CONSULTATION PAPER

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Consultation Paper on Local Implementation of Basel III Liquidity Rules – Liquidity Coverage Ratio

Monetary Authority of Singapore

PREFACE / EXECUTIVE SUMMARY

1 On 6 January 2013, the Group of Central Bank Governors and Heads of Supervision ("GHOS") endorsed the Basel III Liquidity Rule - Liquidity Coverage Ratio ("LCR") as the global minimum standard for liquidity risk.[1] The LCR framework aims to improve the short-term resilience of a bank's liquidity risk profile. It does this by ensuring that a bank has an adequate stock of unencumbered high quality liquid assets ("HQLA") that can be converted into cash at little or no loss of value to meet its liquidity needs for a 30 calendar day liquidity stress scenario.

2 Under the timeline for implementation, the LCR requirement starts at 60% on 1 January 2015 and increases 10% annually to reach 100% by 1 January 2019. As a member of the Basel Committee of Banking Supervision ("BCBS"), Singapore will adopt Basel's recommended implementation timeline. MAS is proposing to replace the existing MLA framework with the LCR framework for all banks and finance companies. The new framework will also be extended to merchant banks.

3 MAS will be conducting a Quantitative Impact Study ("MAS QIS") for all banks, merchant banks and finance companies ("financial institutions") in Singapore based on 28 June 2013 positions, to analyze the potential impact resulting from the local implementation of LCR.

4 The details of the proposed local implementation of the LCR framework in Singapore are provided in this consultation paper. We invite comments on the proposals made in this paper. Electronic submission is encouraged. Please submit written comments by 16 September 2013 to:

[1] The finalized rules text can be accessed through this link: http://www.bis.org/publ/bcbs238.pdf

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5 Please note that any comments received may be made public unless confidentiality is specifically requested.

6 The draft rules for implementation of LCR in Singapore ("draft LCR rules for local implementation") will be released at a later date after we have studied the data collected from the MAS QIS and the comments received from this public consultation.

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1 Introduction

1.1 In January 2013, the Basel Committee issued the "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools" document that sets out the finalized LCR rules. The LCR is an essential component of the Basel III reforms, which are global regulatory standards on bank capital adequacy and liquidity endorsed by the G20 Leaders.

1.2 As a member of the BCBS, Singapore will adopt the Basel III LCR rules and proposes to make refinements in certain areas for local implementation. The existing MLA framework will also be replaced with the adoption of the LCR rules. Section 2 of this consultation paper covers the regulatory framework and scope of application for the local implementation of LCR requirements in Singapore. The refinements and additional requirements for local implementation are discussed in Section 3.

2 Regulatory Framework and Scope of Application

2.1 Compliance and Reporting of LCR Requirement

2.1.1 The existing Minimum Liquid Assets ("MLA") requirement, as stated under MAS Notice 613, stipulates that every bank shall hold, at all times, a minimum percentage of its SGD-denominated qualifying liabilities in liquid assets. Similar requirements apply to finance companies under MAS Notice 806. The objective of the MLA is similar to the LCR, which is to ensure that banks hold sufficient liquid assets to meet their estimated cash outflows over a short-term horizon. In addition, allowing MLA assets to be drawn down during a liquidity crisis on notification to the MAS is also aligned with the intent of the LCR framework.

2.1.2 While there are similarities between the MLA and LCR frameworks, the scope of coverage for the LCR framework is broader as it covers assets and liabilities beyond those denominated in the domestic currency. The LCR framework also includes all cashflows of the financial institution in determining its liquidity risk instead of only deposit liabilities in the existing MLA framework. Overall, the new LCR framework is more comprehensive than the MLA framework and MAS is proposing that it replaces the MLA framework as the main liquidity requirement for financial institutions in Singapore.

2.1.3 Similar to the current MLA requirement, financial institutions that are subject to the LCR rules will be required to comply with them on a daily basis but only need to submit a monthly report under MAS Notice 613. The financial institutions may utilize their HQLA in a liquidity stress situation after notifying MAS in writing. MAS Notice 613 will be amended accordingly to take into account the necessary changes. The detailed reporting requirements will be released at a later date when the draft LCR rules for local implementation are finalized.

2.2 Scope of Application of LCR Requirement

2.2.1 The Basel III LCR standard establishes a minimum level of liquidity for internationally active banks, to be met at a Group level. Consistent with the Basel Capital Adequacy standard, the LCR standard recognises the need for national authorities to require higher minimum and additional levels of liquidity to be held, if they deem that the LCR requirement does not adequately provide for the liquidity risks that their banks face.

2.2.2 Locally incorporated banks, foreign bank branches and finance companies in Singapore are currently required to comply with the MLA requirement, as stipulated under MAS Notice 613 and MAS Notice 806 respectively. These banks and finance companies will be required to comply with the LCR requirement with the shift from the MLA to the LCR framework. In addition, MAS is proposing that merchant banks, which are currently excluded from the MLA requirement, be subject to the LCR requirement, in order to strengthen their liquidity risk management.

