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Circular to all Chief Executives of Commercial Banks

<u>Roll out of the Liquidity Coverage Ratio (LCR)</u>

Following the completion of a successful 2 year pilot monitoring period involving four banks, Bank of Uganda will be rolling out the Basel III Liquidity Coverage Ratio (LCR) effective March 1 2014. All commercial banks shall be required to comply with the minimum Liquidity Coverage Ratio (LCR) of 100% on an ongoing basis starting September 01, 2014.

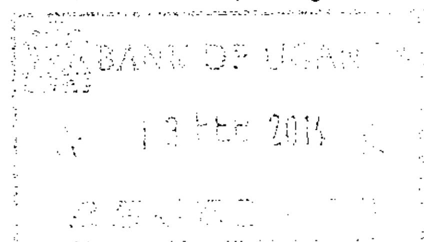
Accordingly, Commercial banks that are currently below the LCR minimum requirement of 100% are advised to build up their stock of liquid assets with a view to meeting the LCR starting September 01, 2014.

Please note that the LCR will be calculated using data from the *Monthly Maturity Analysis of Assets and Liabilities Report.* Bank of Uganda will circulate a revised version of this return at a later date, which will require reporting of positions in Shillings, foreign currency and total.

The purpose of this circular is therefore to notify you of the roll out of the LCR on **March 01, 2014** and to direct all commercial banks to comply with the minimum LCR of 100% effective **September 01 2014**. A detailed guideline on the calculation of the LCR is attached for your attention.

Yours sincerely,

Benedict Ssekabira
Ag. Executive Director, Supervision



BANK OF UGANDA

CALCULATION OF THE LIQUIDITY COVERAGE RATIO (LCR)

a) Introduction

All commercial banks are required to meet the LCR on an ongoing basis. The LCR is intended to promote resilience to potential liquidity disruptions over a thirty day horizon. The ratio ensures that institutions have sufficient unencumbered, high quality liquid assets to offset the net cash outflows it could encounter under an acute short-term stress scenario.

b) Application of the LCR

This section outlines a number of issues related to the application of the LCR. These issues include the frequency with which the LCR will be calculated, the scope of application of the LCR (whether they apply at group or entity level and to foreign bank branches) and the.

Frequency of calculation and reporting

All commercial banks should calculate and use the LCR on an ongoing basis to help monitor and control liquidity risk. Bank of Uganda will calculate the LCR for each bank on a monthly basis, and for Systemically Important Banks on a weekly basis. For some banks, this may be extended to daily calculation in stressed situations at the discretion of BOU.

Banks are expected to notify Bank of Uganda immediately if their LCR has fallen, or is expected to fall, below 100% and of large changes in their liquidity profile that may impact on their ability to meet the LCR on an ongoing basis

Scope of the LCR

The LCR standard and monitoring tools will be applicable to banks on a consolidated basis, except for certain restrictions outlined in Appendix A.

Aggregation of currencies within the LCR

The LCR should be met in shillings. However, Bank of Uganda may require banks to meet the LCR in significant currencies.

c) The minimum requirement and Components of the LCR

The LCR is calculated as:

$$\frac{\textit{Stock of high quality liquid assets}}{\textit{Net cash outflows over a } 30 - \textit{day time period}} \geq 100\%$$

The LCR should be no lower than 100 percent i.e. the stock of high-quality liquid assets should at least equal total net cash outflows. The amount of inflows that can be used to offset outflows has been capped in the denominator of the LCR. This was done to ensure that banks maintain a minimum stock of liquid assets equal to 25 percent of the outflows. This will prevent banks from relying solely on anticipated inflows to meet their liquidity requirement.

The LCR has two components:

- Stock of high-quality liquid assets; and
- Net cash outflows over 30 days

- ***High-quality liquid assets (HQLA)***

The numerator of the LCR is the "stock of high-quality liquid assets". Under the standard, banks must hold a stock of unencumbered high-quality liquid assets to cover the total net cash outflows (as defined below) over a 30-day period. High-quality liquid assets include some of the 'liquid assets' specified in Section 28 (b) of the FIA 2004 (with varying conversion factors as applicable to LCR) and any other assets with the following characteristics; should be liquid in markets during a time of stress and, ideally, be central bank eligible, low risk, ease and certainty of value, low correlation with risky assets, listed on a developed and regional exchange. Market related characteristics of HQLA include: Existence of an active and sizable market characterized by low bid-ask prices, high volumes of trading and large number of market participants, Low volatility of traded prices and spreads, Flight to quality: Market participants tend to move to this asset type in times of distress.

