

Annex 1

Summary description of the LCR

To promote short-term resilience of a bank's liquidity risk profile, the Basel Committee developed the Liquidity Coverage Ratio (LCR). This standard aims to ensure that a bank has an adequate stock of unencumbered high quality liquid assets (HQLA) which consists 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.

The LCR has two components:

- (a) the value of the stock of HQLA; and
- (b) total net cash outflows,

and is expressed as:

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

High Quality Liquid Assets

The numerator of the LCR is the stock of HQLA. Under the standard, banks must hold a stock of *unencumbered* HQLA to cover the total net cash outflows over a 30-day period under the prescribed stress scenario. In order to qualify as HQLA, assets should be liquid in markets during a time of stress and, in most cases, be eligible for use in central bank operations. Certain types of assets within HQLA are subject to a range of haircuts.

HQLA are comprised of Level 1 and Level 2 assets. Level 1 assets generally include cash, central bank reserves, and certain marketable securities backed by sovereigns and central banks, among others. These assets are typically of the highest quality and the most liquid, and there is no limit on the extent to which a bank can hold these assets to meet the LCR. Level 2 assets are comprised of Level 2A and Level 2B assets. Level 2A assets include, for example, certain government securities, covered bonds and corporate debt securities. Level 2B assets include lower rated corporate bonds, residential mortgage backed securities and equities that meet certain conditions. Level 2 assets may not in aggregate account for more than 40% of a bank's stock of HQLA. Level 2B assets may not account for more than 15% of a bank's total stock of HQLA.

Total net cash outflows

The denominator of the LCR is the total net cash outflows. It is 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* 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 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. Total

cash inflows are subject to an aggregate cap of 75% of total expected cash outflows, thereby ensuring a minimum level of HQLA holdings at all times.

Liquidity Coverage Ratio

The standard requires that, absent a situation of financial stress, the value of the ratio be no lower than 100%¹ (ie the stock of HQLA should at least equal total net cash outflows). Banks are expected to meet this requirement on an ongoing basis and hold a stock of unencumbered HQLA as a defence against the potential onset of liquidity stress. During a period of financial stress, however, banks may use their stock of HQLA, thereby falling below 100%.

¹ The 100% threshold is the minimum requirement absent a period of financial stress, and after the phase-in arrangements are complete. References to 100% may be adjusted for any phase-in arrangements in force at a particular time.