



September 14, 2012

Mr. Wayne Byres
Head of the Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland
Email – baselcommittee@bis.org

Dear Mr. Byres:

Please find attached comments by the Payments Risk Committee (PRC or the Committee) on the Basel Committee for Banking Supervision's consultative document, *Monitoring indicators for intraday liquidity management*. Intraday liquidity is an important topic for the PRC, to which it has devoted considerable attention over the years.

The PRC is a private-sector organization sponsored by the Federal Reserve Bank of New York. The Committee's membership, drawn from financial firms, meets at regular intervals to identify and analyze risk issues in payments, clearing, and settlement of financial transactions.¹ The Committee's primary goal is to foster enhancements to the safety and resiliency of financial market infrastructure, including steps to strengthen the clearing and settlement of financial transactions, and to inform the Federal Reserve Bank of New York about developments, conditions, and practices in payments, clearing, and settlement systems. The views expressed in this document are the views of the PRC and its members only. Nothing herein reflects official views of the Federal Reserve Bank of New York, the Board of Governors of the Federal Reserve System, or any other entity within the Federal Reserve System.

We appreciate the opportunity to comment on the important issues addressed in this consultation paper and to make recommendations to improve the proposed intraday liquidity monitoring framework. In particular, we would like to highlight our concern that if this document were issued without more in-depth consultation and modification, the implementation of the proposed indicators could have significant unintended consequences. The attached comment document provides details of our concerns and recommendations.

¹ The current members of the Committee represent Bank of America N.A., The Bank of New York Mellon, Bank of Tokyo-Mitsubishi UFJ, Citibank N.A., Deutsche Bank AG, Goldman Sachs, HSBC Bank USA, JPMorgan Chase, Morgan Stanley, State Street Bank and Trust Company, UBS AG, and Wells Fargo. More information on the PRC and its members is available at: <http://www.newyorkfed.org/prc>.

Mr. Wayne Byres
September 14, 2012

2

The PRC would welcome an opportunity to work with the Basel Committee for Banking Supervision prior to the implementation of the proposed framework, to further develop liquidity measures that work effectively and efficiently for both the regulatory and private sector communities.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Paul Galant', with a long horizontal flourish extending to the right.

Paul Galant
Chairman, Payments Risk Committee
Chief Executive Officer, Global Enterprise
Payments Citibank, NA

Enclosure

PAYMENTS RISK COMMITTEE

Comments to BCBS Consultative Document *Monitoring Indicators for Intraday Liquidity Management*

Introduction

The Payments Risk Committee (PRC or the Committee) has a long history of examining the important role intraday liquidity plays in the efficiency of domestic and global payments infrastructure. The Committee has worked to assess and encourage implementation of a number of new payment system risk reducing initiatives over the years. For example the PRC studied the migration from a pricing- to a collateral-based model for participant use of intraday liquidity through the Federal Reserve Banks' Fedwire® Funds service and made suggestions to reduce liquidity risk in the system.¹ Beginning in 2003 the PRC undertook a study to consider the need for enhanced cross-border liquidity management solutions. Several potential solutions were considered and the conclusions from the study generated a global dialogue on the cross-border liquidity management options available to the industry in both the public and private sectors. The industry dialogue and PRC work continued in 2005 when the Committee developed a business case assessment for a private sector cross border liquidity solution. As market conditions continued to evolve, the PRC revisited the business case for private sector solutions in 2009. While the PRC work did not produce a compelling business case for a private sector solution, these PRC initiatives helped the industry maintain a focus on the role intraday liquidity plays in global payments markets. One outcome was that bilateral intraday liquidity arrangements between financial market infrastructures (FMIs) and global banking participants were implemented in several markets.

In 2012 the PRC published a study on the flow of US dollars over the course of a business day across key payment, clearing, and settlement systems globally. This first-time study provides a better understanding of the magnitude of these flows and highlight the interconnectedness of global market infrastructures. It produced informative benchmark data that will be updated periodically so that the industry and the public can clearly understand the impact that market events, practices, and regulations have on the efficiency of the global payments and clearing markets.

