Jersey Financial Services Commission

Consultation Paper No. 3 2017

Basel III: Liquidity Management

A consultation on proposals to amend liquidity management, monitoring and reporting requirements to:

- Address the new international standards established in Basel III
- Amend prudential reporting requirements to provide relevant evidence of compliance and
- Require an annual internal liquidity assessment process to be performed by all Jersey incorporated banks, subject to supervisory review, building on similar current requirements regarding capital adequacy.

Issued: 26 April 2017

Consultation Paper

Please note that terms in *italics* are defined in the Glossary of Terms.

The JFSC invites comments on this consultation paper. Responses may be sent directly to **David Fisher** at the JFSC by **26 July 2017**. If you require any assistance, clarification or wish to discuss any aspect of the proposal prior to formulating a response, it is of course appropriate to contact the JFSC.

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Alternatively, **Thomas Cowsill** at *Jersey Finance* is co-ordinating an Industry response that will incorporate any matters raised by local businesses. Comments should reach *Jersey Finance* by **26 July 2017**.

Responses should be sent to:

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It is the policy of the JFSC to make the content of all responses available for public inspection (unless specifically requested otherwise by the respondent).

It is the policy of Jersey Finance (unless otherwise requested or agreed) to collate all responses and share them verbatim with the JFSC on an anonymised basis (with reference made only to the type of respondent, e.g. individual, law firm, trust company etc). This collated, anonymised response will, typically, be placed in Jersey Finance's permanent electronic archive which is currently open to all Jersey Finance members.

Glossary of Terms

All defined terms used in this consultation are indicated by *italics* and defined in the Glossary of Terms. Please click here to view the Glossary of Terms.

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1 Executive Summary

1.1 Overview

1.1.1 This paper proposes revised regulatory requirements for liquidity management and reporting in Jersey. It uses as its basis papers issued by the Basel Committee as part of the group of new and revised standards referred to as *Basel III***.** In so doing, it addresses the similar *EU* proposals incorporated in *CRR*.

1.1.2 This paper builds upon the earlier *Liquidity DP*, issued jointly by the *Tri-Party Group*, feedback received and the joint feedback document issued to industry, which are all available on the JFSC's website, specifically in the page titled *"Basel III: Implementation in Jersey*", at:

1.1.2.1 http://www.jerseyfsc.org/banking_business/basel/index.asp

1.1.3 This website also contains links to the other documents issued by the JFSC regarding Basel III, including both consultation papers, discussion papers (whether issued solely by the JFSC or jointly with other members of the *Tri-Party Group*) and feedback papers issued addressing responses from industry.

1.2 What is proposed and why?

1.2.1 **Sections 4, 5,** and **6** establish proposals for the implementation of the liquidity element of *Basel III* in respect to *Jersey Incorporated Banks* (herein also designated by the acronym *JIB* where there are repeated references in a Section), where under international standards the JFSC has primary responsibility for oversight.

1.2.2 **Section 5** (on reporting) also addresses changes to the prudential reporting of the liquidity position of *Overseas Incorporated Banks* (herein also designated by the acronym *OIB* where there are repeated references in a Section), this being the only section that is directly relevant to *OIBs.*

1.2.3 The central proposal, set out in Section 4, is for the implementation in Jersey of the *LCR* component of *Basel III* as set out in the *LCR Standard,* with certain amendments being proposed to reflect local banking sector characteristics, including:

1.2.3.1 The fact that all impacted banks (*JIBs* only) are subsidiaries of large banking groups, whereas the standard was designed for application on a consolidated basis and

1.2.3.2 The importance and differentiated nature of funding derived from a wide variety of fiduciary relationships.

1.2.4 These amendments are limited, reflecting the fact that most of the *LCR's* principles are considered to be appropriate for solo application to a subsidiary in Jersey. The only significant divergences are in respect of the treatment of intra-group lending and fiduciary deposits.

1.2.5 The most impactful changes, versus the current liquidity management requirements for *JIBs*, are:

1.2.5.1 The *LCR* requires that liquid assets (called *HQLA* in the *LCR*) exceed net outflows predicted over a one month period. In comparison, existing rules allow a small mismatch at one month (5%) though one week net predicted outflows must be covered in full;

1.2.5.2 The new rules regarding the recognition of *HQLA* are more extensive and conservative than the current rules regarding the recognition of marketable assets. In particular, most bank issued debt instruments, such as floating rate notes and certificates of deposit, are ineligible, and as such have only got a value for *LCR* purposes where payments are contractually due within one month; and

1.2.5.3 The *LCR* establishes minima for different categories of predicted outflows (as a percentage of outflows falling due on a contractual basis within one month) that vary from 5% for the most sticky retail deposits to 100% for inter-bank deposits. In most cases, these minima would not result in higher outflows being predicted than under current behavioural adjustments agreed with banks. The proposals in respect of fiduciary deposits are a possible exception, where the proposed exceptions to the *LCR Standard's* 100% requirement has been modified but the resultant proposal may still impact some *JIBs***.**

1.2.6 **Section 5** addresses revisions to reporting requirements. For a *JIB*, these are more extensive than current requirements, reflecting a desire to more fully understand its liquidity position including, but not limited to, its *LCR.* In particular, reporting of its *NSFR***,** a longer term standard specified in *Basel III*, is required in order to provide information on the stability of a *JIB's* funding base beyond the narrow timeframe (one month) of the *LCR*.

1.2.7 More limited reporting requirements are proposed for *OIBs*, to provide the necessary understanding of the *OIB's* liquidity, whilst recognising that the principal responsibility for oversight rests with the *OIB's* home regulator.

1.2.8 **Section 6** contains proposals for how *JIBs* should document their internal liquidity assessment processes within their *ICAAP* documentation. Specific stress testing will be required:

1.2.8.1 In connection with all modifications to predicted flows, an assessment of anticipated stressed behaviour (including an assessment of evidenced historical behaviour; during recent periods and any relevant stress periods); and

1.2.8.2 In connection with *HQLA*, an assessment of stressed availability (through sale or repo, based on operational use tests).

1.2.9 These proposals form part of the JFSC's implementation of *Basel III*. **Section 7** provides an outline of local implementation plans, building on the plans provided in the *Capital Elements DP***,** issued in March 2016.

1.2.10 **Sections 8** and **9** set out respectively a cost benefit analysis of the proposals and a summary of specific questions raised herein.

1.2.11 Draft proposed prudential reporting guides and revisions to the Banking Codes are set out in **Appendices B** to **I**, whilst **Appendix J** contains draft revisions to the *Banking Codes*.

1.3 Who would be affected?

1.3.1 The proposals in this consultation paper have the potential to affect all persons that are registered under the *Banking Law*.

1.3.2 Current and proposed regulation of *OIBs* does not include prudential requirements in respect of capital; *OIBs* will not be subject to the new local prudential liquidity regulations but instead only be impacted by limited changes to regulatory reporting set out in **Section 5**. All other proposed changes impact *JIBs* only.

1.3.3 The proposals may, and are intended to, encourage those directly affected to manage their business to reflect liquidity costs and risks. This could result in the preferential pricing of longer-term funding compared to short-term funding, particularly in the case of deposits, where no adjustment is permitted in the proposed *LCR*, such as pooled fiduciary deposits.

