

THE LIQUIDITY COVERAGE RATIO

CONSULTATION PAPER



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Consultation on the Proposed Liquidity Coverage Ratio in Jamaica (For licensees under the Banking Services Act)

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Responding to this Document

This document is being circulated to entities licensed under the Banking Services Act (BSA) and other relevant stakeholders to facilitate industry consultation and feedback on the proposed liquidity coverage ratio (LCR). Comments on this Consultation Paper are most helpful if they:

- indicate the clause and specific point to which a comment relates;
- contain a clear rationale;
- provide substantive evidence to support the feedback given; and
- describe any alternative regulatory approaches the Bank of Jamaica should consider.

Submission of Responses

Comments should be submitted by 14 August 2019 via email to: fisdfeedback@boj.org.jm.

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List of Abbreviations

BSA	Banking Services Act
ECAI	External Credit Assessment Institution
FDIG	Financial Deepening Implementation Group
FHC	Financial Holding Company
HQLA	High Quality Liquid Assets
LCR	Liquidity Coverage Ratio
MSME	Micro Small and Medium Enterprise
PSE	Public Sector Entity
SPE	Special Purpose Entity
VRDN	Variable Rate Demand Notes

Glossary

“Aggregated funding” means the gross amount of all forms of funding, including deposits or debt securities or similar derivative exposure for which the counterparty is known to be a micro, small, or medium enterprise customer. For the purposes of consolidated LCR, affiliated MSME customers may be considered a single creditor subject to a limit applied to the total funding received by the deposit taking institution from this group of customers.

“Cash management relationship” means the provision of cash management and related services to customers.

“Cash management services” means products and services provided to a customer to manage its cash flows, assets and liabilities and conduct financial transactions necessary to the customer’s ongoing operations. Such services are limited to payment remittance, collection and aggregation of funds, payroll administration, and control over the disbursement of funds.

“Clearing relationship” means a service arrangement that enables customers to transfer funds (or securities) indirectly through direct participants in domestic settlement systems to final recipients. Such services are limited to the following activities: transmission, reconciliation and confirmation of payment orders; daylight overdraft, overnight financing and maintenance of post-settlement balances and determination of intra-day and final settlement positions.

“Correspondent banking” means arrangements under which one deposit-taking institution (correspondent) holds deposits owned by other deposit-taking institutions (respondents) and provides payment and other services in order to settle foreign currency transactions.

“Custody relationship” in this context, means the provision of safekeeping, reporting, processing of assets or the facilitation of the operational and administrative elements of related activities on behalf of customers in the process of their transacting and retaining financial assets. Such services are limited to the settlement of securities transactions, the transfer of contractual payments, the processing of collateral and the provision of custody related cash management services. Also included are the receipt of dividends and other income, client subscriptions and redemptions. Custodial services can furthermore extend to asset and corporate trust servicing, treasury, escrow, funds transfer, stock transfer and agency services, including payment and settlement services (excluding correspondent banking) and depository receipts.

“Effective deposit insurance scheme” for these purposes, means a scheme (i) that guarantees that it has the ability to make prompt pay-outs; (ii) for which the coverage is clearly defined; and (iii) of which public awareness is high.

“Fiduciary” in this context, means a legal entity that is authorised to manage assets on behalf of a third party. Fiduciaries include asset management entities such as pension funds and other collective investment vehicles.

“Foreign currency retail deposits” means deposits denominated in any other currency than the domestic currency in a jurisdiction in which the deposit taking institution operates.

“Fully insured” means that 100% of the deposit amount, up to the deposit insurance limit, is covered by an effective deposit insurance scheme. Deposit balances up to the deposit insurance limit can be treated as “fully insured” even if a depositor has a balance in excess of the deposit

insurance limit. However, any amount in excess of the deposit insurance limit is to be treated as “less stable”.

“**LCR stress scenario**” means the 30 day period of stressed liquidity conditions described in the “Definition of the LCR”, which incorporates, but not limited to, many of the shocks experienced during the global financial crisis that started in 2007.

“**Micro small and medium enterprise**” means a business with annual sales or turnover of less than J\$425 million (on a consolidated basis where applicable).

“**Prime brokerage**” means a package of services offered to large active investors, particularly institutional hedge funds. These services usually include clearing, settlement and custody; consolidated reporting; financing (margin, repo or synthetic); securities lending; capital introduction; and risk analytics.

“**Public sector entity (PSE)**” means a statutory entity or authority or any government company, but does not include an executive agency designated under the Executive Agencies Act.

“**Rehypothecation**” means the practice by financial institutions of using, for their own purposes, assets that have been posted as collateral.

“**Retail deposits**” means as deposits placed with a deposit taking institution by a natural person.

“**Retail exposures**” means the total exposure of the banking group to a micro, small, or medium borrower (on a consolidated basis where applicable) is less than J\$40 million, when determining the possible retail treatment of loans to micro, small, or medium enterprises. Micro, small or medium enterprise loans extended through or guaranteed by an individual are subject to the same exposure threshold, in addition to the annual sales or turnover requirement of less than J\$425 million.

“**Secured funding**” means those liabilities and general obligations that are collateralised by legal rights to specifically designated assets owned by the borrowing institution in the case of bankruptcy, insolvency, liquidation or resolution.

Customer “**Short position**” in this context, means a transaction where a bank’s customer sells a security it does not own, and the bank subsequently obtains the same security from internal or external sources to make delivery into the sale. Internal sources include the financial institution’s own inventory of collateral as well as rehypothecatable collateral held in other customer margin accounts. External sources include collateral obtained through a securities borrowing, reverse repo, or like transaction.

“**Stable deposit**” means the amount of the deposits that are fully insured by an effective deposit insurance scheme or by a public guarantee that provides equivalent protection.

“**Total expected cash inflows**” are calculated by multiplying the outstanding balances of various categories of contractual receivables by the rates at which they are expected to flow in under the scenario up to an aggregate cap of 75% of total expected cash outflows.

“Total expected cash outflows” are calculated by multiplying the outstanding balances of various categories or types of liabilities and off-balance sheet commitments by the rates at which they are expected to run off or be drawn down.

“Total net cash outflows” means the total expected cash outflows minus total expected cash inflows in the LCR stress scenario for the subsequent 30 calendar days. Where applicable, cash inflows and outflows should include interest that is expected to be received and paid during the 30 day time horizon.

“Unencumbered” means free of legal, regulatory, contractual or other restrictions on the ability of the relevant financial institution to liquidate, sell, transfer, or assign the asset.

“Unsecured wholesale funding” for the purposes of the LCR, means those liabilities and general obligations that are raised from non-natural persons (i.e. legal entities, including sole proprietorships and partnerships) and are not collateralised by legal rights to specifically designated assets owned by the borrowing institution in the case of bankruptcy, insolvency, liquidation or resolution. Obligations related to derivative contracts are explicitly excluded from this definition.

“Wholesale funding” means all funding that is callable within the LCR’s horizon of 30 days or that has its earliest possible contractual maturity date situated within this horizon (such as maturing term deposits and unsecured debt securities) as well as funding with an undetermined maturity. This should include all funding with options that are exercisable at the investor’s discretion within the 30 calendar day horizon.

SECTION 1: INTRODUCTION

1. Following the global financial crisis beginning in 2007, one of the key reforms issued by the Basel Committee on Banking Supervision was the introduction of global liquidity standards for financial institutions with the intended purpose of promoting a more resilient financial sector. One such liquidity standard is the Liquidity Coverage Ratio (LCR), which has the primary objective of supporting and improving the short-term resilience of the liquidity profile of financial institutions by ensuring that they have sufficient high quality liquid assets (HQLA) to survive a significant stricture to funding sources lasting 30 calendar days.
2. This standard aims to ensure that a financial institution has an adequate stock of unencumbered HQLA, consisting of cash or assets that can be converted into cash at little or no loss of value in private markets to meet its liquidity needs for a 30 calendar day liquidity stress scenario. For the purposes of the LCR, the stress scenario reflects a financial institution's total net cash outflows (i.e. the difference between cash outflows and inflows) that arise over a period of 30 calendar days. At a minimum, the stock of unencumbered HQLA should enable the financial institution to survive until day 30 of the stress scenario, by which time it is assumed that Management¹ would have taken appropriate corrective actions and the Supervisor would have implemented appropriate intervention measures to address the root cause of any liquidity problem. Furthermore, given the uncertain timing of outflows and inflows, financial institutions are also expected to be aware of any potential mismatches within the 30 day period and ensure that sufficient HQLA are available to meet any cash flow gaps throughout the period.
3. The standard requires that, absent a situation of financial stress, the value of the ratio be no lower than 100% (i.e. the stock of HQLA should at least equal total net cash outflows) on an ongoing basis because the stock of unencumbered HQLA is intended to serve as a defence against the potential onset of liquidity stress. Ultimately, the LCR is designed to improve the deposit-taking sector's ability to survive the shocks arising from financial and economic stress, thereby reducing spill-over risk from the financial sector to the real economy.
4. Recent policy measures aimed at fiscal consolidation have materially changed the operating environment for liquidity risk management in Jamaica. This ongoing reform programme provides an opportunity for the modernization of Jamaica's prudential framework to be better aligned with international sound practice. In this regard, under Jamaica's Memorandum of Economic and Financial Policies and following recommendations from the IMF's Financial Sector Stability Assessment of 2018, Bank of Jamaica ("the Bank") intends to introduce the LCR by 30 September 2019 as part of its Basel II/III implementation.

¹ Management is ultimately responsible for ensuring that adequate systems, procedures and processes are put in place to support the ongoing identification, measurement, monitoring and control of liquidity risks.

SECTION 2: LEGAL REQUIREMENT

5. The proposed LCR requirements will be issued pursuant to section 132(1)(f) of the Banking Services Act (BSA), 2014, which allows the Supervisory Committee to make rules for the operation of licensees in relation to prudential liquidity requirements.

SECTION 3: SCOPE OF APPLICATION

6. The LCR proposals outlined in this document would be applied to licensees as defined in the BSA on the following bases:
 - a) For each deposit-taking institution (DTI) licensed under the BSA, on a standalone basis; and
 - b) For each financial holding company (FHC)² licensed under the BSA, on a consolidated basis, where the entities within the scope for consolidation are the FHC, and other members of the group that perform maturity and liquidity transformation in the normal course of business, including DTIs and securities dealers.
7. Further, the proposed LCR will provide for the Supervisor's authority to make determinations, on a case-by-case basis, in terms of members of financial groups that should be included or excluded from the scope of consolidation for the purposes of the LCR.
8. Notably, the scope of the LCR will not include liquidity risks stemming from insurance business conducted within financial groups. Nonetheless, pursuant to section 75(1) of the BSA, FHCs are required to manage risks, including liquidity risk, effectively on a group-wide basis, taking into account any legal, regulatory, and operational limitations on the transferability of liquidity around their respective financial groups, and the resilience of group-wide liquidity risk profiles will need to be assessed under a separate framework that takes appropriate account of the unique liquidity risks associated with the business of insurance.

Explanatory Note: Application on a Standalone or Consolidated Basis

For the purposes of the LCR, only HQLA, cash outflows and cash inflows relating to the standalone balance sheet of a licensee are to be included in the calculation of the LCR on a standalone basis. On the other hand, all HQLA cash outflows and cash inflows relating to the balance sheets of financial group members which fall within the scope of application identified above are to be included in the calculation of the LCR on a consolidated basis.

² It should be noted that there will be no distinction in how the LCR applies to operating and non-operating FHCs.