3 Key Modifications

3.1 Aggregated Country Level versus Entity Level

3.1.1 The LCR rules are silent on its scope of application beyond the internationally active banks on a group basis. An area which the national authorities have to decide when they extend the LCR requirement beyond the internationally active banking groups is whether related entities in a country are subject to individual LCR requirement on an entity level or collective LCR requirement on an aggregated country level. In the latter, all related entities in Singapore will compute and comply with a single collective LCR requirement. For example, Foreign Bank A and its related Merchant Bank B will be treated as a 'country banking group' and instead of maintaining an individual LCR for each entity, a collective LCR will be computed and maintained on a 'country banking group' level under this treatment.

3.1.2 We propose to impose an individual LCR requirement on an entity level for financial institutions in Singapore given that most of the individual entities have different liquidity profiles, separate liquidity management policies and liquid assets management frameworks. However, MAS is prepared to consider imposing a collective LCR requirement on an aggregated country level where the related entities in Singapore can justify and demonstrate that their liquidity needs are managed on a country level basis; governed by clear and common liquidity management frameworks, policies and processes; and that there are effective inter-related entity liquidity support in place. MAS will assess the merits of each application for collective LCR requirement and approve it on a case by case basis.

3.2 Varying LCR Requirement for Foreign Bank Branches under Certain Conditions

3.2.1 The recent financial crisis has demonstrated the need for foreign bank branches to maintain sufficient level of liquidity locally to meet their immediate short-term liquidity obligations. MAS noted the industry feedback that maintaining liquid assets by foreign bank branches at each location to meet the LCR requirement is inefficient for liquidity risk management at the group. On balance, MAS is prepared to vary the LCR requirement for foreign bank branches under certain conditions. For example, where the Head Office has fully met the 100% LCR requirement at the Group level and MAS is satisfied with the strength of the liquidity risk management of the Group and the Singapore branch as well as assured of the Head Office providing liquidity support to the Singapore branch during periods of stress. A reduction in the LCR requirement for each foreign bank branch, if any, will be granted on a case-by-case basis based on supervisory assessment.

3.3 LCR by Currency

3.3.1 Singapore Dollars ("SGD") LCR Requirement

3.3.1.1 As SGD is the local currency of financial institutions based in Singapore and it is systemically important to our financial system, sufficient SGD-denominated liquid assets must be available as a buffer for their SGD-denominated net outflows. Imposing a SGD LCR requirement will ensure that there is adequate SGD-denominated HQLA within the total HQLA pool. This is also in line with the current requirement under the MLA framework. In view of the fact that the LCR requirement is meant to replace the MLA requirement and most financial institutions are already in compliance with the SGD LCR requirement, we propose to impose a SGD LCR requirement of 100%.

3.3.2 Foreign Currency LCR Requirement

3.3.2.1 While the LCR requirements are calculated on a consolidated basis and reported in a common currency, the Basel liquidity standard also expects banks and their supervisors to closely monitor LCR by significant currency.[2] Singapore is a regional treasury centre for many banks and their liabilities here are diversified in terms of currencies. U.S. Dollar ("USD") is the dominant foreign currency for most financial institutions in Singapore and one-third of these financial institutions also have 3 or more other significant currencies. As such, there is a need to impose LCR by

[2] A currency is considered "significant" if the aggregate liabilities denominated in that currency amount to 5% or more of the financial institution's total liabilities.

significant currencies, on top of the consolidated currency LCR requirement, to ensure that financial institutions have sufficient liquid assets in the foreign currencies and are not overly-reliant on the FX swap markets to meet their foreign currency liquidity needs during a liquidity stress situation, as highlighted by the reduced FX swap market liquidity during the last financial crisis.

3.3.2.2 MAS proposes to impose a USD LCR requirement on all financial institutions in Singapore given that it is the next most significant currency in the banking industry besides SGD. The proposed LCR requirement for USD in Singapore will be set at 80%, allowing financial institutions to rely on external sources such as the FX swap market to some extent. MAS will monitor the market liquidity of the other non-USD foreign currencies as well as the adequacy of each financial institution's liquidity management of these currencies through its supervisory process. Bank-specific requirements will be imposed on a case-by-case basis if prudential concerns warrant them.

3.4 Definition of High Quality Liquid Assets ("HQLA")

3.4.1 HQLA are assets that can be easily and immediately converted into cash at little or no loss of value through sale or repo transaction even in times of stress. HQLA are categorised into three broad categories, Level 1, Level 2A and Level 2B assets. In the December 2010 version of the LCR rules text, HQLA comprised mainly cash, central bank reserves, and certain marketable securities backed by sovereigns and central banks, among others. The finalized LCR framework has three additions to the definition of HQLA, subject to certain criteria:

a) Residential mortgage-backed securities ("RMBS") rated AA or higher;

b) Non-financial corporate securities rated A+ to BBB-; and

c) Non-financial equities that are a constituent of the major stock index in the home jurisdiction.

3.4.2 RMBS under (a) are subject to a 25% haircut while non-financial corporate securities and equities under (b) and (c) are subject to a 50% haircut.