2 Consultation

2.1 Basis for consultation

2.1.1 The JFSC has issued this consultation paper in accordance with Article 8(3) of the *Commission Law*, as amended, under which the JFSC "*may, in connection with the carrying out of its functions - ….consult and seek the advice of such persons or bodies whether inside or outside Jersey as it considers appropriate*".

2.2 Responding to the consultation

2.2.1 The JFSC invites comments in writing from interested parties on the proposals included in this consultation paper. Where comments are made by an industry body or association, that body or association should also provide a summary of the type of individuals and/or institutions that it represents.

2.2.2 To assist in analysing responses to the consultation paper, respondents are asked to:

2.2.2.1 Prioritise comments and to indicate their relative importance; and

2.2.2.2 Respond as specifically as possible and, where they refer to costs, to quantify those costs.

2.2.3 An Excel based response form has been published alongside this consultation, available at:

2.2.3.1 https://www.jerseyfsc.org/Word/Consultation-Paper-No3-Basel-III-Liquidity-Management-Response-Template-April-2017.xlsx

2.2.4 Direct respondents that are registered under the Banking Law are requested to complete that form in Excel and then upload it to the JFSC by using the secure upload site on the JFSC's website at:

2.2.4.1 https://www.jerseyfsc.org/fileuploaddc/

2.2.5 All other respondents are requested to use the response form when responding, either directly or via *Jersey Finance*. For the avoidance of doubt, all responses received, in whatever fashion, will be considered, with the response form intended only to ease processing by the *JFSC*.

2.3 Next steps

2.3.1 Feedback will be assessed and it is intended to provide industry with a document that addresses this in due course, outlining any changes to the proposals documented herein. The expectation is that:

2.3.1.1 Work on revisions to prudential reporting systems and the testing thereof will take place in 2017/2018, with all banks affected by implementation towards the end of this period. Updates will be provided on technical matters and revised guidance issued in due course.

2.3.2 The *Banking Codes* will be revised in 2018 to introduce the new and revised requirements set out in **Sections 4** to **6** (see **Appendix J** for full details) as follows:

2.3.2.1 **Section 5** of the *Banking Codes* will be expanded to include a sub-section on liquidity risk, establishing the requirement to monitor the *LCR***/***LMR* daily and include coverage of liquidity risk in the *ICAAP***;**

2.3.2.2 **Section 6** of the *Banking Codes* will be expanded to include notification requirements that would arise if the *LCR***/***LMR* dropped below 100%; and

2.3.2.3 The **Schedule** in the *Banking Codes* will be amended to reflect the new reporting requirements, as specified in **Appendices B** to **I**.

2.3.3 The *Pillar 2 Guidance Note* will be amended and issued together with the revised *Banking Codes* to reflect the proposals outlined in **Section 6** and any feedback received to this consultation, and provide any additional guidance necessary to aid *JIBs* in assessing liquidity risk in their *ICAAPs***.**

3 The JFSC

3.1 Overview

3.1.1 The JFSC is a statutory body corporate established under the *Commission Law*. It is responsible for the supervision and development of financial services provided in or from within Jersey.

3.2 JFSC's functions

3.2.1 The *Commission Law* prescribes that the JFSC shall be responsible for:

3.2.1.1 The supervision and development of financial services provided in or from within Jersey;

3.2.1.2 Providing the States of Jersey, any Minister or any other public body with reports, advice, assistance and information in relation to any matter connected with financial services;

3.2.1.3 Preparing and submitting to the Chief Minister recommendations for the introduction, amendment or replacement of legislation appertaining to financial services, companies and other forms of business structure;

3.2.1.4 Such functions in relation to financial services or such incidental or ancillary matters:

› As are required or authorised by or under any enactment, or

› As the States of Jersey may, by Regulations, transfer and

3.2.1.5 Such other functions as are conferred on the JFSC by any other Law or enactment.

3.3 Guiding principles

3.3.1 The JFSC's guiding principles require it to have particular regard to:

3.3.1.1 The reduction of risk to the public of financial loss due to dishonesty, incompetence, malpractice, or the financial unsoundness of persons carrying on the business of financial services in or from within Jersey;

3.3.1.2 The protection and enhancement of the reputation and integrity of Jersey in commercial and financial matters;

3.3.1.3 The best economic interests of Jersey; and

3.3.1.4 The need to counter financial crime in both Jersey and elsewhere.

4 LCR Requirements

4.1 Background

4.1.1 In June 2006, the *Basel Committee* issued, in comprehensive form, a framework for regulatory requirements for the capital adequacy of international banks. This document, "*International Convergence of Capital Measurement and Capital Standards*", became known as *Basel II*.

4.1.2 Latterly, the *Basel Committee* has worked to revise *Basel II*. This work has resulted in a number of standards being issued that either revise *Basel II* or establish new international standards regarding the financial strength of international banks. Collectively, this initiative is described by the *Basel Committee* as *Basel III*, which encompasses liquidity measures as well as revised capital adequacy rules.

4.1.3 The *Tri-Party Group* - the JFSC*, GFSC* and *IOMFSC* (now part of the *IOMFSA*) – sought to establish a unified approach, wherever possible, to implementing *Basel II* during the period 2005 to 2008.

4.1.4 The *Tri-Party Group* issued the *Basel III DP* in September 2012 to all banks that are incorporated in the *CDs* to provide information on *Basel III* and an indication of initial views, and in order to solicit feedback. This noted that local banks are not necessarily considered to fall under the scope of *Basel III***,** except on consolidation.

4.1.5 However, it was explained that the *Tri-Party Group* considered that aspects of *Basel III* may be relevant in the *CDs* and that a move to a more uniform minimum standard across the *CDs* is a worthwhile goal in itself, to meet industry's regular calls for commonality and to limit opportunities for regulatory arbitrage.

4.1.6 Subsequently, the *Tri-Party Group* issued the *Basel III Liquidity DP* in July 2015 (and issued the *Basel III DP Feedback* in February 2016 to address feedback received), building on the *Basel III DP*. This addressed the new international standards set out in *"Basel III: International framework for liquidity risk measurement, standards and monitoring*", issued in December 2010 and subsequently revised further in the *LCR Standard* and the *NSFR standard*.

4.1.7 In the *Basel III Liquidity DP*, the *Tri-party Group* proposed that a *Basel III* consistent approach should be implemented for liquidity at local level.

4.1.8 This paper establishes proposals for *Jersey Incorporated Banks* that are:

4.1.8.1 Based on relevant elements of the *LCR* and *NSFR,* as set out in the relevant standards;

4.1.8.2 Appropriate for *JIB* management of liquidity; and

4.1.8.3 Consistent with the common proposals set out in the *Basel III Liquidity DP*, save for modifications intended to reflect the *Basel III DP Feedback***.**

4.1.9 To facilitate the introduction of revised prudential reporting requirements, much of the terminology used will be in line with the definitions in the *Basel Committee* paper "*Liquidity coverage ratio disclosure standards*", issued in January 2014 and revised March 2014. This sets out a disclosure framework for internationally active banks regarding the *LCR*. The framework is a useful starting point and many *JIBs* will be subject to either it or similar disclosure requirements on a consolidated level.

4.1.10 Timescales for implementation are uncertain at this time, principally due to practical constraints regarding the introduction of a new prudential reporting system. However, the JFSC intends to have the new system fully operational and in place by the end of 2018 at the latest. Further transition details are provided in **Section 4.9**.