SECTION 4: MINIMUM LCR REQUIREMENT

9. Under the LCR, licensees are expected to maintain a stock of High Quality Liquid Assets (HQLA) of at least 100% of total net cash outflows at all times. This can be expressed as a ratio, where the numerator of the LCR is the stock of HQLA, and the denominator is total net cash outflows. The stock of HQLA may be comprised of Level 1 and Level 2 assets, to which differential haircuts or market valuation discounts are applied, reflecting the relative quality of the respective assets. Expressed as a formula, the minimum LCR requirement is:

$$\frac{\text{Stock of HQLA}}{\text{Total net cash outflows over the next 30 calendar days}} \geq 100\%$$

where

- (a) The stock of HQLA = Level 1 + Level 2A + Level 2B assets where, after relevant haircuts or market valuation discounts have been applied to Level 1, Level 2A & Level 2B assets:
- (i) Level 2A assets + Level 2B assets \leq 40% of HQLA; and
 - (ii) Level 2B assets \leq 15% of HQLA.

and

- (b) Total Net Cash Outflows = Total Expected Cash Outflows – (the lesser of: (i) Total Expected Cash Inflows and (ii) 75% of Total Expected Cash Outflows³), over the next 30 calendar days.

SECTION 5: STOCK OF HIGH QUALITY LIQUID ASSETS

10. High quality liquid assets are intended to be a defence against potential liquidity stress. Therefore, licensees will be required to maintain a stock of unencumbered high quality liquid assets equal to or greater than the total net cash outflows over a 30 day period. Assets qualifying as HQLA must be liquid in markets during a time of stress and can be converted into cash at minimal or no loss of value in private markets to meet liquidity needs. Specifically, the liquidity-generating capacity of HQLA should remain intact even in periods of severe idiosyncratic and market stress.
11. For the purposes of the LCR, in addition to the specific qualifying criteria which apply to various asset classes, liquid assets must also exhibit certain fundamental and market characteristics and satisfy certain operational requirements in order to be classified as HQLA. The following paragraphs outline these fundamental characteristics, market characteristics and operational requirements.

5.1 Fundamental Characteristics

12. The fundamental characteristics that assets must meet to qualify as HQLA are as follows:

³ The maximum amount of inflows that can offset outflows is limited to 75% of total expected cash outflows over the stress period. This translates to an ongoing requirement that financial institutions must maintain HQLA equivalent to at least 25% of expected cash outflows associated with the 30 day stress scenario.

- (i) **Low risk:** Assets that are less risky tend to have higher liquidity. High credit standing of the issuer and a low degree of subordination increase an asset's liquidity. Low duration, low legal risk, low inflation risk and denomination in a convertible currency with low foreign exchange risk all enhance an asset's liquidity.
- (ii) **Ease and certainty of valuation:** An asset's liquidity increases if market participants are more likely to agree on its valuation. Assets with more standardised, homogenous and simple structures tend to be more readily exchangeable, promoting liquidity. The pricing formula of a high-quality liquid asset must be easy to calculate and not depend on strong assumptions. The inputs into the pricing formula must also be publicly available. In practice, this should rule out the inclusion of most structured or exotic products.
- (iii) **Low correlation with risky assets:** The stock of HQLA should not be subject to wrong-way (highly correlated) risk. For example, assets issued by financial institutions are more likely to be illiquid in times of liquidity stress in the banking sector.
- (iv) **Listed on a developed and recognised exchange:** Being listed increases an asset's transparency, which enhances its liquidity.

5.2 Market characteristics

13. The market characteristics that assets must meet to qualify as HQLA are as follows:
- (i) **Active and sizable market:** The asset should have active outright sale or repo markets at all times. This means that:
 - There should be historical evidence of market breadth and market depth. This could be demonstrated by low bid-ask spreads, high trading volumes, and a large and diverse number of market participants. Diversity of market participants reduces market concentration and increases the reliability of the liquidity in the market in times of stress.
 - There should be robust market infrastructure in place. The presence of multiple committed market makers increases liquidity as quotes will most likely be available for buying or selling HQLA.
 - (ii) **Low volatility:** Assets whose prices remain relatively stable and are less prone to sharp price changes over time will have a lower probability of triggering forced sales to meet liquidity requirements. Volatility of traded prices and spreads are simple proxy measures of market volatility. There should be historical evidence of relative stability of market terms (e.g. prices, and haircuts or market valuation discounts) and volumes during stressed periods.
 - (iii) **Flight to quality:** Historically, the market has shown tendencies to move into these types of assets in a systemic crisis. The correlation between proxies of market liquidity and banking system stress is one simple measure that could be used.

5.3 Operational Requirements

14. For the purposes of the LCR, to qualify as HQLA, assets must satisfy certain operational requirements. These operational requirements are designed to ensure that the stock of HQLA is managed in such a way that the financial institution can, and is able to demonstrate that it can, immediately use the stock of assets as a source of contingent funds that is available for the financial institution to convert into cash through outright sale or repo, to fill funding gaps between cash inflows and outflows at any time during the 30 day stress period, with no restriction on the use of the liquidity generated.
15. **Periodic testing of market access:** A bank should periodically monetise a representative proportion of the assets in the stock through repo or outright sale, in order to test its access to the market, the effectiveness of its processes for monetisation, the availability of the assets, and to minimise the risk of negative signalling during a period of actual stress.
16. **All assets in the stock should be unencumbered:** “Unencumbered” means free of legal, regulatory, contractual or other restrictions on the ability of the financial institution to liquidate, sell, transfer, or assign the asset. An asset in the stock should not be pledged (either explicitly or implicitly) to secure, collateralise or credit-enhance any transaction, nor be designated to cover operational costs (such as rents and salaries). Assets received in reverse repo and securities financing transactions that are held at the financial institution, have not been re-hypothecated, and are legally and contractually available for the financial institution's use can be considered as part of the stock of HQLA. In addition, assets which qualify for the stock of HQLA that have been pre-positioned or deposited with, or pledged to, the central bank or a public sector entity (PSE) but have not been used to generate liquidity may be included in the stock.
17. **Under the control of the liquidity risk management function:** The stock should be under the control of the function charged with managing the liquidity of the financial institution (e.g. the treasurer), meaning the function that has the continuous authority, and legal and operational capability, to monetise any asset in the stock. Control must be evidenced either by maintaining assets in a separate pool managed by the function with the sole intent for use as a source of contingent funds, or by demonstrating that the function can monetise the asset at any point in the 30 day stress period and that the proceeds of doing so are available to the function throughout the 30 day stress period without directly conflicting with a stated business or risk management strategy. For example, an asset should not be included in the stock if the sale of that asset, without replacement throughout the 30 day period, would remove a hedge that would create an open risk position in excess of internal limits.
18. **Operational capability to monetise assets:** A financial institution should exclude from the stock, those assets that the financial institution would not have the operational capability to monetise to meet outflows during the stress period. Operational capability to monetise assets requires having procedures and appropriate systems in place, including providing the function charged with managing the liquidity of the financial institution with access to all necessary information to execute monetisation of any asset at any time. Monetisation of the asset must be executable, from an operational

perspective, in the standard settlement period for the asset class in the relevant jurisdiction.

19. **Take account of close out risks from hedges:** A financial institution is permitted to hedge the market risk associated with ownership of the stock of HQLA and still include the assets in the stock of HQLA. If it chooses to hedge the market risk, the financial institution should take into account (in the market value applied to each asset) the cash outflow that would arise if the hedge were to be closed out early (in the event of the asset being sold).
20. **Subject to appropriate collateral management practices:** A financial institution should monitor the legal entity and physical location where collateral is held and how it may be mobilised in a timely manner. Specifically, it should have a policy in place that identifies legal entities, geographical locations, currencies and specific custodial or bank accounts where HQLA are held. In addition, the financial institution should determine whether any such assets should be excluded for operational reasons and therefore have the ability to determine the composition, and hence the availability, of its stock of HQLA on a daily basis.
21. **Freely available to count towards consolidated LCR:** As a general principle, no excess liquidity should be recognised by a cross-border financial group in its consolidated LCR if there is reasonable doubt about the availability of such liquidity. Liquidity transfer restrictions (e.g. ring-fencing measures, non-convertibility of local currency, foreign exchange controls, etc.) in jurisdictions in which a financial group operates will affect the availability of liquidity by inhibiting the transfer of HQLA and fund flows within the group. Accordingly, qualifying HQLA that are held to meet statutory liquidity requirements at the legal entity or sub-consolidated level (where applicable) may only be included in the stock at the consolidated level to the extent that the related risks (as measured by the legal entity's or sub-consolidated group's net cash outflows in the LCR) are also reflected in the consolidated LCR. Any surplus of HQLA held at the legal entity can only be included in the consolidated stock if those assets would also be freely available to the consolidated (parent) entity in times of stress.
22. For example, the eligible HQLA that are held by a legal entity being consolidated to meet its local LCR requirements (where applicable) can be included in the consolidated LCR to the extent that such HQLA are used to cover the total net cash outflows of that entity, notwithstanding that the assets are subject to liquidity transfer restrictions. However, if the HQLA held in excess of the total net cash outflows of that entity within a group are not transferable, such surplus liquidity should be excluded from the consolidated LCR computation.
23. For practical reasons, the liquidity transfer restrictions to be accounted for in the consolidated ratio are confined to existing restrictions imposed under applicable laws, regulations and supervisory requirements. A financial group should have processes in place to capture all liquidity transfer restrictions to the extent practicable, and to monitor the rules and regulations in the jurisdictions in which the group operates and assess their liquidity implications for the group as a whole. Further, financial institutions should take reasonable steps to assess the impact of such restrictions, with a view to clarifying the potential impact that these restrictions could have on the availability of HQLA across the group.

24. In assessing whether assets are freely transferable for regulatory purposes, financial institutions should be aware that assets may not be freely available to the consolidated entity due to regulatory, legal, tax, accounting or other impediments. Assets held in legal entities without market access should only be included to the extent that they can be freely transferred to other entities that could monetise the assets.
25. **Take account of impediments to sale:** In certain jurisdictions, large, deep and active repo markets do not exist for eligible asset classes, and therefore such assets are likely to be monetised through outright sale. In these circumstances, a financial institution should exclude from the stock of HQLA those assets where there are impediments to sale, such as large fire-sale discounts which would cause it to breach minimum solvency requirements, or requirements to hold such assets, including, but not limited to, statutory minimum inventory requirements for market making.
26. **Take account of constraints on liquidity generated from re-hypothecated assets:** Financial institutions should not include in the stock of HQLA any assets, or liquidity generated from assets, they have received under right of re-hypothecation, if the beneficial owner has the contractual right to withdraw those assets during the 30 day stress period.
27. Assets received as collateral for derivatives transactions that are not segregated and are legally able to be re-hypothecated may be included in the stock of HQLA provided that the financial institution records appropriate outflows for risks associated with derivatives positions taken.
28. **Management of intraday liquidity positions:** Financial institutions should actively manage its intraday liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions and thus contribute to the smooth functioning of payment and settlement systems.
29. **Maintenance of LCR by Currency:** Financial institutions are expected to be able to meet their liquidity needs, as measured by the LCR, in each significant currency, where a significant currency is defined as one that comprises at least 5% of the deposit-taking institution's total liabilities, and maintain HQLA consistent with the distribution of their liquidity needs by currency.
30. The financial institution should be able to use the stock of HQLA to generate liquidity in the currency and jurisdiction in which the net cash outflows arise. As such, the LCR by currency is expected to be monitored and reported to allow financial institutions and the Central Bank to track any potential currency mismatch issues that could arise.
31. In managing foreign exchange liquidity risk, the financial institution should take into account the risk that its ability to swap currencies and access the relevant foreign exchange markets may erode rapidly under stressed conditions. Financial institutions should be aware that sudden, adverse exchange rate movements could sharply widen existing mismatched positions and alter the effectiveness of any foreign exchange hedges in place.
32. **Transition before exclusion from HQLA to avoid cliff effects:** In order to mitigate cliff effects that could arise, if an eligible liquid asset became ineligible (e.g. due to

rating downgrade), a financial institution is permitted to keep such assets in its stock of liquid assets for an additional 30 calendar days. This would allow the financial institution additional time to adjust its stock as needed or replace the asset.

