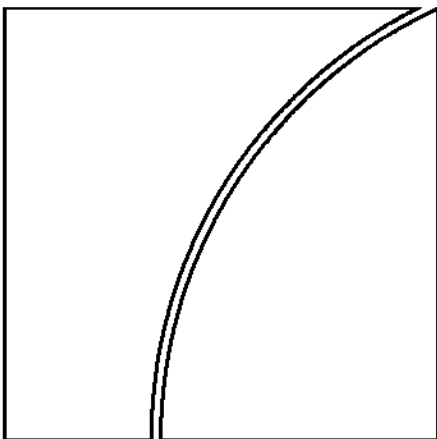


Basel Committee on Banking Supervision



Basel III framework for liquidity frequently asked questions

July 2011



BANK FOR INTERNATIONAL SETTLEMENTS

Copies of publications are available from:

Bank for International Settlements
Communications
CH-4002 Basel, Switzerland

E-mail: publications@bis.org

Fax: +41 61 280 9100 and +41 61 280 8100

This publication is available on the BIS website (www.bis.org).

© *Bank for International Settlements 2011. All rights reserved. Brief excerpts may be reproduced or translated provided the source is stated.*

ISBN print: 92-9131-875-2

ISBN web: 92-9197-875-2

Contents

Section 1: clarification on the calculation of the cap on Level 2 assets with regard to short term secured funding.....	1
Part 1: Guiding principles.....	1
Part 2: Clarification of the calculation of the cap on Level 2 assets.....	2
Part 3: Examples	2
Repo transaction	2
Reverse repo transaction	5
Section 2: other questions and answers.....	8
LCR 8	
NSFR.....	14
Section 3: Miscellaneous edits	15

Basel III liquidity frequently asked questions

The Basel Committee on Banking Supervision has received a number of interpretation questions related to the 16 December 2010 publication of the Basel III regulatory frameworks for capital and liquidity. To help ensure a consistent global implementation of Basel III, the Committee has agreed to periodically review frequently asked questions and publish answers along with any technical elaboration of the rules text and interpretative guidance that may be necessary.

This document sets out the first set of frequently asked questions that relate to Basel III's liquidity rules. The first section of the document provides clarification on the calculation of the cap on Level 2 assets with regard to short-term secured funding. Section 2 addresses other questions and answers pertaining to the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) of the rules text. Section 3 sets out miscellaneous edits to the rules text.

Section 1: clarification on the calculation of the cap on Level 2 assets with regard to short term secured funding

This section seeks to clarify the appropriate method for the calculation of the cap on Level 2 assets with regard to short-term secured funding by highlighting the principles and providing examples that are consistent with the Committee's intent and requirements, as set out in the December 2010 Basel III rules text.

Part 1: Guiding principles

The following guiding principles provide the rationale for the calculation of the cap on Level 2 assets, as described in paragraphs 34–37:

- Assets to be included in each category (Level 1 and Level 2) are those that the bank is holding on the first day of the stress period;
- Level 2 assets can only comprise up to 40% of the pool of high-quality liquid assets;
- The calculation of the 40% cap should take into account the impact on the amounts held in cash or other Level 1 or Level 2 assets caused by secured funding transactions (or collateral swaps) maturing within 30 calendar days. Critically, consistent with paragraph 37, the composition of the liquidity pool should take into consideration the unwind of all short-term transactions that mature in the 30 day period, not just the assumed outflows associated with the scenario or runoff factors;
- The maximum amount of adjusted Level 2 assets in the stock of high-quality liquid assets is equal to two-thirds of the adjusted amount of Level 1 assets after haircuts have been applied, where the method for calculating adjusted Level 1 and adjusted Level 2 assets is outlined in paragraph 37.

These principles reflect the efforts of the Committee to implement a requirement that is consistent with the stated concerns about banks' efforts or capacity to arbitrage the restrictions on the composition of the liquidity pool.

Part 2: Clarification of the calculation of the cap on Level 2 assets

Consistent with the above principles, when it comes to the calculation of the cap on Level 2 assets for short-term secured funding, banks must subtract the amount, if any, that adjusted Level 2 assets exceed two thirds of adjusted Level 1 assets from the sum of Level 1 and Level 2 assets. Stated another way, taking into consideration the cap on Level 2 assets, a bank's pool of high-quality liquid assets is the sum of Level 1 and Level 2 assets less the amount, if any, that adjusted Level 2 assets exceed two thirds of adjusted Level 1 assets, as expressed in the following formula:

$$\text{Pool of High-Quality Liquid Assets} = \text{Level 1 Assets} + \text{Level 2 Assets} - \text{Max} ((\text{Adjusted Level 2 Assets} - 2/3 * \text{Adjusted Level 1 Assets}), 0)$$

As noted in paragraphs 34-37, these calculations are applied after taking account of the relevant haircuts. Notwithstanding the outcome of the calculation, the numerator of the LCR must not be less than zero.

As mentioned, the key of the calculation is that a bank should not be able to engage in short-term (ie under 30 day) securities financing transactions to evade or arbitrage the Committee's restrictions on Level 2 assets. The comparison of "adjusted" assets reflects both the banks holdings of Level 1 and Level 2 assets and the funding of those assets.

