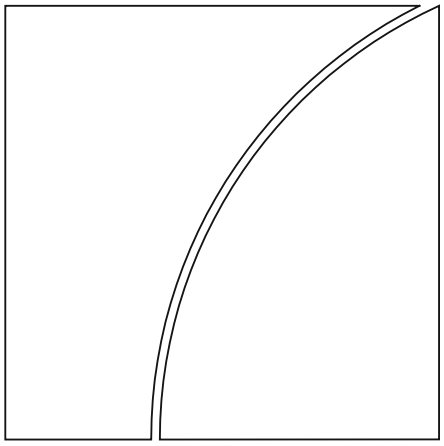
Basel Committee
on Banking Supervision



The 2023 banking turmoil and liquidity risk: a progress report

A report to G20 Finance Ministers and Central Bank Governors

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Introduction

The banking turmoil of March-May 2023 was the most significant system-wide banking stress since the Great Financial Crisis in terms of scale and scope. Over the span of 11 days – from 8 to 19 March 2023 – four banks with total assets of about $900 billion were shut down, put into receivership or rescued. Subsequently, a bank with roughly $230 billion of assets was closed on 1 May 2023. The bank failures, while having largely distinct causes, triggered a broader crisis of confidence in the resilience of banks and banking systems across multiple jurisdictions. In response, wide-scale public support measures were deployed by some jurisdictions to mitigate the impact of the stress, including significant central bank liquidity provision to banks, the activation of FX swap lines, government backstops / guarantees, and, in certain cases, an extension of deposit guarantee schemes.

Against that backdrop, the Committee undertook a stocktake of the regulatory and supervisory implications of the turmoil. It published its assessment and initial lessons learnt in October 2023.[1] It noted that it would pursue a series of follow-up initiatives related to the turmoil, including:

- prioritising work to strengthen supervisory effectiveness and identify issues that could merit additional guidance at a global level; and
- pursuing additional follow-up analytical work based on empirical evidence to assess whether specific features of the Basel Framework performed as intended during the turmoil, such as liquidity risk and interest rate risk in the banking book, and assessing the need to explore policy options over the medium-term.

This follow-up work is fully in line with the imperative and near-term priority of implementing the Basel III standards in a full and consistent manner, and as soon as possible, as recently reaffirmed by the GHOS.[2]

As requested by the Brazilian G20 Presidency, this progress report updates the G20 Finance Ministers and Central Bank Governors on the Committee's follow-up work, with a particular focus on work related to liquidity risk. Section 1 reviews the main findings on liquidity risk as set out in the Committee's October 2023 report. Section 2 provides a high-level summary of the additional analytical work by the Committee on liquidity risk dynamics during the turmoil. Section 3 concludes and sets out the planned next steps by the Committee. The annex summarises the rationale and objectives of the Basel III liquidity standards.

1 BCBS (2023b).

2 BCBS (2024).

Section 1: Summary of initial lessons learnt on liquidity risk

The Committee's stocktake report of October 2023 outlined several initial lessons learnt with regard to the liquidity risk dynamics observed during the banking turmoil. This section reviews these findings.

Liquidity supervision may need to evolve in light of recent experience

The Committee issued supervisory principles for managing liquidity risk in 2008 and found that they remain fit for purpose in 2019.[3] Nevertheless, the 2023 banking turmoil highlighted clear challenges in overseeing banks' liquidity risk. These challenges related to: the speed and volume of deposit outflows and changes in banks' funding profile (eg see Box A); the importance of banks being operationally prepared for liquidity stress scenarios (eg by having credible and tested contingency funding plans, operational readiness to access central bank liquidity facilities, etc); and the role of social media and the digitalisation of financing in hastening the speed and impact of a bank's distress.[4]

These developments, in turn prompt considerations for supervisors around whether:

- their monitoring of bank, sectoral and market information, including the Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR) and liquidity supervisory review processes (which rely on liquidity monitoring metrics) provides the relevant information, in a timely manner, for them to identify when material liquidity outflows start to take place;
- the frequency of monitoring can be increased both during times of stress (for example to daily or even intra-day monitoring) and business as usual times (eg weekly liquidity monitoring), given possible negative signalling effects or other challenges of ramping-up reporting requirements in moments of stress;
- monitoring can leverage on different sources of information and high-frequency data, complementing the normal supervisory reporting;
- monitoring of concentration risks is warranted, and ways to implement it;
- the specific features of the bank's business model or asset/liability structure are adequately taken into account, both by the bank and by the supervisor;
- liquidity can be expected to be freely transferable and available to the consolidated level of banking groups in times of stress;
- the liquidity stress testing conducted by banks (including their ability to monetise liquid assets and potential interactions with other risks and capital as well as increased intraday needs) and their contingency funding plans (including the use of emergency facilities at the central bank where available) are sufficiently robust;
- bank stress testing is (or could be) supplemented by supervisory stress testing of liquidity; and

[3] BCBS (2008, 2019).

[4] Advances in the digitalisation of finance – including faster payment / settlement services and on-demand access to banking services through mobile apps – are removing many of the frictions that may have previously slowed down the magnitude of liquidity outflows (in some jurisdictions, limits on the amount of online credit transfers have been introduced by banks in response to digital fraud incidents, which may potentially reduce the speed and magnitude of outflows). Second, the proliferation and prevalence of a wide range of social media channels – including public platforms, encrypted messaging channels, internal corporate messaging services and specialist forums – are accelerating the spread of (founded or unfounded) concerns about banks' viability and uninsured depositors' fear about incurring losses in the event of resolution.

- they have sufficient tools to ensure banks take appropriate action to remediate supervisory concerns with respect to their liquidity risk management and funding profile and that the tools can be deployed sufficiently quickly.

The importance of monitoring and managing risks for internationally active banks and at a consolidated group and legal entity level

The Basel Framework applies on a consolidated basis to internationally active banks. It does not define the concept of internationally active banks. Jurisdictions have full responsibility in deciding on the scope of banks beyond internationally active ones and have opted for different approaches in implementing Basel III. Regardless of the approach pursued by each jurisdiction, the Basel Core Principles set out a general principle that banks should be subject to supervision commensurate to their risk profile and systemic importance.

As the 2023 banking turmoil events have shown, however, the failure of a bank can have systemic implications through multiple channels, including first- and second- round propagation effects. For example, the distress of relatively small banks (which are not subject to the full Basel III Framework) can trigger broader and cross-border systemic concerns and contagion effects.

Additionally, the Basel Framework relies on a consolidated level approach but recognises the importance of monitoring the distributions of resources among legal entities. This is particularly important, for example, in the context of liquidity risk where appropriate and efficient allocation and management of liquidity resources and collateral at group level to individual entities within the group is a key factor. Since the distribution of resources could either alleviate local liquidity pressures or spread them throughout the group, it is necessary to closely monitor this aspect.

A key takeaway from the 2023 banking turmoil – most notably regarding the distress of Credit Suisse (CS) – is therefore the importance of supervisors monitoring risk dynamics throughout the group (including at an individual entity level and/or at a relevant sub-group level), and ensuring that bank risk management is also doing this appropriately, in order to have a comprehensive view of the group's / entity's exposures. Supervisors should also take into account possible limitations to the free transferability of capital and liquidity resources within banking groups that may arise (eg from national laws, supervisory approaches or banks' internal managerial practices), as these can limit or restrict actions by banks or supervisors in stress.

Liquidity standards

All of the distressed banks during the 2023 banking turmoil experienced a series of liquidity shocks. Even though many of these banks were not subject to Basel III, the turmoil raised questions about the design and calibration of the Basel III liquidity standards.