5.4 Components of HQLA

33. The numerator of the LCR is the “stock of HQLA” and is comprised of Level 1 and Level 2 assets. Level 2 assets may be further broken down into Level 2A and Level 2B assets.
34. There is no limit on the amount of Level 1 assets that can be included in HQLA. However, Level 2 assets, which are less liquid than Level 1 assets, may only count for as much as 40% of total HQLA. Furthermore, Level 2A assets may count for all Level 2 assets, whereas Level 2B assets can only count up to 15% of HQLA. The value of the assets that are included in Level 2 is limited by certain haircuts or market valuation discounts prescribed under the LCR.

5.5 Summary of the stock of HQLA

35. The following table summarizes the value of each HQLA item that will be recognized in the calculation of the stock of HQLA.

Table 1: Valuation factors for the calculation of the stock of HQLA

STOCK OF HQLAs	
Item	Valuation Factor
A. Level 1 Assets	
1. Coins and banknotes;	100%
2. Cash reserves placed at central banks;	100%
3. Securities issued or guaranteed by Bank of Jamaica	100%
4. Securities issued or guaranteed by the Government of Jamaica ⁴ ;	75%
5. Qualifying marketable securities from sovereigns, central banks, and multilateral development banks.	100%
B. Level 2 Assets (maximum of 40% of HQLA)	
<i>Level 2A Assets</i>	
1. Qualifying marketable securities from foreign governments, foreign central banks, foreign public sector entities, multilateral development banks with 20% credit risk weighting	85%
2. Qualifying corporate debt securities rated AA- or higher	
<i>Level 2B Assets (maximum of 15% of HQLA)</i>	
1. Qualifying corporate debt securities rated between A+ and BBB-	50%
2. Qualifying common equity shares	

⁴ Conditional on the security being held in the JAMClear CSD.

5.5.1. Level 1 Assets

36. As stated earlier, Level 1 assets can comprise an unlimited share of the pool of HQLA and are generally not subject to a haircut or market valuation discount under the proposed LCR (i.e. they are reflected in the stock of HQLA at their current market value). However, under the proposed LCR, the Supervisor will have the authority to impose either haircuts or market valuation discounts for Level 1 securities based on, among other things, their duration, credit and liquidity risk, and typical repo haircuts. For example, upon the commencement of the LCR rules, Bank of Jamaica proposes to impose a market valuation discount on Government of Jamaica debt securities. The Bank's proposal to introduce a market valuation discount on such securities is informed by current market dynamics as well as the absence of a robust trading platform to support transparency and price discovery in that market.
37. Level 1 assets are considered the highest quality liquid assets, which means, in the practical sense, that these assets should be capable of being converted into cash at minimal or no loss of value in private markets to meet liquidity needs. The following paragraph enumerates the classes of assets that may count towards Level 1. It should be noted that this listing of Level 1 assets is indifferent to nuances relating to currency and reporting basis (standalone or consolidated). Accordingly, financial institutions should, in every case, only count Level 1 items that are relevant to the currency and reporting basis for which they are satisfying the LCR requirements.
38. Level 1 assets under the proposed LCR will include:
- (a) coins and banknotes held by the financial institution;
 - (b) cash reserves placed with Bank of Jamaica⁵;
 - (c) reserves at other central banks, as approved by the Supervisor;
 - (d) securities issued or guaranteed by Bank of Jamaica;
 - (e) 75% of the value of GOJ benchmark investment notes, limited to net cash outflows denominated in Jamaican currency;
 - (f) marketable securities issued or guaranteed by:
 - 1. foreign governments, foreign central banks, and multilateral development banks, as approved by the Supervisor, or
 - 2. the Bank for International Settlements or the International Monetary Fund, satisfying all of the following conditions:
 - (i) assigned a 0% risk-weight under the capital adequacy regulations applicable to licensees under the Banking Services Act,
 - (ii) traded in large, deep, active, and diversified repo or cash markets characterized by a low level of concentration,
 - (iii) have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions, and

⁵ For the purposes of the LCR, central bank reserves includes cash reserves, overnight deposits with the central bank, and term deposits with the central bank that: (i) are explicitly and contractually repayable on notice from the depositing financial institution; or (ii) that constitute a loan against which the financial institution can borrow on a term basis or on an overnight but automatically renewable basis (only where the financial institution has an existing deposit with the relevant central bank). Other term deposits with central banks are not eligible for the stock of HQLA. However, if the term expires within 30 days, the term deposit could be considered as an inflow per paragraph 141.

- (iv) not an obligation of a financial institution or any of its affiliated entities;
- (g) where a sovereign has a non-0% risk weight under the capital adequacy regulations applicable to licensees under the Banking Services Act, government or central bank debt securities issued in its own currency by the government or central bank if the government or central bank is from a host jurisdiction where a financial institution has operations and the financial institution takes liquidity risk in that jurisdiction; and
- (h) where a sovereign has a non-0% risk weight under the capital adequacy regulations of the Banking Services Act, domestic government or central bank debt securities issued in foreign currencies, limited to the financial institution's total net cash outflows in that specific foreign currency stemming from the financial institution's operations in the jurisdiction where the financial institution's liquidity risk is being taken.

Explanatory Note: Non-0% Risk-Weighted Sovereign Level 1 Assets

Sovereign or central bank debt securities that would have, under normal circumstances, be assigned a non-0% risk-weight, should only be eligible as Level 1 assets in the event that these assets are issued by the sovereign or central bank in host countries where the financial institution has operations. Therefore, non-0% risk-weighted Level 1 assets do not apply to a country in which the institution's only presence is liquidity risk exposures denominated in the currency of that country. This provision accommodates non-0% risk weighted sovereign or central bank securities issued in its own currency. This accommodation acknowledges the capacity of a sovereign or central bank to satisfy obligations in its own currency given its control of its monetary system, even when faced with fiscal constraints.

For the purposes of the LCR, the amount of foreign currency non-0% risk-weighted Level 1 securities issued by sovereigns/central banks that may be included in Level 1 is strictly limited to the foreign currency exposure in the jurisdiction of the issuing sovereign/central bank. The limited extent to which these securities are accommodated in Level 1 reflects natural constraints in the capacity of a sovereign or central bank to meet obligations in a foreign currency.

The overall effect of the foregoing accommodations is to limit the extent to which non-0% risk weighted Level 1 securities can count towards satisfying consolidated LCR requirement.

Proposal: Application of a haircut to GOJ securities

39. Notably, the Basel III LCR standard generally does not apply haircuts to Level 1 assets but makes an allowance for supervisory discretion in applying haircuts to Level 1 securities considering factors such as duration, and credit and liquidity risk. Bank of Jamaica is proposing to commence the LCR with market valuation discounts on GOJ debt securities to be in alignment with the Bank's current collateral policy. The Bank's proposal is for a 25% market valuation discount on GOJ Benchmark Investment Notes (BIN).

40. The current collateral policy is in the process of being revised to apply market valuation discounts based on the credit quality of the issuer, time to maturity, and liquidity of the instrument in the secondary market. The intention, for the purposes of the proposed LCR, is to amend the treatment for GOJ securities to align the Bank's revised collateral policy upon its finalization.

5.5.2 Level 2 Assets

41. Level 2 assets (comprising Level 2A assets and Level 2B assets) can count towards the stock of HQLA in the proposed LCR on the condition that they comprise no more than 40% of the overall stock of HQLA after the application of relevant haircuts or market valuation discounts. Notably, Level 2A assets may count for all Level 2 assets, whereas Level 2B assets cannot count for more than 15% of total HQLA.

Level 2A Assets

42. A 15% haircut is applied to the current market value of each Level 2A asset held in the stock of HQLA. The following paragraph enumerates the classes of assets that may count towards Level 2A. It should be noted that this listing of Level 2A assets is indifferent to nuances relating to currency and reporting basis (standalone or consolidated). Accordingly, financial institutions should, in every case, only count Level 2A items that are relevant to the currency and reporting basis for which they are satisfying the LCR requirements.
43. Level 2A assets under the proposed LCR, include the following:
 - (a) marketable securities issued or guaranteed by foreign governments, foreign central banks, foreign public sector entities, and multilateral development banks as approved by the Supervisor, satisfying all of the following conditions:
 - (i) assigned a 20% risk weight under the capital adequacy regulations applicable to licensees under the BSA;
 - (ii) traded in large, deep, active, and diversified repo or cash markets characterized by a low level of concentration;
 - (iii) have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions (i.e. the maximum decline in price not exceeding 10% or increase in haircut not exceeding 10 percentage points for any rolling 30-day period); and
 - (iv) not an obligation of a financial institution or any of its affiliated entities.
 - (b) corporate debt securities⁶ satisfying all of the following conditions:
 - (i) not issued by a financial institution or any of its affiliated entities;
 - (ii) have a long-term credit rating from a designated external credit assessment institution (ECAI) of at least AA- or, in the absence of a long-term rating, a

⁶ For the purposes of the LCR, corporate debt securities qualifying as HQLA must have a readily available valuation based on standard methods that does not depend on private knowledge. HQLA will therefore exclude complex structured products or subordinated debt.

- short-term rating equivalent in quality to the long-term rating as characterized by the ECAI;
 - (iii) traded in large, deep, active, and diversified repo or cash markets characterized by a low level of concentration; and
 - (iv) have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions (i.e. the maximum decline in price not exceeding 10% or increase in haircut not exceeding 10 percentage points for any rolling 30-day period).
- (c) Jamaican corporate debt securities issued in Jamaican currency and satisfying all of the following conditions:
- (i) not issued by a financial institution or any of its affiliated entities;
 - (ii) have a long-term credit rating, including a national scale rating, from a designated external credit assessment institution (ECAI) of at least AA- or, in the absence of a long-term rating, a short-term rating equivalent in quality to the long-term rating as characterized by the ECAI;
 - (iii) listed and traded on an acceptable market infrastructure that facilitates price discovery;
 - (iv) part of an active, reliable, robust, and diversified repo or cash market where there are no dominant investors with significant influence over the market; and
 - (v) have not suffered a decline in price exceeding 10% or increase in haircut exceeding 10 percentage points for any rolling 30 day period.

Level 2B Assets

44. A 50% haircut is applied to the current market value of each Level 2B asset held in the stock of HQLA. The following paragraph enumerates the classes of assets that may count towards Level 2B. It should be noted that this listing of Level 2B assets is indifferent to nuances relating to currency and reporting basis (standalone or consolidated). Accordingly, financial institutions should, in every case, only count Level 2B items that are relevant to the currency and reporting basis for which they are satisfying the LCR requirements.
45. Level 2B assets under the proposed LCR, will include:
- (a) corporate debt securities satisfying all of the following conditions may be included in Level 2B:
 - (i) not issued by a financial institution or any of its affiliated entities;
 - (ii) have a long-term credit rating from a designated ECAI between A+ and BBB- or, in the absence of a long term rating, a short-term rating equivalent in quality to the long-term rating as characterized by the ECAI;
 - (iii) traded in large, deep, active, and diversified repo or cash markets characterized by a low level of concentration; and
 - (iv) have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions (i.e. the maximum decline in price not exceeding 20% or increase in haircut not exceeding 20 percentage points for any rolling 30 day period).
 - (b) Jamaican corporate debt securities issued in Jamaican currency and satisfying all of the following conditions may be included in Level 2B:

- (i) not issued by a financial institution or any of its affiliated entities;
 - (ii) have a long-term credit rating, including a national scale rating, from a designated ECAI between A+ and BBB- or, in the absence of a long term rating, a short-term rating equivalent in quality to the long-term rating as characterized by the ECAI;
 - (iii) listed and traded on an acceptable market infrastructure that facilitates price discovery;
 - (iv) part of an active, reliable, robust, and diversified repo or cash market where there are no dominant investors with significant influence over the market; and
 - (v) have not suffered a decline in price exceeding 20% or increase in haircut exceeding 20 percentage points for any rolling 30 day period.
- (c) common equity shares satisfying all of the following conditions may be included in Level 2B:
- (i) not issued by a financial institution or any of its affiliated entities;
 - (ii) exchange traded and centrally cleared;
 - (iii) a constituent of a major stock index in the home jurisdiction or where the liquidity risk is taken;
 - (iv) denominated in the domestic currency of a financial institution's home jurisdiction or in the currency of the jurisdiction where a financial institution's liquidity risk is being taken;
 - (v) traded in large, deep, active, and diversified repo or cash markets characterized by a low level of concentration; and
 - (vi) have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions (i.e. the maximum decline in price not exceeding 40% or increase in haircut not exceeding 40 percentage points for any rolling 30 day period).

