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French Banking Federation Recommendations for the Delegated Act on Liquidity Coverage Ratio (LCR) in the Capital Requirement Regulation (CRR)

In accordance with articles 456 and 460 of Regulation n° 575/2013 (CRR) of the European Parliament and the Council, Commission should adopt Delegated Acts to specify certain provisions and requirements relative to Liquidity Coverage Ratio (LCR). It should notably be based on the reports published by the European Banking Authority on 20 December.

In this context this FBF paper aims at listing and clarifying the issues that need to be addressed in elaborating the Delegated Act on the in the Capital Requirement Regulation (CRR).

In our opinion the Reports and the EBA policy recommendations contain elements of uncertainty and room for potential interpretation. This paper seeks to highlight these issues and make recommendations for changes to the CRR text for consideration by the European Commission. We stand ready to complement this paper with additional information, if need be.

The FBF hope the following comments, which are illustrated in further detail in the annex, will offer constructive recommendations. As a summary:

Definitions and assumptions in the denominator (net cash outflows)

Facilities:

The treatment of facilities should be aligned with BCBS proposals in terms of both category and drawdown assumption.

Retail deposits

The proposed EBA guidance on the determining of higher outflows for retail deposits deemed to be high risk is extremely complex and prescriptive and requires banks to allocate runoff factors on those categories for which they have no historical data evidence, and that do not align with their own stress tests assumptions. The method would not enable a consistent approach across the industry.

We recommend that enough time is allocated to collect retail deposit balances on the EBA methodology, from which runoff factor could be derived in the future from an evidence based approach. In the meantime, we recommend that the currently applicable runoff factors apply (3%; 5% and 10%).

Established operational relationship definition

The definition of "operational established relationship" seems to be overly restrictive and prescriptive, with the possibility that there will be limited ability to allocate deposits to the operational category. The guidance appeared to exclude deposits from financial institutions as

Operational Deposits, which is inconsistent with the Basel rules which explicitly allow deposits from financial institutions to qualify as Operational Deposits provided they meet the relevant criteria.

We recommend that deposits from financial customers are eligible for operational established relationship treatment, if they meet the criteria for such a treatment.

Correspondent banking

The guidance issued by the EBA in December appeared to support the notion that correspondent banking deposits should not be subject to a 0% outflow factor, without specifying what the factor would be. This does not seem to be consistent in our view with the Basel rules which do allow deposits from financial institutions to qualify as Operational Deposits, provided they meet the relevant criteria.

We recommend that correspondent banking entities are not discriminated against, and that the portion that meets the criteria for established relationship should be considered as such.

Additional Liquidity Outflows on collateralized derivatives transactions (EBA draft RTS)

The EBA draft proposal is inconsistent with the LCR framework, as additional liquidity outflows are based on a market scenario that is at odds with the LCR scenario.

Moreover, as the LCR applies at entity level in Europe, the draft approach of EBA that consists in retaining the worst market scenario for each entity creates inconsistencies between entity level-LCR and Group-level-LCR which leads to an increased requirement for LCR-buffer and funding requirements.

We recommend the Commission to ensure that the method to determine liquidity outflows for collateralized transactions is consistent with LCR scenario, between entity level and Group level. The implementation complexity should remain limited.

Others Inflow and outflow assumptions

There should be a closer alignment of outflows and run off rates with the Basel rules, this is especially the case on retail deposits, and financial customers.

Some clarifications need to be made regarding outflow / inflows rates relative to operations with central banks and also inflow rates adequately defined in CRR but which seem to be questioned by the EBA in its report, such as trade finance.

Moreover we recommend that a principle of symmetry on intragroup transactions is applied for entities of a same Group.

Definition in the numerator (liquid assets)

High quality liquid assets (HQLA)

The definition of Liquid Assets is unclear on many aspects, especially regarding non-EEA assets. For EEA assets, we make some proposals that we invite the Commission to consider.

Regarding specific liquid assets, we recommend a modification allowing other types of residential loans to be included in the buffer, notably residential loans fully guaranteed by an eligible protection. Moreover we think specific requirements on covered bonds and RMBS defined in the EBA report are too numerous to be tested empirically.

For regional banks of cooperative banking networks we recommend they should be given the right to constitute their HQLA buffer through deposits placed at the central institution of the network.

Impact of LCR

We are concerned that the EBA concludes that there is no significant impact due to the different caps on level 2A and level 2B assets. The authority seems to have limited its study on the consolidated level and has taken no consideration about the impact on the solo level or jurisdiction level.