On the one hand, the experience with CS at an entity level raises doubts about the operationalisation of the high-quality liquid assets (HQLA) buffer needed to meet LCR requirements. A large part of CS' HQLA held to meet its minimum LCR requirement was reserved for purposes other than to cover the outflows in a 30-day stress scenario as foreseen in the LCR framework. For example, CS set aside HQLA to cover daily operational and intraday liquidity needs. This raises issues about the design and operationalisation of liquidity requirements. The amended Swiss Liquidity Ordinance, which entered into force on 1 July 2022, allows FINMA to impose institution-specific surcharges, in particular for intraday liquidity needs. The affected banks have been subject to new requirements since the beginning of 2024.

Supervisory and market scrutiny were considered by CS as an impediment to the use of its LCR buffer. CS was of the view that "breaches" of Pillar 1 or Pillar 2 liquidity requirements needed to be communicated to comply with ad hoc disclosure requirements, which in turn may have affected its willingness to draw down the LCR buffer in a manner as envisaged in the LCR standard.

A related issue is the calibration of the LCR. In the case of CS, during a severe stress event, a large part of its Pillar 1 LCR requirement was needed to cover daily operational/intraday liquidity needs – which are not covered by the LCR – instead of potential outflows over the envisaged 30-day horizon, which raises questions about the design of the LCR, including the scope of risks captured. In a similar vein, the speed and scale of deposit outflows for the distressed banks suggests that banks may not always be able to rely on an extended (eg 30-day) window of time to address their liquidity problems. As such, while acknowledging that the LCR/NSFR cannot prevent all runs and must be complemented by other tools, the turmoil calls into question the scope of risks covered by the LCR (eg intraday liquidity risk, trapped liquidity and the necessity to preposition liquidity to cover for operational needs) and the outflows rates currently assumed in the LCR. It also underlined the importance for banks and supervisors to monitor and manage liquidity risks robustly. Put differently, greater focus could be placed on the role of the LCR to "buy time" for banks and authorities to act in times of liquidity stress.

Another question raised by the turmoil is whether the NSFR performed its role as an indicator of banks' structural liquidity mismatch, particularly for banks that faced a "slower burn" liquidity stress. For example, the NSFR for CS increased from 126% in the third quarter of 2021 to 136% a year later – in contrast, the aggregate NSFR for European banks during this period remained flat at about 120% – before falling to 117% by the end of 2022.[5] CS never reported an NSFR below 100% during this period. As the NSFR was designed as a structural measure, the "available stable funding" factors of deposits were calibrated at levels that do not correspond with the outflow rates faced by CS (see box A).

The turmoil also raises questions about the role and frequency of standardised stress indicators to complement the analytical toolbox available to supervisors under Pillar 2. For example, to what extent should existing indicators be reported/disclosed on a more frequent basis? Is there added value in developing additional indicators, such as a bank's "five-day forward counterbalancing capacity" (ie their liquidity positions in five working days' time), survival period and/or a simple non-risk-based liquidity metric that does not rely on run-off assumptions (broadly analogues to the role of the leverage ratio in the capital framework) Another issue is whether liquidity standards should more clearly mitigate risks related to the accounting treatment of HQLA assets.

On the other hand, another perspective is that existing liquidity standards are adequate, and that the focus should be on their effective implementation. For example, the operational requirements for HQLA in the LCR standard already consider the issue of buffer availability at a consolidated level and note the potential of intraday liquidity needs. Moreover, there are already additional Pillar 2 liquidity metrics included in the LCR standard, including those related to funding concentration, maturity ladders and the monetisation of HQLA. This perspective suggests that recent events have demonstrated that the liquidity regulations alone cannot prevent all liquidity runs on banks in an age characterised by easy access to information as well as banking services via various digital tools.