Proposal: Addition of separate category for Jamaican corporate debt securities in Level 2A and 2B assets

46. The major issuer of liquid securities in the Jamaican landscape, the Government of Jamaica, continues to embark on a programme of fiscal consolidation that has resulted in a diminishing stock of government debt securities. This material shift in the fiscal environment has resulted in worsening scarcity of investable high quality liquid assets in Jamaica. This reality motivates the need to develop alternative classes of assets that can count towards HQLA. Bank of Jamaica therefore proposes to specifically recognize a class of Jamaican corporate debt securities within the categories of Level 2A and Level 2B HQLA for the purposes of the LCR. Under the LCR framework, both classes of HQLA corporate debt securities will be subject to certain criteria, including the need to be externally rated and price discoverable.
47. It should be noted that there is ongoing work in Jamaica to promote financial deepening by a Financial Deepening Implementation Group (FDIG) established by the Ministry of Finance. One strategy being pursued by the FDIG is the promotion of external ratings for Jamaican corporate issuers and issues. The development of a class of externally rated corporate debt securities could potentially alleviate the problem regarding the dearth of investable assets, which may in turn qualify as Level 2 HQLA. The FDIG is also pursuing the strengthening of trading microstructures that will

promote transparency and price discovery. The efforts of the FDIG will serve to incentivize investment in externally rated corporate debt securities and support overall market deepening.

48. For high quality Jamaican corporate issuers, external ratings present the opportunities for lowered cost of funding to the extent that the debt issues of these corporates are met with significant demand. In turn, financial institutions' demand for corporate debt issues carrying investment grade external ratings will be incentivised by opportunities for investment in alternative sources of liquid assets that meet risk management and regulatory objectives, whilst delivering potentially higher yielding prospects.
49. It is believed that the proposal to recognize a class of highly rated Jamaican corporate debt securities within the category of Level 2 HQLA aligns well with the context and realities of the market for liquid assets in Jamaica and the landscape for Jamaican corporate debt instruments.
50. Notably, the forthcoming LCR proposes to provide the Supervisor with the authority to disqualify otherwise qualifying issues of corporate debt if, among other things, the Supervisor determines that the issue size or investor base is not large enough to support adequate liquidity of these instruments.

Proposal: Designation of CariCRIS as an External Credit Assessment Institution

51. Under the proposed LCR, the Supervisor will be conferred with the authority to designate qualifying external credit assessment institutions (ECAI). Upon the commencement of the LCR, the Bank of Jamaica proposes to recognize CariCRIS as one of the designated ECAs. This proposal is supported by the Bank's view that CariCRIS satisfies the qualifying criteria for external credit assessment institutions (ECAI) published by the Basel Committee on Banking Supervision.⁷
52. Furthermore, for the purposes of the HQLA qualifying criteria, the Bank proposes to recognize external ratings derived from national rating scales. Accordingly, in determining whether Jamaican corporate debt securities qualify within the class of Level 2 assets, the framework will admit "investment grade" ratings derived from CariCRIS' national rating scales.
53. As outlined in further detail in **Appendix 1**, the Bank's proposal to recognise CariCRIS-derived external ratings, including its national scale ratings, is expected to address certain jurisdiction specific matters, and produce opportunities for issuers and financial institutions alike. Concomitant with the tailored approach to external ratings to be adopted in the proposed LCR, the Level 2 qualifying criteria is intended to clearly establish the need for such securities to be traded on financial market infrastructure that promotes transparency and price discovery in the market for these securities.

⁷ See paragraph 99 at <https://www.bis.org/bcbs/publ/d424.pdf>

SECTION 6: TOTAL NET CASH OUTFLOWS

54. The denominator of the LCR is total expected net cash outflows⁸, defined as total expected cash outflows minus total expected cash inflows in the specified stress scenario for the subsequent 30 calendar days. Total expected cash outflows is calculated by multiplying the outstanding balances of various categories or types of liabilities and off-balance sheet commitments by the rates at which they are expected to run off or be drawn down. Total expected cash inflows is calculated by multiplying the outstanding balances of various categories of contractual receivables by the rates at which they are expected to flow in under the scenario. The maximum amount of inflows that can offset outflows is limited to 75% of total expected cash outflows over the stress period. This imposes an ongoing requirement that a financial institution must maintain a minimum stock of HQLA equivalent to at least 25% of expected cash outflows associated with the 30 days stress scenario.
55. Total net cash outflows is expressed by the formula:
- Total Net Cash Outflows = Total Expected Cash Outflows – (the lesser of: (i) Total Expected Cash Inflows and (ii) 75% of Total Expected Cash Outflows), over the next 30 calendar days.
56. The method for calculating the denominator is detailed in **section 7**.
57. The LCR uses a stress scenario which incorporates many of the shocks experienced during the crisis that started in 2007 into one significant stress scenario for which a licensee would, under the proposed LCR, need sufficient liquidity on hand to survive for up to 30 calendar days. The LCR stress scenario, therefore, entails a combined idiosyncratic and market-wide shock that would result in:
- a. the run-off of a proportion of retail deposits;
 - b. a partial loss of unsecured wholesale funding capacity;
 - c. a partial loss of secured, short-term financing with certain collateral and counterparties;
 - d. additional contractual outflows that would arise from a downgrade in the licensee's public credit rating, if externally rated, by up to and including three notches;
 - e. increases in market volatilities that impact the quality of collateral which lead to increased collateral haircuts or additional collateral, or lead to other liquidity needs;
 - f. unscheduled draws on committed but unused credit and liquidity facilities that the deposit taking institution or securities dealer has provided to its clients; and
 - g. the potential need for the financial institution to buy back debt or honour non-contractual obligations in the interest of mitigating reputational risk.
58. It should be noted that where there is potential that an item could be counted in multiple outflow categories, a licensee only has to assume up to the maximum contractual outflow for that item.
59. The table below summarizes the outflow rates to be applied to the various items. The table will be followed by explanations for the various categories of items.

⁸ Where applicable, expected cash outflows and expected cash inflows should include interest that is expected to be paid and received during the 30-day time horizon.

Table 2: Cash Outflow Rates

CASH OUTFLOWS	
Item	Outflow Rate
A. Retail Deposits	
1. Demand deposits and term deposits (less than 30 days maturity):	
a) Stable deposits	5%
b) Less stable deposits	10%
2. Term deposits with residual maturity greater than 30 days	0%
B. Unsecured wholesale funding	
1. Demand and Term deposits (less than 30 days maturity) provided by micro, small, and medium sized business customers	
a) Stable deposits	5%
b) Less stable deposits	10%
2. Operational deposits generated by clearing, custody, and cash management activities, of which, the portion fully covered by deposit insurance	25%
the portion fully covered by deposit insurance	5%
3. Non-financial corporates, sovereigns, central banks, multilateral development banks, and PSEs, of which, the portion fully covered by deposit insurance scheme	40%
the portion fully covered by deposit insurance scheme	20%
4. Other legal entity customers	100%
C. Secured funding	
1. Secured funding transactions with a central bank counterparty or backed by Level 1 assets with any counterparty except GOJ	0%
2. Secured funding transactions backed by securities issued or guaranteed by GOJ	25% or 60%
3. Secured funding transactions backed by Level 2A assets, with any counterparty	15%
4. Secured funding transactions backed by non-Level 1 or non-Level 2A assets, with domestic sovereigns, multilateral development banks, or domestic PSEs as a counterparty	25%
5. Backed by other Level 2B assets	50%
6. All other secured funding transactions	100%
D. Contingent funding obligations	
1. Drawdowns on committed credit and liquidity facilities:	
a) Retail and small business clients	5%
b) Non-financial corporates, sovereigns and central banks, multilateral development banks, and PSEs	10% for credit 30% for liquidity
c) Deposit taking institutions subject to prudential supervision	40%
d) Other financial institutions (include securities firms, insurance companies)	40% for credit 100% for liquidity
e) Other legal entity customers	100%
2. Treatment of Trade Finance Instruments	5%
3. Treatment of Direct Import or Export Financing	Apply outflow rates specified under Item 4 (A)
4. Other contingent funding obligations:	
a) Uncommitted credit and liquidity facilities	0%
b) Guarantees and letters of credit unrelated to trade finance obligations	10%

c) Non-contractual contingent funding obligations	10%
d) Non-Contractual Obligations such as structured products and stable value collective investment funds.	10%
e) Customer short positions are covered by other customers' collateral	50%
f) Outflows from potential repurchases of outstanding debt obligations of issues with an affiliated dealer or market maker.	10%
E. Additional Outflows	20% or 100%

6.1 Expected Cash Outflows

60. Total expected cash outflows are calculated by multiplying the outstanding balances of various categories or types of liabilities and off-balance sheet commitments by the rates at which they are expected to run off or be drawn down. Cash outflows, under the proposed LCR, are broken down into five broad categories: retail deposits, unsecured wholesale funding, secured funding, contingent funding obligations, and additional outflows. These five outflow categories are further broken down into subcategories of claims to which differential run-off rates are ascribed, reflecting the relative stability of those claims. Table 3 provides an illustrative summary of the factors applied to each category in the calculation of expected cash outflows.

6.2 Retail Deposits

61. For the purposes of the LCR, retail deposits are deposits placed with a deposit taking institution by natural persons. Retail deposits under the LCR will include demand deposits and term deposits,⁹ unless otherwise excluded. The treatment of deposits from legal entities, sole proprietorships or partnerships is addressed in wholesale deposit categories below.
62. Retail deposits are divided into “stable” and “less stable” portions of funds as described below, with minimum run-off rates listed for each category.

Stable deposits (run-off rate = 5%)

63. For the purposes of the proposed LCR, stable deposits will attract a run-off factor of 5%. Under the proposed framework, retail deposits will be characterized as stable where such deposits are fully insured¹⁰ by a qualifying deposit insurance scheme,¹¹ or by a public guarantee that provides equivalent protection, and where the deposit is either:
- part of an established relationship making withdrawal highly unlikely (“the first limb”); or
 - held in a transactional account (“the second limb”).

⁹ It should be noted that, for this purpose, savings deposits may be categorized as either a demand deposit or a term deposit, depending on the features of the account.

¹⁰ “Fully insured” means that 100% of the deposit amount, up to the deposit insurance limit, is covered by an effective deposit insurance scheme. Deposit balances up to the deposit insurance limit can be treated as “fully insured” even if a depositor has a balance in excess of the deposit insurance limit. However, any amount in excess of the deposit insurance limit is to be treated as “less stable”.

¹¹ The Jamaica Deposit Insurance Corporation is treated as a qualifying deposit insurance scheme under the framework.

