Banking on Change

Actuaries Institute

16 September 2015 • Sydney

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Preparing for NSFR

Implementing regulatory change and optimising outcomes.

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Agenda

Introduction: system theory and liquidity.

Regional impacts of NSFR.

Optimising outcomes: liquidity and other regulatory change.

Managing and implementation.

New Liquidity and Funding Ratios

	Liquidity Coverage Ratio (LCR)	Net Stable Funding Ratio (NSFR)
Objective:	Aims to ensure a bank maintains an adequate level of high quality liquids to enable the bank to survive a 30 day liquidity stress scenario.	Aims to promote more stable funding of a bank's assets to reduce liquidity risk.
Definition:	$\dfrac{\text{Stock of high quality liquid assets}}{\text{Total net cash outflows over 30 day period}}$	$\dfrac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}}$
Compliance:	>100% by 1 Jan 2015	>100% by 1 Jan 2018

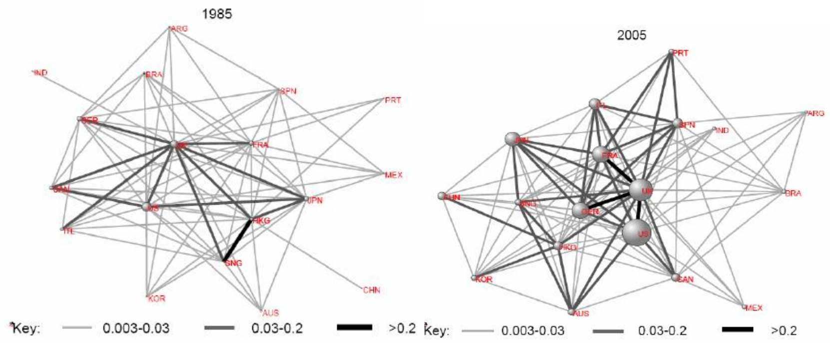
Liquidity and the NSFR.

- Insufficient liquidity is a binding constraint on bank growth.

- Network effects and contagion. Propagation of a crisis may be driven by liquidity.
  - Initial impact due to credit
  - Reduced liquidity in markets, banks hoard liquidity
  - Feedback loop to asset pricing due to asset sales
  - Further implications on credit and capital.

- Lack of stable funding is a key propagator of shocks in the system. It is in this context that increased liquidity buffers have been introduced.

Increasing interconnectivity of the Global financial network

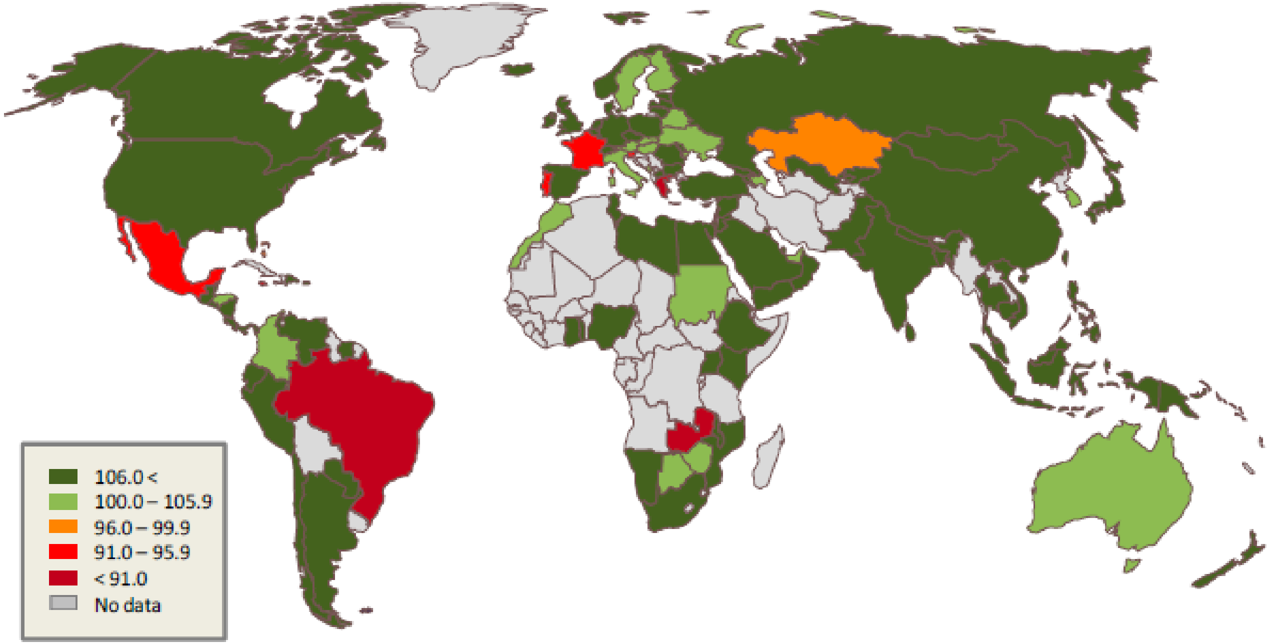


Source: Haldane, 2009.