A related issue is whether held-to-maturity (HTM) assets should be eligible as HQLA for the purpose of the LCR and NSFR. The LCR requires the stock of HQLA to be measured at an amount no greater than their current market value, which helps ensure that reported LCRs do not include unrealised losses in the valuation of the HQLA buffer. Nevertheless, this could potentially be an insufficient safeguard, since the LCR does not distinguish between the accounting classification of HQLA-eligible securities. As such, distressed banks that monetise HQLA held on an HTM basis in times of stress may still incur unrealised losses for capital purposes under the current definition of regulatory capital, which could further

[5] These numbers are derived from CS (2021, 2022) and BCBS (2023a).

exacerbate their solvency and liquidity problems. At the same time, it should be acknowledged that HTM assets could be monetised not only via outright sale but also via repo transactions. Therefore, banks could generate liquidity from such assets irrespective of their accounting classification without reporting a loss in financial statements.

Another perspective is that removing HQLA that are HTM for the purpose of the LCR and NSFR could have potentially far-reaching structural consequences for banks' balance sheets and business models, as it would lead to an increase in the volatility and procyclicality of prudential capital, not only in the event of unrealised capital losses but also in the event of unrealised capital gains. According to this view, other regulatory standards – such as the LCR and interest rate risk in the banking book standards – and supervisory measures may allow banks and supervisors to assess the unrealised capital losses of the securities resulting from changes in rates, regardless of the accounting classification of these securities. In addition, Pillar 3 disclosures of unrealised losses provide additional information that can help signal the accumulation of risks, although it may be relevant to review such disclosures to make sure they are sufficiently informative.

Box A[6]: Liquidity outflows of distressed banks – a historical comparison

Table A.1 summarises the outflow rates and associated time period of selected banks during the recent turmoil and the GFC based on public / readily-available data. A.1 compares these outflows with some of the outflow rates in the Liquidity Coverage Ratio (LCR).

Table A.1: Deposit outflow of distressed banks

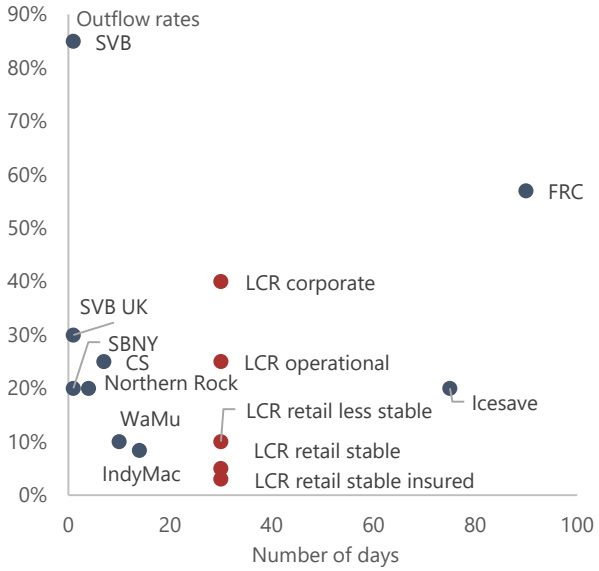
Bank	Deposit outflow	Number of days
SVB (2023)[(a)]	85%	2
FRC (2023)[(a)]	57%	90
SVB UK (2023)	30%	1
CS (2023)	25%	7
SBNY (2023)	20%	1
Icesave (2008)	20%	75
Northern Rock (2007)	20%	4
WaMu (2008)	10%	10
IndyMac (2008)	8%	14
LCR[(b)]	3% - 40%	30

Sources: FRB (2023), SNB Financial Stability Report (2024), NAO (2009), Rose (2015), Zeissler et al (2019), published accounts and Secretariat calculations.

(a) FRC deposit outflows excludes $30bn of deposits placed by banks during Q1 23. SVB outflows include expected outflows by management for 10 March.

(b) LCR outflow rates are the range for retail, SME, operational and corporate deposits.

