BASEL COMMITTEE PAPER - LIQUIDITY

by Steve Brown

Yesterday we focused our discussion on the latest report from the Basel Committee related to capital, so today we switch gears and zero in on the liquidity paper they released along with it. Here are some of the highlights from the report that community bankers should know since they will eventually be incorporated in some format into US banking regulations.

When it comes to liquidity, the proposal sets some minimum standards and minimum monitoring metrics. The goal is to enhance tools, metrics and benchmarks to ensure banks have liquidity cushions and stronger buffers.

The first minimum standard set is the Liquidity Coverage Ratio (LCR). This ratio is designed to ensure the amount of high quality liquid assets is enough to continuously meet or exceed net cash outflows over a 30 day time horizon given various shocks. The ratio must meet or exceed 100% during the 30 day period. The numerator of the ratio includes cash, marketable securities assigned a 0% risk weight and central bank debt. These should all be central bank eligible (pledgeable at the FRB). The Basel committee is considering including high quality corporate bonds, subject to haircuts, in this definition. To qualify, these assets cannot be pledged, used as collateral or provide credit enhancements of any kind. The denominator of this ratio is expected cash outflows minus cumulate expected cash inflows. Here, banks will apply a minimum cash outflow rate of 7.5% for stable retail deposits and stable small business customers. Less stable retail deposits are subject to a 15% run-off factor, while unsecured wholesale funding is subject to a 25% run-off factor. In addition, unsecured wholesale funding provided by non-financial customers is subject to a 75% run-off factor. The denominator also requires a 20% adjustment for any market valuation change on derivatives.

When dealing with cash outflows, the proposal indicates banks will have to hold liquid assets equal to 10% of undrawn committed credit and liquidity facilities to customers, unless the facility is unconditionally cancelable by the bank. It also indicates other contingent funding liabilities will be considered.

The second minimum standard set is the Net Stable Funding Ratio (NSFR). This requires a bank to ensure it has a minimum amount of stable funding over a 1Y horizon given its liquidity profile. This ratio is also required to be maintained at 100%. To calculate average stable funding, banks sum up total capital,; preferred stock with a maturity > than 1Y; borrowings and liabilities with a maturity > 1Y (can be adjusted by embedded options); and other funding sources subject to haircuts. Of note, haircuts the proposal applies include 15% for stable nonmaturity retail deposits; 15% for unsecured small business funding; 30% for less stable (no established bank relationship) nonmaturity retail deposits; 30% for less stable small business funding; 50% for unsecured wholesale funding and a 100% haircut for all other funding sources. To calculate the level of Required Stable Funding, banks must add up the values of the assets held and multiply them by the applicable factor that reflects the amount of the asset that can not be monetized under stress (cash = 0% factor, marketable securities = 5% factor; corporate bonds = 20% factor; gold or equity = 50% factor; loans to corporate clients with maturity less than 1Y = 50%; loans to retail clients w/maturity < 1Y = 85% and all other assets = 100%.

As the proposal stands, banks would also have to perform the calculations at least monthly (more frequently in times of stress); report gaps between contractual inflows and outflows of liquidity; identify asset flows by latest possible maturity and liabilities by the earliest; report concentrations of wholesale funding and available unencumbered assets. Further, banks would need to be able to track and report market information, financial sector information and bank specific information.

We will see how all this turns out, but a lot seems to be happening in Switzerland these days when it comes to banking that will eventually trickle through to the community banks.

BANK NEWS

Financial Fees

President Obama unveiled his plan yesterday urging Congress to propose a tax on financial firms larger than $50B in assets. The assessment would charge 15bp on "net liabilities" (assets minus Tier One capital and insured deposits) to recover an estimated $117B in losses from bailouts

Credit Rating Downgrade

Facing a $20B budget deficit, the state of California was dealt another blow following S&P's downgrade of the state's $64B general obligation bonds to A-. S&P also indicated that the outlook for the state was negative.

Foreclosures

According to RealtyTrac, Dec. filings jumped 14% vs. the prior month and are up 15% from last year.

Cars

For the first time ever, 2009 data shows that China, at 13.6mm cars sold surpassed the US (10.3mm cars sold) as the largest auto market.