64. Under the proposed LCR, the following relationships will be presumed to constitute the type of relationship referred to under the first limb of the criteria for stable deposits.
- i. Circumstances where a depositor has a borrowing relationship with the deposit-taking institution for mortgages or other long-term loans.
 - ii. Circumstances where a depositor has at least one other active product¹², other than a loan, with the deposit-taking institution.
65. In order to apply the first limb of the criteria for stable retail deposits and benefit from the related preferential run-off treatment, reporting institutions have the burden of proof to establish that the relevant relationship is one which makes deposit withdrawal highly unlikely within the 30 day LCR stress scenario. Financial institutions will have the burden of proof for assessing whether deposits from non-residents meet the criteria for stable deposits. This assessment should take into consideration relevant factors such as whether the relationship between the depositor and the financial institution meets the first or second limb of the criteria for stable deposits above and where the depositor is domiciled.
66. Under the proposed LCR, deposits will be considered as being held in a transactional account, under the second limb of the criteria for stable deposits, where salaries and income are regularly credited and debited against the account.

Less stable deposits (run-off rates = 10% and higher)

67. Other retail deposits that do not meet the criteria for stable deposits outlined above will be characterized as “less stable” and be ascribed a 10% run-off rate. Furthermore, in instances where a deposit taking institution is not able to readily identify which retail deposits would qualify as “stable” according to the definition of stable deposits outlined above, the full amount should be treated as “less stable”.

Treatment of Retail Term Deposits with residual maturity greater than 30 days

68. It should be noted that cash outflows related to retail term deposits with a residual maturity or withdrawal notice period of greater than 30 days will be excluded from total expected cash outflows if the depositor has no legal right to withdraw deposits within the 30 day horizon of the LCR. Accordingly, a 0% run-off factor would apply to such deposits. However, if the Supervisor is of the view that a deposit taking institution has allowed a depositor to withdraw such deposits without applying a significant penalty, or despite a clause stating that the depositor has no legal right to withdraw, the entire category of these funds would be treated as demand deposits regardless of the remaining term and be subject to the applicable run-off rates for the respective categories of retail deposits under which they fall, as outlined above.

1.1.1 Unsecured Wholesale Funding

69. For the purposes of the LCR, unsecured wholesale funding is defined as those liabilities and general obligations that are raised from non-natural persons (i.e. legal entities, including sole proprietorships and partnerships) and are not collateralized by legal rights to specifically designated assets owned by the borrowing institution in the case of bankruptcy, insolvency, liquidation, or resolution. Obligations related to derivative contracts are explicitly excluded from this definition.

70. The wholesale funding included in the LCR is defined as all funding that is callable within the LCR's horizon of 30 days or that has its earliest possible contractual maturity date situated within this horizon (such as maturing term deposits and unsecured debt securities), as well as funding with an undetermined maturity. This should include all funding with options that are exercisable at the investor's discretion within the 30 calendar day horizon. For funding with options exercisable at the financial institution's discretion, the Supervisor will take into account reputational factors that may limit a financial institution's ability not to exercise the option¹³. In particular, where the market expects certain liabilities to be redeemed before their final legal maturity date, financial institutions should assume such behaviour for the purpose of the LCR and include these liabilities as outflows.
71. Wholesale funding that is callable by the funds provider subject to a contractually defined and binding notice period surpassing the 30 day horizon is not included.
72. For the purposes of the LCR, unsecured wholesale funding will be categorized based on the assumed sensitivity of the funds providers to the rate offered as well as the credit quality and solvency of the borrowing financial institution. This is determined by the type of funds providers and their level of sophistication, as well as their operational relationships with the deposit taking institution. The run-off rates for the scenario are listed for each category below.

Unsecured wholesale funding provided by micro, small, and medium enterprise customers: (run-off factor 5% and 10%)

73. Unsecured wholesale funding provided by micro, small and medium enterprise (MSME) customers will be treated the same way as retail deposits. Following the approach to the treatment of retail deposits, the proposed LCR will distinguish between a "stable" portion of funding provided by MSME customers and the "less stable" portion. The same criteria and associated run-off factors will apply as for retail deposits.
74. This category consists of deposits and other extensions of funds made by non-financial MSME customers. For the purposes of the LCR, MSME customer deposits will be treated as retail customer deposits where:
1. the total aggregate funding raised from the customer is less than J\$40 million (on a consolidated basis where applicable); and
 2. the deposit is managed as a retail deposit.
75. The foregoing criteria for treatment as MSME deposits means that a deposit taking institution should treat such deposits in its internal risk management systems consistently over time and in the same manner as other retail deposits, and that the deposits are not individually managed in a way comparable to larger corporate deposits.

¹³ This could reflect a case where a financial institution may imply that it is under liquidity stress if it did not exercise an option on its own funding.

Table 3: National Definition of Micro, Small, and Medium Enterprises

	Primary Indicator	Secondary Indicator
Firm Category	Total Annual Sales/Turnover	No. Employees
Micro	up to J\$15 million	up to 5
Small	greater than \$15 million and up to J\$75 million	6 to 20
Medium	greater than J\$75 million and up to J\$425 million	21 to 50
MSME	up to J\$425 million	up to 50

Proposal: To recalibrate the qualification threshold for MSMEs

76. One of the proposed qualifying criteria for MSME deposits to receive the preferential run-off rate assigned to retail deposits is that funding raised from such MSMEs by the deposit-taking institution must not exceed a certain threshold - the ‘aggregated funding’ threshold. The Basel standard sets the maximum of aggregated funding to enable an MSME to be treated as retail at €1 million.
77. This threshold of €1 million is equivalent to 10% of the turnover or balance sheet total for entities classified as small businesses by the European Commission (i.e. €10 million).
78. Using this same methodology, we propose an aggregate funding threshold of J\$40 million or roughly 10% of turnover threshold used in the official definition for MSMEs in Jamaica (i.e. J\$425 million in annual turnover). This is meant to reflect the smaller economy and context in Jamaica.

Treatment of MSME Term Deposits

79. Term deposits from MSME customers should be treated in accordance with the earlier described treatment for retail term deposits.

Operational deposits generated by clearing, custody, and cash management activities: 25%

80. Some customers (financial and non-financial) place deposits with DTIs for the purposes of accessing and using the payments and settlement systems and otherwise make payments. The proposed LCR applies a preferential run-off treatment to certain categories of deposits where a customer has a substantive dependency on the DTI to access the payments and settlement systems in order to facilitate its clearing, custody and cash management activities. This category of deposits is called operational deposits and these deposits will receive a 25% run-off factor if they meet the qualifying criteria for clearing custody and cash management relationships outlined below.
81. For the purposes of the proposed LCR, the qualifying criteria for clearing, custody and cash management relationships are as follows:
 - a) The customer is reliant on the deposit taking institution to perform these services as an independent third party intermediary in order to fulfil its normal deposit-taking activities over the next 30 days.
 - b) These services must be provided under a legally binding agreement to institutional customers.
 - c) The termination of such agreements shall be subject either to a notice period of at least 30 days or significant switching costs (such as those related to

transaction, information technology, early termination or legal costs) to be borne by the customer if the operational deposits are moved before 30 days.

- d) The deposits are by-products of the underlying services provided by the deposit taking institution and not sought out in the wholesale market in the sole interest of offering interest income.
 - e) The deposits are held in specifically designated accounts and priced without giving an economic incentive to the customer (not limited to paying market interest rates) to leave any excess funds on these accounts. In the case that interest rates are close to zero, it would be expected that such accounts are non-interest bearing. Deposit taking institutions should be particularly aware that during prolonged periods of low interest rates, excess balances could be significant.
82. Any excess balances that could be withdrawn and would still leave enough funds to fulfil these clearing, custody, and cash management activities do not qualify for the 25% factor. In other words, only that part of the deposit balance with the service provider that is proven to serve a customer's operational needs can qualify as stable. Excess balances should be treated according to the treatment for non-operational deposits.
83. If deposit taking institutions are unable to determine the amount of the excess balance, then the entire deposit should be assumed to be excess to requirements and, therefore, considered non-operational.
84. Deposit taking institutions must determine the methodology for identifying excess deposits that are excluded from this treatment. This assessment should be conducted at a sufficiently granular level to adequately evaluate the risk of withdrawal in an idiosyncratic stress. The methodology should take into account relevant factors such as the likelihood that wholesale customers have above average balances in advance of specific payment needs, and consider appropriate indicators such as ratios of account balances to payment or settlement volumes or to assets under custody to identify those customers that are not actively managing account balances efficiently.
85. For the purposes of calculating inflows under **section 6.2** below, operational deposits would receive a 0% inflow assumption for the depositing institution given that these deposits are required for operational reasons, and are therefore not available to the depositing institution to repay other outflows.
86. Notwithstanding these operational categories, if the deposit under consideration arises out of correspondent banking¹⁴ or from the provision of prime brokerage services¹⁵, it will be ascribed a 100% run-off factor per **section 6.1.2**.
87. The following paragraphs describe circumstances that could constitute clearing, custody and cash management relationships for the purposes of the proposed LCR.

¹⁴ Correspondent banking refers to arrangements under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services in order to settle foreign currency transactions.

¹⁵ Prime brokerage means a package of services offered to large active investors, particularly institutional hedge funds. These services usually include clearing, settlement and custody; consolidated reporting; financing (margin, repo or synthetic); securities lending; capital introduction; and risk analytics.

However, a deposit taking institution should assess whether the presence of such an activity does indeed generate an operational deposit as not all such activities qualify due to differences in customer dependency, activity, and practices.

(i) Clearing relationship

88. A clearing relationship, in this context, refers to a service arrangement that enables customers to transfer funds (or securities) indirectly through direct participants in domestic settlement systems to final recipients. Such services are limited to the following activities: transmission, reconciliation and confirmation of payment orders; daylight overdraft, overnight financing and maintenance of post-settlement balances; and determination of intra-day and final settlement positions.

(ii) Custody relationship

89. Custody relationship, in this context, means the provision of safekeeping, reporting, processing of assets or the facilitation of the operational and administrative elements of related activities on behalf of customers in the process of their transacting and retaining financial assets. Such services are limited to the settlement of securities transactions, the transfer of contractual payments, the processing of collateral, and the provision of custody related cash management services. Also included are the receipt of dividends and other income, client subscriptions and redemptions. Custodial services can furthermore extend to asset and corporate trust servicing, treasury, escrow, funds transfer, stock transfer and agency services, including payment and settlement services (excluding correspondent banking), and depository receipts.

(iii) Cash Management

90. Cash management services, in this context, means those products and services provided to a customer to manage its cash flows, assets and liabilities, and conduct financial transactions necessary to the customer's ongoing operations. Such services are limited to payment remittance, collection and aggregation of funds, payroll administration, and control over the disbursement of funds.
91. Notably, under the proposed LCR, the portion of the operational deposits generated by clearing, custody, and cash management activities that is fully covered by deposit insurance may attract the same run-off treatment as "stable" retail deposits.
92. The granting of supervisory approval is required to ensure that deposit (It should be noted that under the proposed LCR, deposit-taking institutions will require Supervisory approval in order to apply the treatment for operational deposits). Furthermore, if a significant portion of operational deposits is provided by a small proportion of customers, these deposits may be excluded from treatment as operational deposits at the discretion of the Supervisor.

Unsecured wholesale funding provided by non-financial corporates and sovereigns, central banks, multilateral development banks, and PSEs: 20% or 40%

93. This category comprises all deposits and other extensions of unsecured funding from non-financial corporate customers (that are not categorized as micro, small, and medium enterprise customers) and (both domestic and foreign) sovereign, central bank, multilateral development bank, and PSE customers that are not specifically held for operational purposes (as defined above). The run-off factor for these funds is 40%,

unless the entire amount of the deposit is covered by a qualifying deposit insurance scheme or by a public guarantee in which case a run-off factor of 20% may be applied.

