 and 123. Banks have queries on the scope of "other transactions". Is it the policy intent that paragraphs 118, 119 and 123 are generally applicable to derivatives transactions only?*

**Response** – *Paragraphs 118, 119 and 123 are only applicable to derivatives and other transactions not specifically captured in the LCR framework. Thus, they are not applicable to secured funding transactions addressed in paragraphs 112–15 and secured lending transactions addressed in paragraphs 145–6.*

#### 14. Historical look-back approach for market valuation changes (*Paragraph 123*)

What does "the largest absolute net 30-day collateral flow" refer to?

**Response** – The largest absolute net 30-day collateral flow is the largest aggregated cumulative net collateral outflow or inflow at the end of all 30-day periods during the preceding 24 months. For this

purpose, banks have to consider all 30-day periods during the preceding 24 months. Netting should be considered on a portfolio level basis. Bank management should understand how collateral moves on a counterparty basis and is encouraged to review the potential outflow at that level. However, the primary mechanism for the “look-back approach” is collateral flows at the portfolio level.

#### 15. *Excess collateral (paragraph 120)*

*Paragraph 120 of the LCR text requires a bank to cater for liquidity risk arising from excess collateral held by it by applying an outflow rate of 100% to the value of “non-segregated collateral” that is in excess of its counterparty’s current collateral requirements and could contractually be recalled by the counterparty at any time. The current wording suggests that all types of collateral have to be captured. What is the meaning of excess “non-segregated” collateral? Does it only capture excess non-segregated collateral that has been rehypothecated by the bank to obtain funding or has been counted in the bank’s HQLA pool?*

**Response** – Paragraph 120 refers to excess collateral that is not subject to segregation requirements and that can count towards HQLA (ie where a recall by the counterparty would reduce the stock of HQLA) or where a recall by the counterparty would need to use additional funding.

#### 16. *Loss of funding on ABS, covered bonds and other structured finance (Paragraph 124)*

Can Level 1 and Level 2 securities in a collateral pool (for covered bonds or other collateralised own issuances) that become unencumbered in the next 30 days due to maturity of the covered bond be considered as inflows?

**Response** – These inflows can be offset against the redemption payment for the maturing secured debt instrument. Such offsetting inflow amount should consider the respective haircuts for Level 2 assets applied to the market value of the asset. Any net inflow should be considered as other contractual cash inflow.

#### 17. *Liquidity facilities (paragraph 128)*

*According to paragraph 128, a facility is a liquidity facility to the extent that the customer is unable to roll over debt in financial markets. Although it explicitly refers to “rollover” of debt, do these liquidity facilities also capture newly issued positions?*

**Response** – Yes. A liquidity facility according to paragraph 128 is any type of commitment that backs up market funding needs of the customer.

#### 18. *Special purpose entities (SPEs) and conduits (Paragraphs 129–131)*

Paragraph 129 requires a facility provided to SPEs or conduits used to finance a bank’s own assets to be captured as a liquidity facility to other legal entities (and assume a 100% drawdown of the undrawn portion per paragraph 131(g)). To what extent should this provision be applied to commercial conduits for clients?

**Response** – Facilities to SPEs and conduits are subject to the 100% drawdown rate of paragraph 131 (g). The LCR framework does not provide any other category for these entities independent of their business purpose.

## 19. *Other contractual/contingent obligations (paragraph 130)*

*Paragraph 130 states that for the “portion of financing programs that are captured in paragraphs 124 and 125... banks... do not need to double count the maturing financing instrument and the liquidity facility for consolidated programs.” We wonder why the exclusion of double-counting of outflows is limited to consolidated programmes. Do banks have to count outflows for other maturing financing instruments in the LCR twice when they are backed by a facility that is captured in paragraph 131?*

**Response** – No. There is no requirement for any double-counting in the LCR. Outflows from non-consolidated financing programmes that are captured both in paragraph 124 or 125 and paragraph 131 need to be counted only once.

## 20. *Other contractual/contingent obligations (paragraphs 132 and 133)*

*The treatment of banks’ contractual obligations to central banks, sovereigns, multilateral development banks, PSEs etc is not mentioned in either paragraph 132 or 133. We wonder whether it is the actual policy intention to exclude counterparties such as central banks, sovereigns, multilateral development banks and PSEs from the calculation of expected cash outflows under paragraphs 132 and 133?*

**Response** – Paragraph 133 also captures non-financial counterparties other than retail, SME and corporate clients, specifically sovereigns, multilateral development banks and PSEs. Any contractual obligation to extend funds to central banks is, if not captured elsewhere, subject to paragraph 132.