4.2 Overview

4.2.1 This section describes how the *LCR Standard* requirements will be implemented in Jersey for all *JIBs* (it is not relevant to *OIBs*).

4.2.2 The *LCR Standard* is similar to the liquidity mismatch requirements currently prescribed for *JIBs* in that:

4.2.2.1 It requires predicted outflows to be met by a mixture of predicted inflows and *HQLA*; and

4.2.2.2 Predicted flows are based on a mixture of contractual and behaviourally based projections.

4.2.3 The main differences are:

4.2.3.1 The definition of *HQLA* in the *LCR Standard* is more conservative and detailed than the definition of marketable assets used currently;

4.2.3.2 the *LCR Standard* limits the extent to which inflows may offset outflows as it requires that *HQLA* must equate to at least 25% of adjusted outflows in all cases, whereas the current standard has no limit, permitting inflows to fully offset outflows;

4.2.3.3 Current allowances for depositor behaviour currently vary across banks, based solely on individual submissions, with no minima. In particular, the *LCR Standard* specifies that for fiduciary deposits 100% of contractually due flows must be covered, whereas currently the mismatch approach permits banks to use assumptions based on their own analysis;

4.2.3.4 a one week metric applies under the current mismatch approach, in addition to a one month metric; and

4.2.3.5 The current mismatch permits a small shortfall (5% of deposits) whereas the *LCR Standard* requires *HQLA* to exceed net predicted outflows.

4.2.4 Sub-sections **4.3** to **4.5** describe how the proposals have been amended to reduce the impact of the first three of these items.

4.2.5 Proposals are outlined in detail in **Appendices B** and **C**, published as separate documents, which will form the basis for reporting and guidance regarding internal assessment. **Sections 5** and **6** respectively provide an overview of these documents.

4.3 Fiduciary deposits

4.3.1 Fiduciary deposits, for these purposes, include:

4.3.1.1 "Swiss fiduciary deposits": amalgamated customer deposits placed by banks with other banks;

4.3.1.2 Deposits from trustees on behalf of trusts, whether pooled or not;

4.3.1.3 Deposits placed by investment firms on behalf of one or more clients, within an investment mandate; and

4.3.1.4 Any other deposit that is known to be managed by a financial entity on behalf of a customer.

4.3.2 The *LCR Standard* requirement for fiduciary deposits to be treated as a 100% contractual outflow in all cases, with no reflection of stickiness except in the case of certain operational deposits, is not considered to be an appropriately balanced approach for all local circumstances.

4.3.3 On 10 October 2014, the *EU* adopted the *EU LCR Delegated Act*, which effected *EU* implementation of the *LCR*. This provides that a deposit made by a *PIC* could be treated similarly to a deposit from a non-financial corporate customer and hence attract a 40% outflow rate. A *PIC* is defined in that Act as:

4.3.3.1 *"… an undertaking or a trust whose owner or beneficial owner, respectively, is a natural person or a group of closely related natural persons, which was set up with the sole purpose of managing the wealth of the owners and which does not carry out any other commercial, industrial or professional activity. The purpose of the PIC may include other ancillary activities such as segregating the owners' assets from corporate assets, facilitating the transmission of assets within a family or preventing a split of the assets after the death of a member of the family, provided these are connected to the main purpose of managing the owners' wealth".*

4.3.4 It is proposed to provide a similar specific beneficial treatment locally for *PIC deposits.* This is considered appropriate because:

4.3.4.1 There is evidence locally of stickiness. This might not reflect the experience of overseas supervisors that have seen a greater number of bank failures, which appears to have driven the very conservative approach set out in *Basel III*;

4.3.4.2 *Basel III* is designed for implementation by a small number of internationally active institutions, whereas locally it will apply to all *JIBs*;

4.3.4.3 *And Basel III* is designed to be applied at the consolidated level, whilst it will apply at the solo level in Jersey.

4.3.5 Specific intentions regarding the beneficial treatment are set out below (and expanded in the "*LCR/LMR Guide*" (**Appendix C**):

4.3.5.1 It is proposed that adjustments be permitted for short-term deposits from *PICs* (using a similar definition for *PIC* to that in the *EU LCR Delegated Act*), where (1) the deposit is placed by the *PIC* itself or (2) it is placed on a designated basis by a fiduciary.

4.3.5.2 Such deposits would be treated as deposits from non-financial corporates, and hence a 40% minimum outflow assumption will apply.

4.3.6 This is not intended to benefit all fiduciary deposits: clear parameters will be established and fiduciary deposits that fall outside of these (such as deposits placed on a pooled basis and deposits from trusts that do not meet the specific definition in **Appendix C**) would attract the 100% minimum outflow assumption set in the *LCR* (unless they meet the definition of an operational deposit, see **Appendix C**).

4.3.7 The impact for fiduciary deposits that do not meet the definition of a *PIC deposit* (such as deposits placed on a pooled basis and deposits from trusts that do not meet the specific definition in **Appendix C**) but for which behavioural adjustments are currently applied would be that they now attract a 100% outflow rate, requiring more liquidity to be held where the deposit matures within one month.

4.3.8 It is anticipated that the period before implementation would enable banks to work with fiduciary managers to mitigate any negative consequences as follows:

4.3.8.1 Banks could perhaps better reflect liquidity costs in pricing, in order to provide fiduciary managers with an incentive to place deposits longer term and reduce the net liquidity cost to the bank. Fiduciary managers could then place deposits on a longer term basis to mitigate the consequential impact on the pricing of short-term deposits; and

4.3.8.2 Products such as longer term notice or fixed term deposits could be used to balance the need for access versus liquidity cost. Where banks pursue such approaches, they should comprehensively assess the impact on liquidity.

4.3.9 **Question 1: Do you consider that the proposals regarding fiduciary deposits would be likely to give rise to a loss of business or profitability? If so, are there appropriate additional measures that could mitigate the impact of these proposals? If so, please outline them, together with a brief assessment of pros and cons and provide relevant evidence.**

4.4 Limited recognition of inflows

4.4.1 The impact arising from the *LCR's* limited recognition of inflows stems from its limitation that inflows may only offset 75% of outflows when determining the *HQLA* requirement.

4.4.2 Most banks in the *CDs* are part of larger groups that hold *HQLA* but in many cases these assets are held centrally, with loans from group used to provide liquidity to local banks when needed.

4.4.3 It is therefore proposed to establish, as an option, an alternative standard (the *LMR*), whereby projected inflows that occur within one week from group banks for which a Concession Limit has been established are permitted to fully offset projected outflows, rather than being subject to the 75% of outflows limitation that would apply for all other classes of inflow.

4.4.4 It is anticipated that *JIBs* utilising such an approach would have no requirement for *HQLA* and hence the *LMR* is formulated as the ratio of [*HQLA* plus projected inflows] to projected outflows to avoid this causing calculation issues (see **Section 5** and **Appendix C** for full details).

4.4.5 *JIBs* would be required to use the *LCR* (default) or seek approval to use the *LMR*. Permission would depend on an assessment of specific circumstances, including the extent to which the *JIB's* internal management of liquidity, as set out in its *LMP,* relied on projected inflows as opposed to *HQLA* (any substantial reliance would be inconsistent with *LMR* use) and confirmation that the group was subject to *LCR* based liquidity requirements on a consolidated basis.