Unsecured wholesale funding provided by other legal entity customers: 100%

94. This category consists of all deposits and other funding from other institutions (including financial institutions, securities firms, insurance companies), fiduciaries¹⁶, beneficiaries, conduits and special purpose vehicles, affiliated entities of the financial institution and other entities that are not specifically held for operational purposes and not included in the prior three categories. The run-off factor for these funds is 100%.
95. All notes, bonds and other debt securities issued by the financial institution are included in this category regardless of the holder, unless the bond is sold exclusively in the retail market and held in retail accounts (including MSME customer accounts treated as retail), in which case the instruments can be treated in the appropriate retail or MSME customer deposit category. To be treated in this manner, it is not sufficient that the debt instruments are specifically designed and marketed to retail or MSME customers. Rather there should be limitations placed such that those instruments cannot be bought and held by parties other than retail or MSME customers.
96. Customer cash balances arising from the provision of prime brokerage services, including but not limited to the cash arising from prime brokerage services, should be considered separate from any required segregated balances related to client protection regimes imposed by national regulations, and should not be netted against other customer exposures included for these purposes. These offsetting balances held in segregated accounts are treated as (other wholesale) inflows and should be excluded from the stock of HQLA.

1.1.2 Secured funding run-off

97. For the purposes of the LCR, secured funding includes those liabilities and general obligations that are collateralized by legal rights to specifically designated assets owned by the borrowing institution in the case of bankruptcy, insolvency, liquidation, or resolution. Secured funding transactions or borrowing backed by collateral maturing within the 30 calendar-day period may give rise to cash outflows during the LCR stress period. This section outlines the treatment of cash outflows from such transactions for the purposes of the proposed LCR.
98. In this scenario, the ability to continue to transact repurchase, reverse repurchase and other securities financing transactions is limited to transactions backed by HQLA or with the financial institution's domestic sovereign, PSE that are risk-weighted 20% or better, or central bank. Collateral swaps should be treated as repurchase or reverse repurchase agreements, as should any other transaction with a similar form. Additionally, collateral lent to the financial institution's customers to effect short positions should be treated as a form of secured funding. For the scenario, a financial institution should apply the following factors to all outstanding secured funding transactions with maturities within the 30 calendar-day LCR stress period, including

¹⁶ Fiduciary, in this context, means a legal entity that is authorized to manage assets on behalf of a third party. Fiduciaries include asset management entities such as pension funds and other collective investment vehicles.

customer short positions¹⁷ that do not have a specified contractual maturity. The amount of outflow is calculated based on the amount of funds raised through the transaction, and not the value of the underlying collateral.

99. Due to the high quality of Level 1 assets, no reduction in funding availability against these assets is assumed to occur, with the exception of Level 1 GOJ securities, for which 25% and 60% reductions in funding availability are assumed for GOJ Benchmark Investment Notes, and GOJ global bonds and bonds guaranteed by the GOJ, respectively, consistent with the haircut treatment ascribed of the purposes of computing the numerator — HQLA. Moreover, no reduction in funding availability is expected for any maturing secured funding transactions with the financial institution’s domestic central bank.
100. A reduction in funding availability will be assigned to maturing transactions backed by Level 2 assets equivalent to the amount of the haircuts applicable to items under that category. Furthermore, a 25% factor is applied for maturing secured funding transactions with the financial institution’s domestic sovereign, multilateral development banks, or domestic PSEs that have a 20% or lower risk weight, when the transactions are backed by assets other than Level 1 or Level 2A assets, in recognition that these entities are unlikely to withdraw secured funding from financial institutions in a time of market-wide stress. This, however, gives credit only for outstanding secured funding transactions, and not for unused collateral or merely the capacity to borrow.
101. For all other maturing transactions, the run-off factor is 100%, including transactions where a financial institution has satisfied customers’ short positions with its own long inventory. The applicable standards are summarized in the following table.

1.1.3 Contingent Funding Obligations

Drawdowns on committed credit and liquidity facilities:

102. For the purposes of the proposed LCR, credit and liquidity facilities only include contractually irrevocable (“committed”) or conditionally revocable agreements to extend funds in the future. Unconditionally revocable facilities (in particular, those without a precondition of a material change in the credit condition of the borrower) are excluded from this section and included in “Other Contingent Funding Obligations” outlined at **section 6.1.4**. These off-balance sheet facilities or funding commitments can have long or short-term maturities, with short-term facilities frequently renewing or automatically rolling-over. In a stressed environment, it will likely be difficult for customers drawing on facilities of any maturity, even short-term maturities, to be able to quickly pay back the borrowings. Therefore, under the proposed LCR, all facilities that are assumed to be drawn will remain outstanding at the amounts assigned throughout the duration of the test, regardless of maturity.

¹⁷ Customer short position, in this context, means a transaction where a deposit taking institution’s customer sells a security it does not own, and the deposit taking institution subsequently obtains the same security from internal or external sources to make delivery into the sale. Internal sources include the financial institution’s own inventory of collateral as well as rehypothecatable collateral held in other customer margin accounts. External sources include collateral obtained through a securities borrowing, reverse repo, or like transaction.

103. Under the proposed LCR, the currently undrawn portion of these facilities is calculated net of any assets eligible for the stock of HQLA, if the HQLA have already been posted as collateral by the counterparty to secure the facilities or that are contractually obliged to be posted when the counterparty will draw down the facility, if the financial institution is legally entitled and operationally capable to re-use the collateral in new cash raising transactions once the facility is drawn, and there is no undue correlation between the probability of drawing the facility and the market value of the collateral. The collateral can be netted against the outstanding amount of the facility to the extent that this collateral is not already counted in the stock of HQLA, in line with the principle stipulating that items cannot be double-counted for the purposes of computing the LCR.
104. A liquidity facility is defined as any committed, undrawn back-up facility that would be utilised to refinance the debt obligations of a customer in situations where such a customer is unable to rollover that debt in financial markets (e.g. pursuant to a commercial paper programme, secured financing transactions, obligations to redeem units, etc.). For the purposes of the proposed LCR, the amount of the commitment to be treated as a liquidity facility is the amount of the currently outstanding debt issued by the customer (or proportionate share, if a syndicated facility) maturing within a 30 day period that is backstopped by the facility. The portion of a liquidity facility that is backing debt that does not mature within the 30 day window is excluded from the scope of the definition of a facility. Any additional capacity of the facility (i.e. the remaining commitment) would be treated as a committed credit facility with its associated drawdown rate. General working capital facilities for corporate entities will not be classified as liquidity facilities, but as credit facilities.
105. Notwithstanding the above, any facilities provided to hedge funds, money market funds and special purpose funding vehicles, or conduits, or other vehicles used to finance the financial institution's own assets, should be captured in their entirety in the category labelled "liquidity facility to other legal entities".

Outflow Rates for Drawdowns on Committed Credit and Liquidity Facilities

106. Any contractual loan drawdowns from committed facilities, that is, those that are irrevocable, and estimated drawdowns from revocable facilities within the 30 day period should be fully reflected as outflows. The following drawdown rates will apply to the undrawn portions of the facilities outlined below.
- i. Committed credit and liquidity facilities to retail and micro, small, and medium sized enterprises (drawdown rate = 5%)
 - ii. Committed credit facilities to non-financial corporates, sovereigns and central banks, PSEs and multilateral development banks (drawdown rate = 10%)
 - iii. Committed liquidity facilities to non-financial corporates, sovereigns and central banks, PSEs, and multilateral development banks (drawdown rate = 30%)
 - iv. Committed credit and liquidity facilities extended to banks subject to prudential supervision (drawdown rate = 40%)
 - v. Committed credit facilities to other financial institutions including securities firms, insurance companies, fiduciaries, and beneficiaries (drawdown rate = 40%)
 - vi. Committed liquidity facilities to other financial institutions including securities firms, insurance companies, fiduciaries, and beneficiaries (drawdown rate = 100%)

- vii. Committed credit and liquidity facilities to other legal entities, including SPEs¹⁸, conduits and special purpose vehicles, and other entities not included in the prior categories) (drawdown rate = 100%)
107. It should be noted that under the LCR, any contractual lending obligations to financial institutions, within the 30 day period, not captured elsewhere in this standard should be captured here at a 100% outflow rate.
108. For the purposes of the proposed LCR, if the total of all contractual obligations to extend funds to retail and non-financial corporate clients within the next 30 calendar days (not captured in the prior categories) exceeds 50% of the total contractual inflows due in the next 30 calendar days from these clients, the difference should be reported as a 100% outflow.

Treatment of Trade Finance Instruments (drawdown rate = 5%)

109. Under the proposed LCR, contingent funding obligations stemming from trade finance instruments will be ascribed a drawdown rate of 5%, where such instruments are directly underpinned by the movement of goods or the provision of services, such as:
- a) documentary trade letters of credit, documentary and clean collection, import bills, and export bills; and
 - b) guarantees directly related to trade finance obligations, such as shipping guarantees.

Treatment of Direct Import or Export Financing

110. Lending commitments, such as direct import or export financing for non-financial corporate firms, are excluded from the foregoing treatment for Trade Finance Instruments under the proposed LCR and financial institutions will apply the drawdown rates specified in paragraph 107 regarding “Drawdowns on Committed Credit and Liquidity Facilities” under **section 6.1.4**.

Other contingent funding obligations

111. For the purposes of the proposed LCR, other contingent funding obligations will be ascribed drawdown rates as follows.
- i. Unconditionally revocable (“uncommitted”) credit and liquidity facilities: (drawdown rate = 0%).
 - ii. Non-contractual contingent funding obligations related to potential liquidity draws by unconsolidated joint ventures or minority investments in entities: (drawdown rate = 10% of investment value).
 - iii. Guarantees and letters of credit unrelated to trade finance obligations: (drawdown rate = 10% of the amount of guarantees and letters of credit).
 - iv. Non-Contractual Obligations such as:
 - v. Potential requests for debt repurchases of the financial institution’s own debt or that of related conduits, special investment vehicles, and other such financing facilities: (drawdown rate = 10% of the total outstanding amount).

¹⁸ Special purpose entity (SPE) means a corporation, trust, or other entity organized for a specific purpose, the activities of which are limited to those appropriate to accomplish the purpose of the SPE, and the structure of which is intended to isolate the SPE from the credit risk of an originator or seller of exposures. SPEs are commonly used as financing vehicles in which exposures are sold to a trust or similar entity in exchange for cash or other assets funded by debt issued by the trust.

- vi. Structured products where customers anticipate ready marketability, such as adjustable rate notes and variable rate demand notes (VRDNs): (drawdown rate = 10% of total outstanding amount).
- vii. Managed funds that are marketed with the objective of maintaining a stable value (e.g. money market mutual funds, other types of stable value collective investment funds, etc.): (drawdown rate = 10% of total outstanding amount).
- viii. Non-contractual obligations where customer's short positions are covered by other customers' collateral, where the collateral does not qualify as Level 1 or Level 2 asset: (drawdown rate = 50% of the collateral amount used to cover customer's short positions).
- ix. Outflow amount to cover potential repurchases of any outstanding debt securities (unsecured and secured, term as well as short-term) having maturities greater than 30 calendar days where the issuer has an affiliate that is a dealer or market maker: (drawdown rate = 10% of total outstanding amount).

1.1.4 Additional Outflows

- 112. Additional items under the proposed LCR will be ascribed the outflow factors outlined under the following categories.

Derivatives cash outflows (outflow rate =100%)

- 113. The sum of all net cash outflows relating to derivatives should receive a 100% factor. Financial institutions should calculate, in accordance with their existing valuation methodologies, expected contractual derivative cash inflows and outflows. Cash flows may be calculated on a net basis (i.e. inflows can offset outflows) by counterparty, only where a valid master netting agreement exists. Financial institutions should exclude from such calculations those liquidity requirements that would result from increased collateral needs due to market value movements or falls in value of collateral posted (as treated with in other categories below). Options should be assumed to be exercised when they are 'in the money' to the option buyer.
- 114. Where derivative payments are collateralized by HQLA, cash outflows should be calculated net of any corresponding cash or collateral inflows that would result, all other things being equal, from contractual obligations for cash or collateral to be provided to the financial institution, if the financial institution is legally entitled and operationally capable to re-use the collateral in new cash raising transactions once the collateral is received. This is in line with the principle that financial institutions should not double count liquidity inflows and outflows.

