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Tougher than Basel

Basel implementation in the United States continues to progress, as shown by the recent release of a proposed rule on the application of the liquidity coverage ratio, or LCR. The proposed LCR is largely consistent with the Basel Committee on Banking Supervision's LCR standard, but tougher.

The proposed rule would apply to internationally-active banking organisations with $250 billion or more in total consolidated assets, or $10 billion or more in on-balance sheet foreign exposure, as well as designated non-bank systemically important financial institutions that do not have substantial insurance operations. A less stringent version, termed LCR lite, would apply to smaller depository institutions. As under the Basel rule, covered companies would be required to hold high-quality liquid assets (HQLA) of at least 100% of the company's total net cash outflows over a prospective 30 calendar-day period. However, the types of assets that qualify as HQLA for US banks are more limited than those considered qualifying for European banks. Under the proposed rule, the measure of the rate of cash outflow is also more punitive, as it is based on the bank's largest net cumulative cash outflow day within a 30-day liquidity stress, as opposed to the more moderate Basel version of this calculation. US banks would have a shorter transition period than that contemplated by Basel. Covered US banks would be required to maintain an LCR of 80% as of January 1 2015, with step-ups until January 1 2017 when the LCR will be fully implemented.

Maybe these more stringent rules should not have come as a surprise, given the pattern that the US banking agencies seem to be setting, with tougher regulatory capital rules and more stringent stress tests. It also seems clear, based on recent speeches from regulators, that more is on the way in 2014. At the very least, the banking agencies seem to be focused on a new long-term debt requirement for large internationally active financial institutions to have minimum amounts of long-term unsecured debt outstanding to absorb losses in an insolvency and facilitate an orderly liquidation. We can also anticipate measures designed to discourage reliance on short-term wholesale funding.

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