Recognition of Committed Liquidity facility

The BCBS has now recognised the Restricted Committed Liquidity facility (R-CLF) as HQLA, we ask the Commission to align with this recommendation, and leave the conditions of granting and pricing to the central bank competency.

ANNEX

A. *OUTFLOWS:*

1. *Outflows from Credit and Liquidity Facilities (Article 424)*

As Article 424(5) has not factored in BCBS§131(e)[1] in its break down of financial customers, it should be modified to break down Article 425.

Article 424(5)(d)"(d) facilities extended to financial institutions and investment firms." should therefore be modified into: "(d1): facilities extended to an insurance undertaking, a CIU or non-open ended investment scheme; (d2): financial customers not covered above".

Recommendation: The drawdown assumptions of Article 424(5) should be consistent with BCBS as follows:

> *"5. The institutions shall report the maximum amount that can be drawn of other undrawn committed credit facilities and undrawn committed liquidity facilities within the next 30 days. This applies in particular to the following:*
>
> *(a0) 30% for liquidity facilities that the institution has granted to non-financial customers;*
> *(a) 100% for liquidity facilities that the institution has granted to SSPEs other than those referred to in point (b) of paragraph 3;*
> *(b) 100% for arrangements under which the institution is required to buy or swap assets from an SSPE;*
> *(c) 40% for facilities extended to credit institutions;*
> *(d1): 40% for credit facilities extended to an insurance undertaking, a CIU or non-open ended investment scheme, financial institutions and investment firms;*
> *(d2): 100% for facilities to financial customers not covered above"*

Note: (a0) is added to explicit the 30% drawdown assumption for liquidity facilities to non-financial customers since, as is, the CRR does not isolate those facilities.

2. *Outflows on Retail Deposits (Article 421)*

Lower (3%) runoff factor for stable retail deposits:

BCBS 238 §78[2] enables jurisdiction to allocate a 3% runoff factor for stable retail deposits when the deposit insurance mechanism meets specific criteria. As the CRR applies to European banks and groups that operates in different jurisdictions, including jurisdictions that may elect to apply the 3%

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[1] *"§131(e) Committed credit facilities to other financial institutions including securities firms, insurance companies, fiduciaries [Fiduciary is defined in this context as a legal entity that is authorised to manage assets on behalf of a third party. Fiduciaries include asset management entities such as pension funds and other collective investment vehicles.], and beneficiaries [Beneficiary is defined in this context as a legal entity that receives, or may become eligible to receive, benefits under a will, insurance policy, retirement plan, annuity, trust, or other contract.] Banks should assume a 40% drawdown of the undrawn portion of these credit facilities."*

[2] *"78. Jurisdictions may choose to apply a run-off rate of 3% to stable deposits in their jurisdiction, if they meet the above stable deposit criteria and the following additional criteria for deposit insurance schemes:*

- *the insurance scheme is based on a system of prefunding via the periodic collection of levies on banks with insured deposits;*
- *the scheme has adequate means of ensuring ready access to additional funding in the event of a large call on its reserves, eg an explicit and legally binding guarantee from the government, or a standing authority to borrow from the government; and*
- *access to insured deposits is available to depositors in a short period of time once the deposit insurance scheme is triggered.*

Jurisdictions applying the 3% run-off rate to stable deposits with deposit insurance arrangements that meet the above criteria should be able to provide evidence of run-off rates for stable deposits within the banking system below 3% during any periods of stress experienced that are consistent with the conditions within the LCR."

runoff factor for a portion of retail deposits in their jurisdiction (such as in the US[3]), CRR LCR should recognise that 3% can be allocated to the portion of deposits that would meet the BCBS requirement. We note also that a political agreement on the recast of the Deposit Guarantee Scheme Directive has been reached which would make insured deposits in the EU eligible for the 3% run-off rate as proposed by Basel.

***Recommendation**:* CRR LCR should recognise that 3% can be allocated to the portion of deposits that would meet the BCBS requirements, without waiting for the adoption of the European legislative package on Deposit Guarantee Scheme.

Definition of retail deposits:

Alignment with BCBS:

It should be noted that the criterion to "*qualify for the retail exposure class under the Standardised or IRB approaches for credit risk*", applied to natural person, as per Article 411(2)[4] is overly restrictive compared to BCBS[5] in which this criterion applies only to SME.

***Recommendation**:* The Delegated Act should resolve this discrepancy with modifying Article 411(2) into: *"retail deposit' means a liability to a natural person or to an SME, where ~~the natural person or the~~ SME would qualify for the retail exposure class under the Standardised or IRB approaches for credit risk, or a liability to a company which is eligible for the treatment set out in Article 153(4) and where the aggregate deposits by all such SMEs and corporates on a group basis do not exceed EUR 1 million."*.