Increased liquidity needs related to downgrade triggers embedded in financing transactions, derivatives and other contracts (outflow rate =100%)

- 115. The proposed LCR will ascribe an outflow rate of 100% to the amount of collateral that would be posted for, or contractual cash outflows associated with, any downgrade up to and including a 3-notch downgrade. Often, contracts governing derivatives and other transactions have clauses that require the posting of additional collateral, drawdown of contingent facilities, or early repayment of existing liabilities upon the financial institution's downgrade by a designated ECAI. The scenario therefore requires that for each contract in which "downgrade triggers" exist, the financial institution assumes that 100% of this additional collateral or cash outflow will have to be posted for any downgrade up to and including a 3-notch downgrade of the financial institution's long-term credit rating. Triggers linked to a financial institution's short-term rating should

be assumed to be triggered at the corresponding long-term rating in accordance with published ratings criteria. The impact of the downgrade should consider impacts on all types of margin collateral and contractual triggers which change re-hypothecation rights for non-segregated collateral.

Increased liquidity needs related to the potential for valuation changes on posted collateral securing derivative and other transactions (outflow rate =20%)

116. The proposed LCR will ascribe an outflow factor of 20% to the value of non-Level 1 posted collateral.
117. Observation of market practices indicates that most counterparties to derivatives transactions typically are required to secure the mark-to-market valuation of their positions and that this is predominantly done using cash or sovereign, central bank, multilateral development banks, or PSE debt securities with a 0% risk weight under the capital adequacy regulations applicable to licensees under the Banking Services Act. When these Level 1 liquid asset securities are posted as collateral, the framework will not require that an additional stock of HQLA be maintained for potential valuation changes. If, however, counterparties are securing mark-to-market exposures with other forms of collateral to cover the potential loss of market value on those securities, 20% of the value of all such posted collateral, net of collateral received on a counterparty basis (provided that the collateral received is not subject to restrictions on reuse or re-hypothecation) will be added to the stock of required HQLA by the financial institution posting such collateral. This 20% will be calculated based on the notional amount required to be posted as collateral after any other haircuts have been applied that may be applicable to the collateral category. Any collateral that is in a segregated margin account can only be used to offset outflows that are associated with payments that are eligible to be offset from that same account.

Increased liquidity needs related to excess non-segregated collateral held by the financial institution that could contractually be called at any time by the counterparty (outflow rate = 100%)

118. The proposed LCR will ascribe an outflow factor of 100% to non-segregated collateral that could contractually be recalled by the counterparty because the collateral is in excess of the counterparty's current collateral requirements.

Increased liquidity needs related to contractually required collateral on transactions for which the counterparty has not yet demanded the collateral be posted (outflow rate = 100%)

119. The proposed LCR will ascribe an outflow factor of 100% to collateral that is contractually due but where the counterparty has not yet demanded the posting of such collateral.

Increased liquidity needs related to contracts that allow collateral substitution to non-HQLA (outflow rate = 100%)

120. The proposed LCR will ascribe an outflow factor of 100% to the amount of HQLA collateral that can be substituted for non-HQLA assets without the financial institution's consent that have been received to secure transactions that have not been segregated.

Loss of funding on structured financing instruments (outflow rate = 100%)

121. The scenario assumes the outflow of 100% of the funding transaction maturing within the 30 day period, when these instruments are issued by the financial institution itself (as this assumes that the re-financing market will not exist). Financial institutions having structured financing facilities that include the issuance of short-term debt instruments, such as asset backed commercial paper, should fully consider the potential liquidity risk arising from these structures. These risks include, but are not limited to, (i) the inability to refinance maturing debt, and (ii) the existence of derivatives or derivative-like components contractually written into the documentation associated with the structure that would allow the “return” of assets in a financing arrangement, or that require the original asset transferor to provide liquidity, effectively ending the financing arrangement (“liquidity puts”) within the 30 day period. Where the structured financing activities of a financial institution are conducted through a special purpose entity¹⁹ (such as a special purpose vehicle, conduit or structured investment vehicle - SIV), the financial institution should, in determining the HQLA requirements, look through to the maturity of the debt instruments issued by the entity and any embedded options in financing arrangements that may potentially trigger the “return” of assets or the need for liquidity, irrespective of whether or not the SPV is consolidated.

Increased liquidity needs related to market valuation changes on derivative or other transactions (outflow rate = 100%)

122. As market practice requires collateralisation of mark-to-market exposures on derivative and other transactions, financial institutions face potentially substantial liquidity risk exposures to these valuation changes. Inflows and outflows of transactions executed under the same master netting agreement can be treated on a net basis. Any outflow generated by increased needs related to market valuation changes should be included in the LCR calculated by identifying the largest absolute net 30 day collateral flow realized during the preceding 24 months. The absolute net collateral flow is based on both realized outflows and inflows.

Other Contractual Outflows (outflow rate = 100%)

123. Any other contractual cash outflows within the next 30 calendar days (not captured under any other category of outflows) should be counted as outflows for the purposes of the proposed LCR and reported separately. These outflow items may include outflows to cover unsecured collateral borrowings, uncovered short positions, dividends, or contractual interest payments.

1.2 Expected Cash Inflows

124. When considering its available cash inflows, a financial institution should only include contractual inflows (including interest payments) from outstanding exposures that are fully performing and for which the financial institution has no reason to expect a default within the 30 day time horizon. Contingent inflows are not included in total net cash inflows.

¹⁹ A special purpose entity (SPE) is defined as a corporation, trust, or other entity organised for a specific purpose, the activities of which are limited to those appropriate to accomplish the purpose of the SPE, and the structure of which is intended to isolate the SPE from the credit risk of an originator or seller of exposures. SPEs are commonly used as financing vehicles in which exposures are sold to a trust or similar entity in exchange for cash or other assets funded by debt issued by the trust.

125. In adhering to the LCR, financial institutions will be required to monitor the concentration of expected inflows across wholesale counterparties in the context of the financial institutions' liquidity management in order to ensure that their liquidity position is not overly dependent on the arrival of expected inflows from one or a limited number of wholesale counterparties.
126. **Cap on total inflows:** In order to prevent financial institutions from relying solely on anticipated inflows to meet their liquidity requirement, and also to ensure a minimum level of HQLA holdings, the amount of inflows that can offset outflows is capped at 75% of total expected cash outflows as calculated in the standard. This requires reporting institutions to maintain a minimum amount of stock of HQLA equal to 25% of the total cash outflows.
127. Under the proposed LCR, cash inflows are broken down into four broad categories:
- A. Secured Lending Inflows;
 - B. Inflows Relating to Committed Facilities;
 - C. Inflows from Specified Counterparties; and
 - D. Other Cash Inflows.
128. The cash inflow rates for the proposed LCR are summarized in table 6, and will be explained in further detail below.

Table 4: Cash Inflow Rates

CASH INFLOWS	
A. Secured Lending Inflows	
1. Maturing secured lending transactions backed by the following collateral:	
a) Level 1 assets, except GOJ securities	0%
b) Level 1 GOJ securities	25% or 60%
c) Level 2A assets	15%
d) Level 2B assets	50%
e) Margin Lending backed by all other collateral	50%
2. All other assets	100%
B. Inflows Relating to Committed Facilities	
0%	
C. Inflows from Specified Counterparties	
1. Amounts to be received from retail counterparties, except from credit card facilities	50%
2. Amounts to be received from credit card facilities	5%
3. Amounts to be received from non-financial wholesale counterparties, from transactions other than those listed in above inflow categories	50%
4. Amounts to be received from financial institutions and central banks, from transactions other than those listed in above inflow categories.	100%
D. Other Cash Inflows	
1. Net derivative cash inflows	100%
2. Other contractual cash inflows	0%

Secured Lending Inflows

129. A financial institution should assume that maturing reverse repurchase or securities borrowing agreements secured by Level 1 assets will be rolled-over and will not give rise to any cash inflows, therefore attracting an inflow rate of 0%. Maturing reverse repurchase or securities borrowing agreements secured by Level 2 HQLA will lead to cash inflows equivalent to the relevant haircut for the specific assets. A financial

institution is assumed not to roll-over maturing reverse repurchase or securities borrowing agreements secured by non-HQLA assets, and can assume to receive back 100% of the cash related to those agreements. Collateralized loans extended to customers for the purpose of taking leveraged trading positions (“margin loans”) should also be considered as a form of secured lending. However, for this scenario, financial institutions may recognize no more than 50% of contractual inflows from maturing margin loans made against non-HQLA collateral. This treatment is in line with the assumptions outlined for secured funding in the outflows section.

130. As an exception to the preceding paragraph, if the collateral obtained through reverse repo, securities borrowing, or collateral swaps, which matures within the 30 day horizon, is re-used (i.e. re-hypothecated) and is used to cover short positions that could be extended beyond 30 days, a financial institution should assume that such reverse repo or securities borrowing arrangements will be rolled-over and will not give rise to any cash inflows, therefore attracting an inflow rate of 0% - reflecting its need to continue to cover the short position or to re-purchase the relevant securities. Short positions include both instances where, in its ‘matched book’, the financial institution sold short a security outright as part of a trading or hedging strategy and instances where the financial institution is short a security in the ‘matched’ repo book (i.e. it has borrowed a security for a given period and lent the security out for a longer period).
131. It should be noted that in the case of a financial institution’s short positions, if the short position is being covered by an unsecured security borrowing, the financial institution should assume the unsecured security borrowing of collateral from financial market participants would run-off in full, leading to a 100% outflow of either cash or HQLA to secure the borrowing, or cash to close out the short position by buying back the security. This should be recorded as a 100% other contractual outflow according to **section 6.1.5**. If, however, the financial institution’s short position is being covered by a collateralized securities financing transaction, the financial institution should assume the short position will be maintained throughout the 30 day period and receive a 0% outflow.
132. Despite the roll-over assumptions relating to ‘Secured Lending’ outlined above, a financial institution should manage its collateral such that it is able to fulfil obligations to return collateral whenever the counterparty decides not to roll-over any reverse repo or securities lending transaction. This is especially the case for non-HQLA collateral, since such outflows are not captured in the LCR framework.
133. The inflow rates relating to secured lending transactions are summarized in the table below.

Inflows Relating to Committed Facilities

134. No credit facilities, liquidity facilities or other contingent funding facilities that the financial institution holds at other institutions for its own purposes are assumed to be able to be drawn. Such facilities receive a 0% inflow rate, meaning that this scenario does not consider inflows from committed credit or liquidity facilities. This is to reduce the contagion risk of liquidity shortages at one financial institution causing shortages at other financial institutions and to reflect the risk that other financial institutions may not be in a position to honour credit facilities, or may decide to incur the legal and

reputational risk involved in not honouring the commitment, in order to conserve their own liquidity or reduce their exposure to that financial institution.

Inflows from Specified Counterparties

135. For all other types of transactions, either secured or unsecured, the inflow rate will be determined by counterparty. In order to reflect the need for a financial institution to conduct ongoing loan origination/roll-over with different types of counterparties, even during a time of stress, a set of limits on contractual inflows by counterparty type is applied.
136. When considering loan payments, the financial institution should only include inflows from fully performing loans. Further, inflows should only be taken at the latest possible date, based on the contractual rights available to counterparties. For revolving credit facilities, this assumes that the existing loan is rolled over and that any remaining balances are treated in the same way as a committed facility under **section 6.1.4**.
137. Inflows from loans that have no specific maturity (i.e. have non-defined or open maturity) should not be included. Therefore, no assumptions should be applied as to when maturity of such loans would occur. An exception to this would be minimum payments of principal, fee or interest associated with an open maturity loan, if such payments are contractually due within 30 days. These minimum payment amounts should be captured as inflows at the rates prescribed in the two paragraphs below.

Inflows Relating to Credit Card Facilities

138. Under the proposed LCR, it is assumed that financial institutions will generally receive at least the amount of the minimum repayment requirement on outstanding credit card facilities with retail and MSME customers. The LCR ascribes an inflow rate of 5% to capture these inflows.