## 21. *Secured lending transactions – reuse of the collateral to cover a customer’s short position (paragraphs 140 and 145–6)*

*What is the appropriate treatment of using the collateral obtained through a margin loan to cover a customer short position? The margin loan will be a 50% inflow, but will the customer short be reflected by the minimum 50% outflow in paragraph 140 and/or the outflow due to paragraphs 113 and 115 of the LCR framework? Regarding paragraph 140, how should it be determined whether or not to take a 50% outflow or a greater percentage?*

**Response** – Paragraph 140 should be applied to quantify the outflow arising from lending out a non-HQLA asset to affect a customer’s short position if this asset is received as collateral to secure another customer’s margin loan. Thus, the 50% inflow from borrowing the assets to secure a margin loan is symmetrical to the 50% outflow for lending these assets to cover another customer’s short position, subject to national discretion.

## 22. *Maturity of margin loans (Paragraph 145)*

Many margin loans are “overnight” and can be terminated at any time by either side. Others, however, have “term” provisions whereby the bank agrees to make funding available for a given period, but the client is not obliged to draw down on that funding, and where the client has drawn down on the funding, they can repay it at any time. May banks apply paragraph 145 to such margin loans with a contractual maturity beyond 30 days?

**Response** – No, paragraph 145 and the table in paragraph 146 are specific to secured loans with a contractual maturity up to and including 30 days. No inflow can be assumed for funds extended under such “term” provisions that give the client the possibility to repay after more than 30 days.

### 23. Operational deposit inflows (*Paragraph 156*)

How should a bank determine whether or not a deposit it has placed at another financial institution is an operational deposit?

**Response** – The same methodology applied in paragraphs 93–104 for operational deposit outflows should also be applied to determine if deposits held at another financial institution are operational deposits and receive a 0% inflow. As a general principle if the bank receiving the deposit classifies the deposit as operational, the bank placing it should also classify it as an operational deposit.

### 24. Other cash flows (*Paragraphs 141, and 160*)

(a) What is the treatment of inflows and outflows of cash and collateral during the next 30 days arising from forward transactions (eg forward repos)?

**Response** – The following transactions do not have any impact on a bank's LCR and can be ignored:

- Forward repos, forward reverse repos and forward collateral swaps that start and mature within the LCR's 30 day horizon,
- Forward repos, forward reverse repos and forward collateral swaps that start prior to and mature after the LCR's 30 day horizon, and
- All forward sales and forward purchases of HQLA.

For forward repos, reverse repos and collateral swaps that start within the 30 day horizon and mature beyond the LCR's 30 day horizon, the treatments are as follows:

- Cash outflows from forward reverse repos (with a binding obligation to accept) count towards "other cash outflows" according to paragraph 141 and should be netted against the market value of the collateral received after deducting the haircut applied to the respective assets in the LCR (15% to Level 2A, 25% to RMBS Level 2B assets, and 50% to other Level 2B assets).
- Cash inflows from forward repos are "other contractual inflows" according to paragraph 160 and should be netted against the market value of the collateral extended after deducting the haircut applied to the respective assets in the LCR.
- In case of forward collateral swaps, the net amount between the market values of the assets extended and received after deducting the haircuts applied to the respective assets in the LCR counts towards "other contractual outflows" or "other contractual inflows" depending on which amount is higher.

Forward repos, forward reverse repos and forward collateral swaps that start previous to and mature within the LCR's 30-day horizon are treated like repos, reverse repos and collateral swaps according to paragraphs 113–115 and paragraphs 145–148 respectively.

Note that HQLA collateral held by a bank on the first day of the LCR horizon may count towards the stock of HQLA even if it is sold or repoed forward.

Unsettled sales and purchases of HQLA can be ignored in the LCR. The cash flows arising from sales and purchases of non-HQLA that are executed but not yet settled at reporting date count towards "other cash inflows" and "other cash outflows".

Note that, in accordance with the response to Q9 (g), any outflows or inflows of HQLA in the next 30 days in the context of forward and unsettled transactions are only considered if the assets do or will count toward the bank's stock of HQLA. Outflows and inflows of HQLA-type assets that are or will be

excluded from the bank's stock of HQLA due to operational requirements are treated like outflows or inflows of non-HQLA.