Part 3: Examples

Repo transaction

Base case: Bank A has \$10b of reserves, \$5b of AAA-rated covered bonds and \$5b of exchange traded equities in an AAA-rated company. Bank A total net cash outflows equal \$20b.

Stock = 14.25b; Outflows = 20b

LCR = 14.25/20 = 0.713

Rationale: The stock is comprised of 10b L1 plus 4.25b L2 due to a 15% haircut.

1. Bank A now has \$15b of reserves and \$5b of exchange traded equities in an AAA-rated company after executing an over night (O/N) repo of \$5b of AAA-rated covered bonds for \$5b in reserves.

Stock = 15b; Outflows increase by 0.75b

LCR = 15/20.75 = 0.723

Rationale: The stock is now comprised of 15b L1 and 0b L2. Adjusted L1 is 10b (determined by unwinding the transaction). The 5b generated by the repo does not exceed the L2 cap (2/3 of adjusted L1), therefore, no amount is deducted from the stock. Outflows increase by 0.75b because secured funding transactions collateralised by L2 receive a 15% run-off rate.

2. Bank A now has \$15b of reserves and \$5b of exchange traded equities in an AAA-rated company after executing a 60-day repo of \$5b of AAA-rated covered bonds for \$5b in reserves.

Stock = 15b; No impact on outflows

$$\text{LCR} = 15/20 = 0.750$$

Rationale: The stock is now comprised of 15b L1 and 0b L2. As the transaction is greater than 30 days, the amount is assumed to remain with the bank during the LCR time horizon and there is no impact on outflows.

3. Bank A now has \$12.5b of reserves and \$5b of AAA-rated covered bonds after executing an O/N repo of \$5b of exchange traded equities in an AAA-rated company for \$2.5b in reserves.

Stock = 16.75b; Outflows increase by 2.5b

$$\text{LCR} = 16.75/22.5 = 0.744$$

Rationale: The stock is now comprised of 12.5b L1 and 4.25b L2, post-haircut. Adjusted L1 is 10b, to which the cap on L2 is subject. Outflows increase by 2.5b because secured funding transactions that are not collateralised by high-quality liquid assets receive a 100% run-off rate (and are not subject to a cap in the numerator).

4. Bank A now has \$12.5b of reserves and \$5b of AAA-rated covered bonds after executing a 60-day repo of \$5b of exchange traded equities in an AAA-rated company for \$2.5b in reserves.

Stock = 16.75b; No impact on outflows

$$\text{LCR} = 16.75/20 = 0.837$$

Rationale: The stock is now comprised of 12.5b L1 and 4.25b L2, post-haircut. There is no adjustment on L1 (to which the cap on L2 is subject) because the repo does not mature within 30 days. As the transaction is greater than 30 days, the amount is assumed to remain with the bank during the LCR time horizon and there is no impact on outflows.

5. Bank A now has \$12.5b of reserves and \$5b of AAA-rated covered bonds after executing an O/N repo of \$5b of exchange traded equities in an AAA-rated company with its central bank for \$2.5b in reserves.

Stock = 16.75b; Outflows increase by 0.625b

$$\text{LCR} = 16.75/20.63 = 0.812$$

Rationale: The stock is now comprised of 12.5b L1 and 4.25b L2, post-haircut. Adjusted L1 is 10b, to which the cap on L2 is subject. Unlike examples 4 and 5, however, outflows increase by 0.625b because secured funding transactions with a central bank (that are not collateralised by high-quality liquid assets) receive a 25% run-off rate. This is principally because a transaction with the central bank (as well as domestic sovereign and certain PSEs) is assumed to result in a more favourable run-off rate.

6. Bank A now has \$12.5b of reserves and \$5b of AAA-rated covered bonds after executing a 60-day repo of \$5b of exchange traded equities in an AAA-rated company with its central bank for \$2.5b in reserves.

Stock = 16.75b; No impact on outflows

$$\text{LCR} = 16.75/20 = 0.837$$

Rationale: see rationale in example 4.

Base case: Bank B has \$10b of reserves, \$10b of AAA-rated covered bonds and \$10b of exchange traded equities in an AAA-rated company. Bank B total net cash outflows equal \$20b.

Stock = 16.67b; Outflows = 20b

LCR = $16.67/20 = 0.833$

Rationale: The stock is comprised of 10b L1 and 6.67b L2. The bank has 8.5b L2 after the 15% haircut. Since it can only hold 2/3 of L1 (6.7b) in L2, 1.8b (8.5b-6.7b) is deducted from the stock, post-haircut. The calculation is expressed as: $10+10*85\%-\text{Max}((10*85\%-10*2/3),0) = 16.67$.

1. Bank B now has \$20b of reserves and \$10b of exchange traded equities in an AAA-rated company after executing an O/N repo of \$10b of AAA-rated covered bonds for \$10b in reserves.

Stock = 18.17b; Outflows increase by 1.5b

LCR = $18.17/21.5 = 0.845$

Rationale: The combined stock (L1+L2) is now 18.17b. Adjusted L1 is 10b and adjusted L2 is 8.5b. The adjusted amounts are determined by unwinding the transaction and, in the case of adjusted L2, applying a 15% haircut. Since the bank can only hold 2/3 of adjusted L1 (6.7b) in L2, 1.8b (8.5b-6.7b) is deducted from the stock. Therefore, the bank subtracts 1.8b from the 20b of its current reserves. The calculation is expressed as: $20+0*85\%-\text{Max}((10*85\%-10*2/3),0) = 18.17$. Outflows increase by 1.5b because secured funding transactions collateralised by L2 receive a 15% run-off rate.