Cross-border stocks of external assets and liabilities in 18 countries. The nodes are scaled in proportion to total external financial stocks, while the thickness of the links between nodes is proportional to bilateral external financial stocks relative to GDP

Regional impacts of NSFR: how well understood?

Unweighted NSFR average by country



Source: IMF, 2014.

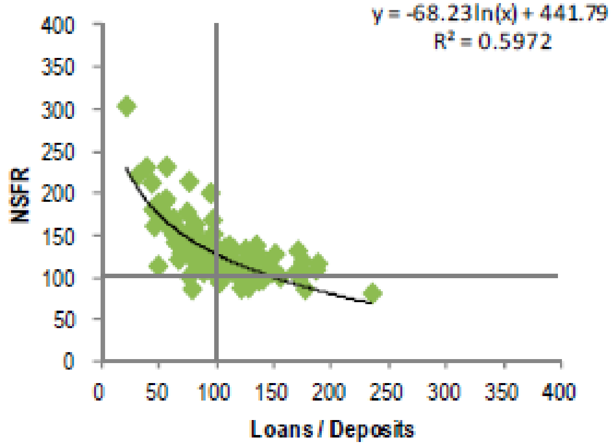
Note: weighted average NSFR tends to be lower than simple average NSFR. D-SIBs tend to have lower NSFRs than smaller banks.
IMF research is based on an earlier version of NSFR, and has optimistic assumptions on bank deposits. This will overstate reported NSFR.

Regional distributions of NSFR.

- Asian banks generally perform well on NSFR measures.
- Strong loan to deposit ratios should support NSFR, with strong relationship between metrics.
- Australian banks are more constrained on NSFR for structural reasons.

Loan/deposit to NSFR relationship

Country Averages



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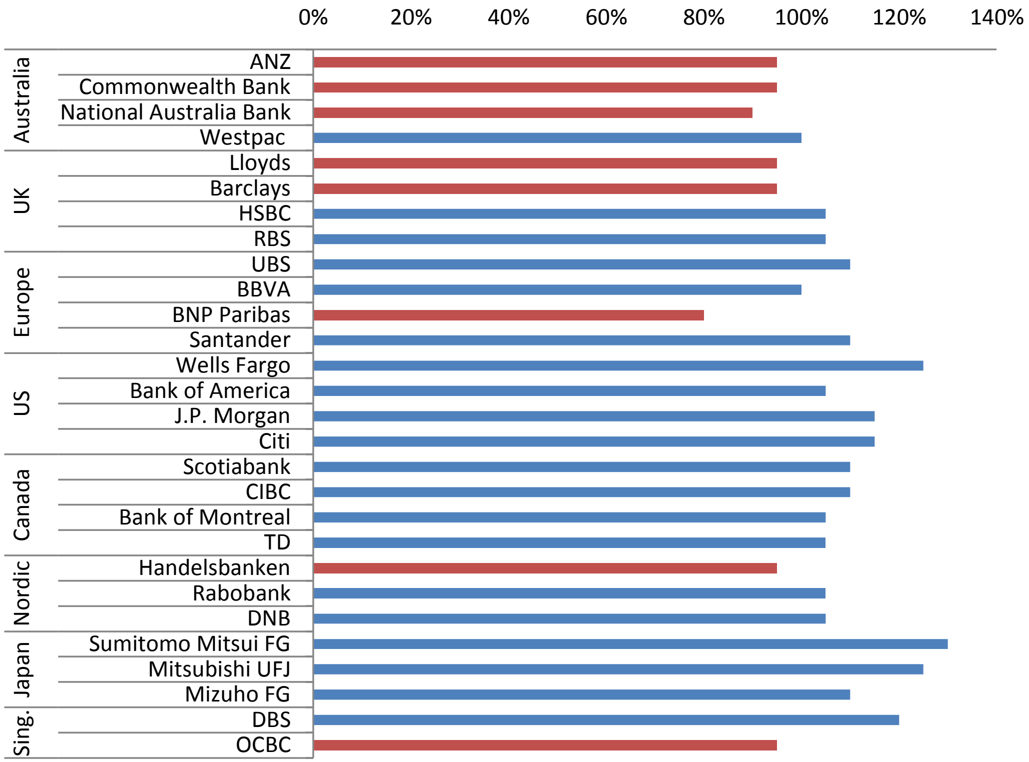
Regional distributions of NSFR.



