

Response to feedback received

Liquidity Coverage Ratio

Introduction

Bank Negara Malaysia (“the Bank”) issued a concept paper on 30 September 2014 to seek feedback on the Bank’s proposals for the implementation of the Liquidity Coverage Ratio (LCR), which are primarily based on the Basel III rules. A key objective of the proposed LCR framework is to ensure that banking institutions hold sufficient liquid assets and are able to raise the necessary liquidity to withstand a short-term liquidity stress scenario. Key issues and feedback received during the public consultation include the following:

1. Recognition of statutory reserves and deposit placements with the Bank as HQLA;
2. Recognition of ‘A’-rated corporate debt securities denominated in foreign currency as HQLA;
3. Definition of the “significant penalty” criterion for qualifying term funding and premature withdrawal of fixed term deposits under emergency circumstances;
4. Treatment of unrestricted investment account (UA) funds with liquid underlying assets and surplus HQLA;
5. Clarification on the “established relationship” criterion for stable deposits;
6. Identification of excess balances for operational deposits;
7. Timeline for regulatory reporting of the LCR; and
8. LCR requirements at the level of the financial group

The Bank appreciates the constructive feedback and suggestions received during the consultation period. These have been taken into account and incorporated in the final LCR framework where appropriate. The Bank’s responses are provided in the following sections.

1. Recognition of statutory reserves and placements with the Bank as HQLA

- 1.1 Several respondents viewed that the proposed non-recognition of SRR balances could place Malaysian banking institutions and banking groups in a less competitive position against other global peers that operate in jurisdictions where statutory reserves are either not required or are recognised as HQLA.
- 1.2 The final framework recognises SRR balances as Level 1 HQLA on the basis that these balances can be utilised during times of liquidity stress. However, banking institutions should not rely upon their SRR balances as a source of liquidity, and are expected to maintain a minimum level of HQLA over and above their SRR balances. Further operational requirements for the utilisation of the SRR balances during a liquidity stress scenario are set out in paragraph 11.2 of the policy document. The Bank may review the treatment of SRR balances as necessary, taking into account factors such as the ratio of SRR balances to total HQLA and the role of the reserves in the management of systemic liquidity. Any proposed review will be in consultation with the industry.
- 1.3 The final framework also clarifies the recognition of placements with the Bank as Level 1 HQLA, which will be supported by appropriate terms and conditions for term deposit placements to be published by the Bank.

2. Recognition of 'A'-rated corporate debt securities denominated in foreign currency as HQLA

- 2.1 Several respondents suggested that the scope of eligible corporate debt securities that may qualify as Level 2 HQLA should be broadened to be more aligned with the Basel III rules to include the recognition of 'A'-rated corporate debt securities issued in foreign currency. This is to reflect the sovereign ceiling policy applied by most international rating agencies which would cap ratings on corporate debt securities at an 'A' rating.

2.2 The final framework recognises non-Ringgīt corporate debt securities rated between A- to A+ by an international rating agency as Level 2B HQLA, with a haircut of 50%, taking into consideration the credit quality and liquidity of such debt securities, most of which are denominated in major foreign currencies.

3. Definition of “significant penalty” for qualifying term funding and premature withdrawal of fixed term deposits under emergency circumstances

3.1 One of the criteria proposed in the Concept Paper for qualifying term deposits/funding is the imposition of a penalty for early withdrawals that is materially greater than the loss of interest or profit, in line with the Basel III rules. The industry has requested for greater clarity on the interpretation of this broad criteria, including whether or not the penalty must result in a loss of principal. The industry is concerned that a conservative interpretation of the criteria would require significant modification to the terms and conditions of the existing term deposit/funding products and potentially higher funding costs to compensate depositors for the more restrictive early withdrawal terms.

3.2 The final framework (paragraphs 14.8 and 15.3) clarifies that the penalty would be considered sufficiently material if early withdrawal results in a loss of at least 100% of the interest accrued on the deposit. The revised definition is aimed to ensure that appropriate incentives are in place to promote the stability of term funding, while maintaining fair treatment for depositors. Currently, most short-term fixed term deposit products offered by banking institutions have already incorporated a penalty clause which would result in a total loss of accrued interest if such deposits are withdrawn prematurely, while a proportion of the longer-term fixed term deposits currently apply a penalty clause which would result in a loss of at least 50% of accrued interest. To facilitate a smooth transition, banking institutions will be allowed to exclude fixed-term deposits from the LCR if the withdrawal of such deposits before contractual maturity results in a loss of at least 50% of the accrued interest until 31 December 2018.

3.3 The Bank acknowledges that there are cases where retail customers may need to withdraw their funds early due to personal emergencies. Such withdrawals can be made without imposing the corresponding penalty or despite the absence of the legal right to withdraw provided that banking institutions have established and can demonstrate that withdrawals are properly justified, taking into account the specific circumstances of individual depositors. Early withdrawals resulting from personal hardship or emergencies will not result in the entire pool of qualifying term deposits being treated as demand deposits and subject to higher run-off rates under the LCR framework.