2. Bank B now has \$20b of reserves and \$10b of exchange traded equities in an AAA-rated company after executing a 60-day repo of \$10b of AAA-rated covered bonds for \$10b in reserves.

Stock = 20b; No impact on outflows

LCR = $20/20 = 1$

Rationale: The stock is now comprised of 20b L1 and 0b L2. As the transaction is greater than 30 days, the amount is assumed to remain with the bank during the LCR time horizon and there is no impact on outflows.

3. Bank B now has \$15b of reserves and \$10b of AAA-rated covered bonds after executing an O/N repo of \$10b of exchange traded equities in an AAA-rated company for \$5b in reserves.

Stock = 21.67b; Outflows increase by 5b

LCR = $21.67/25 = 0.867$

Rationale: The combined stock (L1+L2) is now 21.67b. Adjusted L1 is 10b and adjusted L2 is 8.5b. The adjusted amounts are determined by unwinding the transaction and, in the case of adjusted L2, applying a 15% haircut. Since the bank can only hold 2/3 of adjusted L1 (6.7b) in L2, 1.8b (8.5b-6.7b) is deducted from the stock. The calculation is expressed as: $15+10*85\%-\text{Max}((10*85\%-10*2/3),0) = 21.67$. Outflows increase by 5b because secured

funding transactions that are not collateralised by high-quality liquid assets receive a 100% run-off rate (and are not subject to a cap in the numerator).

4. Bank B now has \$15b of reserves and \$10b of AAA-rated covered bonds after executing a 60-day repo of \$10b of exchange traded equities in an AAA-rated company for \$5b in reserves.

Stock = 23.5b; No impact on outflows

LCR = $23.5/20 = 1.175$

Rationale: The stock is now comprised of 15b L1 and 8.5b L2, post haircut. There is no adjustment on L1 (to which the cap on L2 is subject) because the repo does not mature within 30 days. As the transaction is greater than 30 days, the amount is assumed to remain with the bank during the LCR time horizon and there is no impact on outflows.

5. Bank B now has \$15b of reserves and \$10b of AAA-rated covered bonds after executing an O/N repo of \$10b of exchange traded equities in an AAA-rated company with its central bank for \$5b in reserves.

Stock = 21.67b; Outflows increase by 1.25b

LCR = $21.67/21.25 = 1.02$

Rationale: The combined stock (L1+L2) is now 21.67b. Adjusted L1 is 10b and adjusted L2 is 8.5b. The adjusted amounts are determined by unwinding the transaction and, in the case of adjusted L2, applying a 15% haircut. Since the bank can only hold 2/3 of adjusted L1 (6.7b) in L2, 1.8b (8.5b-6.7b) is deducted from the stock. The calculation is expressed as: $15+10*85\%-\text{Max}((10*85\%-10*2/3),0) = 21.67$. Unlike examples 4 and 5, however, outflows increase by 1.25b because secured funding transactions with a central bank (that are not collateralised by high-quality liquid assets) receive a 25% run-off rate. This is principally because a transaction with the central bank (as well as domestic sovereign and certain PSEs) is assumed to result in a more favourable run-off rate.

6. Bank B now has \$15b of reserves and \$10b of AAA-rated covered bonds after executing a 60-day repo of \$10b of exchange traded equities in an AAA-rated company with its central bank for \$5b in reserves.

Stock = 23.5b; No impact on outflows

LCR = $23.5/20 = 1.175$

Rationale: see rationale in example 4.

Reverse repo transaction

Base case: Bank C has \$10b of reserves, \$5b of AAA-rated covered bonds and \$5b of exchange traded equities in an AAA-rated company. Bank C total net cash outflows equal \$20b.

Stock = 14.25b; Outflows = 20b

LCR = $14.25/20 = 0.713$

Rationale: The stock is comprised of 10b L1 plus 4.25b L2 due to a 15% haircut.

1. Bank C now has \$5b of reserves, \$10.5b of AAA-rated covered bonds and \$5b of exchange traded equities in an AAA-rated company after executing an O/N reverse repo of \$5b of reserves for \$5.5 AAA-rated covered bonds.

Stock = 13.93b; Inflows increase by 0.75b

LCR = $13.93/19.25 = 0.723$

Rationale: The stock is now comprised of 5b L1 and 8.93 L2, post-haircut. Since adjusted L1 is 10b and adjusted L2 is 4.25 (post-haircut, which is less than the 2/3 cap on adjusted L1), no additional amount is deducted. Outflows decrease by 0.75b because secured funding transactions collateralised by L2 receive a 15% inflow rate.

2. Bank C now has \$5b of reserves, \$10.5b of AAA-rated covered bonds and \$5b of exchange traded equities in an AAA-rated company after executing a 60-day reverse repo of \$5b of reserves for \$5.5b AAA-rated covered bonds.

