RESERVE BANK
OF NEW ZEALAND

Quantitative Liquidity Requirements Guidelines

Prudential Supervision Department
Non-bank deposit takers

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Part 1—Introduction

1. **Purpose of this document**

This document provides non-binding guidance to non-bank deposit takers (NBDTs) and trustees in relation to the quantitative liquidity requirements established by the Deposit Takers (Liquidity Requirements) Regulations 2010 (“the regulations”).

2. **Relationship of this document to other requirements and guidelines**

These guidelines should be considered alongside the risk management programme requirements set out in section 27 of the Non-bank Deposit Takers Act 2013 (the Act) and the Reserve Bank’s Risk Management Programme Guidelines.

3. **Meaning of Liquidity Risk**

Liquidity risk is the risk that an NBDT is unable to meet its financial commitments as they fall due or that it suffers material loss in doing so.

Part 2—Quantitative Liquidity Requirements

General Matters

4. **Requirement for quantitative liquidity requirements in trust deeds**

Since 1 December 2010 the regulations have required an NBDT’s trust deed to include one or more quantitative liquidity requirements. These quantitative requirements must:

(a) take into account the liquidity of the NBDT and any borrowing group that it is part of; and

(b) be appropriate to the NBDT’s business, as well as the borrowing group if present.

5. **Expectation for quantitative liquidity requirements**

(1) Quantitative liquidity requirements are intended to enhance an NBDT’s ability to meet its financial commitments for an extended period of time under both normal and stressed conditions.

(2) A quantitative liquidity requirement refers to a quantitative risk metric that an NBDT can use to measure and manage its exposure to liquidity risk.

(3) In some cases, more than one risk metric may be needed to meet the requirements of the regulations.

Quantitative risk metrics

6. **Risk metrics in trust deeds**

(1) An NBDT's trust deed should specify the quantitative risk metrics used to meet its quantitative liquidity requirements.

(2) Quantitative risk metrics that may be relevant for an NBDT include:

(a) a liquidity coverage ratio – to measure the extent to which the NBDT holds sufficient liquid assets able to meet withdrawals of some proportion of its liabilities; and

(b) a mismatch ratio – to measure the extent to which the maturity profile of the NBDT's funding matches the maturity profile of its lending.

7. **Suitability of risk metrics**

(1) The quantitative risk metrics specified for an NBDT should be appropriate to the NBDT's business, i.e. funding and lending. For example, an NBDT's business may be based on attracting longer-term funding or on shorter-term funding or on a combination of both.

(2) An NBDT could include liquid asset coverage ratios in its trust deed to measure and manage liquidity risk that arises in the short term, and mismatch ratios for liquidity risk that arises in the medium to long term. For example, the trust deed for an NBDT with a funding profile containing maturities ranging from call funding to 5 year securities could include:

(a) a liquid asset coverage ratio requirement for call funding: i.e. liquid assets as a percentage of call funding;

(b) a liquid asset coverage ratio requirement for call plus 30 day funding: i.e. liquid assets as a percentage of call funding and 30 day funding;

(c) a mismatch ratio requirement over the next 180 days: i.e. funding repayable within 180 days less lending due to mature within 180 days as a percentage of total liabilities;

(d) a 360 day mismatch ratio requirement; and

(e) a 5 year mismatch ratio requirement.

(3) Limits for the ratios should be set in accordance with guidance provided under sections 10 and 11 and will typically be expressed as a minimum requirement for a liquid asset coverage ratio or as a maximum mismatch permitted for the NBDT (i.e. its funding repayable less its maturing lending).

Elements of the risk metric

8. **Cash flow modelling**

(1) An NBDT should have a robust cash flow model underlying its quantitative risk metrics.

(2) The cash flow model used by an NBDT should be as sophisticated as is needed to capture the cash flows in the NBDT's business. In some cases simple cash flow models may be sufficient.