These initiatives underscore the importance that the PRC places on the need for an effective use of intraday liquidity in the global payments and clearing infrastructure. Building on this expertise, the PRC is pleased to offer the collective expertise of its member institutions to provide recommendations for the proposed monitoring indicators for intraday liquidity management.

Key recommendations

The PRC supports good liquidity measures and agrees that the consultative document's attempt to define specific intraday monitoring indicators is a positive step toward establishing a common understanding of intraday liquidity risk under Principle 8 of the Principles for Sound Liquidity Risk Management and Supervision.² However, several topics covered in the consultative document would benefit from further refinement.

¹ *Report of the Joint Task Force on the PSR Policy Consultation Paper*, Payments Risk Committee & Wholesale Customer Advisory Group, New York, February 2007, http://www.newyorkfed.org/prc/prc_wcag_tf_report.pdf.

² *Principles for Sound Liquidity Risk Management and Supervision*, Basel Committee for Banking Supervision, September 2008

September 14, 2012

We welcome the opportunity to work cooperatively with the Basel Committee for Banking Supervision prior to the implementation of the proposed intraday liquidity monitoring framework, with the goal of developing liquidity measures that work effectively and efficiently for both the regulatory and private-sector communities.

The PRC offers the following key recommendations:

1. The Basel Committee should take a more “principles-based” approach that enables banks to monitor and manage intraday liquidity and associated risk in a manner which reflects individual circumstances and processes, while managing the reporting burden. The principles should include governance, control, strategies, policies, and procedures.
2. Banks should be encouraged to develop “best practices” for governance, control, and policy for intraday liquidity management, to monitor and manage their risks effectively.
3. The distinction between proposed monitoring and regulatory reporting should be clarified with regard to the intended use of the indicators by regulators. Regulators should also consider how implementation of this consultative document might influence financial institutions’ payment behavior, potentially causing unintended consequences such as gridlock.
4. A cost/benefit analysis should be developed when defining the scope of the reporting. Central banks that own payment and settlement systems and private sector payment and settlement service providers hold much of the data required to assess intraday liquidity risk, and these data should be readily available to supervisors. To the extent possible, supervisors should utilize these currently available data sources in monitoring intraday liquidity risk, augmented as needed by information from individual banks.
5. Standards for certain indicators should be developed in partnership with appropriate standard setting bodies and payment service providers before intraday liquidity monitoring reporting is implemented.

The importance of payment systems and liquidity

The PRC would like to emphasize the importance of intraday liquidity for the smooth and efficient functioning of payment systems. This importance is highlighted in the PRC’s Intraday Liquidity Flow report that states: “Intraday liquidity is the life-blood of global payments, clearing, and settlement (PCS) systems – it is absolutely critical for the health and survival of the infrastructure and, without sufficient liquidity, the infrastructure will simply not function properly, if at all.”³

The amount of liquidity needed in both private and central bank payment systems is largely related to the systems’ design, which can be very diverse. For example, real time gross settlement (RTGS) systems (often operated by central banks) typically have greater intraday liquidity demands than net settlement systems because transactions are settled one by one on a gross basis. At the same time, due to design characteristics, RTGS systems do not face settlement risk.

Over the years, central banks and payment system operators have invested significant time and resources to improve payment systems both from a safety and a liquidity perspective. Initial efforts were focused on speed and safety of payments. Later, the focus turned more to reducing liquidity usage and achieving greater

³ Intraday Liquidity Flows - Report of the Payments Risk Committee, March 30, 2012, http://www.newyorkfed.org/prc/prc_120329.pdf

September 14, 2012

flexibility in intraday liquidity management.⁴ Information and communication technology have also contributed to a safer and more efficient payment systems environment.

Central banks play an important role in providing intraday liquidity to institutions using central bank payment systems (mostly collateralized) and contribute to the smooth and efficient functioning of the payment system. Commercial banks also provide large amounts of intraday liquidity for payment systems and other financial market infrastructures. As a result, financial firms usually do not find it necessary to hold payments waiting for incoming funds. Improving the smooth and efficient functioning of payment systems, reducing potential gridlock, and effectively using liquidity, are well-established goals of both central banks and payment system participants.

With these concepts in mind, the PRC offers the following detailed comments.