Stock = 8.33b; No impact on inflows

LCR = $8.33/20 = 0.417$

Rationale: The stock is now comprised of 5b L1 and 3.33 L2. Since the transaction exceeds 30 days, the cap on L2 should be based on 5b rather than the adjusted L1 of 10b. Therefore, L2 equals 2/3 of 5b (3.33b). As the transaction is greater than the LCR time horizon, there is no increase in inflows.

3. Bank C now has \$5b of reserves, \$5b of AAA-rated covered bonds and \$15b of exchange traded equities in an AAA-rated company after executing over an O/N reverse repo of \$5b of reserves for \$10b of exchange traded equities in an AAA-rated company.

Stock = 9.25b; Inflows increase by 5b

LCR = $9.25/15 = 0.6167$

Rationale: The stock is now comprised of 5b L1 and 4.25 L2, post-haircut. Since adjusted L1 is 10b and adjusted L2 is 4.25 (post-haircut, which is less than the 2/3 cap on adjusted L1), no additional amount is deducted. Net cash outflows decrease by 5b because secured funding transactions that are not collateralised by high-quality liquid assets receive a 100% inflow rate.

4. Bank C now has \$5b of reserves, \$5b of AAA-rated covered bonds and \$15b of exchange traded equities in an AAA-rated company after executing a 60-day reverse repo of \$5b of reserves for \$10b of exchange traded equities in an AAA-rated company.

Stock = 8.33b; No impact on inflows

LCR = $8.33/20 = 0.417$

Rationale: see rationale in example 2.

Base case: Bank D has \$10b of reserves, \$10b of AAA-rated covered bonds and \$10b of exchange traded equities in an AAA-rated company. Bank D total net cash outflows equal \$20b.

Stock = 16.67b; Outflows = 20b

$$\text{LCR} = 16.67/20 = 0.833$$

Rationale: The stock is comprised of 10b L1 and 6.67b L2. The bank has 8.5b L2 after the 15% haircut. Since it can only hold 2/3 of L1 (6.7b) in L2, 1.8b (8.5b-6.7b) is deducted from the stock, post-haircut. The calculation is expressed as: $10 + 10 * 85\% - \text{Max}((10 * 85\% - 10 * 2/3), 0) = 16.67$.

1. Bank D now has \$5b of reserves, \$15.5b AAA-rated covered bonds and \$10b exchange traded equities in an AAA-rated company after executing over night an O/N reverse repo of \$5b reserves for \$5.5b AAA-rated covered bonds.

Stock = 16.34b, Inflows increase by 0.75b

$$\text{LCR} = 16.34/19.25 = 0.849$$

Rationale: The combined stock (L1+L2) is now 16.34b. The adjusted amounts are determined by unwinding the transaction and, in the case of adjusted L2, applying a 15% haircut. Since the bank can only hold 2/3 of adjusted L1 (6.67b) in L2, 1.8b (8.5b-6.7b) is deducted from the stock. The calculation is expressed as: $5 + 15.5 * 85\% - \text{Max}((10 * 85\% - 10 * 2/3), 0) = 16.34$. Net cash outflows decrease by 0.75b because secured funding transactions collateralised by L2 receive a 15% inflow rate.

2. Bank D now has \$5b of reserves, \$15.5b of AAA-rated covered bonds and \$10b of exchange traded equities in an AAA-rated company after executing 60-day reverse repo of \$5b of reserves for \$5.5b AAA-rated covered bonds.

Stock = 8.33b; No impact on inflows

$$\text{LCR} = 8.33/20 = 0.417$$

Rationale: The stock is now comprised of 5b L1 and 3.33 L2. Since the transaction exceeds 30 days, there is no adjustment on L1. Therefore, L2 should be capped at 2/3 of 5b L1. As the transaction is greater than the LCR time horizon, there is no increase in inflows.

3. Bank D now has \$5b of reserves, \$10b of AAA-rated covered bonds and \$20b exchange traded equities in an AAA-rated company after executing an O/N reverse repo of \$5b of reserves for \$10b exchange traded equities in an AAA-rated company.

Stock = 11.67b; Inflows increase by 5b

$$\text{LCR} = 11.67/15 = 0.778$$

Rationale: The combined stock (L1+L2) is now 11.67b. Adjusted L1 is 10b and adjusted L2 is 8.5b. The adjusted amounts are determined by unwinding the transaction and, in the case of adjusted L2, applying a 15% haircut. Since the bank can only hold 2/3 of adjusted L1 (6.7b) in L2, 1.8b (8.5b-6.7b) is deducted from the stock. The calculation is expressed as: $5 + 10 * 85\% - \text{Max}((10 * 85\% - 10 * 2/3), 0) = 11.67$. Net cash outflows decrease by 5b because secured funding transactions that are not collateralised by high-quality liquid assets receive a 100% inflow rate.

4. Bank D now has \$5b of reserves, and \$10b of AAA-rated covered bonds and \$20b exchange traded equities in an AAA-rated company after executing 60-day reverse repo of \$5b of reserves for \$10b of exchange traded equities in an AAA-rated company.

Stock = 8.33b; No impact on inflows

$$\text{LCR} = 8.33/20 = 0.417$$

Rationale: see rationale in example 2.