4. Treatment of unrestricted investment account (UA) funds with liquid underlying assets and surplus HQLA

Run-off rate for UA funds with liquid underlying assets

4.1 While respondents agreed for run-off rates to be based on the type of IAH, some respondents requested for an alternative treatment for UA funds that are fully invested in underlying assets that can be easily liquidated to meet redemptions, such as HQLA or securities traded in a secondary market.

4.2 The Bank recognises that such UA funds may pose a lower level of liquidity risk to the banking institution relative to UA funds that invest in non-liquid underlying assets such as financing. The final framework (paragraph 27.7) thus accords a run-off rate of 10% for UA funds that are fully invested in highly liquid underlying assets.

Treatment of surplus HQLA held in a UA fund

4.3 Some respondents requested that the Bank consider allowing the flexibility to use surplus HQLA held in a UA fund to meet the liquidity needs of other UA funds or the banking institution.

4.4 The final framework clarifies that the surplus HQLA of a UA fund can be transferred to other UA funds or to the banking institution on an arm's length basis, consistent with the requirement in paragraph 22.5 of the Investment Account policy document. Such transfers should be reflected in the LCR

computation for both the provider and receiver of the surplus HQLA. The computation rules will be further detailed in an Implementation Guidance to be issued at a later date.

5. ‘Established relationship’ criterion for stable deposits

5.1 The Concept Paper proposed that “established relationships” refer to a non-deposit relationship that has been established with the banking institution for a minimum period of 12 months.

Length of deposit relationship as an indicator of stability

5.2 Some respondents viewed that the existence of a non-deposit relationship is less relevant for deposit stability, and that it would be sufficient to apply the 12-month minimum period to the length of the deposit relationship alone.

5.3 As deposits may be withdrawn easily, assessments based solely on the historical length of the deposit relationship may not indicate its stability. The Bank maintains the view that the existence of a non-deposit relationship with the banking institution is likely to provide a stronger indicator of deposit stability arising from the broader contractual and customer relationships associated with multiple products and services obtained from the banking institution.

Minimum period for non-deposit relationships

5.4 For respondents who found the existence of a non-deposit relationship relevant, it was suggested that the minimum period should not only apply to the historical length of the relationship, but also take into account the future period for which a customer will be contractually bound. For example, this would be applicable to housing loans which have a minimum lock-in period of two to three years.

5.5 The Bank agrees with the industry view and has further refined the scope of “established relationships” to include non-deposit relationships which are contractually binding for at least the next 12 months (paragraph 14.4).

6. Identification of excess balances for operational deposits

- 6.1 The Concept Paper proposed that a banking institution must develop a methodology to determine the excess balances in an operational deposit, without which all balances in the account must be assumed as non-operational and hence be subject to the corresponding run-off rate according to counterparty.
- 6.2 While most respondents highlighted that the balances in corporate accounts are primarily intended for operational purposes such as payment and settlement, a defined methodology for identifying the excess balances in these accounts is currently not available in most banking institutions.
- 6.3 The Bank maintains that the requirement to develop a methodology to identify excess balances is necessary to ensure that only the operational balances are accorded a lower run-off rate of 25%, consistent with the intention of the rules. Nonetheless, as a practical expedient, a banking institution may assume that there are no excess balances in accounts that are paying below market interest rates (paragraph 15.14). For such accounts, a methodology to identify excess balances is not required given that customers are unlikely to have strong incentives to leave excess balances in such accounts. The final framework also clarifies that while assessments can be applied at the portfolio level to meet the requirements, this may not be appropriate for all circumstances, such as where there is significant concentration of deposits by a single (or group of) customer(s).

7. Timeline for regulatory reporting of the LCR

- 7.1 Most respondents highlighted operational challenges to meet the proposed LCR reporting timeline (“proposed reporting timeline”) set at 7 days (for entity-level) and 14 days (for consolidated-level) from the end-of-month position date due to constraints on existing information systems. Most respondents indicated that at least 6 to 24 months would be required to complete system enhancements to meet the reporting timeline.

7.2 The LCR document provides for a 2-year transition period, during which banking institutions are expected to complete the necessary infrastructural developments or enhancements to their reporting systems. During the transition, the LCR position should be reported to the Bank no later than 30 days from the end-of-month position date. The proposed reporting timeline shall be effective beginning 1 June 2017.

8. LCR requirements at the level of the financial group

8.1 Some respondents proposed for fund management companies to be excluded from the scope of consolidation given that a banking institution's or a financial holding company's liquidity risk exposure to such entities is likely to be low as fund redemptions at the fund management company are expected to be met by the liquidation of the underlying investment assets. Respondents also highlighted that these entities are subject to the oversight of the Securities Commission Malaysia.

8.2 While fund management companies should be able to meet redemption requests on an individual basis, the Bank maintains that it is important for liquidity buffers to be held at the consolidated group level in the event that liquidity support is expected from the parent institution (despite there being no contractual obligations) as more frequent and sizable redemption requests occur under a severe stress scenario.

8.3 As part of the implementation of prudential standards applicable to financial groups, the Bank will publish further details on the application of the LCR framework at the financial holding company level in due course.