Clarification that deposits from some legal entities could be considered as retail deposits:

More generally, the deposits from entities that have been set up for the benefits of natural persons, either sole individual or group of individuals that are relative should be considered as retail deposits.

Recommendation: we suggest defining retail deposits as liabilities from:

(a) A natural person
(b) An entity whose beneficiary is a natural person or a group of relatives of natural persons
(c) an SME, where the natural person or the SME would qualify for the retail exposure class under the Standardised or IRB approaches for credit risk, or a liability to a company which is eligible for the treatment set out in Article 153(4) and where the aggregate deposits by all such enterprises on a group basis do not exceed EUR 1 million.

[3] http://www.gpo.gov/fdsys/pkg/FR-2013-11-29/pdf/2013-27082.pdf , p19 "*Therefore, under the proposed rule, stable retail deposit balances would be multiplied by the relatively low outflow rate of 3 percent.*"

[4] *"retail deposit' means a liability to a natural person or to an SME, where the natural person or the SME would qualify for the retail exposure class under the Standardised or IRB approaches for credit risk, or a liability to a company which is eligible for the treatment set out in Article 153(4) and where the aggregate deposits by all such enterprises on a group basis do not exceed EUR 1 million."*

[5] "*§73. Retail deposits are defined as deposits placed with a bank by a natural person. Deposits from legal entities, sole proprietorships or partnerships are captured in wholesale deposit categories. Retail deposits subject to the LCR include demand deposits and term deposits, unless otherwise excluded under the criteria set out in paragraphs 82 and 83. […] §89. Unsecured wholesale funding provided by small business customers is treated the same way as retail deposits for the purposes of this standard, effectively distinguishing between a "stable" portion of funding provided by small business customers and different buckets of less stable funding defined by each jurisdiction. The same bucket definitions and associated run-off factors apply as for retail deposits. §90. This category consists of deposits and other extensions of funds made by nonfinancial small business customers. "Small business customers" are defined in line with the definition of loans extended to small businesses in paragraph 231 of the Basel II framework that are managed as retail exposures and are generally considered as having similar liquidity risk characteristics to retail accounts provided the total aggregated funding41 raised from one small business customer is less than €1 million (on a consolidated basis where applicable).*"

More time is needed to determine whether higher outflow rates for retail deposits are necessary:

The proposed EBA guidance on the determining of higher outflows for retail deposits deemed to be high risk is extremely complex (all possible combination of 9+ risks factors) and prescriptive (3 categories are score-derived from risk factors) and require banks to allocate runoff factors on those categories for which they have no historical data evidence, and that do not align with their own stress tests assumptions. The method would not enable a consistent approach across the industry.

Recommendation: We recommend that enough time is allocated to collect retail deposit balances on the EBA methodology, from which runoff factor could be derived in the future from an evidence based approach. In the meantime, we recommend that the currently applicable runoff factors apply (3%; 5% and 10%).

3. Definition of 'established Operational Relationship'

The EBA suggested definition of an 'established operational relationship' (page 17 of the Report) contains components that would render its application very difficult, if not impossible, notably the underlined portion of the recommended criteria:

> "*The bank shall present evidence to the competent authority upon request that the deposit is vital for the client's operations, i.e. the client has a substantive dependency with the bank and the deposit is required for its activities.*"

It is our view that it might be impossible to evidence, to a sufficiently high standard, that operations are vital to the client's operations.

> "*The client is unable to withdraw amounts legally due over a 30-day horizon, without compromising its operational functioning. Evidence shall be presented at any time upon request of the NCAs based on data spanning at least 24 months.*"

Similarly, a bank could have an expectation that withdrawing amounts *could* be detrimental to operational functioning, but the bank might be unable to demonstrate to a sufficiently high standard that the withdrawal would compromise the customer's operational functioning.

> "*Only the deposit base is treated as operational balance. It is defined as the balance necessary to make use of the service to which the deposit is a by-product. Excess funds are treated as non-operational. Non-operational balances are considered to be all balances in excess of the average 5-day rolling cumulative net-cash outflow over the preceding 90 days. The deposit is held in specifically designated accounts and priced without giving an economic incentive to the customer to leave any excess funds on these accounts.*"

The EBA has not explained the rationale supporting this calculation method nor the actual calculation that must be undertaken. It is not clear why only 5 days has been chosen as the desired timeframe and when mentioning the 'net-cash outflow' it is not clear if this is based upon the intra-day flows of payments, the end of day balances or some other assessment.