4.4.6 **Question 2: Do you consider that there are appropriate additional measures to those outlined in Section 4.4 that could mitigate the impact of these proposals? If so, please outline them, together with a brief assessment of pros and cons.**

4.5 Liquid assets

4.5.1 These proposals use the *LCR standard's* definition of *HQLAs*, which is tighter than the current definition of marketable assets. The impact will vary, depending on the assets banks currently use and the extent to which they were already planning to only use *HQLA*.

4.5.2 Few *JIBs* hold any marketable assets for liquidity management purposes that do not meet the *HQLA* criteria (outside of *JIBs* that are currently solely reliant on intragroup flows) and hence the expected impact on industry of the changed definition is expected to be relatively small.

4.5.3 However, *JIBs* will need to ensure that all relevant criteria are met (as set out in **Appendix B**) and some might see higher net liquidity costs, if higher yielding marketable assets are found to be ineligible and hence need to be replaced with lower-yielding eligible *HQLA*.

4.5.4 These are a mixture of general and operational requirements. The general requirements relate to the asset itself, whilst the operational requirements relate to the ability of the *JIB* to realise the asset.

4.5.5 In particular, it is proposed that where a *JIB* wishes to classify an asset as *HQLA*, it should be able to show that it can either repo the asset or sell the asset without any undue barriers applying. The potential impact on capital of a sale could be such a barrier, hence it is proposed to require that if designation relies on the ability to sell an asset then it must be held at fair-value, in order to minimise the risk of loss on sale. This does not mean that such assets must be held in a Trading Book but it is anticipated that *JIBs* will give due consideration to such designation when considering how to manage the risk relating to the revaluation of *HQLA.*

4.5.6 The *HQLA* criteria are particularly onerous for jurisdictions where the available securities do not meet the eligibility criteria. This is not considered to be the case for any *JIB* nor is this considered to be an issue for any jurisdiction in which a *JIB* currently has a branch. However, relevant provisions from the *LCR Standard* will be implemented to enable adjustments to be made in the case that a branch operated in a jurisdiction where the local supervisor determined that such circumstances applied (see **Appendix B**).

4.5.7 The *CRR* definitions are generally less tight and include covered bonds in Tier 1, low rated government securities and a wider range of asset backed securities. No *JIB* currently relies on such assets to provide liquidity locally. (The *EU's* implementation appears in a number of aspects to go against the official advice provided publically by the *EBA*).

4.5.8 It is concluded that there is no necessity or clear basis for such a divergence locally and *JIBs* should therefore be aware that the local implementation is more conservative than that required by the *CRR*.

4.5.9 Nevertheless, the use of the international standard definition of *HQLA* should aid group reporting for all *JIB* banks as assets should be eligible *HQLA* at group level, and hence useful in meeting consolidated liquidity in all cases.

4.5.10 **Question 3: Do you consider that there are appropriate additional measures to those outlined in Section 4.5 that could mitigate the impact of the proposals for HQLA? If so, please outline them, together with a brief assessment of pros and cons.**

4.6 Status of the LCR

4.6.1 The *Basel Committee* emphasised that it is intended that *HQLA* held would be available for use in a crisis. The wording in the *LCR Standard* is:

4.6.1.1 *"The Committee also reaffirms its view that, during periods of stress, it would be entirely appropriate for banks to use their stock of HQLA, thereby falling below the minimum. Supervisors will subsequently assess this situation and will give guidance on usability according to circumstances."*

4.6.2 It is proposed to adopt a similar position locally. Hence, the *LCR* (or *LMR*) will be established as a notification requirement in the *Banking Codes*, rather than an absolute minimum. *JIBs* would be required to calculate the ratio daily using approaches consistent with the prudential reporting guidance provided in the *HQLA* and *LCR/LMR* Guides (**Appendices B** and **C**) and immediately inform the JFSC of any actual or imminent breach of the 100% minimum, and would be expected to put forward plans to remedy it. The supervisory response would depend on the specific circumstances, and the nature and scale of the breach.

4.6.3 It is accepted that extraordinary circumstances may lead to breaches even outside times of widespread stress but a pattern of repeated breaches should be avoided.

4.7 Consolidated vs solo

4.7.1 For all *JIBs* currently registered, it is considered that the solo position (i.e. the liquidity position of the company on a standalone basis) is the most important at times of stress.

4.7.2 However, it may be considered necessary, on a case-by-case basis, to also consider the consolidated position (i.e. the liquidity position of the company and its sub-group of subsidiaries, measured on a consolidated basis, discounting flows within this sub-group) but only where the *JIB* itself has significant deposit-taking subsidiaries.

4.7.3 In these cases, it is proposed to require that the consolidated position of the *JIB* sub-group be subject to the same rules and reporting requirements as for the solo position. It is envisaged that this would be established as a condition of registration.

4.8 Self-assessment

4.8.1 It is proposed to require that self-assessment of liquidity be undertaken by *JIBs*. As part of this, *JIBs* will be required, via the *Banking Codes*, to consider the appropriateness of the minimum standards established in the *LCR*/*LMR* and document this within their *ICAAPs*. This would be subject to JFSC review as part of its review of the ICAAP – mirroring the Pillar 2 processes applicable currently for capital adequacy.

4.8.2 Where the percentages in the *LCR*/*LMR* are found to be insufficiently conservative, *JIBs* will be required to determine and use more conservative numbers (that lead to increased *HQLA* requirements). The *LCR Standard* will serve as a minimum and hence no adjustments will be permitted if a *JIB* considers a percentage to be inappropriate where this would lead to *HQLA* requirements being reduced.

4.8.3 The *JIB* should also consider if 100% is the most appropriate minimum ratio; it is possible that, following the review, a notification ratio could be set that is higher than 100%.

4.8.4 It is envisaged that any:

4.8.4.1 *JIB* specific outflow/inflow rates (above/below those set out in *the LCR Standard*);

4.8.4.2 *JIB* specific notification ratio; and

4.8.4.3 Other changes required as a result of the JFSC's review of a *JIB's ICAAP*

Would be established as a Condition of Registration.

4.8.5 The revised requirements would apply for internal monitoring and prudential reporting purposes, in place of those in the relevant Guides.

4.8.6 A revised *Pillar 2 Guidance Note* will be published in due course. **Section 6** provides an outline of the principles that will be established.

4.9 Transition

4.9.1 Before 2019, the *LCR Standard* allows banks to hold only a proportion of the *HQLA* required by the calculation.

4.9.2 There does not appear to be sufficient benefit locally from such a phased approach.

4.9.3 Instead, the proposal is to introduce the new approach for the quarter period ending December 2018 (at 100%). It is envisaged that parallel reporting will be enabled for the period ending September 2018.

4.9.4 The exact timing of this switch may be affected by practicalities such as the development of revised reporting systems but will not be made mandatory for any earlier date than December 2018 (earlier parallel testing may occur on a voluntary basis, to the extent practical).

4.9.5 *JIBs* will be required to fully assess the appropriateness of all the parameters used for the purpose of calculating their *LCR* in their 2019 *ICAAPs*.

4.9.6 Prior to the assessment of these *ICAAPs*, and subject to prior agreement from the JFSC**,** it is proposed to allow *JIBs* to use existing *LBAs* (those relating to 1 month outflows) as a basis for deriving percentage outflows for the *LCR* in 2018 and throughout 2019 provided that:

4.9.6.1 They can provide a mapping of *LBAs* to the *LCR* categories; and

4.9.6.2 They apply the relevant minima.

4.9.7 For example, if a *JIB* had an *LBA* for all deposits that was demonstrated to be equivalent to a 30% outflow rate under the *LCR*, it could use this rate for retail deposits, (sticky and non-sticky) as lower rates are permitted in the *LCR* but would use the *LCR* minimum of 100% for deposits from banks, this being the minimum permitted.

