BETTER MARKETS

February 2, 2016

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue N.W.
Washington, D.C. 20551

Re: Liquidity Coverage Ratio: Public Disclosure Requirements; Extension of Compliance Period for Certain Companies to Meet the Liquidity Coverage Ratio Requirements, Docket No. R-1525, RIN 7100 AE 39

Dear Mr. Frierson:

Better Markets[1] appreciates the opportunity to comment on the above-captioned rule proposed ("Proposed Rule") by the Board of Governors of the Federal Reserve System ("Board") requiring financial institutions subject to the liquidity coverage ratio to disclose publicly information about their liquidity profiles.

INTRODUCTION AND SUMMARY OF COMMENTS

The financial crisis of 2008 made it painfully apparent that many of the world's largest financial institutions had insufficient liquid assets on hand to withstand the financial crisis. In fact, the illiquidity of these institutions worsened the financial crisis by precipitating a fire sale of illiquid assets as institutions sought to obtain liquidity to meet their obligations as they came due. Because of the catastrophe that resulted from grossly insufficient stores of liquidity, financial regulators adopted—for the first time ever—formal standards governing the liquidity management of large, complex financial institutions.

To ensure that large, complex financial institutions had sufficient amounts of high quality liquid assets during times of stress, the Basel Committee on Banking Supervision adopted a requirement that these institutions have enough cash or easily monetizable assets on hand to meet their liquidity needs to survive for 30 days if their usual sources of short-

1 Better Markets, Inc. is a nonprofit organization that promotes the public interest in the domestic and global capital and commodity markets. It advocates for transparency, oversight, and accountability in the financial markets.

term funding dried up. This requirement is the liquidity coverage ratio, which is defined as a financial institution's stock of high-quality liquid assets divided by its net cash outflows over a 30-day time period under an acute liquidity stress scenario.

The Proposed Rule would require certain financial institutions to disclose publicly information about its liquidity coverage ratio on a quarterly basis. The Proposed Rule would require these institutions to disclose information about its high-quality liquid assets, its cash outflows, and maturity mismatches. As the Proposed Rule notes, such disclosure would help market participants better assess the risk that market participants are in fact bearing in dealing with these institutions. As a result, the Proposed Rule would increase transparency and strengthen market discipline.

Better Markets strongly supports the Board's efforts to require financial institutions to disclose publicly information about their liquidity profiles. Such disclosure would help ensure that market participants have a better understanding of the risks they are assuming in dealing with these institutions as creditors and counterparties, which would help them better manage their liquidity and credit risks. As a result, the terms and prices on which these market participants do business with large, complex financial institutions would better reflect these risks, helping to ensure that these institutions internalize the full costs of the systemic risk these institutions pose to the broader financial system.

Quarterly disclosure, however, would be too infrequent to provide the benefits that the Board outlined in its proposal and seeks to achieve. Quarterly disclosure will not provide the market with the information that market participants need to timely price risk. Market discipline requires high quality, authoritative and timely information. Rather than improving market discipline and forestalling crisis, quarterly disclosure of information related to a firm's liquidity coverage ratio will be destabilizing at times of crisis and engender creditor runs.

COMMENT

The Board should require institutions to report information about their liquidity profiles more frequently than once a quarter.

Financial institutions, market participants, and regulators frequently underestimate or misunderstand the liquidity risks that large, complex financial institutions take in managing balance sheets that total in the hundreds of billions or trillions of dollars. These risks can change quickly, leaving creditors and counterparties blindsided when asset prices change suddenly and liquidity disappears. As economists at the International Monetary Fund put it,

> [T]he liquidity properties of assets and liabilities can change abruptly during crisis periods; information amplifiers may render illiquid assets that are

> normally close substitutes for cash, or subject even notionally long-term liabilities to "runs."[2]

It is precisely because the liquidity position of a firm can change so quickly that the Board should require more frequent disclosure. Given the frequency and speed with which financial institutions can change their positions, a firm's liquidity profile could change significantly over the course of a single day. As a result, requiring quarterly disclosure all but guarantees that the information being provided to market participants, creditors, and counterparties will be stale and of little use in managing risk or pricing credit. Quarterly disclosure gives creditors and counterparties the data they would have needed to price for risk one, two or three months earlier—not the data they need to price for risk at the time they are extending credit or entering into transactions with a large, complex financial institution.

The most effective way to ensure that the disclosure of the liquidity coverage ratio meets the needs of transparency and market discipline would be to require large, complex financial institutions to disclose their liquidity profiles on a daily basis. In its Proposed Rule, the Board appears to have contemplated daily disclosure and rejected it because "destabilizing covered companies . . . could occur with more frequent public disclosure."

The concern expressed by the Board is misplaced. More frequent disclosure would not be destabilizing. Instead, it is quarterly disclosure that would be destabilizing: rather than being able to adjust to daily incremental changes in a covered institution's liquidity position, market participants, creditors, and counter-parties would instead find themselves responding to large changes that have occurred in an institution's liquidity profile since its last quarterly disclosure. As a result, market participants, creditors, and counterparties will be on a hair trigger, requiring them to react precipitately to any change in a firm's liquidity profile.

If the Board required more frequent disclosure, market participants could react more often to smaller, more gradual changes, rather than reacting once every three months to sharp, discontinuous changes in liquidity profiles. If the Board's goal is to provide transparency and enhance market discipline without destabilizing companies or roiling financial markets, more frequent disclosure would better serve the Board in achieving these goals.

CONCLUSION

Better Markets supports the goals that underlay the liquidity coverage ratio and the Board's Proposed Rule. The financial crisis demonstrated that large, complex financial institutions had shifted the downside of liquidity risk to taxpayers. The only way to ensure that these institutions do not externalize that risk to the financial system as a whole or the taxpayer is to adopt robust and frequent disclosure requirements for their liquidity profiles.

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[2] Daniel C. Hardy and Philipp Hochreiter, "A Simple Macroprudential Liquidity Buffer," IMF Working Paper (Dec. 2014), *available at* https://www.imf.org/external/pubs/ft/wp/2014/wp14235.pdf.

Requiring these institutions to disclose their liquidity profiles only once every three months is not enough and will be destabilizing.

We hope these comments are helpful.

Sincerely,

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