

Cayman Islands Monetary Authority

SUMMARY OF PRIVATE SECTOR CONSULTATION AND FEEDBACK STATEMENT



BASEL III – LIQUIDITY RISK MANAGEMENT FRAMEWORK

Regulatory Measure: *Rules and Guidelines– Liquidity Risk Management for Banks*

Section of proposed Regulatory Policy	Industry Comment	Authority’s response	Consequent amendments to the draft Requirements
<p>General Comments Implementation Timeframe</p>	<p>With regard to the proposed implementation date, given the extent of the measures proposed and the amount of data mining that it would require, our feeling is that 1 January 2019 may be somewhat ambitious. Given the complexity and extent of the regulations for the Class A Retail banks vis-à-vis the relative simplicity of their balance sheets we feel that 30 June 2019 might be a more realistic deadline.</p> <p>Given the time and effort in ensuring that systems, process and people are aligned the proposed timeline for implementation effective Jan 01, 2019 is aggressive.</p> <p>Consideration – delay to a mutually</p>	<p>The implementation timeline will be revised to include a commencement date of 01 June 2019.</p>	<p>No amendments required</p>

	<p>agreeable date discussed at the local bankers' association level</p> <p>As another option, if 1 January 2019 is immovable, we suggest applying the same calculation applicable to Class B banks except with a higher percentage. The calculation proposed for Class A Retail banks appears to be aimed at international institutions that are active in the likes of derivatives, foreign exchange and other markets for their own account as market makers rather than those that have comparatively simple balance sheets, match their customers' positions and are therefore highly risk averse in this space?</p>	<p>The implementation timeline will be revised to include a commencement date of 01 June 2019.</p>	<p>No amendments required</p>
<p>Reporting Forms</p>	<p>Are there templates for calculation purposes available for review, and if not, is there an expected timeline when they will be available for review and feedback?</p>	<p>The forms are being completed and are expected to be circulated for review by mid-February 2019.</p>	<p>No amendments required</p>
<p>High Quality Liquid Assets (HQLA)</p>	<p>With regards to High Quality Liquid Assets (Section 12), the Bank for International Settlements states that "some jurisdictions may have an insufficient supply of Level 1 assets (or both Level 1 and Level 2 assets) in their domestic currency to meet the aggregate demand of banks with significant exposures in this currency. To address this situation the Committee has developed alternative treatments for holdings in the stock of HQLA, which are expected to apply to a limited number of currencies and jurisdictions." As there is no central bank in Cayman (and thus no central bank reserves) the proposal as stated may well disadvantage indigenous</p>	<p>The Rules and Guidelines make provisions for the concerns raised in the comment in that in determining HQLA, the measure states that "<i>the haircut does not apply to the relevant portion, or that part of the relevant portion, that is not more than 25% of the banks CI\$-denominated or US\$¹-denominated total net cash outflows.</i>" (Paragraph 12.6)</p>	<p>No amendments required</p>

¹ This will apply as long as the CI\$ currency peg with the US\$ is in place.

<p>High Quality Liquid Assets (HQLA)</p>	<p>institutions given this asset class is not available to them as a contributor to HQLA. Is the Authority therefore willing to consider, either formally or informally, an alternative liquidity approach such as an element of USD-denominated foreign bank placements and/or USD-denominated securities (including those with an implicit US government guarantee)?</p> <p>Without some recognition of the impact on HQLA and LCR as a result of no central bank reserves in the Cayman Islands, this proposed liquidity requirement will result in Cayman indigenous and home regulated banks likely having to significantly reduce their foreign bank placements and increase investments in corporate debt securities and be subjected to the price volatility associated with such exposures for liquidity purposes."</p> <p>Day to Day Banking - Customer Activity (third party) - all of the surplus cash generated from day to day banking, through the various business lines (Retail/Corporate/Wealth), is placed with our treasury unit. . This unit serves as our internal regional treasury. Under the Basel III guidelines the unit would be classified as "Deposits with Banks" and any surplus liquidity held therein would not qualify as liquid assets under the Liquidity Coverage Ratio (LCR).</p> <p>Consideration: liquidity managed under internal treasury arrangements to be considered liquid assets (under definition of High Quality Liquid Assets</p>		
			<p>No amendments required</p>
		<p>The Rules and Guidelines state:</p> <p>"For the purposes of LCR, Level 1 assets shall include:</p> <p>...any liquid assets recognized as alternative liquid assets in jurisdictions that implement the Alternative Liquidity Approach (ALA) and which the banking supervisor of that jurisdiction recognises for purposes of including in the liquid assets as Level 1 assets..." (Paragraph 14.2)</p> <p>The measure goes on to clarify that:</p> <p>"A bank shall treat a liquid asset as HQLA only if the liquid asset complies with the following operational requirements: ... the asset is freely transferable and</p>	<p>No amendments required</p>