4.9.8 Where no such mapping is agreed, *JIBs* will be required to either:

4.9.8.1 Provide full coverage in their 2018 *ICAAP*; or

4.9.8.2 Use the most conservative rates applicable in all cases (100% outflow rates for all deposits maturing within one month).

4.9.9 In respect of *HQLA,* it is proposed to permit *JIBs* to recognise marketable assets as *HQLA* until the end of 2019, provided that they meet established group criteria for the recognition as *HQLA* for group *LCR* reporting purposes, without needing to demonstrate that all the JFSC's requirements are met.

4.9.10 For the *JIB's* 2019 ICAAP, the *JIB's* assessment, and the JFSC'*s* review and resultant feedback provided to the *JIB,* will be based solely on the requirements set out in the *HQLA* Guide (**Appendix B**).

4.9.11 The intended result will therefore be that, by the end of 2019, an *ICAAP* will have been provided that includes a full assessment of all aspects of liquidity, so that in 2020 and later years all aspects have been fully assessed by the *JIB* and reviewed by the JFSC.

4.9.12 Section 6 provides further details on what should be assessed and how this will be implemented through changes to the *Banking Codes* and *the Pillar 2 Guidance Note*.

4.9.13 **Question 4: Do you consider the transitional approach is appropriate? Are there any particular measures that would ease transition?**

4.10 Implementation: Amendments to the *Banking Codes*

4.10.1 In accordance with the preceding parts of **Section 4**, it is intended to amend the *Banking Codes*, which will involve changes to **Sections 5** and **6** of the *Banking Codes*, where the existing requirements concerning the Risk Asset Ratio will be expanded to also address the *LCR*.

4.10.2 **Appendix J** contains proposed relevant sections of the *Banking Codes*, which would replace those so numbered in the current *Banking Codes*. Where necessary, titles of sections are amended also, which is reflected in the text provided.

4.10.3 **Question 5: Do you consider the approach to implementation, including the proposed Banking Codes and Guides set out in the Appendices, is appropriate? Are there any specific changes that would ease implementation?**

5 Reporting

5.1 Introduction

5.1.1 The revised reporting requirements are intended to enable *Jersey Incorporated Banks* to report a comprehensive view of liquidity, including on:

5.1.1.1 The *JIB's* compliance with the *LCR*;

5.1.1.2 The level of its *NSFR*; and

5.1.1.3 Other data on the *JIB's* liquidity position.

5.1.2 For *Overseas Incorporated Banks*, the reporting requirements are less, being intended to provide an understanding of the *OIB's* liquidity and an understanding of the cashflows emanating from its Jersey branch.

5.1.3 **Question 6: Do you consider the approach to prudential reporting requirements set out in Section 5 is appropriate? Are there any specific changes that would ease implementation?**

5.2 JIB prudential reporting

5.2.1 It is envisaged that *JIB* prudential reporting will in total comprise seven sets of data, as set out below.

5.2.2 For **Appendices B** and **C**, respectively the '*HQLA Guide*' and the '*LCR/LMR Guide'*, the relevant appendix takes the form of a draft prudential reporting guide. These would be issued in due course as part of the implementation process, with the only likely amendments being to formatting or to reflect technical or administrative requirements regarding the submission process. The final guides will be issued at least three months prior to the commencement of parallel running (anticipated to be for the period ending September 2018) and may be revised before being issued in final form at least three months prior to becoming requirements (anticipated to be for the period ending December 2018).

5.2.3 **Appendix B,** describes the full reporting requirements relating to each component of *HQLA* and the calculation of total *HQLA* held, after all required adjustments. The guidance closely follows the international standard. This includes the establishment of provisions that could be used if insufficient liquid assets existed in a jurisdiction in which a *JIB* operated. It is not considered that these should be adopted, based on existing operations, and hence implementation of that aspect is only intended to ensure flexibility in case of changes.

5.2.4 **Appendix C,** describes the full reporting requirements relating to each component flow and the calculation of total net-flows and the resultant *LCR* or *LMR* ratio, after all required adjustments. The guidance is intended to follow the *LCR Standard* save for those aspects noted in **Section 4**.

5.2.5 **Appendices D** to **F** provide an outline of likely prudential guides for three areas that would support the consideration of short-term liquidity. The final guides will be issued as drafts at least three months prior to the commencement of parallel running and may be revised before being issued in final form at least three months prior to becoming requirements.

5.2.6 **Appendix D**, the 'Funding Concentrations Guide', addresses the reporting of funding concentrations, replacing the current reporting regarding large deposits from individuals and banks.

5.2.7 **Appendix E**, 'HQLA Concentration and Encumbrance Guide', addresses the reporting of concentrations regarding HQLA and the extent to which any assets reported as HQLA are encumbered.

5.2.8 **Appendix F**, 'LCR/LMR Performance Guide', addresses the reporting of the *JIB's LCR/LMR,* as per internal monitoring performed daily by the *JIB*, for the period between the last prudential return reporting date and the current prudential return reporting date.

5.2.9 **Appendices G** and **H** provide an outline of likely prudential guides for two areas that would support the consideration of long-term liquidity (to be issued in accordance with the process outlined at **5.2.5**).

5.2.10 **Appendix G**, 'NSFR Guide', addresses the reporting of the *JIB's NSFR* as at the prudential return reporting date, based on the *NSFR Standard*.

5.2.11 **Appendix H**, 'Cashflow Reporting Guide', addresses the reporting of the *JIB's* cashflows, using the current prudential report as a basis, with little change to the periods specified for which inflows and outflows are required to be reported but with a degree of alignment with the categories used in the *LCR*/*LMR*.

5.3 OIB prudential reporting

5.3.1 As noted in the introduction, it is not intended to require *OIBs* to comply with local prudential regulations regarding liquidity. Notwithstanding this, it is anticipated that most such banks will become subject to *LCR*-like requirements in their home jurisdiction, or are already subject to such requirements, owing to home country adoption of the *LCR Standard*.

5.3.2 It is not intended to implement this change until December 2018, with a parallel run intended for September 2018. This would provide *OIBs* with an opportunity to test their reporting systems and for the JFSC to identify any systems issues ahead of the live date.

5.3.3 The requirements are intended to insure that the JFSC:

5.3.3.1 Is aware of the liquidity of the *OIB* (as a whole); and

5.3.3.2 Understands the branch's cashflows and the extent to which any *HQLA* is held locally.

5.3.4 **Appendix I** provides an outline of a likely prudential guide addressing both aspects, with the requirements consisting of:

5.3.4.1 For *OIBs*' subject to an *LCR*-like requirement in the home jurisdiction: the level of *HQLA*, net predicted outflows, the resultant *LCR* and the pass rate set by the supervisor;

5.3.4.2 For *OIBs*' subject to an *NSFR*-like requirement in the home jurisdiction: the level of *ASF*, *RSF*, the resultant *NSFR* and the pass rate set by the supervisor;

5.3.4.3 For *OIBs*' subject to other liquidity requirements in the home jurisdiction: relevant local metrics will be required to be reported. For each, the name of the metric, the measurement and up to three supporting pieces of data, will be required to be reported. In the period prior to implementation, agreement will be sought on an individual basis regarding which metrics to report, which it is intended to specify as a condition of registration; and

5.3.4.4 A cashflow report on the *OIB's* Jersey branch only. This is intended to provide an understanding of flows through the branch and in particular of the possible extent of demands that might arise. (The limitations are recognised: this is not intended to provide a picture of the extent to which the *OIB* is positioned to meet such demands or the likely extent of similar demands across the *OIB* that might occur in a stressed period). This is based on the similar existing prudential report on cashflows.