Recognising also that the LCR will need to be calculated by banks regularly (up to daily), it is not clear if this calculation must also be undertaken with the same frequency so as to ensure that the correct amount of operational balances has been specified.

We are not aware that a detailed assessment by EBA of operational accounts has been made using the EBA's proposed definitions and associated calculations.

Recommendation*:* We support the desire for a single rule book approach to the definition of *established operational deposits* but are concerned that compliance with the EBA's proposals will be very challenging. It should be clear in the Delegated Act (in Article 422 (4)) that the EBA's approach is, at least initially, for guidelines to be used as an example for possible approach to determine the portion of deposits that could be considered as established operational deposits.
Other approaches should be made possible. For instance, –based on a list of product/services that can be considered typical in the frame of an established operational relationship, the deposits of a customer that uses at least one of these products/services could be considered to have met the criteria for the established operational relationship.

Recommendation*:* Article 422(3-4) should clarify that that deposits from financial customers should be eligible for established operational deposits, as in BCBS, provided they meet the criteria to qualify for this treatment.

4. Correspondent banking and prime brokerage

In page 46 of the EBA report, an analysis of the outflow rate for correspondent banking and prime brokerage has been undertaken, assessing whether the outflow should be reduced from 100% to 0%. It is our view that this binary reduction is too simplistic and that the EBA should have considered a variety of outflow percentages in its assessment. They conclude however that banks in only one country would benefit from this recalibration, for other banks in the EU it would have a 'negligible impact'.

We are concerned that the EBA has dismissed further analysis of the outflows associated with correspondent banking and prime brokerage simply because it affects only one country.

Recommendation: It should be clarified that, provided that they meet the criteria to qualify for clearing, custody, cash management or other established operational relationship, the portion of deposits from correspondent banking or prime brokerage services should not be discriminated against and should qualify for those operational deposits.

5. Outflows from Secured Funding from Central Banks

Confirmation*:* The outflow from secured funding from Central Banks should be confirmed to 0%, as in Article 422(2)(e) ("*0% if the lender is a central bank*") in line with BCBS 238 §114 ("*no reduction in funding availability is expected for any maturing secured funding transactions with the bank's domestic central bank*").

6. Treatment of liabilities with callability features

Article 420(1)(b) requires that banks consider as outflows:

1. all liabilities that can be called by the provider of the funding within the 30 day,
2. all liabilities where the bank has a call option and the provider of the funding expects that bank call the funding,
3. all liabilities where the bank has a call option but when there is no market expectation to call the funding.

Recommendation: This latter paragraph has no rationale and would create unjustified distortion with the Basel 3 framework238 (§86). Article 420(1)(b) should be modified from:

> *"the current amounts outstanding of other liabilities that come due, can be called for payout by the issuing institutions or by the provider of the funding or entail an implicit expectation of the provider of the funding that the institution would repay the liability during the next 30 days as set out in Article 422;"*
>
> in:
>
> *"the current amounts outstanding of other liabilities that come due, can be called for payout by the issuing institutions or by the provider of the funding or entail an ~~implicit~~ expectation of the provider of the funding that the institution ~~would~~ **will** repay the liability during the next 30 days as set out in Article 422;"*

7. *Additional liquidity outflows : RTS to be published by 31/3/2014*

Our key concern is the inconsistency of the EBA draft proposal with the LCR framework. It is not acceptable that additional liquidity outflows are based on a market scenario that is at odds with the LCR scenario. As an example, liquidity outflows can't be derived from a scenario for which the values of securities increase while LCR assumes that those securities decrease for other LCR component (liquidity outflow for loss of posted collateral value). As an example, financial equities which are deemed non liquid assets for LCR can't be assumed to increase by 20, 40 or 60% for the calculation of additional outflows.

Moreover, as the LCR applies at entity level in Europe, the draft approach of EBA that consists in retaining the worst market scenario for each entity (ie: the worst market scenario is entity-specific) creates inconsistencies between entity level-LCR and Group-level-LCR which leads to an increased requirement for LCR-buffer and funding requirements (ie: a form of trapped pool of liquidity).

Recommendation: We encourage the Commission to ensure that the method to determine liquidity outflows for collateralized transactions is consistent with LCR scenario, between entity level and Group level; and with empirical evidence. The implementation complexity should remain limited.