Graph A.1: Distressed banks and LCR outflows[(a)]



Sources: FRB (2023), SNB Financial Stability Report (2024), NAO (2009), Rose (2015), Zeissler et al (2019) published accounts and Secretariat calculations.

(a) FRC deposit outflows excludes $30bn of deposits placed by banks during Q1 23. SVB outflows include expected outflows by management for 10 March.

A comparison among outflow rates of distressed banks based on publicly-available information is subject to a number of caveats. First, each bank's liquidity distress reflected idiosyncratic factors. In some instances, banks failed or were put into resolution, while other banks were rescued or acquired by other banks, before a 30-day period, making a direct comparison with LCR outflow rates difficult. Second, readily-available data on banks' liquidity outflows differ with regards to the time period covered; longer time ranges may not reflect the magnitude of outflows during the most acute phase of a stress and therefore some of the outflow rates above understate the magnitude of outflow rates during the most "acute" phase of some of the banks' distress. For example, FRC faced outflows of about 37% of its (end-2022) deposits over two business days in March. Third, publicly available data on these banks' deposit outflows is subject to definitional differences and may therefore not be directly comparable. And while retail/SME deposits are likely to have constituted an important share of liquidity outflows for these banks, in some instances other funding sources (eg corporate funding) may have also contributed to their liquidity distress. So banks' actual outflow rates (eg the blue dots in Graph A.1) would need to be compared with a weighted average of the relevant outflow rates of the LCR (eg the red dots) based on each bank's funding sources. Fourth, all of the banks discussed in this box, with the exception of CS, were not subject to the LCR. A counterfactual analysis would be needed to gauge whether these banks' liquidity risk profile would have differed in a world where they were subjected to the LCR.

[6] Box A reflects more recent publicly-available information following the publication of the Committee's initial report in October 2023 about CS' deposit outflows.

Section 2: Summary of additional analytical work

As part of its follow-up analytical work, the Committee assessed whether specific features of the Basel liquidity standards performed as intended during the turmoil. This section summarises the main takeaways.

While the evidence from the 2023 banking turmoil highlighted specific dynamics of liquidity risk for certain banks and some jurisdictions, it is challenging to draw more generalised conclusions given that: (i) the scale and scope of timely public support measures may have affected the subsequent crystallisation of liquidity risk; and (ii) the peak of the turmoil was limited to a few jurisdictions.

Distressed bank outflow rates

Evidence from failed banks in the US suggests that the stressed outflows of uninsured deposits were associated with deposit concentrations, idiosyncratic business models and unique balance sheet structures. Also, as the withdrawals were amplified by widespread access to digitalisation and social media, the scale and speed of the outflows far exceeded the levels assumed in either the LCR or NSFR, irrespective of these rules not being applied to the US banks that failed. Related to financial stability, these uninsured deposit outflows led to systemic considerations with knock-on impacts to other large US regional banks that had similarities in terms of their reliance on uninsured deposits, customer base and business risk profile.

The crisis at CS was the result of repeated incidents at the bank itself, primarily triggered by breaches of legal and supervisory obligations and shortcomings in risk management. These failings led to an increasingly critical assessment of the bank by its clients, market participants and rating agencies. In early October 2022 and in mid-March 2023, CS experienced two episodes with exceptionally large and rapid deposit outflows, significantly exceeding the assumptions of the LCR and NSFR for retail clients, especially uninsured high-value deposits. The analysis of the failure of CS also suggests that internationally active banks may face different stressed outflows in different locations. In particular, the observed outflow rates at the domestic business of CS were lower than the outflow rates of wealth management client balances observed at its international operations.

For purposes of measuring overall outflow speeds, the full potential of outflow rates in the US and Switzerland is difficult to gauge as immediate government interventions were taken at the onset of stress (and well before the LCR's 30-day time horizon elapsed), which served to mitigate outflows from the affected banks and contagion.