(b) *Other contractual outflow is determined as 100% as per paragraph 141 of the LCR framework, while other contractual inflows are subject to national discretion as per paragraph 160. Some industry members are concerned about the potential asymmetrical treatment between the two items with respect to unsettled sales and purchases as addressed in Q.15 (a) of the 2014 LCR FAQs. Does this requirement apply broadly to all unsettled trades, ie does it also apply to "open" and "failed" trades, or does it only apply to forwards? Banks which apply settlement date accounting for open trades would not have any "open trades" on their balance sheet and therefore this requirement might create an unlevel playing field for different accounting frameworks.*

**Response** – *Unsettled transactions are addressed in the second to last paragraph of the response to Q.25 (a) published as part of the April 2014 FAQs as Q.15. It refers to any sales or purchases that are executed but not yet settled at reporting date and follows the approach set out for forward transactions. It captures both "open" and "failed" trades if settlement is expected within 30 days irrespective of the balance sheet treatment. In doing so, the response to Q. 25 (then Q.15) allows for a symmetrical treatment by applying "other cash outflows" to executed but not yet settled purchases of non-HQLA and, subject to national discretion, "other cash inflows" to executed but not yet settled sales, while unsettled sales/purchases of HQLA can be ignored.*

## 25. *Unsecured securities borrowings/lending (Paragraphs 141, and 160)*

(a) What is the treatment of Level 1 and Level 2 assets that are lent/borrowed without any further offsetting transaction (ie no repo/reverse repo or collateral swap) if the assets will be returned or can be recalled during the next 30 days? Are these assets eligible HQLA on the side of the lender or borrower?

**Response** – These assets do not count towards the stock of HQLA for either the lender or the borrower. On the side of the borrower, these assets do not enter the LCR calculation. On the lender's side, these assets count towards the "other contractual inflows" amounting to their market value – in the case of Level 2 assets after haircut.

(b) *Given that Q.26 (a) published as part of the 2014 LCR FAQs is titled "unsecured securities borrowings/lending", does it therefore apply to assets borrowed/lent on an unsecured basis only and not to secured transactions? Is it correct to interpret that the Basel Committee means "reused" when it uses the wording "further offsetting transaction"?*

**Response** – *Q.26 (a) of the 2014 FAQs refers to assets borrowed/lent on an unsecured basis only. The wording "without any further offsetting transaction" means the absence of a corresponding transfer of cash or securities that would secure the securities borrowing/lending, such as in a repo, reverse repo or collateral swap. If the borrower has reused the securities, there would be an "other contractual cash outflow" to cover unsecured collateral borrowings according to paragraph 141.*

*The starting point and focus of Q.26 (a) (as well as the response to it) is the HQLA eligibility of the assets on the part of either the borrower or the lender. In this context, it is assumed that the borrower has not reused the assets as this would have made the question of HQLA eligibility obsolete anyway. The reuse of the collateral by the borrower, however, introduces an outflow because the borrower may have to source these securities if the borrowing arrangement is not extended.*

## 26. *Central bank facilities (paragraph 142)*

(a) *May any facilities from the central bank other than the restricted-use committed liquidity facility (RCLF) be counted towards inflows? If yes, under what conditions?*

**Response** – No, facilities including those from central banks are considered to be contingent inflows in the LCR which are excluded from the inflows according to paragraph 142 of the LCR framework.<sup>28</sup> Loans with fixed interest rate periods (Paragraphs 142, and 152)

**27. Secured lending transactions – reuse of the collateral in a repo transaction with collateral substitution right (paragraphs 145–6)**

Can a bank record an inflow for a reverse repo with a residual maturity of up to 30 days where collateral is being funded in a repo with a residual maturity of more than 30 days and such repo has full rights of substitution for collateral of the same or better HQLA classification under the LCR? Unlike short positions under paragraph 146, in this case repos are not tied to reverses (especially in triparty transactions) and banks generally have rights of substitution under repos.

**Response** – Paragraph 146 states that there is an inflow rate of 0% when collateral received through a secured lending transaction is reused to cover a short position, including matched repo books where the collateral reuse transaction has a longer maturity than the secured lending transaction. The ability to substitute collateral in the reuse transaction should not be considered in determining the inflow rate of the secured lending transaction.

**28. Loans with fixed interest rate periods (Paragraphs 142, 152)**

Is it correct to exclude inflows from loans with a fixed interest rate period that ends in the next 30 days as we assume that these loans will be generally prolonged irrespective of whether the contractual arrangements provide for early termination of the loan if no agreement on the interest rate adjustment was reached?

**Response** – Yes, such loans should be considered as having an open maturity where any inflows exceeding those according the regular amortisation schedule would be “contingent” (in terms of a possible cancellation) in nature. Such inflows are excluded from the calculation of the net cash outflow under the LCR.

**29. Received collateral used to cover short positions (Paragraph 146)**

Can you confirm that the exception rule in paragraph 146 only applies where the reverse repo has a residual maturity of  $\leq 30$  days and the short position can be extended  $> 30$  days? And, should the reporting institution also apply a 0% outflow to such short positions even if the contractual or expected residual maturity of the shorts is up to 30 days, given that the secured lending transactions covering such shorts are assumed to be extended?

