Impacts of Basel III on EMSEs: Liquidity

Michaela Erbenova

BCG workshop

Prague, August 26, 2013

Monetary and Capital Markets Department

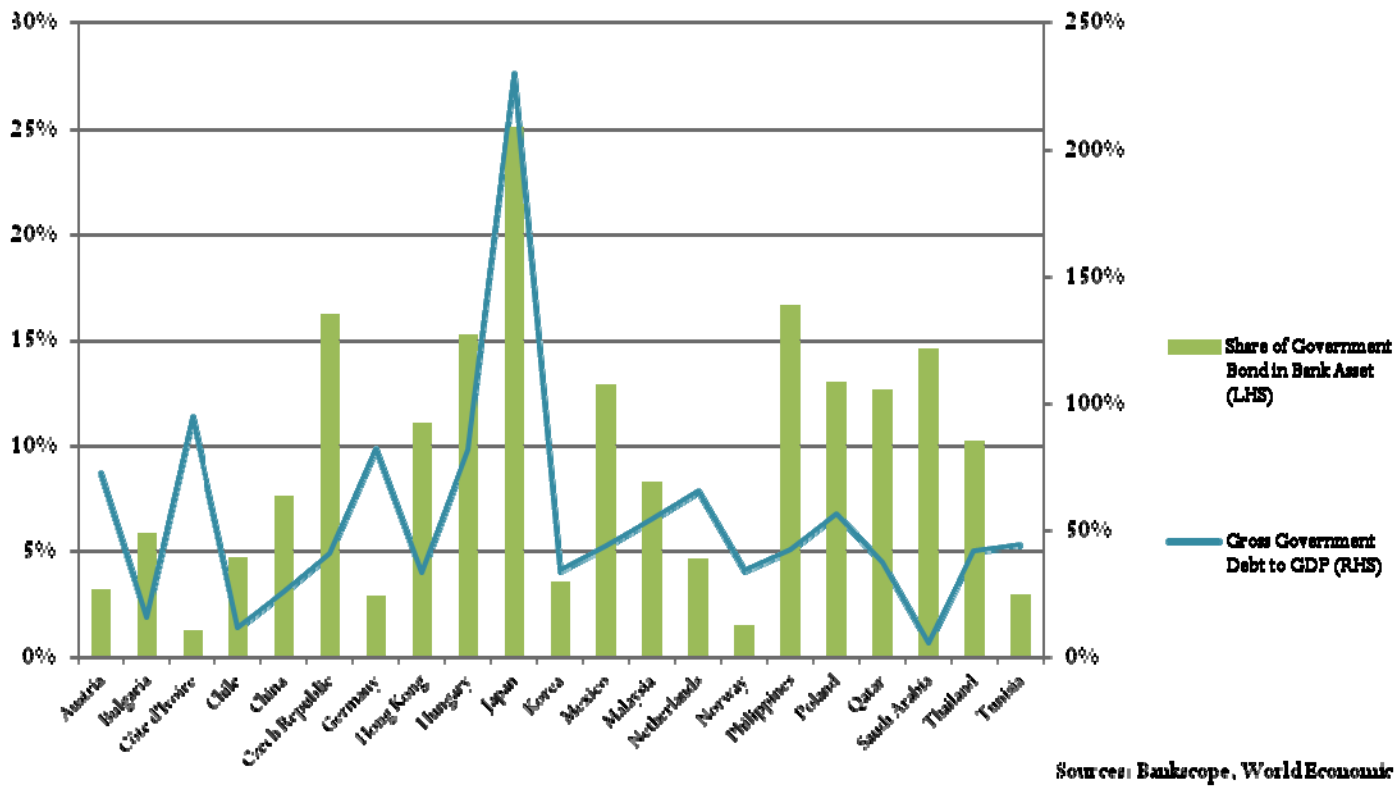
Introduction

- Implementing the LCR: Challenges for EMSEs
- Limited High Quality Liquid Assets (HQLA)
- Run-off assumptions for deposits

- Practical recommendations
- Options to expand HQLA (ALA), covered bonds
- QIS and national discretion