With respect to drivers, a surge in negative media coverage (including social media) and wide access to digital bank accounts were common risk drivers for the severe deposit outflows at the failed US banks and CS. These set in motion extraordinary outflows that occurred within concentrated funding sources. Specifically, the customer base of the failed US banks was concentrated in certain industries and the funding relied heavily on uninsured deposits, with a relatively elevated level of high net worth individuals as customers. While CS's funding structure was rather well diversified across retail and wholesale deposits as well as market funding, CS also had a higher concentration of high-value deposits from its wealth management clients compared to its peers. In both the US and CS cases, deposit outflows were substantially accelerated by effects of digitalisation and negative media coverage (including social media), resulting in a large fraction of these outflows occurring within just a few days.

Materiality of additional risk factors that are not covered by the LCR

Aside from risks covered by the LCR, additional liquidity needs materialised in the case of CS during the March 2023 turmoil. A large portion of the liquidity buffer was used to meet these additional needs and accordingly was not available to cover the outflows assumed in the LCR. Increased prepositioning

requirements were imposed by payment agents (mainly banks), central counterparties and clearing institutions to facilitate settlements. Some counterparties also increased collateral quality requirements. In addition, regulatory and supervisory HQLA requirements and expectations in other jurisdictions as well as CS's own liquidity management requirements at the entity level to ensure payment needs all added to the level of liquid assets that had to be held at the entity level. The increase of intraday requirements was another significant driver of CS' liquidity needs. During the stress period, incoming payments were delayed due to changes in the payment behaviour of counterparties. CS, however, wanted to maintain normal outgoing payments to avoid negative signalling to counterparties. The total increased liquidity needs which arose from these risk factors is estimated to account for almost 100% of the LCR net outflows for the operating parent bank, CS AG, during March 2023.

Outside of Switzerland, supervisors reported that no banks experienced additional liquidity needs similar to CS during the March 2023 turmoil. Some jurisdictions – including Switzerland – exclude prepositioned assets from the stock of HQLA. However, no member jurisdictions have additional outflow assumptions under Pillar 1 to cover possible procyclical increases in prepositioning requirements during times of stress. In a few cases Pillar 2 requirements are in place or foreseen to cover the issue. Intraday liquidity risk is addressed by a minority of jurisdictions and with different approaches.

The experience with CS also highlighted issues with the management of liquidity risk at a legal entity level. HQLA held by a legal entity to meet its local liquidity requirements, which cannot be transferred to other entities within the group ("trapped liquidity"), can nevertheless be included in the consolidated LCR under the LCR standard to the extent that such HQLA cover the total net cash flows of that entity. For CS, the uneven distribution of outflows across legal entities during the period of stress exacerbated issues with trapped liquidity, as it was not possible for the bank to extract liquidity from some entities which experienced lower actual outflows than assumed in the LCR scenario to counterbalance outflows in other entities exceeding the LCR scenario. Consequently, authorities assessed the availability of HQLA across the CS group mainly by monitoring the group's largest operating entities' standalone LCR and HQLA. Complex banking groups like CS in stress may face additional challenges to make use of their entire HQLA buffers of local entities when liquidity transfer within the group becomes necessary. Therefore, it is important for a bank, as is the case with CS and in accordance with the LCR standard, to fully understand the amount of HQLA that are truly transferable within the group under stress.

Impact of the accounting treatment and valuation of HQLA-eligible assets on their liquidity

In the LCR, HQLA is based on market value regardless of the accounting treatment. In addition, eligible HQLA is subject to operational requirements to ensure that banks can immediately use HQLA as a source of contingent funds at any time during the 30-day stress scenario. The LCR does not distinguish between outright sale and repo transactions as monetisation tools.

In principle, banks that hold fixed-income securities at amortised cost (AC) with a substantial amount of unrealised losses may refrain from selling them in a liquidity stress. This is because the sale of such assets will crystalise associated losses in their accounting statements, with a negative impact on bank capital. Under these circumstances, banks may be able to use repo transactions, on an interbank basis and/or with the jurisdiction's central bank, to generate liquidity without necessarily crystalising unrealised losses.

