# Amendments to the Basel Committee liquidity risk framework

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# I. The December consultative document on the liquidity risk framework - recap

- Basel Committee develops an international liquidity risk framework:
  - Purpose: (1) increase banks' resilience to liquidity shocks and (2) increase the market confidence in the liquidity position of banks.
- Framework mainly consists of:
  - A liquidity risk coverage ratio (LCR), to establish a minimum level of high-quality liquid assets to withstand an acute stress scenario lasting one month.
  - A net stable funding ratio (NSFR), to ensure a closer alignment of the funding of longer-term assets or activities by more stable medium or longer-term liability and equity financing.
  - A set of tools for ongoing monitoring of liquidity risk exposures and information exchange among supervisors

# II. Industry reactions

- Generally industry participants voiced support for the objectives and the overall structure of the liquidity risk framework;
- However the industry also clearly voiced concerns that the liquidity proposal could create severe economic consequences for the financial industry and the global economy;
  - Particularly the NSFR measure was criticised as it would not allow to perform the essential maturity transformation of banks within the economy.
  - The NSFR measure raised questions regarding the impact on particular business models and the incentives it might provide.
  - As for the LCR, the proposed narrow definition of liquid assets was heavily criticised as it could lead to severe concentration risk and would be too restrictive.

# III. Quantitative Impact Study results

- As the reform package puts forward for the first time a liquidity risk framework for banks, it had as implication that banks did not collect or dispose of the data as required by the standards.
  - Despite the guidance provided a variance in assumptions and in reported internal liquidity data was observed.
- E.g. different treatment of cash inflows and the assumptions of the ongoing business, which were left to the discretion of the bank.
  - Some banks assumed that 100% of maturing loans should be counted as inflows others assumed 0%.
  - Made that in some cases the inflows were estimated to be of the order that banks did not require a stock of liquid assets.
- This has affected the outcome of the Quantitative Impact Study (QIS) and the comparability across banks and jurisdictions..

# III. Quantitative Impact Study results

- Therefore, the QIS results for liquidity are more useful as a directional tool to view the calibration changes, rather than a tool that shows the actual numerical impact of the standards.
- The QIS does show that alternative scenarios – that go into the direction of the agreement reached by the Governors and Heads of Supervision – are more favourable than the December consulted proposals.
- Finally the QIS importantly revealed elements in the framework that need clarification and tightening up of definitions and explanations.

# IV. a) The GHOS agreement on the Liquidity Coverage Ratio

- Provided the QIS results, the industry comments and the further assessment of the liquidity risk framework, the Basel Committee proposed a series of changes.
- Under the agreement reached by the Governors and Heads of Supervision (GHOS), changes to the LCR are primarily related to recalibration:
  - Recalibration of the stress scenario “a conservative bank level and plausible system wide shock”, translated into
  - Run-off rate floors lowered to 5% for stable and 10% for less stable retail deposits
  - 25% outflow bucket for custody, clearing, settlement as well as selected cash management activities.

# IV. a) The GHOS agreement on the Liquidity Coverage Ratio

- Recalibration of LCR continued
  - Run-off rates for deposits of Sovereigns, Central Banks and PSEs were lowered from 100% to:
    - 75% run-off rate for unsecured funding of all sovereigns, central banks and PSEs;
    - Secured funding backed by assets not included in the stock of liquid assets are assumed to run-off at a 25% rate;
    - Secured funding backed by buffer eligible assets are recognised to be rolled-over.

# IV. a) The GHOS agreement on the Liquidity Coverage Ratio

- Recalibration of LCR continued
  - Definition of liquid assets.
  - Level I liquid assets:
    - Cash and Central bank reserves – if can be drawn in times of stress;
    - Government bonds assigned a 0% risk weighting;
    - Domestic sovereign debt for non-0% risk weighted sovereigns issued in foreign currency (to the extent currency matches currency needs in that jurisdiction);
  - Level II liquid assets:
    - Apply 15% haircut and cap that allows 40% of the stock to be made up of;
    - Government securities qualifying for the 20% risk weighting;
    - High-quality non-financial corporate and covered bonds (not own-issued);
    - Still determination of eligibility criteria (outside of ratings);

# IV. b) The GHOS agreement on the Net Stable Funding Ratio

- As for the NSFR measure, the Basel Committee remains committed to the introduction of the NSFR as a longer-term structural complement;
  - Besides recalibration changes, modifications could be necessary to better address differences in the business models;
  - Observation ratio to guard the smooth introduction of the measure.

# V. Next steps

- Finalise LCR by end 2010;
- Phase in LCR by 2015;
- Develop by end 2010 a revised NSFR proposal;
- Introduce the NSFR as a minimum standard by January 2018.

Thank you for your attention