B. INFLOWS:

1. Trade Financing Inflows

Confirmation: It should be confirmed that Article 425(2)(b) is unchanged with a 100% inflow from trade financing transactions, even if EBA Report' Policy Recommendations does not mention the point. Article 425(2)(b): "*monies due from trade financing transactions referred to in point (b) of the second subparagraph of Article 162(3) with a residual maturity of up to 30 days, shall be taken into account in full as inflows;*"

2. Inflows from Central Banks

Confirmation: It should be clarified that loans/deposits to Central Banks that mature in the next 30 days should be fully recognised as proposed by the EBA report (page 63 §(ii)). CRR needs to be fixed since, by default, those loans/deposits to Central Banks are covered by Article 425(2)(a) with a 50% multiplying factor. This is not consistent with BCBS238 §154 ("*In addition, banks are assumed to* *continue to extend loans to wholesale clients, at a rate of 0% of inflows for financial institutions and central banks*").

Article 425(2)(b) could be slightly modified for that: "*monies due from central banks, trade financing transactions referred to in point (b) of the second subparagraph of Article 162(3) with a residual maturity of up to 30 days, shall be taken into account in full as inflows;*"

3. Inflows from received facilities

Recommendation: The scope of Article 425(2)(g) on received facilities should be limited to facilities from non-affiliated entity (since intra-group transaction are covered separately in article 425-4)) and from non-central banks (so as not to cancel out the role of Committed Liquidity Facilities).

4. Inflows exempted from the 75% cap

In its Report, EBA does not take into account that the LCR applies at entity level in Europe. Though this has the dramatic consequence of magnifying the LCR requirement this has not been considered in EBA's implication to the LCR shortfall and on the European economy.

Recommendation: To avoid creating trapped pools of liquidity, while maintaining the prudential objective, it is recommended that all inflows from an affiliated entity that is subjected to LCR requirement are exempted from the 75% cap since they are counted as outflows for the counterpart. EBA suggests this clarification in its report.

5. Treatment of internal flows within Group

In the current European framework, a lot of asymmetries exist in the treatment of internal flows notably concerning off-balance-sheet items.

It is particularly important that all internal flows are granted a symmetrical treatment under the LCR framework. Indeed, another solution would have the following drawbacks:

- unjustified (and currently not measured) increase in the LCR shortfall of the European economy;
- great difficulties to manage some internal contracts within banks, especially in cooperative networks (due to the very high amount of links between the central institution and the local institutions);
- supervisors should however be given the right to modify the outflow and inflow rates applied on internal deals. This would be the case, for example, if the supervisor decides to allow the group to manage its internal LCR through liquidity facilities, in which case a 100% inflow and outflow rate should be granted, instead of the 40% outflow rate. This would allow a more consistent management of internal liquidity.

Recommendation: We recommend that a principle of symmetry for intragroup transactions is applied in the Delegated Act, referring to Articles 422(8-9) and 425(4-5):

- intragroup transactions are allocated symmetrical LCR treatment;
- with LCR-inflows from one entity derived from the LCR-outflows from the other entity.

C. LIQUID ASSETS:

1. Committed Liquidity Facilities from Central Banks

Considering the recently published GHOS decision to consider Committed Liquidity Facilities from Central Banks as Liquid Assets in the LCR, Article 416(1)(e) should be modified.

Recommendation: We recommend substituting,

> "*standby credit facilities granted by central banks within the scope of monetary policy to the extent that these facilities are not collateralised by liquid assets and excluding emergency liquidity assistance;*"

by:

> "*committed liquidity facilities granted by central banks to the extent that these facilities are not collateralised by liquid assets that are already counted in the liquidity buffer*"

The characteristics of prices and the definition of 'market wide stress' (referred to in BCBS 238 §54(a)) should be defined by Central Bank whose mandate of financial stability gives it the authority and the perspective to robust and flexible definitions.

2. Treatment of Central Bank reserves

According to CRR, it is up to the supervisor and to the Central Bank to decide on whether minimum reserves should count in the LCR buffer.

Recommendation: We recommend that the treatment of Central Bank reserves in LCR remains under the control of Central banks, considering the potential interaction with monetary policy (changing the level of minimum reserves will mechanically change the LCR of the system if minimum reserves cannot be considered as liquid assets), and the level playing field issues (all Central Banks do not have the same level of minimum reserve requirement).