The experience of the US banks during the March 2023 turmoil highlighted, however, that private repo markets may become a less reliable option for monetising securities held at AC for distressed banks during idiosyncratic liquidity stress scenarios. Moreover, in such scenarios the repo market itself may stop functioning smoothly, which suggests it could be highly procyclical and an unreliable source of contingent liquidity in severe idiosyncratic and market stress scenarios. This raises questions as to whether HQLA held at AC can indeed be "repo-ed" through private markets in severe stress scenarios (particularly when such

securities have substantial unrealised losses). Under these specific circumstances, the central bank or other public sector counterparties may be the only viable monetisation channel for these assets, subject to haircuts applied by the central bank (which may not have been accounted for in the LCR-valuation, given the 0% haircut for Level 1 assets).

Furthermore, secured funding raised using liquidity buffer assets, could have a significantly higher funding rate (cost) than the prevailing rates on HQLA securities purchased in prior years. This "negative carry" is transparent to market participants through public financial disclosures, which could trigger additional liquidity stress. In the case of First Republic Bank (FRC), it undermined confidence in the ability of the bank to restructure its balance sheet and precipitated additional outflows.

HQLA held at fair value (FV), with gains and losses immediately realised through regulatory capital, can in principle be more easily monetised through an outright sale without adversely impacting capital upon sale and may therefore provide more flexibility for banks to recover from certain stress scenarios relative to HQLA held at AC, subject to banks' appetite or capacity for making this accounting choice. This form of HQLA would at a minimum not be susceptible to the problem of negative carry that was evident at FRC or the signaling risk of crystallising unrealised losses that occurred at Silicon Valley Bank (SVB. The difference in ease of monetisation between HQLA held at AC and FV may be smaller if banks have either appropriately managed the interest rate risk or otherwise have sufficient capital headroom to fully cover unrealised losses on securities held at AC.

Other identified impediments to the use of liquidity buffers

During the March 2023 stress, the lack of preparedness and operational capacity at some banks to quickly finance their securities via established access to secured financing channels or other types of contingent sources, such as central bank liquidity, impacted their ability to meet outflows. The US experience demonstrated that in part this reflected shortcomings in liquidity risk management and lack of an effective contingency funding plan, as well as challenging market conditions during stress. This lack of operational preparation for access to liquidity was a major driver of the difficulties that certain US banks had in responding to the recent turmoil.

The negative market impact of disclosures, other than those foreseen by the LCR standard, also played a role in the March 2023 stress for CS. While the LCR standard specifies a lagged disclosure of an average LCR, CS appeared to have had concerns about the impact of potential capital market-related ad hoc disclosures that would follow a breach of its regulatory requirements or the use of emergency liquidity assistance (ELA). With respect to the use of ELA, market participants could have possibly inferred the firm's usage of the facility from aggregate balance sheet positions in the Swiss National Bank's regular reporting with some time delay, which might have further deteriorated their confidence in the bank.

Use and role of existing supervisory monitoring tools and other stress indicators

The banking turmoil highlighted the importance of supervisory monitoring tools in addition to the LCR and NSFR in supervising liquidity risk. As far as the Basel liquidity monitoring tools are concerned, most have been implemented. While the granularity and frequency of implementation differ across jurisdictions, regulators have found the tools to be overall useful in both business-as-usual (BAU) and during the recent banking turmoil. Supervisors also use these tools to inform supervisory actions on banks, and in some cases, although less common, supervisors also use these tools to set Pillar 2 add-ons. The frequency and scope of reporting are important features to ensure its usefulness, as well as the ability to increase reporting frequency during stress.