Detailed comments

Monitoring versus Regulatory Reporting

The consultative document states its primary purpose is *“to enable banking supervisors to monitor a bank’s intraday liquidity risk management and its ability to meet payment and settlement obligations on a timely basis, both in normal times and in stressed scenarios. Over time, the indicators will also enable supervisors to gain a better understanding of payment and settlement behavior and the management of intraday liquidity risk by banks.”* The consultative document goes on to state that *“the proposed indicators are for monitoring purposes only and do not represent the introduction of new standards around intraday liquidity management.”* However, the consultative document also indicates that *“Banks are expected to report the monitoring indicators to their supervisor on a monthly basis in line with the proposed LCR reporting requirements.”*

The distinction between the proposed monitoring and new regulatory reporting is not clear. We are concerned that the statement quoted above sets the stage for the prescribed measures to be used as a regulatory tool to be supervised against, as opposed to a monitoring tool. The ambiguity of the statement may result in unintended consequences, such as influencing changes in payment patterns and/or liquidity usage to conform to an “ideal” state. As such the PRC recommends clarity with regards to the intended use of the indicators and accompanying reporting by regulators. Similarly, while it is important that banks have appropriate procedures, governance and controls in place to accurately track intra-day liquidity, they should not be forced to do so in an overly prescriptive manner. The current consultative document fails to address aspects such as governance and control. These aspects are equally important in monitoring liquidity and should be carefully assessed.

Frequency of Reporting

While the consultative document sets out the objective of capturing and analyzing trends related to payment and settlement behaviors, we disagree with the prescribed monthly reporting standard. Creating monthly reports is not necessary to achieve this objective, as these reports do not necessarily manage or measure intraday liquidity risks. This goal could be achieved with data gathered on a less frequent basis (e.g., semi-annually) that are focused on providing better qualitative insights into a bank’s intraday liquidity risk management. For example, large US banks already report average hourly daily settlement positions for the month on a semi-annual basis to their supervising Federal Reserve Banks. Also and consistent with the

⁴ Examples of these are the move to RTGS systems, additional liquidity saving mechanisms (e.g., via liquidity algorithms), off-setting mechanisms, settlement finality rules and regulations, and intraday settlement of net settlement systems.

premise that the proposed indicators are not intended to establish new intraday liquidity management requirements, the PRC suggests that the Basel Committee take a more principles-based approach that enables firms to comply with monitoring obligations while and respecting firm-specific circumstances and processes. This should enable the provision of appropriate risk management information while limiting the reporting burden.

Influence on Payment Behaviors

Regulators should thoroughly consider how this consultative document will influence a financial institution's payment behavior. Payment patterns and sources of liquidity are unique for each institution in that they are influenced by the lines of business and markets in which financial institutions operate. These drivers of payment and settlement behaviors should be factored into the proposed measures, and regulators should consider these measures individually. No indication is given in the consultative document as to any assessment of the indicators, or when indicators would be considered "good" or "bad." In a move to "improve" their indicators, banks might change their payment behavior such as waiting for funds before making payments, which can considerably increase the risk of an unacceptable unintended consequence in the system. Central banks and regulators have spent considerable time and effort to ensure the seamless functioning of payment channels, mitigating payments systems risk by identifying liquidity traps and working with stakeholders to overcome these challenges. In all circumstances, care should be taken to avoid altering these indicators by triggering changes in the behavior of institutions (i.e., increased payment throttling and elimination of pre-funding expected settlements).

Definitions

Intraday Liquidity

While *intraday liquidity* is defined, the concept of *intraday liquidity risk* is not. A clarification would contribute to analytical understanding of the goals of the consultative document. In addition, a clear definition of *intraday liquidity risk management* would also be helpful.

Sources for intraday liquidity are different for direct and indirect participants, yet paragraph 12 of the consultative document seems to indicate otherwise. Sources of intraday liquidity for indirect participants, which primarily consist of balances with correspondent banks, intraday credit facilities and incoming funds should be included in the definition. It is also not clear what exactly constitutes an intraday liquidity source for direct participants. As an example, it is not clear how credit provided by financial market utilities and service providers, e.g., the Federal Reserve Banks' net debit cap, would be interpreted (i.e., on par with secured overdraft facilities) as this is an intraday liquidity source for eligible US institutions. Such a determination may affect how banks in the US would behave (especially under the 5th bullet in Annex 3 on "combining the indicators") and contribute to the late day payments (gridlock) issue that the PRC has been actively working to address.⁵ The consultative document also references intra-day liquidity bridges and foreign currency cash collateral as direct participant sources of liquidity. As these concepts are not inherent in all RTGS systems, further clarification would be valuable.