Section 2: other questions and answers

LCR

1. *Paragraph 16 states "given the uncertain timing of outflows and inflows, banks and supervisors are expected to be aware of any potential mismatches within the 30-day period and ensure that sufficient liquid assets are available to meet any cashflow gaps throughout the period". What are supervisors actually expected to do here? Is there any guidance on this in the document?*

There is no specific guidance on this in the rules text. We would draw the attention of national supervisors to the potential mismatches within 30 days, as it is not accounted for in the ratio. National supervisors should consider how this would be interpreted in their own jurisdiction.

2. *Paragraph 26 states that, "the assets must be available for the bank to convert into cash at any time to fill funding gaps between cash inflows and outflows during the stressed period". What is the meaning of "at any time"?*

"At any time" means the assets must be available to the bank starting **at day 0** and remain available during the next 30 days such that they are available to fund gaps between cash inflows and outflows arising during that 30-day period. As stated in paragraph 27 of the rules text, assets received in reverse repo which are not technically available over the next 30 days on a contractual basis can be included in the stock of high-quality liquid assets.

3. *Paragraph 27 states, "...assets which qualify for the stock of high-quality liquid assets that have been pledged to the central bank or a public sector entity (PSE) but are not used may be included in the stock." What assumption is to be applied in the case where a collateral pool consists of both eligible and ineligible assets for the stock?*

If the bank has deposited both eligible and ineligible assets for the stock in a collateral pool and no assets are specifically assigned as collateral for the secured transaction, the bank may assume that the assets with the lowest liquidity get assigned first: assets that are not eligible for the stock of liquid assets are assumed to be assigned first, then if all those assets are already assigned, Level 2 assets are assumed to be assigned. If all Level 2 assets are already assigned, then Level 1 assets are assumed to be assigned.

4. *If a bank holds shares in a mutual fund which invests exclusively in high-quality liquid assets, can these shares be included in the LCR stock of liquid assets?*

If a bank holds shares in a mutual fund, it does not hold the underlying securities unencumbered, rather it holds the shares. Equity instruments are not eligible for inclusion in the liquid assets buffer.

5. *Paragraphs 28-29 state, "...sole intent for use as a source of contingent funds... [t]he stock should be under the control of a specific function." Is cash physically held in retail branches still eligible as liquid assets as it would be the first to cover retail outflows assumed in the LCR?*

The fact that cash is held at retail branches is not reason alone for its exclusion from the stock of high-quality liquid assets; if it meets all requirements, then it should be included.

6. *With regards to paragraph 32, within a multinational banking group, does liquidity in different currencies constitute adequate liquidity when observing liquidity at a group consolidated level or should the liquidity be in the home regulator's currency at a group consolidated level?*

There is no requirement for liquidity to be held solely in the home regulator's currency at the group consolidated level. In fact, paragraph 32 says that banks should "maintain high-quality liquid assets consistent with the distribution of their liquidity needs by currency". Therefore, if the liquidity needs are denominated in several currencies, the bank should hold assets denominated in different currencies in its stock of high quality liquid assets such that the currency composition of its stock is consistent with the currency composition of its liquidity needs.

The rules text also says that supervisors and banks should be aware of the liquidity needs in each significant currency. Banks and supervisors cannot assume that currencies will remain transferable and convertible in a stress event, even for currencies that in normal times are freely transferable and highly convertible.

7. *How are the credit ratings by rating agencies used in calculation of these ratios, aside from what qualifies as Level 2 assets?*

Credit ratings are involved in determining: (1) Level 1 and Level 2 assets in the LCR; (2) potentially indirectly - through criteria for central bank eligibility – in the roll-over assumptions on secured financing in the LCR; (3) increased liquidity needs related to downgrade triggers; and (4) weights on certain components of the RSF in the NSFR.

8. *Paragraph 34 states that "The stock of high-quality liquid assets should be comprised of assets which meet the characteristics outlined above. Paragraph 40 further describes the assets which meet these characteristics as follows:*

*"(c) Marketable securities representing claims on or claims guaranteed by sovereigns, central banks, non-central government public sector entities (PSEs), the Bank for International Settlements, the International Monetary Fund, the **European Commission**, or **multilateral development banks**..." subject to certain specified criteria.*

*Please clarify why this particular wording is used in listing the European Commission and the multilateral development banks separately rather than to subsume these issuers under the general term of "supranational issuers"? Please clarify which entities are classified as **non-central government public sector entities (PSEs)**? Is there a further definition or list of issuers you could provide in this respect?*

The Basel III liquidity framework follows the categorisation of market participants applied in the Basel II Capital Accord, where relevant. The parties categorised under the Level 1 assets are consistent with those receiving a 0% risk weight under the Standardised Approach of the Basel II Capital Accord. The term "supranational issuers" is not used in the Basel II Capital Accord. Regarding PSEs, the same classification should be applied as for the Basel II Capital Accord.

9. *Paragraph 40: Do term deposits with central banks qualify for the stock of high-quality liquid assets?*

Term deposits with central banks, other than overnight deposits, are not available to the bank starting at day 0 and therefore do not qualify for the stock of high-quality liquid assets. If the term expires within 30 days, the deposits qualify as an inflow.