6 Internal Liquidity Assessment

6.1 Introduction

6.1.1 This section is only relevant to *JIBs*.

6.1.2 The proposed new process is intended to replace the current liquidity behavioural adjustment processes.

6.1.3 It is proposed to integrate internal assessment and supervisory review within the existing Pillar 2 processes. Hence, each *JIB's* assessment will be subject to at least an annual review.

6.1.4 The goal of the assessment will be to determine if adjustments in the *LCR* are appropriate to the *JIB* or, conversely, more conservatism is warranted.

6.1.5 Documentation will be required in *ICAAPs* and the *Pillar 2 Guidance Note* will be revised to reflect this content.

6.1.6 **Question 7: Do the proposals outlined in Section 6 provide sufficient clarity on expectations regarding internal liquidity assessment? Conversely, which aspects would it be useful to expand upon in the envisaged Pillar 2 Guidance Note?**

6.1.7 **Question 8: Do you disagree with any of the proposals outlined in Section 6? If so, please outline your rationale and provide an alternative that you consider to be appropriate?**

6.2 Historical data

6.2.1 Historical data should be collected to assist:

6.2.1.1 In determining how to classify assets for *HQLA* purposes (prices and depth of market data);

6.2.1.2 In determining whether *LCR* adjustments regarding flow assumptions are prudent (outflows and inflows, including in relation to commitments); and

6.2.1.3 Carrying out general stress testing of liquidity.

6.2.2 *JIBs* should seek to obtain data relating to (1) a stressed period and (2) the past five years.

6.2.3 Where data is obtained via group or third parties (as is envisaged would apply in the case of data on *HQLA*), the *JIB* should assess the reliability of the source used.

6.2.4 Where data is limited, this should be taken into account when developing stress tests, warranting additional conservatism.

6.2.5 Specific relevant considerations are provided in **Sections 6.4** and **6.5**.

6.2.6 For individual classes of deposits, the methodology used by the bank for computing outflows over a 30 day period should be consistent with the following approach:

6.2.6.1 Establish on day one a set of deposits that fall within the definition for the class and determine the initial balance for each;

6.2.6.2 For that set of deposits, determine the final balances as at day 30;

6.2.6.3 Quantify the outflow for each deposit in the set by subtracting the final balance from the initial balance, with a zero outflow resulting where, for any deposit in the set, the final balance exceeds the initial balance. Sum these to give the total outflows for the set; and hence

6.2.6.4 The historical outflow percentage for that period would then be the total of all outflows divided by the total of all initial balances.

6.2.7 Where the class includes multiple deposits from individual customers, these calculations may be applied on an aggregated basis for each customer, rather than account level (hence eliminating any impact of transfers between the customer's accounts).

6.2.8 *JIBs* may use other approaches, but:

6.2.8.1 If less conservative approaches or incomplete historical datasets (for example, ones that do not include a relevant period of stress or methods that in effect allow inflows to be recognised) are used, the *JIB* must consider the impact when developing stressed assumptions (see below); and

6.2.8.2 If more conservative and/or more complex approaches are used, the *JIB* should also compute results consistent with the above in order to assist the JFSC in comparing results across industry.

6.3 Stress testing

6.3.1 The *LCR Standard* explains that the *LCR* is intended to be a stressed assessment of a bank's ability to meet outflows out of a combination of HQLA held and offsetting inflows over a 30 day horizon if the following occurred at the same time:

6.3.1.1 *"The run-off of a proportion of retail deposits;*

6.3.1.2 *A partial loss of unsecured wholesale funding capacity;*

6.3.1.3 *A partial loss of secured, short-term financing with certain collateral and counterparties;*

6.3.1.4 *Additional contractual outflows that would arise from a downgrade in the bank's public credit rating by up to and including three notches, including collateral posting requirements;*

6.3.1.5 *Increases in market volatilities that impact the quality of collateral or potential future exposure of derivative positions and thus require larger collateral haircuts or additional collateral, or lead to other liquidity needs;*

6.3.1.6 *Unscheduled draws on committed but unused credit and liquidity facilities that the bank has provided to its clients; and*

6.3.1.7 *The potential need for the bank to buy back debt or honour non-contractual obligations in the interest of mitigating reputational risk."*

6.3.2 *JIBs* will need to be familiar with the *Sound Principles* and consider stress testing in this light.

6.3.3 The *LCR* is a minimum standard. *JIBs* will be required to determine if the minima set out in the LCR are appropriate to it through stress testing, and include documentation in the *ICAAP*. This will include assessment based on historical data as a baseline upon which assessment of potential impacts of one or more stressed scenarios should be performed, including scenarios where the *JIB* itself and/or its parent are downgraded by 3 notches during a financial crisis.

6.3.4 These stress scenarios should take into account the extent to which the historical data is relevant to a stressed period. In most cases, it is anticipated that stressed assumptions would significantly exceed any historical movements seen in the last five years, as many financial crises impacts pre-date this. Also, in many cases, data available to *JIBs* on periods where there was a financial crisis of the nature envisaged does not reflect a scenario where the *JIB* or its group was subject to a three notch downgrade.

6.3.5 *JIBs* will be required to document all stress testing performed to support liquidity management (not only that conducted to validate the *LCR*/*LMR*). Each stress scenario should assess whether the current level of liquidity is adequate and be used as part of the processes used to determine the appropriate framework of controls.

6.3.6 Such stress testing should include stresses that cover longer and shorter periods than specified in the *LCR*, for each currency in which they operate, and for each jurisdiction in which they have a branch. This will require the construction of a range of scenarios that are relevant to their specific business activities. The JFSC will not be prescriptive regarding the scope but will provide guidance on expectations and will review the scope when reviewing each *ICAAP*.

6.3.7 *JIBs* should document all stress testing in their *ICAAPs* and will be required to determine the appropriateness of minima for outflows in the *LCR*. Where a minimum is found to be insufficiently conservative, a prudent level should be determined, consistent with stress test results.

6.3.8 They will also be required to document the measures that they consider to be necessary to address other liquidity risks identified, including the use of other ratios (such as the *NSFR* or similar ratios) and appropriate minima for these.

6.4 What must be considered: HQLA

6.4.1 *JIBs* will be required to document:

6.4.1.1 The *JIB's* processes for ensuring that all *HQLA* is compliant with the general and operational requirements set out in **Appendix B;**

6.4.1.2 Where testing of historical data is required, the activity undertaken and the results; and

6.4.1.3 Evidence relating to testing of the operational processes (sale and repo) relied upon for the realisation of *HQLA*.

6.4.2 The *JIB* should document its policy on diversification. This should include the establishment of limits for holdings, taking into account both the dangers of over-reliance on single names but also the depth of markets for types of holdings and industrial and geographical concentrations.