Required Liquidity

As defined, *required liquidity* is the liquidity a bank actually uses but it is not necessarily the liquidity required to fulfill its payments obligations in a timely fashion. A difference between *used* liquidity and *required* liquidity is for example illustrated by payments released to the market earlier than the market rules require. These earlier payments help improve flows and reduce the likelihood of gridlock situations. The definition

⁵ *Report of the Joint Task Force on the PSR Policy Consultation Paper*, Payments Risk Committee, February 2007, http://www.newyorkfed.org/prc/prc_wcag_tf_report.pdf.

September 14, 2012

should take these aspects into consideration and be refined to more clearly identify the requested information.

Financial Institution Customer Information

The most difficult indicators to implement are those that would require a bank to go beyond its gross intraday exposures and report individual exposures to financial institution customers (indicators v and vi). These should be clarified to include the intended definition of a *financial institution customer* and, also, what is meant by “intraday credit (offered) as part of providing payment services to customers.” The customers covered by such a definition should be limited to arrangements that are functionally equivalent to correspondent banking relationships.

Reporting Requirements, Metrics, and Indicators - Scope, timing, and ease of reporting

The PRC would like to offer the following recommendations on the scope and timing of the reporting requirements, and also make several observations with respect to specific indicators cited in the consultative document.

Data Sources

Both central banks and banks own payment and settlement systems. This means that significant data on intraday payments are readily available to central banks and payment system operators. The PRC believes that it would be efficient to make use of these data sources instead of creating additional reporting burden by requesting the same data from financial institutions. Additionally, in many markets there is already a good deal of reporting being done, and regulators should make sure that old reporting requirements align with new ones and are not duplicative. When analyzing indicators, care should also be taken to ensure that the figures are correctly interpreted.

Data Considerations

The PRC suggests that the Basel Committee on Banking Supervision provide additional clarity on several data-related issues. First, daily and monthly indicators can be impacted by the timing of payments and payment types. As an example, indicators can be impacted by a few very large movements which may or may not be risky, depending on the nature of the underlying transactions. At the same time, large positions might be understated due to averaging. Second, the scope of desired monitoring is not clear. For example, would reporting apply to every currency and system that a bank uses (and for global banks the number of systems used is considerable) or only the major ones, and what is the definition of major? Third, there are many different systems around the world and banks and systems in different countries are not subject to the same standards. As such, the reporting requirements may not be practical in many countries. Fourth, cross border issues are not addressed. These include the complexity involved in entering into discussions with individual local regulators to agree on the scope of application at the legal entity, currency, and payment system level.

Indirect Participant Reporting

As proposed, the required reporting for an indirect participant may not be practical. An indirect participant's payments are usually made at the discretion of its correspondent bank. Furthermore, not all correspondent banking service providers offer the reporting information required in this consultative document.⁶

Cost

The PRC believes that the proposed indicators will require significant investment in the development of MIS, especially where banks are active in multiple currencies and systems. The cost burden will be even more

⁶ For instance, paragraphs 17, 20, 50 and 60 may not be applicable to an indirect participant.

considerable where banks are both direct and indirect participants. Given that some of the required data would need to be sourced from payment and settlement systems (e.g., timing of automated liquidity transfers), as well as from correspondent banks (timing of outgoing and incoming payments), a vast reporting framework across the industry would be required. A cost/benefit analysis should therefore be undertaken when defining the proper scope of the reporting obligation.