10. *Regarding paragraph 40(c), which Level 1 assets are subject to the general characteristics set out in Paragraphs 21 to 33? What is the impact of the repetition of criteria in Paragraph 40(c)?*

Paragraphs 21 to 25 outline the factors that influence whether the market for an asset can be relied upon to raise liquidity when considered in the context of possible stresses. They do not constitute requirements to be assessed for all potentially eligible liquid assets. The operational requirements in Paragraphs 26 to 33 apply to any liquid asset.

The criteria set out in Paragraph 40(c) are only those relevant for determining eligibility for Level 1 assets. They are not applicable to assets according letters (a), (b), (d) and (e), (ie marketability is not required for non-0% sovereign and central bank securities).

11. *Paragraph 40(c) states that marketable securities issued by certain parties and receiving a 0% risk-weight under the Basel II Standard Approach will be recognised as Level 1 assets. Since there is no reference to Basel II paragraph 53 (the ratings-based risk weight table under the standardised approach to credit risk), does this mean that sovereign debt which qualifies for a 0% risk weight only under Basel II paragraph 54 (issued in domestic currency and funded in that currency) can be recognised as Level 1 assets according to paragraph 40(c)?*

Paragraph 40(c) includes only marketable securities that qualify for Basel II paragraph 53. Sovereign debt securities issued by governments or central banks that do not receive a 0% risk weight in paragraph 53 of the Basel II accord can potentially qualify as Level 1 assets based on paragraph 40(d) or 40(e), if all other conditions listed in those paragraphs are satisfied.

12. *Two questions pertaining to paragraph 40(d) and (e) on the eligibility of non-0% risk weighted sovereign/central bank bonds.*

(a) *How should non-0% risk-weighted sovereign bonds be treated where the currency is a domestic currency for the sovereign or for the reporting company?*

The currency should be domestic a) for the issuing sovereign or central bank **and** b) to the jurisdiction where the liquidity risk is taken or to the bank's home jurisdiction.

(b) *In paragraph 40(e), how should the following phrase be interpreted: "...to the extent that holding of such debt matches the currency needs of the bank's operations in that jurisdiction"? Does this relate to LCR by currencies?*

No, this does not pertain to LCR by currencies. Rather it means holdings of such debt securities are eligible for Level 1 up to the amount of the bank's stressed net cash outflows in that specific foreign currency stemming from the bank's operations in that specific jurisdiction.

13. *Paragraphs 40 and 42 state "... for non-0% risk weighted sovereigns, sovereign or central bank debt securities..." , "Marketable securities representing claims on ... sovereigns, central banks... assigned a 20% risk weight..." What is the category for assets that meet the requirements of both paragraph 40(d) or (e) and paragraph 42 (a)?*

Paragraphs 40(d) and (e) may overlap with paragraph 42 (a) in terms of sovereign and central bank securities with a 20% risk weight. In such a case, the assets can be assigned to the Level 1 category according to Paragraph 40(d) or (e), respectively.

14. *Paragraph 42: Regarding the characteristics of high-quality liquid assets, what is the correct treatment for the following assets?*

(a) *Marketable securities that are “not an obligation of a financial institution or any of its affiliated entities”?*

The holder of the security must not have recourse to a financial institution or any of the financial institution’s affiliated entities as these instruments are highly likely to be illiquid in the LCR scenario.

(b) *Corporate bonds that are “not issued by a financial institution or any of its affiliated entities”*

The holder of the security must not have recourse to a financial institution or any of the financial institution’s affiliated entities as these instruments are highly likely to be illiquid in the LCR scenario.

(c) *Covered bonds that are “not issued by the bank itself or any of its affiliated entities”*

Covered bonds cannot be included in the stock of high-quality liquid assets of a given bank, if they are issued by the bank itself or by any of its affiliated entities.

15. *With reference to paragraph 42,(as well as the 5% treatment in the RSF of the NSFR) is it possible for non-covered bank securities issued by a financial institution and guaranteed by the government to be interpreted as “not an obligation of a financial institution”?*

If the holder of the non-covered debt securities has recourse to the bank, except for the case outlined below, the securities do not qualify for the stock of liquid assets. In practice this would exclude securities, such as government-guaranteed issuance during the financial crisis, which remain liabilities of the financial institution. The only exception is when the bank also qualifies as a PSE under the Basel II Capital Accord. In that case, securities issued by the bank could qualify for Level 1 or Level 2 assets if all necessary conditions are satisfied.

16. *Paragraph 45: What is the meaning of “domestic currency” for those countries in a monetary union with a common currency?*

For member states of a monetary union with a common currency, that common currency is considered the domestic currency.

17. *Paragraph 45 states: “Globally active banks...only qualify for the alternative treatment if there are shortfalls in domestic currency for domestic currency outflow needs”. How might the cap on total inflows, that is equivalent to a minimum requirement for the stock of liquid assets independent of the overall outflows, apply to institutions that are subject to different definitions of liquid assets?*

Alternative treatments may only be used up to the amount of the bank’s stressed net cash outflows in that particular currency. The question then arises how this stressed net cash outflows should be determined on a per currency basis in the case that the cap on inflows is binding in the LCR aggregated across all currencies. The rules text does not specify which inflows should be excluded from the net cash outflow calculation if the cap on inflows is binding. Since the alternative treatments are meant to be used scarcely, however, the bank

should assume that inflows denominated in currencies that do not fall under one of the special treatments, are excluded first.