6.4.3 In particular, a zero limit should apply where the *JIB* has not considered that such assets are to form part of its *HQLA* and hence has not specifically assessed whether all the requirements are met. This might apply where assets are purchased for investment purposes that would otherwise be eligible for inclusion, including all assets that the *JIB* intends to hold to maturity.

6.5 What must be considered: Deposit outflows and other flows

6.5.1 In two areas, *JIBs* will be permitted to use the *LCR* adjustments unless available historical data or other evidence available clearly evidences the need for a more conservative approach. These are:

6.5.1.1 Stable retail deposits and

6.5.1.2 Outflows connected with committed facilities.

6.5.2 For all other areas, *JIBs* should determine the likely behaviour in a stressed scenario of the nature described in the *LCR Standard* (as outlined in **Section 6.3**), taking into account historical data and all relevant information on likely behaviour in a stressed period, including any relevant information from group or third party sources.

6.5.3 For these categories, the *LCR* percentages serve as a maximum/minimum only, as applicable, and should not be relied upon to form the basis of a conclusion. Where no conclusion is reached, the most conservative outcome (100% outflow/0% inflow) should be used.

6.5.4 When considering liabilities that are fixed term, liabilities with short terms (one month or less) and longer term liabilities with break clauses[1] can be grouped together with on-demand liabilities when analysing historical data.

[1] A break clause that is subject to the *JIB's* discretion should be disregarded, as should a break clause where the client would suffer a penalty significantly greater than loss of interest.

6.5.5 For longer term liabilities other than liabilities with break clauses, the assessment of historical data should seek to compare the *contractual amount due* with the actual outflow. This is necessary as only outflows that are contractually due within one month will be included in the LCR.

6.5.6 As an example of this, if data on one year term accounts showed a maximum outflow rate of 10% in any one month period then this needs to be compared to the amount contractually due for the relevant period in order to determine if an adjustment is warranted.

6.5.7 In the absence of relevant data, term deposits should either:

6.5.7.1 Be given a 100% outflow rate, with the predicted amount being determined as the amount contractually due; or

6.5.7.2 Treated in line with other shorter term deposits, in which case all such deposits must be included in the LCR outflows, irrespective of the maturity date.

6.5.8 All relevant related considerations should be documented in the *JIB's ICAAP*.

6.5.9 The *JIB* should document its policy on addressing funding concentrations. This should include the establishment of limits for individual and connected parties, as well as other forms of concentration, such as reliance on particular sectors.

6.5.10 In all cases, no adjustment should be applied (hence 100% of the contractually due amount should be covered) where the outflow in respect of one customer or connected customers (when aggregated) exceeds £20 million.

7 Basel III Implementation Update

7.1 Introduction

7.1.1 The *Capital Elements DP* outlined the scope *of Basel III*, setting out the large number of new and revised standards and other documents issued by the *Basel Committee* at that time and expected to be issued on certain subjects in future years.

7.1.2 At that time, the most locally impactful changes (concerning credit risk and operational risk) had not been finalised, nor had potentially impactful changes regarding capital floors.

7.1.3 Since then, the anticipated deadline for concluding work on these changes has passed, with the Basel Committee stating in its press release on 3 January 2017[2]:

7.1.3.1 "*The Group of Central Bank Governors and Heads of Supervision (GHOS), the oversight body of the Basel Committee on Banking Supervision, welcomes the progress made towards completing the Basel Committee's post-crisis regulatory reforms.*

7.1.3.2 *However, more time is needed to finalise some work, including ensuring the framework's final calibration, before the GHOS can review the package of proposals. A meeting of the GHOS, originally planned for early January, has therefore been postponed. The Committee is expected to complete this work in the near future*."

7.1.4 Thus uncertainty remains and, as such, it is not possible to outline in detail all the JFSC's plans regarding implementation. The below sets out the next steps and an outline of plans for implementation of other areas, building on the approach outlined in the *Capital Elements DP*.

7.2 Elements to be introduced in 2018, based on this and prior consultation

7.2.1 For prudential reporting as at end of December 2018, and for internal capital adequacy and liquidity management and reporting purposes from 31 December 2018, it is intended to have implemented the changes set out in this paper and those set out in CP No. 8 2015 "*Basel III: Capital Adequacy and Leverage*", issued July 2015, regarding:

7.2.1.1 Revised capital quality requirements and the division of capital into three tiers, each with its own minimum ratio;

7.2.1.2 Implementation of changes to liquidity management and reporting requirements relating to the establishment of a new minimum *LCR*;

7.2.1.3 Associated changes to prudential reporting in relation to both of the above;

[2] http://www.bis.org/press/p170103.htm

7.2.1.4 The use of *Tier 1 capital* for *Large Exposures* purposes, in place of total capital; and

7.2.1.5 A requirement to report a *leverage ratio* and the *NSFR* on a quarterly basis, as part of prudential reporting.

7.2.2 These will be achieved through amendments to the *Banking Codes* together with the issuance of revised prudential reporting guidance and revisions to the *Pillar 2 Guidance Note*.

7.3 Consultations planned for 2017

7.3.1 It is intended to consult on the implementation of other new and revised Basel standards in 2017, building on the plans for 2017 set out in the *Capital Elements DP*.

7.3.2 This will focus on securitisations and funds (**Section 3** in the *Capital Elements DP*) and provide a further update on other matters. Any changes will not be implemented before the proposals outlined in this paper and the consultation will seek feedback on the question of whether to implement the changes together or in stages.

7.3.3 It will also provide an opportunity to communicate initial thoughts on how to address other areas, such as any new *Basel Committee* standards on credit and operational risk, ahead of full consultation in 2018 and beyond (see below).

7.4 Areas that will be consulted on in 2018 and beyond

7.4.1 In the most impactful areas (credit and operational risk), there is considerable uncertainty regarding the development of international standards at this time and also over the likely timescales for adoption in key jurisdictions (broadly, home jurisdictions and competitor jurisdictions).

7.4.2 Although it is considered likely that more new standards will be published in 2017, it is intended to delay consideration of these at least until 2018 to enable information on *Basel Committee* specified adoption timescales to become known and for banking groups to develop views on implementation.

7.4.3 As part of the work on credit risk, it will also be necessary to consider anew the permission for use of advanced modelling approaches and the expected limitations arising out of standards being developed by the *Basel Committee* on capital floors (for more details, see the December 2014 *Basel Committee* consultation paper on this[3]).

7.4.4 In that respect, it is anticipated that the core of the existing approach will be unaltered:

7.4.4.1 Continued reliance on home supervisor approval of models, given the lack of local capacity;

[3] http://www.bis.org/bcbs/publ/d306.htm

7.4.4.2 A requirement that the entity's *ICAAP* fully addressing the risk, including any relevant stress testing; and

7.4.4.3 A requirement that outputs be adequate for the Commission's assessment purposes.

7.4.5 Consideration will be given to two issues that arise because local application will be to a subsidiary rather than on a consolidated basis (the intended scope for the *Basel Committee* standards). These are:

7.4.5.1 Permission for use of models for only a part of the asset book; and

7.4.5.2 Application of capital floors (whether under new or existing *Basel Committee* requirements for a floor to be established at 80% of the Basel I capital requirement) both in general and for cases where only a partial use permission is requested, with one option being to apply the capital floor to the relevant exposures covered by the partial use permission.