**Response** – No, the inflow rates in the third column of the table in paragraph 146 apply to all reverse repos, securities borrowings or collateral swaps where the collateral obtained is used to cover short positions. The reference in the first sentence of paragraph 146 to “short positions that could be extended beyond 30 days” does not restrict the applicability of the 0% inflow rate to the portion of secured lending transactions where the collateral obtained covers short positions with a contractual (or otherwise expected) residual maturity of up to 30 days. Rather, it is intended to point out that the bank must be aware that such short positions may be extended, which would require the bank to roll the secured lending transaction or to purchase the securities in order to keep the short positions covered. In either case, the secured lending transaction would not lead to a cash inflow for the bank’s liquidity situation in a way that it can be considered in the LCR. For customer shorts, paragraph 146 only refers to those that could be extended beyond the 30-day horizon, so the reverse repo can be considered to have a maturity within the 30-day LCR time horizon. For firm shorts, paragraph 147 of the LCR rules text applies a

0% cash inflow rate to the reverse repo, irrespective of the residual maturity, but does not assume any outflow associated with the closure of the firm's short position.

### 30. Ability to return collateral (paragraph 148)

Does paragraph 148 of the LCR framework mean to capture specific outflows/inflows or is it rather outlining liquidity risk principles?

**Response** – Paragraph 148 does not address specific cash flows. Rather, it calls to mind that a bank should be prepared to return any received collateral as soon as it may be recalled by the provider irrespective of the treatment in the LCR.

### 31. Other wholesale cash inflows (paragraphs 150–4)

Paragraphs 150–4 of the LCR text relate to the inflow treatments of transactions with various types of counterparties (retail, small business, non-financial institution wholesale, financial institutions etc). Are these paragraphs only referring to expected cash inflows arising from loans to be received from the specified counterparties?

**Response** – Paragraphs 151 and 152 refer specifically to loans, but paragraphs 150 and 154 have broader language to have a broader meaning. For example, demand deposits at other banks are subject to paragraph 154. And the general assumption in the LCR is a complete return of liquidity between a bank and other financial institutions, ie all financial institutions withdraw their non-operational deposits from the bank (100% outflow) and the bank withdraws all non-operational deposits held at other financial institutions (100% inflow).

### 32. Maturing Level 1 and Level 2 assets (Paragraph 155)

(a) Can banks count as inflows the difference between the actual redemption amount of Level 2 securities and the amount considered as HQLA (ie after application of the LCR haircut)?

**Response** – No, assets including Level 2 assets that fulfil the requirements of HQLA eligibility shall be considered as such and not as inflows.

(b) Can inflows from maturing Level 2 assets that are excluded from the stock of HQLA due to operational requirements count towards the inflows?

**Response** – Yes, maturing assets including Level 1 and Level 2 assets that are not HQLA-eligible due to operational requirements may be considered as inflows.

(c) Can inflows from maturing securities in a collateral pool for covered bonds be considered as inflows?

**Response** – Yes, inflows are not subject to operational requirements. Hence, these inflows are not per se excluded from the LCR even if the maturing securities are (or have been) excluded from the stock of HQLA due to being "encumbered" according to paragraph 31. However, if the matured securities need to be substituted in the collateral pool within the 30-day horizon, an "other outflow" per paragraph 141 should be considered amounting to the liquidity value of these securities in the LCR.

### 33. Inflows on nostro accounts (paragraph 156)

Is a non-zero inflow rate applicable to deposits held by a bank on nostro accounts at other banks?

**Response** – Deposits held for the purpose of correspondent banking are held for operational purposes and, as such, are subject to a 0% inflow rate according to paragraph 156 of the LCR framework. This does not affect the 100% outflow rate of these deposits at the part of the bank that has received the deposits according to paragraph 99. This treatment applies to all deposits that are used in the context of correspondent banking arrangements according to paragraph 99 and footnote 42 irrespective of the account name. Within this scope, correspondent banking deposits refer to deposits a (customer) bank holds with another bank for the purpose that the other (correspondent) bank holds balances and settles payments in a currency other than the (customer) bank's domestic currency and on the (customer) bank's behalf. However, a 100% inflow rate would be applicable to the amount for which the bank is able to determine that the funds are "excess balances" in the sense of paragraph 96 of the LCR framework, ie they are not tied to operational purposes and may be withdrawn within 30 days.

**34. Adjustment of HQLA – relevance of rehypothecated collateral for the unwind mechanism (Annex 1, paragraph 4)**

HQLA collateral received from reverse repos is only subject to the unwind mechanism when it is buffer-eligible. This is not the case when the collateral is rehypothecated in a repo transaction. Is it adequate that both the repo and reverse repo transaction are subject to the unwind?

**Response** – When maturing within the LCR time horizon, both the reverse repo transaction and the repo transaction using the collateral received from the reverse repo should be subject to the unwind.