HQLA consist of both Level 1 assets and Level 2 assets. Level 1 assets can be included without limit and these include cash and balances held at Bank of Uganda. Level 2 assets are less liquid and a haircut will be applied subject to national discretion. In the case of Uganda, marketable securities maturing in 91 days or more fall in this category. Level 2 assets can only comprise of up to 40 percent of the stock of HQLA.

- ***Net cash outflows***

Total net cash outflows are defined as the total expected cash outflows minus total expected cash inflows for the subsequent 30 calendar days. ***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. In Uganda, cash outflows include liabilities with a contractual maturity of 30 days or less for example: customer deposit withdrawals,

amounts due to banks in Uganda, amounts due to banks abroad (which may include maturing currency swap transactions to non-resident customers), and off-balance sheet items.

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 percent of total expected cash outflows. Banks are not be permitted to double count items – i.e. if an item is included as part of the "stock of high-quality liquid assets" (i.e. the numerator), the assets cannot also be counted as cash inflows. For banks in Uganda, cash inflows include; loans and advances, due from banks in Uganda and amounts due from banks outside Uganda including repos, placements, swaps and short term loans.

Net cash outflows over the next 30 calendar days = Total expected cash outflows – Min {total expected cash inflows; 75% of total expected cash outflows}

d) Conversion factors for computing the Liquidity Coverage Ratio

Following the BCBS guidelines, Bank of Uganda conducted several studies to fine-tune conversion factors for the LCR. These were further tested during the pilot phase.

For HQLA, the fundamental and market principles outlined above were effected and the legal considerations on what banks can discount at BoU were taken into consideration. For the expected cash inflows and outflows, the conversion factors were set based on the observed trend in the Ugandan banking sector during stressful periods, as well as supervisory judgment in line with Basel recommendations. Table 1 below shows the conversion factors to be used in the computation of LCR for Ugandan commercial banks.

Table 1: Conversion factors for computing Liquidity Coverage Ratio for Commercial Banks in Uganda

	Factor (to be multiplied against amount)
Stock of high quality liquid assets	
Cash	100%
Balances with BOU	100%
Investment securities maturing in 91 days	100%
Marketable securities maturing in 91 days	100%

Marketable securities with maturity of more than 91 days	20%
Total value of stock of highly liquid assets	
Cash Outflows	
Demand and savings deposits	15%
Time deposits (maturing in 30 days)	100%
Due to banks and non banks in Uganda (maturing in 30 days)	100%
Due to Banks and non-Banks abroad (maturing in 30 days)	100%
Other liabilities (maturing in 30 days)	100%
Off-balance sheet cash outflows	5%
Total cash outflows	
Cash Inflows	
Loans and advances (maturing in 30 days)	15%
Due from Banks and Non-Banks in Uganda (maturing in 30 days)	100%
Due from Banks and Non-Banks abroad (maturing in 30 days)	100%
Total cash inflows	
Total net cash outflows = Total cash outflows minus min [total cash inflows, 75% of gross outflows]	
Liquidity coverage ratio = (Total value of stock of high quality liquid assets / Net cash outflows)	

Appendix A.

B. Further Instruction on Scope of application

A bank should actively monitor and control liquidity risk exposures and funding needs at the level of individual legal entities, foreign branches and subsidiaries, and the group as a whole, taking into account legal, regulatory and operational limitations to the transferability of liquidity.

1. Differences in home / host liquidity requirements

When calculating the LCR on a consolidated basis, a cross-border banking group should apply the liquidity parameters adopted in Uganda to all legal entities being consolidated except for the treatment of *retail / small business deposits* that should follow the relevant parameters adopted in the host country in which the entities (branch or subsidiary) operate. This approach will enable the stressed liquidity needs of legal entities of the group (including branches of those entities) operating in host jurisdictions to be more suitably reflected, given that deposit run-off rates in host jurisdictions are more influenced by jurisdiction-specific factors such as the type and effectiveness of deposit insurance schemes in place and the behaviour of local depositors.

2. Treatment of liquidity transfer restrictions

No excess liquidity will be recognised by a cross-border banking 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 banking group operates will affect the availability of liquidity by inhibiting the transfer of HQLA and fund flows within the group. The consolidated LCR should reflect such restrictions. A banking 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.