In other words: if the sum of inflows denominated in currencies that fall under an alternative treatment is less than 75% of the total outflows (summed across all currencies), then the net cash outflows in each of the currencies under an alternative treatment can be calculated as the outflows in the currency minus the inflows in that currency.

Otherwise, the bank may choose which inflows denominated in currencies falling under an alternative treatment it would include in the inflows that are used to calculate the net stressed outflows, up to the total sum equal to 75% of the outflows. Therefore, if the bank has only one such currency to consider, the bank should calculate the net cash outflows in that currency as the difference between the inflows in that currency and 75% of the total outflows (summed across all currencies).

18. *Paragraph 56 states “stable deposits ... are those deposits that **are fully covered** by an effective deposit insurance scheme”. In the December 2009 consultative document, similar wording in paragraph 41 said: “stable deposits... refer to the portion of deposits which are covered by an effective deposit insurance scheme”. What is the reason for this change? If a bank has a retail client with a transactional account (where salaries are automatically deposited) with a balance of 150,000 in a country where the deposit insurance coverage is just 100,000, what is the amount to be considered as stable, 100,000 or 0?*

The change was made to clarify the condition for being regarded as stable deposits. “Fully covered” means that no portion of the depositor’s losses can fall under his/her “own risk”. Therefore, if a depositor loses 10,000, he/she receives 10,000 on the deposit insurance that provides full coverage. If the deposit guarantee scheme only covered a percentage of the funds deposited up to a limit (eg 90% up to a limit of 100,000) then the entire balance would be “less stable”. In the example, 100,000 would qualify as stable provided that the deposit insurance would pay out the full amount up to the limit of 100,000.

19. *Paragraph 62 states: fixed-term deposits that can be withdrawn without applying a “significant penalty materially greater than loss of interest” have to be treated as demand deposits. If only 10% of a term deposit can be withdrawn without such a penalty, should the entire fixed-term deposit be treated as a demand deposit, or only the 10% portion?*

Only the 10% portion should be treated as demand deposit. The other 90% should be treated as a fixed-term deposit.

20. *Regarding paragraph 62, what is meant by “significant penalty that is materially greater than the loss of interest”? For example, suppose a 6 month term deposit with an interest rate of 4% per annum for this term. Suppose further the interest rate applicable for a term deposit for 1 month or less is 3% per annum. If a term deposit placed for a period of 6 months in the above case is withdrawable (ie the depositor has a legal right to withdraw deposits in the specific country), what should be considered a significant penalty which is materially greater than the loss of interest?*

National supervisors must clarify the appropriate treatment and determine whether the penalty is material in terms of loss of accrued interest. The interest rate of other deposits is not relevant.

21. *Regarding paragraphs 72 and 77 on operational relationships with non-financial wholesale customers, if a non-financial wholesale customer has an established cash management or other administrative funds relationship with a bank upon which it has a substantive dependency, should it be interpreted that the bank has an “operational*

relationship" with the customer? How should "pension" or "agent" business for property management and investment be treated in this context of the rules text?

The bank has an "operational relationship" with the customer when the criteria outlined in paragraph 72 to 78 are met. All other activities, including pension and agent business for property management and investment, are excluded.

22. *Does paragraph 82 mean that for unsecured wholesale funding provided by affiliates of financial institution a 100% run-off rate should be taken into account?*

Outflows on unsecured wholesale funding from affiliated entities of the bank are included in this category. The 100% run-off factor applies, unless the funding is part of an operational relationship as defined in par. 72-78 (run-off is 25%), a deposit in an institutional network of cooperative banks as defined in par. 79-80 (run-off is 25%) or the affiliated entity is a non-financial corporate (run-off is 75%).

23. *Paragraph 83 states that "All notes, bonds and other debt securities issued by the bank are included in this category regardless of the holder, unless the bond is sold exclusively in the retail market and held in retail accounts...". Are retail accounts in this context applied limitedly to those held by individuals (or natural persons), or more broadly to those held by small business customers as well as individuals?*

Since deposits placed by individuals and small business customers are treated consistently, debt instruments held in accounts limited to individuals and small business customers should be treated equally in the paragraph 83.

24. *Paragraph 83 states that "All notes, bonds and other debt securities issued by the bank are included in this category regardless of the holder, unless the bond is sold exclusively in the retail market and held in retail accounts..." Is it sufficient that own issuance are specifically designed and marketed to retail clients eligible in order to apply the assumptions for retail clients as long as there is no indication that the assets are (meanwhile) held by non-retail market participants?*

No, there should be limitations placed such that they cannot be bought and held by other parties than retail and small business customers.

25. *In paragraph 97, what treatment should be given to multiple-use facilities?*

If a multiple-use facility falls within the definition of liquidity facility as stated in paragraph 95, it should be treated as such. The facility should otherwise be treated as a credit facility. Over time banks are expected to clarify in legal documentation as they renew these facilities whether, and if relevant, what portions, are applicable to credit and liquidity facilities.

26. *Paragraph 98-99 states "Any contractual lending obligations to financial institutions not captured elsewhere in this standard should be captured here at a 100% outflow.", "...obligations to extend funds to retail and non-financial corporate clients within the next 30 calendar days...a 100% outflow.", Is it possible to exclude funding obligations related to specific acquisition financings, where we have considerable certainty that there is no draw down within 30 days and where the probability of a draw down is not correlated with the LCR stress assumptions, from the LCR calculation?*

No, Paragraphs 98 and 99 apply to any contractual obligations to extend funds to the respective type of counterparty, if they are not otherwise captured in the categorisation of cash outflows provided in the rules text.