7.4.6 The Trading Book/market risk/counterparty credit risk proposals have been issued in final form by the *Basel Committee* and, partially at least, implemented in most home jurisdictions. Locally, the current level of relevant exposures are minimal and the proposals are complex and, for these reasons, consideration will be deferred to 2018 or beyond.

7.4.7 This will enable dialogue with firms on an individual basis to seek an understanding of likely plans that might lead to increased market/Trading Book exposures, including any linked to the management of *HQLA*.

7.4.8 One option likely to be considered would be to enable banks to use the existing rules for market risk if they have no Trading Book and provided market risk is minimal.

7.4.9 For *JIB's* that become exposed to more material Trading Book or market risk, one option would be to enable home country rules to be used provided that three criteria (similar to those applying to use of advanced approaches) were met:

7.4.9.1 The home country would need to have been subject to a peer review that found it to be compliant regarding market risk;

7.4.9.2 The *JIB's* implementation would need to include full consideration of all risks, which would be required to be documented in its *ICAAP*, including assessment and management of model risk; and

7.4.9.3 The *JIB* would need to be able to provide appropriate reporting, including summary information on the various components, which would be by way of a JFSC-specified template, and breakdown information, which it is anticipated would be by way of a *JIB*-specified template.

7.4.10 In each case or in combination, consultation papers will be issued (not before 2018) with the aim of providing at least one year's notice of any proposed changes.

7.5 Changes to Prudential Reporting

7.5.1 Prudential reporting will be amended to facilitate the submission of *Basel III* data but certain revisions may also be necessary to improve the functioning of related systems or to enable the *Basel III* data to be combined with existing *Basel II* related data items – an example being the need to combine existing *Basel II* measures of risk weighted assets with Basel III measures of capital in order to determine trends in risk asset ratios.

7.5.2 As part of this process, existing prudential reporting requirements will be either continued or, in the short term, replaced on a like-for-like basis (in data terms) with a system that combines existing (*Basel II*) and new (*Basel III*) elements, at least until such time as all the relevant *Basel III* components are implemented in Jersey.

7.5.3 It is intended that in, all cases, copies of revised guidance will be provided in draft form at least six months prior to the date of first use, and published in final form at least three months prior to use.

7.5.4 Here "use" refers to submissions for the purpose of meeting *Banking Codes* requirements; it is anticipated that, in many cases, parallel running or other testing would take place on a voluntary basis before final versions are issued in order to allow issues to be addressed.

8 Cost Benefit Analysis

8.1 Costs to industry

8.1.1 The direct liquidity related costs of the introduction of the *LCR* are expected to be limited because:

8.1.1.1 the expected impact on liquidity requirements is small or, in the case of *HQLA*, can be alleviated by replacing affected instruments or, in the case of fiduciary deposits, can be minimised through management action (as suggested herein); and

8.1.1.2 The overwhelming majority of *JIBs* and *OIBs* are part of groups that are, or will be, subject to similar liquidity standards.

8.1.2 The internal liquidity assessment proposals build on and replace existing guidance with respect to liquidity or the Pillar 2 process. Whilst changes are required, it is considered that sufficient time has been provided in order to adequately manage the operational impact of these changes.

8.1.3 Revised prudential reporting, set out in **Section 5,** and in respect of liquidity is expected to impact mainly on *JIBs*, with the impact on *OIBs* being minimal. Delaying implementation to 2018 is intended to ease this process and enable costs to be contained.

8.2 Costs to the JFSC

8.2.1 The JFSC will need to substantially revise its prudential reporting system and the processes and systems used to analyse the data submitted, as well as train the relevant staff. Delaying implementation to 2018 will ease this process and enable costs to be contained and delivery to take place as a piece of a wider project looking at data delivery, with the aim of minimising the costs of the complete package of work intended.

8.3 Benefits to industry

8.3.1 Industry benefits indirectly from demonstrable compliance with international standards, reinforcing Jersey's reputation, and that of its banking industry, as a safe, well-regulated home for deposits. Specifically, compliance should assist in securing a positive outcome from any relevant future international assessment of Jersey.

8.3.2 Enhancing liquidity standards reduces the likelihood of bank failures. This benefits banks, through guarding against the consequences of a failure.

8.4 Benefits to the JFSC

8.4.1 The JFSC does not consider liquidity to currently be a significant issue in respect of any *JIB* or *OIB*. However, introducing these proposals guards against the risk that liquidity deteriorates over time, for example through over-reliance on marketable assets.

8.4.2 Completing the work as part of the larger change project is intended to minimise costs, particularly surrounding maintenance, and ensure that sufficient flexibility is delivered to enable future changes to be delivered.

8.4.3 **Question 9: Are there any specific measures that should be considered that would either increase the benefits of the proposals or reduce any of the associated costs of implementation?**

9 Summary of Questions

9.1 Questions

Reference	Question
4.3.9	**Question 1**: Do you consider that the proposals regarding fiduciary deposits would be likely to give rise to a loss of business or profitability? If so, are there appropriate additional measures that could mitigate the impact of these proposals? If so, please outline them, together with a brief assessment of pros and cons and provide relevant evidence.
4.4.6	**Question 2:** Do you consider that there are appropriate additional measures to those outlined in Section 4.4 that could mitigate the impact of these proposals? If so, please outline them, together with a brief assessment of pros and cons.
4.5.10	**Question 3:** Do you consider that there are appropriate additional measures to those outlined in Section 4.5 that could mitigate the impact of the proposals for HQLA? If so, please outline them, together with a brief assessment of pros and cons.
4.9.13	**Question 4:** Do you consider the transitional approach is appropriate? Are there any particular measures that would ease transition?
4.10.3	**Question 5:** Do you consider the approach to implementation, including the proposed Banking Codes and Guides set out in the Appendices, is appropriate? Are there any specific changes that would ease implementation?
5.1.3	**Question 6:** Do you consider the approach to prudential reporting requirements set out in Section 5 is appropriate? Are there any specific changes that would ease implementation?
6.1.6	**Question 7**: Do the proposals outlined in Section 6 provide sufficient clarity on expectations regarding internal liquidity assessment? Conversely, which aspects would it be useful to expand upon in the envisaged Pillar 2 Guidance Note?
6.1.7	**Question 8**: Do you disagree with any of the proposals outlined in Section 6? If so, please outline your rationale and provide an alternative that you consider to be appropriate?
8.4.3	**Question 9:** Are there any specific measures that should be considered that would either increase the benefits of the proposals or reduce any of the associated costs of implementation?

Appendix A

List of representative bodies and other persons who will be sent this consultation paper

- Jersey Bankers' Association
- Jersey Finance Limited

Appendices B to J

Drafts of proposed new and varied requirements

Appendices B and C: LCR requirements and reporting

- Please click here to view **Appendix B: HQLA Guide**
- Please click here to view **Appendix C: LCR/LMR Guide**

Appendices D to F: supporting data for the LCR

- Please click here to view **Appendix D: Funding Concentration Guide**
- Please click here to view **Appendix E: HQLA Concentration and Encumbrance Guide**
- Please click here to view **Appendix F: LCR Performance Guide**

Appendices G and H: liquidity backdrop

- Please click here to view **Appendix G: NSFR Guide**
- Please click here to view **Appendix H: Cashflow Reporting Guide**

Appendix I: OIB Reporting Guide

- Please click here to view **Appendix I: Overseas Incorporated Bank Reporting Guide**

Appendix J: Changes to the Banking Codes

- Please click here to view **Appendix J: Changes to the Banking Code**