3.4.3 MAS proposes to exclude RMBS as HQLA in the local LCR implementation as we have concerns about the liquidity of RMBS in a financial crisis, as seen during the recent global financial crisis. MAS is also proposing to exclude equities as HQLA in view of prudential considerations, in particular concentration and contagion risks as only a small number of counters can satisfy the HQLA criteria. MAS proposes to accept non-financial corporate securities as HQLA but limited to those that are rated A and above.

3.4.4 MAS has considered the need to adopt the Alternative Liquidity Approaches ("ALA"), which allow jurisdictions with insufficient supply of Level 1 HQLA in their domestic currency to meet the aggregate demand of financial institutions to adopt alternative treatments for HQLA.[3] We have assessed that there are sufficient SGD-denominated HQLAs in Singapore and there is no need to adopt ALA at the current juncture. However, we may consider adopting ALA in future when the need arises.

3.5 Treatment of Minimum Cash Balance ("MCB")

3.5.1 The MCB requirement, as stipulated in MAS Notice 758 and MAS Notice 806, is intended to prevent payments gridlock in the MAS Electronic Payment System ("MEPS+") by ensuring that banks and finance companies hold sufficient liquidity to meet their payment obligations each day. While banks and finance companies are allowed to utilise the full amount of their cash balances within a day, they are required to maintain a minimum cash balance of 2% of their Qualifying Liabilities at the end of each day and a minimum daily average of 3% over each two-week maintenance period. The end-of-day minimum cash balance is intended to ensure that banks and finance companies start the next settlement day with sufficient balances to meet their payment obligations for the day.

3.5.2 Recognising that requiring banks and finance companies to continue holding a 2% end-of-day cash balance could exacerbate their liquidity shortfall in a stress situation, MAS is prepared to waive the end-of-day cash balance requirement for banks

[3] There are three ALA options namely, contractual committed liquidity facilities from relevant central bank with a fee, foreign currency HQLA to cover domestic currency and additional use of Level 2 assets with a higher haircut. Currently we are aware that Australia will be adopting ALA option 1.

and finance companies in a liquidity stress situation, to allow them to meet their payment obligations for the day. Banks and finance companies intending to utilise their cash balances held to meet the MCB requirement should notify MAS of the intent prior to the utilisation, and be able to demonstrate that they have drawn down all other available liquid assets. On this basis, we propose to allow cash balances held to meet the MCB requirement to be included as HQLA for the computation of LCR.

3.6 Trade Finance

3.6.1 Trade finance instruments consist of trade-related obligations directly underpinned by the movement of goods or the provision of services. Examples include documentary trade letters of credit and guarantees directly related to trade finance obligations, such as shipping guarantees. Some of these contingent funding obligations are explicitly contingent upon a credit or other events that are not always related to the liquidity events simulated in the stress scenario, but may nevertheless have the potential to cause significant liquidity drains in times of stress. Under the LCR framework, national authorities have discretion to apply a run-off rate of 5% or less on contingent funding obligations stemming from trade finance. We propose to apply an outflow factor of 3% to trade finance instruments.

3.7 Intragroup Flow

3.7.1 The LCR rules do not make any explicit reference to intragroup transactions and they are treated as third party financial institution transactions. For example, funds to and from Head Office or other related financial entities will be given 100% inflow and 100% outflow factors, in line with that given to third party financial institution transactions.

3.7.2 We note that this treatment coupled with the 75% cap on inflows, can result in some of the entities, in particular group funding centres, having very low LCR which may not be a true indication of their liquidity position. As intragroup transactions carry less liquidity risk as compared to transactions with external parties, we propose to allow netting of intragroup flows within each day inside the 30 days period in recognition of the lower liquidity risk associated with intragroup flows within the same day. For instance, the gross intragroup inflow and gross intragroup outflow can be netted within each day to arrive at the net inflow and outflow for each day. The respective net daily inflow or outflow will then be added up to arrive at the 30 days intragroup inflow and outflow. By only allowing netting within each day instead of across the full 30 days period, the timing mismatches are reduced. MAS will however, have the power to disallow financial institutions from netting their intragroup flows if they have intragroup transactions that carry substantial liquidity risk.

3.8 Timeline of Implementation

3.8.1 Under the finalized LCR rules, the LCR requirement will be introduced as planned on 1 January 2015, but the minimum requirement will be set at 60% and rise in equal annual steps to reach 100% on 1 January 2019. We propose to adopt the same timeline and level of requirement for the consolidated LCR requirement in Singapore to provide financial institutions with sufficient time for compliance. Financial institutions that are currently holding more than the required amount of HQLA are expected not to materially weaken their liquidity positions in the interim.

3.8.2 As MLA will be superseded by the LCR and most financial institutions are already able to meet the 100% SGD LCR based on preliminary analysis, we propose to impose a 100% SGD LCR on 1 January 2015. As for the USD LCR, we propose to start at 40% on 1 January 2015 and rise in equal annual steps to reach 80% on 1 January 2019.

3.8.3 The proposed timeline will apply to all entities subject to the LCR requirement.

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