Clarification: It should be made clear that the definition of Central Bank reserves in CRR is aligned with the definition in BCBS§50(b)-footnote #12: "*In this context, central bank reserves would include banks' overnight deposits with the central bank, and term deposits with the central bank that: (i) are explicitly and contractually repayable on notice from the depositing bank; or (ii) that constitute a loan against which the bank can borrow on a term basis or on an overnight but automatically renewable basis (only where the bank has an existing deposit with the relevant central bank).*"

3. Definition of Liquid Asset

Scope

The Report on the definition of Liquid Assets gives rise to uncertainties that the Delegated Act should clarify:

- What is the scope of application of the EBA Report?
    - It should be clarified that it relates to Article 416(1)(b) and (d), and Article 416(1)(c) remains as it is.
    - What is the definition of EEA asset? Instrument issuer? Instrument Currency? Instrument Listing Location?
    - Not all types of assets are covered by EBA Report. Does this mean that they are not eligible as Liquid Assets? As an illustration, securities issued by Public Sector Entities (PSE) are not mentioned in EBA report (refer to article 416(1)(c). Should they not be Level 2 assets?

    - Clarification is required concerning the treatment of bank issued government guaranteed bonds. On page 24 of the report these are defined as not being sufficiently liquid, while on page 26 the report states that "*all sorts of bonds issued or guaranteed by EEA sovereigns*" can be treated as Liquid Assets.

A definitive list of what is eligible should be available, to ensure a widespread and clear understanding of what is eligible and in which category.

- How should EBA policy recommendations be considered?
    - Sufficient criteria?
    - Necessary criteria? If yes, what are the criteria to be considered to get 'sufficient' criteria (notably: how do those criteria relate to already listed CRR criteria? It there an articulation with the recent publication of BCBS on '*Guidance for supervisors on market-based indicators of liquidity*'?[6]
- What is the classification process that would not be covered by EBA report (e.g.: non-EEA jurisdiction asset), notably when they have not implemented binding LCR in their jurisdiction (and may not intend to)?
    - Shall CRR or BCBS238 apply? For example, what it the treatment of covered bonds issued in Canada but denominated in Euro? We think that covered bonds denominated in Euro, which meet the requirements of CRR and are eligible for the ECB, should be classified as HQLAs (at least Level 2A).
    - How should non EBA Report covered assets eligible to Article 416(1)(c) ('*transferable assets representing claims or guaranteed by…*') be dealt with? Should BCBS238§50(d-e) be used?
- What is the articulation between Article 416(1)(c) ('*transferable assets representing claims on or guaranteed by…*') and local application of BCBS238§50(d)-(€ In other words, for non EEA assets, should Article 416(1)(c) apply or should the local application of BCBS238§50(d)-(e) apply?Article 416(1)(c) does not cover the perimeter of foreign currencies while BCBS238§50-(e) does.
- From EBA's report it is unclear how bonds issued by local governments that are guaranteed by sovereigns are to be treated. The delegated act should clarify that these bonds are Level 1, because they have a guarantee by a sovereign and fulfill all conditions of BCBS 238 § 50c.
- The same should apply for bonds by promotional banks that are guaranteed by a sovereign.
- A similar question as above for the Committed Liquidity Facility: what is the articulation between Article 416(1)(e) and BCBS238 §54a?[7]
- What is the mapping (notably for reports and caps) between BCBS-LCR and CRR-LCR categories?

It is a major concern for banks that the EBA report on Liquid Assets does not give indications for certain types of securities which are HQLA in the Basel III framework and are currently part of the bank's liquidity buffer: mainly securities issued by European Public Sector Entities (in domestic or foreign currencies) and securities issued by European Sovereigns in non EEA currencies, such as the US Dollar.
Since these types of securities have not been included in the scope of the EBA report, it is important that the Delegated Act leave enough flexibility for the banks to classify them as Liquid Assets (consistently with BCBS).

[6] http://www.bis.org/publ/bcbs273.pdf
[7] http://www.bis.org/publ/bcbs274.pdf

Recommandation:

- The scope of application of the EBA report is EEA assets defined as issued by EEA counterparties in EEA currencies.
- For EEA asset:

  EBA criteria are considered sufficient criteria. The criteria listed in Article 416(3) should be used, documented and reviewed to qualify other assets that could not be applied the 'sufficient criteria' The fact that the EBA will define eligible asset classes is expressively welcomed by respondents, as banks lack the (data) resources to conduct a comprehensive liquidity analysis on their own. Doubts remain however, as to what extent banks will have to assess the liquidity of the single selected asset. In this context the wish for an ISIN list of liquid assets is repeatedly mentioned."

  In this respect - and with the aim to preserve the maximum leveled playing field - an additional (not necessarily alternative) simplified approach to be developed in the medium term could be to individuate the above mentioned ISIN list of liquidity.