Source: IMF, 2014.

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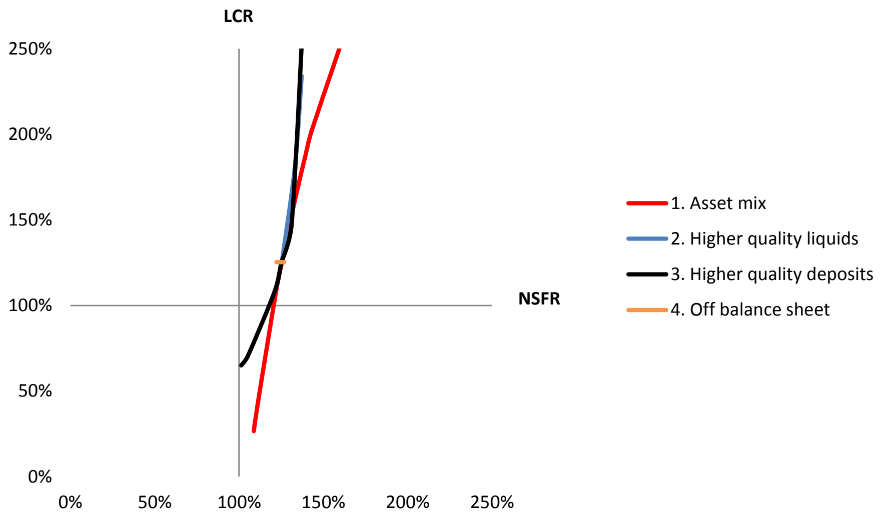
Optimising for LCR and NSFR.

- Optimal liquidity outcomes involve managing LCR and NSFR simultaneously
- Implications for liquidity transfer pricing
- Asset strategies:
  - Asset mix
  - HQLA composition
  - Off balance sheet
- Liability strategies:
  - Higher quality deposits; more long-term funds



Optimising for LCR and NSFR in the context of regulatory change.

Markets and trading

- IRRBB
- CVA
- SA-CCR
- FRTB

Balance Sheet

- Securitisation
- TLAC
- Cost of capital
- Product
- Portfolio composition
- Competitive positioning
- Liquidity portfolio

LCR

NSFR

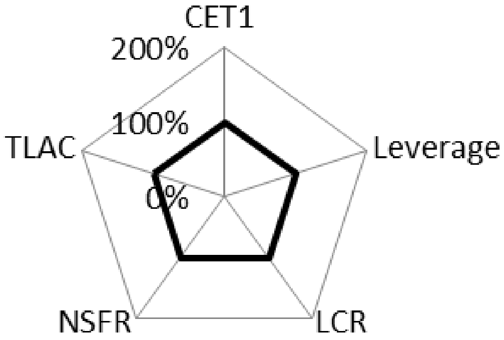
Capital

- Capital Floors
- Revised std credit risk
- Stress Testing
- Leverage ratio
- Operational risk
- Macroprudential tools
- Securitisation
- Countercyclical capital buffer
- TLAC

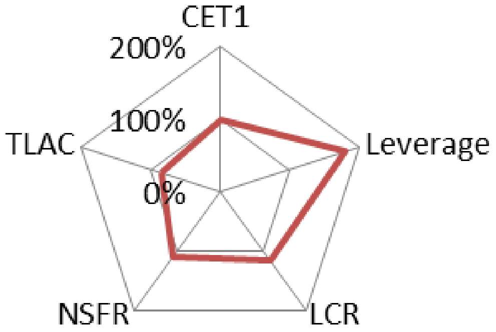
Solving for binding constraints.

- Banks need to be well balanced across a number of dimensions.
- An 'unbalanced' bank will need to solve for its binding constraint, which may result in sub-optimal outcomes across other dimensions.
- Subsidiarisation can create inefficiencies at a Group level when buffers/inefficiencies cannot be balanced out on consolidation.

A balanced bank



An unbalanced bank



Management and implementation.

- Product design
- Managing levers: balance sheet mix; pricing; funding
- Implementation:
  - Leverage LCR capability
  - Data
  - Reporting
  - Pricing and integration with liquidity transfer pricing

- Structural balance sheet change takes time.

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