Challenges for EMSEs: Limited HQLA

- Domestic bond markets: some are shallow



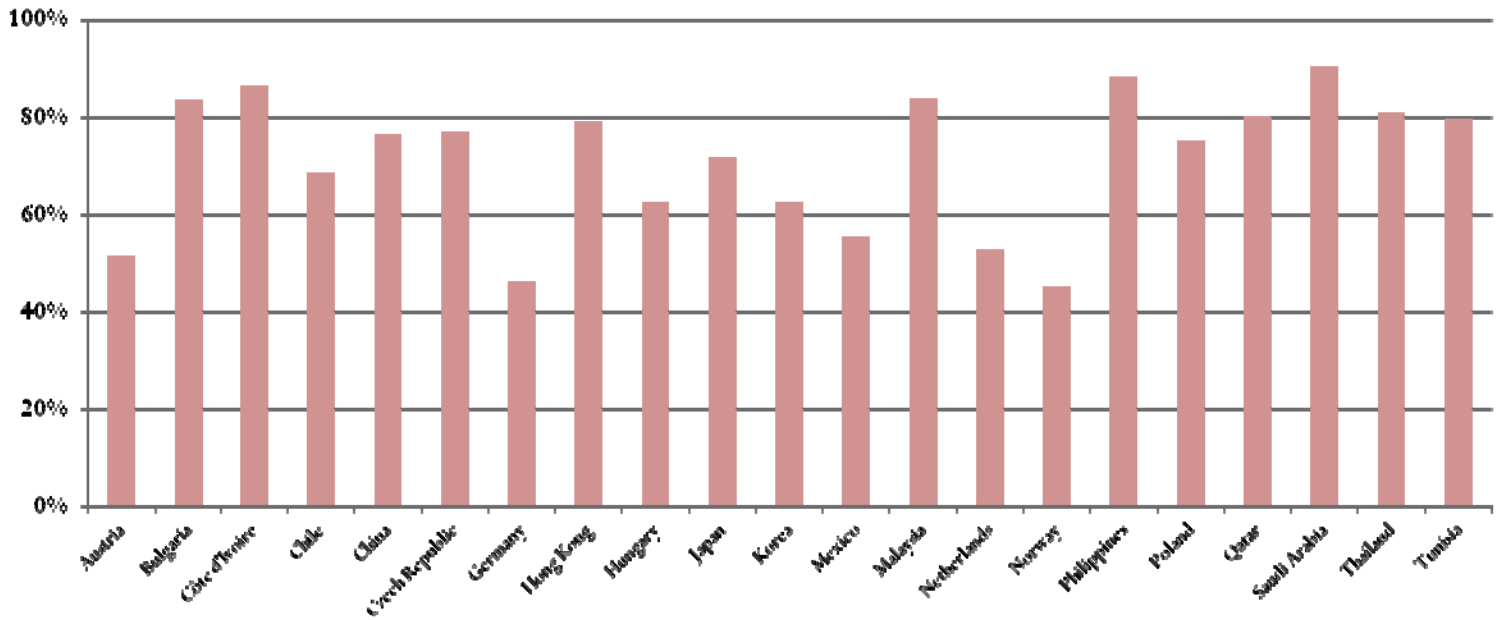
Sources: Bankscope, World Economic Outlook Database

Challenges for EMSE: Limited HQLA

- Limited benefits from expansion of level 2 assets
- Higher demand for high grade collateral, OTCD
- Risks
  - Market risk
  - Lower profit margin
  - Credit Risk/Concentration

Challenges for EMSEs: Run-off Assumptions for Deposits

- Setting appropriate run-off rates for deposits is particularly important for EMSEs, who tend to rely on deposits for funding



Challenges for EMSEs: Run-off Assumptions for Deposits

- Categorization of deposits is key
  - Different characteristics of deposits
  - Limited data

Dealing with Limited HQLA: ALA options

Option 1: CLF

- Does not change banks' asset and liability characteristics
- Difficult to design and calibrate to provide right incentives

Option 2: Use of foreign currency HQLA

- For banking systems with high levels of liquid foreign assets
- Could introduce higher foreign exchange risk

Option 3: Additional use of Level 2 assets

- For jurisdictions with deep and well-developed capital markets
- Needs careful assessment of true liquidity of L2 assets during times of stress

Dealing with Limited HQLA: Covered Bonds

- Covered bonds have been used by several jurisdictions
  - Reliable source of secured funding during the crisis
  - Diversifies a bank's funding base

- But, has implications for bank resolution
  - Prudent limits to restrict asset encumbrance may be necessary

Dealing with Deposit Run-Off Assumptions

- A cautious approach is important
  - Qualification as "stable deposits"
  - Conditions to benefit from reduced run-off rate
- Run-off characteristics vary among jurisdictions
  - Exercising national discretion on run-off rates may be necessary
- Understanding liquidity characteristics of banks is critical
  - QIS is first step to design LCR appropriately

NSFR has its own challenges…

- Intent to reduce banks' structural imbalance between their assets and funding
  - Focus on longer timeframes (vs. 30 days for LCR)
  - Adjustment more difficult than LCR
  - Under review by BCBS

- Possible impacts concerning EMSEs:
  - Availability of long-term financing (limit maturity transformation)
  - Business models (e.g. impact on mortgage banks)
  - Cross-border activities (impact on intra-group funding; consolidated vs. stand-alone application)

Conclusions

- LCR implementation is a challenge for EMSEs
  - Options to deal with insufficient supply of HQLA: progress has been made, but obstacles remain
  - Understanding liquidity characteristics is first step to design LCR: learning from detailed QIS exercise and experience in other countries is essential.

- Further guidance by BCBS-BCG important to ease transition for EMSEs

Thank you!