27. Paragraph 111 states "No lines of credit, liquidity facilities or other contingent funding facilities that the bank holds at other institutions..." Are lines received from non-financial counterparties assumed to be available under the LCR, in particular if the counterparty is a non-financial affiliate or parent entity?

No contingent funding facilities are assumed to be able to be drawn by the bank.

NSFR

28. Paragraph 122: Is "equity and liability financing" measured simply as the balance sheet amount at any point in time?

Yes, banks should generally use the "carrying value" (see paragraph 127) which is the value recorded on the balance sheet. In the case of equity, however banks should report the "total amount of capital, including both Tier 1 and Tier 2 as defined in existing global capital standards issued by the Committee" as stated in Table 1.

29. Paragraph 132 states "encumbered assets on the balance sheet receive a 100% RSF, unless there is less than a year remaining in the encumbrance period. In that case, the assets are treated as 'unencumbered'." We would like to get further information concerning this paragraph. We don't understand why such secured assets receive a 100% RSF.

This paragraph refers to assets that the bank has extended as collateral. In the period during which the assets tied up as collateral exceed one year, they are not available to raise additional funds within the year. They therefore should be completely funded by stable funding, thus receiving an RSF factor of 100%.

30. Regarding paragraph 133 on securities with the option to extend maturity at the issuer's discretion, what is the maturity of securities with an option to extend maturity to more than one year at the issuer's discretion but currently under one year?

The maturity of such securities is treated as more than one year, ie it is assumed the options to extend the maturity of instruments which are not at the bank's discretion are exercised by the counterparty.

31. Regarding the NSFR, what is meant by "encumbered asset"? This point is not clearly defined in table 2.

The LCR definition of "encumbrance" is to be applied for the one-year horizon of the NSFR correspondingly. An "encumbered asset" is any asset that is **not** "unencumbered" as defined in paragraph 27. Encumbered assets are assets that are pledged to secure, collateralise or credit-enhance any transaction. Assets pledged to the central bank or a PSE, but not used, are considered unencumbered.

32. What is the RSF factor for loans to retail and small business customers (other than mortgage loans) with remaining maturity < 1 year?

If the credit risk weight is $\leq 35\%$, the RSF is 65%; if the credit risk weight is $> 35\%$, the RSF is 85%.

33. Concerning paragraph 187, should banks be required to maintain assets at the branch level (ie assets to pay out to customers in the event of a bank run, the amount guaranteed under a deposit protection scheme)?

There is no specific requirement on this in the rules text. As stated in paragraph 188, regardless of the scope of application of the liquidity standards, in keeping with Principle 6 as outlined in the *Principles for Sound Liquidity Risk Management and Supervision*, a bank should actively monitor and control liquidity risk exposures and funding needs at the level of individual legal entities, foreign branches and subsidiaries, and the group as a whole, taking into account legal, regulatory and operational limitations to the transferability of liquidity.

Section 3: Miscellaneous edits

34. *The following edits in the standards should be noted:*

- (a) Footnote 11, page 9: “accrued instrument” shall be replaced by “accrued interest”.
- (b) Paragraph 40 (c), (d) and (e): include a reference to paragraph 53 of the Basel II accord.
- (c) Paragraph 61: “Foreign currency deposits” should be replaced with “Foreign currency retail deposits”.
- (d) Paragraph 71. “Term deposits from small businesses” should be replaced with “Term deposits from small business customers”.
- (e) Multilateral Development Banks will receive the same treatment as PSEs, which are referenced in the following:
 - Paragraph 78, (d) under paragraph 80, 90, 97b, 114,
 - Paragraph 86, 25% factor,
 - Table 2 (page 29): 20% category; (page 30), 50% category,
 - Annex 1, Stock of high-quality liquid assets, “B. Level 2 assets”, 85% category;
 - Annex 1, Total value of stock of highly liquid assets, “B. Unsecured wholesale funding, 75% category
 - Annex 1, Total value of stock of highly liquid assets, “C. Secured funding”, 25% category,
 - Annex 1, Total value of stock of highly liquid assets, “D. Additional requirements”, 10% of outstanding credit lines category and 100% of outstanding liquidity lines category,
 - Annex 2, 20% and 50% Required Factor categories.
- (f) Paragraph 92: “Debt maturities” should be replaced by “Debt maturing”.
- (g) Annex 1, Stock of high-quality liquid assets, “A. Level 1 assets”: “Domestic sovereign debt or central bank debt in domestic currency” should be replaced with “Domestic sovereign or central bank debt for non-0% risk weighted sovereign, issued in domestic currency”.
- (h) Annex 2, 100% Availability Factor category, second line: delete “and capital instruments in excess of Tier 2 allowable amount”.
- (i) Annex 2, 5% Required Factor category: “Debt issued” should be replaced by “Debt securities issued”.

(j) Annex 2, 85% Required Factor category: “Other loans to retail clients and small businesses” should be replaced by “Other loans to retail clients and small business customers”.