Proposal: Limit the Calculation of Inflows from Credit Card Facilities to Retail and MSME Customers

139. The proposed limitation on inflows relating to credit card facilities is geared towards accounting for customers whose common repayment practice is to satisfy only the minimum repayment requirement on their credit cards. Taking account of repayment and drawdown behaviours associated with these credit card facilities, an inflow rate of 5% will be applied to balances associated with credit card facilities in the calculation of cash inflows under the proposed LCR.

Other Retail and MSME Customer Inflows

140. This scenario assumes that financial institutions will generally receive all payments (including interest payments and instalments) from other (non-credit card) credit extensions to retail and MSME customers that are fully performing and contractually due within a 30 day horizon. At the same time, however, financial institutions are assumed to continue to extend loans to retail and MSME business customers, at a rate of 50% of contractual inflows. This results in a net inflow number of 50% of the contractual amount.

Other Wholesale Inflows

141. This scenario assumes that financial institutions will receive all payments (including interest payments and instalments) from wholesale customers that are fully performing and contractually due within the 30 day horizon. In addition, financial institutions are assumed to continue to extend loans to wholesale clients, at a rate of 0% of inflows for financial institutions and central banks, and 50% for all others, including non-financial corporates, sovereigns, multilateral development banks, and PSEs. This will result in inflow rates of:
 - i. 100% for financial institution and central bank counterparties; and
 - ii. 50% for non-financial wholesale counterparties.
142. Inflows from securities maturing within 30 days not included in the stock of HQLA should be treated in the same category as inflows from financial institutions (i.e. 100% inflow). Financial institutions may also recognize in this category, inflows from the release of balances held in segregated accounts in accordance with regulatory requirements for the protection of customer trading assets, if these segregated balances are maintained in HQLA. This inflow should be calculated in line with the treatment of other related outflows and inflows covered in this document. Level 1 and Level 2 securities maturing within 30 days should be included in the stock of liquid assets, provided that they meet all operational and definitional requirements for HQLA.
143. Deposits held at other financial institutions for operational purposes, such as those stemming from relationships described earlier under the category of outflows relating to clearing, custody, and cash management activities, are assumed to stay at those institutions, and no inflows can be counted for these funds – i.e. they will receive a 0% inflow rate.

Other Cash Inflows

144. The sum of all net cash inflows relating to derivatives should receive a 100% inflow factor. The amounts of derivatives cash inflows and outflows should be calculated in accordance with the methodology described under “Derivatives Cash Outflows” at **section 6.1.5**.
145. Where derivatives are collateralized by HQLA, cash inflows should be calculated net of any corresponding cash or contractual collateral outflows that would result, all other things being equal, from contractual obligations for cash or collateral to be posted by the financial institution, given these contractual obligations would reduce the stock of HQLA. This is in accordance with the principle that financial institutions should not double-count liquidity inflows or outflows.
146. It should be noted that cash inflows related to non-financial revenues are not taken into account in the calculation of the net cash outflows for the purposes of the proposed LCR.
147. Under the proposed LCR, all other contractual cash inflows not included elsewhere in this document are ascribed a cash inflow rate of 0%.

SECTION 7: REPORTING REQUIREMENTS

148. This section outlines general requirements for licensees with respect to the reporting of their various LCR positions at the consolidated and standalone levels.
149. Under the proposed LCR, the components of the LCR must be reported in a single currency for the purposes of determining the LCR in the domestic currency and various foreign currencies. In addition, the proposed LCR would also require that amounts be monitored and reported in each significant currency, where a significant currency is one that comprises at least 5% of the deposit taking institution's total liabilities. For amounts in currencies not deemed significant, the amounts will be required to be converted into Jamaican dollars and reported in the "other" category.
150. The monitoring and reporting of LCR in significant foreign currencies will be required for the purposes of tracking potential currency mismatch issues that could arise in a time of stress. There is no internationally defined minimum foreign currency LCR threshold. However, under the proposed LCR, licensees will be expected to adhere to the 100% minimum threshold that obtains for domestic currency LCR.
151. Expressed as a formula, the minimum LCR requirement for each significant foreign currency in the proposed LCR will be:

$$\frac{\text{Stock of HQLA in each significant currency}}{\text{Total net cash outflows over the next 30 calendar days}} \geq 100\% \\ \text{in each significant foreign currency}$$

152. For the purposes of the LCR, funds that are necessary to fulfil the day-to-day operational needs of the financial institution, including salaries and benefits, information technology, marketing, taxes, and other operating expenses, should be excluded from calculation of the stock of HQLA.
153. Licensees would be required under the proposed rule to notify the Supervisor immediately if their domestic or foreign currency LCR has fallen, or is expected to fall, below 100%, with their report explaining the following:
- Factors leading to LCR falling below or the expectation thereof;
 - Remedial measures to restore LCR position; and
 - Expected duration of LCR falling below 100%.

Proposal: Using the add-on approach to calculate total net cash outflows

154. The proposed will adopt an add-on approach for the purposes of calculating the denominator of the LCR requirement – total net cash outflows. The add-on approach determines the denominator of the LCR by considering the largest daily net cumulative cash outflow amount within the following 30 calendar day period rather than total net cash outflows as calculated at the end of a 30 calendar day period, which is the method employed in the Basel III LCR. This approach for calculating total net cash outflows is used in the US LCR rule.
155. The peak day approach takes into account potential maturity mismatches between a financial institution's outflows and inflows during the 30 calendar day period, which are not contemplated in the Basel III LCR. That is, the risk that a financial institution

could have a substantial amount of contractual inflows that occur late in a 30 calendar day period while also having substantial outflows occurring early in the same period. Such maturity mismatches have the potential to threaten the liquidity position of the organization during a time of stress – a possibility that would not be accounted for in the Basel III LCR denominator calculation. The “peak day approach” expansion of the denominator has the effect of requiring financial institutions to hold a greater stock of HQLA to cover a potential maturity mismatch. By requiring the recognition of the largest net cumulative outflow day within the 30 calendar day period, the add-on approach of the proposed LCR aims to more effectively account for a financial institution’s liquidity risk and foster more sound liquidity management.

156. The categories of inflows and outflows included in the add-on calculation comprise those categories that are the most likely to expose financial institutions to maturity mismatches within the 30 calendar day period, such as repurchase agreements and reverse repurchase agreements with financial sector entities. The calculation does not assume that all transactions and instruments that do not have a contractual maturity date have an outflow amount on the first day of the 30 calendar day period. Therefore, outflows such as non-maturity retail deposits are not a part of the add-on calculation. However, the add-on calculation includes the non-maturity deposits that are not retail deposits and treats them as maturing on day 1 of the stress scenario. This approach avoids potential unintended consequences by eliminating the assumption that all non-maturity outflows occur on the first day of a 30 calendar day period while still achieving the underlying goal of recognizing maturity mismatches.

Illustrative Example: Calculation of Total Net Cash Outflows using the add-on approach

157. For the purposes of the proposed LCR, the add-on approach, which involves two steps, will be used to calculate total net cash outflows for financial institutions. The first step involves calculating net cumulative outflows by netting the cumulative cash outflows and cash inflows over the 30 day period, mirroring the net cash outflows calculation from the Basel III LCR.
158. In the example below, the first step is calculated by Column (1) + Column (2) minus the lower of 75% of Column (1) + Column (2) and Column (4) + Column (5).
That is, Net Cash Outflows = 250 + 715 – MIN (0.75 * (250 + 715), 100 + 845)
159. The add-on approach, however, expands on the approach in the Basel III LCR in the second step. The second step in the example below involves calculating the add-on, which identifies the highest single-day maturity mismatch within the 30 calendar day period. This is done by calculating the daily difference in cumulative cash outflows and cash inflows that have maturity dates within the 30 calendar day period (Column 3 and Column 6). The day with the highest difference is the net cumulative peak day. That is, Net cumulative peak day = 120 – 80
160. Next, calculate the difference between the cumulative peak day and the net cumulative outflow amount on the final day of the 30 calendar day period for those same outflow and inflow categories (i.e. Column 3 and Column 6). The difference is the add-on.
161. The net cumulative outflow amount on the final day of the 30 calendar day period is Column 3 minus Column 6 on day 30 = 715 – 845

162. In calculating the add-on, both the net cumulative peak day amount and the net cumulative outflow amount on the last day of the 30 calendar day period cannot be less than zero. Therefore, the higher of 40 and 0 minus the higher of 0 and -130, is the add-on, which in this instance is $40 - 0 = 40$

Appendix: External Ratings Framework

1. The introduction of the LCR presents opportunities for the application of external ratings within Jamaica’s prudential regulatory framework. External ratings, for these purposes, are credit ratings produced by external credit assessment institutions (ECAIs) that are independent of the entity being assessed and approved by the Supervisor.
2. The adoption of a framework that recognizes external ratings holds the potential to broaden the range of high quality investable assets that financial institutions may rely on as sources of liquidity in the management of liquidity risk. Furthermore, to the extent that these assets qualify as HQLA, they may also facilitate financial institutions in satisfying the forthcoming LCR requirements.
3. To complement the introduction of an external ratings regime, the regulatory framework will impose due diligence requirements on financial institutions that utilise externally rated securities for the purposes of satisfying the regulatory requirements, in order to avoid the risk of mechanistic reliance on external ratings – one of the frequently cited causes for the 2007 global financial crisis.
4. As stated earlier, the proposed LCR will designate CariCRIS as an ECAI. Two key benefits that may be derived from designating CariCRIS as an ECAI for the purposes of the proposed LCR are discussed below.

1. Rating Methodology - National Scale

5. One advantage associated with CariCRIS is the availability of a national rating scale, including a Jamaican rating scale.²⁰ This stands in contrast to the top 3 international rating agencies (Moody’s, S&P and Fitch) which generally produce ratings on a global scale, with national ratings available on a limited basis.
6. Another benefit arising from national ratings is the opportunity for comparison of issuer ratings within Jamaica. CariCRIS provides a consistent, objective means of risk differentiation for debt securities issued by corporates in Jamaica.
7. Another benefit arising from the national rating scale is that it provides a solution to the sovereign ceiling problem generally associated with international ratings. The impact of this problem is that it is extremely difficult for corporate issuers in a given jurisdiction to receive a higher external credit rating than the rating ascribed to its sovereign, although it has been widely recognised that a sovereign ceiling often places undue and distortive downward pressure on the ratings of corporates. This is particularly problematic in view of the fact that Jamaica’s sovereign rating, is currently below investment grade rating based on assessments produced by the international rating agencies.²¹ Furthermore, there is no evidence of any corporate issuer in Jamaica “piercing” the sovereign ceiling. Notably, under the LCR, only investment grade rated corporate securities may qualify as HQLA.

²⁰ The CariCRIS regional scale assesses the creditworthiness of an obligor relative to other issuers and issues across the Caribbean region, while the national scale assesses the creditworthiness of an obligor relative to other issuers and issues in the applicable jurisdiction – with the sovereign carrying the highest rating of AAA.

²¹ Jamaica’s latest sovereign rating from Moody’s, S&P, and Fitch was B3, B, and B, respectively.

8. CariCRIS national rating scales avoid the sovereign ceiling dilemma by treating the sovereign in the respective jurisdiction as having the highest rating on that jurisdiction. Notably, the admission external ratings derived from a Jamaican rating scale for the purpose of determining whether Jamaica corporate debt securities qualify as HQLA will be accompanied by appropriate due diligence obligations imposed on licensees.

2. *Relative Cost*

9. A CariCRIS rating also offers a cost advantage when compared to the costs of procuring ratings by international rating agencies. This will therefore enable a wider range of issuers to get rated, and access the associated funding and reputational benefits. The cost of procuring credit ratings from the big three rating agencies may be prohibitive for Jamaican corporates.