David Morgan
Prudential Standards
Conduct and Organisational Policy
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

6 January 2009

Dear Mr Morgan,

Response to the risk reporting questions within the Consultation Paper 08/22 entitled "Strengthening liquidity standards", issued for comment in December 2008.

Avantage Reply has pleasure in submitting responses to some of the questions raised in section 8 of the above referenced document (CP 08/22), entitles "Discussion: liquidity Reporting" as follows:

Q66: Do you consider that a consultation period of less than three months will provide firms with an adequate period in which to consider our liquidity reporting CP and make representations to us?

Given the importance of establishing a robust and cohesive liquidity risk regulatory framework, it seems that imposing a very tight deadline on responses from industry may lead to a significantly reduced number of contributions.

Many organisations are likely to seek either a whole firm liquidity waiver, whole firm liquidity modification or an intra-group liquidity modification. The reporting requirements for these organisations have yet to be defined in terms of both format and frequency. It is therefore unlikely that such organisations will feel compelled to contribute to debate.

For those organisations not eligible for waivers or modifications there is a danger that seeking a consensus on reporting before finalising the new regulatory rules and guidelines is a little like putting the cart before the horse. Reporting represents the output from the deliberations yet to be completed. It therefore makes sense to ensure that all deadlines are coterminous but if one element could be allowed to come after all others then that would be reporting.

In conclusion the deadline appears aggressive. However, the main issue is more where in the process sign off on reporting should come. It is suggested that reporting consultation should finish no sooner than the rest of the subjects within the overall consultation process.

Q70: Will the proposed data items give us a sufficiently clear view of firms' liquidity positions, as well as a market-wide view? Are there any aspects of liquidity risk that are missing and should be captured?

Q71: Are there any current data items which you think unnecessarily duplicate the data collected through liquidity reporting and should therefore be withdrawn?
Q72: Do you have any specific comments on the details in the proposed data items?

The analysis is restricted to a three month view. The current credit crunch has been in place for approximately 18 months without an immediate end in sight. It is possible that without looking at aggregated data (e.g. 3 to 6 months, 6 to 12 months and 1 to 2 years) potential liquidity issues will not be flagged.

The report on marketable assets requests details of the top 20 assets by liquidity value. The term liquidity value needs to be explained on the form which may in turn clarify the purpose of the report. A large holding of a security is inherently less liquid than an average holding. Is it therefore expected that the liquidity value should factor in this attribute? Is the liquidity value a function of the value the asset will generate in a secured borrowing transaction? If so, does the firm have sufficient secured borrowing capacity (excluding central banks) to realise the value of the marketable assets? Details of secured borrowing capacity would provide a greater degree of comfort that liquidity values would be realised, especially where large asset exposure exist and amongst more illiquid asset classes that may require longer to sell as opposed to lend.

20 is a fairly arbitrary number. Furthermore, 20 seems a very small number in the case of the balance sheets of the larger organisations. It may be advisable to select a proportion of the total unencumbered assets to evaluate the liquidity capacity that might be reliably determined, say 20/25% or 50 ISINs as a maximum.

Finally many of the reports are monthly or quarterly and represent a point in time analysis. They are therefore subject to the same weaknesses associated with the previous regulatory reporting practices e.g. susceptible to window dressing and do not reflect forward looking nature of the risk.

A notable omission from the reporting requirements is any data on no contractual items. One of the features of the recent market turmoil has been the amount of non-contractual financial support provided by institutions to special purpose vehicles they have sponsored, particularly in the asset backed markets. The degree to which an institution is reliant on such financing tool may provide a level of commercial pressure to take on an obligation not formalised under contract.

Similarly, no reference is made to potential commitments in the pipeline. Financing high profile programmes often carry a degree of publicity and market awareness in advance of contractual closings that could not only undermine organisational credibility but also liquidity if for any reason the institution were to fail meet market expectations by not providing finance after all.

Q77: Do you foresee any issues (e.g. constraints related to IT systems) in the proposed possibility of switching at very short notice from weekly to daily reporting? If so, how could firms best address these challenges?

Effectively firms are being asked to report on a daily basis. Best practice would suggest that this capability should exist. However it is not unreasonable to expect that some firms will find it difficult initially, given their relative size and probable tradition of having always been cash long and therefore never having devoted too much resource on a risk perceived to be less important than others.

Another factor is that for many firms, accounting is based on trade date data whereas liquidity is a function of value dated dynamics. The classification of balance sheet data by value date as opposed to trade date has provided and may continue to provide many organisations with difficulties. The generation of new reports requires their accuracy to be verified. Ultimately an extensive process of reconciliation between trade date data and the liquidity reports may be required.

Some organisations have disparate trading and settlement systems (especially organisations that have acquired legacy systems) that require extensive capture and collation processing prior to reporting functions being run. It is not unreasonable to project that the addition of a significant number of daily regulatory liquidity reports to the overnight batch processes of many organisations will place a significant burden on IT and Treasury support.

Q78: Do you agree with our proposed approach to current reporting?

For most UK institutions, the vast majority of the currency liquidity exposures will be captured through an analysis of the two major global currencies and Sterling. However, where this is not the case the obligation is placed on the organisation to determine this and supply the equivalent data. The approach represents a sensible compromise between the desire to retain proportionally and the need to recognise significant risk drivers where they arise.

Q82: What are your views on our proposals for submission deadline?

While this may be regarded as reinforcing good risk management practice, the requirement to provide information before the start of the next working day will represent a significant strain on resources, especially for smaller complex organisations.

Automation of reporting is welcome. However it comes with the need for significant up-front investment by firms in IT and back office support at a time when cost containment is high on most organisations agenda. Furthermore, as mentioned, earlier, those organisations with multiple trading platforms and front office systems and legacy infrastructure frameworks across multiple locations may require significant development resource to enhance reporting capabilities to satisfy the new requirements.

In addition to the initial IT investment required, further investment will be needed to ensure that new service and product offerings are adequately integrated into the regulatory risk reporting framework. Once again the strain on resources will be disproportionately greater for smaller firms.

Finally the whole reporting capability will need to be supported within the risk and back office operational and reporting functions. The aggregation of data across many systems and departments even if achieved through 100% automation will require checks and reconciliations to be performed and validated. In the absence of full automation, manual work around will be necessary and in the case of new products and service offerings these will also require an investment in developing appropriate systems and developing capabilities.

In conclusion, the requirement to provide a capability for reporting externally risk data before the start of business next day will present many organisations with a significant increase in resources necessary to comply with this proposal.

Should you require any clarification of the points noted above, please do not hesitate to contact me on 020 7709 4000 or by e-mail at n.walker@reply.eu.

Yours sincerely,

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