  - Article 416(1)(c) and (d) apply
- For non EEA asset:
  - EEA definitions or qualification process should be applied if the LCR is implemented as a binding requirement in their jurisdiction,
    - Local definitions or qualification process should be applied
    - including for assets eligible to BCBS238(d-e) / Article 416(1)(c) and for Article 416(1)(e)
  - otherwise banks should develop their own analysis for qualifying assets as Liquid Asset within the framework of Article 416(2-3) and Article 417

4. Operational Requirements

Recommendation: The policy recommendation on '*Control by a liquidity management function*' and '*Not used in ongoing operations*', should align with Article 417(1)(e) and with BCBS238, as mentioned in EBA report: "*The EBA recommends allowing the use of liquid assets in hedging or trading strategies as long as they can easily be monetised without conflicting with existing risk limits that control for market, credit and counterparty risk.*" This is consistent with BCBS 238 §33.[8]

[8] *« The stock should be under the control of the function charged with managing the liquidity of the bank (eg the treasurer), meaning the function has the continuous authority, and legal and operational capability, to monetise any asset in the stock. Control must be evidenced either by maintaining assets in a separate pool managed by the function with the sole intent for use as a source of contingent funds, or by demonstrating that the function can monetise the asset at any point in the 30-day stress period and that the proceeds of doing so are available to the function throughout the 30-day stress period without directly conflicting with a stated business or risk management strategy. For example, an asset should not be included in the stock if the sale of that asset, without replacement throughout the 30-dayperiod, would remove a hedge that would create an open risk position in excess of internal limits"*

5. Specific liquid assets

Specific requirements on Covered Bonds and RMBS

The specific requirements on covered bonds and RMBS are too numerous to be tested empirically. One of these requirements is over-prescriptive: the one specifying that only first-lien residential mortgage are eligible collateral for the RMBS.

Recommendation: We recommend a modification allowing other types of residential loans to be included, notably residential loans fully guaranteed by an eligible protection provided they respect the conditions mentioned in article 129 e of CRR. Indeed, these loans have proven to be at least as reliable as mortgage loans and we do not think there is an economic reason to disincentivise their use as collateral.

Eligibility of CIUs as liquid assets

Although CIUs may be treated as liquid assets under certain conditions (CRR, art. 416.6), it is currently unclear whether in practice they may be treated as Liquid Assets at all.
Due to regulatory requirements, all investment companies have to maintain a sufficient level of liquidity for CIUs. Such liquidity requirements comprise, for example, deposits with the custodian bank, which do not comply with the definition of Liquid Assets. Hence, a CIU holding a deposit with a bank, in fact all open-ended CIUs, might not be considered as Liquid Asset at all.
The maintenance of an appropriate liquidity management system for the CIU should not lead to disqualifying CIU as Liquid Assets. Such result is neither intended by the European legislative bodies nor would it be consistent.

Recommendation: We recommend that CIUs' deposits held at banks be permitted by the CRR, considering that these deposits should be subtracted from the CIUs' value calculated according to CRR, art. 418.

6. Applicable Buffer Caps

As the Report did not consider that LCR applies in Europe at entity level and not only at consolidated level, EBA did not analyse the ramifications of applying the buffer caps at entity level in Europe.

Recommendation: Should there be caps, specific components need to be clarified:

- The categories that are subject to caps should be clearly identified in CRR terms (i.e.: not in BCBS terms).
- It should be clarified that those caps are set after applying the haircut to Liquid Assets.
- The method to apply those caps needs to be clarified. As all transactions on Liquid Assets are assumed to be fully rolled over, we strongly recommend that the caps are applied to the Liquid Asset inventory as of LCR calculation date. Any other method (for instance based on assumed partial or non-rollover assumptions) would be very detrimental to the auditability of the Liquid Assets and the application of caps. Considering the inventory as of the LCR calculation date also enables to check the Liquid Asset buffer as available in the custodian account.

Recommendation: On the Committed Liquidity Facilities, considering the European specificities, and to avoid mitigating the benefits of the extension of Liquid Assets to Level 2B (equities, RMBS and corporate bonds), **we recommend that the Committed Liquidity Facilities is subject to a stand-alone cap, aside from the cap that applies to Level 2B.**

7. Applicable Haircuts

EBA report on the definition of Liquid Assets approves the haircut levels suggested by the Basel Committee should be used as a lower bound in the setting of these haircuts:
15% for covered, corporate, sovereign and public sector securities in Level 2A,
25% for RMBS in Level 2B
and 50% for equities and corporate bonds rated between A+ and BBB-

Recommendation: we recommend aligning articles 416 "Reporting on liquid assets" and 418 "valuation of liquid assets" with BCBS categories and haircuts