(3) An NBDT should model cash flows for the risk metrics based on the likely effective maturity profiles of assets and liabilities rather than their contractual

maturities. Assumptions about effective maturities should be based on previous demonstrated behaviour of similar assets and liabilities. A material difference between contractual maturities and effective maturities can lead an NBDT to underestimate liquidity risk if its cash flows are modelled on contractual maturities.

(4) Examples of when there may be a material difference between contractual and effective maturities are:

(a) Loans provided on call – these loans are contractually repayable immediately when called. However these loans typically take the form of overdrafts that have been extended and are not likely to be repaid on demand.

(b) Loans that have a fixed contractual maturity date but an expectation that it can be rolled over. If the loan is rolled over, the effective date of the cash inflow from the loan repayment will be later than its contractual maturity.

9. Eligible liquid assets

(1) An NBDT and its trustee should consider the type of liquid assets eligible for inclusion in the calculation of a quantitative risk metric.

(2) An NBDT and its trustee should consider specifying eligible liquid assets in the NBDT's trust deed.

(3) Eligible liquid assets should include cash and securities that are readily realisable, and of high quality.

(4) The undrawn balance of a committed line granted to an NBDT could be included as a liquid asset provided that the NBDT and its trustee are satisfied that the line is a sufficiently reliable source of funds, after considering factors including:

(a) whether the line is irrevocable for a long enough period for the nature of the risk metric; and

(b) whether the provider is sufficiently creditworthy, as indicated for instance by an external credit rating.

(5) For the purposes of subsection (3), "cash" should generally refer to:

(a) notes and coins; and

(b) on-call balances that in normal circumstances can be called on the day they are required to meet payments.

Setting limits for risk metrics

10. Approach to setting limits

(1) An NBDT should agree with its trustee the limit for each quantitative liquidity risk metric in the trust deed.

(2) The limit for each quantitative liquidity risk metric should be set in the NBDT's trust deed based on the NBDT's tolerance for liquidity risk.

(3) An NBDT should consider a range of stress scenarios when determining its tolerance to liquidity risk.

(4) The NBDT's risk tolerance should be:

(a) determined by the governing body of the NBDT as outlined in the Risk Management Programme Guidelines; and

(b) agreed by its trustee.

11. **Stress scenarios**

(1) The stress scenarios considered by an NBDT should include those that have a low probability of occurring and a high impact if they occur such as those which could arise from economic downturns, firm-specific events or systemic liquidity shocks.

(2) When testing its cash flow models with stress scenarios, an NBDT should consider how its assets and liabilities behave when stressed. For example, as a result of a shock an NBDT may be faced with:

(a) a reduced ability to raise new funding;

(b) withdrawals of funding before contractual maturity;

(c) defaulting loans;

(d) illiquidity of its loan book; or

(e) a combination of the above.

(3) Particular firm-specific characteristics will influence the extent to which an NBDT is impacted by a stress event. For example:

(a) when lending is concentrated in a sector or individuals, the liquidity risk for the NBDT from a stress scenario that affects the sector or individuals is high;

(b) when an NBDT has a large proportion of lending where the interest on the lending is capitalised, the NBDT's exposure to deteriorating asset quality is high;

(c) when there are covenants and credit rating triggers associated with an NBDT's funding, if the NBDT is faced with a shock that results in financial pressures on the entity these pressures may be intensified by further funding withdrawals; and

(d) when an NBDT's funding is sticky, then it may be better able to retain funding in a stress event than its counterparts. If an NBDT's funding is not sticky then it should assume that its call funding as well as a proportion of its fixed funding will be withdrawn in a stress event.

Review

12. **Review of the risk metrics**

(1) An NBDT and its trustee should keep under review the NBDT's exposure to liquidity risks and the quantitative risk metrics and the limits set in relation to each quantitative risk metric in light of the NBDT's exposure to liquidity risks.

(2) An NBDT and its trustee should review the quantitative risk metrics and the limits set in relation to each quantitative risk metric when the NBDT's business or structure changes.