	<p>(HQLA)) (section 15.2.d).</p>	<p>available to the bank, whether between its Cayman Islands office and any of its specified associated entities and overseas branches, and is not subject to any liquidity transfer restriction;..." (Paragraph 15.2)</p>	<p>No amendments required</p>
<p>Investment Portfolio – Subordinated Bonds purchases (related party) – Similar to Offshore Loan portfolios the Bank has Investment portfolios in various currencies that are 100% funded by Head office on a back to back basis in the respective currencies. This forms part of the Banks Capital Management strategies.</p> <p>Consideration – propose that this investment portfolio be treated as highly liquid assets.</p>	<p>The Rules and Guidelines clearly articulate the characteristics of HQLA, the principal ones being:</p> <p>"The principal characteristics in order to qualify as HQLA include:</p> <p>a) The assets should be liquid in markets during a time of stress. Liquid assets comprise of high quality assets that can be readily sold or used as collateral to obtain funds in a range of stress scenarios.</p> <p>b) They should be unencumbered i.e. without legal, regulatory or operational impediments on the ability of the bank to liquidate, sell, transfer or assign the asset.</p> <p>c) Assets are considered to be high quality liquid assets if they can be easily and immediately converted into cash at little or no loss of value. The liquidity of an asset depends on the underlying stress scenario, the volume to be monetised and the timeframe considered. Nevertheless, there are certain assets that are more likely to generate funds without incurring large discounts due to fire-sales even in times of stress."</p> <p>(Paragraph 13.1)</p> <p>The nature and characteristics of related party bonds do not coincide with the required characteristics of HQLA as presented in the measure. Overall, there</p>	<p>The Rules and Guidelines clearly articulate the characteristics of HQLA, the principal ones being:</p> <p>"The principal characteristics in order to qualify as HQLA include:</p> <p>a) The assets should be liquid in markets during a time of stress. Liquid assets comprise of high quality assets that can be readily sold or used as collateral to obtain funds in a range of stress scenarios.</p> <p>b) They should be unencumbered i.e. without legal, regulatory or operational impediments on the ability of the bank to liquidate, sell, transfer or assign the asset.</p> <p>c) Assets are considered to be high quality liquid assets if they can be easily and immediately converted into cash at little or no loss of value. The liquidity of an asset depends on the underlying stress scenario, the volume to be monetised and the timeframe considered. Nevertheless, there are certain assets that are more likely to generate funds without incurring large discounts due to fire-sales even in times of stress."</p> <p>(Paragraph 13.1)</p> <p>The nature and characteristics of related party bonds do not coincide with the required characteristics of HQLA as presented in the measure. Overall, there</p>	<p>No amendments required</p>

		<p>is a lack of quality assurance that is required, particularly in times of stress and crisis. For example, in the case where the crisis is not contained within the jurisdiction and the parent company may not be in a position to provide immediate liquidity for these securities. That is the case. See paragraph 2.3 for the scope of application of the MLR.</p>	<p>No amendments required</p>
<p>Sec 4.10</p>	<p>If we are a Category "A" non-retail bank, confirm that we are subject to the Minimum Liquidity Ratio requirements (MLR).</p> <p>Regarding the first sentence "A bank's management should set limits to ensure adequate liquidity", what specifically should limits be set on?</p> <p>Suggested drafting: Possibly a better phrasing might be "...set appropriate metrics and tolerances around suitable liquidity indicators and ensure that they are measured and monitored regularly..."</p>	<p>Without being overly prescriptive, the Authority has expanded the broad parameters for setting limits in paragraph 4.10.</p>	<p>Paragraph 4.10 has been expanded to read:</p> <p><i>"A bank's management should set limits to ensure adequate liquidity and to control liquidity risk exposures and vulnerabilities. The limits imposed should include, but are not limited to, operational limits, concentration limits, exposure and sensitivity limits, and trading and stop loss limits for the investment portfolio..."</i></p>
<p>Sec 5.9</p>	<p>"Instruments" in line one is somewhat general. Maybe the Authority could be more specific in this regard. The sentence on correspondent banking is not relevant to Cayman entities – potentially another Cayman-specific example could be found.</p> <p>Cash flow mismatches in foreign currencies should be reviewed on a regular basis in addition to an annual review of limits. Should foreign exchange sensitivity analysis (by currency) also be considered given that this also affects liquidity?</p>	<p>The term "instrument" is meant to be broad and general. Its meaning is explained in the previous paragraphs.</p>	<p>No amendments required</p>
<p>Sec 8.2</p>		<p>The measure imposes a minimum requirement of reviewing mismatches annually. Banks, particularly those with large foreign currency exposures should set more stringent internal requirements for assessing their foreign currency mismatches, in line with the size of their exposures and potential risk.</p>	<p>No amendments required</p>