BCBS categories	BCBS Haircuts	416 (1)	418(2)
Level1	0%	(a) cash & CB deposits (b) Gov bonds in local currency © supranational bonds	(b) 0for the assets referred to in points (b) and (c) of Article 416(1)
Level 2A	15%	(d) cat.D1: covered bonds, local gov bonds, high grade corporate	(d) 15% for the assets cat. D1 referred to in point (d) of Article 416(1))
Level 2B1	25%	(d) cat.D2 A: RMBS	(d) 25% for the assets cat. D2A referred to in point (d) of Article 416(1))
Level 2B2	50%	(d) cat. D2B other corporate bonds, equity	(d) 50% for the assets cat. D2B referred to in point (d) of Article 416(1))
Level 2B3	0%	(e) CB stand by facility	(d) 0% for the assets referred to in point (e) of Article 416(1))

D. Treatment of internal deposits inside cooperative networks

1. Internal deposits recognized as LCR liquid assets

Article 416(1)(f) CRR gives the possibility to recognise some internal deposits as liquid assets, provided that certain circumstances are met. We strongly support that this possibility is indeed given to regional banks inside a network.

However, according to this article, the concerned deposits should be statutory or legal minimum deposits inside cooperative networks. The notion of "minimum" does not fit with the intrinsic fluctuation of a short term liquidity position. It seems more linked to deposits made under solvability considerations.

With a restrictive understanding this could prevent regional banks in a cooperative network from constituting HQLA by deposits at the central institution. It is important that regional banks are guaranteed to have this possibility, as they do not always have access to the Central Bank. Instead, in many countries cooperative banks have developed liquidity systems, in which specific functions are performed by the central institutions. Typically, cooperative banks deposit their excess liquidity at their networks' central institutions. It has to be underlined that these systems have functioned well throughout the crisis.

Recommendation: Regional banks of cooperative banking networks should be given the right to constitute their HQLA buffer through deposits placed at the central institution of the network. For making sure the playing field is levelled, this should apply to deposits in a banking group when the deposit is made in an institution that is subject to liquidity requirements.

The Commission's delegated act should define only broad conditions for such a recognition as highly liquid (such as the use of a specific account, separation from other internal current accounts, ITC). Instead, national authorities should have the discretion to recognise the different national characteristics of established liquidity networks.

At the level of the central institution, these internal deposits could either be treated as outflows (which is the way article 422 3 proposes to treat statutory minimum deposits) or deducted from its level 1 HQLA assets. This last solution would have the advantage of simplicity and this is the one we favour: the HQLA at the Group level would still be consistent with the addition of the HQLA at the individual level.

2. *Treatment of Minimum statutory internal deposits*

The Basel Committee is addressing the issue in paragraphs 105 and 106 of the Basel III LCR paper.

Under the conditions of Art. 422(3) CRR, such deposits can be considered as stable funding for the central institutions and benefit of a 25% outflow rate. A symmetrical treatment should be recognized at the level of the regional banks (25% inflow rate).

Recommendation: This provision should be adequately reflected in the delegated act.

3. *Minimum reserves at the cooperative central institutions and other operations with Central Banks*

Local banks often constitute their minimal reserves at the Central Bank through deposits placed at the central institution.

Recommendation: These internal deposits should be treated in a symmetrical way with the required reserves at the Central Bank placed by the central institution at the Central Bank. It is currently unclear which CRR article to apply regarding these deposits.

E. *Reporting on LCR and NSFR (ITS to be adopted by European Commission*

The drafy ITS published by EBA on July 26th 2013 raises a number of questions:

- Inflows and outflows calculations should be clarified for repo, reverse repo and collateral swaps. EBA may end up with very different calculations from institutions.

- The template does not include a line “repo on other asset” and “reverse repo on other asssets”, hence for example operations with financial equities cannot be reported.
- For the liquid asset template, institutions can double report some asset categories. This will prevail EBA to take benefit from the reports

Recommendation: We recommend EBA to align reporting template with the BCBS QIS template for LCR and NSFR.

F. *Reporting issues*

a. *ITS on LC and SF:*

The draf ITS published by EBA on July 26th 2013 raises a number of questions:

- Inflows and outflows calculations should be clarified for repo, reverse repo and collateral swaps. EBA may end up with very different calculations from institutions.
- The template does not include a line “repo on other asset” and “reverse repo on other asssets”, hence for example operations with financial equities cannot be reported.
- For the liquid asset template, institutions can double report some asset categories. This will prevail EBA to take benefit from the reports

Recommendation: We recommend EBA to adopt a reporting template that is consistent with the BCBS QIS template for LCR and NSFR