As far as non-Basel liquidity monitoring tools are concerned, supervisors have highlighted around 30 tools which were deemed very helpful. While some of those tools partially collect information that is

similar or related to the information captured under the Basel Framework, the non-Basel monitoring tools are often being implemented to account for business models specificities and interrelated activities of financial institutions. In several cases, these tools provided for a comparably high reporting frequency, even during BAU, thus enabling supervisors to assess in a timely and systematic way changes in the liquidity and funding situation of banks at an early stage.

The assessment concludes that the Basel monitoring tools are generally fit for purpose provided they are properly implemented and extensively used to address vulnerabilities of banks. However, keeping in mind how these tools are implemented in some jurisdictions, it should be noted that the Basel monitoring tools could be even more effective where they: (a) are rigorously used by supervisors via the calculation of dedicated indicators; (b) are reported with a higher reporting frequency during BAU for institutions with a structural high-risk liquidity profile; (c) are additionally applied to individual entities of banking groups; (d) provide an overview of the accounting classification of HQLA and its monetisation; (e) provide more granularity on the concentration of funding, especially by category of deposits or by business activity; and (f) complement external market-related information and social media information.

Section 3: Follow-up initiatives

Drawing on the findings of this progress report, the Committee is continuing to pursue a series of follow-up initiatives related to the turmoil, including:

- prioritising work to strengthen supervisory effectiveness and identify issues that could merit additional guidance at a global level; and
- pursuing additional follow-up analytical work based on empirical evidence to assess whether specific features of the Basel Framework performed as intended during the turmoil, such as liquidity risk and interest rate risk in the banking book, and assessing the need to explore policy options over the medium-term.

This follow-up work is fully in line with the imperative of implementing the Basel III standards in a full and consistent manner, and as soon as possible.

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Annex: Rationale and objectives of Basel III liquidity standards

The Basel III Framework comprises two minimum standards for funding and liquidity, namely the LCR and NSFR, to achieve two separate but complementary objectives. The LCR aims to promote the short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient HQLA to survive a significant stress scenario lasting for 30 calendar days. It is expected to improve the banking sector's ability to absorb shocks arising from financial and economic stress thus reducing the risk of spillover from the financial sector to the real economy. The objective of the NSFR is to reduce funding risk over a longer time horizon by requiring banks to fund their activities with sufficiently stable sources of funding. It aims to reduce the likelihood that disruptions to a bank's regular sources of funding will erode its liquidity position in a way that would increase the risk of its failure and potentially lead to broader systemic stress.

Assets are considered as HQLA if they can be easily and immediately converted into cash at little or no loss of value and fulfil certain operational requirements (to ensure usability). During periods of stress, banks may use their stock of HQLA, thereby falling below the minimum requirement. Both the LCR and NSFR are comprised mainly of specific parameters, notably haircuts, outflow and inflow rates in the LCR and available stable funding and required stable funding factors in the NSFR.

The Basel III liquidity standards serve similar pre-emptive purposes as capital requirements by fostering and maintaining stress resilience of and confidence in banks to avoid negative repercussions from bank-specific difficulties resulting from market-wide or idiosyncratic stress events for the financial system. Therefore, they are geared towards absorbing a liquidity shock (crisis prevention) in the context of the specific stress events to which they are calibrated. In doing so, the calibration of the LCR and NSFR involve trade-offs between liquidity resiliency and the extent to which banks can engage in credit creation and intermediation. Hence, the standards do not intend to, and thus cannot be expected to, cover all stress events that might take place. They are designed to apply to the activities of internationally active banks in general, and not to address additional risks arising from specific activities or business models that could be developed by banks.

To further strengthen and promote global consistency in liquidity risk supervision, the Basel III Framework also includes a set of liquidity risk monitoring tools under the supervisory review process (Pillar 2). Those tools aim to measure other dimensions of a bank's liquidity and funding risk profile that are not captured by the LCR and NSFR, such as maturity mismatches beyond the time horizons of the LCR and NSFR, intraday liquidity needs and concentration risk.