			<p>The Rules and Guidelines set a requirement for individual currency analysis which is expected to include sensitivity and stress testing.</p> <p>Recommended change does not change the substance of the requirement; however, the Authority has incorporated a slight amendment to add some clarification.</p>	<p>Paragraph 9.1 was amended as follows:</p> <p><i>"The results of such reviews should be clearly documented and made available to the Authority upon request."</i></p> <p>Paragraph 9.4 was amended as follows:</p> <p><i>"In addition, an important element of a bank's internal control system is regular evaluation and review of its liquidity risk management process by its risk management/compliance function."</i></p> <p>No amendments required</p>
Sec 9.1	<p>Suggest adding in the last sentence that "...the results of such reviews should be recorded and made available..."</p>	<p>Is the internal audit review separate to independent evaluation requirement stated in Sec 9.4? If not then suggest this section be removed, but if so can the Authority then define what their expectations are around the independent review in Sec 9.4?</p>	<p>Central bank reserves, although not relevant at this time within the Cayman Islands jurisdictions, are applicable in the broader context where subsidiaries, branches etc in other jurisdictions, may hold such assets.</p> <p>Once 30 days have elapsed following the asset being deemed as ineligible as HQLA, the bank may no longer include the asset in its stock of liquid assets.</p> <p>That is the case</p>	<p>No amendments required</p> <p>No amendments required</p> <p>No amendments required</p>
Sec 14.2 (b)	<p>Are central bank reserves applicable in the Cayman context?</p>			
Sec 15.3	<p>Can the Authority provide guidance as to what must happen to the asset after the 30 days?</p>			
Sec 18.3	<p>As there is no such deposit insurance or guarantee scheme does this then disqualify the inclusion of stable deposits in the Cayman context?</p>			
Sec 18.4	<p>Many countries insure up to a maximum amount rather than cover all deposits. Are amounts up to those thresholds</p>		<p>The amount of the deposits that can be considered stable would be that which falls under the definition as presented in</p>	<p>No amendments required</p>

	considered stable or is the entire deposit, regardless of whether it is 100% covered by insurance/guarantee, considered stable?	18.3, that is, the amount which is fully insured or attracts a public guarantee.	
Sec 18.11	Can the Authority give guidance as to what defines a small business customer or is that a matter for each individual institution? If the latter can appropriate language be added?	The Authority has taken the decision not to standardise the definition for the term small business customer at this time. As such, institutions should utilise an interpretation which aligns with their internal classification of such customers.	The following footnote was appended to paragraph 18.7: "For the purposes of this document, small business customer is defined based on the bank's internal classification." No amendments required
Sec 18.17	Should this methodology also be formally documented?	Bank processes, procedures and methodologies which are implemented to effect regulatory requirements should always be formally documented, approved and reviewed at regular intervals.	No amendments required
Sec 18.30	Should this read Level 2B?	The Rules and Guidelines will be amended to reflect that a 50% outflow rate should be applied to transactions backed by Level 2B assets.	LCR Table 2 (iv) of the Rules and Guidelines document has been changed to: "Backed by Level 2B assets"
Sec 18.42	Regarding the contractual obligation should consideration be given to covering this to the extent that the institution has legally enforceable rights of exercise over the collateral?	The Rules and Guidelines state: <i>"This is provided that the bank is legally entitled and operationally capable to re-use the collateral in new cash raising transactions once the facility is drawn, and there is no undue correlation between the probability of drawing the facility and the market value of the collateral."</i>	No amendments required
Sec 19	Are inter-group or other related party items considered here?	The statement makes provisions for, <i>inter alia</i> , collateral that the bank has legally enforceable rights over. The measure does not state any exclusion of inter-group or related party items. Hence, only cash inflows which fit the description of "...contractual inflows (including interest payments) from outstanding exposures that are fully performing and for which the bank has	No amendments required