Comments on Specific Indicators

- Indicator 1) Daily maximum liquidity requirement: The definition of positive net cumulative position and the assumption that this would mean a surplus in excess liquidity is not entirely correct, especially for those banks that participate in RTGS and net-settlement systems for any single currency. A bank's cumulative position should be representative of the balances across the two payment channels. Additionally, with regard to the timing of payments made across an account held with a correspondent bank, a bank's business profile should also be factored into the intraday usage/requirement calculation. As an example, daily maximum liquidity requirements for payments made via a payment system without liquidity saving features are much different than those of a system with liquidity saving features. The standards applied consistently would result in more accurate analyses, measurement and monitoring of risks.
- Indicator 2) Available intraday liquidity: It is not clear which currencies and systems *available intraday liquidity* will need to be reported. In the case of USD, the Federal Reserve debit cap or collateral at the discount window could be used (if the debit position is less than the available collateral, then no additional fees are charged for intraday liquidity). For other jurisdictions where a bank self-clears (e.g., EUR, GBP) this is a function of posted, or access to incremental collateral. Where a bank relies on a clearing bank, it is relying on the clearing bank's credit and liquidity. One could demonstrate that a clearing bank executes payments in a timely manner, however, it is hard to demonstrate uncommitted unadvised credit lines as they are undisclosed and can be withdrawn at the discretion of the correspondent service provider.
- Indicator 3) Total payments: This measure requires further refinement. Certain RTGS systems and private-sector systems, such as CHIPS, have liquidity saving features. How the liquidity saving features of these systems are used must be taken into consideration.
- Indicator 4) Time-specific and other critical obligations: This indicator is very open ended and should be clarified to offer more detail on what is considered to be "time critical," e.g., CLS nostro settlements, DTCC progress payments and final settlement, CHIPS final settlement, etc. Other time-sensitive clearinghouse settlements actually take place on the books of the settlement banks, and as such, are not necessarily dependent on a central bank or financial market infrastructure. Without a refined definition, this could be a challenge to report. With respect to time specific and other critical obligations - do these refer to each bank's own time specific and critical obligations, or do these also include correspondent bank customers? In many cases, a correspondent bank does not know in advance which of their customers' payments are time specific and critical obligations. Depending on a customer's creditworthiness and its liquidity position, the "critical" payments may or may not be executed in their preferred time frame. Also, there are no standards across the industry for an indirect participant to notify its correspondent banks of time-specific and critical payments. Thus, the responsibility of the correspondent bank needs to be better defined.
- Indicator 5) Value of customer payments made on behalf of FI customers: Assuming that this relates only to correspondent banking payments, the paper should clarify whether the reporting should be across systems or broken out into different systems. In addition, it might make sense to combine indicator III

and V, and make V a sub-indicator of total payments. Paragraph 26 should also include customer payments for corporate customers. Certain corporates have a high volume of payments. Expanding this paragraph would add clarity. Depending on each bank's business profile, business with corporate and FI customers may account for a small piece or could be quite large. As a result, perhaps reporting could be limited to instances in which a bank's business with corporate and FI customers exceeds a specified threshold.

- Indicator 6) Intraday credit lines extended to financial institution customers: These credit lines are in general unadvised (i.e., undisclosed) internal guidance limits that can be withdrawn by the provider at its own discretion. Reporting uncommitted lines for which a bank is the provider is not very difficult, but we question the value of this number as it does not correlate to payment systems data. It is only an independent indicator of how much intraday credit and additional liquidity a providing bank is potentially prepared to inject into the process.
- Indicator 7) Timing of intraday payments: This metric is not clear and the usage of it can be questioned. Is it the time between the initial receipt of the instruction and final confirmation of settlement from the clearing system? This is problematic as it potentially includes the time held pending in credit or funds control. Paragraph 28 requires a better explanation. The timing of outgoing payments in many cases depends on incoming payments for customers and which banks go first in sending their outgoing payments.
- Indicator 8) Intraday throughput: The request is hourly, payments only. It is not clear if this is across systems or system/currency specific.
- Scope of reporting: Many large financial institutions have offices outside the US and hold nostro accounts. The paper should clarify whether the desired reporting should aggregate the reporting in the home currency. Such aggregation could be a challenge, as not all payment systems work in the same way.
- Annex 1, Indicator 3: If the expectation is to only pick up outgoing payments, then the reference in paragraph 23 to the total value of gross daily payments "made and received" in payment and settlement systems should be clarified.