		<p><i>no reason to expect a default within the next 30 calendar days...</i>" (Paragraph 19.1) are to be included, subject to all the other requirements presented in section 19.</p> <p>Banks should also note that <i>"Inflows from intragroup banking entities may be computed on a net basis with outflows from intragroup banking entities."</i> (Paragraph 19.15).</p> <p>Not applicable.</p>	<p>LCR Table 4 was edited to ensure correct alignment of inflow rates for Level 2B assets.</p> <p>No amendments required</p>
Sec 19.4	Check alignment of items against percentages	Paragraph 29.5 of the Rules and Guidelines states:	No amendments required
Sec 29.2	Can the Authority give guidance as to what it considers 'significant' in relation to counterparty and product/instrument?	<p>"A <i>"significant counterparty"</i> is defined as a single counterparty or group of connected or affiliated counterparties accounting in aggregate for more than 1% of the bank's total balance sheet."</p> <p>The liquid funds in this case should be committed and a guarantee provided and specified that the funds will be immediately available should the bank encounter a liquidity issue. In cases where the Group Bank will provide liquidity on a best efforts basis, these funds may not be included in the calculation of liquid assets.</p>	No amendments required
Sec 34.1 (c)	In the event of encountering a liquidity issue, can the agreement with the group bank be on a best-efforts basis or does it need to be committed? If so, is there specific language that the Authority wants to see at a minimum?	<p>Month maintains its standard definition which is a period starting on a specified day in a calendar month and ending on the numerically corresponding day in the next calendar month. In cases where there is no numerically corresponding day in the calendar month in which the period is to end, the month shall end on the last day in that calendar month.</p>	No amendments required
Sec 35.1 (b)	Refers to liabilities due within one month of the computation date. With an example calculation date of February 28 th does one month mean by March 28 th or will the rules be flexible enough to permit March 31 st ?		No amendments required

<p>Sec 35.1 (c)</p>	<p>References 15% of all undrawn commitments in the qualifying liabilities description. Section 33.1 references liquid asset requirements as needing to be greater than 15% of the value of the qualifying liabilities. With regard to the formula for this calculation does it mean that Liquid Assets need to be greater than 15% of 15% undrawn commitments (i.e. 2.25 of undrawn commitments)?</p>	<p>Paragraph 33.1 states: <i>"All Category "A" Non-Retail banks and Category "B" banks shall hold at all times, Liquid Assets, as defined in section 34, denominated in any currency, amounting to no less than 15% of the value of its Qualifying Liabilities, as defined in section 35, denominated in all currencies."</i></p> <p>The calculation of liquid assets and qualifying liabilities for the purpose of determining the MLR, considers that the bank calculates its total liquid assets based on paragraph 34 and ensures that this total is equal to or more than the 15% of the aggregate of its qualifying liabilities (calculated based on the definition presented in paragraph 35). Therefore, the ratio is not calculated based on the individual components of either the bank's assets or liabilities.</p>	<p>No amendments required</p>
<p>Internal funding arrangements – related parties?</p>	<p>Internal Funding Arrangements – Offshore Banking Units (related party) – The vast majority of the assets and liabilities on our balance sheet arise from internal funding arrangements (related parties) under its Offshore Banking Unit portfolio. Most of these arrangements are structured on a back to back basis. Consideration – assets and liabilities under this category should be: 1) excluded from the ratio computation or; 2) if included, treated as stable and liquid.</p> <p>Does this have any impact on the</p>	<p>The bank should be guided by the definitions presented in the measure and guidance provided on related parties. These assets and liabilities should therefore be assessed based on the criteria given for liquid instruments and stable liabilities and the characteristics of these balance sheet items.</p>	<p>No amendments required</p>
	<p>Once the Rules and Guidelines are in a</p>		<p>No amendments required</p>



regulatory fines regime which only lists Rules 4.1 to 4.4 (as very serious, serious, serious and very serious respectively)?

final form, the Authority will discuss the appropriate amendments to the Administrative Fines Regulations with the Ministry of Financial Services and Home Affairs.

